

# CHECKPOINT LEARNING

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Topics for future editions may include:

- FASB Update on crypto assets and income tax disclosures
- Auditing Digital assets and crypto in 2024

# EXECUTIVE SUMMARY

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## PART 1. ACCOUNTING

### FASB Update Joint Ventures.....3

Russ Madray, CPA reviews recent accounting for joint ventures. *[Running time: 28:15]*

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

- Identify a joint venture and its accounting
- Identify when to measure the fair value of total assets
- Determine which arrangements are part of a joint venture
- Identify the accounting for IPR&D costs

## PART 2. AUDITING

### PCAOB Guidance on Confirmations ..... 15

Jennifer Louis, CPA discusses recent guidance from the PCAOB on the use of confirmations. *[Running time: 31:50]*

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

- Identify when confirmations became required
- Identify a common deficiency related to inspections of confirmations
- Determine the impact of technology on confirmations
- Define negative confirmations

## PART 3. SMALL BUSINESS

### Fraud Considerations..... 32

Kurt Oestrieher, CPA, discusses fraud considerations by practitioners in all levels of services. *[Running time: 34:30]*

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

- Identify the accountant's responsibilities under the SSARS
- Identify means of identifying fraud in reviews
- Identify where the guidance on fraud communications exists
- Determine the impact of fraud

## ABOUT THE SPEAKERS

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

**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.

**Kurt Oestrieher, CPA**, is a CPA and partner with the accounting firm of Oestrieher and Company in Alexandria, Louisiana. He is in charge of accounting and auditing services, and is also involved in litigation support and small business consulting engagements. In addition to his client responsibilities, Kurt has served as a discussion leader for numerous accounting and auditing courses. He has served on the AICPA Accounting and Review Services Committee and is currently serving a three-year term on the AICPA Council.

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### PART 1. ACCOUNTING

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#### FASB Update Joint Ventures

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In August of 2023 the FASB issued guidance related to recognition and initial measurement of assets by joint ventures in ASU 2023-05. GAAP did not previously provide specific authoritative guidance. This new guidance provides that an entity meeting the definition of a joint venture must apply a new basis of accounting when the entity is formed. Having this guidance should assist in providing decision-useful information to stakeholders and reduce diversity in practice.

For more on this new guidance from the FASB, let's join J. Russell Madray, a CPA in Greenville, South Carolina, and CPE Network's Debi Grove Casey.

#### Ms. Grove Casey

Today we want to talk a little bit about some recent activity at the FASB [Financial Accounting Standards Board]. Now, they haven't been particularly active on major standards over the last few years, other than to tweak a few things. But recently there's been a flurry of activity towards the end of 2023.

There are two specific ASUs that we want to talk about today (Note: The second ASU is 2023-07 on reportable segments and will be covered in a future edition of our program.). The first one relates to business combinations, and that was ASU 2023-05 on joint venture formations, the recognition and initial measurement. So, let's start with that standard, ASU 2023-05 related to joint ventures, as I mentioned. Can you explain what this new guidance applies to?

#### Mr. Madray

Sure. This is something that was issued in August 2023, basically to require joint ventures in the initial formation to measure all the contributions at fair value. A lot of this is going to sound familiar because it's largely consistent with the existing guidance in Topic 805, on business combinations, but there are some specific exceptions to that because of the unique nature of a joint venture.

The problem is, before this ASU was issued, there was no authoritative guidance in U.S. GAAP [generally accepted accounting principles] that addressed how a joint venture should recognize those contributions that are received at formation, and as a result of that, obviously, there was some diversity in practice. Some joint ventures accounted for contributions at a carryover basis. Others applied a fair value basis, but, again, there was no specific guidance on what to do. So, this new ASU is intended to reduce that diversity and provide the financial statement users with more useful information.

Importantly, this ASU applies to the initial formation of a *joint venture* (sometimes called a *corporate joint venture*), and that has a specific definition in the accounting guidance as a result of this ASU. We'll just refer to those collectively as a *joint venture* or a *JV* in our discussion.

Transactions where two or more entities contribute assets or subsidiaries to a newly formed entity, or somehow, in another way, agree to jointly develop or market products together, are sometimes referred to as a joint venture even though they wouldn't meet the accounting definition of a joint venture under this new guidance. So, it's always important to distinguish between arrangements that might be described by the parties as a joint venture even though they might not qualify for this joint venture accounting.

It does require some judgment to apply the definition, and some of the characteristics that are used to define a joint venture are fairly broad. But the definition or the criteria that are used, according to this new ASU—you see on our first slide here, to be considered a joint venture for accounting purposes, then all of these criteria that you see here have to be met.

First, there has to be joint control over all the significant decisions of the entity. Secondly, the venturers should actively participate in the overall management of the joint venture. Finally, the joint venture should operate for the mutual benefit of the venturers, doing things like sharing risks and rewards; developing a new product, market, or technology; [or] perhaps to combine complementary technology or to pool resources in developing some production or other types of facilities.

Again, importantly, those three criteria must be met in order to apply this particular guidance. As you well know, there [are] other types of business ventures that are sometimes referred to as joint ventures but wouldn't meet this particular definition. Obviously, it's important to understand the purpose, the nature, [and] the operations of the entity to determine if it actually meets this definition and these criteria. So, for example, you have an arrangement where Company A contributes a business, and Company B contributes cash and acts as a passive investor. That wouldn't meet this definition because one of the key things is all the venturers have to actively participate in the overall management of the joint venture.

Another thing to keep in mind about this new guidance, it does not impact the accounting by the venturers themselves. Under current guidance, a venturer is required to initially recognize its contribution to the joint venture at fair value as of the date the entity loses control of those net assets. That's defined in Subtopic 610-20, dealing with gains and losses from derecognition of nonfinancial assets, or it may fall under Topic 810 under consolidation, depending on what's being contributed. Is it a group of assets or is it a business that's being contributed to the joint venture?

That treatment's not going to change as a result of this new guidance. But since the venturer's accounting is based on a fair value model, you would think, given this new guidance that applies to the accounting of the joint venture itself, that it would eliminate or reduce a lot of the current basis differences that would exist between a joint venture's financial statements. For example, they can use a carryover basis and the investment that's reported by the venturers. So, hopefully this will make all of this look a bit more clear and transparent.

Another thing to keep in mind is this new guidance would not apply to formations of joint ventures that are determined to be not-for-profit entities or entities that could be proportionally consolidated under some specialized industry guidance.

Also, collaboration agreements would be excluded from the scope of the new guidance unless there's some part of the collaboration that's conducted in a separate legal entity that would meet that definition that we saw a moment ago. In that case, the joint venture would apply the new guidance in its standalone financial statements, whereas it may not apply to the overall collaboration agreement. So, long-winded answer to your question, that's what this new guidance will apply to.

### **Ms. Grove Casey**

Let's talk a little bit about what some of the main provisions of this new guidance are.

### **Mr. Madray**

Sure. The formation of a joint venture would result in the creation of a new reporting entity. None of the assets or businesses that were contributed would survive as an independent entity or as the historical operations of the entity. This is one thing that sets it apart from a traditional business combination.

The formation of a joint venture would not result in the identification of an acquirer, which is a requirement under Topic 805, or the determination that one party gains control over another party, again, a key part of Topic 805. As a result, this guidance requires that a newly formed joint venture apply a new basis of accounting to all of its contributed net assets, which are initially measured under the guidance in Topic 805, which is a fair value recognition of those contributed net assets. There are some exceptions; again, we'll touch on those in a moment.

While a lot of the aspects of this new guidance are very similar to acquisition accounting—as I said earlier, it's going to sound familiar—[the] key thing is you won't see any reference to the joint venture, or any of the venturers themselves as the *acquirer*, or contributed net assets as something called an *acquiree*. Key is [that] the FASB didn't

want to imply that this new guidance would affect the application of acquisition accounting, particularly where you have a newly formed entity—where you have NewCo, OldCo, and all of that. Even though there are some similarities, again, in the traditional business combination, the guidance would still be what existed in Topic 805, and this [new ASU] will only apply to those types of new entity formation that we described earlier that would meet the definition of a joint venture.

Now, [we will discuss] some of the specifics of things like measurement. The joint venture is going to measure the net assets that are contributed as of the formation date. [The] *formation date* is a substitute for that term that we're familiar with in business combinations of the *acquisition date*. It's the relevant date that's used to measure all of the contributed assets and liabilities.

But, unlike that typical determination of consideration in a business combination, a joint venture would measure its total net assets as the fair value of the joint venture entity as a whole after the contributions are received. So, total net assets of the joint venture would be measured as the fair value of 100% of the joint venture's outstanding equity interest immediately following the formation of the joint venture. That would include any non-controlling interest in those contributed net assets. The total net assets would not include, though, the fair value of any contingent consideration or replacement share awards. As a result of that, the total net assets would not simply reflect the sum of the individual groups of net assets contributed by each of the venturers.

Back to the formation date, it's defined as the date on which the entity initially meets the definition of a joint venture. Again, that's open to some interpretation. There's no further guidance about making that determination in the ASU itself, so it's going to require some judgment to determine exactly what that formation date is, depending on when the entity initially meets that definition of a joint venture that we saw earlier. That can be particularly challenging when the assets and liabilities are not all contributed at the same time. It can be further complicated if multiple arrangements constitute the actual formation transaction.

This next slide shows that idea of multiple arrangements. When determining whether to account for multiple arrangements as a single transaction that establishes that joint venture formation, the entity will need to consider these things: (1) if the arrangements are entered into at the same time or in contemplation of one another; (2) if the arrangements form a single transaction designed to achieve an overall commercial effect; (3) if the occurrence of one arrangement is dependent upon the occurrence of at least one other arrangement; or (4) if one arrangement on its own would not be considered economically justified, but the multiple arrangements considered together would be. Again, it's a bit challenging to pin down this formation date idea, especially if you've got multiple arrangements going on that lead to the formation of that joint venture.

With some limited exceptions, all those contributed net assets to the joint venture would be recorded in accordance with the guidance in Topic 805-20, which is your traditional business combination guidance, which means most of the assets and liabilities would be recognized at fair value. But much like acquisition accounting, there are certain assets and liabilities—like contract assets, contract liabilities, certain contingencies, pensions, post-retirement benefits, leases, income taxes—the same exceptions you have in acquisition accounting to the fair value measurement principle. You have the same exceptions here where you're recognizing those things at amounts other than fair value.

As we mentioned earlier, if a venturer contributes financial assets to the joint venture and accounts for derecognition of those under Topic 860, which is transfers and servicing, the joint venture would then also determine if the transfer results in the recognition of the transfer of financial assets by applying that same guidance in Topic 860.

Now, this would not apply to those situations where a venturer contributes a business or a group of assets that contains financial assets if they're considered *in substance nonfinancial assets*. That concept is in Topic 610-20, which is where you get into the gain or loss from transfers of nonfinancial assets. In that type of situation, the venturer would account for the disposition of all the assets including those financial assets under Topic 810 or 610—810 if it was a business; 610 if it's a group of assets—and, similarly, would not apply that guidance in Topic 860 in assessing how to record the financial assets in the financial statements.

Now, joint ventures can apply the measurement period guidance in Topic 805. In typical acquisition accounting that gives the entities up to one year after the formation date to obtain the information that's necessary to identify and measure the total of the net assets of the joint venture, the assets acquired, liabilities assumed, and any existing noncontrolling interest. During that measurement period, the joint venture would be able to adjust those provisional amounts that were recognized for new information about facts and circumstances that existed as of that formation date.

So, that's the gist of what it's about. Again, it should sound familiar because a lot of it is very, very similar to our traditional acquisition accounting with those handful of exceptions that we mentioned.

**Ms. Grove Casey**

Is there guidance for determining what's part of the joint venture formation similar to what's in the business combinations guidance?

**Mr. Madray**

Yes, good point. [With] a joint venture, the entity and the venturers might enter into multiple arrangements at or around the same time as the formation of the joint venture. For example, the joint venture might enter into a service contract with a venturer to pay the venturer for future services to be performed for the joint venture, so similar to an acquisition accounting issue, to determine what's part of the formation, the joint venture would need to follow the guidance for assessing what is part of a business combination. That would include evaluating why the payments are included in the arrangement, which party initiated them, when the parties entered into the arrangement, and so on.

As the formation of a joint venture is the formation of an entirely new entity, the joint venture would not apply or analogize to the guidance related to pre-existing relationships that you have in a business combination. Also, a joint venture would be prohibited from applying the guidance in Topic 805 related to accounting for acquisition-related costs and transactions that reimburse the acquiree for paying the acquirer's acquisition-related costs, again, because it's not an acquisition. A joint venture is always formation of a new entity.

If there [are] share-based payment awards that are issued at formation to replace awards that are held by grantees of the contributed entities, here the joint venture would allocate the fair value of the awards at the formation date between the pre-formation vesting and the post-formation compensation cost, similar to what we would do in accounting for these types of awards in a business combination. However, instead of the portion of the fair value of the awards that are attributed to pre-formation vesting being accounted for as additional purchase price, as you would in a business combination, this amount would be accounted for as a reallocation or additional paid-in capital in an equity account of the member's equity.

Finally, similar to acquisition accounting, the joint venture would record the portion of the fair value of the awards that are attributable to post-formation service as compensation cost over the applicable service period. So, [there are] a lot of similarities [between] determining what's part of the joint-venture formation [and] determining what's part of a business combination, again, with some limited exceptions as we saw there.

**Ms. Grove Casey**

What about goodwill and in-process research and development? Is there specific guidance related to that?

**Mr. Madray**

Yes, there is. Regardless of whether the contributions that are received by the joint venture at formation represent a business or simply a group of assets, accounting for any goodwill and in-process research and development (IPR&D) would typically follow the accounting model for business combinations.

Goodwill would be recognized when the fair value of the joint venture as a whole exceeds the amount of the identifiable net assets that have been recognized. You could have a situation with negative goodwill, and it would be recognized as an adjustment to equity, but not as a bargain purchase gain as you have in a business combination because there's not a purchase or an acquisition.

I've got an illustration of this on the next slide. Company A and Company B form Joint Venture C, which meets the definition of a joint venture and is a for-profit entity. At formation, Company A contributes a business that manufactures automotive parts, and Company B contributes a business that distributes automotive parts. Company A and Company B each receive equity in the joint venture in exchange for their contributions and apply the equity method to account for their investments. Under this new guidance, Joint Venture C would determine the fair value of the joint venture as a whole by estimating the fair value of 100% of its equity immediately after the formation. Joint Venture C would then separately measure the identifiable assets and liabilities, including any identifiable intangible assets, the same as we would under the acquisition method for business combinations.

So, let's assume that Joint Venture C determines that a fair value of 100% of its equity is \$200, and the fair value of its identifiable assets is \$180. Then Joint Venture C would recognize \$20 of goodwill to reflect the difference between the fair value of the joint venture as a whole and the fair value of the identifiable net assets. So, yes, we can have recognition of goodwill in a joint-venture formation as that illustrates.

Now, as it relates to IPR&D, all intangible research and development assets that are contributed to a joint venture at formation would be capitalized as indefinite-lived intangible assets, which is consistent with what we do in business combination accounting.

Based on the FASB's research as it was writing this guidance, they found that IPR&D assets would typically make up a significant portion of assets that are contributed to research-oriented joint ventures. In those instances, the FASB concluded that recognizing the costs associated with the IPR&D immediately as an expense might not provide the best information [or] the most useful information. It would be inconsistent with business combination guidance, so that's why they went with this route of capitalizing them as indefinite-lived intangible assets.

One side note here since we're talking about goodwill. We know that in the business combination world, acquisition accounting world, a private company has accounting alternatives related to recognition of certain intangible assets, amortization, and impairment of goodwill. Those accounting alternatives also will apply to a joint venture, assuming that joint venture is a private company. They can also take advantage of those accounting alternatives related to recognition of some of those intangible assets and the accounting for goodwill.

### **Ms. Grove Casey**

Well, all accounting standards—I shouldn't say all—most accounting standards have some kind of disclosures associated with them. I'm assuming that this one is probably not much different because they like to have that transparency out there, and you can't always capture, for a stakeholder, everything in the measurement number. You need some explanation. So, can you talk about the requirements that we have for disclosure in this particular case?

### **Mr. Madray**

Sure. As you would expect, the disclosure requirements for formation of a joint venture are fairly consistent with those that we have for a business combination under Topic 805. This next slide has some of the items that would need to be disclosed in the financial statements related to the formation, including (1) the formation date; (2) a description of the purpose of the joint venture and why it was formed; (3) the formation-date fair value; (4) a description of the assets and liabilities that were recognized at the formation date; (5) amounts that are recognized for each major class of assets and liabilities; (6) a qualitative description of the factors that make up any of the goodwill that's recognized; and finally, (7) if the evaluation of any of the amounts recognized is incomplete or any measurement period adjustments are recognized, a description of those amounts that are affected. So, [it is] very similar to what we have for a business combination at an acquisition date.

### **Ms. Grove Casey**

Finally, let's talk about when this ASU becomes effective.



**Mr. Madray**

Sure. This ASU will be effective for both public and private joint venture entities that have a formation date on or after January 1, 2025. The guidance will be applied on a prospective basis to all joint ventures that are formed on or after that effective date, and early adoption is permitted.

