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CPE NETWORK
# ACCOUNTING & AUDITING REPORT

OCTOBER 2023 VOLUME 36, ISSUE 9



Topics for future editions may include:

- Debits and Credits related to Reassessments and Remeasurements
- COSO on Internal Control over Sustainability Reporting
- SAS 145

# EXECUTIVE SUMMARY

## PART 1. ACCOUNTING



Russ Madray, CPA reviews the accounting for leases under ASC 842, both transitioning from ASC 840 and for new arrangements. He provides examples and journal entries for operating and finance leases. [*Running time: 42:24*]

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

- Determine the differences to lease accounting under ASC 842 versus ASC 840
- Identify how leases are classified under ASC 842
- Identify how the practical expedients provided affect the guidance in ASC 842
- Determine how journal entries are reflected in the financial statements for leases

## PART 2. AUDITING



Jennifer Louis, CPA discusses Artificial Intelligence (AI), RPAs, and other tech trends that may be useful in accounting and auditing. *[Running time: 31:50]*

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

- Identify the time efficiency related to manual repetitive tasks by new and emerging technology
- Identify the purpose of RPA
- Determine what AI and OCR can be used for in an audit
- Define visualization

## PART 3. SMALL BUSINESS



Kurt Oestriecher, CPA, discusses moving from the incurred loss model to the current expected credit loss and what it will mean for business entities. *[Running time: 32:42]*

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

- Identify the types of entities most impacted by this guidance
- Identify when entities typically evaluate for credit losses
- Identify considerations in creating an allowance for credit losses
- Identify how units of account should be evaluated for CECL purposes
- Determine the affect of CECL on most businesses

# 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 Oestriecher, CPA,** is a CPA and partner with the accounting firm of Oestriecher 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

## Journal Entries for Leases Under ASC 842

The FASB released the new lease guidance in 2016. Although the implementation date was postponed and the guidance was tweaked a few times, the guidance in ASC 842 is now effective. Among other things, it places a right-to-use asset and a lease liability on the balance sheet of the lessee, other than those leases qualifying as short-term leases.

For more on the debits and credits we record related to leases under this new guidance, let's join Russ Madray, a CPA in Greenville, South Carolina, and CPE Network's Debi Grove Casey.

**Ms. Grove Casey**

So, today we want to talk a little bit about the journal entries associated with the lease accounting standard. To begin with, that lease accounting standard was ASU 2016-02, and the FASB [Financial Accounting Standards Board] had a long effective date on that. And we had a couple of delays, as well. So, we really want to talk about what kinds of things that private companies need to be doing. To begin with, can you give us a brief overview of that new lease accounting guidance?

**Mr. Madray**

Sure, I'll be glad to. This will be brief for anybody who's familiar with that guidance, more of a reminder than anything. Of course, you're referring to the standard that was issued in 2016, which was ASU 2016-02. We usually refer to it now as Accounting Standards Codification, or ASC, 842.

Basically, under that guidance, lessees are going to be recognizing a right-of-use asset and a lease liability for virtually all the leases that they have. The only exception really is a lease that meets the definition of a short-term lease. Liability, of course, will be equal to the present value of the lease payments, and that's greatly oversimplified. The asset will be based on the liability measurement, but then, maybe slightly different due to adjustment for things like initial direct costs, that kind of thing.

For income statement purposes, the FASB did retain a dual model there where leases are classified as either operating leases or finance leases. Operating leases result in a straight-line expense pattern on the income statement, while finance leases are going to result in more of a front-loaded expense pattern like the old capital lease would have. The classification criteria on differentiating between operating and finance leases is going to be based on criteria that are essentially similar to what we had in the prior lease accounting. They did try to remove some of the explicit bright lines in that classification criteria, but it's essentially the same. There's been one additional characteristic added that has to do with a unique asset that has no alternative use to the lessor.

