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CPE NETWORK

ACCOUNTING & AUDITING REPORT

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Note: Beginning with the March 2023 edition of the Network programs DVDs will no longer be shipped by Thomson Reuters. Videos will be available for download or streaming only. For customers wishing to adopt an online only format sooner, please contact your customer representative.

NOTE: During the COVID-19 crisis, direct person to person contact can be reduced by forwarding this to participants and reminding others that the video is also available online through the CPL player. Additionally, video/discussion/Q&A may be shared via Teams, Zoom, or other conferencing-type software. Participants may submit the quiz for self-study credit, or Group Internet Based credit (similar to a webinar) is now available. Consult the user guide at the end of the newsletter for instructions on how to earn credit in this manner.

Topics for future editions may include:

- Group and Compliance Audits
- Cybersecurity Risk



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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Rabbi Trusts3

Russ Madray, CPA discusses FASB guidance on rabbi trusts and the accounting for deferred compensation.
[Running time: 34:27]

Learning Objectives: Upon completion of this segment, the user should be able to:

- Define a rabbi trust and identify the location of the guidance
- Identify the types of Plans used in rabbi trusts.

PART 2. AUDITING

PCAOB Areas of Focus23

Jennifer Louis, CPA reviews recent areas of PCAOB focus.
[Running time: 28:25]

Learning Objectives: Upon completion of this segment, the user should be able to:

- Identify active time periods for IPOs
- Determine who is focusing on non-GAAP measures
- Identify how prevalent ESG informational reporting is
- Identify areas with a disproportionate number of SEC comments and critical areas for quality audits

PART 3. SMALL BUSINESS

SAS 143 and Small Businesses47

Kurt Oestrieher, CPA, reviews the guidance in SAS 143 on auditing accounting estimates.
[Running time: 32:57]

Learning Objectives: Upon completion of this segment, the user should be able to:

- Identify why the standard was necessary and who was instrumental in its issuance
- Define accounting estimate
- Determine which areas in the financial statements include the most estimates
- Identify the guidance related to planning and auditing financial statement disclosures

ABOUT THE SPEAKERS

Russ Madray, CPA, CGFM, has more than 30 years of professional experience, including stints at two Big 4 accounting firms. Russ is a nationally-known accounting and auditing thought leader, writer, and advisor helping CPAs throughout the country understand and implement technical accounting and auditing issues.

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PART 1. ACCOUNTING

Rabbi Trusts

Previously, we looked at deferred compensation. Today we're focusing on the guidance related to Rabbi trusts. The FASB Master Glossary defines rabbi trusts as "...grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer."

The accounting for Rabbi trusts is found in FASB ASC 710-10. Under this type of arrangement an employee invests part of his or her compensation in the employer's stock with the trust holding the stock for future settlement. Although some plans permit diversification, it is plan specific. The Rabbi Trust subsections in ASC 710 do not apply to stock appreciation rights.

For more on rabbi trusts, let's join Russ Madray, a CPA in Greenville, South Carolina, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk about something that's kind of an unusual topic and that's rabbi trusts. FASB ASC 710 addresses an employer's accounting for a variety of compensation related issues, including a special type of deferred comp plan called a rabbi trust. To start with could you give us an overview of the guidance related to these plans and explain what a rabbi trust is?

Mr. Madray

I'll be glad to, and you're right. Your reference to Topic 710. In fact, I kind of put that in context. If we take a look at our first slide, you see where Topic 710 fits in with our other compensation related topics 710 is the general topic, then there's one on nonretirement post-employment benefits, one on retirement benefits, and then, one on stock based compensation Topic 710, then has some subsections within the overall subtopic, which is where we get some details. So there's the general subtopic or subsection that deals with compensated absences, with deferred compensation arrangements, and with lump sum payments under union contracts. And then another subsection that deals specifically with rabbi trusts.

Now to start with the master glossary within the accounting standards, as a definition of a rabbi trust, which is on our next slide, if want to take a look there, it defines rabbi trust as a grantor trust generally set up to fund compensation for a select group of management or highly paid executives to qualify as a rabbi trust for income tax purposes. The terms of the trust agreement

must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer. So that's the technical definition from the master glossary.

Now this still doesn't answer the question of why they're called Rabbi trusts. So the story behind that is the first trust of this type, meeting these requirements or having these characteristics was established in 1980 by a Jewish congregation for its rabbi. That congregation applied for and obtained a private letter ruling from the IRS that clarified the tax consequences of the establishment of the trust for the rabbi. And from that time forward, these have been referred to as a rabbi trust, the deferred compensation -- rabbi trust. Subsections in Topic 710 provide the guidance for the employer's accounting for what is essentially a deferred comp plan that utilizes a rabbi trust. Under this type of plan, essentially, the employee invests a portion of his or her compensation in the employer's stock. The trust holds the stock for future settlement with the employee.

There are different types of these plans. Some plans permit the employee to select alternative investments either immediately or after holding the employer's stock for some specified time period. And the accounting will be different depending on those types of characteristics within the plan. Some of them don't allow that type of diversification. So, all the trust will ever hold is the employer's stock--side note here though, the guidance that is in topic 710 specifically related to deferred comp--rabbi trust, that guidance does not apply to stock appreciation rights. Even if the employer funds these

benefits through a rabbi trust again, stock appreciation rights are where the stock itself or actual stock is not issued.

It's an award that tracks the change in the price, the upward change in the price of the shared stock. So typically under a stock appreciation right plan, the employee will eventually receive compensation equal to the increase in the value of the stated number of the employer shares on some designated future date. At that time, the employee receives cash or an equivalent amount of the employer stock that would represent the fair value of that of that increase. Now, although an employer might provide these stock appreciation rights and segregate the contract in a rabbi trust, the employer would still account for the stock appreciation rights under Topic 718, which deals with stock-based compensation. So long story short, it has to be employer stock going into the trust.

Now at least initially it can't be some other type of award that goes in, some deferred comp plans that utilize a trust specify the consideration in terms of how the employer will settle the obligation with the employee. So to settle the claim for deferred comp, depending on the terms of the plan, the employee might receive any or a combination of cash or shares of the employer stock, or some other investment assets that are held, if the plan allows for that type of diversification. Typically several years will pass between the time the employee earns the compensation that he or she designates to a deferred comp plan, and then the eventual payment that comes out of that. An employer can use a trust like a rabbi trust to designate and segregate the assets.

In most cases, employer's stock will eventually pay the employer's compensation claim. The reason for using a trust in this matter is it gives the employee some added confidence that he or she will actually receive that promised compensation. Again, the deferred comp arrangement without using the rabbi trust arrangement is just basically the employee has to be in some way confident that he or she, that the employer will remain a going concern and is able to pay that compensation in the future. So using a trust like this will add some additional comfort to the employee. Couple of other things about these trusts a rabbi trust can be revocable, or it can be irrevocable. If it's revocable, the employer can terminate the trust but not necessarily the benefits that are promised under the plan. If it's irrevocable, the assets of the employer cannot terminate the trust, but

the assets would remain payable to the employer's creditors in the case of bankruptcy because that's part of what defines these types of trusts.

Although the assets in a case like that would remain subject to the employer's creditors, the establishment, again, of a trust does provide the employee with some assurance that the employer funding for the compensation will be available when the employee is able to settle the claim for that deferred compensation. With all that said, rabbi trusts usually are set up as irrevocable trusts. As I mentioned earlier, employees have to have some reasonable confidence in the employer's future financial condition and confidence that the assets even in a trust were not passing in the hands of creditors for some reason down the road. So on the employee side, the employee's going to have to consider risks like that, that the trust assets are subject to claims of unsecured creditors. If the employer goes bankrupt even if they're segregated into a rabbi trust and also even though the employer can establish the trust, it doesn't have any specific obligation to fund the trust or irrevocably segregate the assets for the employees.

So any type of deferred comp arrangement comes with some level of risk to the employee and referring to non-qualified plans but through the use of a trust and specifically a rabbi trust for specific tax reasons can provide some additional confidence to the employee about the safety of those funds and the funds being available at the time the claim is settled.

Ms. Grove Casey

Well, our interview today isn't really about tax issues, although you just mentioned something related to tax, but could you briefly touch on when the employer can claim a deduction for employee compensation under these plans?

Mr. Madray

I think I can do that, but I know I personally don't want to dig any deeper into the tax implications because again that's not my area. I mentioned earlier the Jewish congregation that established the first rabbi trust applied for and obtained that private letter ruling from the IRS. Since technically taxpayers are not allowed to rely on private letter rulings issued to other taxpayers what happened in the years following 1980 is a number of employers applied for their own private letter ruling with respect to their trust. After that initial one was issued in in 1980, eventually the IRS decided to limit

the issuance of these types of private letter rulings and issued a revenue procedure (rev. proc.) instead. It's Revenue Procedure 92-64 that contains model rabbi trust language. It also said, we're not going to issue any more private letter rulings on these types of arrangements.

So my suggestion would be to look closely at Revenue Procedure 92-64. At a high level though the tax considerations are, essentially, the creation or adoption of a rabbi trust would not result in income to the employee under the constructive receipt or economic benefit doctrines. Further the employee's deposit into a rabbi trust is not taxable to the employee, as long as the rabbi trust requirements are met, which for example, the trust assets are subject to the claims of the employer's creditors. Again, the crediting of the deferred amount would not result in a constructive receipt of income because participants in the deferred comp plan only have the rights of unsecured creditors. One other thing-- as a general principle, an employer cannot deduct or claim a deduction for employee compensation until the employee has to include it on his or her return as part of his or her taxable income.

So an employer's contribution to a non-qualified deferred compensation plan is deductible in the tax year where the employees are required to include those deferred amounts in their gross income. What this means is, if you have more than one employee participating in a funded, deferred comp plan whether rabbi trust or not, the employer is going to have to maintain separate accounts for each employee for contributions to the plan to ultimately be deductible. So the deductible amount for the employer, amount of a contribution to a funded plan, would be limited to the amount actually contributed. Even if the employee has to include a larger amount in income that's actually ultimately received from the plan. So those are just some high level tax applications. That's about as detailed as I would be comfortable getting when we're talking about anything tax related, but those are some general implications at least.

Ms. Grove Casey

Okay, well, let's go back to the accounting issues then. Exactly. How do we account for a rabbi trust arrangement?

Mr. Madray

Well it depends, and it depends on what type of plan it is. In Topic 710 there are characteristics of four

different types of rabbi trust. The employer will have to determine what type of plan or how to classify t, their rabbi trust's plan in order to follow the correct accounting. They're referred to as plan A, plan B, plan C, and plan D. And again, there's different characteristics of each one. The different characteristics typically are generally focused on what's happening-- what can the employee do in terms of diversification and that kind of thing. So if we take a look at the next slide, this is the characteristics of a plan A-type rabbi trust. It would be classified as a plan A if the employee cannot diversify his or her holdings, which means the employee will contribute shares of employer stock to the trust. And that's all that will ever be in there. And the second characteristic is, the plan settles the employee claims with a fixed number of shares of the employer's stock. You'll see some differences in the other types of plans when we look take a look at those, but let's look at the accounting for each one in order.

Essentially, if an employer characterizes the deferred comp plan that utilizes a rabbi trust as plan A the employer will account for the shares that are held in trust in a manner similar to treasury stock using the guidance in Topic 505 on equity. Also in a plan A type of rabbi trust the employer would classify the obligation for that deferred compensation as an equity instrument. So we'll look at an example in a moment that actually shows some debits and credits of how we would go about doing that. Importantly keep in mind the deferred comp plan that utilizes the rabbi trust is characterized as a plan A after initial recognition. In other words, contribution to the trust, the employer does not account for any changes in the fair value of the shares or in the change in fair value of the obligation to the employee.

So let's look at an example of how we would account for a plan A rabbi trust. So take a look at the next slide. Let's assume the employer offers certain employees, the ability to participate in this deferred compensation plan. They establish a rabbi trust to hold the funds that an employee defers pursuant to the plan itself to help satisfy the obligation to pay the employee compensation in the future, the employer designates its own shares to the trust. The plan does not allow the employee to diversify into other securities, and then, when the employer settles the employee's claims, the employee will receive the employer's shares the exact characteristics of a plan A.

So with that type of deferred comp plan, let's further assume that the chief operating officer designates 6%

of her annual salary, \$475,000 to the plan. So to account for the initial compensation deferral, the employer will designate shares of the employer's stock with a fair value of \$28,500 that's 475,000 times 0.06. So they will designate shares of their own stock worth that amount to the trust. And the employer would account for these shares similar to how they would account for treasury stock. You see the journal entry example here. There would be a debit to a contra-equity account as you would with treasury stock but just some type of contra-equity for the amount, and then, a credit to equity for that same amount, because in a plan A the obligation is an equity-classified award.

So basically it is a wash with regard to the equity of the employer. So on the balance sheet, the employer's going to present those equity shares as a contra-equity item. It's going to present the obligation, pay the employee as an equity item. So they're going to offset to zero. Because again, in reality, nothing has really happened. The employer has simply moved some shares to a trust that could, ultimately, come back. And again, as I mentioned earlier, there's no adjustment subsequently for any fluctuation in the value of those shares from that point forward.

Now let's look at plan B type trust. If you take a look at the next slide, plan B trust first the employee cannot diversify his or her holding. So the employer stock goes in and that's what will remain in the trust and what makes it different than the plan A that we looked at earlier is, in a plan B the plan will settle the employee claims either in cash or in shares of the employer stock.

Remember in a plan A it's settled in a fixed number of the employer's shares. So if an employer characterizes a deferred comp plan that utilizes a rabbi trust as plan B, they would account for the shares again, in a manner similar to treasury stock. But here, the difference is the employer has to classify the obligation for the deferred compensation as a liability subsequent to the contribution to the plan. The employer will not recognize any changes in the fair value of its own stock, but they will adjust the deferred comp obligation, that liability, for changes in the fair value of the amount. That's going to be owed to the employee. The corresponding entry would be a charge or credit to compensation cost. So let's look at the next slide. We have an example that has a characteristic of a plan B here non-qualified deferred comp plan establishes a rabbi trust plan but does not permit the employee to diversify the trust holdings. But the employee can elect

to receive the compensation in cash rather than shares of stock. Therefore, it's going to be characterized as a plan B. So let's assume again, this same chief operating officer designates 6% of her salary, \$475,000, to the plan. To satisfy the future obligation, the employer elects to fund the deferred compensation by transferring its own shares with a fair value of \$28,500. The employer will account for the shares as if they were treasury stock by using a contra-equity account. Again, they'll classify the obligation as a liability. As the fair value of the stock changes the employer will adjust the obligation to the employee, but not, again, the stock itself. So let's assume that one year after designating this compensation, the fair value of the shares has increased to \$29,500. As the fair value of the stock changes, the employer will adjust the liability, the obligation to the employee. But again, it will not recognize any of this increase in the fair value of its own stock that is accounted for, essentially, as treasury shares. So the journal entry would look, as you see here. There would be a debit to compensation expense, and a credit to that liability for the deferred compensation. So that's a plan B.

Let's look at the next slide. These are the characteristics of a plan C, where you see the two here. The employee may diversify the holdings within the plan, but the employee has not done so. The employer contributed shares of the employer stock and it still stopped even though the employee under the terms of the plan can diversify that into other assets. They also will settle the claims in cash, shares of employer stock, or other diversified assets. The accounting for this type of plan is identical to a plan B because the key is even though the employee has the ability to diversify, the employee has not done so. As a result, it's, essentially, exactly the same as a plan B. So in that case, again as the fair value of the shares fluctuate, the liability will be adjusted with the offsetting part of that being the compensation expense. But again, the shares of stock will not be adjusted for those changes in fair value, because it's still stock, it's not other types of assets. So we won't go through another example of the plan C because it looks exactly like what we just saw for a plan B.

That takes us to plan D. If you take a look at the next slide the two characteristics there, the employee has the ability to diversify the holdings in the trust and the employee has actually done so, and then, ultimately the plan will settle the employee claims in cash, shares of stock, or the other assets that are in the trust. And, in that case an employer who characterizes the deferred

comp plan that utilizes a rabbi trust as a plan D, it will account for any of the other assets in the plan in accordance with the guidance in accordance with GAAP for the asset in question. So for example, if the plan holds an equity security, so the employee, again, initially it was employer stock contributed to the trust, but the employee has directed that to be switched out. For example, I hate to use the technical term there, but essentially diversify that into, in this case, an equity security in another company, then they would follow the guidance or the employer would follow the guidance under Topic 321 that covers investments in, in equity securities. Again, the obligation for the ultimate claim of the employee for that deferred comp would be accounted for as a liability.

Now, this is where it can get even a bit more tricky because at acquisition an employer might classify debt securities that are held in the rabbi trust as trading securities by classifying securities that are held in a rabbi trust as trading, the employer will recognize the fluctuations in those debt securities fair value through, through net income. The change in the deferred comp obligation would also be recognized through net income. So by classifying those debt securities as trading it avoids an accounting mismatch that could occur if they were classified as say, available for sale, as they would be would run through other comprehensive income. Whereas the change in compensation expense would be run through net income and that's only going to be applicable to debt securities because equity securities under the change in guidance there all fair value fluctuations of equity securities go through net income. In other words, there is no available for sale category for equity securities. So again, the employer will account for assets in accordance with other guidance. The obligation for the deferred comp will be adjusted for changes in the fair value of the amount owed to the employee. Changes in fair value in the deferred comp obligation doesn't go through net income. It cannot go through other comprehensive income. That's true, even if the changes in the fair value of the assets held in the trust are recorded through other comprehensive income. So again, by designating those as trading, it avoids that mismatch. But if you don't do that, you will have that mismatch. You can't run the change in the liability through other comprehensive income, even if changes in the fair value of the assets are going there in accordance with other GAAP.

So let's look at another illustration. This is a plan D. So here, the employer offers the non-qualified deferred

comp plan to its employees. Employer establishes a rabbi trust to hold the compensation that the employee defers under the plan. The plan permits the participating employee to direct diversification under the deferred comp plan after one year of additional employment. At settlement, the employee will receive either cash or the diversified assets. Therefore, we have the very definition of a plan D, so let's assume that in accordance with plan provisions, the employer's chief operating officer designates 6% of that annual salary, again, to the deferral plan. To satisfy the future obligation, the employer elects to fund the obligation by transferring its own shares of stock with a fair value of \$28,500, 6% of the 475,000.

After six months, the chief operating officer redirects the trust to acquire mutual fund shares. Let's assume that after one year after the initial deferral, the fair value of the investment is now \$32,000. The employer will account for the increase here as if it classified the securities as trading under Topic ASC 320. So the investment in securities, mutual fund is going to increase \$3,500 and the \$3,500 credit is going to be an unrealized gain on those securities that will run through net income. The employer will also adjust the liability by that amount. So the liability for deferred comp is increased \$3,500 and compensation expense is increased by 3,500. So those are illustrations of the different plan, a plan B, plan C, plan D, and what would be effective based on the different characteristics of those plans.

Now, one other thing about accounting we want to mention, how these arrangements are presented on the financial statements of the employer. Essentially, regardless of how the rabbi trust is characterized, whether it's plan A, plan B, plan C, plan D the employer has to consolidate the trust accounts into the employer's financial statements that's because in substance, any assets, cash, or other securities or whatever remain the assets of the employer. They're still subject to claims of the employer's creditors. So you mentioned earlier they will consider any of their own stock that's held in the rabbi trust as treasury shares and account for them as such. If the trust earns interest or dividends from the other diversified assets the employer will account for that type of income on its own financial statements.

And finally, if the rabbi trust holds securities the employer will need to consider including those securities in their fair value disclosures, those disclosures required under Topic 820. So interesting

type of deferred compensation arrangement. These are often used, especially for larger publicly traded companies. And again, we get some unique and interesting accounting requirements when these types of trusts are utilized for these deferred compensation arrangements. So hopefully this has been helpful for our folks to gain an understanding of what these are all about.

Accounting for Rabbi Trusts

by J. Russell Madray, CPA

Overview

The Financial Accounting Standards Board *Accounting Standards Codification* (FASB ASC) provides guidance regarding employee compensation in the following four topics:

- FASB ASC 710, *Compensation—General*
- FASB ASC 712, *Compensation—Nonretirement Postemployment Benefits*
- FASB ASC 715, *Compensation—Retirement Benefits*
- FASB ASC 718, *Compensation—Stock Compensation*

FASB ASC 710 contains only the “Overall Subtopic” and provides guidance on general compensation-related matters that are not within the scope of the topics listed above. The “Overall Subtopic” contains the following two Subsections to segregate the guidance:

- General
 - Compensated absences
 - Deferred compensation arrangements
 - Lump-sum payments under union contracts
- Deferred Compensation—Rabbi Trusts

The FASB ASC Master Glossary defines rabbi trusts as “...grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer.” The Deferred Compensation—Rabbi Trust Subsections in FASB ASC 710-10, *Compensation—General—Overall*, provide guidance regarding an employer’s accounting for a deferred compensation plan that utilizes a rabbi trust. Under this type of plan, an employee invests a portion of his or her compensation in the employer’s stock; the trust holds the stock for future settlement with the

employee. Some plans permit an employee to select alternative investments either immediately or after holding the employer’s stock for a specified time period. Other plans prohibit diversification.