For joint ventures that are formed before the effective date, you can make an election to apply the new guidance retrospectively if there's sufficient information available to make that retrospective application feasible. That would require application back to the original formation date of the joint venture [and] using the fair values of the contributed assets and liabilities at that date along with adjustment of all the subsequent periods to reflect those assets and liabilities, including things like depreciation, amortization, impairment, and so on. Obviously, in many cases, that's simply not going to be feasible to do that.

If the retrospective adoption is elected, then for any guidance in the new standard, this ASU, that's the same as the business combination guidance, the joint venture would apply the business combination guidance as it existed at the date of formation. For example, if the joint venture was formed in 2010, then when applying the new guidance for any reference to the application of Topic 805, the joint venture would apply Topic 805 as it existed in 2010. So, again, it's pretty challenging to try to do a retrospective adoption of this if the joint venture formation was more than just a couple of years prior to the effective date. But the key is, even though the effective date is in 2025, it can be early adopted for any formation that occurs between the time this was issued and that effective date. So, it's out there and ready to be used, in other words.

## SUPPLEMENTAL MATERIALS

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### **FASB Update** by J. Russell Madray, CPA

ASU 2023-05, *Business Combinations—Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*

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#### **Overview**

In August 2023, the FASB issued ASU 2023-05, which requires a joint venture to initially measure all contributions received upon its formation at fair value. This accounting will largely be consistent with ASC 805, *Business Combinations*, although there are some specific exceptions. Before the ASU, there was no authoritative guidance in U.S. generally accepted accounting principles (GAAP) that addressed how a joint venture should recognize contributions received. As a result, there has been diversity in practice, with some joint ventures accounting for contributions received at carryover basis and others at fair value. This new guidance is intended to reduce diversity in practice and provide users of the joint venture's financial statements with more useful information.

ASU 2023-05 applies to the initial formation of a *joint venture* or a *corporate joint venture*, as defined in the accounting literature (collectively referred to as a JV). Transactions in which two or more entities contribute assets or subsidiaries to a newly formed entity, or otherwise agree to jointly develop or market products together, are often referred to as joint ventures when they do not meet the accounting definition of a JV. Therefore, it is important to distinguish between arrangements described as joint ventures by the parties involved and arrangements that qualify for joint venture accounting. This determination of whether an entity qualifies for joint venture accounting requires judgment, and some of the characteristics defining a JV are broad in nature. To be considered a JV for accounting purposes, all of the following criteria must be met.

- There must be joint control over all the significant decisions of the entity.
- The venturers should actively participate in the overall management of the JV.
- The JV should operate for the mutual benefit of the venturers to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities.

**OBSERVATION:** It is important to understand the purpose, nature, and operations of the entity when determining if it represents a JV. For example, an arrangement in which Company A contributes a business and Company B contributes cash and acts as a passive investor would not meet the definition of a JV.

The new guidance does not impact accounting by the venturers. Under current guidance, a venturer is required to initially recognize its contribution to (which represents its initial investment in) the JV at fair value as of the date the entity loses control of those net assets as defined under ASC 610-20, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets*, or ASC 810, *Consolidation*, depending on whether a group of assets or a business is contributed. This treatment will not change. However, since the venturers' accounting is based on a fair value model, it is expected that the new guidance eliminates or reduces many of the current basis differences between the JV's financial statements (if the JV had recorded the contributions at carryover basis) and the reported investment by the venturers, thus reducing complexity.

The new guidance does not apply to formations of JVs that are determined to be not-for-profit entities or entities that may be proportionally consolidated under certain specialized industry guidance. Additionally, collaboration agreements are excluded from the scope of the new guidance unless there is a part of the collaboration that is conducted in a separate legal entity that meets the definition of a JV. In that case, the JV should apply the new guidance in its standalone financial statements.

#### **Main Provisions**

The formation of a JV results in the creation of a new reporting entity, and none of the assets or businesses that were contributed survive as an independent entity or as the historical operations of the entity. Accordingly, unlike in a

business combination, the formation of a JV does not result in the identification of an accounting acquirer or a determination that one party gained control over another party.

As a result, the guidance requires a newly formed JV to apply a new basis of accounting to all of its contributed net assets, which results in the JV initially measuring its contributed net assets under ASC 805-20 with certain exceptions that are highlighted below. While many aspects of the new guidance are comparable to acquisition accounting, the new guidance does not refer to the joint venture or any of the venturers as the *acquirer* or the contributed net assets as the *acquiree*. The FASB did not want to imply that this new guidance would affect the application of acquisition accounting, particularly when a newly formed entity is utilized.

### Measurement

A JV is required to measure the net assets contributed as of the formation date. The formation date is meant to function similar to the acquisition date in a business combination; it is the relevant date to measure all of the contributed assets and liabilities. However, unlike the typical determination of consideration in a business combination, a JV should measure its total net assets as the fair value of the JV entity as a whole after the contributions are received. Total net assets of the JV are measured as the fair value of 100% of the JV's outstanding equity interests immediately following formation, including any noncontrolling interests in the contributed net assets. However, the JV's total net assets do not include the fair value of any contingent consideration or replacement share awards. As a result, total net assets do not simply reflect the sum of the individual groups of net assets contributed by each venturer.

The *formation date* is defined as the date on which an entity initially meets the definition of a JV. There is no further guidance about this determination in the ASU, and it could require significant judgment, particularly when assets or liabilities are not all contributed at the same time. Determination of the formation date can be further complicated when multiple arrangements constitute the JV formation transaction. In determining whether to account for multiple arrangements as a single transaction that establishes the JV's formation, the entity should consider if: (1) the arrangements are entered into at the same time or in contemplation of one another; (2) the arrangements form a single transaction designed to achieve an overall commercial effect; (3) the occurrence of one arrangement is dependent upon the occurrence of at least one other arrangement; or (4) one arrangement on its own would not be considered economically justified, but the multiple arrangements considered together would be. With the limited exceptions, all of the contributed net assets should be recorded in accordance with the guidance in ASC 805-20. Therefore, most assets and liabilities are recognized at their fair values. However, similar to acquisition accounting, certain assets and liabilities, such as contract assets and contract liabilities, certain contingencies, pension and postretirement benefits, leases, and income taxes, are recognized at amounts other than fair value.

The ASU also states that if a venturer contributes financial assets to the JV and accounts for the derecognition of those financial assets under ASC 860, *Transfers and Servicing*, then the JV should similarly determine if the transfer results in the recognition of the transferred financial assets by applying the guidance in ASC 860. This would not include scenarios in which a venturer contributes a business (or group of assets) that contains financial assets if they are considered "in substance nonfinancial assets" under ASC 610-20. In this scenario, the venturer would account for the disposition of all assets, including the financial assets, under ASC 810 or ASC 610-20; therefore, the JV would similarly not apply ASC 860 when assessing how to record the financial assets in its financial statements. JVs can apply the measurement period guidance in ASC 805, which allows entities up to one year after the formation date to obtain information necessary to identify and measure the total net assets of the JV, assets acquired, liabilities assumed, and any noncontrolling interest. During the measurement period, the JV is able to adjust the provisional amounts recognized for new information about facts and circumstances that existed as of the formation date.

### Determining What Is Part of the JV Formation

A JV and its venturers may enter into multiple arrangements at or around the same time as the formation. For example, the JV may enter into a service contract with a venturer to pay the venturer for future services to be performed. To determine what arrangements are part of its formation, the JV should follow the guidance for assessing what is part of a business combination. This includes evaluating why the payments are included in the arrangement, which party

initiated them, and when the parties entered into the arrangement. As the formation of a JV is the formation of an entirely new entity, the guidance related to pre-existing relationships in a business combination should not apply. Additionally, a JV is prohibited from applying the guidance in ASC 805 related to accounting for acquisition-related costs and transactions that reimburse the acquiree for paying the acquirer's acquisition-related costs. When share-based payment awards are issued at formation to replace awards held by grantees of the contributed entities, the JV should allocate the fair value of the awards at the formation date between pre-formation vesting and post-formation compensation cost similar to the accounting for share-based payment awards in a business combination. However, instead of the portion of the fair value of the awards attributed to pre-formation vesting being accounted for as additional purchase price as it is in a business combination, this amount is accounted for as a reallocation of additional paid-in capital (or a similar equity account such as members' equity). Similar to acquisition accounting, the JV should record the portion of the fair value of the awards attributable to post-formation service as compensation cost over the applicable service period.

### Recognition of Goodwill and IPR&D

Regardless of whether the contributions received by the JV upon formation represent a business or an asset group, accounting for goodwill and in-process research and development (IPR&D) largely follows the accounting model for business combinations. Goodwill should be recognized when the fair value of the JV as a whole exceeds the amount of identifiable net assets recognized. Negative goodwill should be recognized as an adjustment to equity, not as a bargain purchase gain as in a business combination.

As it relates to IPR&D, all intangible research and development assets contributed to a JV at formation should be capitalized as indefinite-lived intangible assets, consistent with the accounting model for business combinations. Based on the FASB's outreach, it understands that IPR&D assets may make up a significant portion of the assets contributed to research-oriented JVs. In those instances, the FASB concluded that recognizing the costs associated with IPR&D immediately as an expense may not provide the most decision-useful information and would be inconsistent with the business combinations guidance on which the new guidance is largely based.

**Observation:** A JV operating as a private company may apply the accounting alternatives related to the recognition of certain intangible assets and amortization and impairment of goodwill.

### Disclosures

The disclosure requirements are relatively consistent with those for business combinations under ASC 805 and include disclosure of the following:

- Formation date
- Description of the JV's purpose and why it was formed
- Formation-date fair value
- Description of assets and liabilities recognized at formation
- Amounts recognized for each major class of assets and liabilities
- Qualitative description of factors that make up any goodwill recognized
- The amounts that are affected if the valuation of any of the amounts recognized is incomplete or any measurement period adjustments are recognized

### Effective Date and Transition

The new guidance is effective for both public and private JV entities with a formation date on or after January 1, 2025. Entities should apply the new guidance on a prospective basis to all JVs formed on or after the effective date. Early adoption is permitted.

For JVs formed before the effective date, an election can be made to apply the new guidance retrospectively if sufficient information is available to do so. This would require application of the guidance all the way back to the original formation date of the joint venture, using fair values of the contributed assets and liabilities at that date, and adjustment of all subsequent periods to reflect those assets and liabilities (e.g., depreciation, amortization, impairment assessments).

If retrospective adoption is elected, for any guidance in the new standard that is the same as the business combinations guidance, the JV would apply the business combinations guidance as it existed at the date of formation. For example, if the JV was formed in 2010, then when applying the new guidance, for any reference to application of ASC 805, the JV would apply ASC 805 as it existed in 2010.

## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Transactions in which two or more entities contribute assets or subsidiaries to a newly formed entity, or otherwise agree to jointly develop or market products together, are often referred to as joint ventures when they do not meet the accounting definition of a JV. Describe the criteria that must be met in order to meet the accounting definition of a JV.
2. Explain the accounting for goodwill in a JV formation.
3. Discuss the disclosures required for joint ventures.

## **B. Suggested Answers to Discussion Problems**

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1. To be considered a JV for accounting purposes, all of the following criteria must be met.
  - There must be joint control over all the significant decisions of the entity.
  - The venturers should actively participate in the overall management of the JV.
  - The JV should operate for the mutual benefit of the venturers to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities.
2. Goodwill should be recognized when the fair value of the JV as a whole exceeds the amount of identifiable net assets recognized. Negative goodwill should be recognized as an adjustment to equity, not as a bargain purchase gain as in a business combination.
3. The disclosure requirements for joint ventures are relatively consistent with those for business combinations under ASC 805 and include disclosure of the following:
  - Formation date
  - Description of the JV's purpose and why it was formed
  - Formation-date fair value
  - Description of assets and liabilities recognized at formation
  - Amounts recognized for each major class of assets and liabilities
  - Qualitative description of factors that make up any goodwill recognized
  - The amounts that are affected if the valuation of any of the amounts recognized is incomplete or any measurement period adjustments are recognized

## PART 2. AUDITING

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### PCAOB Guidance on Confirmations

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Confirmation of accounts receivable has been a required audit procedure in the United States since 1939. If properly designed and executed by an auditor, the confirmation process may provide important evidence that the auditor obtains as part of an audit of a company's financial statements. The PCAOB is updating its current auditing standard on confirmations with a new standard.

For more on the changes to this standard, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

#### **Ms. Grove Casey**

Today we want to talk about a topic that we auditors have had some experience with. It's related to confirmations. We've had confirmations for quite some time—several decades, as a matter of fact—as a requirement. But the PCAOB has recently come out with a new standard on confirmations. Let's talk a little bit about how important confirmations are to quality audits, because the reason we ended up with them was due to an inventory case back in the 1930s which, obviously, has been a while now. So, let's talk a little bit about why we're still using confirmations.

#### **Ms. Louis**

You're right. It was back in 1939 that we had our first requirement in the United States for there to be confirmations. It was in direct response to the fraud case you mentioned that involved fraudulent reporting of inventories, and the failure on the part of the auditors to detect that because they weren't confirming receivables as well. So, it was both an inventory and a receivable issue that was happening. As a result, though, it did become something that highlighted the need [for an] obligation to have an independent check around things. It started with confirmations, then using confirmations for other areas, like cash deposits and demand notes. They determined that those were things that could really help on every audit. The PCAOB is looking at updating this really important standard for these reasons.

#### **Ms. Grove Casey**

Let's talk about one of the primary reasons behind making changes in the PCAOB standards, because we've had a standard for quite a while.

#### **Ms. Louis**

Yes, as we look at the standards, the original standard (being the one that was in place before they made the changes) was written over 30 years ago, and there were very minimal amendments that have been made to that from the PCAOB standard that was established back in 2003 when the PCAOB audit standards were created. So, there were things that needed to reflect changes in how people communicate, and changes in business practices. When the original standard was written, for example, it was more paper-based (your requests and your responses) as the primary means of communication. Since then, things have evolved with technology to not only include faxes, but emails and other technology-enabled capabilities in the communication process. As these mechanisms become more commonplace, it is important to think about those issues.

Also with technology, there became in recent years an increased wariness about phishing attempts and cybersecurity risk. So, when you're sending something to somebody and they're not expecting it (an unsolicited request to confirm something), there is starting to be more hesitancy on the part of the respondents to respond to it and think it's legitimate.

#### **Ms. Grove Casey**

Let's talk about when this standard becomes effective, because the technology piece is really kind of critical. It's not just the email-sending part, it's that funds transfer so much more rapidly now than they used to. It used to be, for a lot of things, it was three days or more before things would clear. If you're using paper, in some cases it's still the same, but you can do electronic funds transfers and things transfer almost immediately anymore.



**Ms. Louis**

Right. The amendments are intended to take effect for audits of financial statements for fiscal years ending on or after June 15, 2025, but obviously, early application of these principles is something that you always have an option to do.

**Ms. Grove Casey**

Can we talk about some examples of common deficiencies that the PCAOB noted during the inspections and enforcement proceedings?

**Ms. Louis**

Yes, so the PCAOB goes out and does regular inspections, looking at the working papers of the auditors that do work for registered public companies, and they were noticing that for all sizes of firms, whether you were a small audit firm or a large one, whether you focused domestically here or had international practices, there were common issues.

Part of it was just maintaining control over the confirmation processes—particularly if you might have been using a third party to assist in that confirmation process—and failure, in general, to do appropriate confirmation procedures or to have alternative procedures if you weren't able to receive confirmations for areas (particularly accounts receivable where there's that presumption that you would confirm). Also, failure to follow up when you got contradictory evidence; there wasn't sufficient follow-up on things that potentially could have been an issue. The other one was around using negative confirmations versus positive confirmations. The [firms] weren't using those with the appropriate intent, either.

So, those are some examples of things that they found that led them to decide that they needed to upgrade this particular standard.

**Ms. Grove Casey**

The old confirmation standard did not have a specific objective. What is the overall objective of this new confirmation standard?

**Ms. Louis**

In general, as new standards are coming out, standard-setting bodies as a whole are making sure that we start with, well, why do we even have this? The new standard does establish the objective that the auditor's goal is to get relevant and reliable evidence, to design and execute a confirmation process that will enable them to do that, and to get the information from what would be a knowledgeable external source. The elements of ensuring that it truly is coming from a knowledgeable external source and to make sure that it is relevant and reliable, those will be key things that they try to reinforce as they're looking at the issues. So, it needs to be that the auditor believes the knowledge of the information being obtained should be sufficient and appropriate.

**Ms. Grove Casey**

Let's talk about some examples of the more significant changes in this new standard.

**Ms. Louis**

Some of the more significant changes are going to include things like a new requirement related to confirming cash and cash equivalents that are being held by a third party, or otherwise making sure that you are obtaining relevant and reliable evidence related to those cash and cash equivalents by directly accessing information that is maintained by this knowledgeable source.

They also reinforced the existing requirement to confirm receivables and looked at situations where it would not be feasible for the auditor to send confirmations or to get the confirmations. So, how else do I get this information? This could include directly accessing information (once again, thinking about the use of technology).