[The] bottom line is lease accounting will continue to require significant judgment, including things like estimates related to the lease term; estimating lease payments that may involve contingencies and so forth; and, of course, using the correct discount rate for the present value calculation. Also, similar to the prior guidance, the term of the lease will essentially be the non-cancellable lease term, plus renewal periods that are reasonably certain to be exercised by the lessee or, if they're within the control of the lessor, they would be included. Variable rent payments are generally excluded from the calculations, except those that vary based on an index or a rate, and, if that is the case, then those variable rents are included in the initial calculation based on the index or rate that exists at lease commencement.

So that's a, again, very brief review/reminder of what's in this guidance. But, I know, today we want to focus more on some specific accounting and journal entry types of things for transitioning, and then, accounting for leases under this new guidance.

**Ms. Grove Casey**

Before we look at some examples of journal entries associated with lease accounting, there were a number of practical expedients that the FASB released to help entities in terms of complying with this literature. So, maybe you want to remind everybody of what those are. Could you give us a little bit of a description of those practical expedients related to the lease accounting?

**Mr. Madray**

Yeah. Those are important to understand, especially as some of the examples we'll look at in a moment will incorporate some of these practical expedients. If we take a look at this first slide, you see that lessees—and there are some practical expedients for lessors, [but] our focus today is on the lessees' side of the accounting—they're permitted to make an election to apply a package of practical expedients. Essentially, this package allows the lessee to not have to reassess the three things we see here. [First,] whether any expired or existing contracts are or contain leases. Secondly, the lease classification for any expired or existing leases. Finally, any initial direct costs for any expired or existing leases—in other words, whether those costs would qualify for capitalization under the new guidance under ASC 842.

Now, importantly, related to these practical expedients, the FASB did note, in their Basis for Conclusions of ASU 2016-02, that [the] particular practical expedient that allows entities to not reassess whether existing contracts contain leases—related to the classification as well—is not intended to grandfather [in] incorrect assessments that were made under the old guidance, which was ASC 840. In other words, the practical expedients apply to arrangements that were appropriately assessed under Topic 840. So, for example, the practical expedient would not grandfather [in] a previous incorrect determination that a lease didn't exist in a contract in terms of applying the current definition of a lease. In other words, the older guidance—the ASC 840 guidance—must have been applied correctly. If so, then these practical expedients are available.

The three [practical expedients] that we just looked at have to be elected as a package, and they have to be consistently applied to all leases. In other words, an entity cannot pick and choose which of those three individual expedients they want to apply or which leases they can apply them to. In other words, the entity must apply all three of these expedients to all leases or apply none of the expedients at all. It's an all or nothing determination. So, that's the package.

There's one other practical expedient that lessees can use where they're permitted to make an election to use hindsight when determining the lease term. So, for example, when we're evaluating the lessee's option to renew or terminate the lease or purchase the underlying asset, we can use the advantage of hindsight to make that determination. Another example would be assessing impairment of the right-of-use assets. When entities apply this hindsight practical expedient, they need to consider all the facts and circumstances that have changed through the effective date of the lease accounting guidance. However, they would not consider any events that occurred after the effective date, but prior to the first time [they] issue the financial statements. In other words, the hindsight only extends up to the effective date, not in that period of time between effective date and the first financial statements being issued using this new guidance. This particular practical expedient can be elected separately from that package of three, but if the entity does elect this one, then it has to apply it to, again, all leases or not apply that hindsight practical expedient at all. So, it's all or nothing, but it can be elected separately from the package of three that we just looked at.

**Ms. Grove Casey**

So, let's look at some examples. And I would say, I don't know that the operating leases underneath this guidance are easier, but it's less complex than having to do the other side.

**Mr. Madray**

Right.

**Ms. Grove Casey**

Can we take a look at the operating leases to begin with where the entity elects the practical expedient?

**Mr. Madray**

Sure, that's a good place to start. Let's take an example. We have it on the next series of slides here. So, let's assume that Acme Company has an existing office space lease. This is going to deal with a transition from adopting the new lease guidance for an existing lease. We have some relevant information about that existing lease. Commencement date: January 1, 2020. It's a five-year lease term. The annual rental payments [are] paid at the end of each year—$31,000 for the first two years and then $33,000 for the remaining three years. The lease classification for this lease under the old guidance was an operating lease. There were some initial direct costs that are being amortized on a straight-line basis over the lease term [for a] total of $500. And the lessee, Acme, their incremental borrowing rate [on] January 1, 2021, is 6%. That date's important because that's going to be the beginning of the earliest period for this particular company.