Observation: The Deferred Compensation—Rabbi Trust Subsections in FASB ASC 710-10 do not apply to stock appreciation rights, even if an employer funds these benefits through a rabbi trust. Typically, under a stock appreciation rights plan, an employee eventually receives compensation equal to the increase in the fair value of a stated number of the employer’s shares on a designated future date. At the specified time, the employee receives cash or an equivalent amount of the employer’s stock that represents the fair value increase. Although an employer that provides a stock appreciation rights plan may segregate the contract in a rabbi trust, the employer still accounts for the stock appreciation rights plan under FASB ASC 718.

Some deferred compensation plans that utilize a rabbi trust specify the consideration with which the employer may settle its obligation to the employee. To settle a claim for deferred compensation, depending on the terms of the plan, the employee may receive any (or a combination of) the following:

- Cash (after the trust sells the employer’s stock or other assets through market transactions)
- Shares of the employer’s stock
- Other investment assets held pursuant to diversification

Observation: A “rabbi trust” is so called because the first such trust was established in 1980 by a Jewish congregation for its rabbi. The congregation applied for and obtained a private letter ruling (PLR) from the Internal Revenue Service (IRS) which clarified the tax consequences of the establishment of the trust to the rabbi.

Typically, several years elapse between the time that an employee earns the compensation that he or she designates to a deferred compensation plan and eventual payment. An employer can use a trust, such as a rabbi trust, to designate and segregate the assets (or employer stock) that will eventually pay the

employee's compensation claim. The use of a trust gives the employee added confidence that the promised compensation will be received.

A rabbi trust can be revocable or irrevocable. If it is revocable, the employer can terminate the trust (but not necessarily the benefits promised under the deferred compensation plan). If the trust is irrevocable, the employer cannot terminate the trust, but the assets remain payable to the employer's creditors in the case of bankruptcy. Although the assets remain subject to the employer's creditors, establishment of a trust provides the employee with some assurance that the employer funding will be available when the employee seeks to settle his or her claim for the deferred compensation. Usually, rabbi trusts are irrevocable trusts.

Observation: An employee must have reasonable confidence in the employer's future financial condition and confidence that the assets will not pass into the hands of other creditors. Accordingly, an employee must consider risks, such as:

- The trust's assets are subject to the claims of unsecured creditors if the employer becomes bankrupt, even though the employer has segregated the plan's holdings into a rabbi trust
- Even though an employer may establish a trust, it does not have any specific obligation to fund the trust or irrevocably segregate assets for the employee

Tax Considerations

As mentioned earlier, the Jewish congregation that established the first rabbi trust applied for and obtained a PLR from the IRS. Since taxpayers are not allowed to rely on PLRs issued to other taxpayers, many employers applied for PLRs with respect to their draft trusts after the issuance of the initial rabbi trust PLR. Eventually, the IRS decided to limit the issuance of these PLRs. Instead, in Revenue Procedure 92-64, the IRS issued model rabbi trust language. The Revenue Procedure also set forth restrictions on future PLR applications.

At a high level, the tax considerations of using rabbi trusts are as follows:

- The creation or adoption of a rabbi trust does not result in income to the employee under the constructive receipt or economic benefit doctrines

- An employer's deposit into a rabbi trust is not taxable to the employee as long as the rabbi trust requirements (e.g., the trust's assets are subject to the claims of the employer's creditors) are met (the crediting of deferred amounts does not result in the constructive receipt of income, because participants in the deferred compensation plan have only the rights of unsecured creditors)

As a general principle, an employer cannot claim a deduction for employee compensation until the employee must include it in his or her taxable income. An employer's contribution to a nonqualified deferred compensation plan (NDCP) is deductible for the tax year in which the employee is required to include the deferred amounts in gross income. If more than one employee participates in a funded plan, separate accounts must be maintained for each employee for contributions to the plan to be deductible. The deductible amount of a contribution to a funded plan is limited to the amount actually contributed, even if the employee has to include in income a greater amount received from the plan.

Accounting for a Rabbi Trust

In order to account for a rabbi trust, an employer must first classify it into one of four types. A trust's assets and settlement terms determine its classification as a Plan A, Plan B, Plan C, or Plan D rabbi trust. FASB ASC 710-10-25 provides guidance regarding the four types of rabbi trusts, as follows:

- **Plan A**—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan A if the plan has the following characteristics:
 - The employee cannot diversify his or her holdings
 - The plan settles employee claims with a fixed number of shares of the employer's stock
- **Plan B**—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan B if the plan has the following characteristics:
 - The employee cannot diversify his or her holdings
 - The plan settles employee claims either in cash or shares of the employer's stock

- **Plan C**—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan C if the plan has the following characteristics:
 - The employee may diversify his or her holdings, but the employee has not done so
 - The plan settles employee claims in cash, the shares of the employer's stock, or other diversified assets
- **Plan D**—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan D if the plan has the following characteristics:
 - The employee may diversify his or her holdings, and the employee has done so
 - The plan settles employee claims in cash, shares of the employer's stock, or other diversified assets

Plan A Rabbi Trusts

If an employer characterizes a deferred compensation plan that utilizes a rabbi trust as Plan A, the employer must account for its shares held in the trust in a manner similar to treasury stock, using the guidance in FASB ASC 505-30, *Equity—Treasury Stock*. Further, the employer must classify its obligation for deferred compensation as an equity instrument.

Subsequent accounting for the plan must comply with the following guidelines:

- The employer cannot recognize changes in the fair value of its own stock held in the trust
- The employer does not recognize any changes in the fair value of its deferred compensation obligation

Observation: If an employer characterizes a deferred compensation plan that utilizes a rabbi trust as Plan A, then after initial recognition in accordance with FASB ASC 710-10-25-16, the employer does not account for changes in the fair value of the shares or its obligation to the employee.

Illustration 1

An employer offers certain employees the ability to participate in a NDCP. The employer establishes a rabbi trust to hold funds that an employee defers

pursuant to the plan. To help satisfy its obligation to pay the employee compensation in the future, the employer designates its own shares to the trust. The plan does not permit the employee to direct diversification into other securities. When the employer settles an employee's claims to the deferred compensation, the employee will receive the employer's shares. The employer, therefore, characterizes and accounts for the arrangement as Plan A.

Assume that Mary, the Chief Operating Officer designates 6 percent of her \$475,000 salary and bonus to the plan. To account for the initial compensation deferral, the employer designates shares with a fair value of \$28,500 ($\$475,000 \times .06$) to the trust. The employer accounts for the shares in a manner similar to treasury stock, as follows:

Dr. Contra-Equity (shares held for NDCP) 28,000

Cr. Equity (obligation for deferred comp) 28,000

On its balance sheet, the employer presents the equity shares held as a contra-equity item. It also presents the obligation to pay the employee in the future as an equity item. These balance sheet items offset to zero, because in substance, the employer is retaining the designated shares. Subsequently, the employer does not adjust these recorded amounts for fair value fluctuations.

Plan B or Plan C Rabbi Trusts

If an employer characterizes a deferred compensation plan that utilizes a rabbi trust as Plan B or Plan C, the employer must account for its shares held in the trust in a manner similar to treasury stock, using the guidance in FASB ASC 505-30. Further, the employer must classify its obligation for deferred compensation as a liability.

Subsequent accounting for the plan must comply with the following guidelines:

- The employer cannot recognize changes in the fair value of its own stock held in the trust
- The employer must adjust its deferred compensation obligation for changes in the fair value of the amount owed to the employee (the employer makes the corresponding entry as a charge or credit to compensation cost)

Illustration 2

An employer offers a NDCP to its employees. The employer establishes a rabbi trust to hold the

compensation that an employee defers under the plan. The plan does not permit the employee to direct diversification of the trust's holdings, but the employee can elect to receive compensation in cash rather than the employer's stock. Accordingly, the employer characterizes and accounts for the rabbi trust arrangement as Plan B.

Assume that Mary, the employer's Chief Operating Officer, designates 6 percent of her \$475,000 salary and bonus to the plan. To satisfy its future obligation to pay the COO, the employer elects to fund the employee's designated compensation by transferring its own shares with a fair value of \$28,500 to the trust. The employer accounts for the shares segregated to the trust as if they were treasury stock, that is, by using a contra-equity account. The employer also classifies its obligation to pay the employee's compensation as a liability on its balance sheet. As the fair value of the stock changes, the employer adjusts its obligation to the employee.

Assume, further, that one year after designating the compensation, the fair value of the shares increases to \$29,500. As the fair value of the stock changes, the employer must increase its obligation to the employee. It cannot, however, recognize any increase in the fair value of its own stock accounted for as treasury shares. The employer must recognize the increase in the fair value of the obligation as additional compensation expense:

Dr. Compensation Expense	1,000	
Cr. Liability for Deferred Compensation		1,000

Plan D Rabbi Trusts

If an employer characterizes a deferred compensation plan that utilizes a rabbi trust as Plan D, it must account for any diversified asset in the plan in accordance with the general guidance for the asset in question. For example, if the plan holds an equity security, the plan must account for the security under the guidance in FASB ASC 321-10, *Investments—Equity Securities—Overall*. Further, an employer must classify its deferred compensation obligation pursuant to a Plan D rabbi trust as a liability.

Observation: At acquisition, an employer may classify debt securities held in a rabbi trust as trading. By classifying securities designated to a trust as trading, the employer recognizes fluctuations in the securities' fair value through net income. The change in the

deferred compensation obligation also is recognized through net income. Classifying the securities as trading avoids an accounting mismatch.

If an employer establishes a deferred compensation arrangement by using a Plan D rabbi trust, the employer must adjust its deferred compensation obligation for changes in the fair value of the amount owed to the employee.

Changes in the fair value of the deferred compensation obligation must be recorded through net income and cannot be recorded in other comprehensive income. This is true even if changes in the fair value of the assets held by the rabbi trust are recorded, pursuant to FASB ASC 320-10, in other comprehensive income.

Illustration 3

An employer offers a NDCP to its employees. The employer establishes a rabbi trust to hold the compensation that an employee defers under the plan. The plan permits a participating employee to direct the diversification of the deferred compensation after one year of additional employment. At settlement, the employee will receive either cash or the diversified assets. Therefore, the employer characterizes and accounts for the trust as Plan D.

Assume that, in accordance with the plan's provisions, Mary, the employer's Chief Operating Officer, designates 6 percent of her \$475,000 salary and bonus to the deferral plan. To satisfy its future obligation to pay the COO, the employer elects to fund the employee's designated amount by transferring its own shares with a fair value of \$28,500 to the trust. After six months, the COO redirects the trust to acquire mutual fund shares.

Further, assume that, one year after the initial deferral, the fair value of the investment is \$32,000. The employer accounts for the increase as if it classified the securities as trading under FASB ASC 320-10, as follows:

Dr. Investment in Securities—Mutual fund	3,500	
Cr. Unrealized Gain on Securities		3,500

In addition, the employer must account for the increase in its obligation to the employee, as follows:

Dr. Compensation Expense	3,500	
Cr. Liability for Deferred Compensation		3,500

Financial Statement Presentation

Regardless of whether an employer characterizes a rabbi trust as Plan A, Plan B, Plan C, or Plan D, the employer must consolidate the trust's accounts into the employer's financial statements. In substance, any assets, such as cash and other securities, held in a rabbi trust remain the assets of the employer. Employers must consider any of its own stock designated to the rabbi trust as treasury shares. If the trust assets earn interest or dividends from the invested assets, the employer accounts for the income on its own financial statements. In addition, if the rabbi trust holds securities, the employer must consider including the securities in its fair value disclosures (FASB ASC 820-10-50, *Fair Value Measurement—Overall—Disclosure*).

The following examples illustrate how this information may be disclosed.

Example 1

In its Form 10-K for the fiscal year ended December 31, 2020, Stepan Company explains its accounting for assets held in a rabbi trust, in its Note 13—*Postretirement Benefit Plans*, as follows:

The Company has a rabbi trust to fund the obligations of its non-qualified supplemental executive defined contribution plans (supplemental plans). The trust comprises various mutual fund investments selected by the participants of the supplemental plans. In accordance with the accounting guidance for rabbi trust arrangements, the assets of the trust and the obligations of the supplemental plans are reported on the Company's consolidated balance sheet. The Company elected the fair value option for the mutual fund investment assets so that offsetting changes in the mutual fund values and defined contribution plan obligations would be recorded in earnings in the same period. Therefore, the mutual funds are reported at fair value with any subsequent changes in fair value recorded in the income statement. The supplemental plan liabilities increase (i.e., supplemental plan expense is recognized) when the value of the trust assets appreciates and decreases (i.e., supplemental plan income is recognized) when the value of the trust assets declines. At December 31, 2020 and 2019, the trust asset balances were \$1,778,000 and \$1,744,000, respectively, and the supplemental plan liability balances were \$1,853,000 and \$1,819,000, respectively. The differences between the trust

asset balances and the supplemental liability balances were due to estimated liabilities that were not funded until after the end of the year when the actual liabilities were determined.

Example 2

In its Form 10-K for the fiscal year ended December 31, 2020, Chipotle Mexican Grill, Inc. reported the following regarding its deferred compensation plan and its use of a rabbi trust in its Note 9—*Employee Benefit Plans*, as follows:

We also maintain the Chipotle Mexican Grill, Inc. Supplemental Deferred Investment Plan (the "Deferred Plan") which covers our eligible employees. The Deferred Plan is a non-qualified plan that allows participants to make tax-deferred contributions that cannot be made under the 401(k) Plan because of Internal Revenue Service limitations. Participants' earnings on contributions made to the Deferred Plan fluctuate with the actual earnings and losses of a variety of available investment choices selected by the participant. Total liabilities under the Deferred Plan as of December 31, 2020 and 2019, were \$15,296 and \$12,811, respectively, and are included in other liabilities on the consolidated balance sheets. We match 100% of the first 3% of pay contributed by each eligible employee and 50% on the next 2% of pay contributed once the 401(k) contribution limits are reached.

We have elected to fund our deferred compensation obligation through a rabbi trust. The rabbi trust is subject to creditor claims in the event of insolvency, but the assets held in the rabbi trust are not available for general corporate purposes. Amounts in the rabbi trust are invested in mutual funds, consistent with the investment choices selected by participants in their Deferred Plan accounts, which are designated as trading securities, carried at fair value, and are included in other assets on the consolidated balance sheets. Fair value of rabbi trust investments in mutual funds is measured using Level 1 inputs. The fair value of the investments in the rabbi trust was \$15,296 and \$12,811 as of December 31, 2020 and 2019, respectively. We record trading gains and losses in general and administrative expenses on the consolidated statements of income, along with the offsetting amount related to the increase or decrease in deferred compensation to reflect our exposure to liabilities for payment under the deferred plan.

Compensation Guidance

FASB ASC 710, Compensation—General

FASB ASC 712, Compensation—
Nonretirement Postemployment Benefits

FASB ASC 715, Compensation—
Retirement Benefits

FASB ASC 718, Compensation—Stock
Compensation

ASC 710 Overall Subtopic

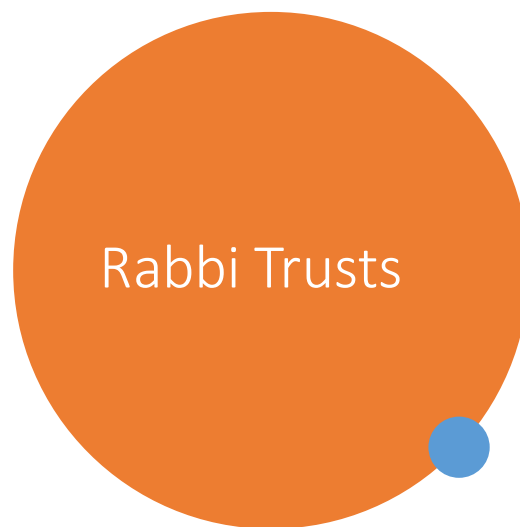
General

- Compensated absences
- Deferred compensation arrangements
- Lump-sum payments under union contracts

Deferred Compensation— Rabbi Trusts



- “...grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer.”



Tax Considerations

- The creation or adoption of a rabbi trust does not result in income to the employee under the constructive receipt or economic benefit doctrines
- An employer's deposit into a rabbi trust is not taxable to the employee as long as the rabbi trust requirements are met



Plan A

- The employee cannot diversify his or her holdings
- The plan settles employee claims with a fixed number of shares of the employer's stock



Illustration 1

- Employer offers certain employees the ability to participate in a NDCP
- Employer establishes a rabbi trust to hold funds that an employee defers pursuant to the plan
- To help satisfy its obligation to pay the employee compensation in the future, the employer designates its own shares to the trust
- The plan does not permit the employee to direct diversification into other securities
- When the employer settles an employee's claims to the deferred compensation, the employee will receive the employer's shares
- The employer, therefore, characterizes and accounts for the arrangement as Plan A

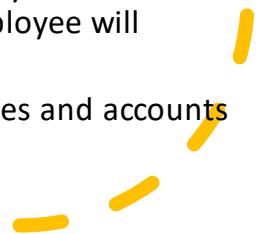


Illustration 1 - continued

- Assume that the COO designates 6% of her \$475,000 salary and bonus to the plan
- To account for the initial compensation deferral, employer designates shares with fair value of \$28,500 ($\$475,000 \times .06$) to the trust
- Employer accounts for the shares in a manner similar to treasury stock, as follows:

Dr. Contra-Equity (shares held for NDCP)	28,500
Cr. Equity (obligation for deferred comp)	28,500

- Employer presents the equity shares held as a contraequity item
- Also presents obligation to pay the employee in the future as an equity item

Plan B

- The employee cannot diversify his or her holdings
- The plan settles employee claims either in cash or shares of the employer's stock



Illustration 2


- Employer offers a NDCP to its employees
 - Employer establishes a rabbi trust to hold the compensation that an employee defers under the plan
 - Plan does not permit employee to direct diversification of the trust's holdings, but the employee can elect to receive compensation in cash rather than the employer's stock
 - Accordingly, the employer characterizes and accounts for the rabbi trust arrangement as Plan B
- 



Illustration 2 – continued

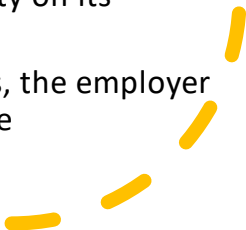
- Assume that employer's COO designates 6% of her \$475,000 salary and bonus to the plan
 - To satisfy its future obligation to pay the COO, the employer elects to fund the employee's designated compensation by transferring its own shares with a fair value of \$28,500 to the trust
 - Employer accounts for the shares segregated to the trust as if they were treasury stock
 - Employer also classifies its obligation to pay the employee's compensation as a liability on its balance sheet
 - As the fair value of the stock changes, the employer adjusts its obligation to the employee
- 

Illustration 2 – continued

- One year after designating the compensation, the fair value of the shares increases to \$29,500
- As the fair value of the stock changes, the employer must increase its obligation to the employee
- The employer must recognize the increase in the fair value of the obligation as additional compensation expense:

Dr. Compensation Expense	1,000	
Cr. Liab. for Def Comp		1,000

Plan C

The employee may diversify his or her holdings, but the employee has not done so

The plan settles employee claims in cash, the shares of the employer's stock, or other diversified assets

Plan D

- The employee may diversify his or her holdings, and the employee has done so
- The plan settles employee claims in cash, shares of the employer's stock, or other diversified assets

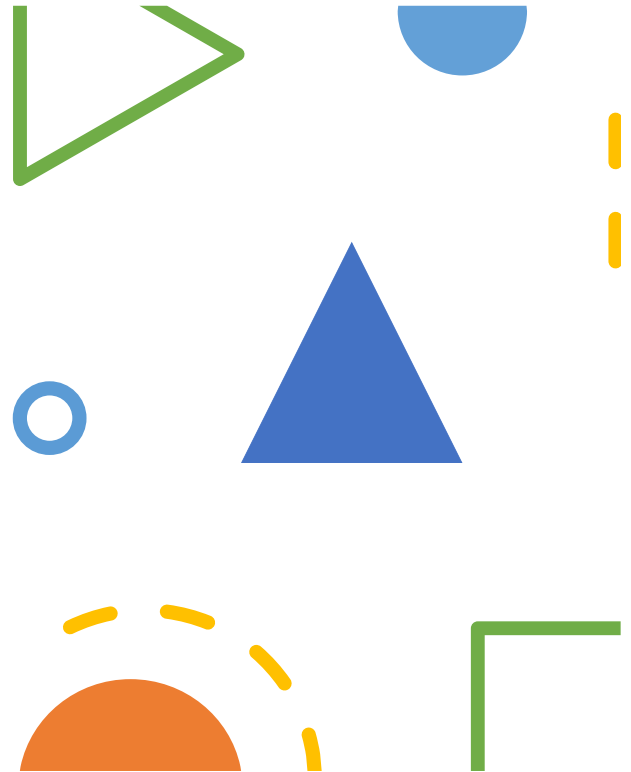


Illustration 3

- An employer offers a NDCP to its employees
- The employer establishes a rabbi trust to hold the compensation that an employee defers under the plan
- The plan permits a participating employee to direct the diversification of the deferred compensation after one year of additional employment
- At settlement, the employee will receive either cash or the diversified assets
- Therefore, the employer characterizes and accounts for the trust as Plan D

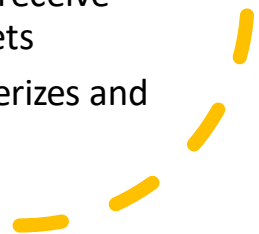


Illustration 3 — continued

- Assume that the COO designates 6% of her \$475,000 salary and bonus to the deferral plan
- To satisfy its future obligation to pay the COO, the employer elects to fund the employee's designated amount by transferring its own shares with a fair value of \$28,500 to the trust
- After 6 months, the COO redirects the trust to acquire mutual fund shares
- Further, assume that, one year after the initial deferral, the fair value of the investment is \$32,000
- The employer accounts for the increase as if it classified the securities as trading under FASB ASC 320 -10, as follows:

Dr. Investment in Securities—Mutual fund	3,500	
Cr. Unrealized Gain on Securities		3,500

- In addition, the employer must account for the increase in its obligation to the employee, as follows:

Dr. Compensation Expense	3,500	
Cr. Liability for Deferred Compensation		3,500

GROUP STUDY MATERIALS

A. Discussion Problems

1. Briefly describe the 4 types of rabbi trusts.
2. Discuss the accounting treatment for a Plan B or Plan C rabbi trust.
3. Explain the financial statement presentation requirements for a rabbi trust.

