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CPE NETWORK

ACCOUNTING & AUDITING REPORT

AUGUST 2024 VOLUME 37, ISSUE 7

Topics for future editions may include:

- Internal control
- PCAOB Recent Proposals on Firm and Engagement Metrics

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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Jennifer Louis, CPA discusses recent accounting guidance providing illustrative examples of when Topic 718 on share-based payments applies and when it does not. [*Running time: 35:35*]

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

- Determine the primary purpose behind issuing the guidance
- Identify when the guidance is applicable and to what transactions and arrangements
- Identify factors useful in determining the accounting for share-based payment awards

PART 2. AUDITING

Sunish Mehta, CPA reviews the different types of SOC Reports and engagements. He discusses what differentiates the different types and the considerations in looking at the frameworks. *[Running time: 1:12:53]*

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

- Define the different types of SOC reports and their purposes
- Identify the trust services principles
- Identify typical system components examined in a SOC 2 report
- Determine what SOC reports are typically used for what application

ABOUT THE SPEAKERS

Jennifer Louis, CPA, is a CPA and president of Emergent Solutions Group, LLC. She has more than 25 years experience in designing and instructing high-quality training programs. Ms. Louis was previously executive vice president and director of training services at AuditWatch Inc., a premier training and consulting firm serving the auditing profession. She also served as financial/operational audit manager for the AARP, and as an audit manager for Deloitte.

Sunish Mehta, CPA, CGMA in California. Sunish is the Founder of Mindful-C-P-A Mindful-PRO and has over 25 years of experience in Advisory and Assurance services. His professional experience includes working with EY, PwC & IBM Global Business Services. He has instructed courses in Financial Auditing and Accounting on an adjunct basis for the UCLA Certification of Accounting Program. He graduated with a Business Degree from California State University, Northridge and has an Inner MBA from New York University.

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Program Level	Update
Prerequisites (Circle One)	• Basic Accounting and Auditing professional experience
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PART 1. ACCOUNTING

ASU 2024-01 and Profits Interest Awards

ASU 2024-01 was issued by the FASB in March 2024. The guidance was issued as a result of work by the Private Company Council due to the prevalence of profits interest awards by private entities. Examples provided in the guidance are intended to reduce complexity in determining if Topic 718 applies and to reduce diversity in practice.

For more on accounting for these awards, 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 about a recent ASU issued by the FASB, and that's ASU 2024-01, and it's related to stock-based compensation. To begin with, let's talk a little bit about what are profits interest awards.

Ms. Louis

Well, there's going to be cases where an entity could give an employee or a non-employee profit interest awards. The goal is to align compensation with the entity's operating performance and to provide the holders of these awards the opportunity to participate in the future profits, or appreciation of the entity, but it's something that hadn't really been defined within GAAP before and to figure out, how do I differentiate these profits interest awards and to figure out how is it that I account for them because there can be cases where you really need to just look at the terms and conditions of these different arrangements to determine whether or not this is something that's accounted for under Topic 718 that deals with stock-based compensation. Is it a cash bonus? Is it a profit-sharing arrangement that's done underneath Topic 710 that deals with more general compensation topics? There was a lot of diversity in practice that happened as it relates to trying to figure out the proper accounting for these issues.

Ms. Grove Casey

Is this just a private company issue?

Ms. Louis

Well, it's something that started as a discussion point within the Private Company Council, the PCC, as these awards are used at private companies. But once they started researching the issue, they found that certain public business entities also might have these profit interest awards as you look at the terms and conditions of some of their compensation arrangements. As different organizations become increasingly more creative on how they're going to incentivize people, they're finding that sometimes that they are falling into this category where there was lack of consistency and there was diversity of practice.

Ms. Grove Casey

How did the FASB decide to respond to try to clarify this diversity in practice?

Ms. Louis

ASU 2024-01 was something that was released in March of 2024, where the attempt was to just give illustrative examples to provide certain fact patterns, and to say, given this fact pattern, would this be an award that would be accounted for under stock compensation, Topic 718, or is it something that would be accounted for in another area of GAAP? They issued illustrative examples to try and show, well, here's why we're making the decisions that we're making given these specific facts. Because of the fact that it's difficult to come up with every possible scenario of how these arrangements can be structured, but to try and provide enough examples that you could look at and say, well, my scenario is most like this one. So this is why I think this is the best answer to give in my particular case.

Ms. Grove Casey

What is the effective date and transition for this new ASU?

Ms. Louis

Well, the ASU is effective for public business entities for their annual periods beginning after December 15th, 2024, and then, interim periods within those annual periods. All other entities have an extra year. It would be for annual periods beginning on or after December 15th, 2025, also with interim periods within those annual periods. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance. It is something that also, as you look at the transition, there's going to be either retrospective transition to all periods presented in the financials, or it could be that you choose to prospectively do it, for profits interest, and similar awards that might have been granted or modified after a given date.

Ms. Grove Casey

Well, you mentioned Topic 718 and more broadly, let's talk about how share-based arrangements are defined by the FASB.

Ms. Louis

Well, underneath even the existing Topic 718, as they're looking at stock compensation, they looked at where there might be share-based arrangements, an arrangement where either one or more suppliers of goods or services, including employees or non-employees, receive awards of equity shares, equity share options, or other equity instruments. So you're actually getting equity.

Or, it could be that I'm incurring a liability to a provider of goods or services that meet one of the two conditions. Either the amount is based, at least in part, on the price of the entity's shares or other equity instruments, so when we say at least in part, an award may be indexed to both the price of the entity shares, and then, something else other than that. That could be one component. The other component is that the awards require or may require settlement by issuing entity shares. As they think about the liability that's being incurred, that it also could be that it meets one of these two conditions. As they think about shares, as they talk about equity shares, for example, it could be various forms of ownership that might not necessarily be in the legal form of securities. It could be something like a partnership interest as they're looking at those cases. Now equity shares in and of themselves would be only shares that are accounted for as equity. And so these are going to be as they thought about share-based arrangements, share-based compensation arrangements that they looked at in those conditions.

Ms. Grove Casey

How are share-based arrangements differentiated from stock-based compensation?

Ms. Louis

Well, so really now we moved to ASU 2024-01 that was released, that they said, well, let's, let's look at that definition, and so to be looking at there to say, how do we really think about how to clarify things for more consistent application. They did look at that topic, section 718. It is focused on share-based payment arrangements. And it is focused on the fact that who's granting these awards, these arrangements, that they're doing it in order to get something. I'm getting a good or a service. It's going to be used or consumed in my own operations. As I'm now creating a payable to another party. Now, when they talk about a customer, it could be, as we think about, I'm getting a good, or it could be an employee, right? It could be an independent contractor or a non-employee. The other party is giving you something. It's like an exchange transaction that is occurring.

But it still is going to be focused on the fact that I'm issuing my shares or my share options or other equity instruments right as we think about shares and share options not really being necessarily focused on equity share options. It could be just equity instruments. But it is still going to be the fact that there could be implications because of an amount in this liability that I owe to somebody, the liability could be based, at least in part, because an award or share-based compensation is indexed to something as relates to the value of the entity's shares or that they require settlement in my equity shares or my equity instruments. But really, in essence, as we looked at things to try and look at the definition and try to figure out what really makes sense in order to really deal with these emerging concerns.

Ms. Grove Casey

Did the definition of stock-based compensation change with ASU 2024-01?

Ms. Louis

So that's a common thing as I've talked about how they changed the wording of the definition, right? But the core definition did not change. They tried to reorganize the presentation of what needs to be met in order to have this be something that was accounted for as stock compensation, just to enhance clarity and readability. They didn't really change the fundamental definition. They just changed the presentation of how they're presenting the definition.

Ms. Grove Casey

Is having an economic interest in an entity always a factor in evaluating how to account for share-based payment awards?

Ms. Louis

Well, certainly it is a factor in that if I'm somebody that has an economic interest in an entity, it can be that I have some form of interest, right? As I think about this could be that I have equity securities. It could be that there's financial instruments with characteristics of equity securities, but also an economic interest can come from my long-term debt, or other debt-financing arrangements. It can come from leases. It can come from management contracts. It can come from intellectual property licensing as I create an economic interest. And so when they are looking at share-based payments awarded to a related party or other holder of an economic interest as compensation for goods or services, then they are saying that if you're providing these things to the reporting entity, would this be something that is a share-based arrangement that should be accounted for as stock-based compensation? Now, if they're saying that the transfer of this interest is for something clearly for purposes other than compensation for goods or services to the reporting entity, then they're saying you wouldn't use this Topic 718. So part of it is, as we think about related parties and we think about economic interest in the entity holders, somebody that holds an economic interest, then we do need to look to see, well, what's driving that? Is this an exchange-based thing for goods or services, or is it really for some other reason, another situation where really another area of GAAP would be more appropriate.

Ms. Grove Casey

Does the guidance of Topic 718 apply to share-based awards to a lender or investor?

Ms. Louis

Topic 718 would not apply to those transactions, if it is for a lender or an investor that's providing financing to the issuer of these awards. Now there may be areas like Topic 815 that deals with derivatives and hedging, it might relate to the fact that I now have a contract in my entity's own equity, but this would not apply if it's an investor or lender. They're saying that wouldn't fall underneath this area of the Codification.

Ms. Grove Casey

Does Topic 718 apply to share-based awards granted to customers?

Ms. Louis

When we're talking about customers and we're focused on these matters, what if they are a customer now as we might think about a customer in terms of Topic 606, as we look at the application of the revenue recognition criteria. And so when we say granting to a customer, it may be that while something's measured and classified in accordance with Topic 718, it actually might affect your revenue recognition as a reduction of the consideration or the transaction price, right? That you're now using to drive your rev rec if they're really intertwined with each other, right? That it's an offset of your revenues as I now have these expenses that I'm giving almost as if it's like incentive based things, right, as we think about the grant into the customers that there could be rev rec implications.

Ms. Grove Casey

What topic applies if there are share-based awards issued in a business combination?

Ms. Louis

So that's going to go under Topic 805. As we think about those that are a part of the consideration that's transferred in exchange for a business combination. That also would be that you need to look at that area. But if we have something post-combination and there are share-based arrangements based on continued service, it may be that Topic 718 starts being applied after you've gone through the business combination from that part going forward.

Ms. Grove Casey

What about equity instruments held in an employee stock ownership plan? Does Topic 718 apply there?

Ms. Louis

It does not, as we have these employee benefit plans that are stock bonus plans or purchase pension plans that are designed in essence as we think about, while it still involves employer stock and employee share ownership plan or stock ownership plan would not be underneath Topic 718 specifically.

Ms. Grove Casey

What are fundamental recognition principles for share-based payment transactions?

Ms. Louis

What if we're dealing with something that is under Topic 718, that I should recognize the goods I'm acquiring or services I'm receiving in a share-based payment transaction. When I'm actually getting the goods or the services right as I'm receiving my benefits I now owe them. There's now a liability and so I should recognize an increase in my equity or my liability depending on whether or not the instrument is an equity or a liability classified instrument. When we are thinking about these matters though, as we think about employee services, services as they're being consumed, there's a cost to the entity. And so the cost is usually as we think about expenses that occurred for employee services I also want to ensure that I'm spreading that cost in a fair and equitable way.

Ms. Grove Casey

Can compensation costs be capitalized rather than expensed?

Ms. Louis

Well, there may be cases where they might initially be capitalized as a part of a cost, maybe to acquire or construct another asset like inventory, but then, ultimately, as the inventory is sold, it ends up in my cost of sales. Eventually there's going to be an expense that's reflected. And so yes, it may be that compensation cost is initially capitalized, but then, is subsequently recognized in the income statement in another way.

Ms. Grove Casey

What are special considerations when transactions are made with non-employees?

Ms. Louis

When we think about the non-employees as they have things where I have exchanges that span over several reporting periods, as I think about what is it that I'm compensating them in terms of the goods I'm acquiring and the services I'm receiving. And sometimes the quantity and terms of the share-based payments awards to be granted may be known or not known when the transaction arrangement is originally established. There may be cases where judgment is required to determine the proper period over which a cost might be recognized as we think about a vesting period that might exist as relates to non-employees that have these arrangements.

Ms. Grove Casey

Shouldn't all share-based payment transactions generally reflect the rights conveyed to the instrument holder?

Ms. Louis

They are saying, yes, it should reflect those rights that we think about as far as who holds these awards, but it also needs to think about the obligations that are being imposed on who's doing the awards. So we really need to think about both sides, right, as we think about rights and obligations that are embodied in this arrangement that exists. And so we do need to think about substantively, like what is it that's the fairest reflection of the circumstances.

Ms. Grove Casey

Related to profits interest awards, what was one of the examples that the FASB provided that would result in the arrangement being accounted for under Topic 718?

Ms. Louis

All right, so, they said that we are dealing with some basic assumptions. The example they gave was that the entity is a partnership and that there are class A units outstanding, but there's also class B incentive units that are given to employees of a subsidiary in exchange for services from those employees of the subsidiary. And so there are a variety of exit events that could occur. It could be because there is an IPO. It could be that there's just a change in control, or it could be that the entity liquidates its assets. Under the first scenario, they are looking at the case where you have class A and class B. So the Class B units are subordinated to the Class A units. After vesting, the Class B units do participate pro rata with the Class A units once the holders of the Class A units have received their distributions based on their predetermined rules that do exist. So they are subordinated even though they can participate once Class A has been satisfied.

The Class B units have a cliff vesting at the end of three years of services. When there is an exit event, the Class B units vest immediately, as long as I'm still providing services, right, to the organization through the fact that I'm still an employee of this subsidiary. So it vests immediately. In addition, upon an exit event, the grantee would either retain my vested units or I would obtain proceeds if the Class B units are settled through whatever this exit event is. If we do have where the grantee, if there is a termination of employment, any unvested Class B shares would be forfeited for no consideration. So whether it's voluntarily determined, retirement, disability or other reasons, if the grantee terminates employment after vesting, the grantee retains ownership of those vested shares. And so now we have a case where if I'm now terminated after vesting, . . . the entity can call back those class B shares. And if the entity decides to call back those shares, they would have to pay the individual cash equal to the fair value of the shares at a given call date. So having gone through that scenario, I think the key things as we think about, well, do we believe that this is really stock-based awards? Like are these share-based compensation awards that should be accounted for under Topic 718? And they're saying, well, when we think about this, right, if we think about holding the vested class B shares provides me rights to participate in the residual interest of the entity, right? As we think about periodic distributions and upon an exit event or upon settlement at some case, because all of this is really tied to the fact that upon vesting, then I definitely have a right to certain forms of consideration. And so therefore, they're saying that entity X is really offering shares that place this award under topic 718.

Ms. Grove Casey

What was another illustrative example the FASB gave that would result in the profits interest award being accounted for under topic 718?

Ms. Louis

So, if we think about comparing it to just the example that we gave, you still could look at a case where maybe the grantee of the Class B awards is eligible to begin participating in non-forfeitable operating distributions as of a given grant date. But also upon an exit event, I could also either retain my vested shares or get settlement rights through this exit event. So because of the fact that in holding this, I still have rights to participate in the residual interest of the entity, that they would say that that really would be that you also still have an equity instrument, right, that should be an award that is accounted for under Topic 718. As we think about the consideration that would be received upon an exit event, but also even before an exit event, I'm going to start participating in these non-forfeitable operating distributions at the same time.

Ms. Grove Casey

Can you talk a little bit more about the illustration you just gave and how it would be considered stock-based compensation to be accounted for under Topic 718?