The third area—probably one of the biggest areas—is identifying situations related to alternate procedures as a whole, and examples of how these alternate procedures really can help in getting relevant and reliable evidence when we're in situations where the confirmation process isn't something that's feasible to do.

**Ms. Grove Casey**

You've mentioned technology and we've talked about electronics and the difference that that has made over the last couple of decades, really. Does the new standard support the use of electronic forms of communication?

**Ms. Louis**

It does. They recognize that audit firms are constantly developing new techniques to enable them to get evidence and to do their substantive audit procedures. So, the new standard does say, yes, there are other procedures in lieu of confirmation where the auditor can get relevant and reliable evidence. That's why you see this focus on directly accessing information that might be maintained by a knowledgeable external source, and [presenting] that as a means of verifying these balances recognizes that these technology-based procedures can be used in lieu of confirmation. As you're accessing [data], like through the internet, you're able to test data against these external data sources.

**Ms. Grove Casey**

Are confirmations meant to enhance the application of professional skepticism?

**Ms. Louis**

They are. Having due professional care is intended to require the auditor to exercise professional skepticism of having an open, questioning mind, and critically assessing the audit evidence that you're getting. Part of it is we look at using that skepticism to really have information about identifying the confirming parties, evaluating the responses, and addressing nonresponses with an open, questioning mind. Not assuming something is right or wrong, and not just going in looking to corroborate, but also looking for contradictory evidence. Sometimes, we tend to look to confirm something and get positive responses, and sometimes, we give less weight to evidence that actually could be contradictory to our hypothesis.

**Ms. Grove Casey**

How does the new standard integrate into the auditor's requirement to take a risk-based approach to audits?

**Ms. Louis**

Definitely it is tied into it, in that the risk-based audit standards are a concept that as your risk of material misstatement increases, the persuasiveness of your audit evidence should also increase. There is an assumption that evidence that we get from these knowledgeable external sources is generally more reliable than what we get from the audited entity itself. This is, then, a particular response that you can have, as you may have an indicator of something being higher risk.

**Ms. Grove Casey**

Is the use of confirmations appropriate for all assertions?

**Ms. Louis**

Certainly, as we think about assertions such as existence, that would be something that is most appropriate as we think about confirmation that *this did exist*, or *this did occur*, or that *I do have rights to this*, or *yes, this is my obligation*.

Completeness, as well, could be something that we look at, but when we're looking at the confirmation process, it's probably less relevant around things like valuation because a confirming party might not actually intend to repay the full amount that is owed, or somebody might not actually know the value of the number of shares held related to an investment, but it is something that you can consider for a variety of pieces of information.

Often, as we think about existence, though, and understanding agreed upon terms and conditions, those would be things that would be most common to be confirmed.

**Ms. Grove Casey**

Does the level of significance of accounts matter?

**Ms. Louis**

Under the new requirements, when they talk about these issues, it does apply to what would be deemed a significant account or a significant disclosure, as we do have this presumption about confirming cash or confirming receivables. If it's not significant, then the requirement would not apply.

**Ms. Grove Casey**

What is the auditor's responsibility for controlling the confirmation process?

**Ms. Louis**

They do emphasize the need to maintain control of the process. The auditor is the one that is responsible for selecting what I'm going to confirm and for actually sending and receiving the request and the response. There is the need for us to ensure that as we're sending the request, whether it's using mail or email, that we're doing it without involvement of the audited entity's personnel. We also want to make sure we're comfortable that it's not being interfered with. When you have an intermediary that sometimes is facilitating a direct electronic communication, then I'm still required to make sure that I'm maintaining control over the process.

So, whether the auditor is doing it, or an intermediary is doing it, we still have the responsibility to think about the process itself and that there isn't any type of interference or fraud that might be perpetrated with that process.

**Ms. Grove Casey**

Maybe they send out an email to their receivables customer base saying, "You're going to be getting an email," so that they don't think it's a phishing attack. Does the new standard prescribe a particular format for a confirmation request?

**Ms. Louis**

They're saying, in essence, that you can have them paper-based, you can have them electronic, you can specify the information that you want confirmed, or you can provide a blank response form. They are giving flexibility as you are looking at the request process. They said you can use an intermediary or not use an intermediary. The key, though, is to make sure that the request can be clearly understood, and to think about the facts and the circumstances of who you're sending the request to. I just want to make sure that it would be understandable to that confirming party.

**Ms. Grove Casey**

Which are more reliable, the blank confirmations or ones where the number is already filled in for them?

**Ms. Louis**

The standard says that using a blank confirmation request generally would provide more reliable evidence because of the fact that if you have filled it in, they are saying there is a risk that the confirming party could simply agree without really going and verifying it against their records. A blank confirmation request requires additional effort on their part, though, so that might result in a lower response rate and might have to lead to more alternative procedures. They do say that you can do either, but just think about your specific circumstances and what you think would be most appropriate.

**Ms. Grove Casey**

Well, you may get a response, but the response may be "file 13," or go to the bottom of the stack because it requires more effort, like you said.

Is the auditor required to confirm all accounts in all cases, or are there alternative procedures that we can do?

**Ms. Louis**

We mentioned how you have to, first of all, determine whether or not the accounts are even significant to begin with, so you're not necessarily doing it if it's not significant. But even if, say, cash or receivables is significant, you don't necessarily need to confirm all cash accounts in all cases. There can be means of selecting items for testing, which could be selecting specific accounts, or it could be using sampling. If you decide you want to do all, there's nothing that is precluding you from doing that. It's important that we look at the company's cash management, treasury functions, and think about their arrangements and transactions and decide, from that point, what you think would be appropriate—maybe focusing on accounts with balances over a certain amount, or accounts with the highest volume of activity. Also though, thinking about things that might be more risk prone, [such as] an account that was recently opened or closed during the audit period, could be something that I use as a basis of determining a specific account to test. I may not need to test them all.

**Ms. Grove Casey**

Let's talk about some of the alternatives to sending a confirmation for cash.

**Ms. Louis**

When we're looking at this presumption, it says, "or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source." That new phrasing (the direct access to information maintained by a knowledgeable external source) is added to the presumption for cash, but it's also added to the presumption for receivables. So, I can do something maybe by getting read-only access to information maintained by the financial institution, or going and looking at balances directly online through a secure website that maybe we could get access to. Still, you directly need to do it. It is direct access by the auditor, but I am able to leverage the technological capabilities that would allow me to access information that is maintained by these sources.

**Ms. Grove Casey**

I noticed that some of my accounts now have a "view" capability. So, if there's another person, say if I wanted to let my kids see the amount in their account, then I can allow them to view it, but they can't make any transactional changes. That kind of thing is really helpful when you're trying to do this kind of a process.

Let's talk about the factors to consider when we're determining who to send those confirmations to.

**Ms. Louis**

Well, it does need to be somebody that's knowledgeable about the information, and it could be that it goes to a specific individual, or it could be that it's going to an organization. The key, then, is to really think about the confirming parties—both their ability to respond and their willingness to respond—and to think about the potential party's objectivity, their freedom from bias, and their motivations because there might be incentives or pressures to provide a response that might be inaccurate or otherwise misleading. That can, obviously, affect the reliability of the information.

As we think about the confirming party, we want it to be relevant, but we also want it to be reliable evidence. [Consider] the source of that information and ensure that we're comfortable that we can have who we think is the best-suited individual in the organization to provide that response.

**Ms. Grove Casey**

Does the auditor need to determine that confirmation requests are properly addressed?

**Ms. Louis**

Yes, in some cases. There may be a case where the auditors compare either some or all of the confirming parties' addresses, particularly if that information is being provided by the audited entity. So, we could look at physical addresses or email domains that could be included, say, on a confirming party's website. That could be a mechanism that we do (either all or on a test basis) when we look at that.

**Ms. Grove Casey**

What if an intermediary is used to facilitate that direct electronic transmission of the confirmation request?

**Ms. Louis**

Then we need to look at the intermediary's controls that address the risk that a confirmation might be intercepted or altered—the request or the response—and to ensure that the controls used by this intermediary are designed and operating effectively. That should be a factor. We're still responsible for maintaining control over the process and being confident in the process, and this should include cases where perhaps the auditor might need to do some procedures where they go and validate the addresses of some or all of the confirming parties. We're trying to ensure that we're comfortable with the process—if it's something that the intermediary is not doing.

**Ms. Grove Casey**

Let's talk a little bit about the use of negative confirmations and when we would want to do that.

**Ms. Louis**

Right. A positive confirmation asks the recipient to respond directly to the auditor about, "Do you agree with what is stated in this request?" or asks them to fill in the blank form. A negative confirmation requests them to respond only if they disagree. So, in practice, these negative confirmations have typically been used to obtain audit evidence that is related to something like the completeness of a deposit liability, or other accounts of similar nature. They're less frequently used in areas like the existence of receivables.

In some cases, though, the auditors might use a combination of positive and negative confirmation requests. You're going to get significantly less persuasive evidence when you're using these negative confirmations. We're running the risk that the confirming party might not respond, either because they didn't receive it, they didn't open it, or they read it and just simply didn't respond because they agreed with the information. We don't really know why we didn't get the negative response back, so it is important that we don't use negative confirmations as the sole substantive procedure when we are looking at performing procedures on these different financial statement assertions. They can supplement other evidence that we're doing. It may be that it's supplementing something like examining a subsequent receipt of cash, but it can't be the sole form of evidence.

**Ms. Grove Casey**

You've mentioned the use of an intermediary in the confirmation process a couple of times. Does this change the auditor's responsibility to maintain control over confirmation requests and responses? Or is it like our other third-party people, let's say, and we still have the responsibility and there is no delegation?

**Ms. Louis**

Right. It still is that, yes, the intermediary does have obligations, but the auditor still has the primary responsibility. Now, certainly, because of the intermediary's involvement, that could affect the integrity of information that is being transmitted, and the auditor should evaluate the implications of that intermediary's involvement. How does that affect the potential reliability of the request and the response?

We should make sure we're comfortable that the intermediary has control to address these risks that could exist and assess circumstances where the audited entity might have the ability to override the intermediary's controls through relationships they have with the confirming party. So, it is important that the auditor *not* use an intermediary if information indicates that the intermediary has not implemented controls that are necessary to deal with this risk of interception or alteration of requests or responses, or if the controls maybe aren't designed well or operating effectively, or if we believe there are circumstances that would give the audited entity the ability to override the intermediary's controls. I would not be able to use the intermediary in those circumstances.

**Ms. Grove Casey**

We have SOC reports for a lot of things. How do SOC reports help with the auditor's responsibilities for evaluating the proper use of an intermediary?

**Ms. Louis**

Getting those SOC reports does help so that I can see, does it cover the access controls at an intermediary? The auditor may then be able to look to see, based on this report, am I comfortable with the design and operating effectiveness of the confirmation process as a whole? And if there are any types of deficiencies or failures that are noted in this report, then the auditor would have to figure out the implications of that as it relates to the ability to get that relevant, reliable information. Obviously, we want to think about the facts and the circumstances of each engagement, and about the understanding that we can get of the intermediary's controls. Use an SOC report when it's available, but if it's not available, figure out how you are going to be comfortable with the intermediary's controls that address the risk of interception and alteration.

**Ms. Grove Casey**

Are bridge letters discussed in the new standard to close the gap between the date of an SOC report and a financial statement audit period? We used to call them "stub periods."

**Ms. Louis**

With the stub periods, the new standard does not specify an appropriate window of time to be covered by a bridge letter, or the window of time between the date covered by the bridge letter and the period when the auditor uses this intermediary to facilitate the confirmation process. They do say that you should use your judgment based on the facts and circumstances to determine whether or not a bridge letter is needed, and for how long that window of time could be—which is also a consideration.

**Ms. Grove Casey**

So, as we wrap up, what are some important concepts that you want to remind us about from our conversation today related to confirmation?

**Ms. Louis**

Mostly, to really understand that this new standard is meant to strengthen existing requirements. It is a principle-based approach that you can apply to any method of confirmation, and it is designed to really enhance things that have been long-standing confirmation methods, like your paper-based methods or sending things through the regular mail. Also, to understand that we have to think about new means of communication, like emails and using intermediaries, and that there are probably methods that are yet to emerge related to different innovations in audits. So, do understand that it is still principle-based in the end, and it is meant to be helpful in improving the quality of our work.

## SUPPLEMENTAL MATERIALS

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### PCAOB New Standard on Confirmations

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By Jennifer F. Louis, CPA

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#### **Background**

The Public Company Accounting Oversight Board (PCAOB) is replacing its auditing standard, AS 2310, *The Confirmation Process*, with a new standard, AS 2310, *The Auditor's Use of Confirmation*. It is also making other conforming amendments to certain related PCAOB auditing standards.

AS 2310 is an important standard for audit quality and investor protection that impacts nearly every audit. For example, auditors may use confirmation for testing cash deposits, accounts receivable, and demand notes. Confirmation of accounts receivable has been a required audit procedure in the United States since 1939, when the American Institute of Accountants adopted Statement on Auditing Procedure No. 1 as a direct response to the McKesson & Robbins fraud case, which involved fraudulently reported inventories and accounts receivable that the independent auditors failed to detect after performing other procedures that did not involve confirmation.

If properly designed and executed by an auditor, the confirmation process may provide important evidence that the auditor obtains as part of an audit of a company's financial statements. Per the new standard, the confirmation process involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party (e.g., a financial institution), evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions.

#### **Changes in Means of Communication**

The original standard was written several decades ago and has had minimal amendments since its adoption by the PCAOB in 2003. Changes are designed to improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice.

The original AS 2310 was written at a time when paper-based confirmation requests and responses were the prevailing means of communication. Since then, emailed confirmation requests and responses, and the use of technology-enabled confirmation tools, including the use of intermediaries to facilitate the confirmation process, have become commonplace. For example, numerous financial institutions globally mandate the use of an intermediary as part of the confirmation process and will not otherwise respond to an auditor's confirmation request.

In recent years there has been an increased wariness about phishing attempts by unauthorized parties aimed at obtaining sensitive personal or financial information of customers. As a result, some recipients might not understand or trust an unsolicited confirmation request from an auditor. In fact, many financial institutions and other companies advise customers not to reply to unsolicited correspondence concerning their accounts or other customer relationships.

#### **Recent Observed Deficiencies**

Over the past several years, PCAOB inspections and enforcement proceedings indicated that some auditors did not fulfill their responsibilities under the existing standard when performing confirmation procedures. The shortcomings have been noted at large and small domestic firms, and at large firms with domestic and international practices.

#### **Example deficiencies include:**

- Failure to maintain appropriate control over the confirmation process, including instances where company personnel were involved in either sending or receiving confirmations.
- Failure to consider performing procedures to verify the source of confirmation responses received electronically.
- Failure to perform appropriate confirmation procedures and alternative procedures for accounts receivable.
- Failure to adequately respond to contradictory audit evidence obtained from confirmation procedures.

- Failure to perform sufficient alternative procedures.
- Failure to restrict the use of negative confirmation requests to situations where the risk of material misstatement was assessed as low.
- Failure to perform appropriate confirmation procedures to address a fraud risk.

### **Clarity of Objective**

Existing AS 2310 does not include an objective. The new standard provides that the objective of the auditor in designing and executing the confirmation process is to obtain relevant and reliable audit evidence from a knowledgeable external source about one or more relevant financial statement assertions of a significant account or disclosure.

A knowledgeable external source generally is a third party who the auditor believes has knowledge of the information that may be used as audit evidence. To the extent that this objective differs from the objective in standards adopted by other standard-setting bodies on the auditor's use of confirmation, the new standard is consistent with the PCAOB's statutory mandate to protect the interests of investors and further the public interest.

### **Summary of Significant Changes**

The new standard enhances the PCAOB's requirements on the use of confirmation by describing principles-based requirements that apply to all methods of confirmation, including paper-based and electronic means of communications. The new standard also expressly integrates with the PCAOB's risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor's responsibilities for obtaining relevant and reliable audit evidence through the confirmation process.

Example significant changes in the new standard include:

- Adds a new requirement regarding confirming cash and cash equivalents held by third parties (cash), or otherwise obtaining relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.
- Reinforces the existing requirement regarding confirming accounts receivable, while addressing situations where it would not be feasible for the auditor to perform confirmation procedures or obtain relevant and reliable audit evidence for accounts receivable by directly accessing information maintained by a knowledgeable external source.
- Clarifies that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence (and includes examples of situations where the auditor may use negative confirmation requests to supplement other substantive audit procedures).
- Identifies situations in which alternative procedures should be performed by the auditor (and includes examples of such alternative procedures that may provide relevant and reliable audit evidence for a selected item).

The new standard supports the auditor's use of electronic forms of communication between the auditor and the confirming party. Some audit firms may have developed or may yet develop audit techniques that enable the auditor to obtain relevant and reliable audit evidence for the same assertions by performing substantive audit procedures that do not include confirmation. Therefore, the new standard allows the performance of other procedures in lieu of confirmation for cash and accounts receivable in situations where the auditor can obtain relevant and reliable audit evidence by directly accessing information maintained by knowledgeable external sources.

Also, the new standard acknowledges that, in certain situations, it may not be feasible for the auditor to obtain audit evidence for accounts receivable directly from a knowledgeable external source and provides that in those situations the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.