B. Suggested Answers to Discussion Problems

1. Plan A—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan A if the plan has the following characteristics:

- The employee cannot diversify his or her holdings
- The plan settles employee claims with a fixed number of shares of the employer's stock

Plan B—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan B if the plan has the following characteristics:

- The employee cannot diversify his or her holdings
- The plan settles employee claims either in cash or shares of the employer's stock

Plan C—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan C if the plan has the following characteristics:

- The employee may diversify his or her holdings, but the employee has not done so
- The plan settles employee claims in cash, the shares of the employer's stock, or other diversified assets

Plan D—an employer must account for a deferred compensation plan that utilizes a rabbi trust as Plan D if the plan has the following characteristics:

- The employee may diversify his or her holdings, and the employee has done so
- The plan settles employee claims in cash, shares of the employer's stock, or other diversified assets

2. If an employer characterizes a deferred compensation plan that utilizes a rabbi trust as Plan B or Plan C, the employer must account for its shares held in the trust in a manner similar to treasury stock, using the guidance in FASB ASC 505-30. Further, the employer must classify its obligation for deferred compensation as a liability.

Subsequent accounting for the plan must comply with the following guidelines:

- The employer cannot recognize changes in the fair value of its own stock held in the trust
- The employer must adjust its deferred compensation obligation for changes in the fair value of the amount owed to the employee (the employer makes the corresponding entry as a charge or credit to compensation cost)

3. Regardless of whether an employer characterizes a rabbi trust as Plan A, Plan B, Plan C, or Plan D, the employer must consolidate the trust's accounts into the employer's financial statements. In substance, any assets, such as cash and other securities, held in a rabbi trust remain the assets of the employer. Employers must consider any of its own stock designated to the rabbi trust as treasury shares. If the trust assets earn interest or dividends from the invested assets, the employer accounts for the income on its own financial statements. In addition, if the rabbi trust holds securities, the employer must consider including the securities in its fair value disclosures (FASB ASC 820-10-50, *Fair Value Measurement—Overall—Disclosure*).

PART 2. AUDITING

PCAOB Areas of Focus

The primary goal of the Public Company Accounting Oversight Board is to improve the quality of audit services. The Board seeks to promote continuous improvement by focusing on both the detection and prevention of audit deficiencies.

For more of what the PCAOB is focusing on in 2022, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk a little bit about the PCAOB's areas of focus for this coming year and to begin with what's the primary goal of the public company accounting oversight board, (PCAOB)?

Ms. Louis

The PCAOB, like their number one goal is to improve the quality of audits. And this is going to be through a combination of activities that will either prevent there from being lack of quality, detect it, deter it, remediate it. PCAOB, ultimately, is overseeing this sense of continuous improvement related to the actual quality of audit services.

Ms. Grove Casey

Well, has the COVID 19 pandemic impacted the areas of focus of the PCAOB in recent years?

Ms. Louis

Absolutely. As we think about significant changes in risks and what they believe the auditors should be considering and testing in their engagements, which might be the fact that revenues have altered dramatically or expenses have significantly increased, or there's been supply chain disruptions, challenges with labor that have presented new risks. Plus business strategies have had to sometimes swiftly adapt to continue to survive and potentially thrive in this new environment. And so obviously, as we think through this next year that's going to be a factor in the areas of expected focus from the PCAOB.

Ms. Grove Casey

Has there been an increase or decrease in the number of initial public offerings recently?

Ms. Louis

The SEC has said that the number of initial public offerings or IPOs has really compared to recent times

doubled. And so if we think about some statistics like the fourth quarter of 2021 was the most active fourth quarter since 2007. And they're anticipating that even moving forward that global markets overall, that there is going to be an increase in the volume of IPOs. And because of a variety of things where the headwinds are still there for that to be a motivation.

Ms. Grove Casey

Has there been any impact on merger and acquisition activity?

Ms. Louis

We also have seen globally, the merger and acquisition activity has surpassed what we had pre-pandemic and recent times have matched some of the peaks that we saw from 2007 and 2015. They're anticipating that this also will continue as there are low interest rates and things are still recovering in the global economy. So you might be able to get a good deal on something, as they're looking to pursue some transformative changes in business and operating models that might exist such as for example, like a traditional industrial or financial services company might be buying a tech company, because they're looking to digitize their business and private equity as well being an increasingly important factor. And they may be involved in some of these deals. As many opportunities are coming up as we head into this next year.

Ms. Grove Casey

Well, special purpose acquisition companies, the abbreviation there is SPACs have become increasingly popular in recent years as a means of raising capital. How has this impacted the focus of the PCAOB?

Ms. Louis

SPACs are something that they've been around for about two decades, but there tended to be starting in

2019 more of a high profile of more institution-led SPACs, acquiring certain higher profile targets, which brought this to the forefront. Largely SPACs had been seen as a mechanism for less well-known companies to seek to go public, but didn't necessarily have a sufficiently compelling story to attract buyers in a traditional IPO. But, now ultimately, you have higher profile targets, you have institution-led special purpose acquisition companies being created. And, one of the perceived advantages of these transactions is that you can include projections for the target in the filing, without which maybe some typically prohibited things that you would have at a traditional IPO, and also as we think about other matters that particularly as we think about having some sort of attestation requirement is also a little bit different as we think about SPAC transactions compared to traditional IPOs because of the increased level of this type of activity, though, that obviously attracts the attention of the SEC and anything that attracts the attention of the SEC is going to also attract the attention of the PCAOB as well.

Ms. Grove Casey

So can SPACs apply private company council (PCC) accounting alternatives?

Ms. Louis

As we look at SPACs and then the targets that they're looking to acquire, they do need to have appropriate governance and internal control structures in place. As the private operating company will immediately be subject to the various regulations as soon as they close and the SPAC, the transaction being that I actually acquired the private company target by the SPAC. So it is still important that we ensure that there are appropriate people and processes in place to create compliant financial statements, which will mean that I would need to reverse any previously elected private company council (PCC) accounting alternatives that were only available to non-public entities.

Ms. Grove Casey

Do you think it's predictable as far as which types of engagements the PCAOB will select for review during inspections of registered public company accounting firms?

Ms. Louis

Well, one of the things that the PCAOB has been striving to do in recent years is to be less predictable. They're going to increase the percentage of random

selections looking at, even as I pick a particular financial statement audit to look at that I'll look at, maybe some of the non-traditional areas of focus such as cash and cash equivalence. This is something that they've started to do in recent times to encourage firms, to make sure that they're performing quality control checks across all of their audits and all of the areas in each audit, because what they were fearful of is that CPA firms were really just putting emphasis on what they thought PCAOB would look at and not really going through and monitoring the entirety of their engagements. And so if PCAOB starts doing some of these non-traditional things, that means that they're hoping the firms will also consider these nontraditional areas in their own areas of monitoring with pre and post issuance type reviews.

Ms. Grove Casey

Will the widespread disruption of supply chains have an effect on PCAOB areas of focus?

Ms. Louis

Certainly, we're still seeing the impact of supply chain disruption, and all of that, as we think about manufacturing delays that are going to exist, even as we head into the next year. I'm looking to build a vacation home that we've had on the agenda for a while. And I'm not even sure if we want to break ground, because we're not sure what's going to happen with pricing with lumber and steel and other things that are critical to have. Ultimately, the goal would be that as the pandemic induced stress and demand thins out that ultimately that is something where just the risks and uncertainties will break away. And some critical sectors of the economy will perhaps have some easing of those strains, but I think that it will take time. And so PCAOB will focus on areas that they believe is in their longer term, as we think about the next year, what, where could there still be risks and uncertainties and to make sure they're properly presented and disclosed?

Ms. Grove Casey

Well, historically entities reporting on non-GAAP measures has been an area of concern. Will that continue to be true in 2022?

Ms. Louis

The SEC has said that they continue to discuss non-GAAP measures in the comment letters that they provide back to these SEC filers. It's important to understand why is a non-GAAP measure useful to

investors, and to make sure that it's clearly differentiated from the GAAP measure and that it has prominence that the GAAP measure has equal prominence in the financial statements compared to the non-GAAP measure. Right? So the GAAP financial information should be the primary focus. The non-GAAP measure is there as supplementary additional information that should garner less of the emphasis. And so, yes, I think that the SEC and PCAOB both will be focused on that concern,

Ms. Grove Casey

Environmental, social, and governance or ESG related matters have grown in prominence in recent years. Will this impact the PCAOB's focus in 2022?

Ms. Louis

I think it is moving to the forefront of our profession. In fact, the center for audit quality that kind of works with the PCAOB has done research and found that 95% of our S&P 500 companies do report some form of ESG information. ESG has been around for a while, but it's just garnered more activity probably in the last year than it has in the last 10 years as investors and users of the financial statements are looking for some way of getting information about environmental, social, governance things, and to consider the effect that they might be having on the organization and its results of operations. And given this increased interest first of all, are there internal controls over the sustainability reporting that mimics those that might be put in place for accounting and financial reporting? Particularly as we might have some of the sustainability information be included in certain filings that we have with these publicly traded organizations and the enhanced disclosure considerations is something that the SEC has notified people about particularly disclosures related to climate change. And so, as the SEC puts more emphasis on these types of disclosures and SEC filings, there's going to be a natural effect that the PCAOB and their financial statement auditors will also pay more attention to those matters.

Ms. Grove Casey

Are there any other areas where there have been a disproportionate number of SEC comments?

Ms. Louis

Well, one of them would be with segment reporting, as there's change that's happening in business operations, and to think about, well, as I change my operations,

how does that affect my reportable segment? Like, have I set up reporting segments and should I be adjusting them based on current period conditions, thinking about the nature of my business to determine whether they really do meet because I have reporting segments, do they meet all the characteristics as what's defined within codification Topic 280?

Ms. Grove Casey

Well, if a reporting entity determines that a correction of an error is needed is an amended SEC filing required?

Ms. Louis

The SEC's made a lot of comments recently about what they call little R restatements, corrections of an immaterial error. So it often doesn't result in an amended filing compared to a big R restatement. There certainly have been examples of objections that the SEC's made to the issuer's conclusions about whether or not this is a little R or big R restatement. And so, therefore I think that as we think about the audit and the auditor's involvement in helping these clients with perhaps doing amended filings, they do need to consider the SEC's guidance as they look at SAB 99, that gives some qualitative factors to figure out whether something is, ultimately, immaterial as opposed to being considered material. It's not a checklist, but it's certainly something that gives some factors to consider as we're trying to come up with that overarching analysis that might exist as we're looking at identifying errors in the financial statements,

Ms. Grove Casey

Well, digital assets have increased in popularity in recent years. How will that influence the need for oversight by the SEC and the PCAOB?

Ms. Louis

Well, I think that ultimately there's lots of questions that have been coming up, legal questions regarding ownership treatment of digital assets to determine if I have an embedded derivative sometimes in these transactions that are involving these digital assets, including cryptocurrency. So there is a digital assets working group that's been created by the AICPA that is constantly looking at giving guidance for accounting for and auditing of these digital assets. This originally was created in 2019, it was updated in 2020, and it has been indicated that there is going to be further content that's added to these topics as they are starting to flush

out the common questions and issues that people have associated with particularly the proper accounting treatment of these matters, but also the auditing risk, including fraud in implications, as we think about how somebody can misappropriate or misuse a digital asset, and how there does need to be controls over digital assets, that may be unique as you think about your accounting, financial reporting systems. And another concern might be, can I get sufficient appropriate evidence related to these digital assets, as we think about who is actually involved, which could involve a service organization, a third party custodian of that, and, and it's been a little slow to develop? What do I really have to understand related to the design, implementation, and possible testing of operating effectiveness of those controls?

Ms. Grove Casey

Has remote working impacted the PCAOB's perception about audit quality risk?

Ms. Louis

Well, obviously, as things are different than what we historically have done in the past, there'll be a concern about, well, how did that affect quality, whether it was because of time constraints, availability of information, access to client management? How it is that I observe, things like physical inventory. Evidence may be in digital form naturally. As they, PCAOB goes through and starts looking at these registered accounting firms in their next cycle of quality reviews that they will be thinking about, how did you address that as you looked at putting together your overall plans for this audit?

Ms. Grove Casey

Is there anything else that PCAOB has indicated needs to be critical for quality audits, post pandemic?

Ms. Louis

They did highlight that they as always, because this comes up every year, it seems like they want you to focus on maintaining professional skepticism in all aspects of the audit and exercising due professional care. So as we think about some of these disruptions and risks that exist, that they want to ensure that we're not forgetting that that's important for quality audits.

Ms. Grove Casey

Retaining independence when performing audit and other attest services seems to also be a recurring issue, is that expected to be any different than 2022?

Ms. Louis

It's not, and in some cases, it's only getting worse as you might have where you're thinking about supporting an organization in helping them prepare certain pieces of financial information. And so, I might be doing a blending of attest and non-attest services because my client lost some people or somebody's been out on extended sick leave. And as we have the need for us to backfill certain needs that my client has as we're trying to help them get their financial statements prepared on time to meet certain filing deadlines, whether it's because of a debt covenant with the bank or because you're dealing with a public company that that's a concern, what is it that I really should be doing as I'm trying to be helpful to my clients. And also, it needs to think about just some of the complexity of various relationships that exist as well.

Ms. Louis

And, as there are more of these mergers and acquisitions and other types of activities where we have made, have had a previous relationship with that target, how does that affect my ability to now continue maybe as an auditor, attest provider as well? The SEC has said that they really like even if a client, if a CPA firm identifies and notifies the SEC about an independence violation, it's not just identifying the issue, it's preventing it to begin with. And so you can see particularly for public companies where SEC penalties may be ratcheted up a bit because they're trying to change some of that behavior.

Ms. Grove Casey

So in the past, the auditor's independence has been a primary concern of well, really any oversight body and probably a lot of the financial statement readers as well, is considering whether providing non audit services. So those non-attest services and its impact on an auditor's ability to be independent, still a primary concern?

Ms. Louis

Yeah. As we were talking about just independence from a bigger point of view, whether you're a public company or whether you're a non-public company, both, right, it's going to be a primary concern that the auditors are going to have to think about everything that they do for you outside of the scope of the audit. That's a consequence we're thinking about the implications of a prudent person, agreeing that we're independent enough to do this work. If you're going to be following

the same principles to make sure that we're not creating a conflict of interest, that we're not putting the accountant in the position of auditing their own work, that the accountant is not acting like management or an employee of the audit client. I'm not being put in a position to advocate for my client like these basic guiding principles, whether it's public or non-public has to be consistently viewed as a hurdle as we are trying to make a case that, are there threats to my independence? How significant are those threats? How am I comfortable that I have safeguards in place where I've either eliminated or mitigated that threat to what would be deemed an acceptable level? And there are different bars that I'm trying to jump over. Obviously, with public companies, there's a higher bar to overcome compared to a non-public company, but both of them need to be making that assessment.

Ms. Grove Casey

What specifically will the PCAOB focus on when reviewing registered public accounting firms?

Ms. Louis

As they are planning their own procedures, they are going to be looking at how firms identify independence violations. They also will be focused on if you are doing non-audit services. Did you get the pre-approval from the governing body of the client? And ultimately, did you communicate with audit committees about independence factors, right? Where there could be risks at how you're eliminating or mitigating them, but then also, how is it that you are responding to any past quality control criticisms? We're not just trying to identify violations, but we're trying to proactively work to prevent them from happening to begin with.

Ms. Grove Casey

Well, are there any specific considerations about how auditors apply the concept of materiality that the PCAOB is interested in?

Ms. Louis

Certainly as we think about materiality, some audit teams are focused too heavily on just quantitative materiality and the PCAOB would say, we also need to think about qualitative materiality, and to ensure that ultimately we give them both a balanced perspective, as we think about the points of focus, particularly in areas like disclosures, as being something that qualitatively might be a material omission or misrepresentation.

Ms. Grove Casey

Is there anything else related to planning an audit engagement that we should discuss as a potential area of PCAOB focus?

Ms. Louis

Well, I think that once again, they want to know, how did you make your procedures unpredictable, right? What the PCAOB's going to look at the auditor to say, how did you build unpredictability into your audit plans? But then they also are going to look at the quality of what you're doing as it relates to risk assessments, and did you fully understand the known and potential changes that are out there due to the current environment that we're operating within?

Ms. Grove Casey

Well, increasingly auditors are using service providers as part of the external confirmation process. Does this pose any concerns from the PCAOB?

Ms. Louis

Well, part of it is that if you are using a service provider to do your confirmations for you, I'm hiring somebody to go get that confirmation information. It doesn't relieve the auditor of the requirement to maintain control over the confirmation process. And they're looking to seeded audit firms, are they considering their policies and procedures related to the use of a service provider to send and receive confirmations on my behalf?

Ms. Grove Casey

What GAAP accounting and financial reporting issues do you generally think will merit more audit work compared to prior audits?

Ms. Louis

There's a plethora of them that we think are going to be of concern, think mostly around areas of accounting, uncertainty, impairment, going concern, allowance for credit risk increase, fraud, risk. Like those areas are going to be the areas that the PCAOB will naturally focus on also.

Ms. Grove Casey

Well, is there anything else related to quality management that we should discuss before we wrap up?

Ms. Louis

I think one of the things is to keep in mind that there are quality control standards that have to be followed by CPA firms, including registered public accounting firms and the PCAOB is really focused on how a firm's system of quality control is embedded in the culture of the organization. How is it that you are taking a risk-based approach to your own firm's quality control, and to really ensure that there are ways that there can be tools or templates that can really help a firm better manage their risk. In addition, there are some changes that may be coming where quality control standards become quality management standards, which is just really an evolution of really thinking about things, being more of a risk based approach.

Ms. Grove Casey

What audit standard activity could be on the horizon for PCAOB

Ms. Louis

For them, they're really still focused on data and technology, and how does that affect audit evidence, particularly as we might be doing sampling and analytics that are using this electronic data and technology, but also to get a more uniform approach to how it is that we supervise the work of others, particularly because a lot of times for public company audits, we are using other auditors as a part of that audit process.

PCAOB Areas of Focus – 2022

by Jennifer F. Louis, CPA

Background

Per the Public Company Accounting Oversight Board's (PCAOB's) Strategic Plan, the number one goal of the PCAOB is to drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation. The PCAOB is successful when oversight promotes continuous improvement in the quality of audit services. To drive such improvement, the PCAOB must focus on not only detecting audit deficiencies, but also preventing them from occurring in the first place. This requires a forward-looking approach to the design and conduct of the oversight of registered firms.

The business environment amid the COVID-19 pandemic has meant significant changes in the risks and results auditors consider and test during their engagements. In many cases, revenue and expenses have been altered dramatically; supply chain and labor challenges have presented new risks; and business strategies have changed swiftly as audit clients attempt to survive and thrive in the new environment. This segment will focus on some of the expected areas of focus that the PCAOB will emphasize in its 2022 inspections of audits of registered public accounting firms.

Initial Public Offerings

According to SEC staff, the number of initial public offerings (IPOs) reviewed has doubled compared to recent times. 4th Quarter 2021 was the most active fourth quarter since 2007. Through 2021, global markets also experienced overall increases by both IPO volume and proceeds.