So, you can see it kind of graphically illustrated here. The effective date is actually January 1, 2022, but the beginning of the earliest period presented—because this company is going to present comparative statements, so calendar year 2021 [and] calendar year 2022. And, as such, for comparative purposes, this has to be retroactively applied back to that January 1, 2021 date. Effective date: January 1, 2022. End of the current period: December 31, 2022.

Again, a reminder of a couple of amounts that exist before [the] transition to the new guidance. There's an accrued rent liability of $1,200. What that represents is the difference between the cash payments that are being made. Remember, it's escalating lease costs: $31,000 first two years, $33,000 thereafter. Under the old guidance, when we have any kind of escalation clauses like that in operating leases, they have to be recognized as expense on a straight-line basis. So, the difference in those cash payments and that straight-line expense recognition at that point is $1,200. There [are] some unamortized initial direct costs. They've amortized $100 of it, so there's $400 left.

In this example, we're going to assume that Acme elects the package of practical expedients, so they're not going to reassess whether the contract is or contains a lease. We'll assume that was correctly done under the old guidance and there is a lease. [They're] not going to reassess whether the classification of the lease would be different. They applied the guidance in [Topic] 840 and determined it was an operating lease, so we will continue to treat it as an operating lease. Also, we don't have to reassess whether there was unamortized initial direct costs that would meet the definition of initial direct costs under [Topic] 842, so we'll assume they do.

All right, so, looking at working up some numbers here that we'll need, we're getting to some journal entries in a moment. The lease liability that would exist at January 1, 2021, which is the beginning of that earliest period presented, would be $112,462. That's those remaining rental payments. There's one more $31,000 payment and then three payments of $33,000. All of that [is] discounted at 6%, which was that borrowing rate that we mentioned earlier. The right-of-use asset, in many cases, will be exactly equal to the lease liability, but here it's adjusted because there's $400 of unamortized initial direct costs and, also, that accrued rent liability. So, we take the $112,462; add the $400; subtract the $1,200; and we get $111,662 for the asset that we will record. That accrued rent balance will be eliminated in our transition entry. Unamortized initial direct costs will be eliminated. Our annual lease expense going forward will be, again, the total of all the payments—$31,000 and then three payments of $33,000—plus the initial direct costs divided by the initial five-year lease term, [which] comes out to $32,300 per year.

So, with all that, finally we get to our journal entry. The transition at January 1, 2021, would look like we see here on this slide. We would debit the right-of-use asset (ROU)—that's the new asset under the new guidance—$111,662 as we showed how that was calculated on the previous slide. We eliminate that accrued rent balance, so a debit of $1,200. We establish the new lease liability balance, calculated as we saw on the previous slide [as] $112,462, and we eliminate the old unamortized initial direct costs. Then, as a result, we now will have an ROU asset of $111,662 and a lease liability of $112,462.

Now, assuming there's no modifications, no reason for remeasurement, and so on, if we look [at] how this would amortize over the remaining period of years, we see, on the next slide, our annual expense, which we calculated at $32,300. The payment for 2021 is $31,000. The next three years is $33,000.

We calculate an interest amount, although we're not going to recognize interest as such under an operating lease. We do that so we can determine the difference between the payment [and the interest expense]. So, in 2021, we have the $31,000 minus $6,748—that's 6% of the existing lease liability—and the difference is $24,252. And we take the difference between the expense of $32,300 and the interest amount of $6,748, and that tells us how much we are going to reduce the right-of-use asset, the amortization amount. And, you see, that will play all the way through the end of the lease.

[On the] next slide, we see what the journal entry would look like for each year. We would debit our lease liability, $24,252, which came from our amortization table on the previous slide; recognize lease expense of $32,300, which is the same every year; [and] reduce our right-of-use asset by $25,552, which came from our amortization table on the previous slide. And the cash we paid out at $31,000.