Examples of using technology-based procedures in lieu of confirmations include accessing company balances directly at the relevant financial institution and testing internal data against external data sources using audit data analytics.

### **Effective Date**

The new standard and related amendments will apply to all audits conducted under PCAOB standards. Subject to approval by the Securities and Exchange Commission (SEC), the new standard and related amendments will take effect for audits of financial statements for fiscal years ending on or after June 15, 2025.

### **Relationship to Risk Assessment**

Due professional care requires the auditor to exercise professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of audit evidence. Professional skepticism should be exercised throughout the audit process, including when identifying information to confirm, identifying confirming parties, evaluating confirmation responses, and addressing nonresponses. The requirements are designed to reduce the risk of confirmation bias, where auditors may actively seek out and give more weight to evidence that confirms their hypothesis and give less weight to evidence that could disconfirm their hypothesis.

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding designing and implementing appropriate responses to the risks of material misstatement. Fundamental to the PCAOB's risk assessment standards is the concept that as risk increases, so does the amount of evidence that the auditor should obtain. It is assumed that evidence obtained from a knowledgeable external source generally is more reliable than evidence obtained only from internal company sources.

Performing confirmation procedures can effectively and efficiently provide evidential matter about certain financial statement assertions, including existence, occurrence, completeness, and rights and obligations. For example, confirmation may provide audit evidence related to the existence of cash, accounts receivable, and financial instruments, or the completeness of debt. However, the confirmation process generally provides less relevant evidence about the valuation assertion (e.g., the confirming party may not intend to repay in full the amount owed, or the custodian may not know the value of shares held in custody).

Confirmation could also be used to obtain audit evidence about the terms of contractual arrangements (e.g., by verifying supplier discounts or concessions, corroborating sales practices, or substantiating oral arrangements and guarantees). Information in confirmation responses may indicate the existence of related parties, or relationships or transactions with related parties, previously undisclosed to the auditor.

Determining the nature, timing, and extent of confirmation procedures, and any other additional audit procedures, is part of designing and implementing the auditor's response to the assessed risk of material misstatement. In some situations, an auditor may determine that evidence obtained through confirmation may provide sufficient appropriate audit evidence for a particular assertion, while in other situations performing other audit procedures may be necessary. For example, for significant unusual sales transactions and the related accounts receivable balances, an auditor might confirm significant terms of the transactions and the receivable balances with the transaction counterparties and perform additional substantive procedures, such as examination of shipping documents and subsequent cash receipts.

The requirements under the new standard apply to a "significant" account or disclosure. The new standard does not establish a presumption to confirm cash or accounts receivable if the auditor has not determined cash or accounts receivable to be a significant account.

### **Controlling the Confirmation Process**

The new standard emphasizes the auditor's responsibility to maintain control over the confirmation process and provides that the auditor is responsible for selecting the items to be confirmed, sending confirmation requests, and receiving confirmation responses.

AS 2310 provides that the auditor should maintain control over the confirmation process. Complying with this requirement generally involves the auditor directly sending the confirmation request to the confirming party via mail or email, without involving company personnel. The auditor's confirmation request generally specifies that any correspondence should be sent directly to the auditor's location (or email address) to minimize the risk of interference by company personnel.

When an intermediary facilitates direct electronic communications between the auditor and the confirming party, the auditor is still required to maintain control over the confirmation process. Procedures performed by audit firms to address this requirement vary depending on facts and circumstances. Some auditors have used a report on controls at a service organization (SOC report) to evaluate the design and operating effectiveness of the intermediary's controls relevant to sending and receiving confirmations.

### **Designing Confirmation Requests**

The new standard does not prescribe a particular format for a confirmation request. For example, requests could be paper-based or electronic, specifying the information to be confirmed or providing a blank response form, or sent with or without the involvement of an intermediary that facilitates electronic transmission.

Generally, the auditor determines the format of a confirmation request to increase the likelihood that the request is received and clearly understood by the confirming party, taking into consideration, among other things, the facts and circumstances of the company and the confirming party.

### **Identifying Information to Confirm**

The auditor should identify information related to the relevant assertions that the auditor plans to verify with confirming parties or (when using a blank form) obtain from confirming parties. Such information could include transaction amounts, transaction dates, significant terms of transactions, and balances due to or from the confirming party as of a specific date.

Using a blank confirmation request generally provides more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., a customer account balance). It is possible that a confirming party could agree to the information without verifying it against the confirming party's records.

However, responding to blank form confirmation requests generally requires additional effort, which might lower the response rates and lead auditors to perform alternative procedures for more selected items. Despite the possibility of lower response rates, responses to blank form confirmation requests may provide more reliable audit evidence than responses to confirmation requests using pre-filled forms.

### **Identifying Cash Accounts to Confirm**

The requirement to confirm cash, as well as accounts receivable, only applies when the auditor has determined that these accounts are significant accounts. An auditor need not necessarily confirm all cash accounts in all cases. Under PCAOB standards, the alternative means of selecting items for testing are selecting all items, selecting specific items, and audit sampling.

In selecting the individual items of cash to confirm, the auditor should consider the auditor's understanding of the company's cash management and treasury function, and the substance of the company's arrangements and transactions with third parties. For example, an auditor might select bank accounts with balances over a certain amount, accounts with a high volume of transactions, accounts opened or closed during the period under audit, or accounts the auditor identifies as particularly risk-prone. Alternatively, the auditor might determine it is appropriate to confirm all cash accounts.

The auditor also follows the direction in PCAOB standards when determining whether performing procedures in addition to confirmation is necessary to address the assessed risk of material misstatement relating to cash.

The PCAOB added to the presumption to confirm cash (and accounts receivable) in the new standard the phrase “or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.” For example, the auditor might satisfy this requirement to obtain relevant and reliable audit evidence under the new standard by obtaining read-only access to information maintained by a financial institution concerning its transactions or balances with the company directly online through a secure website of the financial institution using credentials provided to the auditor by the financial institution.

### **Identifying Confirming Parties**

To obtain reliable audit evidence, the auditor should direct the confirmation requests to third parties (individuals or organizations) who are knowledgeable about the information to be confirmed.

When designing confirmation requests, an auditor may become aware of information about a potential confirming party’s motivation, ability, or willingness to respond, or about the potential confirming party’s objectivity and freedom from bias with respect to the audited entity. Information may indicate that the potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading. Because this type of information can affect the reliability of audit evidence provided by the confirming party to the auditor, the auditor should consider any relevant information that comes to the auditor’s attention when selecting the confirming parties.

The auditor should perform alternative procedures for situations in which the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit evidence about a selected item.

The auditor should determine that confirmation requests are properly addressed. This increases the likelihood that they are received by the confirming party. For example, some auditors compare some or all confirming party addresses, which are typically provided by the company, to physical addresses or email domains included on the confirming party’s website.

Alternatively, when using an intermediary to facilitate direct electronic transmission of confirmation requests and responses, the auditor should obtain an understanding of the intermediary’s controls that address the risk of interception and alteration of the confirmation requests and responses and determine whether the relevant controls used by the intermediary are designed and operating effectively.

In situations where the auditor determines that the intermediary’s controls that address the risk of interception and alteration do not also include controls related to validating the addresses of confirming parties, the auditor would need to perform other procedures. The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.

The reliability of audit evidence depends not only on its nature and source, but also the circumstances under which it is obtained. For example, restrictions on access to a potential confirming party that cause the auditor to identify and send a confirmation request to a different confirming party or to perform alternative procedures may themselves raise questions as to the reliability of the audit evidence that the auditor subsequently obtains from the other confirming party or through performing alternative procedures.

### **Negative Confirmations**

Auditors are permitted to use positive confirmation requests and, provided certain conditions are met, negative confirmation requests.

A positive confirmation request either asks the recipient to respond directly to the auditor about whether the recipient agrees with information that is stated in the request or asks the recipient to provide the requested information by filling in a blank form.

A negative confirmation request directs the recipient to respond only when the recipient disagrees with the information included in the request. In practice, negative confirmation requests have typically been used to obtain audit evidence related to the completeness of deposit liabilities and other accounts of a similar nature and, less frequently, to obtain evidence related to the existence of accounts receivable. In some cases, auditors use a combination of positive and negative confirmation requests.

The auditor generally obtains significantly less audit evidence when using negative confirmation requests than when using positive confirmation requests. A confirming party might not respond to a negative confirmation request because it did not receive or open the request, or alternatively, the confirming party might have read the request and agreed with the information included therein.

Because of the limited evidence provided when using negative confirmation requests, the auditor may not use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement to a financial statement assertion. The auditor may use negative confirmation requests only to supplement audit evidence provided by other substantive procedures (e.g., examining subsequent cash receipts, including comparing the receipts with the amounts of respective invoices being paid; examining shipping documents; examining subsequent cash disbursements; or sending positive confirmation requests).

### **Maintaining Control Over the Process**

The auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted and altered. This is because the reliability of audit evidence provided by confirmation depends in large part on the auditor's ability to control the integrity of confirmation requests and responses. As part of maintaining control, the auditor should send confirmation requests directly to the confirming party and receive confirmation responses directly from the confirming party.

An external auditor can use internal auditors in a direct-assistance capacity as part of the confirmation process.

### **Use of an Intermediary**

Certain financial institutions and other companies have adopted the policy of responding to electronic confirmation requests from auditors only through another party that is engaged as an intermediary to facilitate the direct transmission of information between the auditor and the confirming party. The use of an intermediary does not relieve the auditor of the responsibility under PCAOB standards to maintain control over confirmation requests and responses.

Because an intermediary's involvement may affect the integrity of information transmitted between the confirming party and the auditor, the auditor should evaluate the implications of such involvement for the reliability of confirmation requests and responses. The auditor's evaluation should address certain aspects of the intermediary's controls related to the risk of interception and alteration of communications between the auditor and the confirming party. The auditor's evaluation should also assess whether circumstances exist that give the company the ability to override the intermediary's controls (e.g., through financial or other relationships).

The auditor should not use an intermediary if information obtained by the auditor indicates that:

- The intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses,
- The necessary controls are not designed or operating effectively, or
- Circumstances exist that give the company the ability to override the intermediary's controls.

For example, an auditor could obtain a SOC report stating that a particular access control at an intermediary is not designed or operating effectively. The auditor may then be able to identify and test other controls that could mitigate the control failure described in the SOC report. If the auditor determines that the identified controls are designed and

operating effectively and mitigate the control failure, or the auditor has performed other procedures such as obtaining computer systems event logs generated by the intermediary that provide evidence there was no unauthorized access during the relevant period, the information in the SOC report in this scenario would not necessarily mean that the auditor is not allowed to use the intermediary under the new standard.

In circumstances where the auditor should not use an intermediary to send confirmation requests or receive confirmation responses, the auditor should send confirmation requests without the use of an intermediary or, if unable to do so, perform alternative procedures.

The new standard allows auditors to customize their approach based on the facts and circumstances of the audit engagement and the audit firm. For example, in obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses and determining whether they are designed and operating effectively, the auditor could:

- Use, where available, a SOC report that evaluates the design and operating effectiveness of the relevant controls at the intermediary; or
- Test the intermediary's controls that address the risk of interception and alteration directly.

The new standard does not specify an appropriate window of time to be covered by a bridge letter or a permissible window of time between the date covered by a bridge letter and the period when the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses. Auditors should use their professional judgment based upon the facts and circumstances of the audit to determine the nature of procedures required.

### **Summary of Key Provisions**

The provisions of the new standard the Board is adopting are intended to strengthen existing requirements for the auditor's use of confirmation.

One of the key aspects of the new standard is that it includes principles-based requirements that are designed to apply to all methods of confirmation. The new standard is designed to enhance requirements applicable to:

- Longstanding methods;
- Methods that involve electronic means of communications; and
- Methods that are yet to emerge, encouraging audit innovation.

The new standard specifies certain risk-based considerations and emphasizes the auditor's responsibilities for obtaining relevant and reliable audit evidence when performing confirmation procedures.

The new standard states that the auditor should select the items to be confirmed, send confirmation requests, and receive confirmation responses.

The new standard emphasizes the use of confirmation procedures in certain situations.

- It adds a new requirement for confirmation procedures for cash held by third parties.
- It carries forward the requirement that the auditor confirm accounts receivable.
- It adds a new provision that the auditor may obtain audit evidence by directly accessing information maintained by a knowledgeable external source for cash and accounts receivable.
- In addition, the new standard carries forward the requirement to consider confirming the terms of certain other transactions.

The new standard provides when not feasible for the auditor to obtain audit evidence directly from a knowledgeable external source for accounts receivable, the auditor should perform other substantive audit procedures, including tests of details, to obtain audit evidence from external sources indirectly.

Under the new standard, negative confirmations may be used to provide sufficient appropriate audit evidence only when combined with other substantive audit procedures. Examples of situations where the use of negative confirmation requests combined with other substantive audit procedures may provide sufficient appropriate audit evidence are provided.

The new standard identifies situations where other procedures should be performed by the auditor as an alternative to confirmation, and provides examples of alternative procedures that individually or in combination may provide relevant and reliable audit evidence.

Under the new standard, for significant risks associated with cash or accounts receivable, the auditor is required to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Discuss the new presumed requirement to confirm cash.
2. How would the auditor select individual items of cash for confirmation?
3. Discuss alternatives to confirmation for cash.

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**B. Suggested Answers to Discussion Problems**

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1. The requirement to confirm cash, as well as accounts receivable, only applies when the auditor has determined that these accounts are significant accounts. An auditor need not necessarily confirm all cash accounts in all cases. Under PCAOB standards, the alternative means of selecting items for testing are selecting all items, selecting specific items, and audit sampling.
2. In selecting the individual items of cash to confirm, the auditor should consider the auditor's understanding of the company's cash management and treasury function, and the substance of the company's arrangements and transactions with third parties. For example, an auditor might select bank accounts with balances over a certain amount, accounts with a high volume of transactions, accounts opened or closed during the period under audit, or accounts the auditor identifies as particularly risk-prone. Alternatively, the auditor might determine it is appropriate to confirm all cash accounts.
3. The auditor follows the direction in PCAOB standards when determining whether performing procedures in addition to confirmation is necessary to address the assessed risk of material misstatement relating to cash.

The PCAOB added to the presumption to confirm cash (and accounts receivable) in the new standard the phrase "or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source." For example, the auditor might satisfy this requirement to obtain relevant and reliable audit evidence under the new standard by obtaining read-only access to information maintained by a financial institution concerning its transactions or balances with the company directly online through a secure website of the financial institution using credentials provided to the auditor by the financial institution.



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## PART 3. SMALL BUSINESS

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### Fraud Considerations

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Misstatements in the financial statements can result from either fraud or error. Fraud may be the result of fraudulent financial reporting or from misappropriation of assets. While the auditor may identify it, the primary responsibility for its detection and prevention rests with those charged with governance and management of the entity.

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

#### **Ms. Grove Casey**

So today we want to talk a little bit about fraud and fraud in the financial statements. So, to begin with, let's talk a little bit about why fraud is important for us to understand.

#### **Mr. Oestrieher**

Well, would you like me to talk about that from the perspective of our clients or from the perspective of the standard setters? Because I think there are two divergent views. I'll talk to you, I guess, from the non-standard perspective, from our clients. They think CPAs are all-knowing omnipresent people, and that if we are, "doing their books," that we will magically become aware and should become aware and will become aware and will tell them about any fraudulent transactions, down to the employee that uses the company credit card to buy lunch for the company one day under orders of his or her executive, and then happens to just put their kid's happy meal on there and no one catches it, because that's fraud, Debbie. It's knowingly covering up and taking something. There's actually the theft element and the fraud element. So that's what people think we do and they don't care what level of service, quite frankly, even when we're doing the tax return somehow there's this misperception from our clients and certainly plaintiff attorneys that is what we do. So the best way to answer your question of why we are concerned about fraud is, first of all, from the perspective of the over-expectation of others, we need to understand what those over-expectations are, and then use our engagement letters and reports to communicate the limitations of the engagement, but more so from a standards perspective, depending on the level of service that we're providing for the client, there are specific ways that we need to address fraud because fraud is one of the ways that a material misstatement can enter into the financial statements. That is the primary reason from a standards perspective, that's what we recognize. Mistakes happen and fraud happens and both of those things cause material GAAP departures.

So from that perspective...we need to understand how fraud could happen and then result in a material misstatement. So we're still not going to find that happy meal that was charged on the credit card because I can't imagine in any scenario where that would be material to the financial statements. But we need to consider those ways. And what we're going to explore is the different basic standards we have depending on the level of service we are providing and talk about what those responsibilities are and our communications related to fraud.

#### **Ms. Grove Casey**

... You mentioned the different levels of service, let's talk about fraud in non-assurance engagements. We don't really have a requirement because there's no assurance, right? But we do need to do something because we've got due professional care.

#### **Mr. Oestrieher**

Correct. And that's where . . . we have four engagements now, of course, the preparation, the compilation, the review, and the audit. And the line of demarcation between assurance and non-assurance is right in the middle. The audit and review are assurance engagements and the preparation and compilation are non-assurance engagements. And of course, both of those come from the SSARS. Preparation is in Section 70. Compilation is in Section 80. Then there is a little bit of guidance in AR-C 60, of course, that covers both. But that's where you're looking for any authoritative

guidance as to what responsibilities that we may have in fraud. The first thing we notice when we look at these standards is the required elements of the engagement letter. And within those required elements of the engagement letter, we split out accountants' responsibilities and management's responsibilities.