Looking ahead to 2022, both headwinds and tailwinds are in sight which will likely impact IPO activity. A combination of geopolitical tensions, inflation risks, and new waves and variants of the ongoing COVID-19 pandemic that hamper full economic recovery are all factors to consider. Despite all of these, relatively high valuations and market liquidity are so far keeping the IPO window open in 2022. IPO candidates can expect higher market volatility and thus should remain flexible with a plan B in place to meet financing needs in case the IPO timetable is delayed.

Merger and Acquisition Activities

Global mergers and acquisition activity in 2021 easily surpassed the pre-pandemic level and nearly matched the peaks of 2015 and 2007. And M&A is poised to climb higher in 2022 with easy access to capital, low interest rates, and a recovering global economy. Increasingly, companies are pursuing "transformative" deals that change business and operating models, such as traditional industrial or financial services companies buying tech companies to digitize their businesses.

Private equity players were an increasingly important factor in 2021 and will continue to be in 2022. For deal makers, 2022 will bring many opportunities and increasing challenges, due to high valuations, deal complexity, and the competition for high-quality assets.

Special-Purpose Acquisition Companies (SPACs)

While SPACs have been around for over 20 years, a shift occurred beginning in 2019 with the entrance of high-profile institution-led SPACs acquiring high-profile targets. Prior to this, SPACs had largely been seen as a mechanism for less-well-known companies seeking to go public, but not having a sufficiently compelling story to tell to attract buyers in a traditional IPO.

One of the perceived advantages of SPAC transactions is the ability to include projections for the target in the filing, which is typically prohibited in a traditional IPO. This difference, combined with the lack of a requirement for any type of attestation (e.g., a fairness opinion) creates conditions that could lead to future rulemaking. Currently, there are several hundreds of SPACs seeking targets for a de-SPAC transaction. Therefore, there is a large volume of potential acquisition transactions on the horizon.

This increased level of transaction activity has drawn heightened scrutiny of the related required filings. In particular, there are a range of accounting and reporting issues that entities have been working through related to SPAC transactions, including issues relating to warrant accounting, earnings per share, temporary versus permanent equity classification, compensation, business combinations, and derivatives.

SPACs and their targets need to have appropriate governance and internal control structures in place, as the private operating company will be immediately subject to 1934 Act reporting requirements upon the close of the de-SPAC transaction (i.e., the acquisition of the private target company by the SPAC). It is important to ensure that appropriate personnel and processes are in place to produce compliant financial statements, which includes the reversal of any previously-elected Private Company Council accounting alternatives. The filing review process of the SEC for the de-SPAC transaction would be comparable to that of a traditional IPO.

Unpredictability in Engagements Selected for PCAOB Review

The PCAOB will continue to increase the percentage of random selections and review non-traditional focus areas such as cash and cash equivalents. This is consistent with last year's approach and is meant to encourage firms to perform quality audits across all audits and all areas of each audit. Firms should not focus their pre- and post-issuance reviews monitoring entirely on their larger, "riskier" clients under a traditional risk assessment model but should consider adding a level of randomness in their selection process. In addition, firms should consider including some non-traditional focus areas in your monitoring reviews.

Broker-Dealer Inspections

Audits of broker-dealers with responsibility for holding customer funds, maintaining custody of customer securities and providing customer account statements will continue to garner more focus by the PCAOB and SEC.

Widespread Disruption of Supply Chains

Supply chains already had to contend with high demand, growing port congestion and manufacturing delays going into 2021. Rising COVID-19 cases, extreme weather events and the blockage of the Suez Canal during 2021 only created more challenges.

As COVID-19 vaccines became widely available in the United States and the economy reopened, consumer demand recovered strongly. Significantly, the pandemic-induced increase in demand for goods persisted even as demand for services (such as dining out, entertainment, and travel) largely returned to pre-

pandemic levels. Companies—which for decades had been disciplined by the market into creating “just-in-time” supply chains and holding little inventory—scrambled to keep up.

At the same time, companies in critical sectors such as warehousing struggled to attract and retain workers. These factors, combined with years of underinvestment in U.S. infrastructure, saw goods-heavy containers piling up at major ports and ships waiting for weeks to dock. As a result, shoppers around the country saw empty shelves and higher prices.

There are signs that some of these strains are easing heading into 2022, but economic effects are expected to linger.

Non-GAAP Measures

Per the SEC Division of Corporate Finance, one of the areas that continues to be frequently discussed in comment letters is non-GAAP measures. It is important to understand why the use of a non-GAAP measure is useful to investors. For instance, when presenting a non-GAAP measure, it should be presented with the most relevant financial statement measure, with the financial statement measure having greater prominence. In short, the GAAP financial information should be the focus of the disclosure. Comment letters in this area tend to be related to either the prominence of the non-GAAP measure being greater than that of the GAAP measure, or the non-GAAP measure not being presented with the most relevant financial statement GAAP measure. In addition, it is important to consider how the non-GAAP measure is labeled in the disclosure. Labels should not be misleading, and clear descriptions of the non-GAAP measure and adjustments should be used.

Environmental, Social, and Governance (ESG)

Environmental, Social, and Governance (ESG) has moved to the forefront of the profession. In fact, the Center for Audit Quality (CAQ) research has found that 95% of S&P 500 companies are currently reporting some ESG information. While ESG has been around for decades, there has been more activity in the last ten months than the last ten years.

Investors and users are looking for some sort of approach or standard that ensures that ESG information is comparable, consistent, and reliable from company

to company. It is clear that ESG is going to continue to gain prominence as the CAQ has reported that 91% of stakeholders would like to see ESG information assured over time.

The reporting landscape in this area is rapidly evolving to meet stakeholder demands for simplification and clarity, including through the formation in June 2021 of the Value Reporting Foundation through the merger of the International Integrated Reporting Council and the Sustainability Accounting Standards Board, and their related Integrated Reporting Framework and SASB Standards. In addition, at the 2021 UN Climate Change Conference of the Parties (COP26) meeting in November 2021, the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) to deliver a comprehensive global baseline of sustainability-related disclosure standards. It is anticipated that the ISSB will begin standard-setting activities in 2022, with a goal to achieve an approach that has global consistency, including core metrics that can be evaluated for use in various jurisdictions.

Given the increased stakeholder interest, companies are developing enhanced controls around sustainability reporting that mimic those in financial reporting and including the consideration as to whether sustainability information should be included in certain items of Form 10-K. Adding to the importance of enhanced disclosure considerations is the September 2021 “Dear Issuer” letter from the SEC regarding climate change disclosures. This sample letter contains example comments that the Division of Corporation Finance (Corp Fin) may issue to companies regarding their climate-related disclosure or the absence of such disclosures, based on the Corp Fin’s observations during recent filing reviews. The SEC staff also reminded participants of its 2010 Commission Guidance Regarding Disclosure Related to Climate Change and noted that the Commissioners have directed its staff to write additional guidance.

Segment Reporting

The SEC comment letters in the area of segment reporting have stemmed from either an issuer’s identification of reportable segments or the aggregation of reportable segments. Issuers should factor in changes to their company’s business operations and consider what impact this may have on their current reportable segments. In addition, ASC Topic 280, *Segment*

Reporting, allows reportable segments to be aggregated when certain criteria are met. Issuers should carefully consider the nature of the business for each reportable segment in determining whether they meet all the characteristics of being similar as defined in ASC Topic 280 and, therefore, whether it would be appropriate to aggregate.

Corrections of Immaterial Errors

The SEC has made comments about the recent swing in the number of “Little r” restatements (or corrections of an immaterial error, commonly not resulting in an amended filing) compared to “Big R” restatements and provided examples of two recent objections to issuer conclusions that an identified misstatement resulted in a “Little r” restatement through the application of Staff Accounting Bulletin No. 99 (SAB 99). Specifically, the SEC guidance in SAB 99 should be carefully considered with the individual facts and circumstances.

SAB 99 requires consideration of qualitative factors that may result in a quantitatively immaterial error being considered material. Further, assessing whether an error is material to prior periods is not a mechanical exercise, and should not be based solely on quantitative analysis. The total mix of information and facts and circumstances must be considered to reach such a conclusion.

Furthermore, SAB 99 is not a checklist and should not be evaluated in a vacuum. The qualitative factors listed in the staff guidance explicitly state that it is not an exhaustive list of the circumstances that may affect the materiality of a quantitatively small misstatement. The SEC struggles when issuers support qualitative analysis by suggesting that investors only focus on the most recent financial statements and do not consider a registrant’s financial history. SEC staff have disagreed with such conclusions, stating that there is clear evidence that investors focus both on current and historical company information.

When performing a SAB 99 analysis over an identified misstatement, issuers should identify the error, determine whether it is a material accounting restatement (regardless of restatement type), and consider both the quantitative and qualitative factors in determining the level of restatement necessary. In addition, the analysis should be performed from an objective perspective, and qualitative factors applied should not be biased to result in a certain conclusion.

Digital Assets

There are a number of issues regarding the accounting for and auditing of digital assets, including the various types of digital assets, legal questions regarding ownership and collateralizing, and treatment for regulatory capital purposes. While there are far more questions than answers currently in this space, the AICPA has a Digital Assets Working Group confronting the issues, and has published and is updating their Accounting for and Auditing of Digital Assets Practice Aid.

The original group of Q&As was published in December 2019 and covered topics including classification, measurement, recognition, derecognition and third-party hosted wallets. The practice aid was updated October 2020 to add accounting questions on certain industry-specific topics (investment companies and broker-dealers), fair value considerations, and stable coins. Current topics under development include derivatives, crypto lending, and mining. The auditing content includes July 2020 and May 2021 topics covering client acceptance and continuance, risk assessment and processes and controls, and laws and regulations and related parties.

Other areas of concern include fraud implications and the focus on management controls. The nature of digital assets presents risks associated with misappropriation or misuse of digital assets, and it is important for the entity to have appropriate controls, some of which are unique to digital assets, in place.

In some cases, auditors may not be able to obtain sufficient evidential matter from substantive procedures alone and may be required to test internal controls over digital assets during the audit. The evaluation of controls may include the controls outside of the entity if, for example, a third-party is used to having custody of the private key. Use of Service Organization Control (SOC) reports by third-party custodians has been slow to develop, so understanding and testing controls there may be challenging.

Personnel-Related Challenges & Remote Working

Audit firm's quality-control policies should be designed to consider to the importance of staff knowledge and experience, and firms should be aware of the risk that staff turnover creates for audit quality.

In addition, remote auditing, time constraints, availability of information, and access to management

will also be considered in how these limitations may have impacted audit quality. For example, evidence may be in digital form, requiring procedures to substantiate the validity of such evidence.

Due Professional Care and Professional Skepticism

Exercising due professional care and professional skepticism in all aspects of the audit remains critical. While both should be applied at all times, the continued disruption from the pandemic and the risks associated with the current economic climate serve only to heighten their importance.

Further, with continued remote audit environments and extensive use of virtual meetings with management, audit engagement teams should focus on their responsibility to ensure professional skepticism is being maintained and applied throughout all aspects of the audit.

Independence

Firms continue to struggle to comply with independence standards. With the increasing complexity of client relationships in a global economy, auditors need to pay extra attention to evaluate whether they are truly independent of their clients, especially with firm offices and client subsidiaries located all over the world. Auditor independence must be a shared responsibility – between the auditor, management, and the audit committee. While firms often do their own assessment, they should be asking, “Is the audit committee involved? What is the audit committee’s conclusion?”

The SEC has little patience for firms that notify the SEC of an independence violation that came about out of their own making. Identifying independence violations isn’t sufficient, while preventing them is more important. Penalties may need to be ratcheted up as it seems like the punishments are not severe enough to change behavior.

The SEC’s recent targeted amendments to the independence requirements in Rule 2-01 of Regulation S-X (issued in October 2020 and effective in June 2021) in part aligned certain rules between domestic registrants and foreign private issuers regarding the “look back period” for registration statements. These amendments appeared to offer some dispensation of non-audit services in the look back period. However,

the SEC views the text of Rule 2-01(b) of Regulation S-X together with the four guiding principles laid out in the Introductory Text of Rule 2-01 as a framework to be applied when considering matters that are not directly addressed in other parts of Rule 2-01. Therefore, regardless of the revisions to the “look back period,” when considering non-audit services provided, auditors must also consider the general independence principles in the introductory text of Rule 2-01(b) of Regulation S-X. These principles require consideration of whether the non-audit service either:

- a. creates a mutual or conflicting interest between the accountant and the audit client,
- b. places the accountant in the position of auditing his or her own work,
- c. results in the accountant acting as management or an employee of the audit client, or
- d. places the accountant in a position of being an advocate for the audit client.

In applying the guiding principles, the SEC has consistently provided the view that it would be a high hurdle to reach a conclusion that the accountant could be viewed as objective and impartial under the general standard when an auditor has provided services in any of the periods included in the filing that are contrary to one of these guiding principles. As a result, despite the revisions to the rules, an auditor may not be independent during the look back period.

The PCAOB will likely plan procedures to assess, among other things, how firms:

- Identify violations of independence rules (as indicators of possible firm quality control concerns);
- Comply with pre-approval independence requirements governing the provision of significant non-audit services to audit clients;
- Communicate from engagement teams to audit committees concerning independence matters;
- Respond to past quality control criticisms, including those relating to high rates of non-compliance with internal policies and procedures.

Materiality

Although not a new concept, materiality continues to be a point of focus. Oftentimes engagement teams are misapplying the guidance of SEC Staff Accounting Bulletin No. 99, *Materiality* (“SAB 99”) – which basically requires that even if an error or misstatement is quantitatively immaterial, from a qualitative point of view, such an error or misstatement could ultimately be concluded as being material.

Some audit teams are applying this approach, but in the inverse direction. The SEC has historically challenged and inherently asserted that it is not appropriate (at least, not often) to argue that a quantitatively material error or misstatement is immaterial because the engagement team concluded the error or misstatement to be qualitatively immaterial.

Additional points that auditors should consider as they are concluding on materiality include:

- Disclosures must be accurate and cannot be misleading – don’t walk right up to the line.
- All information needs to be considered, not just the information that supports your preconceived conclusion. What that means is that auditors should try to resist the tendency to use the guidance to get to a pre-determined judgment.
- Do not look at SAB 99 as a checklist that can be added up and scored. The criteria listed in the staff guidance is not an exhaustive list and engagement teams are strongly encouraged to read the staff guidance in its entirety.
- A material accounting error should generally equate to an auditor concluding that there is a material weakness that should be disclosed. It takes a lot to conclude that a material error in the financial statements is something less than a material weakness.

Risk Assessment Procedures

The importance of performing a thorough and continuous risk assessment throughout the audit, including understanding a company’s business and the impact of known and/or potential changes due to the

current economic climate needs to be understood. Auditors should reconsider their initial assessment of risks and modify planned audit procedures as circumstances evolve. Attention must also be given to ensure specific audit procedures are properly performed to address all identified risks of material misstatement.

Unpredictability

Auditors should focus on fraud procedures and incorporating unpredictability in their engagements. Given the ongoing uncertainties, audit engagement management should reiterate its importance to the audit and the expectations of investors. A continued focus on fraud procedures and, in particular, how the auditor incorporates a degree of unpredictability in the audit that is new and different year over year.

For example, incorporating unpredictability could involve:

- Performing audit procedures on an unannounced basis,
- Selecting items for testing that have lower amounts or are otherwise outside customary selection parameters, or
- In multi-location audits, varying the location or the nature, timing, and extent of audit procedures at locations or business units from year to year.

External Confirmations

The PCAOB has expressed concern that firms aren't performing sufficient procedures when a service provider is used in the confirmation process. The use of a service provider doesn't relieve an auditor of the requirement to maintain control over the confirmation process. Audit firms should consider whether their policies and procedures related to the use of a service provider to send and receive confirmations provide reasonable assurance that their personnel comply with professional standards.

FASB Accounting Issues

Accounting and financial reporting issues that will likely garner more focus in areas of accounting uncertainty, which includes impairment of long-lived assets, going concern uncertainty, allowance for loan

losses, and increased fraud risk. Understand the public company's processes to develop its accounting estimates, including the methods, data, and assumptions used, and the extent to which the processes involve the use of third parties.

A new standard as amended was effective for audits of financial statements for fiscal years ending on or after December 15, 2020. This new standard provides guidance to auditors on obtaining and evaluating sufficient appropriate evidential matter to support significant accounting estimates in an audit of financial statements in accordance with the standards of the PCAOB.

The PCAOB will review how firms monitored compliance with the new requirements. It will also seek to understand how the new requirements have been complied with on individual audit engagements selected for review, and to which the new requirements are applicable.

Quality Control Standards Update

Consistent with recent inspection years, the PCAOB will likely plan to perform procedures such as:

- Analyzing how firms' systems of quality control promote a culture of audit quality and respond to risks, including by reviewing areas such as the effective design, implementation, and monitoring of the quality control systems; organizational structure; complexity of firms' practices; and the knowledge and experience of firms' personnel.
- Identifying and reviewing in greater depth those aspects of firms' quality control processes that are critical to audit quality, including engagement acceptance and continuance decisions; firms' internal monitoring programs; engagement performance; and personnel management.
- Evaluating the firm's timely evaluation and consideration of remedial actions to prevent deficiencies from recurring.

Reviewing PCAOB inspection deficiencies and linking them to specific controls may help firms identify flaws in their tools, templates, guidance, or methodology. This can help firms discover policies and procedures that are not appropriately designed or operating effectively. It also can highlight resource issues such as insufficient staffing, competing priorities, timing of

work performed, lack of technical competence, or lack of industry expertise.

Although auditors have no responsibility to retrospectively review their work after a report is issued, working papers relating to particular engagements may be subjected to a PCAOB inspection or other review, whereby an omission of a necessary auditing procedure may be identified. The PCAOB will continue to review how firms respond to deficiencies identified in PCAOB comment forms, including, if applicable, how the firm assessed the importance of any omitted procedures under AS 2901, *Consideration of Omitted Procedures After the Report Date*, or AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

PCAOB quality control procedures are scalable and involve tailoring their approach to evaluating the firm's quality control system based on the size, nature, structure, and complexity of the firm. PCAOB procedures consist of gaining or updating an understanding of the design of a firm's quality control system through inquiry and reviewing documented policies and procedures. In addition, the PCAOB will plan to gather information on changes firms are making to their quality control systems, which may be in response to new or changing regulatory, environmental, or firm-specific factors.

The PCAOB will tailor their approach to inspecting quality control systems at smaller firms, including triennially inspected firms and non-U.S. affiliates to be proportional with our annual firm inspections, to the extent practical.

Best practices for quality control systems include the following:

- Preparing narratives of a firm's system of quality control processes or process flow map to a firm's quality objectives and controls.
- Focus on leadership and governance structures that can impact audit quality, including the approaches used to promote a culture that emphasizes audit quality.
- Identifying where risks to quality exist.
- Documenting controls that are designed to mitigate risk, or mapping of controls against risks.

- Conducting real-time monitoring and measurement.
- Remediating deficiencies.

Self-identification and correction of quality control deficiencies before they become systemic is important for a system of quality control to prevent instead of only detecting audit deficiencies.

The current Quality Control standards were adopted in 2003 and do not reflect relevant developments affecting audit and assurance practices and firms' quality control systems. A concept release was issued in 2019 to solicit stakeholder feedback on ways to modernize the standards, including the consideration of using the International Auditing and Assurance Standards Board's analogous firm-level quality control standard, International Standard on Quality Management 1, as a starting point for a future PCAOB quality control standard. The PCAOB staff is currently working on a proposed standard for board review.

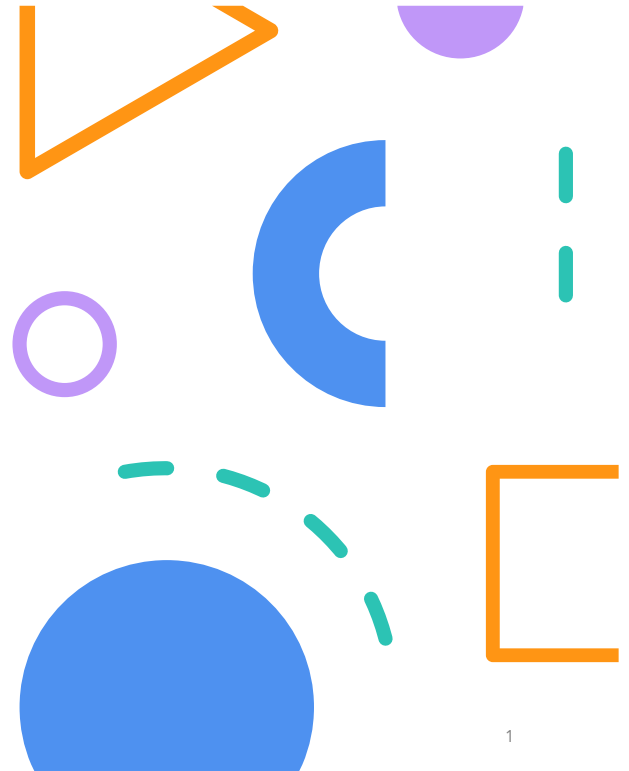
Future PCAOB Audit Standard Activity

As it relates to Supervision of Audits Involving Other Auditors, the PCAOB is evaluating ways to strengthen the existing requirements and impose a more uniform approach to the lead auditor's supervision of other auditors.