That's just a simple overview of how an operating lease will be transitioned from how it was accounted for under the previous guidance, the transition to establish the new ROU asset lease liability, and then how we would calculate those amounts, and what it would look like going forward at that point. So, there's our operating lease example.

**Ms. Grove Casey**

Now let's talk about what happens if it's a capital lease where the entity elects those practical expedients. Could you cover that a little bit so that we can see the difference?

**Mr. Madray**

Sure. We'll do the same kind of thing with a capital lease, assuming it's a capital lease under the old guidance. So, we look at our next slide. We see, in this example [that] Coyote Company has an existing equipment lease and some relevant information. The commencement date of this lease was January 1, 2020, [with a] lease term of seven years. Annual lease payments [are the] same every year: $25,000 paid at the end of the year.

There is a residual value guarantee of $8,190. The lessee has made a determination of the amount that's probable of being owed under that residual value guarantee of $5,190. It's important, why they have two different things there, and that's going to be based on the lessee's estimation of what the piece of equipment actually will be worth. So, they're saying that essentially the guarantee is $8,190. They basically said, looking forward seven years, "We think it's going to be worth about $3,000, so we're going to have to kick in a check for $5,190 to make up the difference."

The classification—assuming it was properly done under the old guidance, [Topic] 840—was a capital lease. The incremental borrowing rate for this lessee at lease inception is 6%, and assume there's some initial direct costs that are being amortized on a straight-line basis of $2,800.

So, looking at that graphically again, we get the same idea. Effective date is January 1, 2022. They're going to present comparative statements, so the beginning of the earliest period presented will be January 1, 2021. So, we have our comparative period and our current period.

If we look at the next slide, we see some numbers that we're going to work up here for our transition journal entry. We see the lease liability is going to be $128,707. That's the same as the capital lease liability because it's calculated the same way under the new guidance ([ASC] 842) as it would have been calculated under the old guidance ([ASC] 840), so, essentially, the present value of the remaining lease payments discounted at that 6% rate. The right-of-use asset—in this case, for transition—would be equal to the capital asset that we had on the books under the old guidance, but we would add in those remaining unamortized initial direct costs of $2,400. So, our right-of-use asset's going to start out at $126,834.

[On] the next slide, we finally get to the journal entry to transition from the old capital lease to the new finance lease under [ASC] 842. [On] January 1, 2021, we would record the right-of-use asset calculated as we saw on the previous slide: $126,834. We would remove the old capital lease asset that existed: $124,434. We would remove the old unamortized initial direct costs of $2,400. Again, because the lease liability doesn't change, we really don't need to change anything there unless there's some type of notation because there's really no change. So, this transition journal entry essentially just removes the old capital lease asset, the old unamortized initial direct costs, and establishes the new right-of-use asset at that date.

Now, assuming [that], going forward, there [are] no modifications [and] no need to remeasure the lease liability, on our next slide we see what the amortization of that would look like. So, we see our remaining payments: $25,000 every year. The interest, which is 6% of the lease liability each year. The principal reduction of the lease liability is the difference in the payment and the interest. Then the right-of-use asset amortization would just be straight line. It would be that beginning amount divided by the remaining lease term.

Based on that, at the end of each year, Coyote would record a journal entry that looks something like this. The first year, the lease liability is decreased by $17,278. Amortization expense related to the right-of-use asset: $20,639. Interest expense is recorded [as] $7,722. The right-of-use asset is reduced [to] $20,639, and then the cash payment that's made there.

Now, one thing to note in the journal entry that you see right there, the interest expense on that lease liability and the amortization of the right-of-use asset are not actually required to be presented as separate line items. Instead, you would present each one of those—the interest and the amortization expense—in a manner that's consistent with how the entity presents other interest expense, depreciation, amortization of similar capital assets, and that kind of thing.