Ms. Louis

All right. Well, part of it would be that if we think about how they say in the illustration, they were saying as well, that if you had a termination for any reason before an exit event, the class B shares are forfeitable. So if we think about termination before an exit event. I'm forfeiting my rights to future distributions and I would forfeit my class B units for no further consideration. And so if that were to occur, then the entity would account for the grantee's rights to participate in these operating distributions, though still in accordance with this Topic 718 because of the fact that I do have rights that I'm entitled to as I think about these services that I'm providing before there is an exit event. So in these cases, as we think about these matters, they are saying, is this really more like a dividend equivalent? So these non-forfeitable operating distributions. As we think about those things, do I really have a dividend equivalent that really should be thought of as it relates to having an effect on my retained earnings instead?

Ms. Grove Casey

How does an entity's accounting policy elections impact the accounting?

Ms. Louis

Well, certainly there has to be accounting policy elections like what happens with forfeited awards? And so, do you estimate the number of awards that are expected to be forfeited as you're coming up with your compensation? Or is it that you wait and you account for the forfeitures as they occur? And so there is already, as you think about any form of stock-based compensation, that accounting policy election is going to change your accounting. You have those same elections that could be made as it relates to these other share-based forms of payment that are happening through these profit interest awards where there are forfeitable terms. Do I estimate how much is going to be forfeited or do I wait for the forfeiture to actually happen? That same accounting policy election would apply as it relates to any other type of equity instruments.

Ms. Grove Casey

Could you give us another example of a profits interest award that would be accounted for under Topic 718?

Ms. Louis

Well, one of them would be that there are cases where you have something called phantom share units, where we have class B units that don't entitle the grantee to receive equity instruments of the entity. They're not eligible to participate in distributions in the ordinary course of business, which is what we saw in the previous example. However, we do have upon an exit event, that my class B shares unit, that these units immediately vest and the vested units must be settled in cash at the fair value of the units. And the fair value of the class B units though is calculated using the fair value of the class A units at the date of the exit event.

In this case, as we think about the fact that I have to still be providing services when an exit event occurs to get any of my proceeds, and if I'm terminated, my units are forfeitable for any reason at any time before the exit event. So they are forfeitable, but as we think about these matters the cash proceeds that are being received by the grantee upon the exit event are at least in part based on the price of the entity because they're based on the fair value of the class A shares, so even though I'm not giving you shares or instruments right I'm not meeting that part of the definition because I'm not entitled to anything it's these phantom shares. But because of the fact that the value of them are still tied to the fair value of the Class A shares, they would say that Topic 718 would still apply in that circumstance.

Ms. Grove Casey

What would be an example of a share-based award that would not be accounted for under Topic 718?

Ms. Louis

All right, yes, so examples of things where we would say it would be applicable based on that definition that we talked about what a share-based award is. In another example, let's say that I have Class B units that don't entitle the grantee to receive equity instruments, phantom shares, but when we think about we have the ability to participate in operating distributions, but it's tied to the preceding year's net income. Since I have something that's not tied to the share price of the entity, it would not be something that would be accounted for under Topic 718. So even as I might be having operating distributions over a period of time, it's not something that's tied to the value of the organization, it's just tied to the operating results.

Ms. Grove Casey

Let's talk about the factors to consider when determining the grant date of a share-based compensation award under Topic 718.

Ms. Louis

You're going to go back to Topic 718 and you would use the same definition of grant date as you would any other award that's covered by this section where there is a mutual understanding about the key terms and conditions of the award. As we go through and use the same criteria for grant date for maybe stock options criteria to determine when the share-based profit interest awards are also granted.

Ms. Grove Casey

What are the initial measurement provisions under Topic 718?

Ms. Louis

When you look at any share-based awards, you're going to try to figure out what's the fair value of these awards at the grant date as we now are creating this obligation, right? Where we have a grantee that's going to be providing goods or services, and so, they're going to have these rights that are available to them. But we are focusing on the grant date, how much I've said I'm going to pay you, it would be based on the fair value of those instruments at that grant date.

Ms. Grove Casey

So tell me a little bit more about the calculated value or intrinsic exception available for certain qualifying non-public entity circumstances.

Ms. Louis

Well, certainly we're going to talk about how I might need to estimate fair value because it's not practicable for me to really come up with a share price as it relates to non-public entities. And so there are certain situations where we can use something that's not truly fair value as of the grant date, that I can use a calculated value that is trying to come up with a substitute for what would truly be fair value, but it would only be something that's available in certain circumstances as we are thinking about these non-public entities to qualify for that as you would have to qualify for that for any share-based payments.

Ms. Grove Casey

Are there any other practical expedients available to non-public entities for determining the value of stock-based compensation awards under Topic 718?

Ms. Louis

There are, and it's not just limited to these profit interest awards, as there might be a practical expedient to say, I'm going to use the reasonable application of a reasonable valuation method as my current price, as relates to trying to fair value these awards. So there is this practical expedient that's available, but even if I don't use the practical expedient if I'm fair valuing that I can call something fair value and using an exception as it relates to the calculated value of certain qualifying instruments, even if I don't use this practical expedient that recently also was made available underneath this section.

Stock-Based Compensation, Including ASU 2024-01 on Profits Interest Awards

by Jennifer F. Louis, CPA

Profits Interest Awards

Certain entities provide employees or nonemployees with profits interest awards to align compensation with an entity's operating performance and provide those holders with the opportunity to participate in future profits and/or equity appreciation of the entity. The term *profits interest* is not defined in GAAP but differentiates those interests from capital interests held by investors that provide those holders with rights to the existing net assets in a partnership or similar entity (for instance, a limited liability company).

Because profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership, it can be complex to determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, Compensation—General, or other Topics). This can lead to diversity in practice, even when there are similar fact patterns.

The scope application issue, along with other related issues, was identified and discussed by the Private Company Council (PCC) because of the prevalence of profits interest awards among private companies. However, because the PCC research indicated that certain public business entities (PBEs) also may be required to account for profits interest awards, the PCC recommended that the Board add a project to address the scope application issue for PBEs and entities other than PBEs (that is, all reporting entities).

In March 2024, the FASB issued ASU 2024-01, *Compensation – Stock Compensation* (Topic 718). The amendments in this Update improve GAAP by adding an illustrative example that includes four fact patterns to demonstrate how an entity should apply the scope guidance in paragraph 718-10-15-3 to determine whether a profits interest award should be accounted for in accordance with Topic 718. The illustrative example is intended to reduce (1) complexity in determining whether a profits interest award is subject to the guidance in Topic 718 and (2) existing diversity in practice.

ASU 2024-01 Effective Date & Transition

For public business entities, the amendments are effective for annual periods beginning after December 15, 2024, and interim periods within those annual periods.

For all other entities, the amendments are effective for annual periods beginning after December 15, 2025, and interim periods within those annual periods.

Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance. If an entity adopts the amendments in an interim period, it should adopt them as of the beginning of the annual period that includes that interim period.

The amendments should be applied either (1) retrospectively to all prior periods presented in the financial statements or (2) prospectively to profits interest and similar awards granted or modified on or after the date at which the entity first applies the amendments.

- If the amendments are applied retrospectively, an entity is required to provide certain specific disclosures in the period of adoption.
- If the amendments are applied prospectively, an entity is required to disclose the nature of and reason for the change in accounting principle.

Share-Based Arrangements Defined

Extant GAAP before ASU 2024-01 defined a share-based arrangement as an arrangement under which either of the following conditions is met:

a. One or more suppliers of goods or services (including employees) receive awards of equity shares, equity share options, or other equity instruments.

b. The entity incurs liabilities to suppliers that meet either of the following conditions:

   1. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase at least in part is used because an award may be indexed to both the price of the entity's shares and something other than either the price of the entity's shares or a market, performance, or service condition.)

   2. The awards require or may require settlement by issuance of the entity's shares.

The term "shares" includes various forms of ownership interest that may not take the legal form of securities (for example, partnership interests), as well as other interests, including those that are liabilities in substance but not in form. *Equity shares* refers only to shares that are accounted for as equity. They are also called share-based compensation arrangements.

Stock-Based Compensation Defined

FASB ASC 718, *Compensation – Stock Compensation*, establishes guidance for entities that enter into share-based payment transactions, unless specifically addressed within other Subtopics.

The guidance in 718-10-15-3 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor's own operations or provides consideration payable to a customer by either of the following:

1. Issuing (or offering to issue) its shares, share options, or other equity instruments to an employee or nonemployee.

2. Incurring liabilities to an employee or a nonemployee that meet either of the following conditions:

   a. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase *at least in part* is used because an award of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a market, performance, or service condition.)

   b. The awards require or may require settlement by issuing the entity's equity shares or other equity instruments.

The core definition did not change due to ASU 2024-01 but did reorganize the presentation of the requirements for enhanced clarity and readability.

Economic Interest in the Entity a Factor

An "economic interest in an entity" is defined as any type or form of pecuniary interest or arrangement that an entity could issue or be a party to, including equity securities; financial instruments with characteristics of equity, liabilities, or both; long-term debt and other debt-financing arrangements; leases; and contractual arrangements such as management contracts, service contracts, or intellectual property licenses.

Share-based payments awarded to a grantee by a related party or other holder of an "economic interest in the entity" as compensation for goods or services provided to the reporting entity are share-based payment transactions to be accounted for under this Topic unless the transfer is clearly for a purpose other than compensation for goods or services to the reporting entity. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to the grantee in exchange for services rendered or goods received.

An example of a situation in which such a transfer is not compensation is a transfer to settle an obligation of the economic interest holder to the grantee that is unrelated to goods or services to be used or consumed in a grantor's own operations.

Share-Based Awards to Lender or Investor

The guidance in this Topic does not apply to transactions involving share-based payment awards granted to a lender or an investor that provides financing to the issuer. See Topic 815, *Derivatives and Hedging* for subsequent measurement when an entity is involved in contracts in the entity's own equity. This includes guidance on an issuer's accounting for modifications or exchanges of written call options to compensate grantees.

Share-Based Awards to a Customer

Share-based payment awards granted to a customer should be measured and classified in accordance with the guidance in Topic 718 and reflected as a reduction of the transaction price and, therefore, of revenue in accordance with Topic 606, unless the consideration is in exchange for a distinct good or service. If share-based payment awards are granted to a customer as payment for a distinct good or service from the customer, then an entity shall apply the guidance in Topic 606.

Share-Based Awards in a Business Combination

Topic 805 provides guidance on determining whether share-based payment awards issued in a business combination are part of the consideration transferred in exchange for the acquiree, and therefore in the scope of Topic 805, or are for continued service to be recognized in the post-combination period in accordance with Topic 718.

Topic 805 provides guidance on determining whether share-based payment awards issued by a joint venture upon formation are part of the joint venture formation transaction and, therefore, are within the scope of Subtopic 805-60, or are for continued service to be recognized in the post-formation period in accordance with Topic 718.

Employee Stock Ownership Plans

The guidance in Topic 718 does not apply to equity instruments held by an employee stock ownership plan. An employee stock ownership plan is an employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986 as a stock bonus plan, or combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock. It is also called an employee share ownership plan.

Recognition Principles for Share-Based Payment Transactions

An entity should recognize the goods acquired or services received in a share-based payment transaction when it obtains the goods or as services are received. The entity should recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria.

Employee services themselves are not recognized before they are received. As the services are consumed, the entity recognizes the related cost. For example, as services are consumed, the cost usually is recognized in determining net income of that period (e.g., as expenses incurred for employee services).

In some circumstances, the cost of services may be initially capitalized as part of the cost to acquire or construct another asset (such as inventory) and later be recognized in the income statement when that asset is disposed of or consumed. Topic 718 refers to recognizing compensation cost rather than compensation expense because any compensation cost that is capitalized as part of the cost to acquire or construct an asset would not be recognized as compensation expense in the income statement.

Transactions with nonemployees in which share-based payment awards are granted in exchange for the receipt of goods or services may involve a contemporaneous exchange of the share-based payment awards for goods or services or may involve an exchange that spans several financial reporting periods. The quantity and terms of the share-based payment awards to be granted may be known or not known when the transaction arrangement is established because of specific conditions dictated by the agreement (e.g., performance conditions). Judgment is required in determining the period over which to recognize cost, otherwise known as the nonemployee's vesting period.

The accounting for all share-based payment transactions should reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. For example, the rights and obligations embodied in a transfer of equity shares for a note that provides no recourse to other assets of the grantee (that is, other than the shares) are substantially the same as those embodied in a grant of equity share options. Thus, that transaction shall be accounted for as a substantive grant of equity share options.

FASB Illustrative Examples

ASU 2024-01 provided some illustrative examples to help make a determination of when profits interest awards are accounted for under Topic 718.

The following will be common assumptions under each of the illustrations:

- Entity X is a partnership
- Before 6/1/20X1, Entity X has Class A units outstanding
- On 6/1/20X1, Entity X grants Class B incentive units to employees of a subsidiary of Entity X in exchange for services
- An exit event may include an initial public offering, a change in control, or a liquidation of Entity’s X’s assets

Fact pattern #1 – Award is a Share-Based Award under Topic 718

1. Class B units are subordinated to Class A units
   – After vesting they participate pro rata with the Class A units once the holders of the Class A units have received distributions equal to a predetermined distribution threshold established on the grant date of the Class B units
2. **Class B units cliff vest at the end of 3 years of service**
3. **Upon an exit event, Class B units vest immediately** if a grantee is still providing services to the subsidiary of Entity X
4. **Upon exit event, the grantee would either:**
   – **Retain the vested Class B units**
   – Obtain proceeds if the Class B units are “settled” through the exit event
5. If a grantee terminates employment, any unvested Class B will be forfeited for no consideration
   – Reasons may be voluntary, death, disability, retirement, or reasons other than cause (at entity’s election)
6. **If grantee terminates employment after vesting, the grantee retains ownership of the vested Class B**
   – But upon termination, Entity X has a call right to repurchase the Class B
   – **If the call right is exercised, Entity X would pay the grantor cash equal to the fair value of the units on the call date**

Conclusion: Both of the following indicate that Entity X is offering to issue shares or other equity instruments placing this award under Topic 718:

1. Either upon three years of service or an exit event, the grantor will have received the agreed-upon consideration (i.e., the service will have been provided and the performance condition will have been met, if applicable) and the award will vest.
2. Holding the vested Class B units provides the grantee with the right to participate in the residual interest of Entity X through periodic distributions, upon an exit event, or upon settlement proportionate to ownership of Class B units of Entity X in accordance with the distribution waterfall.

Fact Pattern #2 – Award is a Share-Based Award under Topic 718

1. Class B units are profits interest awards subordinated to the Class A units
   - **Once granted, they participate pro rata with the Class A once the Class A holders have received distributions equal to the predetermined distribution threshold established at the Class B grant date**
2. **The grantee of the Class B is eligible to begin participating in nonforfeitable operating distributions at the grant date**
3. Class B units only vest upon an exit event
4. **Upon exit event, the grantee would either:**
   - **Retain the vested Class B units**
   - Obtain proceeds if the Class B units are "settled" through the exit event
5. Class B units are forfeitable upon the grantee's termination for any reason at any time before an exit event

Conclusion: Both of the following indicate that Entity X is offering to issue shares or other equity instruments placing this award under Topic 718:

1. Upon an exit event, the grantor will have received the agreed-upon consideration (that is, the service will have been provided and the performance condition will have been met) and the award will vest.
2. Holding the vested Class B units provides the grantee with the right to participate in the residual interest of Entity X through periodic distributions, upon an exit event, or upon settlement proportionate to ownership of Class B units of Entity X in accordance with the distribution waterfall.