Current research agenda topics include Data and Technology and Audit Evidence. The PCAOB staff recently issued guidance as it relates to the use of information obtained from external sources outside the company, specifically focused on the relevance and reliability of the evidence obtained. The PCAOB staff is also looking at how auditors are using technology and how technology is being used in the financial reporting process. The PCAOB is also looking at AS 1105, Audit Evidence, AS 2315, Audit Sampling, and AS 2305, Substantive Analytical Procedures, to determine whether future amendments are needed.

Special Purpose Acquisition Companies (SPACs)

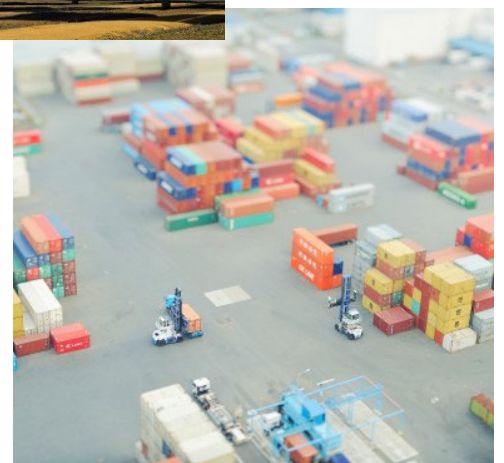
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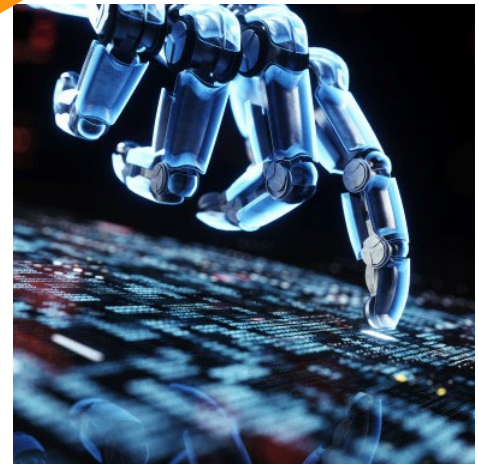
PCAOB Areas of Concern

- Supply Chain
- Non-GAAP Measures (like EBITDA)
- ESG



Digital Assets and Liabilities

- Derivatives
- Crypto lending
- Mining
- Fraud and IC



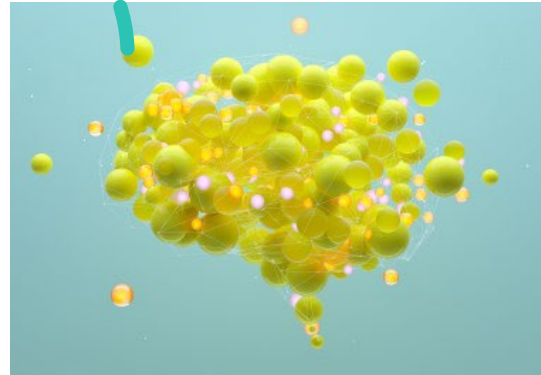
Quality Concerns

- Impact of remote working
- Professional Skepticism
- Independence



PCAOB Concerns Moving Forward

- Prevention of independence issues
- Qualitative Materiality
- Quality control within firms
- Data and Technology



GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss the PCAOB's focus on mergers and acquisition activity.
2. Discuss some of the PCAOB's potential concerns about an auditor's application of materiality on a financial statement audit of an issuer.
3. Discuss the PCAOB's focus and concerns about risk assessment throughout the audit.

B. Suggested Answers to Discussion Problems

1. Global mergers and acquisition activity in 2021 easily surpassed the pre-pandemic level and nearly matched the peaks of 2015 and 2007. And M&A is poised to climb higher in 2022 with easy access to capital, low interest rates, and a recovering global economy. Increasingly, companies are pursuing “transformative” deals that change business and operating models, such as traditional industrial or financial services companies buying tech companies to digitize their businesses.

Private equity players were an increasingly important factor in 2021 and will continue to be in 2022. For deal makers, 2022 will bring many opportunities and increasing challenges, due to high valuations, deal complexity, and the competition for high-quality assets.

2. Although not a new concept, materiality continues to be a point of focus. Oftentimes engagement teams are misapplying the guidance of SEC Staff Accounting Bulletin No. 99, *Materiality* (“SAB 99”) – which basically requires that even if an error or misstatement is quantitatively immaterial, from a qualitative point of view, such an error or misstatement could ultimately be concluded as being material.

Some audit teams are applying this approach, but in the inverse direction. The SEC has historically challenged and inherently asserted that it is not appropriate (at least, not often) to argue that a quantitatively material error or misstatement is immaterial because the engagement team concluded the error or misstatement to be qualitatively immaterial.

Additional points that auditors should consider as they are concluding on materiality include:

- Disclosures must be accurate and cannot be misleading – don’t walk right up to the line.
- All information needs to be considered, not just the information that supports your preconceived conclusion. What that means is that auditors should try to resist the tendency to use the guidance to get to a pre-determined judgment.

- Do not look at SAB 99 as a checklist that can be added up and scored. The criteria listed in the staff guidance is not an exhaustive list and engagement teams are strongly encouraged to read the staff guidance in its entirety.
- A material accounting error should generally equate to an auditor concluding that there is a material weakness that should be disclosed. It takes a lot to conclude that a material error in the financial statements is something less than a material weakness.

3. The importance of performing a thorough and continuous risk assessment throughout the audit, including understanding a company’s business and the impact of known and/or potential changes due to the current economic climate need to be understood. Auditors should reconsider their initial assessment of risks and modify planned audit procedures as circumstances evolve. Attention must also be given to ensure specific audit procedures are properly performed to address all identified risks of material misstatement.

PART 3. SMALL BUSINESS

SAS 143 and Small Businesses

SAS 143 focuses on auditing accounting estimates. Much of financial statement preparation involves the use of estimates. Everything from depreciation to collection of receivables requires the use of judgment on the part of the preparer. As a result, in conducting an audit, the auditor needs to examine the assumptions and underlying assessments in determining if management's judgments seem reasonable. SAS 143 provides auditors with enhanced guidance around the auditor's focus on factors driving estimation uncertainty and possible management bias.

For more on making the determination and how to reflect it in the financial statements, let's join Kurt Oestrieher, CPA and a partner with Oestrieher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk about a standard that was recently issued by the Auditing Standards Board related to auditing estimates. Now we have a lot of estimates in the financial statements, many of which are made by management. Some are due to just the nature of their industry, and some are due to the nature of trying to come up with a number to put into the financial statements to reflect our economic reality. But why did the Auditing Standards Board decide that the standard was necessary?

Mr. Oestrieher

So we've always audited estimates. I mean, you just mentioned that we have estimates that are involved in accounting, and I'm old enough that I think when I first got involved in this profession our major estimates were things like depreciation expense, which believe it or not, that is an estimate. Back then in the 1980s, you actually estimated salvage value because you only depreciated the part that wasn't going to be saleable at the end if you will. So that was an estimate. And, of course, things like the allowance for doubtful accounts. That's always been an estimate. That's been with us over the years, but as accounting standards have moved away from historical cost basis, more toward fair value, we have lots of accounting estimates in fair value. We have impairments of assets, whether they're originally recorded at fair value or not. And even with revenue recognition, the new standard that's out, there are a lot of estimates there.

The lease standard is going to contain a lot of estimates. We'll get into some of these in more detail throughout the talk. But the issue with auditing those, even though

we've always had to obtain sufficient, appropriate audit evidence--if we are obtaining that type of audit evidence on something that is recorded at historical cost, well, we can look at an invoice. We can look at other parts of the transaction or other evidence that supports that transaction and with a great deal of confidence, say yes, this supports management's assertion of the amounts reflected in the elements of the financial statement. And we felt good about that. And as an auditor, you said, I have good audit evidence and, the appropriate term is sufficient, appropriate audit evidence. But, when you get into estimates, we're not looking at an invoice. And that created a challenge to the auditor because you are dealing with estimates of management.

So what should we do to ensure that we have sufficient, appropriate audit evidence? And, of course, this leads to diversity in practice, which is something that is typically reserved for the FASB when they issue a new standard and say there's diversity in practice. So I don't think this was actually ever in the auditing standard, but if you read all the background and basis of conclusions and you follow these projects from the beginning, there was a different methodology that different firms were using to first determine what is the risk, and then, what are the appropriate substantive procedures. So to get us all aligned, which by the way, isn't that the purpose of standards? That everyone's doing things the same way so that users of financial statements can have confidence that we are issuing the appropriate report. The Auditing standards Board said, let's put it in standards. Let's give some very specific guidance on the best way to audit these estimates. So that's why we have it. And, also peer review I think was another driving force behind this. Peer reviewers were saying, Hey, are

people appropriately assessing the risk? Are they performing their appropriate procedures? So that's why we now have this auditing standard out there specifically to address elements of the financial statements that are subject to key estimates.

Ms. Grove Casey

Well, one of the things in getting people to apply the standard the same way is to have the same definition of what it is that you're talking about. And so, let's talk about what some of those key definitions within the standard are.

Mr. Oestrieher

And actually because of some of the requirements of the standard, they had to divide some terms. And then, I think we all kind of know what they meant, but again, to get where we want to get in a standard, they define them. And so, what is an accounting estimate? And it is, I'm going to read it verbatim to make sure we have the exact same definition here, but 'a monetary amount for which the measurement is subject to estimation uncertainty' and notice how the keyword is *measurement*. In other words, we're measuring it for the balance sheet and, of course, as we adjust the balance sheet, it impacts the income statement. So we have that, then they further define estimation uncertainty, because that's in the definition of an accounting estimate. Estimation uncertainty actually comes from the application and explanatory material, and it says, not all accounting estimates are subject to a high degree of uncertainty and that's the key word.

And, when you think about it, it's very accurate. In other words, there are some estimates like depreciation, where you go, okay, there's not a whole lot of uncertainty there. If everyone's depreciating a computer over three years, we know that's typically when you throw them away. So there's not a lot of uncertainty, but when you're talking about reserve for allowance for doubtful accounts, in a volatile market, when you are talking about fair value measurements using level three inputs that's when you have a higher degree of estimation uncertainty. So, following up, not all accounting estimates are subject to a high degree of uncertainty. Estimation uncertainty may exist even when valuation method and data are well defined. It's how you apply that data. It's not a definitive, oh my goodness, now we have all the data that we need. We have all the definitions we need, but that is background information to understand. And the auditor needs to

understand that we need to assess how much uncertainty is within an accounting estimate.

Before we get our planning for an audit in order to obtain sufficient, appropriate audit evidence, then they get into some terms that are actually used in the required elements and an accounting estimate. Again, we've already gone through that one. Management point estimate-- I'd never heard that term before the standard was issued or published, but it says the amount selected by management for recognition or disclosure in the financial statement of an accounting estimate. So I just used to refer to that as, the number management came up with, so that would be a more clear term for management point estimate. Then, we have to define the term, cause there's going to be requirements, the auditor's point estimate or the auditor's range, that's the amount or the range of amounts respectively developed by the auditor in evaluating management's point estimate. So you can almost tell from those definitions what some of our required elements we're about to get into are, where we kind of have to independently, you'll see, come up with these estimates to verify that management's were right. Just not mathematically recalculate them. So before you even start to apply this standard, make sure you have a good feel of what those definitions mean because they're going to be applied in the required elements.

Ms. Grove Casey

Well, let's talk about some examples of the financial statement elements that contain estimates because there are just a slew of them that appear in the financial statements, but sometimes people forget that some of these numbers really are estimates.

Mr. Oestrieher

Right? And we've touched on a little bit in the introductory, but one that now is at the top of the list is revenue recognition. But more importantly if the entity has revenue recognition where they have contracts with customers, where revenue is recognized over time, now, even the determination if revenue is recognized over time or a point in time, even there are some estimates involved in determining what's more appropriate, but again, I don't think there's a lot of uncertainty there. It's pretty straightforward in many of those cases, but once you have construction contractors or if anyone wants to have some interesting reading, go look at Apple's financial statements and their summary of significant accounting policy, how they determine,

oh, part of what you pay for the phone as far as the free updates, you're going to get over the 3.7, 4, or 6 years that we estimate you're going to keep the phone until you get another one. It's all a gigantic estimate subject to uncertainty.

They're now basically deferring revenue from that initial price you pay, knowing that they're paying these programmers to update their operating system. So revenue recognition, when the contract is with customers, you have either a deferred asset or the deferred liability there, tremendous uncertainty there. Ten years ago, I would've said, okay, if you got construction contractors, you have a lot of uncertainty. Other than that, it probably isn't; depreciation, less uncertainty there. We've talked about the allowance for doubtful accounts. And, of course, that's going to change a lot. And I don't think it's a coincidence that the standard is effective right before the current expected credit loss, CECL, right? Because there's a lot more elements that are going to go into current expected credit loss. So more estimates that management has to use because, not only are you going to be looking at historical stuff like we do now, you kind of have to predict the future and I'm oversimplifying there. . . , but to a certain extent, they are asking you to say, Hey, well, what do you think is going to happen?

Based on reasonably known events. Impairments is a big one. Goodwill impairments, intangible assets, I think that's where you get a lot of estimation uncertainty on those types of assets, fair value. And it's not just the level three where you have unobservable inputs or even some estimates. Am I classifying something as an available for sale or a trading? Now that doesn't matter much for marketable securities anymore, since it all runs through income, but certainly for debt instruments, that makes a difference if you have the ability and intent to hold to maturity. Well, now you can have it as held to maturity. That's an estimation of management that has a tremendous impact on how you, report not only on the balance sheet, the value of these held to maturity securities, but also the impact on the income statement. And let's not forget probably the biggest estimate, uncertainty of all embodied in the financial statements is either a defined benefit plan itself or a company that is a sponsor of the defined benefit plan that has to record its share if it's a multi-employer plan either the underfunded or overfunded.

And, as we know, most of the time that is an underfunded liability, and you're estimating how long

the current employees are going to live. How many of them are going to reach retirement age? The estimated return on assets, there are so many estimates embodied in the pension liability or pension asset if it's overfunded. And in my opinion, that has the biggest impact. If you have one of those plans and, as governmental entities are finding out, if they've implemented standards that pick up their proportionate share, Wow! That's a pretty big number that we didn't know that should have been on our balance sheet. Or of course, many are saying, it shouldn't. So this is not intended to be an all-inclusive list, but these are the type things that we need to be aware of, as we implement this standard. If you have these elements or elements that have estimates similar to these in your financials, this is where you have to know, okay, am I doing what [SAS] 143 requires? I can't just sit there and do my planning the same way, or evaluate my audit evidence the same way if I have some of these elements or some items. Let's make sure that I'm complying with SAS 143. I think sometimes that our firm is as guilty of this as anyone, well, as long as we fill out the checklist, we've done everything right. Well, it's not just filling out the checklist. It's applying what the standard wants us to do.

Ms. Grove Casey

When you were talking about impairments and then intangibles, it reminded me that, especially over the last couple of years, we've really seen the impact of technology in a variety of ways. And the speed with which technology has changed and changed a lot of buyer's preferences. A number of other things we could end up having impairments on some of those intangible assets, reputation is what I think of the most that technology just blew things out of the water. So there are things we need to consider now that maybe we never have in the past.

Mr. Oestricheer

Exactly. And it's not just the things I mentioned earlier, those were just the measurement issues. Remember there's accounting estimates embodied in the disclosures. I mean, you're estimating the outcome of pending litigation to determine whether or not I should measure it, or just simply disclose it, nonmonetary exchanges and some other measurement items. So their estimates and we actually, SAS 134 was focused so much on the report that that's what people focused on, the changes in the audit report. Remember there's a big old part of SAS 134 that talks about planning and

auditing the disclosures. So we need to understand that when we audit we're auditing financial statements, not just the balance sheet, income statements, statement of cash flows and statement of change in members' equity, all those notes behind it, we even say they're an integral part of the financial statements and that's right. Various issues. Trust me if the users of the financial statements, aren't reading those disclosures, the lawyers might be if they ever decide there is something wrong with those financial statements. So, there are estimates involved. There're also, of course, we have whole other things that we've done on going concern, but quite frankly, from a disclosure standpoint, going concern may embody the most significant estimates of all of our disclosures. I focused on measurement, but don't forget the disclosures also. There are estimates there.

Ms. Grove Casey

Well, let's talk about how this standard impacts audit planning.

Mr. Oestrieher

I'll go through the standard, but at the same time, I'll tell you what's going to happen in practice too. I think most people out there use third party practice aids. So they're using various checklists to document this understanding. So if you're just carrying forward checklists that you used last year, and you're not changing anything, there's a very good chance you may not be capturing all the information that this standard requires. So when you're understanding the entity and its environment the types of transactions they get into, the environment, that's where you're going to find these things. What types of transactions or events give rise to estimates? You need to think about that in the planning. What are the requirements of the applicable financial reporting framework? Now, most of your audits are U.S. GAAP, but there are audits out there, tax basis, or other basis of accounting, maybe IFRS, but let's just focus for this discussion on U.S. GAAP.

That's most of the examples that you and I have given earlier, because in the small business world, that is the framework that most of us use. So you need to think about, are there changes in standards? In other words, had this standard been in place the same year that an entity adopted revenue recognition, then you would be fully expected that you would have very specific documentation in your understanding of the entity and its environment, that there are new accounting estimates now that the entity needs to be aware of. So

that is understanding that framework, the requirements of those frameworks, not only as it relates to current transactions, but new transactions the entity may have entered into this year or changes in standards. All of that needs to be taken account of when you look at the reporting framework, regulatory requirements, again, for those auditing insurance companies, banks, financial institutions, that's when you're going to get into a lot of the regulatory environment for entities that aren't subject to regulators, probably that will be not applicable.

There can be answers appropriate in some of these checklists to not applicable, and then, the nature of the accounting estimates and the disclosure. So just as you and I kind of discussed some areas, both in measurement and disclosure, I can envision, depending on how you document your planning, a very specific list of these are the elements of the financial statements that we believe that are subject to management accounting estimates. And then I could even see some people saying, and by the way, these have significant uncertainties or these are estimates without significant uncertainties. Based on the nature of the estimate, we saw that in the definitions. And as I read through these standards since I'm in charge of quality control in my firm, and we have a very small firm, we have 11 people so not all of them do audit.

So it's a pretty small firm, but I always think, how can I screw this up? Or how can someone in my firm screw this up? And then you have to define, what is a screw up. Okay, well, your first definition of a screw up is, if I don't follow standards, I've screwed up. Okay. The second thing, even if I follow standards that the peer reviewers are going to get mad at me, that can be considered a screw up. And then, the third thing is, even if I keep the standards that are happy and the peer reviewers happy, how would opposing counsel look at this if I were sued? And, if you audit to that level, you'll never get an audit out, but it's in the back of your mind. And so when I think of, how could someone that's criticizing my audit documentation, come in and say, you screwed something up, this was a big one. I could see myself or my firm when we are deciding what elements of the financial statements are subject to uncertainty that we only talk about the balance sheet and the income statement. So we need to look at the impact of uncertainty in the disclosures.

Now, unfortunately, the statement of cash flows, there's not a lot, because it is cash. It's cash transactions.

Certain non-cash items such as depreciation or subject to it, but you still get to the same number because that's embodied in both the net income and the depreciation. So I have not yet. And maybe someone out there will decide oh, well the statement of cash flows can be hugely impacted by this, but I don't see the statement of cash flows or even the statement of changes in members' equity, unless you're issuing options at fair value or some sort of a capital contribution, something other than a cash transaction, that's how you could have an impact there. But it's the disclosures that scare me, that our firm would not properly address. So make sure that you understand that. And so, the year that you implement this standard that's if you compare it to last year's, that's what you should see additional documentation on what estimates are there to begin with. And then we're going to worry about how we deal with that. You have to identify them first.

Ms. Grove Casey

Well, one of the key things with planning an audit is getting an understanding of the entity's environment and its internal control. But before you decide whether or not you were going to rely on it. So did you want to talk about what kinds of assessments you make looking at internal control?

Mr. Oestricheer

So, we understand the entity and the environment to say, where could estimates be there? Well, the next thing is the internal control. Now, if we were auditing in 1986, we would say the client doesn't have any internal controls over accounting estimates and you're done.

Ms. Grove Casey

We'd do substantive testing. Not really that you're done.