And we also talk about the limitations of the engagement. So there's a paragraph in both of those engagement letters that, interestingly enough, when the samples came out after SSARS 21, the heading for that engagement letter, that section just says, accountant responsibilities. But actually it covers three things, objectives, accountant responsibilities, and limitations. So merged within those paragraphs under that heading of accountant responsibilities, we let people know that the engagement cannot be relied upon to discover fraud, illegal acts, and it uses some other terms, but that's where we see the fraud word first mentioned. So, not only do our standards not contain any specific guidance as far as inquiries or anything proactive that a CPA is required to do in a non-attest engagement, we also specifically describe the limitation of that engagement. But we do tell people, our clients, in those engagement letters, that if we become aware of fraud or noncompliance, then we will communicate. Now there's that clearly inconsequential caveat on noncompliance, you remember that? It's kind of a newer thing, not newer, but NOCLAR, we're not compliant with laws and regulations. We're seeing a lot of things. But certainly if I see that and become aware in a compilation or preparation engagement that fraud is occurring and it could take many different forms. It could be theft. It could be [noncompliance] in other areas where you're not complying with 941 deposits or something like that. Of course, I'm going to communicate that to the client because that's more than clearly inconsequential. But again, the clearly inconsequential is only toward noncompliance. Fraud doesn't have that caveat. I guess it goes under the guise of where there's smoke, there's fire.

So somehow I did become aware that people were charging, and let's say it's a medical practice and every Wednesday they have a staff meeting and they sent someone to go get lunch for everybody. And by the way, I can tell you where they sent them is the Subway near my office. If you ever get in line at Subway and there's someone in scrubs in front of you, don't get in line! They're going to pull out a list and they've got 14 sandwiches they're about to order. And what if 12 were for the people on the staff and the two for their kids and they drop them off at school? Well again, we used that example earlier, that's fraud. And if somehow I became aware of that, I would communicate it to management because maybe they're putting a little gas in their car or things like that. That's the reason why we don't have that clearly inconsequential. Later on in the engagement letter under management responsibilities, it is...assertive and specifically in there that management is responsible for compliance and management is responsible for fraud.

Now something happened not long after the sample engagement letters or the required elements of the engagement letter came out after SSARS 21 because one of management's responsibilities that had to be put in the engagement letter was that management was responsible for internal control over financial reporting. And someone, and it had to be a lawyer, Debbie, told their CPA, I'm not signing this because I'm hiring you to do my financial reporting, which when they use a broad term like financial reporting, generally we think of the year end entries and all, but certainly an argument could be made, and heck, I might be the one making the argument, that all the transactions that are recorded in the general ledger impact financial reporting, therefore internal control is related to that. I have bookkeepers here in my office. We report every transaction in our client's general ledger. We report everything. And yes, independence is impaired. But when this person again, who I think was an attorney involved in signing that engagement letter saying, how can we be responsible for something that happens at your office? Well, the AICPA said, okay, you can take that out. Now it's a non-issue on the preparation.

On the compilation that automatically impairs your independence. But we need to be aware of is, okay, now, because client doesn't have the issues with internal controls, this is the back door that, yes, while the standards say we don't have to look for fraud, if you are processing transactions for your client as non-attest services related to the non-assurance function, and I know that sounded like a word salad. But remember the standards as they are written for preparation and compilation, they don't care what happened up until the time you had a trial balance. Okay. They assume you're starting with an adjusted trial balance that the client did all the bookkeeping, and then, you prepare or compile financial statements. But from a practical standpoint, often our firms, and this is a growing area, and I encourage firms to do this, we want to be their back office accountant. We want to be their accounting function. So when we just say blanket, we're not responsible for fraud at all on the compilation or preparation, you need to consider

due professional care in the non-attest services that you're often providing in these non-assurance functions. And quite frankly, Debbie is much more likely that that's where some fraud is occurring in your exposure there because you are seeing those transactions. While we're not magical, if we are the one processing transactions for the client and we are not providing the client with good advice when we see that, hey, there's a problem. And just to kind of give you a scare story, and this really happened to a CPA somewhere in the United States that called me this past year, their client used email to communicate invoices that need to be paid. Sometimes they drop them off. Sometimes they'd email and they received an email from a contact person who was a new vendor.

So the bookkeeper at the CPA office contacted to ensure that was an appropriate vendor. It was. They set them up and wired the money. Did this three weeks in a row and they were told this would be a weekly invoice, new vendor. Well, the owner of the company looked online and saw these unusual transactions, called the CPA partner, said, okay, I'll look into it. That's what he found out, called the owner back, said, okay, this is just a new vendor and so and so and so and so. So the owner contacted his people and said, uh-uh, no, no. That's not a vendor of ours. That company that was the client of the CPA firm was the victim of a phishing scandal. And we need to understand, and when we talk about fraud, we need to understand what controls were put in place. And the problem was that there were no controls at the CPA firm for new vendors. There were no controls in place at the client's office for new vendors. But because it was a large transaction, she at least contacted them. The problem was the employee of the CPA firm contacted the vendor, not the client. So, of course, the vendor that was phishing and sending false invoices said, oh, yes, that's us. And they said it in a nice accent relative to the area of the country that they were in. And I'm not going to try to do an accent from that area of the country because I can't. I guess that rules out the South, right? So ultimately, the CPA firm was responsible. And those three transactions were somewhere in the \$400,000 range. These were not small transactions. And again, so we need, we say, when our standards say...that we are not responsible for fraud in a preparation, or compilation engagement, that is true, but those standards do not cover the non-attest services. So from a reasonable, and we don't have statements on standards for bookkeeping services, but we do have due professional care in our Code of Professional Conduct. And by the way, the CPA firm booked the check. I mean, they're like, it's our fault. So I don't want people to come away from this discussion thinking, oh, I don't have to worry about fraud in my non-[assurance] engagements now.

Yes, you do. If you're doing, non-attest bookkeeping from a due professional care standpoint, we need to make sure that we are in fact reasonable in what we're doing and install controls. I mean, just my bookkeepers, if one person is responsible for writing checks for a client, someone else reconciles the bank account. We even have that segregation of duties, and we have the client sign all checks. We don't do any wires. And any ACH transfers are limited to things that are like the 941 deposit, but we always tell the client, okay, you told us to pay your American Express bill of \$61,000 or whatever it might be, please approve it in an email. So in other words, we never have any of those transactions without approval. And it has nothing to do with independence because you don't have to maintain independence in a preparation. And we're already disclosing lack of independence in a compilation. It's just good business practice. So that's where...our exposure is on non-assurance.

Now if I have a client that they have an in-house bookkeeper and at the end of the year we do a tax return and they need a compilation or a preparation for the bank, your engagement letter should pretty much cover you. If ultimately there is fraud going on within their organization, you just need a good attorney and you should be able to win that. Unless they have an expense called fraud expense or something like that, which I doubt that they would put that blatantly because all we do are read those financial statements. So those are our responsibilities when it relates to non-assurance engagements.

### **Ms. Grove Casey**

So let's talk about review engagements because that is an assurance, it's an assurance and attest engagement, even if it's limited assurance. What kinds of responsibilities do we have there? Certainly with an audit, our responsibility is, well, at least as perceived by the public is very high.

**Mr. Oestriecher**

Right. Well, and then this was an interesting one, Debbie, because it goes back to when I was on the committee, the Accounting and Review Services Committee of the AICPA when we were writing SSARS-10. And quite frankly, that's when I got to know you, because our joint friend Russ Madray was on the Committee with me, and that's how I got to meet your wonderful organization and start doing some of these projects with you. So lots of good things came from that. And with SSARS-10, we, the Committee were given a mandate by the AICPA that as we revised the standards related to review engagements, they were not going to pass muster and we could not put it out for exposure draft until we included specific inquiries about fraud. Up until that time, that was not a required inquiry. So our responsibilities were nebulous. They were very general in nature and not specified. And so by putting it in there the AICPA believed, okay, now, whether it's litigation or regulators or whomever, or just expectations from the public as to the extent that what is our responsibility when we were providing limited assurance, it seems kind of stupid that well, we didn't even ask management if they were aware of fraud. So it was SSARS-10 about 20 years ago when all we have is the specific inquiry, you must make inquiries related to the existence or knowledge of fraud.

Now, certainly we're still going to have in our engagement letter how management is responsible and you cannot rely on the engagement, but we're still going to ask the question. And I can tell you since then, I guess, that was 20 years ago, we do about 15 reviews a year. I've got my hand in a lot of those. So I've probably done between 140 and 170 reviews since then. And I usually direct inquiries to more than one person at an entity. So...when I am talking, asking general inquiries of maybe those charged with governance or management, I will go ahead and ask that to anyone that I have to ask about it. Even if I'm talking to a payroll clerk about specific inquiries related to payroll, I may throw that in there. So let's just say at least 400 times I have asked in a review engagement if someone was aware of fraud, if they have committed a fraud or a fraud has been reported to them. And surprisingly, no one has ever answered yes, unless they did know about it, but usually I'm the first person they call. It won't even be during the term of a review engagement. I mean, usually the first person someone will call when that happens is their accountant. So I have never uncovered a misstatement or a material misstatement in a review as a result of me asking and inquiring about fraud, and understand also that review standards specifically state that we are not required to obtain evidence to corroborate management's responses. So I ask you, Debbie, you're the controller, are you aware of a fraud? What is your response? No. Did you commit any fraud? No. And now I'm not going to go up to a lie detector test. I remember I was on a panel one time with some folks talking about the review engagement. And I was just talking about our general inquiries.

And in the pandemic, this was back in the pandemic era, and how we moved away from meeting with our clients and we would just send them emails with inquiries. And one of the panel members was shocked. He goes, Kurt, you're not asking them face to face. And I said, no. He goes, well, how can you read their body language to see if they're lying? And then I was shocked by that question. I said, because I don't even do that in an audit. I'm not a trained FBI investigator. And you show me in the standards where I have to, see, if I'm asking someone, hey, have you reconciled your bank accounts? If I think they could lie to me, I'm not accepting the engagement to begin with. So it is just, please do not think that in a review engagement, we have to somehow give someone and see if they're giving us the evil eye and read their body language. Because that's something I would not be very, I can read the body language of my wife after being married for 32 years. I know when she's mad, she doesn't have to say a word. Okay. But for people that I just see once a year. Sorry, I don't know, maybe your nose itches. And so I'm thinking, oh my goodness, their eyes are twitching or something. They must be lying. So from a review perspective, it is highly unlikely that you will ever become aware of fraud as a result of the inquiry. Now, when you're performing analytical procedures, you might look and see some numbers are off, some expenditures are higher compared to budget and prior years. And as a result of those analytical procedures, you might ask questions and maybe fraud isn't even on your mind, but the answer seems kind of evasive. And that's when in a review, in other words, if something appears as though there could be a material departure, you follow with inquiries or other analytical procedures. And if you're still not satisfied, that is the occasion in a review where you might say, okay, well, I'm going to go look at some of these transactions in the general ledger. You start noticing that credit card charges are a lot higher than they've ever been. And there's a lot of stuff coded to office supplies. And again, you can see that when you're doing your comparison year to year, I doubt you'll ever pick office supplies as a specific account to prepare an analytical procedure on. But if I've noticed that typically, this company has between 25 and \$30,000 of office supplies for the last four or five years in

management said, yes, things should be a little bit the same, maybe inflationary and I see there's 85,000 in office supplies. Okay, there's something wrong there. And really, initially I'm not thinking about fraud, I'm thinking about, okay, there are fixed assets that have been coded. So that's what I'm worried about more than anything. So that is how you might actually lay your eyes on the transactions or the items that are recorded in the financial statements. But typically, it's going to be, in my opinion, the analytical procedures that might lead you because it is a material misstatement.

Now someone that's stealing a couple grand a year, that's never going to show up in your analytical procedures. So, and we aren't even responsible if that's not material to even be looking for things, because remember we're looking for departures. So understand we need to make specific inquiries, but at all times we need to be aware that we could find it, not because anyone's going to admit to it, but just from other things. And then if we do find it, then we will communicate it. Those are under the AR communications, AR-C 90, where you can communicate to those charged with governance at any time, anything that you think would be relevant, and of course I would always think that would be relevant if you became aware of fraud.

**Ms. Grove Casey**

So let's talk a little bit more about those communications of fraud in a review engagement. Did you want to do that or do you want to move on to audit?

**Mr. Oestrieher**

I just hit on that briefly. It is, again, when I think of the things that I'm going to communicate in a review, the things that I believe are relevant to management, fraud has to be at the top of the list. And we don't have the formal communications that you will see in our auditing standards. And these communications can be either orally or in writing. So we have very broad standards in the review engagement, I think, on an issue such as this, I highly recommend in writing and I know we have become a world of email. I like email for communications, but every now and then we pull out the letterhead and then put a formal letter like I would in the 1980s when it took me seven hours to get a letter out because I had to dictate it and I had to read the draft and have somebody else look at it. It was real fancy and we put a manual signature on it. Those types of communications, the good news is that was the norm in the 80s.

Now if you receive a communication like that from a CPA firm, it's probably going to get more attention than an email because sometimes emails get deleted or whatever. So this is one of those things you could attach it to an email. But anything that comes to the regular mail for whatever reason seems to get more attention. So this is one of those things, but it also might take seven days for the United States Postal Service to deliver it. So I would certainly call the client, go over everything in the communication. But this is one of the things that if we became aware of it, I would opt to probably send a formal letter on our formal stationery, maybe even send it FedEx. I'm not going to advocate one overnight delivery service over the other, but something to ensure that the client received it.

**Ms. Grove Casey**

Yes, well, when you get, you know, 100 or 150 emails, one would hope that the emails from the accountant would move to the top of the list, but that's not always the case. So, you know, following up with other modes of communication is probably a great idea.

**Mr. Oestrieher**

Right. Well, or if you attach something to it, it could get caught in your quarantine or your spam filter. So there's not a guarantee that they're going to get it or they actually delete it on their smartphone because they have a fat thumb or something, and so you want to make sure. If you do communicate that way and you don't hear from the client in a couple of days, follow up, because if you don't call the client, typically they will call you about, hey, what's going on.

**Ms. Grove Casey**

So let's look at fraud in audit engagements. Obviously, we've got responsibilities there. We've had responsibilities for quite some time, not always matched up exactly with what the public thought our responsibilities were. So let's talk about what our responsibilities actually are in an audit engagement.

**Mr. Oestriecher**

Yes, you made a great point, when you talk about the perception, I guess, of the general public. When I tell my friends, hey, I can't go there this weekend or whatever, I'm working on an audit, they go, oh, who's IRS going after? First of all, as if I would even tell you. Second, no, it's not. It's not, oh, you're auditing someone. You're looking at them. I'm trying to determine whether their financial statements are in accordance with generally accepted accounting principles, which is the applicable financial reporting framework chosen by management. Kurt, will you just shut up? They learn not to ask me questions like that. So, but when they hear the word audit, the public, they think we're looking for fraud. We see that in governmental audits all the time, Debbie, when, because people are always stealing from governmental agencies. And when it comes to light in the paper, people ask, well, where were the auditors? And the answer most of the time is we were doing our jobs, and our job is not to find fraud. In fact, the Louisiana legislature got so tired of that answer we now have to do what's called statewide agreed upon procedures because our legislative auditor said, the audit's not designed for that. And so our legislature said, then design something for it. So we actually do agreed upon procedures, which still, there's limitations there, but that just hammers home your point about misunderstanding. And again, it was just 25 years ago where the F word was not mentioned anywhere in our standards because we wanted to make sure that, hey, we're not responsible, but when Enron was coming up, and this was actually before Enron, but there were other cases, there's one out in Arizona. I can't think of the name of that entity; yes, Waste Management. So ultimately, if we as the AICPA were not going to put specific guidance within our standards related to fraud, we were going to be vulnerable.

And what I mean by vulnerable is the government taking over auditing standards, which a few years later they did for public companies anyway, with PCAOB. [That was] the result of fraud from Enron and WorldCom. So you can see the natural progression. The Auditing Standards Board was tiptoeing around this thing of, okay, what do we require auditors to do, but at the same time, we don't take responsibilities. And again, it is inquiries, okay. We have to assume, we have to ask of certain people of management and employees and those charged with governance about their knowledge or existence of fraud. The same thing we do in a review. And I remember hearing, going to some CPE courses 25 years ago on this where people were saying, well, if they look to the left, they're probably telling them the truth. And if they look to the right, they're not or vice versa. And I kept saying, there's no way they can expect us to be trained investigators. We're not, okay? Because I'm not going to know if someone's going to tell the truth or not. So we make those inquiries. That is one of the things we do. But then the other thing we do is we now have just a general risk discussion. But 25 years ago, we called it...the fraud discussion, but now where we just talked amongst ourselves how fraud could occur both from misrepresentation of management or misappropriation of assets. Interestingly enough, people tended to focus more on the misappropriation of assets, but generally people steal an amount that won't be noticed, therefore it's not material. It is the misrepresentation by management, the false journal entries, the not responding appropriately to inquiries about commitments or contingencies, because it's not just measurement items, that's the type of fraud that generally would lead to a material misstatement in the financials or lack of disclosure, a material misstatement and the lack of disclosure. So we would brainstorm on these things. And of course, this just then became a subset of the overall risk discussion. So from an audit standpoint, we need to consider audit in the planning. And of course, that leads to inherent risk. And we use those sources of information, our knowledge as a CPA, our discussion with various people within the organization, and our engagement team discussion. We use all that data to help formulate and determine, okay, where could fraud exist or what accounts? So prepaid insurance, no. Revenue recognition, yes. In fact, it is presumed that revenue recognition is a fraud risk.