The grantee of the Class B units is not entitled to retain the units if the grantee ceases to provide services before an exit event. Upon termination of employment before an exit event, the grantee of the Class B units would forfeit all rights to future distributions and would forfeit Class B units for no consideration. Entity X would account for the grantee's right to participate in nonforfeitable operating distributions in accordance with Topic 718-10-55-45. Dividend equivalents (the nonforfeitable operating distributions) paid to grantees on the portion of an award that vests should be charged to retained earnings. If grantees are not required to return the dividends or dividend equivalents received if they forfeit their awards, dividends or dividend equivalents paid on instruments that do not vest shall be recognized as additional compensation cost.

If an entity's accounting policy is to estimate the number of awards expected to be forfeited, the estimate of compensation cost for dividends or dividend equivalents paid on instruments that are not expected to vest shall be consistent with an entity's estimates of forfeitures. Dividends and dividend equivalents should be reclassified between retained earnings and compensation cost in a subsequent period if the entity changes its forfeiture estimates (or actual forfeitures differ from previous estimates).

If an entity's accounting policy is to account for forfeitures when they occur, the entity should reclassify to compensation cost in the period in which the forfeitures occur the amount of dividends and dividend equivalents previously charged to retained earnings relating to awards that are forfeited.

Fact Pattern #3 – Award is a Share-Based Award under Topic 718

1. Class B units do not entitle the grantee to receive equity instruments of Entity X
   - Often called "phantom share units"
2. Grantee of Class B is not eligible to participate in distributions in the ordinary course of business
3. Grantee of Class B is eligible to receive cash upon an exit event
   - Class B units vest immediately
   - **Must be settled in cash at the fair value of the Class B**
   - **Fair value is calculated using the Class A unit price at the date of the exit event**
4. The grantee of the Class B units must be providing services when the exit event occurs to receive any proceeds
5. Class B units are forfeitable upon the grantee's termination for any reason at any time before the exit event

Conclusion: The Class B units do not entitle the grantee to receive shares or other equity instruments of Entity X; therefore, Entity X is not issuing, or offering to issue, shares, share options, or other equity instruments. However, the cash proceeds received by the grantee upon settlement in an exit event are based, at least in part, on the price of Entity X's shares. Therefore, Entity X would account for the Class B units by applying the guidance in Topic 718.

Fact Pattern #4 – Award is Not a Share-Based Award under Topic 718

1. **Class B units do not entitle the grantee to receive equity instruments of Entity X**
   - Often called "phantom share units"
2. Grantee of Class B is eligible to participate in operating distributions made by Entity X **equal to 1% of the preceding fiscal year's net income**
   - An operating metric not tied to Entity X's share price
3. Grantee of Class B is eligible to begin participating in these operating distributions after 3 years of service
4. The grantee of Class B units is not eligible to participate in any proceeds distributed upon an exit event
5. Class B units are forfeitable upon the grantee's termination for any reason at any time
   - Including after the grantee has rendered 3 years of service

Conclusion: The Class B units do not entitle the grantee to receive shares or other equity instruments of Entity X. Therefore, Entity X is not issuing or offering to issue shares, share options, or other equity instruments. In addition, the proceeds received by the grantee related to operating distributions are based on an operating metric (1 percent of the preceding fiscal year's net income) of Entity X and are not based, at least in part, on the price of Entity X's shares. Finally, there is no circumstance in which Entity X would be required to issue its equity shares or other equity instruments. Therefore, Entity X would not apply the guidance in Topic 718 to account for the Class B units. Instead, the entity would account for the Class B units in accordance with other Topics.

Determining the Grant Date

A mutual understanding of the key terms and conditions of an award to an individual grantee should be presumed to exist at the date the award is approved in accordance with the relevant corporate governance requirements (i.e., by the Board or management with the relevant authority) if both of the following conditions are met:

1. The award is a unilateral grant and, therefore, the recipient does not have the ability to negotiate the key terms and conditions of the award with the grantor.

2. The key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. A relatively short time period is that period in which an entity could reasonably complete all actions necessary to communicate the awards to the recipients in accordance with the entity's customary practices.

Initial Measurement

The measurement objective for equity instruments awarded to grantees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when grantees have delivered the good or rendered the service and satisfied any other conditions necessary to earn the right to benefit from the instruments (e.g., to exercise share options). A share-based payment transaction shall be measured based on the fair value (or in certain situations specified in Topic 718, a calculated value or intrinsic value) of the equity instruments issued.

A nonpublic entity may not be able to reasonably estimate the fair value of its equity share options and similar instruments because it is not practicable for it to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity's share price (the calculated value). A calculated value is a measure of the value of a share option or similar instrument determined by substituting the historical volatility of an appropriate industry sector index for the expected volatility of a nonpublic entity's share price in an option-pricing model.

In rare circumstances, it may not be possible to reasonably estimate the fair value of an equity share option or other equity instrument at the grant date because of the complexity of its terms. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be accounted for based on its intrinsic value. An intrinsic value is the amount by which the fair value of the underlying stock exceeds the exercise price of an option. For example, an option with an exercise price of $20 on a stock whose current market price is $25 has an intrinsic value of $5. Note: A nonvested share may be described as an option on that share with an exercise price of zero. Thus, the fair value of a share is the same as the intrinsic value of such an option on that share.

Nonpublic Entity – Practical Expedient for Current Price

As a practical expedient, a nonpublic entity may use a value determined by the reasonable application of a reasonable valuation method as the current price of its underlying share for purposes of determining the fair value of an award that is classified as equity at grant or upon modification.

The determination of whether a valuation method is reasonable, or whether an application of a valuation method is reasonable, shall be made based on the facts and circumstances as of the measurement date. The measurement date is the date at which the equity share price and other pertinent factors, such as expected volatility, that enter into measurement of the total recognized amount of compensation cost for an award of share-based payment are fixed.

Factors to be considered under a reasonable valuation method include, as applicable:

1. The value of tangible and intangible assets of the nonpublic entity

2. The present value of anticipated future cash flows of the nonpublic entity

3. The market value of stock or equity interests in similar corporations and other entities engaged in trades or businesses substantially similar to those engaged in by the nonpublic entity for which the stock is to be valued, the value of which can be readily determined through nondiscretionary, objective means (such as through trading prices on an established securities market or an amount paid in an arm's-length private transaction)

4. Recent arm's-length transactions involving the sale or transfer of stock or equity interests of the nonpublic entity

5. Other relevant factors such as control premiums or discounts for lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the nonpublic entity, its stockholders, or its creditors

6. The nonpublic entity's consistent use of a valuation method to determine the value of its stock or assets for other purposes, including for purposes unrelated to compensation of service providers.

The use of a valuation method is not reasonable if that valuation method does not take into consideration when applying its methodology all available information material to the value of the nonpublic entity.

The use of a value previously calculated under a valuation method is not reasonable as of a later date if either of the following conditions is met:

1. The calculation fails to reflect information available after the date of the calculation that may materially affect the value of the nonpublic entity (for example, the resolution of material litigation or the issuance of a patent).

2. The value was calculated with respect to a date that is more than 12 months earlier than the date for which the valuation is being used.

GROUP STUDY MATERIALS

A. Discussion Question

1. Discuss the term *profits interest* and what it means for holders.

2. Discuss the effective date of ASU 2024-01.

3. Describe the elements that would meet the definition of a share-based payment transaction where the accounting would be under Topic 718, *Compensation - Stock Compensation*.

B. Suggested Answers to Discussion Questions

1. The term *profits interest* is not defined in GAAP but differentiates those interests from capital interests held by investors that provide those holders with rights to the existing net assets in a partnership or similar entity (for instance, a limited liability company).

   Because profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership, it can be complex to determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, Compensation—General, or other Topics). This can lead to diversity in practice, even when there are similar fact patterns.

2. For all other entities, the amendments are effective for annual periods beginning after December 15, 2025, and interim periods within those annual periods.

   Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance. If an entity adopts the amendments in an interim period, it should adopt them as of the beginning of the annual period that includes that interim period.

   The amendments should be applied either (1) retrospectively to all prior periods presented in the financial statements or (2) prospectively to profits interest and similar awards granted or modified on or after the date at which the entity first applies the amendments.

   If the amendments are applied retrospectively, an entity is required to provide certain specific disclosures in the period of adoption.

   If the amendments are applied prospectively, an entity is required to disclose the nature of and reason for the change in accounting principle.

3. The guidance in 718-10-15-3 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor's own operations or provides consideration payable to a customer by <u>either</u> of the following:

   1. Issuing (or offering to issue) its shares, share options, or other equity instruments to an employee or non-employee.
   2. Incurring liabilities to an employee or a nonemployee that meet either of the following conditions:
      a. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase *at least in part* is used because an award of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a market, performance, or service condition.)
      b. The awards require or may require settlement by issuing the entity's equity shares or other equity instruments.

The core definition did not change due to ASU 2024-01, but did reorganize the presentation of the requirements for enhanced clarity and readability.

PART 2. AUDITING

Insights and Tips on SOC Reporting

Many entities use outsourced services in their daily business operations, from payroll to billing and collections, to retirement plan operations. While outsourcing the services lifts some of the burden, it doesn't absolve the company from all of its responsibility. That's where system and organization controls reporting comes into the picture.

SOC 1 reports provide comfort on the controls of the service organization relevant to the user entity's internal controls over financial reporting. SOC 2 reports have a wider audience and report on the effectiveness of the controls of the service organization related to operations, based on certain trust services criteria. SOC 3 reports have a wider audience but also report on the effectiveness of controls. In recent years the AICPA has developed a framework for cybersecurity reports in this area, and reports specifically around an entity's supply chain.

SOC 1 and SOC 2 may be either a Type 1 or a Type 2 report. Type 1 reports address the design of controls at a point in time, while Type 2 consider the operating effectiveness of internal controls over a period.

Now let's join Sunish Mehta, a CPA and CGMA, for insights and tips on SOC reports.

Mr. Mehta

So folks, as we get into this topic, the real notion here is that this framework is designed to provide ultimately what we would consider, we used to call SAS 70 in the old days, as in service organizations. The thought process here is that in 2010, the AICPA established this system and organization controls framework. And, again, this framework was created for use by service organizations so that they can prove out to their clients, like for example, our user clients, in case we are the auditors of a user client of a third party service. And so we're going to try and provide you with a full comprehensive insight into the framework and what are all the different engagements and reports that are available.

We'll talk about the history of the framework. We'll also talk about the differences. You'll become familiar in terms of how to choose the correct engagement, regardless of your role, whether you're an external auditor to a user entity that uses a third-party service, or maybe you're in charge of governance of an organization. And we'll also talk about those additional SOC reports that the framework continues to release as we speak.

So the big pivot that took place historically in terms of why is it that we even have this system and organization controls framework is simply the notion that third-party services totally transformed from being traditionally into what we would consider typical things as in payroll or maybe claims processing or maybe mortgage claims processing, et cetera. And what changed with all of that was that a lot of these third-party services were now being done in the cloud

And so with the increase that we see in the number of applications that accountants and our clients need to conduct business in the cloud, again, all of this changed in the way we think about this entire framework. Now, when we think about cloud computing, these things include, but are not limited to bill management, enterprise resource planning applications, payroll services, sales tax processing, tax preparation, certainly workflow type products as well.

The benefits, of course, of working in the cloud include quick implementation, anytime access, lower upfront maintenance costs, and obviously easier and frequent updates. Of course, from our perspective as CPAs, security and reliability always remain top concerns for anybody switching to a cloud environment. And what's interesting with that is, I remember in 2013, the AICPA put out the survey of cloud computing and that's a long time ago now, and they asked CPAs around the US as to what their view was on cloud computing. Based on that survey, when they reported that in the Journal of Accountancy, they said the cloud computing framework or the cloud computing models that are starting to get implemented, of course, this is a while ago, they have a cloudy forecast. Because around 44 % of all CPAs basically don't like the notion of moving to the cloud for their clients or, matter of fact, for their own engagement software and management type tools.

Obviously, security, reliability, integrity of information, certainly availability of information was a big deal for us. Nonetheless, look at where we are as an economy, as a business environment. And certainly if you think about all the different things that have taken place over the last several years, including the pandemic, look at how much of this cloud computing environment has enabled us to remain connected and to manage and tackle certainly many of these things that we had to deal with in terms of challenging work structures, working remotely, again, internal controls, everything that would go into any type of a process for any kind of a business. And so, cloud computing really has become a mainstay per se, whether we like it or not, dealing with the cloud. And when you think about the cloud computing infrastructure, it really comes down to maybe primarily 3 models that we think about.

One would be what we would call IaaS, which is to say that it's an infrastructure as a service, as in the client or the business is hosting their entire infrastructure of technology directly in the cloud online. This is where they can benefit from not having to spend big capital expenditures on computers and networks and monitors and everything that is required, certainly, of a local area network or a local framework and everything would be processed directly on somebody else's hard drive. And that's what really a cloud is all about. And again, in this case, Amazon Web Services, certainly Microsoft Azure, and many of the big, big providers of infrastructure as service, that certainly is a big model.

We also have something called platform as a service (PaaS) That's where the cloud is used to build things, collaborative spaces directly, used on the web directly in the cloud where you could have multiple, perhaps users of that software or multiple builders of a website or a web app working together in remote areas around the world, but being able to collaborate directly on that platform.

The third key model these days we talk about is software as a service or the SaaS model. And that is something that I think most of us as CPAs primarily deal with. This is the notion that we're no longer having to go and install a local version of say QuickBooks versus just using QuickBooks Online. Where QuickBooks is no longer a service that is a self -install and maybe updated every so often versus just directly using it through a web browser that's compatible with the product anytime, anywhere access 24/7 access, regardless of the device that we use.

Another term that's come up lately, which people have been talking about, and I think this is an interesting place to be because I think we're headed there, is XaaS, which is everything as a service, as in really basically using everything on a subscription basis. If you think about it in this day and age, Excel 365, or for that matter, Office 365, when we look at the iCloud, when we look at Apple storage services, when we look at photo sharing, whether it's on the Android system, or certainly on the iOS system, so much of this is cloud -based where your local device, its computing power and or its memory is not as important anymore because everything is on the cloud. So these are the 3 big models that we think about in terms of certainly how the cloud is deployed. The notion simply is this, I no longer have to deal with these DVDs or to download the local install. I'm just using QuickBooks Online.

Now, of course, with all of this, we know, and again, certainly there's been a tremendous amount of evolution that's taken place, but something like QuickBooks Online some years ago was simply not something that was that great because there were a lot of flaws in it. It did not have all the bells and whistles of a local install of QuickBooks. Certainly, there were flaws, but today's version of QuickBooks Online has changed dramatically. So it's always interesting to see how all of these things evolve over time.

And when we think of the cloud deployment model as it relates to, again, service organizations, we can think about them in terms of four key deployment models. One is what we would consider to be a private cloud. A private cloud typically would be for a company that deals with high level security, deals with very secure data. They're very perhaps protective of their intellectual property, they're protective of the product designs, trademarks, patents, anything that is aerospace, pharmaceutical, sensitive type stuff, where the goal is that the organization would have their own private cloud, the servers and everything that is used in the infrastructure is completely private to just that business.

The second deployment model is what we would call the public cloud. This is where it's not that your information is shared with everybody because after all, you still have security over your information, but the infrastructure that is used for a public cloud will be shared. And this is where we get benefits of the economies of scale, where we have the ability to basically take advantage of the low cost. This is where Amazon Web Services, Microsoft, Azure, and all these big hosting companies of the cloud can really give us that price break.