Mr. Oestricheer

But we are required in auditing standards to understand internal controls. And we typically, and our firm is just like most of the small firms out there, man, we go in and we ask people, how do revenues get recorded? How do expenses get recorded? How does payroll get recorded? I mean, we focus on again, those measurement items, but those transactions that are occurring every day, remember auditing estimates are recorded with the general journal entry. I can't think of any automated system in Great Plains or heaven forbid if you're auditing a company using QuickBooks, I don't

understand, or I have not been able to come to the conclusion how any of those transactions would have an estimate in there other than one. I have thought of one--if you have already set up an accrual for an automated accrual for your paid time off, based on hours worked or whatever.

So every time you process a payroll, it says, well, based on this payroll, we need to increase our accrual by X because you're assuming that those people will be there at the end of the period, if you have a carry forward. So that actually could be an accounting estimate that I've identified. That could be part of an automated process, but in most cases, your estimates are at the end of the year when you're recording depreciation, when you're recording the allowance for doubtful accounts, when you're recording an impairment of an asset, though, those are done through general journal entries. So what is the client's internal control over those general journal entries? And if one person is deciding it and one person only, then you have obtained an understanding of the internal control over the recording, the development of the accounting estimate and the recording. The answer is, there is no internal control because one person's doing it all. And you find that a lot in the type of clients that I have. That doesn't mean they're bad people. It means, first of all, you could potentially have a material weakness or a significant deficiency that you may want to report. Again, we have a whole course on that also, but then you have to say, okay, I obviously cannot rely on the client's internal controls to support it. So I'm going to have to do a lot of substantive audit work, but we need to document that. And then I think what has happened so often in many other areas in the back of our minds, we know that, Hey, they don't have anyone. There's no internal control over that. Susie is the one that does all that.

So we know we have to audit the heck out of it, but we skipped that step of specifically addressing that. We've assessed the controls that were there. And maybe you have a situation where multiple people have gotten together and in the end, after multiple steps with proper internal control over the process someone developed, okay, Hey, if we put this data in a spreadsheet and it yields this number, then that's what needs to be recorded. And then there was a quality control process when that was developed. Okay. So, well what internal control do they have to make sure the formulas haven't been altered? What are those locks, so you don't want to get into those formulas. So it can get very, very nuanced, but the standards absolutely require that we

understand their internal control process over the nature and extent of oversight. Are there specialized skills needed?

So this is when we get into the pension estimates. And so we, that's where we document this. This is where you may have to go to the auditing standards on use of a specialist, their information system, their risk assessment process. And again, for most if not all companies, there is no risk assessment process. And please, anytime you are documenting your internal control over these areas and you put the client doesn't do it. So we perform their internal control for them. Congratulations. You've just impaired your independence. Oh, okay. Yes, don't ever do that. You're not. The auditor's response to the lack of internal controls is doing a lot of substantive procedures. So all the recalculation and stuff we're about to talk about is not part of the internal controls or not part of their internal auditing process. It is your recognition they don't have it.

So I have to go do all this work. So yes, let's make sure when we document it, I've seen some pretty sketchy documentation out there that, oh, they don't have any internal controls. So we take care of it for them. No, no, no, no, no. They don't have any internal controls. Our audit response is this, so yes, they're doing the appropriate work. Just those few words you remember we talked about attorney proofing your work. Yes. That's the type of thing or even your regulatory, so watch how you do that. So again, what we would expect to see as a result of this standard in our audit documentation is a more robust discussion of not just the general journal entries and the closing process, because that's where you have it more now, but more specific to how do they handle accounting estimates in the closing process?

Or as I gave an example earlier, if there are estimates getting put into the financial statements, like the accrued paid time off that's an automated process, what is their internal controls to make sure that's status? So make sure you have that additional documentation and you may already have it in other places, nothing in the standard is anything that somebody else may not have already thought of in the past. But if you haven't thought that much through it and many small firms haven't and quite frankly, I know that our documentation of this is going to be more robust now that we're seeing the standard and saying, we should have been more specific about the estimates involved

in the closing process rather than just the general process. So that's what you need to do from a planning standpoint. And then, of course, everyone knows the last thing I'm going to say, now that we have the understanding of the entity and its environment and internal control, now you have the combined risk of material misstatement. This is going to be the interesting part because, and when I say interesting, the developers of third-party practice aids and people like me that are in practice, you have to separately assess the inherent risk and control risk as it relates to accounting estimates. So now for like property, plant, and equipment, we used to assess that combined. Now the cost basis for property plant and equipment is not an estimate. It is transactional in nature. How much did you spend for something? There's no estimates other than potentially maybe capitalized interest or something like that. But for the most part, there's no estimate, but the other half of property, plant, and equipment, the depreciation and accumulated depreciation is a gigantic estimate. So what I anticipate these third party practice aids, folks are now going to separate out property, plant, and equipment, and accumulated depreciation, because it's subject to estimate, same thing with accounts receivable and the allowance accounts, you won't assess the risk together on net accounts receivable. Because the allowance is subject to significant estimate you're going to separate that out. So that's the big thing. And so you can't just bring your risk assessments forward. So other accounts like accounts payable, you're not going to have to separately assess that risk because I don't see a lot of estimates in accounts payable. However, many of your accruals may be subject to estimate, but an accrual for interest is not subject to estimate. It's calculated how many days of interest are out there, but an accrual for paid time off for pension that's separate. So I think what right now, if you might have seven or eight account areas where you're assessing the risk, combined risk of material misstatement. You may not have 11 or 12 cause you're going to have to disaggregate the elements that are subject to uncertainty. And again, within this, you're also going to look at, not only the measurement, but the disclosure uncertainty. So that is how we are going. That's how it's going to impact your planning before we get into the actual substantive audit procedures.

Ms. Grove Casey

Well, how should the auditor respond to risks of misstatement due to estimates? What do we do after we have an issue?

Mr. Oestricher

And that's the last part of this. And even presented in this way, in my reading of this, I think that major change in our audit documentation and approach is going to be in the planning. Quite frankly, I think that our firm and most other firms that I've talked to through continuing education, we have appropriately responded in other words, we're getting sufficient, appropriate audit evidence, but there are specific steps we need to do. We have to get evidence that provides the events that have occurred up to the date of the financial statements in the audit report. And there are subsequent events out there. Then we test management's estimates. Remember we had that definition of management accounting estimate. And when we test that, that's the one thing that might change in practice. It used to be everyone just mathematically said, okay, they did this right.

Now, we need to evaluate what are their assumptions that went into this. And I think that the most important part about this standard is when we had this definition earlier, the auditor's point estimate. And what we're going to now do is say, okay, let's go look at what management came up with. Let's take it back and look at this and say, all right, the entity is implementing current expected credit loss. And based on our conversations with management, first of all, are they using the appropriate inputs? Are they using the appropriate data? They considered everything that they should consider according to the new standard. What would we do if we were sitting in their shoes and then make your own independent estimate of what these items should be. And, again, I think that would be more appropriate for anything that has more estimate uncertainty. I don't think we would do that for depreciation because in depreciation, there isn't as much uncertainty, right?

It's just a matter of math. I mean, they're doing cars over five years, they're doing furniture and fixtures. It's amazing. Once the IRS developed first ACRS and now showing you're really old if you remember ACRS and then ACRS modified, it's amazing how all of a sudden after that, every car was five years, even if you're using straight line GAAP or furniture and fixtures was seven years. So we might use different methods, straight line versus 200%, ACRS 200%, double declining balance. But it seems like those class lives pretty much always match up, which is fine. It's just an estimate. So from an actual methodology, when you are testing the

balance or when you are obtaining audit evidence on the amounts that are disclosed, that's where we might do this approach of again, let's do it independently first, and then, compare.

And the other thing that I've gleaned from reading the standard, which we've always done in practice, don't ever have a first-year staff person that just graduated from University of Louisiana Monroe, my alma mater, which gave me a tremendous education, but after year one, I don't think that I could come up with appropriate audit evidence for an accounting estimate. I was pretty useless. I could vouch cash disbursements and see if the bank account was reconciled and some other things, but folks put your most experienced people on the audit team here. If it is something like pension liability, then you're going to use a specialist . . . We do this all the time with governmental entities. You look at the audit report for the stuff for the GASB 68 calculations, and then, you look at the various reports that the auditor came up with.

There's lots of stuff in there. So assign the most appropriate person. It may not be the highest. Maybe you have someone with 48 years experience and someone with 22 while the 22 year experience, quite frankly, might actually be more investigative, if you will, than the one with 42 years, experience that's one year from retirement, but put the appropriate level of person based on that risk. I think that that should go without saying, but I inferred that from reading an appropriate level of staff and let's, don't just say, wow, if we recalculate it and management had no math errors, then their number must be right. I think you then need to evaluate that estimate in relation to the total financial statements. And if there is a range, are they within that range? And if they were not within that range, would it be a material misstatement?

And if they're not within the range, . . . but you say, well, this is far from being material. It wouldn't influence the user's conclusion then you might be okay, but if you say, wow, they're not within that range, there could be a material misstatement, such as maybe a write down of Goodwill or something like that, then you would do additional steps. So again, I don't see a big difference in how we are going to audit. I have not seen a lot of issues there but there could be some changes, but in your audit documentation, make sure that you are referring to terms such as auditors' accounting point estimate or management's. Use the terminology that we

defined early on that will demonstrate to anyone that might be challenging your documentation.

And yet we've implemented this standard. We understand what the terms are and we're using the appropriate terminology. I had an issue with the CPA firm one time when they were still using the term I think reportable condition, eight years after the standards had eliminated that term. It shows you're not up to speed with the standards when you use outdated terms. So when this new standard comes out, please don't just assume that, Hey, we're going to fill out one checklist and be in compliance with this standard. Embrace the standard. It's there to help our profession. It's there to help users of the financial statements believe and understand that appropriate, sufficient evidence has or sufficient appropriate audit evidence hasn't been obtained. And if you follow the guidelines, you will become a better auditor. That's what the standard wants us to do.

SUPPLEMENTAL MATERIALS

SAS 143 – Auditing Accounting Estimates and Related Disclosures

by Kurt Oestrieher, CPA

Introduction

SAS 143 – *Auditing Accounting Estimates and Related Disclosures* was issued to address the auditor's responsibility related to accounting estimates, with an emphasis on fair value estimates and disclosures related to fair value.

Every financial statement issued in accordance with United States GAAP includes a disclosure that estimates are used in the preparation of financial statement. Depending on the nature of the entity issuing the financial statements, there can be a wide range of assets and/or liabilities that are subject to accounting estimates. Because of the subjectivity that is inherent with accounting estimates, it is important that the auditor obtain an understanding of these estimates and obtain sufficient appropriate evidence related to the estimates.

AICPA Professional Standards AU-C 540 has been amended to reflect the changes enacted by SAS 143.

Key Definitions

SAS 143 includes definitions that are necessary in applying the required provisions.

Accounting estimate – A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty.

Auditor's point estimate or auditor's range – An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate.

Estimation uncertainty – Susceptibility to an inherent lack of precision in measurement.

Management bias – A lack of neutrality by management in the preparation of information.

Management's point estimate – The amount selected by management in the preparation of information.

Outcome of an accounting estimate – The actual monetary amount that results from the resolution of transactions, events, or conditions addressed by an accounting estimate.

Financial statement elements subject to accounting estimates

As GAAP becomes more complex and moves toward fair value accounting, the need for management to make estimates has increased. While this audit standard is adaptable to any financial reporting framework, the discussion in this course will focus on United States GAAP. The following are the most common financial statement elements that are subject to management estimates:

- **Revenue Recognition** – If revenues are recognized at a point in time, management estimates are limited, and in some cases, non-existent. However, when revenue is recognized over time, many estimates are in play, including the contract amount, allocation of the contract price to the performance obligations, and measurement of performance.
- **Depreciation** – The estimated useful lives of assets can be an integral accounting estimate if the entity has a large investment in fixed assets.
- **Allowance for doubtful accounts/loan losses** – Because allowances are based on future expected behavior of customers and debtors, any allowance is an accounting estimate. If the entity is a financial institution, the allowance and related estimates are typically material to the financial statements.
- **Impairments** – Determining whether an asset has an impairment is typically subject to management estimate and the actual recorded impairment is an estimate (unless the asset is fully impaired and the impairment is factual, such as the expiration of a patent). Accounting for goodwill is the prime example of the need for management estimates.
- **Fair value** – Assets and liabilities measured at fair value using level 3 inputs can be subject to multiple estimates, including the methodology used for determining fair value and the inputs to the model used for determining fair value. Management estimates can also be used for level 2 inputs when management is making the determination if a

market is active or inactive and whether the related assets and liabilities that are measured in the market are identical or similar to the asset or liability that is subject to fair value accounting.

- **Defined benefit pension plans** – While defined benefit plans are most commonly found in government entities, some not-for-profit and for-profit entities still sponsor defined benefit plans. Regardless of the type of entity, all of these fall under United States GAAP, and auditors will apply the provisions of this standard when auditing defined benefit plans.
- **Disclosures** – The first inclination when discussing accounting estimates is to apply the guidance to elements that are measured on the face of financial statements. However, SAS 143 is clear that the auditor must also obtain an understanding of the impact of estimates on disclosures. These disclosures may include pending litigation, non-monetary exchanges, and the impact of subsequent events.

Planning requirements

The auditor should obtain an understanding of the following related to accounting estimates when obtaining an understanding of the entity and its environment:

- Transactions, events, or conditions that give rise to accounting estimates
- Requirements of the applicable financial reporting framework related to accounting estimates
- Regulatory requirements related to accounting estimates
- The nature of accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements

When obtaining an understanding of internal controls, the auditor should obtain information related to internal controls related to accounting estimates. This understanding should include the following elements:

- The nature and extent of oversight and governance the entity has in place over accounting policies related to accounting estimates

- How management identifies the need for and applies specialized skill related to accounting estimates
- How the entity's risk assessment process identifies and addresses risks related to accounting estimates
- The entity's information system as it relates to accounting estimates, including the following:
 - Classes of transactions, events, or conditions that are both significant to the financial statements and give rise to a need for or change in the accounting estimates and related disclosures
 - How management identifies relevant methods, sources of data and other information that is appropriate for the accounting estimates; understands the degree of estimation uncertainty; and addresses the estimation uncertainty.
- Control activities relevant to the management process for accounting estimates
- How management reviews the outcomes of previous accounting estimates and responds to the results of that review.

The auditor should review the outcome of previous accounting estimates or their re-estimation to assist in assessing the risk of material misstatement.

The auditor should determine whether the engagement team requires specialized skills or knowledge to:

- Perform the risk assessment procedures,
- To identify the risks of material misstatement,
- To design and perform audit procedures
- To evaluate the audit evidence.

Identifying and Assessing the Risks of Material Misstatement

The auditor should separately assess inherent and control risk related to accounting estimates and related disclosures at the relevant assertion levels. In most cases, the valuation assertion will be a relevant

assertion. The following issues should be considered when assessing the risk of material misstatement:

- The degree to which the accounting estimate is subject to uncertainty
- The degree to which one or both of the following are affected by the complexity, subjectivity, or other inherent risk factors
 - The selection and application of the methods, assumptions, and data in making the accounting estimate
 - The selection of management's point estimate and related disclosures for inclusion in the financial statements

The auditor should determine if any of the risks identified are significant risks. If a significant risk exists, the auditor should obtain an understanding of the entity's controls relevant to that risk and evaluate whether such controls have been suitably designed and implemented to mitigate such risks.

Responses to the Assessed Risks of Material Misstatements

The auditor should perform further audit procedures that are responsive to the assessed risk of material misstatement at the relevant assertion level using one or more of the following approaches:

- Obtain evidence from events occurring up to the date of the auditor's report
 - The selection and application of the methods, significant assumptions, and data used by management in making the accounting estimate
 - How management selected the point estimate and developed disclosures related to uncertainty
- Testing how management made the accounting estimate
 - Whether the method selected is appropriate
 - Presence of management bias
 - Calculations are appropriate and accurate

- If complex modeling is involved
 - The design of the method meets the objective of the financial reporting framework, is appropriate, and if applicable, changes to the model are appropriate
 - Adjustments to the output of the model are consistent with the measurement objective of the financial reporting framework and are appropriate
 - Whether the integrity of the significant assumptions and the date has been maintained in applying the method
- Developing an auditor's point estimate or range
 - Determine that the range includes only amounts that are supported by sufficient appropriate evidence
 - Obtain evidence related to disclosures that describe the estimation uncertainty

The higher the risk of material misstatement, the more persuasive the audit evidence needs to be. The auditor should perform procedures in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory.

Overall Evaluation Based on Audit Procedures Performed

The auditor should evaluate, based on the procedures performed and evidence obtained, whether

- The assessments of the risk of material misstatement at the relevant assertion level remain appropriate, including indicators of possible management bias
- Management's decisions related to the recognition, measurement, presentation, and disclosure of these accounting estimates in the financial statements are in accordance with the financial reporting framework
- Sufficient appropriate audit evidence has been obtained.

Communications with Those Charged With Governance, Management, or Other Relevant Parties

The auditor should consider the requirements in AU-C 260 and AU-C 265 to determine if any issues arose in the performance of the audit procedures related to accounting estimates are required to be communicated.

Documentation

The following should be included in the audit documentation

- Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the accounting estimates
- The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level, taking into account the reasons given to the assessment of those risks
- The auditor's responses when management has not taken appropriate steps to understand and address estimation uncertainty
- Indicators of possible management bias related to the accounting estimates and the implications to the audit
- Significant judgments relating to the auditor's determination of whether the accounting estimate and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated.

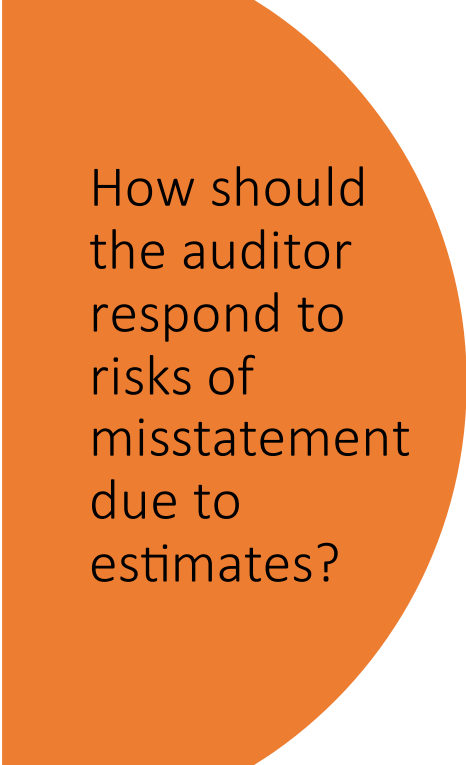
Effective Date

The effective date for this standard is for audits of financial statements for periods ending on or after December 15, 2023.


Summary

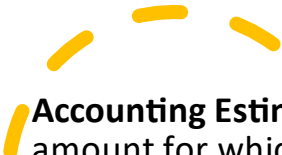
The challenges presented to an auditor when accounting estimates were present in financial statements existed prior to the issuance of SAS 143, therefore, the concept of auditing accounting estimates is not new.

Many of the required elements of SAS 143 have already been incorporated by many firms as they determined the most appropriate procedures for financial statement elements that were subject to management estimate. The auditor should be aware of the minimum requirements of SAS 143 when the standard is effective and ensure that the minimum required elements are performed and documented.




How should the auditor respond to risks of misstatement due to estimates?

- Obtain evidence from events occurring up to the date of the audit report
 - Testing how management made the accounting estimate
 - Developing an auditor's point estimate or range
- 



Accounting Estimate –A monetary amount for which the measurement... is subject to estimation uncertainty

Estimation Uncertainty (para A16)–Not all accounting estimates are subject to a high degree of uncertainty. Estimation uncertainty may exist even when the valuation method and data are well defined.



What are some key definitions within the standard?

Key Definitions - continued

Accounting Estimate – A monetary amount for which the measurement... is subject to estimation uncertainty

Management Point Estimate – The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate

Auditor's point estimate or auditor's range – An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate

What are some examples of financial statement elements that contain estimates?

- Revenue Recognition
- Depreciation
- Allowance for doubtful accounts/loan losses
- Impairments
- Fair value (not just level 3)
- Defined benefit pension plans

Common Accounting Estimates - Disclosure

- Outcome of pending litigation
- Non-monetary exchanges (also measurement)

How does the standard impact audit planning?