And if you don't, then you have to say why it's not a fraud risk. Maybe it's a startup company that has no revenues. So it is all in the planning stages, still not in the actual thing. We do not have to, there's no specific standard in AU-C section that says, do this specifically to find fraud. It is, we may determine as auditors as a response to our risk

assessment that hey, we are going to do some procedures. And then that's how we get to where we are going to now look at some of the things related to misstatements that could be caused by fraud.

**Ms. Grove Casey**

So do you have any suggestions on the audit response to fraud when we find something that triggers interest?

**Mr. Oestriecher**

I mean, it's going to be broad. Yes, it's going to be broad and it's going to be based on your circumstances. But first and foremost, your more experienced auditors, this is where maybe the partners are involved. You don't want new staff in areas where you believe there is inherent risk related to fraud. Now that doesn't mean you can't assign staff to do certain detailed testing on maybe job cost schedules when you're looking for the cost associated with if you're doing a construction audit. But when you're looking at the overall analysis of, okay, how did management come up with these estimates? That's where you want the more experienced person involved.

Certainly larger sample sizes. So if you believe it is a governmental agency, where, and this is where we see a lot of fraud in governmental agencies, is with unauthorized disbursements. So rather than taking a smaller sample size, we take a larger sample size. We can use something like probability proportional to size (PPS) sampling that gives us a sample size of 85. And we just say, you know what, because this is a fraud risk, we're going to go to 150 because it's more like cast a wider net. And there's absolutely nothing wrong with doing that. Quite frankly, I think that is one of the more appropriate responses where you can have fraud. You might reduce ISI, individually significant items, for those areas, which if you're using that within your PPS model, then that's going to yield a larger sample size also. Sometimes you might just say, you know what? I'm going to test 100% of the transactions, and. . . then this would be credit card bills.

So that's where you see a lot of fraud in different areas. Again, thinking more in governmental areas. And so rather than taking an example of, just hoping that maybe your credit card statement or fuel card gets caught within our sample size, I might either A, specifically say, I'm going to go in and look at four of the 12 statements or all 12 statements, especially if you had a history in that particular area, you may want to do 100% testing. Now, I understand that's a lot of audit work, but again, if your risk discussion says, hey, this is where this is likely to happen, look at the type of evidence you're using. Internal evidence are things that come from within the organization. It's easier for the person committing the fraud to cover it up. Using external confirmations, looking at documents to see if they came external to the organization, that will lead generally to better evidence because if there's fraud, somehow an external piece of the document had to be altered. Well, now there'd need to be collusion from someone on the other side. And people that are committing fraud generally don't want to get people colluding with them because they could also give them up. And just overall increased professional skepticism in these areas where they have fraud. I know when you talk about professional skepticism, it isn't supposed to be a range, but reality is, there is. In areas where there's higher risk, we should be more skeptical of the responses that are audit evidence and understand that the risk assessment is ongoing. So if information comes to your attention during the course of the audit that you had not considered early on, then reevaluate and say, okay, we need to do additional procedures because we're starting to see a little smoke here that we had not considered early on in the planning.

**Ms. Grove Casey**

Well, let's finish up with what we need to communicate about fraud.

**Mr. Oestriecher**

In this, under the audit section, this is communications to those charged with governance. This is under 260, where basically anything of significance you need to communicate, and fraud would always be significant. This would be in writing and you communicate it directly. Now of course if it is the people at the highest level of the organization that are committing the fraud, you can tell them about it, but they're not going to do anything. They're not going to change their habits. That is where you withdraw from the engagement. And, of course, this is where depending on regulatory oversight, you just leave it. So if I have a client that's privately held, a bank wants an audit, I find fraud at

the highest level. Okay, at that point I can't propose journal entries because it could be systematic throughout the entire system through the whole thing, so you just withdraw. But again, I'm going to use the example of the Louisiana Legislative Auditor in our engagement letters and our audit clients agree that if we become aware of fraud we will immediately notify the legislative auditor. In other words, they have waived client confidentiality on that issue because there's oversight. So understand if you're in a regulatory type audit, you may be required to communicate to the regulator any fraud. So you just have to look at the engagement letter. That's where anything would be. If it's not in the engagement letter, then you probably just have to withdraw from the engagement and certainly not communicate to anybody.



## SUPPLEMENTAL MATERIALS

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### **Fraud Considerations in SSARS and SAS Engagements**

by Kurt Oestrieher, CPA

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#### **Introduction**

One of the most interesting aspects of attest financial statement engagements is the wide expectation gap between what users of financial statements think we are responsible for in relation to detecting fraud and what our actual responsibilities are according to the relevant standards. Because we cannot control users' unrealistic expectations, it is vitally important that we understand and follow the requirements of the standards for which we have been engaged.

The accountant or auditor is aware that fraud can be a cause of a misstatement in the financial statements. The different levels of service we provide (audit, review, compilation, and preparation) provide guidance as to the extent that we will perform, or not perform, procedures to determine if a misstatement is caused by fraud.

#### **Consideration of Fraud in Compilation and Preparation Engagements**

##### ***SSARS requirements for Compilation and Preparation Engagements***

Preparation and compilation standards under SSARS do not contain any specific requirements that the accountant communicate fraud or illegal acts to management or those charged with governance. However, it would be prudent to communicate such matters, in writing, if the accountant became aware of fraud or illegal acts while engaged to perform a preparation or compilation.

In most engagements, the preparation or compilation engagement is accompanied by non-attest services such as bank reconciliations, accounts payable and payroll services, posting journal entries, and maintenance of underlying accounting records. While non-attest services are not required to have an engagement letter, most firms include a description of non-attest services performed with the preparation or engagement letter. Therefore, the issues discussed below in the engagement letters required by SSARS will also cover the non-attest engagement.

Most fraud and illegal acts that are occurring will come to the attention of the accounting firm during the performance of non-attest services. Bank reconciliations are the most common service that will reveal potential fraud or theft. The following are issues to be aware of:

- Outstanding deposits of more than 2 banking days
- Check numbers that are well outside the numbering sequence of most of the checks
- Reconciling items that are not specific in nature
- Unusual transactions based on client history

Even though the engagement letter and standards specifically place the responsibility of detecting fraud on management, the courts have ruled that obvious issues that were not brought to the attention of management when performing bank reconciliations may result in liability on behalf of the accounting firm.

##### ***Engagement letters in compilation and preparation engagements***

Both the compilation and preparation engagements under SSARS require specific communications on the responsibilities of the accountant and of management. The engagement letter must be signed by both parties.

Sample wording in a preparation and compilation engagement letter related to the limitations of the engagement.

*“Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the Company or noncompliance with laws and regulations.”*

In addition to the language in the engagement letter that describes the limitations of the accountant in a preparation and compilation engagement, the following language is included that specifically describes management's responsibility for fraud:

*The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with [insert appropriate framework] and assist you in the presentation of the financial statements in accordance with [insert appropriate framework]. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSs:*

- a. ...
- b. ....
- c. *The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements*
- d. *The prevention and detection of fraud*
- e. *To ensure that the Company complies with the laws and regulations applicable to its activities*

While there is some legal protection afforded the accountant based on the wording in the engagement letter, the accountant must also adhere to the "due professional care" standard in the AICPA Code of Professional Conduct. It is this backdoor that many plaintiff attorneys use to assert liability. While accountants can usually defend their position if it is a well concealed illegal act, the accountant may be open to liability if the fraud is obvious and the non-attest services provided by the accountant clearly presented issues that were not followed up. For this reason, the accountant should always remain aware that obvious issues should be brought to the attention of management or those charged with governance.

## **Consideration of Fraud in Review Engagements**

### **Procedures required related to fraud or illegal acts**

There are two specific requirements in AR-C 90 that are required by the accountant in relation to fraud or illegal acts.

1. AR-C 90.29 requires the accountant to make the following inquiry of members of management who have responsibility for financial reporting:

"The existence of any actual, suspected, or alleged fraud or noncompliance with laws and regulations affecting the entity"

2. AR-C 90.60 requires the following representations be obtained from management:

Management has disclosed to the accountant significant facts relating to any fraud or suspected fraud known to management that may have affected the entity involving

- i. management,
- ii. employees who have significant roles in internal control, or
- iii. others, when the fraud could have a material effect on the financial statements.

Management has disclosed to the accountant significant facts relating to any allegations of fraud or suspected fraud known to management that may have affected the entity's financial statements communicated by employees, former employees, regulators, or others.

### **Engagement letters in review engagements**

The following paragraph must be included in the review engagement letter in order to inform management of the limitations of the review engagement:

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

The language “clearly inconsequential” that qualifies this part of the engagement letter leaves some room for the accountant to not make the required communication. However, it is only in the rarest of circumstances that an illegal act would be clearly inconsequential in the opinion of the author.

In addition, the management responsibilities section of the engagement letter contains the following:

### **Your Responsibilities**

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. ...
- b. ...
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with laws and regulations applicable to its activities

### ***Communication of fraud or illegal acts***

When performing a review engagement, AR-C 90.18 requires the accountant communicate to management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review that, in the accountant’s professional judgment, are of significant importance to merit the attention of management or those charged with governance, as appropriate. It is the opinion of the author that all instances of fraud are of significant importance and should be communicated.

The communication may be oral or written. If the communication is oral, the accountant should document the details of the communication in the review file.

If the fraud or illegal act involves the owner of the business, the accountant should consider withdrawing from the engagement. The accountant should also consider consultation with legal counsel if the facts and circumstances warrant such a discussion. Factors that could lead to potential legal consultation would include regulatory, civil, or criminal issues related to the fraud or illegal act.

### ***Best practices in a review engagement***

Review engagements are the target of litigation related to fraud or illegal acts due to the fact that while a review is an assurance engagement, the level of assurance is limited, therefore the procedures are limited. Even though the standards require specific inquiries related to fraud, the standards are also clear that the accountant does not have to corroborate the responses of management.

While it is unlikely that management would respond untruthfully to the inquiry if they are aware of others in the organization committing a fraud or illegal act, it is also highly likely that management would respond untruthfully if they are the ones committing the fraud or illegal act. If the fraud is related to financial reporting, and analytical

procedures or other inquiries do not alert the accountant to the fraud, it is very likely that a departure from the applicable financial reporting framework (usually U.S. GAAP) would not be discovered. Third party users that rely on the financial statement would then have a potential dispute with the independent accounting firm.

The best defense against such litigation is documentation, documentation, documentation. Clearly document all inquiries, responses to inquiries, and any other communications related to fraud. It is only when accountants deviate from standards (or hire poor counsel), that there is significant exposure to loss as result of litigation related to fraud that is perpetrated by management or others within the organization.

## Consideration of Fraud in Audit Engagements

### *Procedures related to fraud in audit engagements*

The audit requirements related to consideration of fraud are contained in AU-C 240. AU-C 240.04 clearly states that the **primary** responsibility for the prevention and detection of fraud is the responsibility of management and those charged with governance. However, the auditor must understand that financial statements may contain material misstatements due to fraud, therefore the possibility of fraud, along with other issues that could cause misstatements, must be considered by the auditor when planning the audit and executing the audit plan.

The specific requirements related to fraud are as follows:

- a. A discussion is required among the key engagement team members, which shall include the engagement partner. The discussion should include an exchange of ideas or brainstorming about how and where the entity's financial statements might be susceptible to material misstatement due to fraud.

### **Observation**

It is important that all the participants in the discussion know that their ideas and thoughts are welcome. Complacency is the enemy of the auditor, so new staff that have a fresh perspective should be encouraged to participate. Conversely, the audit partner should not dominate the meeting. Such an atmosphere will typically tend to not allow the desired amount of information to flow.

- b. The auditor should make inquiries of management regarding
  - management's assessment of the risk that the financial statements may be materially misstated due to fraud.
  - management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;
  - management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;
  - management's communication, if any, to employees regarding its views on business practices and ethical behavior; and
  - whether the entity has entered into any significant unusual transactions and, if so, the nature, terms, and business purpose (or the lack thereof) of those transactions and whether such transactions involved related parties

In addition to the specific inquiries of management, the auditor should also make inquiries of others within the organization as to their knowledge of fraud or suspected fraud. If the entity has an internal audit function, the auditor should make inquiries of appropriate individuals with the internal audit function to determine the extent of the consideration of fraud within the scope of their procedures.

**Observation**

The inquiries of management and others should be performed by an experienced auditor and should be directed to different individuals within the organization when possible. An experienced auditor is in a better position to ask follow-up questions when appropriate, and by changing the respondents, the chances of obtaining necessary information are increased.

- c. If there are persons that are charged with governance that are not members of management, the auditor should obtain an understanding of how those charged with governance exercise oversight of management's process for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.

**Observation**

The communication with those charged with governance is often overlooked in audits of not-for-profit entities and governmental entities that have an elected or appointed governing board. Auditors have a tendency to make inquiries of management such as the Executive Director, CEO, or CFO and believe that this is sufficient. While it is often that member of a board charged with governance will not fully understand their role in the prevention and detection of fraud, this is valuable information to the auditor because without oversight of management, the risk of fraud increases.

While performing the various inquiries and discussions related to fraud, the auditor should remember that there are two types of fraud that could cause a misstatement in the financial statements (1) misappropriation of assets and (2) misrepresentation by management. These two terms can be reduced to (1) stealing and (2) lying. The very nature of theft provides an incentive for the perpetrator to not have the theft discovered, so typically small amounts are taken as to not raise any red flags. These types of fraud could lead to material misstatements, but often they are not material.

By contrast, misrepresentation by management (lying) is almost always material by definition. If management has an incentive to "cook the books", they are going to cook them enough to influence the user of the financial statements. If the user is influenced, then the fraud is material.

It is the experience of the author that often the discussion and inquiries related to fraud are geared more toward the stealing than the lying. Consideration should be given to the weight of the inquiries related to lying as that is the type of fraud that is more likely to cause a material misstatement.

**Revenue Recognition**

The auditor must presume that a fraud risk exists related to the recognition of revenue and plan an appropriate audit response. If the auditor concludes that a fraud risk does not exist for revenue recognition, the reasons for that conclusion must be documented.

**Auditor response to fraud assessment**

All of the planning procedures performed by the auditor related to fraud are useless if there is not a proper response to the fraud risks that are identified. The specific responses to fraud risk can be one or more of the following:

- Assignment of more experienced auditors to areas of increased risk
- Larger sampling sizes
- Test of 100% of balances instead of sampling
- More use of external or internal/external evidence
- Increased professional skepticism in high risk areas

***Fraud risk is an ongoing process***

In performing further audit procedures, the auditor may become aware of information that would have influenced or increased the risk of fraud in the planning process had such information been known at the time. The auditor is required to re-assess the fraud risk and response to fraud risk in such circumstances.

***Communications to Management and Those Charged with Governance***

If the auditor has identified a fraud or obtained information that indicates a fraud may exist, the auditor should communicate these matters on a timely basis to the appropriate level of management.

If the auditor identifies or suspects fraud involving management, employees who have significant roles in internal control, or others when the fraud results in a material misstatement to the financial statements, the auditor should communicate these matters to those charged with governance.

**Summary**

As long as accountants and auditors are involved with the performance of any engagement related to issuing financial statements, the risk of misstatement due to fraud and a lack of understanding of the accountant or auditor's responsibility will be present. Fortunately, the AICPA Standards related to preparation, compilation, review, and audit engagements have clear responsibilities and requirements. Knowledge and compliance with the standards are the best line of defense when faced with legal or regulatory challenges to the appropriate level of performance in an engagement involving financial statements.

## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Discuss the most common issues to be aware of in performing nonattest services that may indicate fraud.
2. Discuss specific responses to fraud risk once identified by the auditor.
3. Discuss the auditor's responsibility to communicate fraud once it is identified.

**B. Suggested Answers to Discussion Problems**

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1. Most fraud and illegal acts that are occurring will come to the attention of the accounting firm during the performance of non-attest services. Bank reconciliations are the most common service that will reveal potential fraud or theft. The following are issues to be aware of:
  - Outstanding deposits of more than 2 banking days
  - Check numbers that are well outside the numbering sequence of most of the checks
  - Reconciling items that are not specific in nature
  - Unusual transactions based on client history
  
2. All of the planning procedures performed by the auditor related to fraud are useless if there is not a proper response to the fraud risks that are identified. The specific responses to fraud risk can be one or more of the following:
  - Assignment of more experienced auditors to areas of increased risk
  - Larger sampling sizes
  - Test of 100% of balances instead of sampling
  - More use of external or internal/external evidence
  - Increased professional skepticism in high risk areas
  
3. If the auditor has identified a fraud or obtained information that indicates a fraud may exist, the auditor should communicate these matters on a timely basis to the appropriate level of management. If the auditor identifies or suspects fraud involving management, employees who have significant roles in internal control, or others when the fraud results in a material misstatement to the financial statements, the auditor should communicate these matters to those charged with governance.