There's also the hybrid cloud. A hybrid cloud is where maybe a company, an entity has certain things that they're very, very sensitive to in terms of managing all that in a private cloud, but then they have other information and other transactions that they can manage in a public cloud. So it's a bit of a Prius if you want to call it of a cloud.

Then the fourth model that we have in terms of deployment is what we call the community cloud. And that is primarily maybe in the space of, let's say, for example, census data that state level, a county level, a city level, a town level, certainly federal level agencies want to tap into for certain analysis when it comes to benefits, Medicaid, welfare, anything that is shared as a common pool of data is what we would consider to be a community cloud.

Then when you think about, again, how the cloud works in this day and age and how it's deployed, here are some thoughts around maybe some key things that I think CPA should be aware of. Keep in mind, this is not an all - inclusive list. This is just a list of cloud applications that I thought we should be aware of. For many of us, these are the type of apps that we're dealing with when it comes to cloud computing. Especially when it comes to maybe in the audit world, in the assurance world, your clients, where you are an auditor of a user entity, they're using a third party service like this that then needs to get that SOC audit done so that we as user auditors of this user client have comfort in knowing that build or maybe that ADP or maybe again, a claims processing entity or maybe a TPA, a third party administrator for a benefit plan, have their internal controls in place. So I'm just going to list out some of these things that I've put out here. Of course, all of you can certainly as you think about some of these cloud applications, if you yourself are interested in knowing more about them, you can always go in and do a search on these. Many of these sites will have certainly demos and displays of how these cloud products or applications work.

For audit confirmations, confirmation .com has become the mainstay when it comes to bank confirmations. They're starting to do A/R confirmations. They can also do attorney letters. And that primarily is in the space of an audit. From a billing perspective, we have bill.com, have Sage Billing Boss. We also have in the space of customer relationship management Zendesk is a big player, Zoho, NetSuite, Sage, CRM, and of course, Salesforce.com being the MacDaddy of all things when it comes to CRM products. From an enterprise resource planning perspective as a software that you can run to manage a business, for a small business, it might be something as, again, simple or maybe entry-level as QuickBooks Online. Certainly, NetSuite and Sage Intacct are cloud versions as well as some of these products that you can buy standalone. When it comes to financial statements, certainly BlackLine Systems is a well -known cloud -based system that helps essentially convert your financial statements into something that will be much more perhaps in compliance with the ability for you to furnish that to a bank, to a lender, etc.

ProfitCents is widely used, especially by CPA firms from Sageworks. It's a great tool to use in terms of analytics and also being able to do some industry benchmarking and doing some financial statements. With payroll, we can think about Paychex, ADP online, Intuit online payroll, Surepayroll. In the space of sales and use tax, Avalara is probably the biggest player there is in the cloud. From a document management perspective, certainly GoFileRoom from Thomson Reuters or SmartVault, are big players as well. When you think about, again, things that we think about in terms of accounting AccountantsWorld, SAP, which is of course the largest software company in the world that is used by big corporations. They have a cloud -based solution as well. Oracle Cloud Computing as well are big players. In the space of workflows, Gruntworx, FirmFlow, ProSystemFX, Workstream from CCH, Sureprep, and XCM are widely used by many CPA firms to manage their tax returns. And nowadays even audit engagements is something that we hear about. Again, these are products very, very commonly used.

Then if you think about analytics, certainly, that's a space that is continuing to grow. And the space of analytics, ProfitCents, QlikView, Kaggle, Tableau, which is now owned by Salesforce, Pentaho are big players where these products can be in the cloud. So you're no longer downloading to a data warehouse. You are offloading per se to some web -based cloud -based service that can extract data from your core accounting systems, your clients' core accounting systems.

And then do analysis in terms of providing your client with statistics, with data that they can use again from a third party perspective. And then from a tax perspective, certainly for CPAs, Drake, Intuit Tax Online, CCH Pro System FX Tax, Tax Wise, OLT Pro. From an audit perspective, the big binder softwares that are available now in the cloud are AdvanceFlow from Thomson Reuters, and of course, Checkpoint Engage from Thomson Reuters as well. There's engagement in the cloud from a binder perspective from CCH. So there's a lot of different products available that again, we might be want to be aware of in terms of what we think about in terms of our usage and our clients usage as well. But this fundamental transformation that has happened with cloud computing to drive us to where the old standards simply were not good enough in terms of its impact, in terms of what it covered, in terms of its comprehension of the business world, that's where the SOC or the SOC reporting framework, the System and Organizations framework really came in.

So let's get into some background information. And I always like to define things because that helps us a little bit. In terms of the setup, when we talk about the SOC reporting framework, first things first is let's think about service organizations.

Now, when we think about service organizations, basically, the notion here is that many companies may function more efficiently and profitably by outsourcing certain tasks or functions to other organizations that have the personnel, the expertise, or maybe the equipment for that matter to accomplish these tasks.

So here's a simple example. A health insurance company that outsources the processing of its medical claims to a claims processor. Now, at the end of a specified period, the claims processor reports the cost of those claims processed during the period and whatever that related liability is to the insurer. Then that information is included in the insurer's financial statements. That is the perspective of when we think about the service organization. As third-party services have moved to the cloud and as our economy has really moved to what we call a gig economy where there's a lot of outsourcing, the ability to have this open landscape where your clients no longer have to do everything in-house, they can outsource stuff. This service organization model certainly is something that we need to understand a little bit better. The auditor of the insurer's financial statements is responsible for auditing all of the information, let's say in this case of the insurance company's financials, including the information that was generated by that third-party service, the claims processor. And so the auditor needs to find a way to obtain evidence that supports the information generated by the claims processor and include it, of course, ultimately, in the insurers' financial statements. One way of doing so is to obtain what we call the service auditor's report, which a CPA examines the claims processor's description of its system for processing claims, as in what's taking place systemically in their internal controls, the suitability of the design of controls in the claims processor that affect the information that they would supply to the health insurance company in this case, and, in some cases also what is taking place in terms of the operating effectiveness of those controls. So not only a description, not only maybe another typical assurance where it's a walkthrough, but also maybe in some cases, a service auditor going in and performing tests of controls on that information so that once again, our client has trust in that information that's flowing through. And as a user auditor for a user entity, like if I was the auditor of this insurance company, I have some comfort as well.

Now, the organization that performs a task or function for the other entities would be called the service organization. So in this case, that's going to be the claims processor. And an entity that outsources a task or function to a service organization would be known as the user entity. In this case, it's the health insurer. The auditor auditing the financial statements of a user entity is known as a user auditor. The CPA reporting on the controls at the service organization is known as a service auditor. So the bottom line is that in the context of traditional financial audits, essentially what we're talking about here is there should always be four parties involved--the user, the user auditor, the service organization, and the service auditor.

Now, SAS 70, under the old standards that were superseded back in 2010, was the standard in place for reporting on a service organization's controls that impacted the user's financial statements. As I mentioned, innovations in technology, the increased use of outsourcing, basically led to these reports being used in ways that were never intended to be done. Specifically, the SAS 70 engagements were not designed to examine compliance and operational issues such as security, availability of the data in the cloud, processing integrity, confidentiality, privacy.

Also, this notion of being SAS 70 certified or SAS 70 compliant were terms that gained a lot of traction in the marketplace where service organizations would say, hey, we're SAS 70 certified; we're SAS 70 compliant. In reality, these were never allowed as part of the SAS 70 report. And the bottom line was that the AICPA realized that there was tremendous misuse going on around SAS 70 and something needed to change. Also, SAS 70 reports were meant only for service organization managements, existing user entities, and their auditors. This really restrict the use because, again, third-party services are doing so much more that maybe those charged with governance, like a board of directors, maybe management, maybe ownership, they were interested in knowing what these service organizations do and what kind of controls they have in place around maybe some operational concerns, in addition to, of course, internal control. So bottom line was that the SAS 70 framework just seemed a little outdated. The thought was, can we change this? The marketplace demand had grown for detailed reporting controls, such as subject matter other than internal control, including especially these five elements that we think about from an operational perspective. Security, availability, processing integrity, confidentiality, and privacy. As we mentioned, the changes in IT and the growth in cloud computing played a big role in everything just transforming. So SAS 70 essentially was split into 2 standards. One was for the service auditors back in 2011, and that was under what we used to call SSAE 16. SSAE stands for the statements on standards for attestation engagements. And the other standard that they issued was AU-C 402, which is the clarified audit standard for the use of the user auditors. So if I was that auditor of that insurance company that we talked about, my guidance came from AU-C 402. If I was the service auditor that actually did the audit of the claims processor, then I would use SSAE 16 back in the day.

SSAE 16 became effective for periods ending on or after June 15, 2011, and it lasted until April 2016. Then SSAE 18 superseded all SSAEs, primarily 10 through 17, in April of 2016, and SSAE 18 became effective. What changed then was that originally this framework, SOC, or SOC, was called the **Service** and Organization Controls Framework. And now we, of course, refer to it as the **System** and Organization Controls Framework. On the other hand, AU-C 402, which is the audit considerations related to an entity using a service organization, that's been in effect since 2012 year end audits to the present day.

So the 3 type of SOC reports that were issued initially that primarily dealt with what we had in terms of the SAS 70 replacement, and then, 2 additional reports were the following. A SOC 1 report was where a service auditor reports on the controls at a service organization that may be relevant to the user entity's internal control over financial reporting. Within that, we have 2 types. We have a Type 1 and we have a Type 2. We'll talk about the differences here shortly. A SOC 2 report was generated where a service auditor reports on controls at a service organization other than those relevant to an entity's control over financial reporting. So this got into operational concerns and we'll spell that out as well. And then a SOC 3 report was essentially a service auditor's report on whether an entity maintained effective controls over its system as it relates to the principle being reported on, such as security, privacy, availability, confidentiality, and some other concerns.

So now let's get into the SOC framework for user auditors of user organizations. So we'll deal with SOC 1s primarily, and then, we'll get into SOC 2s and SOC 3s. Question would beg, when does AU-C 402 apply for the user auditor of a user entity? It applies when the services that are provided by that third party service would impact the following: a significant class of transactions, say for example, payroll would be a good example; where ADP is processing payroll and they have a significant play in that matter in terms of what happens with payroll numbers, or a third-party administrator for a benefit plan would have a significant class of transactions that they would have an impact on for an employee benefit plan. Certainly [it applies], when transactions are initiated, authorized, recorded, processed, corrected, recorded in the GL and reported, when the services provided affect accounting records, supporting information and specific financial statement accounts involved, when those third-party services affect how significant events and conditions other than transactions are captured in the financial statements. Also, anything that would impact the financial reporting process, such as these journal entries like a payroll company would provide. And then, of course, anything where the third -party service would have controls over journal entries as well.

So the key thing to keep in mind is that as a user auditor of a user entity that uses ADP, uses a claims processing company for an insurance company, etc., I have to use guidance under AU-C 402. There were certain changes to the practice that came through as well. The inquiry of management about its awareness of fraud, noncompliance with laws or regulations or uncorrected statements now also included the service organization. There were strengthened requirements for the use of a service auditor's report. And the framework here in this case, AU-C 402 permits reference to the work of a service auditor in the auditor's report, which essentially, was a big play because as an auditor, who is, again, a user auditor of a user entity that is trying to audit a company that has information being processed by a third party, we would want to share that liability because simply put, I don't have the ability to go and do an audit of ADP. I don't have the ability to go into an audit of Paychex or some third-party administrative service for a benefit plan. I need to rely on that other auditor that's going to take care of that service organization. So the auditor's objective in terms of the use of service organizations was the following under AU-C 402. First things first was to obtain an understanding of the nature and the significance of the services provided by that third-party service and their effect on the user entity's internal control sufficient to identify and assess the risks of material misstatement. Now, why do we care about that? Because remember, under AU-C 315, which is over risk assessment standards, it is spelled out that as auditors, we are required to update our understanding of internal control on all audits.

Testing controls is a different question. I can test controls. Of course, if I choose to for a non -public entity as a cost-benefit, and from a compliance perspective, I may, of course, need to test controls if a company qualifies for a Sarbanes -Oxley audit. That's a publicly traded company that is under the threshold of SOX, different from SOC. And then, of course, compliance-based test of controls for single audits, governmental audits, etc. But outside of that, when I'm simply updating my understanding, many of us call it the D&I, looking at the design, evaluating the design of the controls, and verifying the implementation.

Of course, all of this is going into the assessment of the risk of material misstatement, because ultimately the risk of material misstatement includes 2 key risks, inherent risk and control risk. Inherent risk, of course, is going to be something that the client controls. All we can do is assess. And the client's inherent risk can be determined by so many different factors. And of course, with SAS 145 in place, we think about it based on the probability of misstatement and the magnitude of misstatement that we refer to commonly now as a spectrum of inherent risk. And so that is something that I like to say in plain English. It's already there, it's baked in the cake.

But on the other hand, as a user auditor, I need to assess the internal controls. And that goes into assessing the control risk part of the risk of material misstatement. And control risk of course is defined as a risk that a client's internal controls either do not prevent, detect, or correct something from going wrong. And so that's going to, of course, include my ability to understand what is taking place in terms of significant numbers that are coming from a third-party service, like, for example, a claims processor for an insurance company. And ultimately, that's going to help the user auditor design and perform audit procedures responsive to these risks. And when we think about that remembering with the audit risk model in place that the only real, what we call area that we, you and I, as user auditors of a user entity can impact is what we call the detection risk portion of the audit risk model.

With detection risk, the notion is that I can impact the detection risk by responding to my assessment of the risk of material misstatement via what we call the nature, extent and timing of what we do. The nature being whether I'm going to do substantive tests like analytics or test of details, or am I going to do something different in terms of maybe just simply inspecting something, observing something, maybe re -performing something, maybe recalculating something, maybe confirming something, maybe for that matter, even it's inquiring, of course, remembering on audits that we must of course corroborate all inquiry.

So bottom line being that if I'm a user audit of a user entity and I'm trying to assess all of this, I've got to include the service organizations play because their controls are going to dictate significant numbers that are reported in my client's financial statements. So certainly some of the requirements that we have in place of the user auditor are that we need to inquire of management about any fraud, non-compliance with laws and regulations, under AU-C 240 and, of course, AU-C 250, which is the illegal acts standard from an auditing perspective. These are the old days for SAS 99 and SAS 54, and uncorrected misstatements of the service organization that affect the financial statements as well. We also need to understand how the client uses the service organization and its operations in terms of the nature and significance of the services provided, the nature and the materiality of transactions processed or accounts affected, the degree of interaction between your user client and that third party service, and what is the nature of their relationship. Materiality will always be an important thing for us to look at because after all the two tools that we as user auditors of user entities have will always be two friends, materiality and risk assessment. We manage those. We can manage the amount of testing that we need to do.

So when we think about the use of the service organizations and the nature of services, what are the things that we can do in terms of obtaining that understanding of such types of services? Well, one thing we could look at is user manuals, system overviews, or technical manuals. I could always look at that contract or service agreement that my client has with that service organization. Certainly, I could look at reports by the service organization.

Maybe a client is big enough to where they have internal auditors. Maybe they have something from a regulatory authority and those are things that can help as well. Then, of course, we can look at service auditor reports, as in what we think about as SOC reports, and then, of course asking questions or observing the client or that service organization person or personnel.