- Understanding the Entity and its Environment
 - Transactions or events that give rise to estimates
 - Requirements of the Reporting Framework
 - Regulatory requirements
 - Nature of accounting estimates and related disclosures



Planning - continued

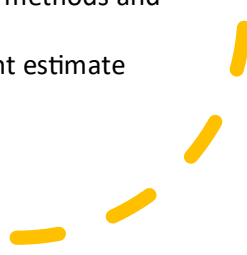
▪ Internal Control

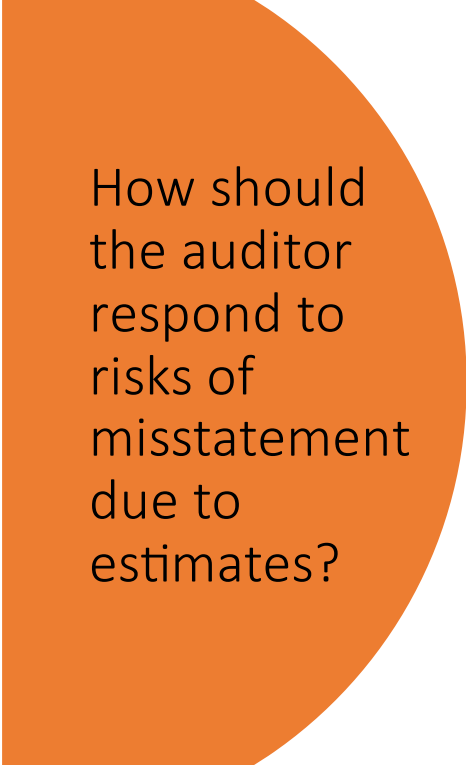
- Nature and extent of oversight of estimates
- Identification of specialized skills needed
- Entity's risk assessment process related to estimates
- Entity's information system related to accounting estimates
- Control activities related to accounting estimates
- Management review of accounting estimates



Planning - continued

▪ Identifying and Assessing the Risk of Material Misstatement

- Separately assess inherent risk and control risk related to accounting estimates
 - Assess risk of disclosure requirements
 - Issues to consider
 - The degree to which the estimate is subject to uncertainty
 - The complexity of the estimate
 - The selection and application of the methods and data used in forming the estimate
 - The selection of management's point estimate
 - Related disclosure issues
 - Identify any significant risks
- 



How should the auditor respond to risks of misstatement due to estimates?

- Obtain evidence from events occurring up to the date of the audit report
- Testing how management made the accounting estimate
- Developing an auditor's point estimate or range



GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss some of the most common financial statement elements that are subject to management estimates.
2. Discuss the issues that should be assessed when considering the risk of material misstatement.
3. Discuss the audit documentation requirements under SAS 143.

B. Suggested Answers to Discussion Problems

1. Some of the most common financial statement elements that are subject to management estimates include:

- **Revenue Recognition** – If revenues are recognized at a point in time, management estimates are limited, and in some cases, non-existent. However, when revenue is recognized over time, many estimates are in play, including the contract amount, allocation of the contract price to the performance obligations, and measurement of performance.
- **Depreciation** – The estimated useful lives of assets can be an integral accounting estimate if the entity has a large investment in fixed assets.
- **Allowance for doubtful accounts/loan losses** – Because allowances are based on future expected behavior of customers and debtors, any allowance is an accounting estimate. If the entity is a financial institution, the allowance and related estimates are typically material to the financial statements.
- **Impairments** – Determining whether an asset has an impairment is typically subject to management estimate and the actual recorded impairment is an estimate (unless the asset is fully impaired and the impairment is factual, such as the expiration of a patent). Accounting for goodwill is the prime example of the need for management estimates.
- **Disclosures** – The first inclination when discussing accounting estimates is to apply the guidance to elements that are measured on the face of financial statements. However, SAS 143 is clear that the auditor must also obtain an understanding of the impact of estimates on disclosures. These disclosures may include pending litigation, non-monetary exchanges, and the impact of subsequent events.

2. The following issues should be considered when assessing the risk of material misstatement:

- The degree which the accounting estimate is subject to uncertainty

- The degree to which one or both of the following are affected by the complexity, subjectivity, or other inherent risk factors
 - The selection and application of the methods, assumptions, and data in making the accounting estimate
 - The selection of management's point estimate and related disclosures for inclusion in the financial statements

The auditor should determine if any of the risks identified are significant risks. If a significant risk exists, the auditor should obtain an understanding of the entity's controls relevant to that risk and evaluate whether such controls have been suitably designed and implemented to mitigate such risks.

3. The following should be included in the audit documentation

- Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the accounting estimates
- The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level, taking into account the reasons given to the assessment of those risks
- The auditor's responses when management has not taken appropriate steps to understand and address estimation uncertainty
- Indicators of possible management bias related to the accounting estimates and the implications to the audit
- Significant judgments relating to the auditor's determination of whether the accounting estimate and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated.

GLOSSARY OF KEY TERMS

Accounting Estimate—a monetary amount for which the measurement is subject to estimation uncertainty

ASB—Auditing Standards Board

Auditor’s point estimate or auditor’s range—An amount, or range of amounts, respectively, developed by the auditor in evaluating management’s point estimate.

Estimation Uncertainty—Susceptibility to an inherent lack of precision in measurement.

FASB—Financial Accounting Standards Board

Management Bias—A lack of neutrality by management in the preparation of information.

Management Point Estimate—the amount selected by management for recognition or disclosure in the financial statement of an accounting estimate

PCAOB—Public Company Accounting Oversight Board

Rabbi Trusts—grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer

SEC—Securities and Exchange Commission

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BY SPEAKER

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Jennifer Louis	Jan, Mar, May-Aug		

Choose the best response and record your answer in the space provided on the answer sheet.

1. According to Russ Madray, the guidance related to stock appreciation rights is found in which of the following?
 - A. ASC 710.
 - B. ASC 712.
 - C. ASC 715.
 - D. ASC 718.

2. According to Russ Madray, in a deferred compensation plan utilizing a rabbi trust, which of the following is correct?
 - A. A rabbi trust is a grantor trust.
 - B. A rabbi trust is a complex trust.
 - C. Usually none of the employee's compensation is invested in the employer's stock.
 - D. All employees are eligible for the deferred compensation plan.

3. According to Russ Madray, rabbi trusts are formed for tax purposes under which of the following?
 - A. Rev. Proc. 80-64.
 - B. Rev. Proc. 92-64.
 - C. Rev. Proc. 00-85.
 - D. Rev. Proc. 15-90.

4. According to Russ Madray, in which of the following rabbi trust plans can an employee only contribute shares of employer stock to the trust?
 - A. Plan A.
 - B. Plan B.
 - C. Plan C.
 - D. Plan D.

5. According to Russ Madray, which of the following rabbi trust plans would have the characteristics where an employee could and has diversified the holdings in the trust?
 - A. Plan A.
 - B. Plan B.
 - C. Plan C.
 - D. Plan D.

Continued on next page

6. According to Jennifer Louis, which of the following was the most active time period for initial public offerings since 2007?
 - A. First quarter 2020.
 - B. Fourth quarter 2020.
 - C. First quarter 2021.
 - D. Fourth quarter 2021.
7. According to Jennifer Louis, which of the following groups state that they continue to focus on non-GAAP measures?
 - A. SEC.
 - B. FASB.
 - C. ASB.
 - D. IASB.
8. According to Jennifer Louis, according to PCAOB research, approximately what percent of S&P 500 companies report some form of ESG information?
 - A. 25%.
 - B. 60%.
 - C. 75%.
 - D. 95%.
9. According to Jennifer Louis, which of the following is an area with a disproportionate number of SEC comments?
 - A. Revenue.
 - B. Segment reporting.
 - C. PPE.
 - D. Inventory.
10. According to Jennifer Louis, which of the following is critical for quality audits post pandemic?
 - A. Lower materiality levels.
 - B. Higher confidence in sampling.
 - C. Professional skepticism.
 - D. More substantive testing.
11. According to Kurt Oestrieher, which of the following is **not** an area mentioned with a lot of estimates?
 - A. Depreciation.
 - B. Allowance for doubtful accounts.
 - C. Prepaid assets.
 - D. Leases.

Continued on next page

12. According to Kurt Oestrieher, which of the following was a driving force in SAS 143?
- A. FASB.
 - B. Peer review.
 - C. ARSC.
 - D. SEC.
13. According to Kurt Oestrieher, 'a monetary amount for which the measurement is subject to estimation uncertainty' is which of the following?
- A. Accounting estimate.
 - B. Management point estimate.
 - C. Auditor range of estimate.
 - D. Estimation uncertainty.
14. According to Kurt Oestrieher, which of the following has the least amount of uncertainty?
- A. Revenue recognition for a construction contractor.
 - B. Depreciation.
 - C. Allowance for doubtful accounts.
 - D. Goodwill impairments.
15. According to Kurt Oestrieher, which of the following requires planning and auditing financial statement disclosures?
- A. SAS 122.
 - B. SAS 134.
 - C. SAS 139.
 - D. SAS 140.

Subscriber Survey Evaluation Form

Please take a few minutes to complete this survey related to **CPE Network® A&A Report** and return with your quizzer or group attendance sheet to 2395 Midway Road, Carrollton, Texas 75006. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to CPLgrading@thomsonreuters.com.

How would you rate the topics covered in the August 2022 **CPE Network® A&A Report**? Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Rabbi Trusts	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
PCAOB Areas of Focus	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
SAS 143 and Small Businesses	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Which segments of the August 2022 issue of **CPE Network® A&A Report** did you like the most, and why?

Which segments of the August 2022 issue of **CPE Network® A&A Report** did you like the least, and why?

What would you like to see included or changed in future issues of **CPE Network® A&A Report**?

How would you rate the effectiveness of the speakers in the August 2022 **CPE Network® A&A Report**? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Russ Madray			
Jennifer Louis			
Kurt Oestrieher			

Which of the following methods would you use for viewing CPE Network® A&A Report? DVD ☐ Streaming ☐ Both ☐

Are you using **CPE Network® A&A Report** for: CPE Credit ☐ Information ☐ Both ☐

Were the stated learning objectives met? Yes ☐ No ☐ _____

If applicable, were prerequisite requirements appropriate? Yes ☐ No ☐ _____

Were program materials accurate? Yes ☐ No ☐ _____

Were program materials relevant and contribute to the achievement of the learning objectives? Yes ☐ No ☐

Were the time allocations for the program appropriate? Yes ☐ No ☐ _____

Were the supplemental reading materials satisfactory? Yes ☐ No ☐ _____

Were the discussion questions and answers satisfactory? Yes ☐ No ☐ _____

Specific Comments: _____

Name/Company _____

Address _____

City/State/Zip _____

Email _____

Once Again, Thank You...

Your Input Can Have a Direct Influence on Future Issues!

CPE Network[®]

Firm/Company Name: _____

Account #:

Location:

Program Title: _____

Date: _____

[illegible]

I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network® newsletter, and earned the number of hours shown.

Instructor Name: _____

Date: _____

E-mail address:

License State and Number:

CPE Network/Webinar Delivery Tracking Report

Course Title	
Course Date:	
Start Time:	
End Time:	
Moderator Name, Credentials, and Signature Attestation of Attendance:	
Delivery Method:	Group Internet Based
Total CPE Credit:	3.0
Instructions:	During the webinar, the moderator must verify student presence a minimum of <u>3 times per CPE hour</u> . This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
Brief Description of Method of Polling	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

[illegible]

CHECKPOINT LEARNING NETWORK

CPE NETWORK®

USER GUIDE

REVISED March 11, 2022

Welcome to CPE Network!

CPE Network programs enable you to deliver training programs to those in your firm in a manageable way. You can choose how you want to deliver the training in a way that suits your firm's needs: in the classroom, virtual, or self-study. You must review and understand the requirements of each of these delivery methods before conducting your training to ensure you meet (and document) all the requirements.

This User Guide has the following sections:

- **“Group Live” Format:** The instructor and all the participants are gathered into a common area, such as a conference room or training room at a location of your choice.
- **“Group Internet Based” Format:** Deliver your training over the internet via Zoom, Teams, Webex, or other application that allows the instructor to present materials that all the participants can view at the same time.
- **“Self-Study” Format:** Each participant can take the self-study version of the CPE Network program on their own computers at a time and place of their convenience. No instructor is required for self-study.
- **Transitioning From DVDs:** For groups playing the video from the online platform, we suggest downloading the video from the Checkpoint Learning player to the desktop before projecting.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), Checkpoint Learning Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

IMPORTANT: If you vary from the instructions noted above, your firm will become the sponsor of the training event and you will have to create your own certificates of completions for your participants. In this case, you do not need to submit any documentation back to Thomson Reuters.

If you have any questions on this documentation or requirements, refer to the “Getting Help” section at the end of this User Guide **BEFORE** you conduct your training.

**We are happy that you chose CPE Network for your training solutions.
Thank you for your business and HAPPY LEARNING!**

Copyrighted Materials

CPE Network program materials are copyrighted and may not be reproduced in another document or manuscript in any form without the permission of the publisher. As a subscriber of the **CPE Network Series**, you may reproduce the necessary number of participant manuals needed to conduct your group study session.

“Group Live” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template after the executive summary of the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance

You must monitor individual participant attendance at “group live” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **attendance sheet**. This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they

attended should be documented on the sign-in sheet and will be reflected on the participant's CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a **qualified, real time instructor while the program is being presented**. Program participants must be able to interact with the instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Make-Up Sessions

Individuals who are unable to attend the group study session may use the program materials for self-study either in print or online.

- If the print materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his/their CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded by Checkpoint Learning Network after the "group live" documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the "group live" session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the "group live" session, it is required that the firm hosting the "group live" session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Group Study Attendance sheets; indicating any late arrivals and/or early departures)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations.

Finding the Transcript

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- <https://get.adobe.com/reader/>

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group live” session should be sent to Checkpoint Learning Network by one of the following means:

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

Email: CPLgrading@tr.com

Fax: 888.286.9070

When sending your package to Thomson Reuters, you must include ALL of the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Attendance Sheet		Use this form to track attendance during your training session.
Subscriber Survey Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to Thomson Reuters any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template following the executive summary in the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance in a Webinar

You must monitor individual participant attendance at “group internet based” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **Webinar Delivery Tracking Report**. This form lists the moderator(s) name and credentials, as well as the first and last name of each participant attending the seminar. During a webinar you must set up a monitoring mechanism (or polling mechanism) to periodically check the participants’ engagement throughout the delivery of the program.

In order for CPE credit to be granted, you must confirm the presence of each participant **3 times per CPE hour and the participant must reply to the polling question**. Participants that respond to less than 3 polling questions in a CPE hour will not be granted CPE credit. For example, if a participant only replies to 2 of the 3 polling questions in the first CPE hour, credit for the first CPE hour will not be granted. (Refer to the Webinar Delivery Tracking Report for examples.)

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and ask that participants confirm their attendance by using the “raise hands” feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone’s hands and continues the training.
2. You are using **Teams** for your webinar. The moderator will pause approximately every 15 minutes and ask that participants confirm their attendance by typing “Present” into the Teams chat box. The moderator records the participants who have entered “Present” into the chat box into the **webinar delivery tracking report**. After documenting in the spreadsheet, the instructor (or moderator) continues the training.
3. If you are using an application that has a way to automatically send out polling questions to the participants, you can use that application/mechanism. However, following the event, you should create a **webinar delivery tracking report** from your app’s report.

Additional Notes on Monitoring Mechanisms:

1. The monitoring mechanism does not have to be “content specific.” Rather, the intention is to ensure that the remote participants are present and paying attention to the training.
2. You should only give a minute or so for each participant to reply to the prompt. If, after a minute, a participant does not reply to the prompt, you should put a NO in the webinar delivery tracking report.
3. While this process may seem unwieldy at first, it is a required element that sponsors must adhere to. And after some practice, it should not cause any significant disruption to the training session.
4. **You must include the Webinar Delivery Tracking report with your course submission if you are requesting certificates of completion for a “group internet based” delivery format.**

Real Time Moderator During Program Presentation

“Group internet based” programs must have a **qualified, real time moderator while the program is being presented**. Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers

during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Make-Up Sessions

Individuals who are unable to attend the “group internet based” session may use the program materials for self-study either in print or online.

- If print materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded by Checkpoint Learning Network after the “group internet based” documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who may not have answered the required amount of polling questions.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the “group internet based” session, it is required that the firm hosting the session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Webinar Delivery Tracking Report)
- Copy of the program materials
- Timed agenda with topics covered
- Date and location (which would be “virtual”) of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations

Finding the Transcript

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. It should look something like the screenshot below. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- <https://get.adobe.com/reader/>

Alternatively, for those without a DVD drive, the email sent to administrators each month has a link to the pdf for the newsletter. The email may be forwarded to participants who may download the materials or print them as needed.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group internet based” session should be sent to Checkpoint Learning Network by one of the following means:

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

Email: CPLgrading@tr.com

Fax: 888.286.9070

When sending your package to Thomson Reuters, you must include ALL the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Webinar Delivery Tracking Report		Use this form to track the attendance (i.e., polling questions) during your training webinar.
Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to Thomson Reuters any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Self-Study” Format

If you are unable to attend the live group study session, we offer two options for you to complete your Network Report program.

Self-Study—Print

Follow these simple steps to use the printed transcript and DVD:

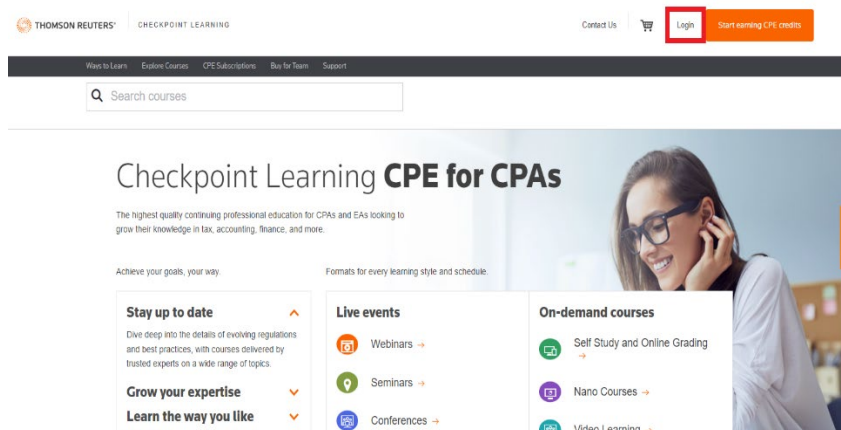
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
- Mail your completed quizzer and survey to:

Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

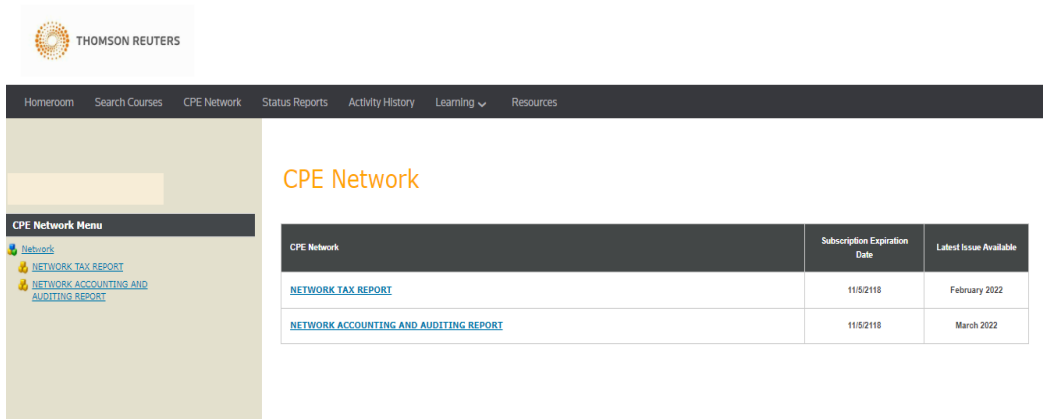
Self-Study—Online

Follow these simple steps to use the online program:

- Go to www.checkpointlearning.thomsonreuters.com.
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).