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## GLOSSARY OF KEY TERMS

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**Formation Date**—The date on which an entity initially meets the definition of a Joint Venture

**Fraud**—a material false statement made with an intent to deceive (scienter) or misappropriation of assets

**Joint Ventures**—Transactions in which two or more entities contribute assets or subsidiaries to a newly formed entity, or otherwise agree to jointly develop or market products together. There must be joint control over all the significant decisions of the entity; the venturers should actively participate in the overall management of the JV; and the JV should operate for the mutual benefit of the venturers to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities.

**Negative Confirmation**—Directs the recipient to respond only when the recipient disagrees with the information included in the request.

**Positive Confirmation**—Asks the recipient to respond directly to the auditor about whether the recipient agrees with information that is stated in the request or asks the recipient to provide the requested information by filling in a blank form.

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

1. According to Russ Madray, the guidance in ASU 2023-05 applies to which of the following?
  - A. Business combinations.
  - B. Governmental entities.
  - C. Joint ventures.
  - D. Nonprofit organizations.
  
2. According to Russ Madray, the formation of a joint venture results in which of the following?
  - A. A new reporting entity.
  - B. A group of loosely linked independent entities.
  - C. An entity that continues to operate as it had historically.
  - D. An entity no longer under the control of the venturers.
  
3. According to Russ Madray, when should a joint venture measure the fair value of its total net assets?
  - A. At the date the assets were originally placed in operation.
  - B. At the end of the venturers' fiscal year prior to formation.
  - C. After they are received by the joint venture (e.g., the formation date).
  - D. At the end of the joint venture's first fiscal year.
  
4. According to Russ Madray, what action will help determine which arrangements are part of a joint venture?
  - A. Analyzing pre-existing relationships like those in a business combination.
  - B. Applying the guidance in Topic 805 related to acquisition costs.
  - C. Determining who is an acquirer and who is an acquiree.
  - D. Following the guidance for assessing what is part of a business combination.
  
5. According to Russ Madray, how should costs related to in-process research and development (IPR&D) be treated?
  - A. They should be recognized immediately as expenses.
  - B. They should be capitalized as indefinite-lived intangible assets.
  - C. They should be recognized when they exceed the amount of identifiable net assets.
  - D. They should be treated as a bargain purchase gain like in a business combination.

*Continued on next page*

6. According to Jennifer Louis, when were auditors in the United States first required to do confirmations?
- A. 1921.
  - B. 1939.
  - C. 1982.
  - D. 2003.
7. According to Jennifer Louis, what is one example of a common deficiency the Public Company Accounting Oversight Board (PCAOB) has noted when inspecting confirmations?
- A. Not using third parties to assist with confirmations.
  - B. Using new technologies to get confirmations.
  - C. Failing to follow up on contradictory evidence.
  - D. Limiting information gathering to external sources.
8. According to Jennifer Louis, the new PCAOB standard on confirmations does which of the following?
- A. Supports the use of new technologies during the confirmation process.
  - B. Eliminates the use of professional skepticism from the confirmation process.
  - C. Expands the use of confirmations to more than just significant accounts/disclosures.
  - D. Requires the use of confirmations for all assertions, including valuation.
9. According to Jennifer Louis, which of the following statements best describes the use of blank confirmations?
- A. Auditors should avoid sending blank confirmations because the confirming parties are less likely to take the extra time to fill them out.
  - B. Blank confirmations provide more reliable information because confirming parties have to fill in their information instead of just agreeing with the auditor's information.
  - C. Auditors are allowed to send blank confirmations, but the new PCAOB standard recommends the use of filled-in confirmations in most cases.
  - D. If auditors choose to use blank confirmations, they must be sent using a paper-based method instead of an electronic method.
10. According to Jennifer Louis, what is a negative confirmation?
- A. Recipients are asked to respond about whether they agree with the information stated in the request.
  - B. Recipients are asked to send detailed information about the information in the request.
  - C. Recipients are asked only to respond if they agree with the information in the request.
  - D. Recipients are asked only to respond if they disagree with the information in the request.

*Continued on next page*

11. According to Kurt Oestrieher, the accountant responsibilities paragraph in the engagement letter under SSARS 21 covers how many items?
  - A. One
  - B. Two
  - C. Three
  - D. Four
  
12. According to Kurt Oestrieher, he has never uncovered fraud in a review as a result of which of the following?
  - A. An analytical procedure
  - B. An inquiry
  - C. A substantive procedure
  - D. Trend analysis
  
13. According to Kurt Oestrieher, which of the following is *not* an appropriate audit response to a fraud trigger?
  - A. New staff
  - B. Experienced staff
  - C. Larger sample
  - D. External confirmations
  
14. According to Kurt Oestrieher, the guidance on communications related to fraud found in an audit is found in which of the following guidance?
  - A. AU-C 210
  - B. AU-C 230
  - C. AU-C 250
  - D. AU-C 260
  
15. According to Kurt Oestrieher, fraud is always which of the following?
  - A. Significant
  - B. Irrelevant
  - C. Immaterial
  - D. Inconsequential



## 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](mailto:CPLgrading@cerifi.com).

How would you rate the topics covered in the March 2024 **CPE Network® A&A Report**? Rate each topic on a scale of 1–5 (5=highest):

|                                 | Topic<br>Relevance   | Topic<br>Content/<br>Coverage | Topic<br>Timeliness  | Video<br>Quality     | Audio<br>Quality     | Written<br>Material  |
|---------------------------------|----------------------|-------------------------------|----------------------|----------------------|----------------------|----------------------|
| FASB Update Joint Ventures      | <input type="text"/> | <input type="text"/>          | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> |
| PCAOB Guidance on Confirmations | <input type="text"/> | <input type="text"/>          | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> |
| Fraud Considerations            | <input type="text"/> | <input type="text"/>          | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> |

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

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

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

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How would you rate the effectiveness of the speakers in the March 2024 CPE Network® A&A Report? Rate each speaker on a scale of 1–5 (5 highest):

|                  | <b>Overall</b> | <b>Knowledge<br/>of Topic</b> | <b>Presentation<br/>Skills</b> |
|------------------|----------------|-------------------------------|--------------------------------|
| Russ Madray      | _____          | _____                         | _____                          |
| Jennifer Louis   | _____          | _____                         | _____                          |
| Kurt Oestriecher | _____          | _____                         | _____                          |

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: \_\_\_\_\_ Date: \_\_\_\_\_

| <u>Name</u> | <u>Email</u> | <u>Total<br/>Hrs</u> | <u>IRS PTIN ID<br/>(if applicable Tax only)</u> | <u>Sign In</u> | <u>Sign Out</u> |
|-------------|--------------|----------------------|---|----------------|-----------------|
|             |              |                      |   |                |                 |
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|             |              |                      |   |                |                 |
|             |              |                      |   |                |                 |

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: \_\_\_\_\_





# CHECKPOINT LEARNING NETWORK

# CPE NETWORK<sup>®</sup>

# 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**

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

# “Group Live” Format

## CPE Credit

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

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

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

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

## Advertising / Promotional Page

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

## Monitoring Attendance

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

Use the **attendance sheet**. This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they attended should be documented on the sign-in sheet and will be reflected on the participant’s CPE certificate.

## **Real Time Instructor During Program Presentation**

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

## **Elements of Engagement**

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

## **Make-Up Sessions**

Individuals who are unable to attend the group study session may use the program materials for self-study 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](mailto: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](mailto: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:

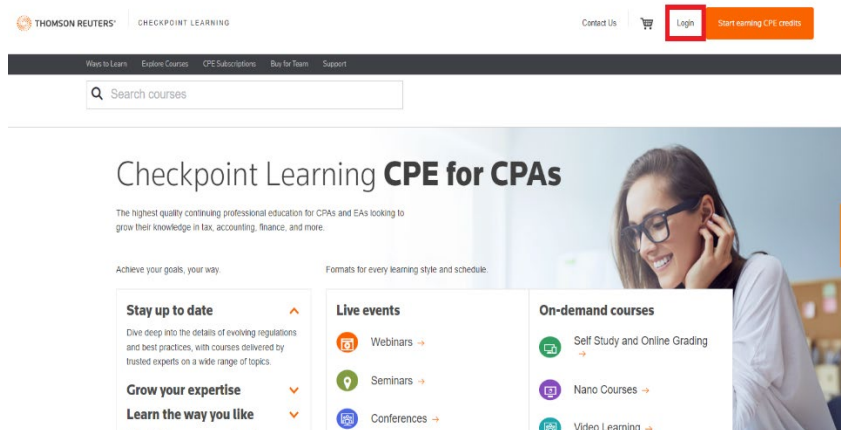
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.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

**CPLgrading@cerifi.com**

## Self-Study—Online

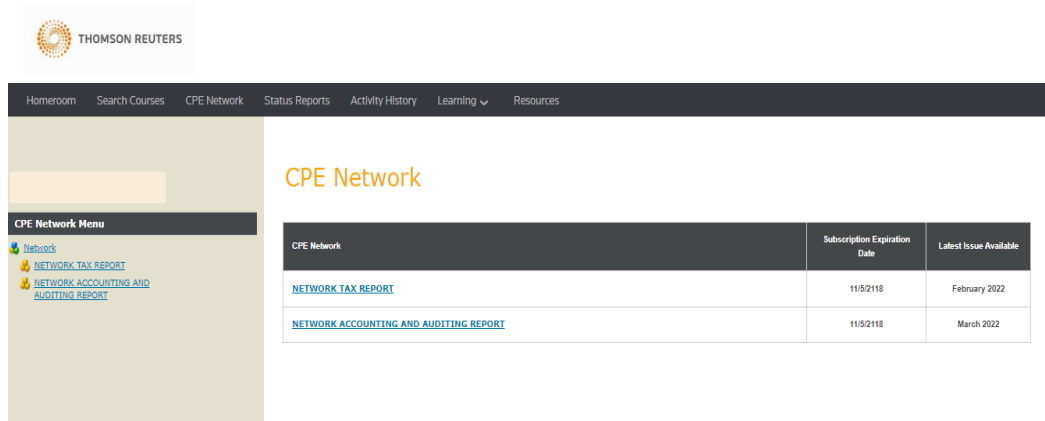
Follow these simple steps to use the online program:

- Go to [www.checkpointlearning.thomsonreuters.com](http://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”).

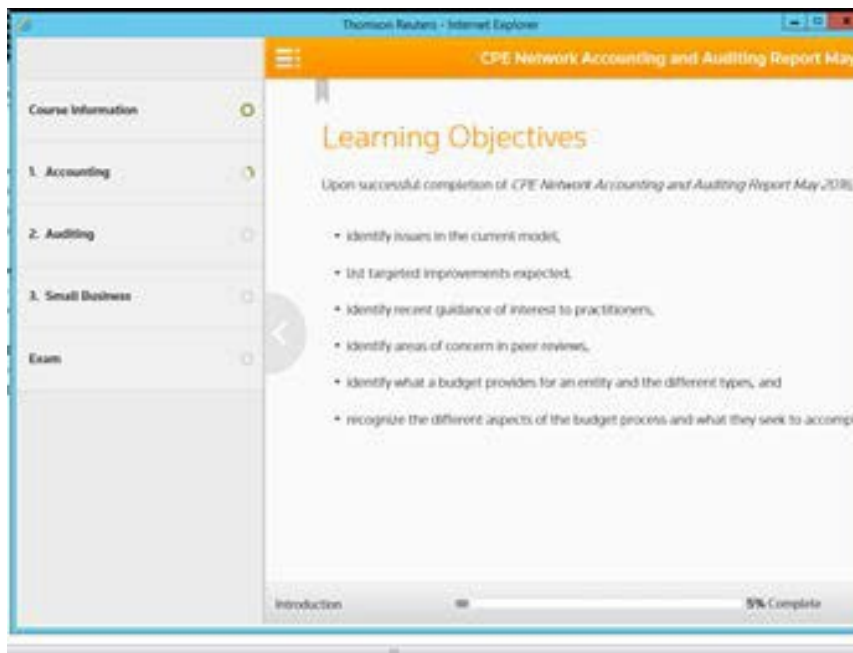


The screenshot shows the homepage of the Checkpoint Learning website. At the top, there is a navigation bar with the Thomson Reuters logo and 'CHECKPOINT LEARNING' text. On the right side of the navigation bar, there are links for 'Contact Us', a shopping cart icon, a 'Login' button, and a 'Start earning CPE credits' button. Below the navigation bar is a search bar with the placeholder text 'Search courses'. The main content area features a large banner with the text 'Checkpoint Learning CPE for CPAs' and a sub-headline 'The highest quality continuing professional education for CPAs and EAs looking to grow their knowledge in tax, accounting, finance, and more.' Below the banner, there are three columns of content: 'Achieve your goals, your way.' with sub-sections 'Stay up to date', 'Grow your expertise', and 'Learn the way you like'; 'Formats for every learning style and schedule' with sub-sections 'Live events' (Webinars, Seminars, Conferences) and 'On-demand courses' (Self Study and Online Grading, Nano Courses, Video Learning). A vertical 'CPE Credits' badge is visible on the right side of the banner image.

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

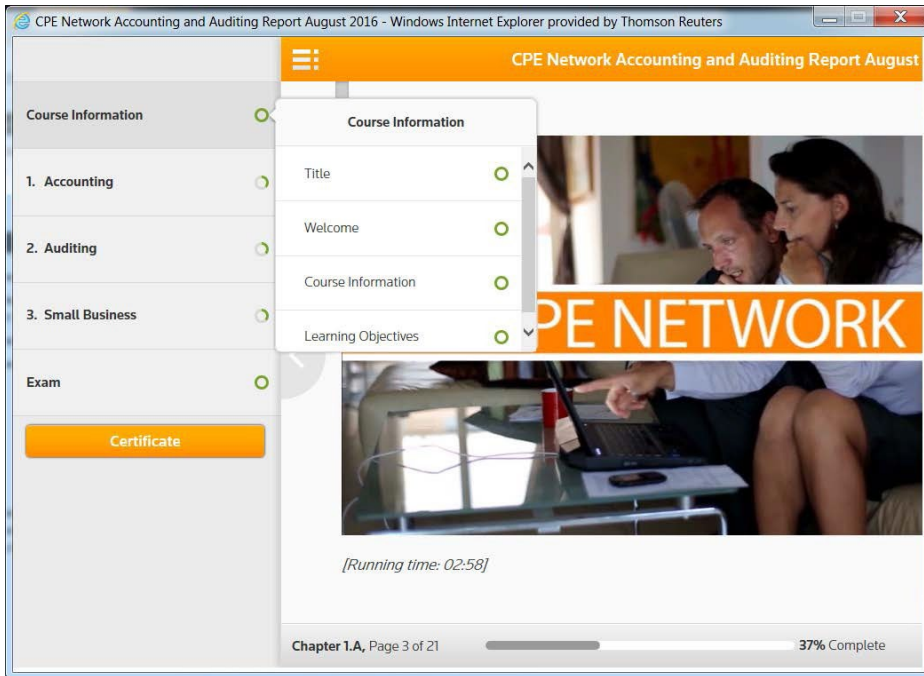


The Chapter Menu is in the gray bar at the left of your screen:

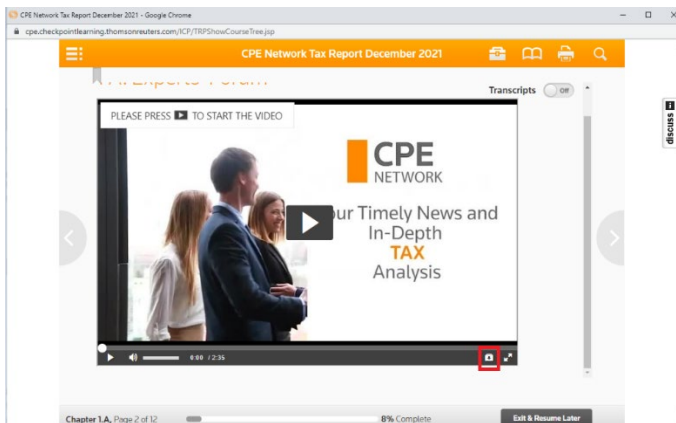


Click down to access the dropdown menu and move between the program Chapters.