When it comes to the significance of processing, because we always care about materiality, we always care about what it is in terms of how significant is it in its role. Say for example, payroll would always be significant. For an insurance company, claims processing would be significant. For an employee benefit plan, the third -party administrator would be significant. Maybe for a situation where their user entity has outsourced its entire IT infrastructure to Amazon Web Services or one of these big infrastructure service providers, essentially you are running everything on someone else's hard drive, that might be significant as well. So we look at the interaction of the client's internal controls that our client has with that service organization. As in, are they looking at testing the numbers that are being provided to them by the service organization? We also need to consider the nature of the services being provided and ultimately, of course, the good old word *materiality*, which always will play a very big role in our understanding of how we go about managing the work that we do.

Now, what is the degree of interaction? The question here to ask ourselves is, is our client, the user entity, able to implement effective controls over any transactions that are processed by the service organization? And if so, then we need to evaluate the design and implementation of those relevant controls that relate to the services provided by the service organization. Because again, that's going to be part and parcel of, of course, what we think about in terms of internal controls.

Now, generally speaking, and this is an important statement here to remember, if the client has effective controls, then we would think that the service organization's controls are not a significant part of the controls over what we would consider the cycle of initiation, of recording, of processing, and ultimately, reporting of the transactions. So if your client has a high degree of interaction, a good solid set of complementary user controls. Maybe I can deem that whatever it is that the third-party service is doing, whether it's payroll, whether it's, again, mortgage processing or claims processing, etc., I don't have to pay that much attention, but that's in theory.

So I'll tell you a little bit about what's happening practically with all of this. So if we look at perhaps the following scenarios, let's look at the degree of interaction as in, do you think it's likely lower or higher? The first scenario, in a discretionary investment arrangement, the service organization initiates securities transactions and the client chooses to rely entirely on the results reported by the service organization. So they're not really doing anything in terms of testing, anything that we would consider in terms of looking at complementary user controls. So clearly in this case, the degree of interaction is going to be lower, and as a user auditor of such an investment arrangement type company, we're going to need to heavily rely on another auditor coming in and looking at whatever that service organization is doing.

Let's look at another example here. A client uses a service organization to process its payroll transactions, including the required tax filings. The client performs the reconciliations and performs the tests over the service organization's controls. So we could say in this case, clearly there's going to be a higher level of interaction because the user entity is testing a whole bunch of stuff provided by the service organization. So what is the bottom line? Bottom line is in a situation like this, I'm going to have to look at a SOC report and I'm going to have to rely on what the third-party service auditor does for that third party service.

On the other hand, in a situation where the degree of interaction is very high, I may decide that I don't need to worry about a soft report because in all reality, I can look at the D[esign] and the I[mplemtation] of my client and go along with that and figure out that, ha, they have good controls in place. Now, again, this is in theory. Now, the reality of this type of situation is the following. I don't know of a single audit firm that I have worked with over the last gazillion years, I could say, or at least 15 years, that has not used a SOC report when they are in a situation where they are the user auditor of a user entity that uses a third-party service. Because as auditors, we know as practitioners, that liability matters. The less liability we can take on or the more liability that we can share, the reality is that if there is a SOC report available, it's better.

Let's just say that our client uses ADP. Now ADP is kind of like Excel. The whole world uses ADP. It's a commodity-type software. They will go through regularly getting all these tests done because they want to prove out to governance, they want to prove out to their clients, certainly that they are trustworthy in terms of confidentiality, integrity of information, availability of information, privacy, security, all of this good stuff. Good controls in place over the numbers because they do provide journal entries for most of our clients.

Now, if my client still went in and did a whole bunch of testing on the numbers that came in from ADP, there's a good chance it's an auditor. I'm going to say, wait a minute, it's ADP. They've got a SOC 1 Type 2 report, let's say available. Let's use that. Let's reference that because we want to share the liability. That's just natural because again, we live in an environment when it comes to public accounting and auditing and whether it's certainly anything that deals with internal controls and risk, where we are a self -regulated vocation, a self -regulated industry, peer reviews, regulations conformity, but the standards greatly matter, and so does then liability play a role in all of this.

So let's dig a little bit into the complementary user controls because in theory, we don't have to then look at the service organization's controls if they are strong. So user entity might have its own controls over the services provided. So for example, you may have logical access by the user entity personnel or completeness and accuracy of inputs submitted to the service organization, which seems fair or reconciliation of the data received from the service organization to its own records of data submitted. I think that's the real driver, because ultimately, when you think about it, what is ADP going to do? ADP is going to simply say, company, give us your wage rates. I'm going to take those. I'm going to look at your employees' withholdings. I'm going to process the numbers for you, and then, supply you with the journal entries that you need to input into your system so that your payroll records are reflected correctly. That's the bottom line. The data still starts with your client. So in this case, that reconciliation might be a good solid complementary user control.

Also, we think about the user auditor in terms of should they evaluate the D&I of the controls applied by the user entity that relate to the service organization's processing. Finally, the user auditor might find it useful or necessary to test those controls at the user entity. And that's going to be judgment based in terms of what's taking place with a client and what is a professional judgment of that user auditor of the user entity.

We also have something available in this framework that we might consider to be agreed-upon procedures where it's sort of just doing a plain SOC 1 Type 1 or a Type 2 engagement. Maybe the client hires us or a third-party like an investor, a stakeholder, etc. They invite us to come in and say, okay, these are the procedures that we would like you to do on this service organization and provide us with the results.

And, of course, with the agreed-upon procedures, the two documents are going to look identical, would be the engagement letter, the contract, and of course, the report, the difference is the report would have the results of what we find. So this may cover the test of controls, substantive tests or both. Again, the procedures performed are agreed upon by the user entity and its auditor, and the service organization and the service auditor. That's why whenever we think about agreed-upon procedures, the distribution of that report is going to be limited to the parties involved because anybody outside that framework would not understand what is taking place. Also, agreed-upon procedures may be more effective for the user entity's auditors because it can be directed at those policies and procedures or financial statement assertions that are of direct interest, whether it's completeness, whether it's existence, whether it's occurrence, et cetera. All of those things will come into play.

So let's talk about the uses of a SOC 1 report. As a user auditor for a user entity, you would be interested in looking at a SOC 1 report to evaluate whether the date or time period is appropriate for the audit purposes, evaluate whether the evidence supplied by the report is sufficient and appropriate to understand any of those relevant internal controls, and finally, to determine whether complementary user entity controls identified by the service organization are relevant. And if so, then we need to obtain an understanding of whether the user entity has designed and implemented such controls. Evaluating the design means that that control prevents, detects or corrects something from going wrong. The implementation means that they're actually doing it. They both are equally important because if I went and did a walkthrough around things that were not really effective or did not mitigate something from going wrong, then what's the point of me doing that walkthrough and just going through the motions on something? On the other hand, if we just do an evaluation of something and we don't see that the client has actually implemented it, then it's meaningless as well. D &I, design and implementation, go hand in hand. So that's a little bit about AU-C 402, and what we would think about in terms of the governance that we have from the standards when it comes to, of course, those of us who are user auditors of user entities that use service organizations in this big gig economy.

Now let's look at the SOC reporting framework for service organizations in terms of what are these different engagements, and ultimately, what do they do in terms of the work. So what changed? The need was, of course, recognized that, not only do we have internal controls that we care about, but again, governance, those charged with governance or maybe even ownership or management might be interested in making sure that the third party service has good controls over several of these operational concerns that we have listed here. So that's something that again was a big deal. There was also a consolidation for all options, but reporting on controls and service organizations again via the SOC reports. There was a new emphasis and focus on supporting the public interest by helping CPA firms and service organizations and correctly applying and using the updated standards.

So, what changed? Essentially, on the SOC reporting framework, we have 3 types of reports to help service organizations demonstrate reliability. Again, the core of the SOC reporting framework, of course, there's some additional reports that are now being added. Also, the notion was that the CPA and the client would determine the proper engagement for the specific market need. And then, knowing what was taking place with SAS 70 up until 2011, where there were service organizations claiming that they're SAS 70 certified or SAS 70 compliant, the AICPA and the Auditing Standards Board realized that there is a need for service organizations to advertise and to publicize that they can be trusted. So in this framework, they also came up with logos that can be used by the service organization's marketing in terms of any literature and their websites as well.

So here's the way to look at it from a framework perspective when it comes to the original three. SOC 1 Report is carried out under the guidance that we get from SSAE 18, again, statements on standards for attestation engagements. Again, for many of you, or certainly in general, my audience tends to be primarily user auditors. But if you are performing a service audit, then this is the place that you get your guidance from. Now, what I've seen over the years is that more and more firms have recognized that this is a revenue source. So they tend to go in and hire people with IT talent, people that have a lot of background with internal controls. Those are the kinds of people that can go in with their skillset and perform these type of service audits under SSAE 18. The report is restricted, as in it's restricted in terms of its usage. There is a Type 1 and a Type 2. And this here would primarily report on the controls for financial audits. So this here, SOC 1, is the clear replacement of SAS 70. That is the only SOC report that we think about in terms of the framework of a user auditor auditing a user entity that uses a third-party service that is now being audited by a service auditor.

The AICPA also realized that, wait a minute, there are other concerns. So they came up with a SOC 2 report, and under the SOC 2 report, the guidance comes from attestation standards (AT) 101 and also the trust services principles and criteria established by the AICPA. This is a restrictive report as well, and we have 2 types, Type 1 and Type 2. We'll get into that detail here. This is going to be a report on the controls related to compliance or operations. They also came up with a SOC 3 report, again under attestation standards 101 using the trust services principles and criteria. This is what we call a general use report. This is not restricted. This is something that a service organization can advertise and it reports on the controls related to compliance and/or operations.

Another way to look at this grid would be maybe something like this. SOC 1 will assess internal controls for financial reporting. The control domains will be transaction processing and supporting ITGCs, which are what we would consider entity level IT controls, security, day -to -day operations, change management of systems, etc. From an audit focus, the service provider defines its control objectives, and the variable type of service involved. The distribution is restricted to the users and the auditors. On the other hand, a SOC 2 assesses internal controls for compliance operations, not financial reporting. This is where the control domains would include infrastructure, software, people, procedures, data. And this is a standardized trust services category report that would focus on the security of the information, the availability of the information, the processing integrity of the information, the confidentiality of the information, and the privacy. And finally, when you think about a SOC 3, it's a smaller scale SOC 2 report for general distribution and sometimes marketing purposes. It's going to involve essentially the same infrastructure, the same five key areas, but the key difference here is that a SOC 3 is unrestricted versus a SOC 2 is restricted to that specific group of people in terms of user auditors and anybody else that is specified in terms of who can receive those reports.

So let's look at the SOC 1 report first. Again, this is reporting on controls at a service organization relevant to the user entity’s internal control over financial reporting. This will meet the needs of the user entity’s management and auditors as they evaluate the effect of a service organization's controls on the user entities financial statement assertions. These reports are important components of the user entity’s evaluation of their internal controls over financial reporting for purposes of compliance with laws and regulations, and for when the user entity auditors plan and perform their financial statement audits. So this is a restricted use. This report is again on internal control. The engagement is performed under SSAE 18. Again, the auditor obtains the same level of evidence assurance as in the old SAS 70 service. There is also an AICPA audit guide applying SSAE 18 when it comes to the SOC reporting framework.

What are the contents of the report package in this case? This is where we would have a description of the service organization systems. There would be a management assertion about the description. And then finally, the CPA's opinion on the fairness of the description, the suitability of the design, and if so, the operating effectiveness of those controls.

Type 1 and Type 2, what is the difference? Both report on the fairness of the presentation, but here's the difference. Type 1 would report on the suitability of the design of the controls to achieve the related control objectives included in the description as of a specified date. So the easiest way to think about this would be that there's a description of the internal controls and somebody performed a walkthrough. One transaction, one date through the entire steps of that, supply chain process and/or a sub-process within the supply chain of space. The difference with the Type 2 would be that, not only does it report on the suitability of the design, it also does a test of controls and it reports on the operating effectiveness of those controls to achieve related control objectives included in the description throughout the audit period. So this is where we would look at TOCs, or test of controls.

Over time, initially a lot of companies just did SOC 1 Type 1s. But then they started realizing that to really be trustworthy, to really be much more transparent, to really have basically a say in the sense that not only are we doing this as of a point in time, but we're doing this on a regular basis, SOC 1 Type 2s became much more popular where the service auditor is going to perform test of controls.

So what you see happening over time is that most user auditors prefer to obtain a SOC 1 Type 2 versus a SOC 1 Type 1 because a Type 2 is going to provide more assurance than simply putting the fact that the service auditor has performed TOCs throughout the audit period, of course, depending on the frequency of those controls. Also, there is a requirement for this written assertion that SSAE 18 brought into place.

The service auditor must obtain a written assertion from the service organization's management about the fairness of the presentation of the description of the service organization system and about the suitability of the design. And then if there is a Type 2 engagement, then of course that needs to include operating effectiveness of the controls in that written assertion. The written assertion will either accompany the service auditor's report or it can be included in the description of the service organization's system. More often than not, in my experience, we see it accompanying the service auditor’s report.

Some other notable items for auditors. There is a minimum specific criteria for evaluating the fair presentation of the description, the controls are suitably designed, and that the controls are operating effectively. There's also modifications available within the framework to these reports where there could be certain modifications done. And there's examples that are provided by the AICPA in their audit guide to SOC 1 reports.

With type 2 reports, there is no reliance on prior testing. And in a situation where the control testing is performed by an internal auditor for larger companies, then there's a reference in the description of the TOCs, the tests of controls, and there's also an explanation of the procedures performed on the work.

What is the content of a SOC 1, Type 1? You will have a description of the system organization system. Then you will have that written assertion from management of the service organization. So say the insurance company's claims processing company, and or ADP or Paychex or TPA, all of these service organizations, that the description fairly presents the system as designed and implemented as of that specified date, walkthrough, and that the controls related to control objectives stated in the description system were suitably designed to achieve these objectives as of that specified date, walkthrough, and then, of course, the assurance report.

A Type 2 would include the description, but then in this case, they're going to have a written assertion for management of the service organization that the description fairly presents the service organization system as designed and implemented notice ***throughout*** the specified period and that the controls related to the control objectives stated in the description of the system for the service organization were suitably designed throughout the specified period to achieve those control objectives. And those controls are operated effectively ***throughout*** the specified period to achieve those control objectives. And then of course you have the actual report. This is why a Type 2 tends to be much more prevalent, much more perhaps favored on by user auditors of user entities that use service organizations.

Now, a SOC 2 report. This is where the audience is going to change. Now we're walking away from the SAS 70 conversation. We're walking away from an audit. This is something that can happen regardless of whether an entity is audited or not audited, has nothing to do with our assurance hat on. This is where the reporting will happen on controls at a service organization relevant to these five operational concerns of security, availability, processing integrity, confidentiality or privacy. This is for those who need to understand the internal controls of a service organization as it relates to these concerns. They can play an important role in the oversight of the organization or maybe vendor management programs, internal corporate governance, and risk management processes, and maybe just plain regulatory oversight. Stakeholders who may use this report include management, those charged with governance, the service organization, customers maybe, maybe regulators, maybe business partners, maybe suppliers, amongst others. So here, the reports will be relevant to those five operational concerns that we've listed. The engagement would be performed under attestation standards 101, and there is an AICPA guide for these types of control reports. And the contents would be quite similar to the SOC 1 report. SOC 2 reports can help user entity management obtain information about a service organization's controls over the system through which the services are provided. They can also help assess and address the risks associated with them, outsource service, carry out its response for monitoring the services. And ultimately for most of us, privacy, confidentiality and security generally are higher concerns for software reports as compared to availability and processing integrity. Though if you really think about it, if you wear again an assurance hat, integrity greatly matters. And if things are online, given what we just talked about in terms of so much of this work now being done directly online through the cloud, then would availability greatly matter? Because if the information is not available in the cloud, then where are you going to transact? So it's interesting how these 3 are big. I suspect the other 2 do play a big role as well.