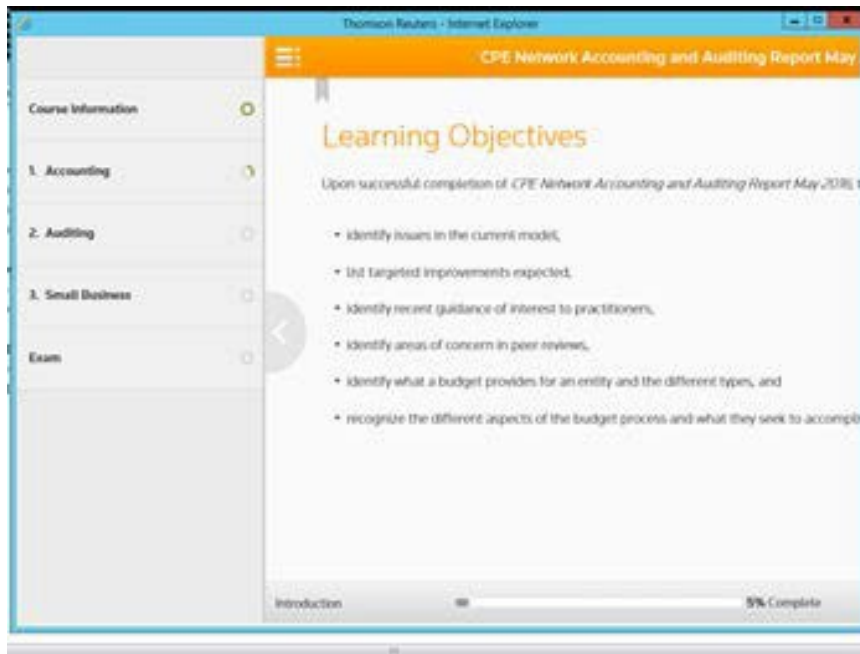


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



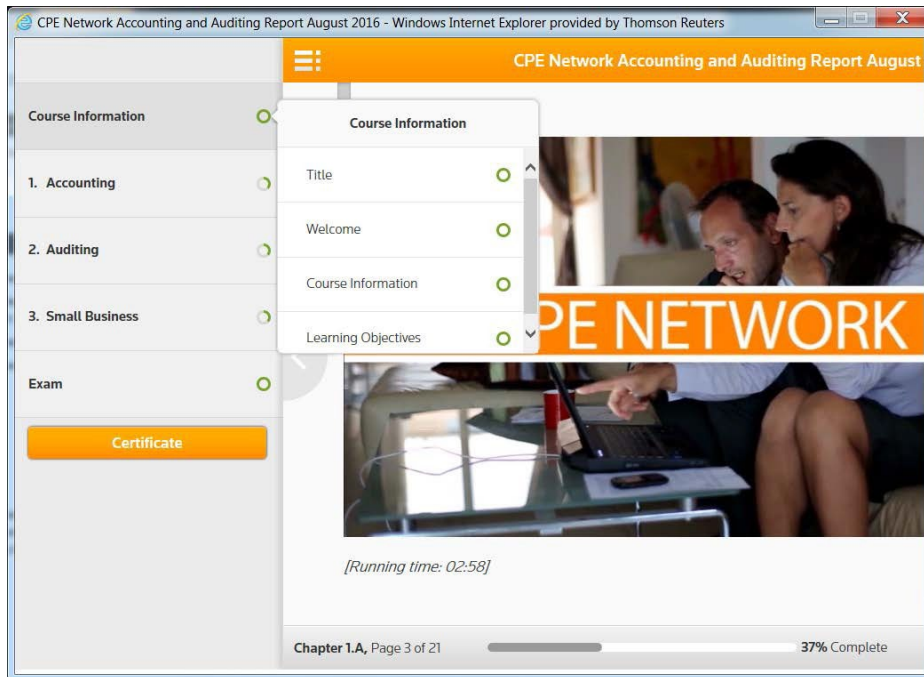
CPE Network	Subscription Expiration Date	Latest Issue Available
NETWORK TAX REPORT	11/5/2118	February 2022
NETWORK ACCOUNTING AND AUDITING REPORT	11/5/2118	March 2022

The Chapter Menu is in the gray bar at the left of your screen:



Click down to access the dropdown menu and move between the program Chapters.

- **Course Information** is the course Overview, including information about the authors and the program learning objectives



- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This more streamlined approach allows administrators and users to more easily access the related materials.



Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.

Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2016

Transcripts ☒

Chapter 1 Liabilities and Equity: Another Look at the Model

Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

For more on the targeted improvements in this area, let's join Paul Munter, professor in practice for the University of Colorado at Boulder, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today, we want to talk a little bit

Please note that the transcript [Liabilities and Equity Transcripts](#) can also be found as a link and in the Tools section.

Chapter 1A, Page 4 of 21 8% Complete [Exit & Resume Later](#)

Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.

D:\xml\production\working\U6015494\N... Network Accounting and Auditing Report May 2016

Transcripts ☒

Chapter 1 Liabilities and Equity: Another Look at the Model

Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

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Please note that the transcript [Liabilities and Equity Transcripts](#) can also be found as a link and in the Tools section.

Chapter 1A, Page 4 of 21 8% Complete [Exit & Resume Later](#)

CHAPTER 1A: ACCOUNTING

Liabilities and Equity: Another Look at the Model

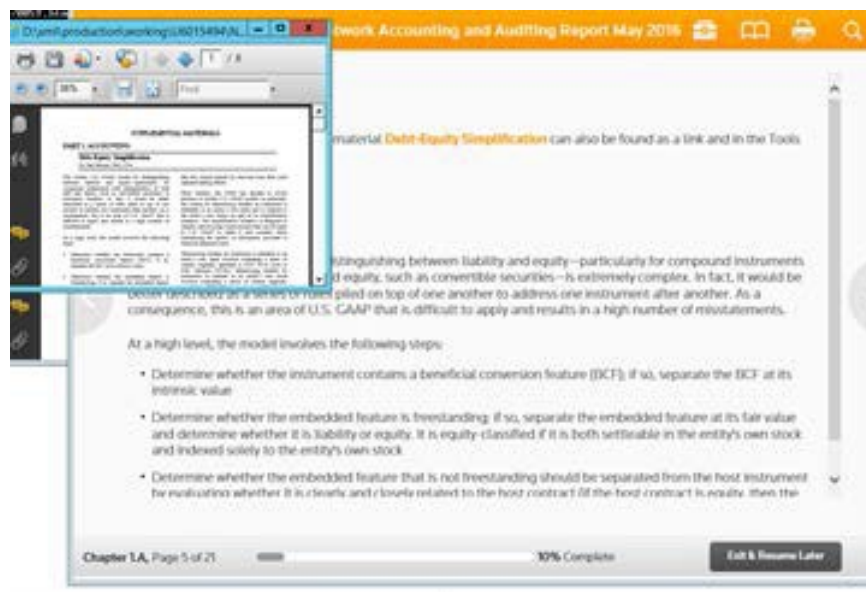
Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

For more on the targeted improvements in this area, let's join Paul Munter, professor in practice for the University of Colorado at Boulder, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today, we want to talk a little bit

Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



Continuing to click the arrow to the right side of the screen will bring the user to the Discussion problems related to the segment.

The Suggested Answers to the Discussion Problems follow the Discussion Problems.

The screenshot shows a web interface for the CPE Network Accounting and Auditing Report July 2016. The header is orange with a menu icon, title, and icons for a calculator, book, printer, and search. The main content area is titled "Suggested Answers to Discussion Problems" and contains three numbered items. Item 1 lists three categories: Held-to-maturity, Trading, and Available-for-sale, followed by a paragraph about classification. Item 2 describes the trading securities category. Item 3 discusses impairment recognition. The footer shows "Chapter 3.A, Page 20 of 20", a progress bar at 100% Complete, and an "Exit & Resume Later" button.

Suggested Answers to Discussion Problems

1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories:
 - Held-to-maturity
 - Trading
 - Available-for-sale

An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions should be made at acquisition and, preferably, formally documented. It is not appropriate to use "hindsight" to classify securities transactions, perhaps by considering changes in value after acquisition.
2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price. "Short-term," in this context, is intended to be measured in hours and days, rather than in months or years, according to ASC 320. However, an entity is not precluded from classifying as trading a security it plans to hold for a longer period, as long as that designation occurs at acquisition.
3. Impairment is recognized in earnings when a decline in value has occurred that is deemed to be other than temporary, and the current fair value becomes the new cost basis for the security. An investment is considered to be impaired if the fair value of the investment is less than its cost basis. Cost includes adjustments made for

Chapter 3.A, Page 20 of 20 100% Complete Exit & Resume Later

The **Exam** is accessed by clicking the last gray bar on the menu at the left of the screen or clicking through to it. Click the orange button to begin.

When you have completed the quizzer, click the button labeled **Grade** or the **Review** button.

The screenshot shows a web interface for the CPE Network Accounting and Auditing Report June 2016. The header is orange with a menu icon, title, and icons for a calculator, book, printer, and search. The main content area is titled "Course Exams Completed" and contains a message about completing the exam, followed by instructions to choose a next course of action. Two orange buttons are visible: "Review My Answers" and "Grade My Answers". The footer shows "Course, Completed", a progress bar at 100% Complete, and an "Exit & Resume Later" button.

Course Exams Completed

You have completed the exam for this course.

Please choose your next course of action by selecting on one of the buttons below.

"Review My Answers" will take you back through exam, giving you the opportunity to make changes.

Review My Answers

"Grade My Answers" will result in providing you with a final score for this course.

Grade My Answers

Course, Completed 100% Complete Exit & Resume Later

- Click the button labeled **Certificate** to print your CPE certificate.
- The final quizzer grade is displayed and you may view the graded answers by clicking the button labeled **view graded answer**.

Additional Features Search

Checkpoint Learning offers powerful search options. Click the **magnifying glass** at the upper right of the screen to begin your search. Enter your choice in the **Search For:** box.

Search Results are displayed with the number of hits.

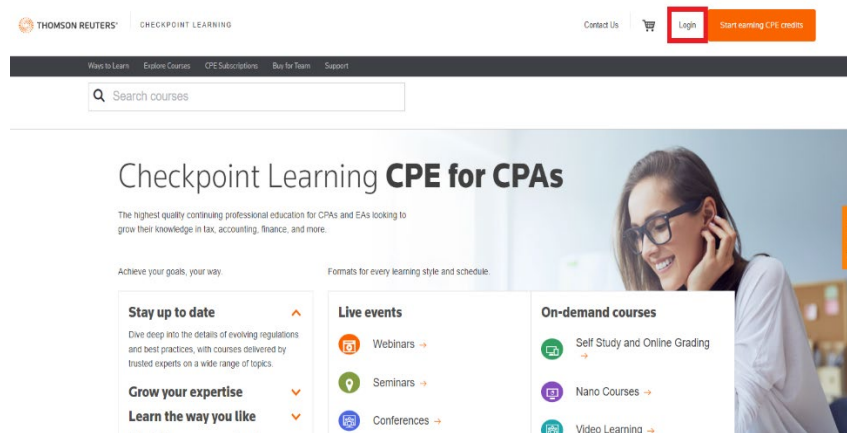
Print

To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.

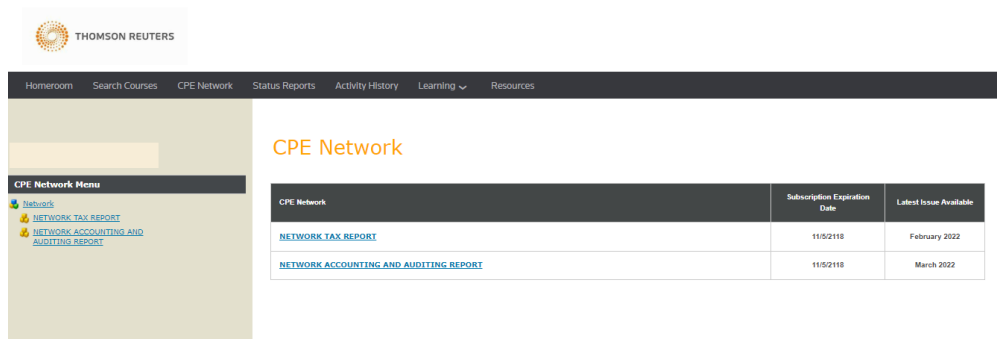
Transitioning From DVDs

Follow these simple steps to access the video and pdf for download from the online platform:

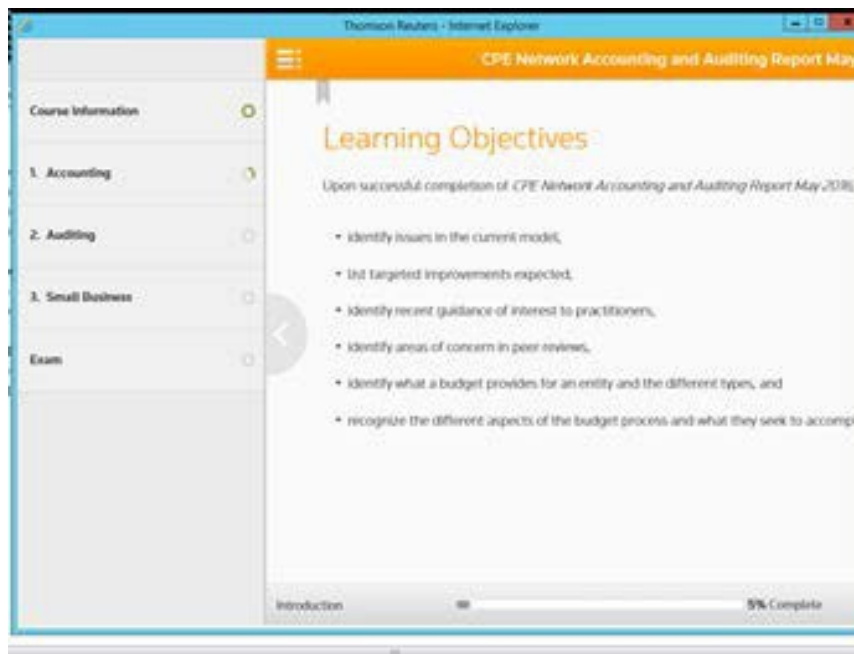
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



- In the CPE **Network** tab, select the desired Network Report by clicking on the title, then select the appropriate edition.

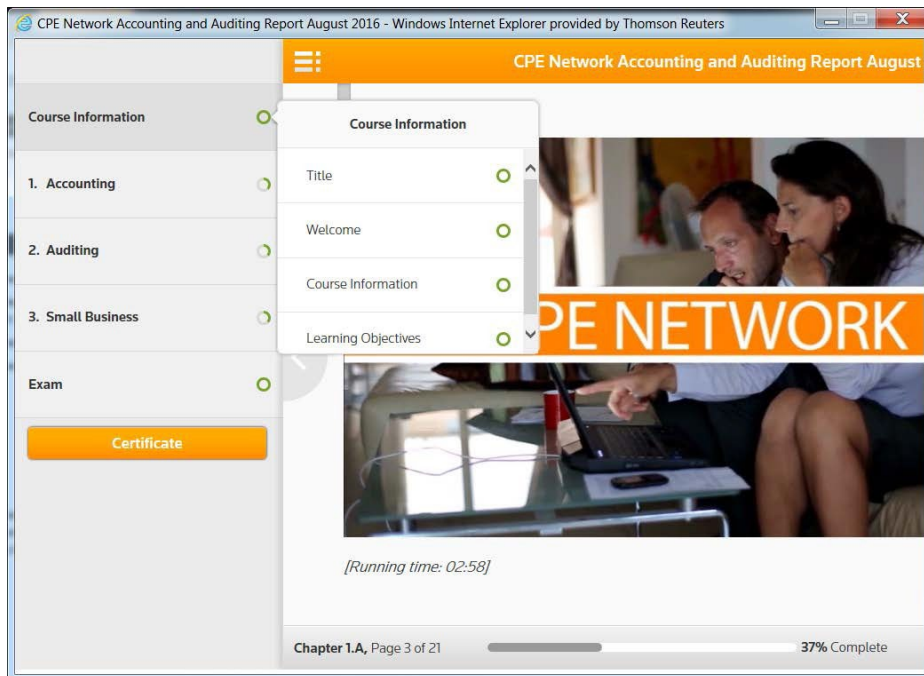


The Chapter Menu is in the gray bar at the left of your screen:

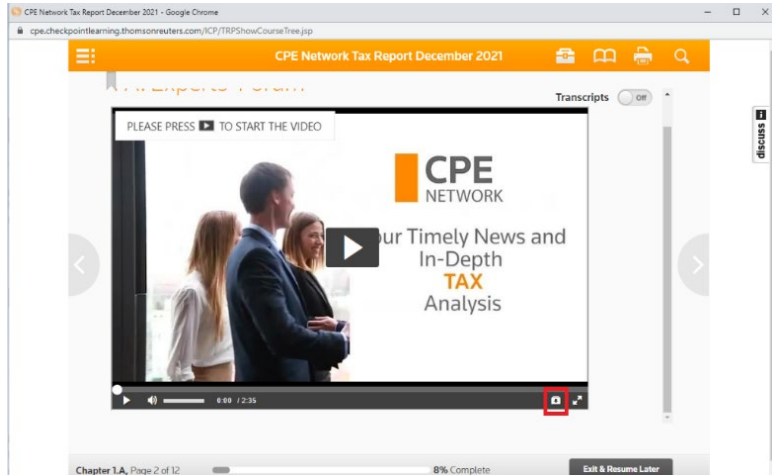


Click down to access the dropdown menu and move between the program Chapters.

- **Course Information** is the course Overview, including information about the authors and the program learning objectives



- Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions.



Video segments may be downloaded from the CPL player by clicking on the download button noted above. Tip: You may need to use the scroll bar to the right of the video to see the download button.

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent by Checkpoint Learning CPE Customer Service.

What Does It Mean to Be a CPE Sponsor?

If your organization chooses to vary from the instructions outlined in this User Guide, your firm will become the CPE Sponsor for this monthly series. The sponsor rules and requirements noted below are only highlights and reflect those of NASBA, the national body that sets guidance for development, presentation, and documentation for CPE programs. **For any specific questions about state sponsor requirements, please contact your state board. They are the final authority regarding CPE Sponsor requirements.** Generally, the following responsibilities are required of the sponsor:

- Arrange for a location for the presentation
- Advertise the course to your anticipated participants and disclose significant features of the program in advance
- Set the start time
- Establish participant sign-in procedures
- Coordinate audio-visual requirements with the facilitator
- Arrange appropriate breaks
- Have a real-time instructor during program presentation
- Ensure that the instructor delivers and documents elements of engagement
- Monitor participant attendance (make notations of late arrivals, early departures, and “no shows”)
- Solicit course evaluations from participants
- Award CPE credit and issue certificates of completion
- Retain records for five years

The following information includes instructions and generic forms to assist you in fulfilling your responsibilities as program sponsor.

CPE Sponsor Requirements

Determining CPE Credit Increments

Sponsored seminars are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned. Sponsors must monitor the program length and the participants' attendance in order to award the appropriate number of CPE credits.

Program Presentation

CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. CPE program sponsors must make the following information available in advance:

- Learning objectives.
- Instructional delivery methods.
- Recommended CPE credit and recommended field of study.
- Prerequisites.
- Program level.
- Advance preparation.
- Program description.
- Course registration and, where applicable, attendance requirements.
- Refund policy for courses sold for a fee/cancellation policy.
- Complaint resolution policy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits).

Disclose Significant Features of Program in Advance

For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (e.g., through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

Monitor Attendance

While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient. The sign-in sheet should list the names of each instructor and her/his credentials, as well as the name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant leaves early, the hours they attended should be documented on the sign-in sheet and on the participant's CPE certificate.

Real Time Instructor During Program Presentation

“Group live” programs must have a qualified, real time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A “group live” program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early. Attached is a sample *Certificate of Attendance* you may use for your convenience.

CFP credit is available if the firm registers with the CFP board as a sponsor and meets the CFP board requirements. IRS credit is available only if the firm registers with the IRS as a sponsor and satisfies their requirements.

Seminar Quality Evaluations for Firm Sponsor

NASBA requires the seminar to include a means for evaluating quality. At the seminar conclusion, evaluations should be solicited from participants and retained by the sponsor for five years. The following statements are required on the evaluation and are used to determine whether:

1. Stated learning objectives were met.
2. Prerequisite requirements were appropriate.
3. Program materials were accurate.
4. Program materials were relevant and contributed to the achievement of the learning objectives.
5. Time allotted to the learning activity was appropriate.
6. Individual instructors were effective.
7. Facilities and/or technological equipment were appropriate.
8. Handout or advance preparation materials were satisfactory.
9. Audio and video materials were effective.

You may use the enclosed preprinted evaluation forms for your convenience.

Retention of Records

The seminar sponsor is required to retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (the original sign-in sheets, now in an editable, electronic signable format)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

Here are the forms noted above and how to get access to them.

Delivery Method	Form Name	Location	Notes
"Group Live" / "Group Internet Based"	Advertising / Promotional Page	Transcript	Complete this form and circulate to your audience before the training event.
"Group Live"	Attendance Sheet	Transcript	Use this form to track attendance during your training session.
"Group Internet Based"	Webinar Delivery Tracking Report	Transcript	Use this form to track the 'polling questions' which are required to monitor attendance during your webinar.
"Group Live" / "Group Internet Based"	Evaluation Form	Transcript	Circulate the evaluation form at the end of your training session so that participants can review and comment on the training.
Self Study	CPE Quizzer Answer Sheet	Transcript	Use this form to record your answers to the quiz.

Getting Help

Should you need support or assistance with your account, please see below:

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	800.431.9025 (follow option prompts)	checkpointlearning.techsupport@thomsonreuters.com	<ul style="list-style-type: none">• Browser-based• Certificate discrepancies• Accessing courses• Migration questions• Feed issues
Product Support	800.431.9025 (follow option prompts)	checkpointlearning.productsupport@thomsonreuters.com	<ul style="list-style-type: none">• Functionality (how to use, where to find)• Content questions• Login Assistance
Customer Support	800.431.9025 (follow option prompts)	checkpointlearning.cpecustomerservice@thomsonreuters.com	<ul style="list-style-type: none">• Billing• Existing orders• Cancellations• Webinars• Certificates