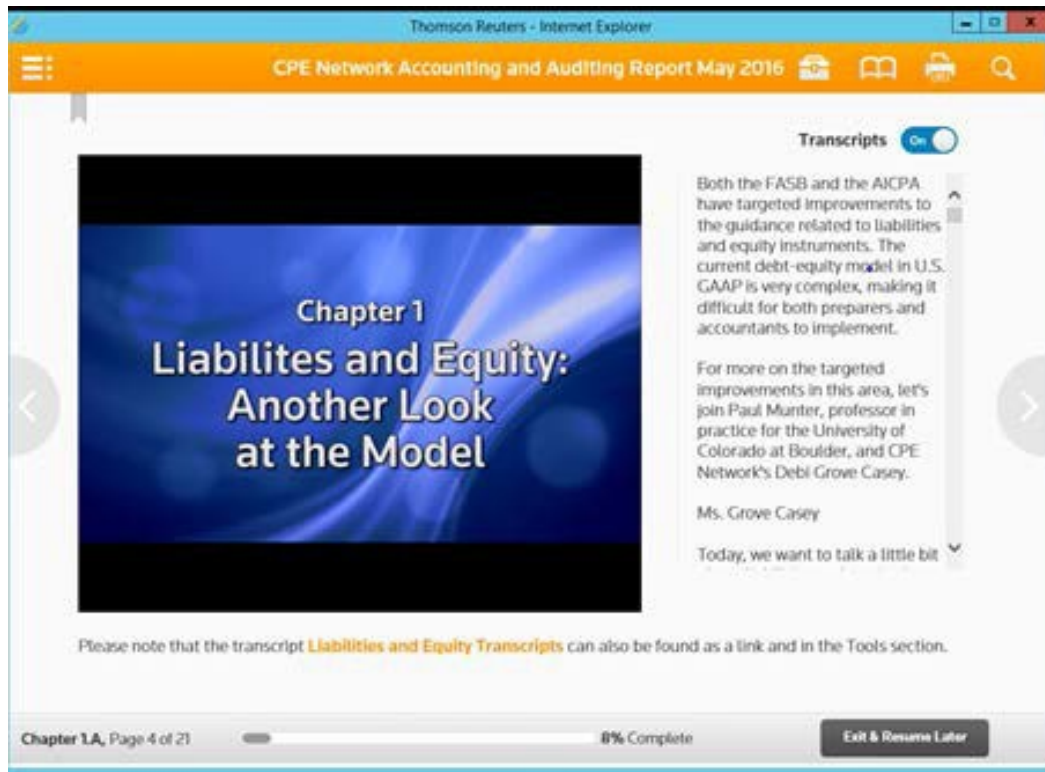
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



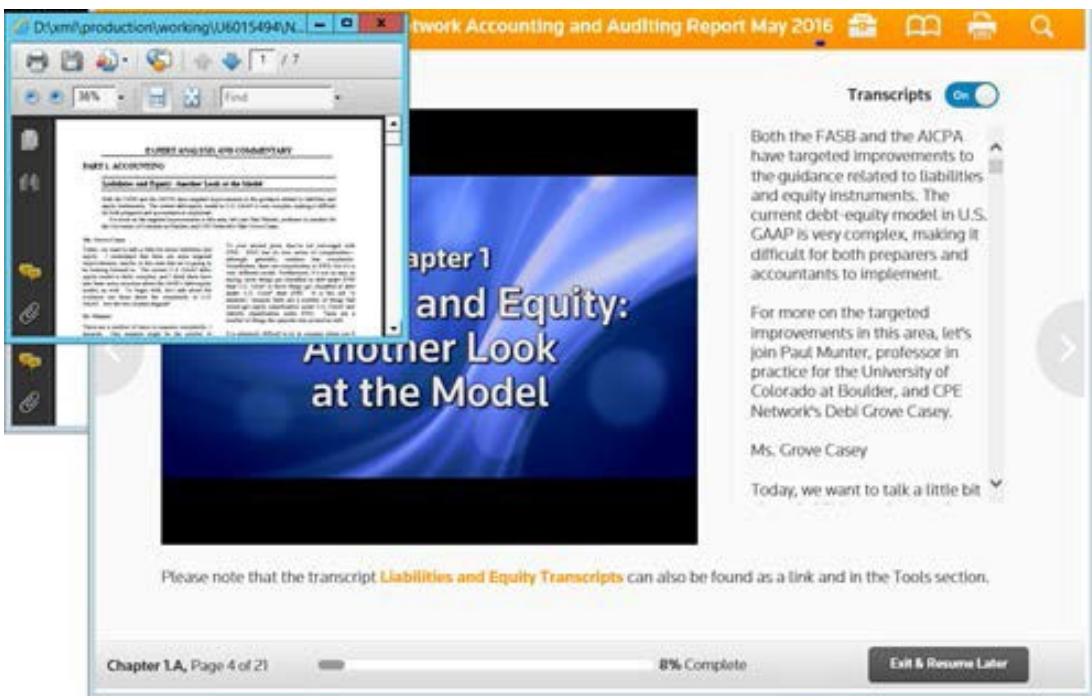
- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access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

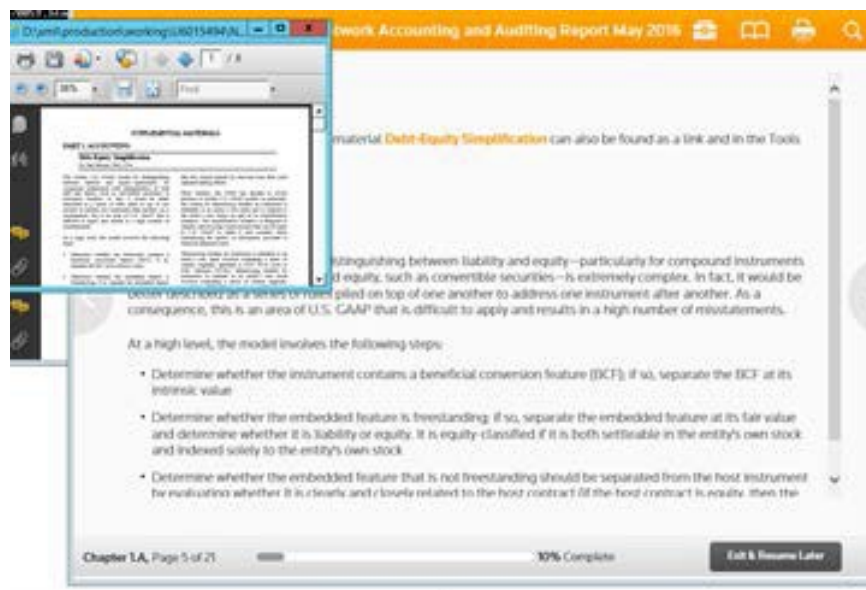


Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.





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 problems related to the segment.

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

The screenshot shows a digital document interface for a CPE report. At the top, an orange header bar contains the text "CPE Network Accounting and Auditing Report July 2016" and several icons: a hamburger menu, a printer, a book, a document, and a search icon. Below the header, the main content area is titled "Suggested Answers to Discussion Problems". It contains three numbered items:

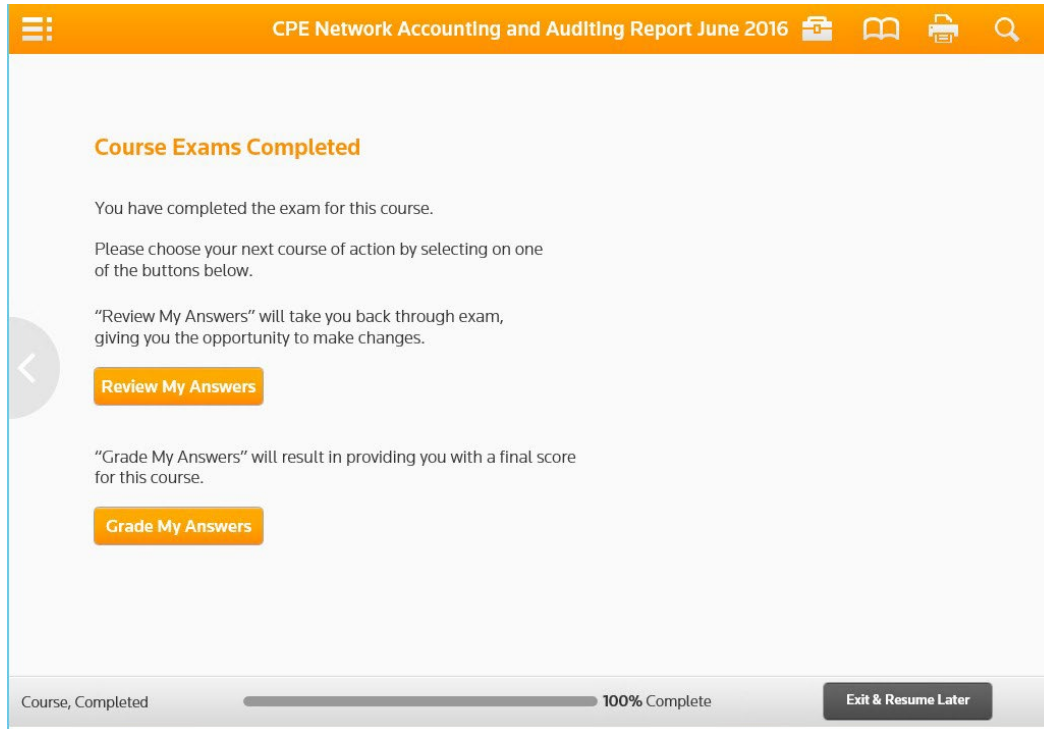
1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories:
  - Held-to-maturity
  - Trading
  - Available-for-sale

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

At the bottom of the page, a grey footer bar displays "Chapter 3.A, Page 20 of 20" on the left, a progress indicator showing "100% Complete" in the center, and an "Exit & Resume Later" button on the right.

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.

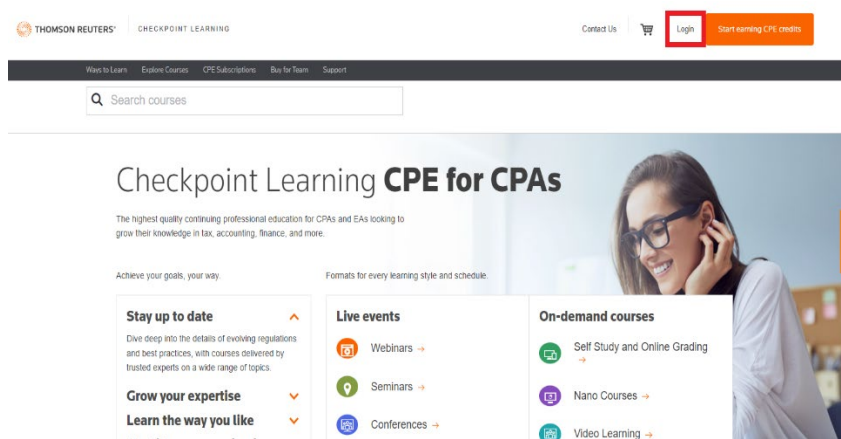
### **Print**

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**.

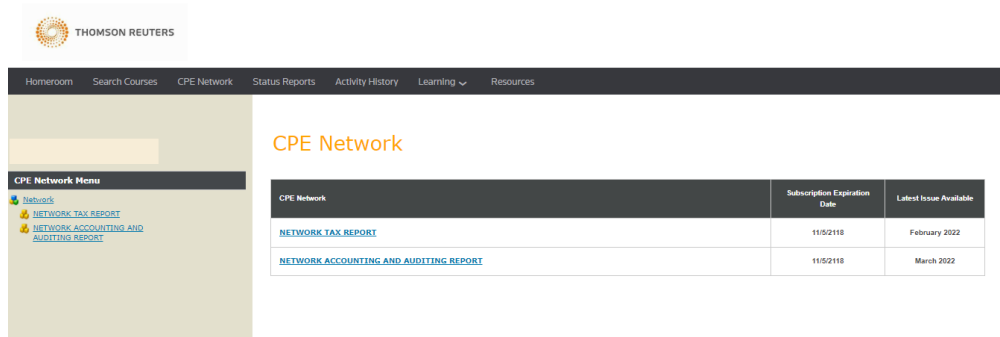
# Transitioning From DVDs

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

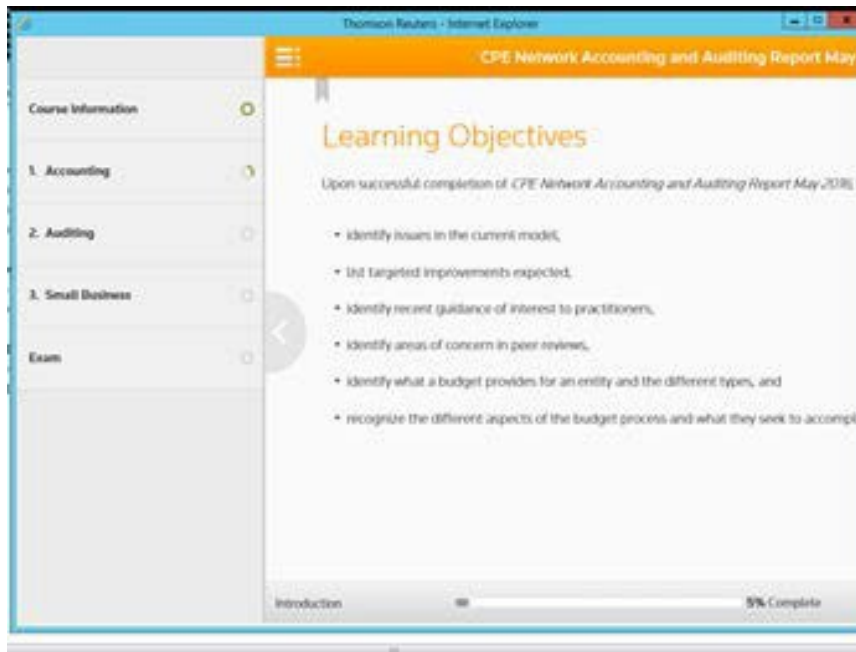
- Go to [www.checkpointlearning.thomsonreuters.com](http://www.checkpointlearning.thomsonreuters.com) .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login”).



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

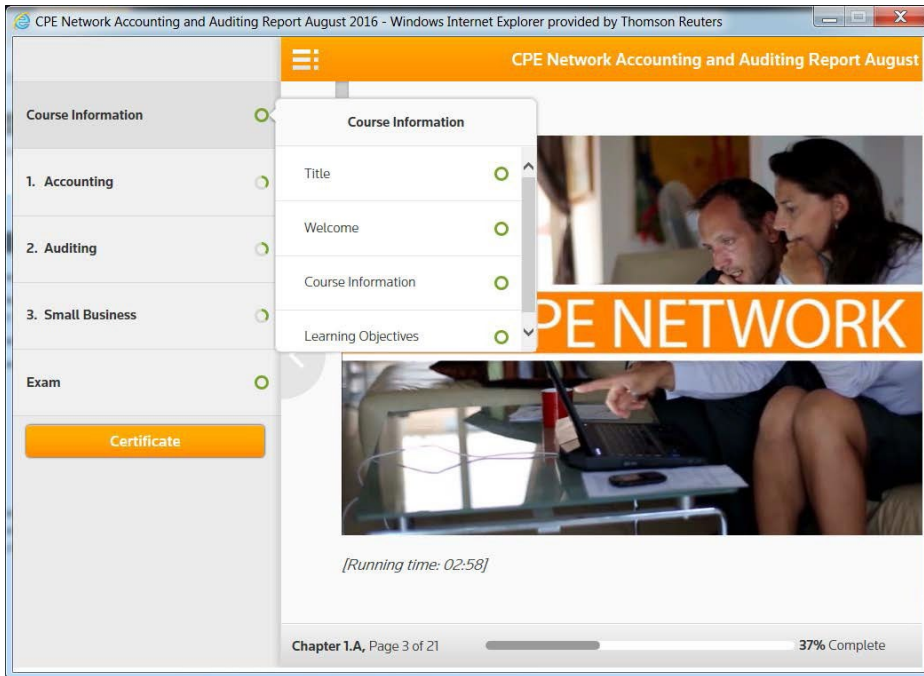


The Chapter Menu is in the gray bar at the left of your screen:



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

### Determining CPE Credit Increments

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

## **Program Presentation**

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

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

## **Disclose Significant Features of Program in Advance**

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

## **Monitor Attendance**

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



## **Real Time Instructor During Program Presentation**

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

## **Elements of Engagement**

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

## **Awarding CPE Certificates**

The CPE certificate is the participant’s record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

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.

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

# Getting Help

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

| <b>Support Group</b> | <b>Phone Number</b> | <b>Email Address</b>   | <b>Typical Issues/Questions</b>   |
|----------------------|---------------------|--|---|
| Technical Support    | 844.245.5970        | <a href="mailto:Cplsupport@cerifi.com">Cplsupport@cerifi.com</a> | <ul style="list-style-type: none"><li>• Browser-based</li><li>• Certificate discrepancies</li><li>• Accessing courses</li><li>• Migration questions</li><li>• Feed issues</li></ul> |
| Product Support      | 844.245.5970        | <a href="mailto:Cplsupport@cerifi.com">Cplsupport@cerifi.com</a> | <ul style="list-style-type: none"><li>• Functionality (how to use, where to find)</li><li>• Content questions</li><li>• Login Assistance</li></ul>                                  |
| Customer Support     | 844.245.5970        | <a href="mailto:Cplsupport@cerifi.com">Cplsupport@cerifi.com</a> | <ul style="list-style-type: none"><li>• Billing</li><li>• Existing orders</li><li>• Cancellations</li><li>• Webinars</li><li>• Certificates</li></ul>                               |