We have Type 1 and Type 2 in this space. A type 1 would be simply the suitability of the design of controls and maybe a walkthrough. A type 2 would be the suitability of the design and operating effectiveness of these compliance, again, operational controls versus again, purely financial reporting controls.

Then we have a SOC 3. This is again, under the guise of the trust services principles criteria and illustration. This is designed to accommodate users who want assurance on a service organization's controls, again, related to security, availability, processing, integrity, confidentiality, or privacy, but they don't need the detailed and comprehensive SOC to report. It can be used in a service organization's marketing efforts as well. So the general use here would be, attestation standards 101, and then the AICPA trust services principles (TSP), criteria, and illustrations, and the content would be a description of the system and its boundaries, much less than a SOC 2 report. The assertion by management regarding the effectives of controls and meeting these applicable trust service criteria, and eventually that service auditor's opinion of whether the entity maintained effective controls over its system.

So here's an example of what we might think about in terms of a service auditor SOC 3 report and how it might look. And so again, this is directly from the AICPA guide, and this is an illustrative management assertion service auditor. So in this case, we have our scope where we've examined ABC's accompanying assertions titled Assertion of ABC Service Organization Management under of course the TSP, etc., the service organization's, what we would consider responsibilities, the service auditor's responsibilities, any inherent limitations, and then the opinion around, again, in this case, controls within ABC's chatbot system are effective throughout the period, et cetera. So that's a SOC 3 report illustration from the AICPA. So a little bit of breakdown in terms of what we might think about when it comes to the five operational concerns that primarily, of course, SOC 2 and SOC 3s relate to. So when we think about security, availability, of course, confidentiality, process integrity, within security, the big thing that we really think about perhaps that comes to mind is that every report includes security as part of the common criteria. Then the management can choose which of the other criterias they'd like included in the examination. Security is going to be a given. And for instance, if you believe a service provider is dealing with confidential information, then you should also push for the trust services categories to be included. Those trust services categories applied to the system components during an examination, where we might think about maybe infrastructure, the physical infrastructure, IT, other hardware, facilities, computers, equipment, mobile devices. Also, what are those devices that we use for telecommunication on the networks? Software, this would include again, application programs and IT system software that supports application programs, such as operating systems, middleware, utilities.

People. Again, the personnel involved in the governance operation and use of a system, namely developers, operators, entity users, vendor personnel, and of course, managers. Procedures, are they automated or are they manual? And then data, transaction streams, files, databases, tables, and the output user processed by a system.

When you think about the different criteria topics by the different categories that a . . . a SOC 2 and a SOC 3 would be looked at these are some of the things that are sub-bullets within each category. So within security, we might think about the client's IT security policy, maybe their risk assessment, logical access and physical access as an informational access and, of course, lock and key type access. Anything around systems development, maintenance would be a big one. Under availability, what's the policy? What about backups and restores? That's a big, big deal. Disaster recovery can be huge.

Under confidentiality, what is their policy? What about data processing? What about information disclosure? Under processing integrity, the completeness, accuracy, timeliness, and authorization of inputs, system processing, and outputs would be a big one. Information tracing from source to disposition, that'd be a big one as well. And then under privacy, we can think about certainly PII, which we consider personally identifiable information and the classification of that. Look at incident breach management could be a big one. Also disclosure of third parties and then ultimately monitoring and enforcement would be big ones as well.

Now there are advancements that have been made in the trust services criteria categories. They were updated to align with the committee of sponsoring organizations, what we call the COSO 2013 framework. So as many of you know, in the past we used to have COSO that was developed way back in the early 90s. And then of course COSO was updated in terms of the framework so that it can reflect what we would consider today's business world, because when COSO was already written, the internet was still in its infancy. What did not change were the five components of control that we think about in terms of the control environment, the client's risk assessment process, information and communication where this would play a big role, certainly monitoring, and then, of course, activity level controls. The adoption date for examinations ending after December 15, 2018, with early adoption was permitted and the implementation of SOC 2s would include Health Information Trust Alliance and other criteria as well. Data integrity may be added as a sixth trust services category that was not explicitly spelled out originally.

So to do a recap on these 3, SOC 1, SOC 2s, and SOC 3s. Who are the potential users? What is the purpose and what is the objective? For a SOC 1, we're looking at the user's controller's office and user auditors. The purpose would be for audits and financial statements. And we really are dealing with controls related to financial reporting. With a SOC 2, the potential users are going to be management, regulators and others. The purpose would be any kind of governance program, oversight or due diligence. And here the objective is around those five concerns of security, availability, processing integrity, confidentiality and privacy. A SOC 3 would be any user with the need for confidence in that service organization's controls. The purpose would be purely marketing. The details are not required. And in this case, a SOC 3 seal can be for an easy to read report for anybody directly on that service organization's website and/or anything they have in place in terms of their marketing materials.

Another way to think about this would be the following. Ask these questions. Will the report be used by your customers and their auditors to plan, perform, and audit their financial statements? If the answer is yes, that's a SOC 1 report, type 1 or type 2. Second question. Will the report be used by the customers and or stakeholders to gain confidence and place trust in the service organization system? If the answer is yes, this would be a SOC 2 or a SOC 3. Finally, does a report need to be made generally available or is the report seal needed? If the answer is yes there, that is going to be a SOC 3 report.

So if you're in a situation where you're trying to figure out SOC 1 or SOC 2, question you would ask, what processes are we performing for the user entity? Do they relate to internal control over financial reporting for the user entity? If the answer is yes, SOC 1. If not, most likely it's an operational concern, SOC 2. And further, do your customers have the need for and/or the ability to understand the details of processing and the controls at a service organization, the tests performed by the service auditor are the results? If the answer is yes, you most likely need a SOC 2, Type 1 or Type 2. And if the answer is no, you can get away with the lighter, easier, less work done report, which is a SOC 3. And that's just a way to kind of really break this down further.

Now we have some new reports that have come out since the original SOC 1, SOC 2, and SOC 3. And that was perhaps one of the big reasons why the AICPA chose to create a framework because within that framework, they now have the ability to issue new reports based on certain needs that again, could be technology oriented, could be rules and regulations oriented, could be certainly anything that's coming down the pike in terms of changes.

So the first one that came out after the SOC 1, 2, and 3 reports was what they call the SOC for Cybersecurity. This was introduced in 2017. This is for businesses, not -for -profits, and virtually any other kind of organization. This provides a user with information about what we call CRMP, as in that specific entity's Cybersecurity Risk Management Program. Its intended users are managers, directors, general users like, for example, an analyst, an investor, any other party who might be impacted by the effectiveness of that entity's cybersecurity risk management program. And this is going to be a general use report available to anybody. Test of controls performed, but details are not included. So that was a big one because of course, in this day and age of working in the cyberspace, given the fact that there's a lot of issues around security, this was certainly a big player.

In March 2020, they also introduced the SOC report for vendor supply chains. And this is for customers of manufacturers and distribution companies to better understand cybersecurity risks in their supply chains. So in this day and age, if you think about it, supply chains have become rather virtual. When you look at the supply chain process in general, with supply chain management, vendors are connected to their customers, customers as in our clients may be connected to their customers, so that every single time an order comes in from a potential customer, your vendor who supplies you the raw materials would have immediate access to what is it that they need to do in terms of what you're going to ask from them. And so the connectivity of supply chain virtually, of course, will create cybersecurity risks in and of themselves. And that's why we have this, of course, report available as well. Now, the SOC application, when you think about it, the SOC reports commonly apply to maybe accounting, benefit management, billing, collections, finance, insurance, clearing houses, IT setups, market research, payroll, investments, data centers, software vendors, and certainly cloud service providers as well.

So some tips and insights when you think about, again, the SOC reporting framework. The goal ultimately would be that we are trying to provide a readiness assessment for the financial audit client or a potential SOC client. You can combine SOC 1 and SOC 2 engagements. Remember, we need to always issue separate reports because the criteria that you're, of course, examining and the rules or the principles that you're using based on the standards that are in play are going to be different.

The audit opinion in a SOC 2 report attests to whether the relevant AICPA trust principles and criteria are met. So this is an important note. If the controls are not suitably designed or operating effectively rather to meet one or more of the applicable trust services criteria, then an explanatory paragraph should be added to the opinion resulting in a qualified audit opinion. That's something we will always remember.

We're not talking about an unqualified except for, but rather a qualified audit opinion. Pretty strong. You want to try and time the SOC engagements as close as to the financial audit timeframes of the user companies, as that way the SOC reports would be most needed by the user company. If not, then certainly you can do semiannual SOC engagements to satisfy multiple user companies with various fiscal audit years. So a good example of this would be a company like confirmation.com, which is used primarily by auditors, clients, and banks on financial statement audits. They go in and get their SOC reports done more often so that regardless of what the client, as in our user entity and their client as well, depending on their fiscal year end, there'll always be a SOC report available that is closest to that year end versus relying on something that was done 11 months ago or 10 months ago. You also want to leverage the AICPA audit guides for SOC reports in terms of testing procedures, exception reporting guidelines, and potential reporting modifications.

Now, given that the SOC reporting framework has been in place since 2011, so it's been many years, even so, there's a lot of confusion as to what needs to be done on these reports, especially for anybody that's a newer firm that's embarking on taking on this kind of work where they've gone in and hired, maybe a CPA who's got perhaps more experience with controls or technologies, etc. So it's a good idea to leverage the AICPA guides around this because they do provide us with a framework and that's why they have the rules and that's why they can provide us with the guidance. And this is again, all available directly on a dedicated page on the AICPA's website.

GROUP STUDY MATERIALS

A. Discussion Questions

1. How has the evolution of cloud computing impacted the need for SOC reporting, and what challenges does this present for auditors?

2. Discuss the key differences between SOC 1, SOC 2, and SOC 3 reports, and explain how an organization might determine which type(s) of report they need.

3. How might the introduction of SOC for Cybersecurity and SOC for Supply Chains reports affect an organization's overall risk management strategy?

4. Explain the importance of complementary user entity controls in SOC reporting and how they impact the responsibilities of both service organizations and user entities.

5. Discuss the potential implications of receiving a qualified opinion in a SOC 2 report and how this might affect a service organization's relationship with its clients.

6. How might the alignment of trust services criteria with the COSO 2013 framework impact the way organizations approach their internal control structures?

B. Suggested Answers to Discussion Questions

1. Cloud computing has significantly transformed the business landscape, moving many critical services to third-party providers. This shift has increased the importance of SOC reporting, as companies rely on these reports to gain assurance about their service providers' controls. For auditors, this presents challenges in understanding complex cloud environments, assessing the relevance of controls, and evaluating the impact on their clients' financial reporting and operations. Auditors must stay updated on cloud technologies, understand the different SOC report types, and be able to interpret their implications for their clients' risk assessments and internal control evaluations.

2. SOC 1 reports focus on controls relevant to financial reporting, while SOC 2 and SOC 3 address operational concerns such as security, availability, processing integrity, confidentiality, and privacy. SOC 1 and SOC 2 are restricted-use reports, whereas SOC 3 is for general use and marketing purposes. An organization should determine its needs based on its services and stakeholders. If the service directly impacts clients' financial statements, a SOC 1 is appropriate. For services handling sensitive data or critical operations not directly tied to financial reporting, a SOC 2 is suitable. If the organization wants to broadly demonstrate its commitment to controls for marketing purposes, a SOC 3 can be valuable.

3. The introduction of SOC for Cybersecurity and SOC for Supply Chains reports provides organizations with more comprehensive tools for risk management. These reports allow companies to assess and communicate their cybersecurity measures and supply chain risks more effectively. By obtaining these reports, organizations can identify potential vulnerabilities in their cybersecurity programs and supply chains, leading to improved risk mitigation strategies. Additionally, these reports can enhance stakeholder confidence by demonstrating a proactive approach to managing emerging risks. Organizations may need to reevaluate their risk assessment processes to incorporate these new areas of focus and potentially allocate additional resources to address identified risks.

4. Complementary user entity controls are critical in SOC reporting as they highlight the shared responsibility for effective control environments. These are controls that the service organization assumes user entities have implemented to achieve control objectives. For service organizations, identifying these controls help define the boundaries of their responsibilities and ensures a comprehensive control framework. For user entities, understanding and implementing these controls is crucial for fully benefiting from the service organization's controls. Auditors of user entities must evaluate whether these complementary controls are in place and operating effectively. This shared responsibility model emphasizes the need for clear communication and coordination between service organizations and their clients to maintain a robust control environment.

5. A qualified opinion in a SOC 2 report indicates that one or more controls are not suitably designed or operating effectively to meet the applicable trust services criteria. This can have significant implications for a service organization. It may erode client confidence, potentially leading to lost business or increased scrutiny from existing clients. The organization might face requests for additional information or remediation plans from concerned clients. In competitive markets, a qualified opinion could be a disadvantage when bidding for new contracts. However, it also presents an opportunity for the organization to demonstrate its commitment to improvement by addressing the identified issues promptly and transparently, potentially strengthening client relationships in the long run.

6. The alignment of trust services criteria with the COSO 2013 framework creates a more cohesive approach to internal control across financial and operational aspects of an organization. This alignment encourages organizations to view their control environment more holistically, considering how operational controls (addressed in SOC 2 and SOC 3 reports) interact with financial reporting controls (addressed in SOC 1 reports). Organizations may need to reassess their control structures to ensure they address all components of the COSO framework effectively. This could lead to more integrated risk assessment processes, improved information and communication systems, and more comprehensive monitoring activities. Ultimately, this alignment can result in a more robust and efficient overall control environment.

GLOSSARY

IaaS—Infrastructure as a Service

PaaS—Platform as a Service

Profits interest holders—Holders of interests different from capital interests held by investors that provide those holders with rights to the existing net assets in a partnership or similar entity (for instance, a limited liability company). Profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership

SaaS—Software as a Service

Service auditor—CPA reporting on the controls at the service organization

Service organization—Organization that performs a task or function for other entities

SOC 1 report—A service auditor reports on the controls at a service organization that may be relevant to the user entity's internal control over financial reporting—Type 1 or Type 2

SOC 2 report—A service auditor reports on controls at a service organization other than those relevant to an entity's control over financial reporting; more operational in nature

SOC 3 report—A service auditor's report on whether an entity maintained effective controls over its system as it relates to the principle being reported on, such as security, privacy, availability, confidentiality, or processing integrity

User auditor—Auditor auditing the financial statements of a user entity

User entity—An entity that outsources a task or function to a service organization

XaaS—Everything as a Service

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

1. According to Jennifer Louis, what was the primary reason for issuing ASU 2024-01?

   A. To eliminate profits interest awards.
   B. To reduce complexity in determining if Topic 718 applies to profits interest awards.
   C. To increase the use of profits interest awards by public companies.
   D. To create new accounting rules for stock options.

2. According to Jennifer Louis, when is ASU 2024-01 effective for public business entities?

   A. Fiscal years beginning after December 15, 2023.
   B. Fiscal years beginning after December 15, 2024.
   C. Fiscal years beginning after December 15, 2025.
   D. Immediately upon issuance.

3. According to Jennifer Louis, which of the following best describes a share-based arrangement under Topic 718?

   A. An arrangement where employees receive cash bonuses.
   B. An arrangement where investors receive preferred stock dividends.
   C. An arrangement where customers receive discounts on future purchases.
   D. An arrangement where suppliers receive equity instruments or equity-linked liabilities.

4. According to Jennifer Louis, which of the following is ***not*** a factor in evaluating how to account for share-based payment awards?

   A. Whether the recipient has an economic interest in the entity
   B. The purpose of the transfer (compensation versus other purposes).
   C. The age of the recipient.
   D. Whether the award is for goods or services provided to the reporting entity.

5. According to Jennifer Louis, does Topic 718 apply to share-based awards granted to customers?

   A. Yes, and it always increases reported revenue.
   B. Yes, but only if the customer is also an employee.
   C. Yes, but it may affect revenue recognition under Topic 606.
   D. No, it never applies to customers.

Continued on next page

6. According to Sunish Mehta, which of the following best describes the purpose of a SOC 1 report?

   A. Reporting on controls related to cybersecurity.
   B. Reporting on controls relevant to a user entity's internal control over financial reporting.
   C. Reporting on controls related to privacy and confidentiality.
   D. Reporting on controls for marketing purposes.

7. According to Sunish Mehta, what is the main difference between a SOC 1 Type 1 and Type 2 report?

   A. Type 1 includes a description of controls, while Type 2 does not.
   B. Type 1 is for internal use only, while Type 2 is for external use.
   C. Type 1 reports on control design at a point in time, while Type 2 also tests operating effectiveness over a period.
   D. Type 1 is for financial controls, while Type 2 is for operational controls.

8. According to Sunish Mehta, which of the following is ***not*** one of the five trust services criteria addressed in a SOC 2 report?

   A. Security.
   B. Availability.
   C. Financial reporting.
   D. Privacy.

9. According to Sunish Mehta, what is the primary purpose of a SOC 3 report?

   A. Marketing and general use by any interested party.
   B. Comprehensive evaluation of operational controls
   C. Detailed control testing for financial reporting.
   D. Assessing cybersecurity risks.

10. According to Sunish Mehta, which of the following is a key difference between SOC 2 and SOC 3 reports?

    A. SOC 2 is restricted use, while SOC 3 is general use.
    B. SOC 2 covers financial controls, while SOC 3 covers operational controls.
    C. SOC 2 is performed under SSAE 18, while SOC 3 is performed under AT 101.
    D. SOC 2 is for internal use only, while SOC 3 is for external use.

11. According to Sunish Mehta, what is the primary focus of the SOC for Cybersecurity report?

    A. Financial reporting controls.
    B. Operational controls.
    C. Cybersecurity Risk Management Program.
    D. Supply chain management.

Continued on next page

12. According to Sunish Mehta, which of the following is ***not*** a typical system component examined in a SOC 2 engagement?

    A. Infrastructure.
    B. Software.
    C. Financial statements.
    D. People.

13. According to Sunish Mehta, what is the primary purpose of the SOC for Supply Chains report?

    A. To assess financial reporting controls in the supply chain.
    B. To evaluate operational efficiency of supply chains.
    C. To report on environmental sustainability in supply chains.
    D. To understand cybersecurity risks in supply chains.

14. According to Sunish Mehta, which of the following statements about SOC report usage is true?

    A. SOC 1 reports are for general marketing use.
    B. SOC 2 reports are restricted to management and regulators.
    C. SOC 3 reports can be used in marketing materials.
    D. All SOC reports are restricted to auditors only.

15. According to Sunish Mehta, which of the following is ***not*** a typical application of SOC reports?

    A. Accounting services.
    B. Manufacturing processes.
    C. Benefit management.
    D. Cloud service providers.

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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 CeriFi, LLC. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to **CPLgrading@cerifi.com.**

How would you rate the topics covered in the August 2024 **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
ASU 2024-01 and Profits Interest Awards	|______|	|______|	|______|	|______|	|______|	|______|
Insights and Tips on SOC Reporting	|______|	|______|	|______|	|______|	|______|	|______|

Which segments of the August 2024 issue of **CPE Network® A&A Report** did you like the most, and why?

____

Which segments of the August 2024 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 2024 **CPE Network® A&A Report?** Rate each speaker on a scale of 1–5 (5 highest):

	Overall	**Knowledge of Topic**	**Presentation Skills**
Jennifer Louis	|______|	|______|	|______|
Sunish Mehta	|______|	|______|	|______|

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®

CPE Group Attendance Sheet

Firm/Company Name: ____________________

Account #: ____________________

Location: ____________________

Program Title: CPE Network Accounting and Auditing Report, August 2024 Date: __________

Name	Email	Total Hrs	IRS PTIN ID (if applicable Tax only)	Sign In	Sign Out

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 3 times per CPE hour. 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.

			First CPE Hour			**CPE Hour 2**			**CPE Hour 3**			**FOR TR USE ONLY**
First Name	**Last Name**	**Student Email**	**Poll 1**	**Poll 2**	**Poll 3**	**Poll 1**	**Poll 2**	**Poll 3**	**Poll 1**	**Poll 2**	**Poll 3**	**Certificate Issued?**

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED December 31, 2023

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 CeriFi, LLC.

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

“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 online.

- If the emailed 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 email 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

Note: DVDs no longer ship with this product effective 3/1/2023.

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/

The entire transcript is also available as a pdf in the Checkpoint Learning player in the resource toolbox at the top of the screen, or via the link in the email sent to administrators.

Requesting Participant CPE Certificates

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

Email: CPLgrading@cerifi.com

When sending your package to CeriFi, 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 CeriFi 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. Participants' two-way video should remain on during the entire presentation.

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 asks 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.

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

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 emailed 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 email 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

Note: DVDs are no longer shipped effective 3/1/2023

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 the following means:

Email: CPLgrading@CeriFi.com

When sending your package to CeriFi, 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 CeriFi 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—Email

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

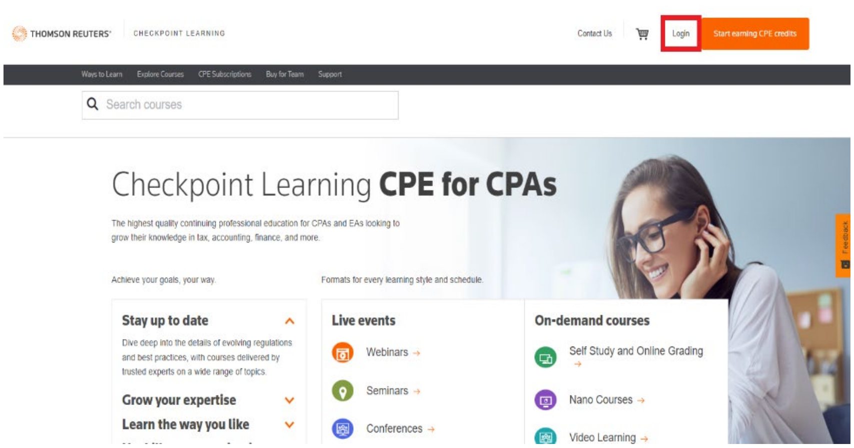
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.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

    CPLgrading@cerifi.com

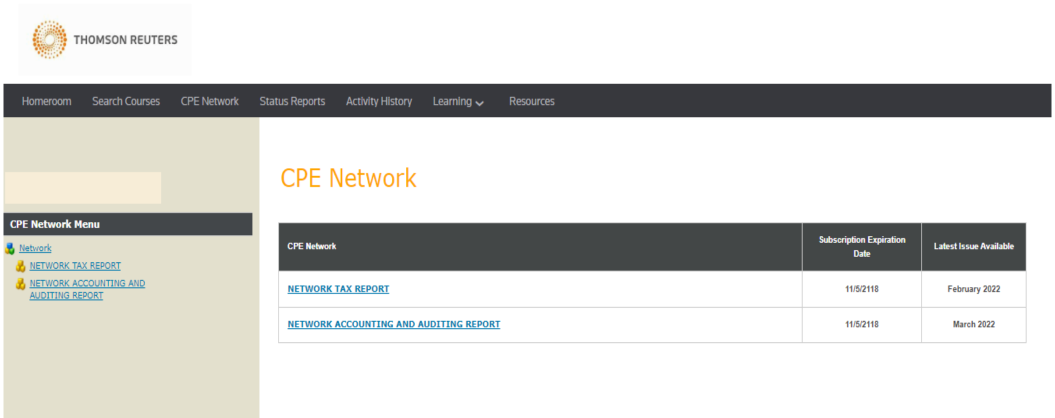
Self-Study—Online

Follow these simple steps to use the online program:

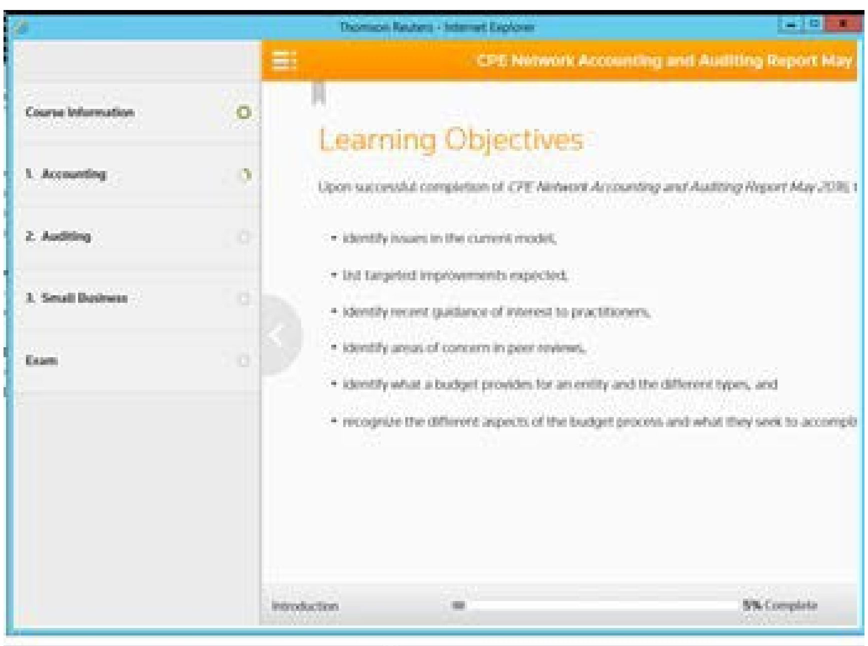
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login or Register").



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

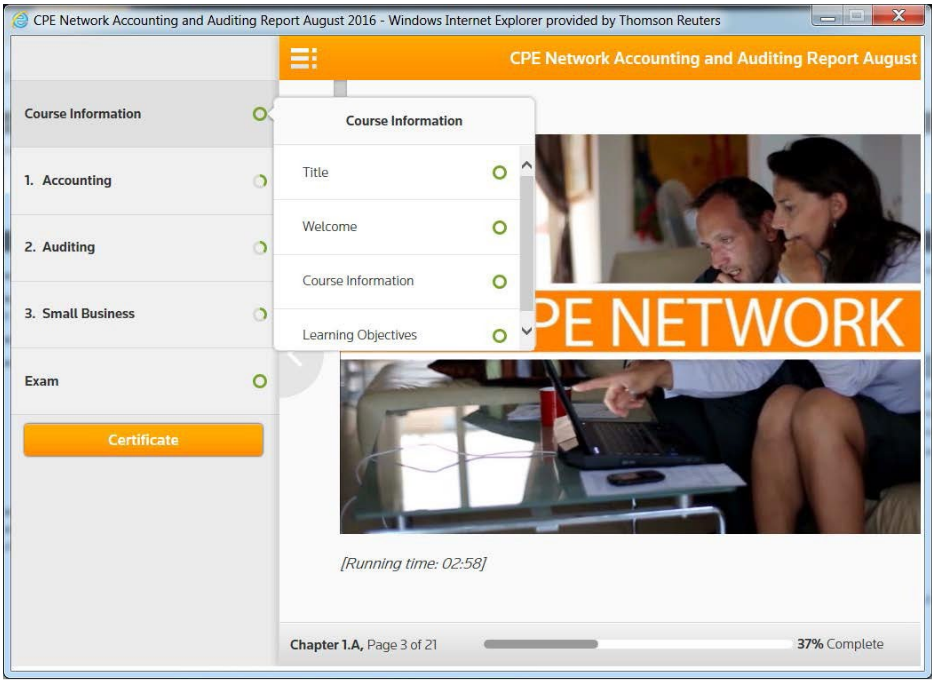


The Chapter Menu is in the gray bar at the left of your screen:

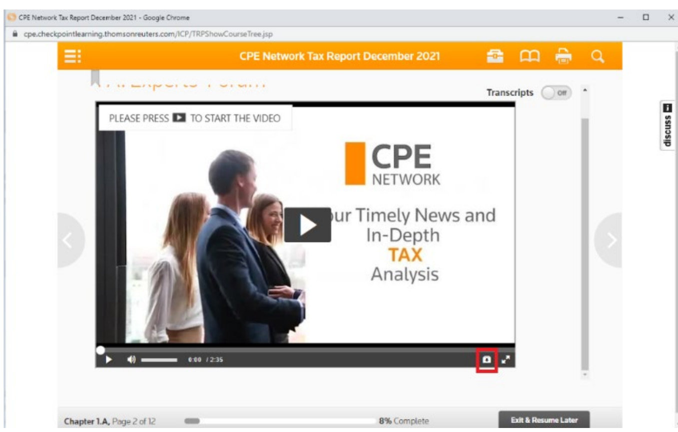


Click down to access the dropdown menu and move between the program Chapters.

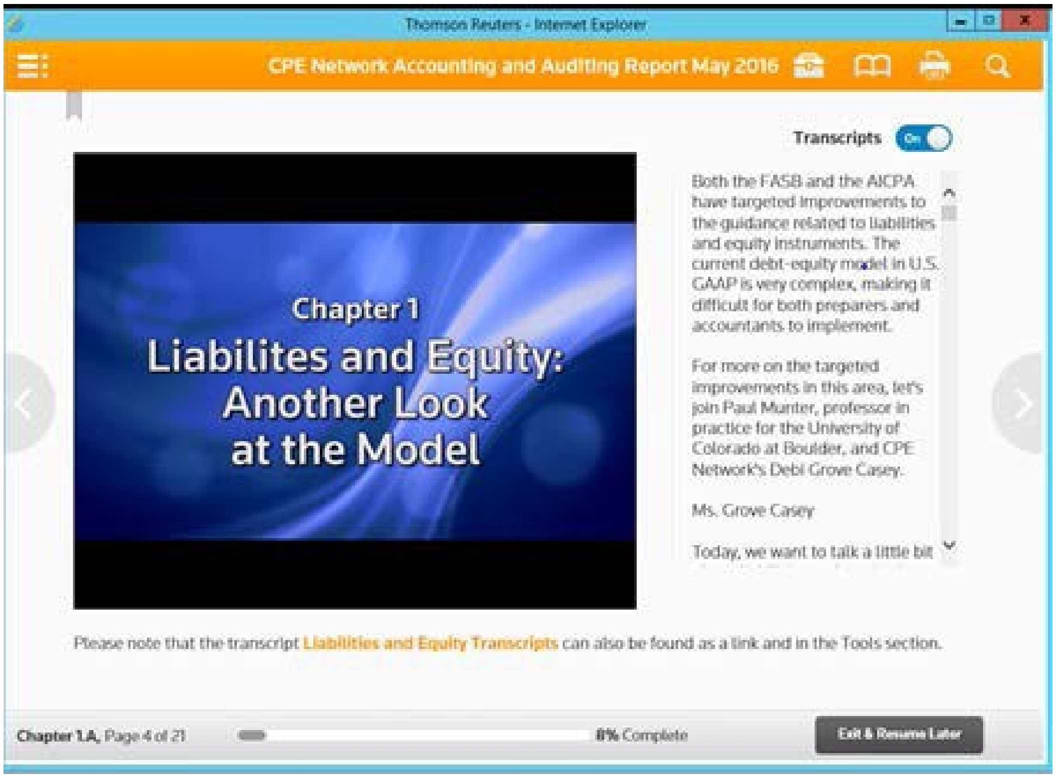
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



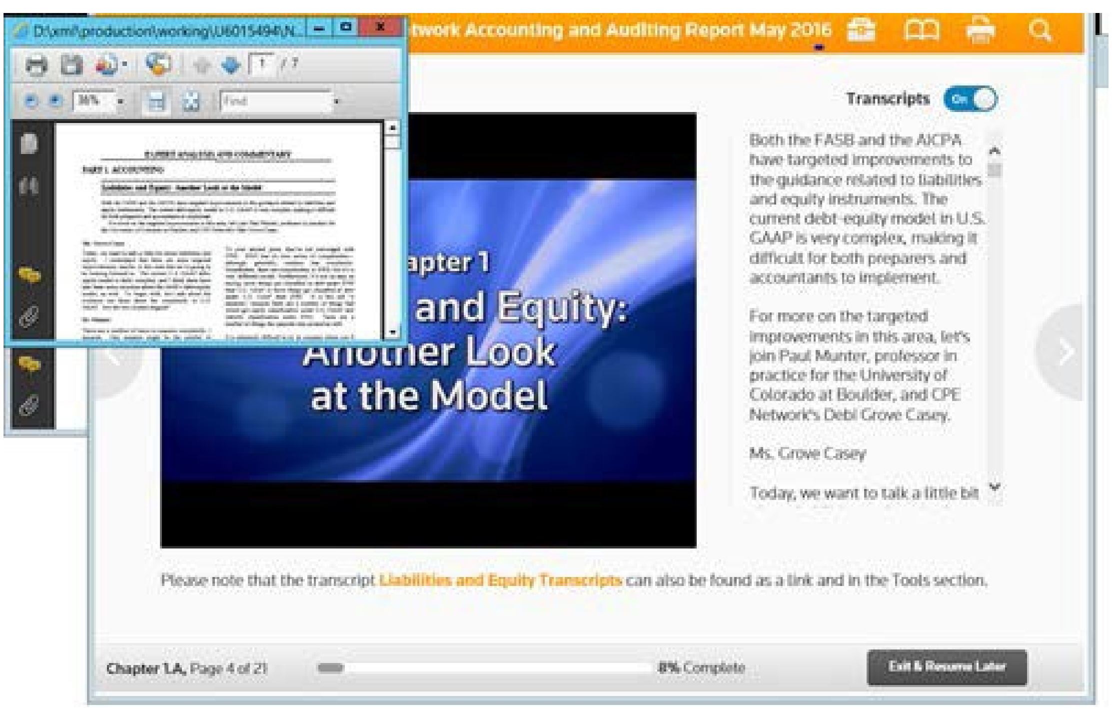
- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access the related materials.



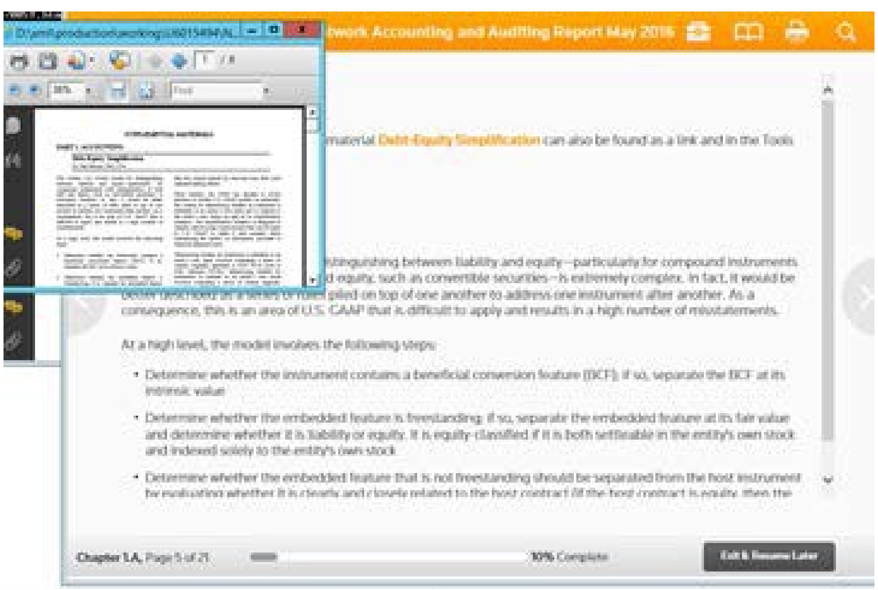
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.



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.



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 p roblems related to the segment.

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

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

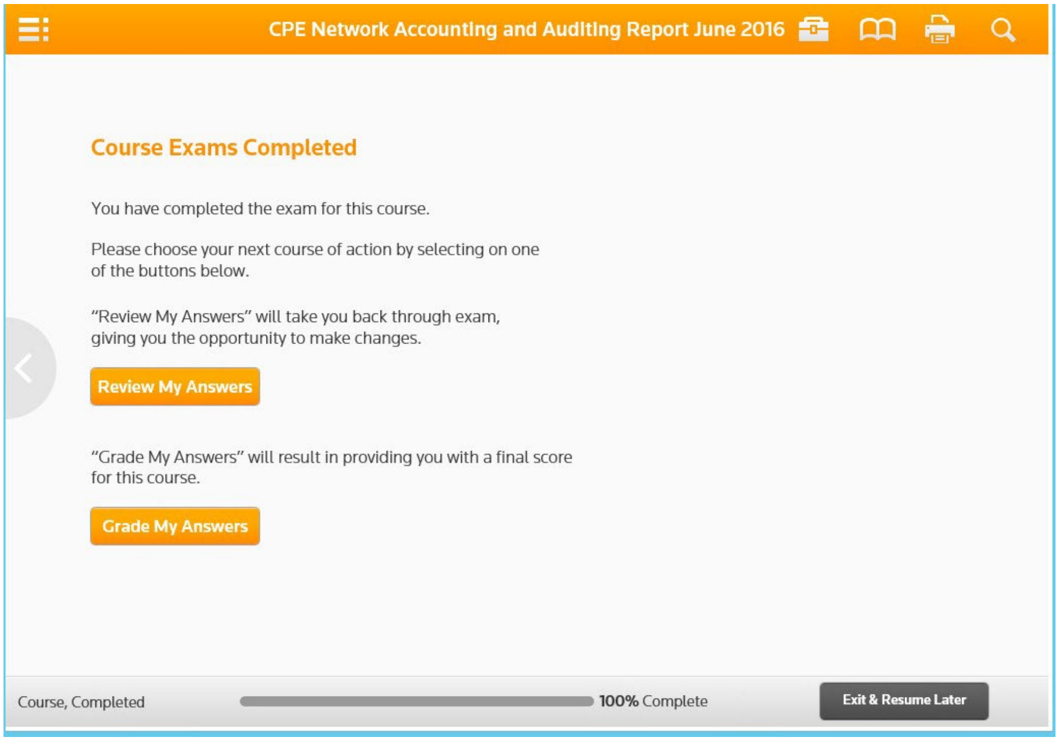
   An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions 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

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**.



- 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.

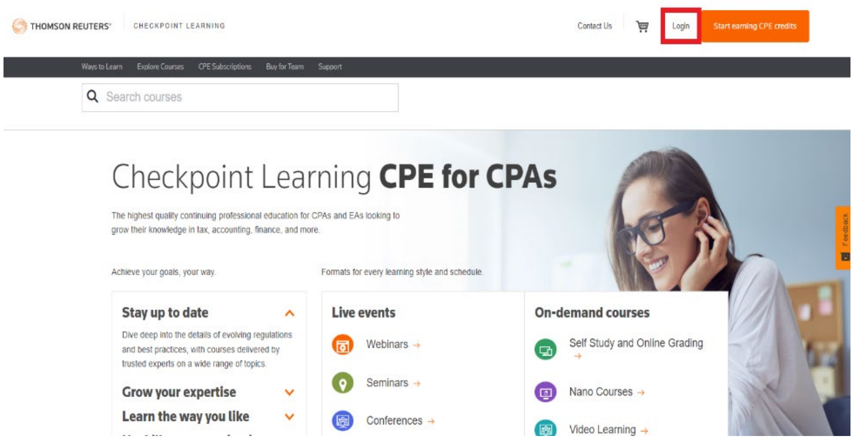
Print

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**.

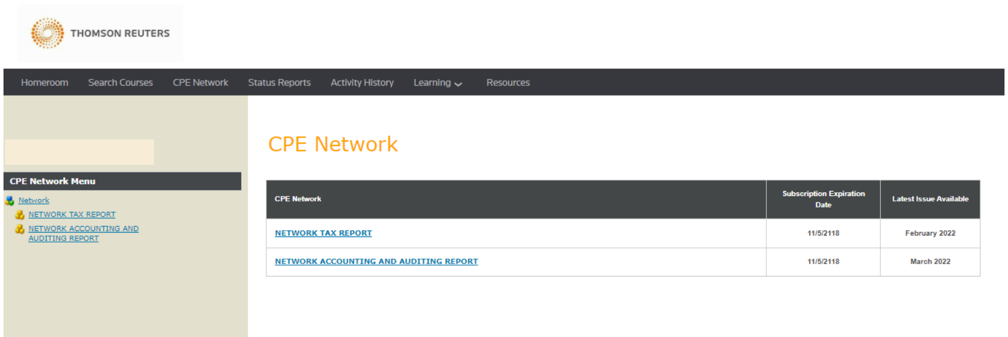
Transitioning From DVDs

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

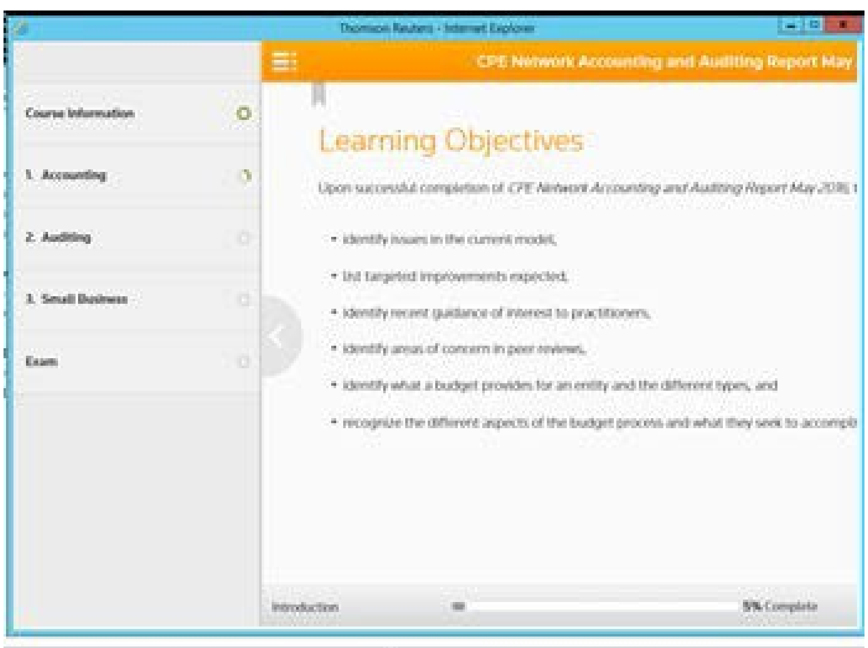
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



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

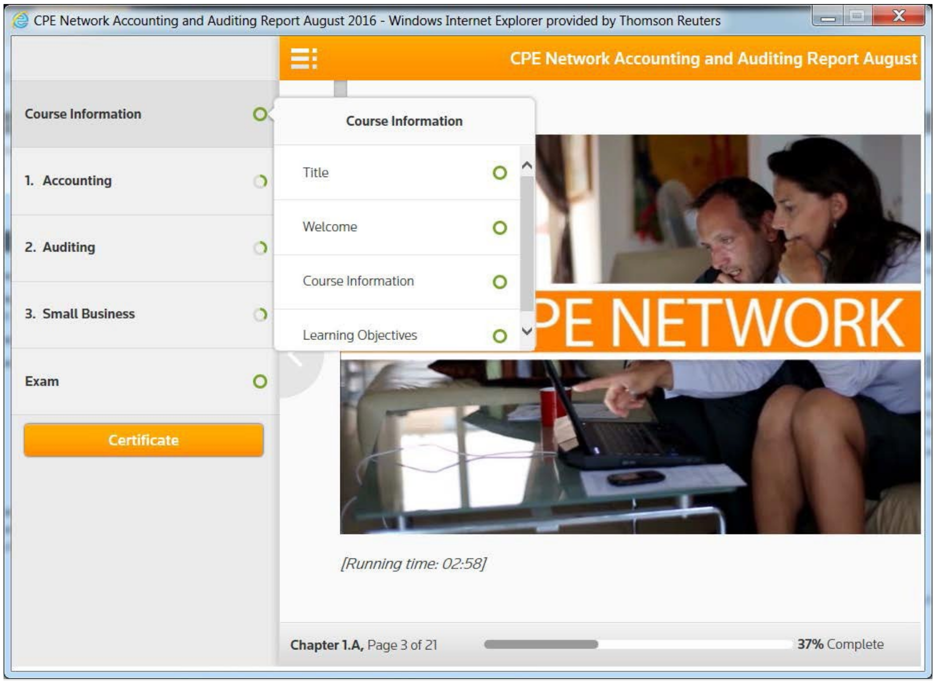


The Chapter Menu is in the gray bar at the left of your screen:

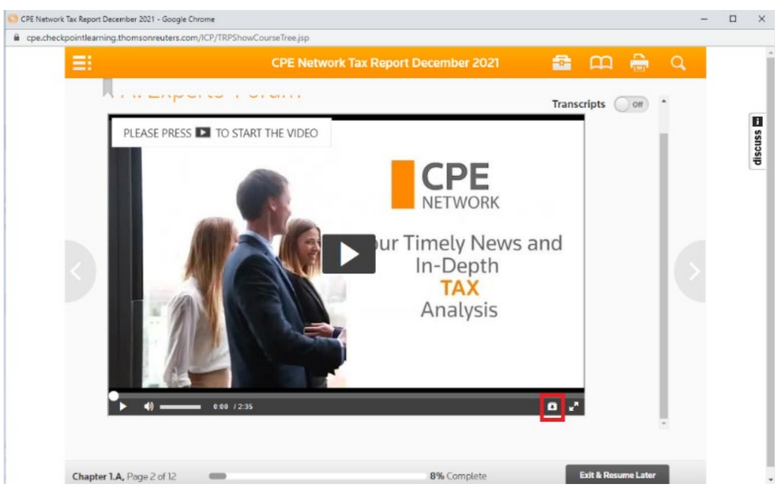


Click down to access the dropdown menu and move between the program Chapters.

- **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. You may need to use the scroll bar to the right of the video to see the download button. **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 to administrators with each release.

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

<u>Determining CPE Credit Increments</u>

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.

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 (if any).
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	844.245.5970	Cplsupport@cerifi.com	• Browser-based • Certificate discrepancies • Accessing courses • Migration questions • Feed issues
Product Support	844.245.5970	Cplsupport@cerifi.com	• Functionality (how to use, where to find) • Content questions • Login Assistance
Customer Support	844.245.5970	Cplsupport@cerifi.com	• Billing • Existing orders • Cancellations • Webinars • Certificates