Then, finally, at the end of the lease term, Coyote would record their final payment. You see this on the next slide. The lease liability, the amortization expense, the interest expense—all of this coming from that amortization table we saw a couple of slides back. [The] right-of-use asset, the cash payment, and then the final entry would be to eliminate the remaining lease liability. At that point, it would be $8,190. Remove the remaining right-of-use asset, which, at that point on our books, would be $3,000 as we, again, estimated it would be. And then we make a cash payment for the difference between the residual value guarantee and what it was actually worth: $5,190. And then that lease is done at that point.

So again, several oversimplifying assumptions we make there, but essentially that's how the capital lease under [ASC] 840 would be transitioned to a finance lease under [ASC] 842. Again, in both of those cases—our operating lease and the capital lease—we assume the lessee was electing all of the practical expedients, which does, in most cases, make things a bit simpler, and most lessees probably will take advantage of those expedients.

**Ms. Grove Casey**

Let's look at how the transition would be different if an entity wasn't fortunate enough to be able to elect those practical expedients or for some reason didn't choose to. Maybe they don't want to take that whole package of three. Could you give us an example of that situation?

**Mr. Madray**

Sure, and again, there could be cases where that would be desirable. There may be situations where the practical expedients are simply not practical for all of our leases, and, remember, it's an all-or-nothing endeavor.

To see what might come out differently, let's look at the next example we have on the next slide here, this one involving Richards Company. They have an existing equipment lease. Let's assume the commencement date of this lease was January 1, 2018—a six-year lease term. The annual lease payments: $51,000 for the first three years and $55,000 for the last three years. There is a residual value guarantee in this lease of $6,000. The lease classification under Topic 840 was an operating lease, and, in this case, we're going to assume they're not electing the practical expedients.

Let's assume for our example purposes that this lease would be classified as a finance lease under [ASC] 842. You may wonder if the criteria are similar, how could that happen? Remember [ASC] 842 does include one extra criterion, and that is if the leased asset is specialized or unique in that it would have no alternative use to the lessor. So, let's just assume that's what happened here, which means that is an example of something that could properly be classified as an operating lease under [ASC] 840 but would be classified as a finance lease under [ASC] 842.

We're going to go with our standard 6% borrowing rate for calculation purposes. Like we've seen before, the effective date in this case [is] January 1, 2022, [and the] beginning of the earliest period presented [is] January 1, 2021. So, we have our comparative period [and] our current period. [The] main thing that we have related to this one is the accrued rent liability; at that point [it] would be $4,000. Again, as I said earlier, if it were classified as an operating lease under [Topic] 840 and you had those escalating payments, the payments should be accounted for straight line. The expense should be accounted for straight line over the life of the lease, and, as such, there would be that accrued rent liability for the difference in the cash payments and the rent expense [that] has been recognized up until that point.

So, continuing this example, [on] January 1, 2021, this lessee would measure the finance lease liability, which would be based on the present value of one remaining payment of $51,000 and three payments of $55,000 paid at the end of each year, discounted at 6%. That present value would come out to $186,807, simply the present value of those four remaining payments.

Now, the carrying amount of the right-of-use asset is a bit tricky, and we'll see on the next slide a series of steps we need to go through to get the right amount. The first step, as you see here, is to determine minimum rental payments over the remaining lease term. So, that [would] be one payment of $51,000 [plus] three payments of $55,000—a total of $216,000 in remaining payments.

The lease term at lease commencement was six years. The remaining lease term at the transition date would be four remaining years. So, next, we divide the amount of the minimum lease payments that we determined in step one, which will be $216,000, by the remaining number of years—in this case, four years. That gives us $54,000 per year.

We now need to determine the present value of that $54,000 over the lease term of the initial lease of six years using leasee's incremental borrowing rate. So, $54,000—which is $216,000 total lease payments divided by four years—discounted at 6% would be $265,536.

[For the] next step, we need to multiply the amount that we just determined, $265,536, by the ratio of the remaining lease term divided by the lease term of the initial lease, which is remaining lease term of four, initial lease term of six. So, $265,536 × 4 / 6; that's $177,024.

[The] final step is to add any previously recognized rental payments or subtract any accrued rental payments. Again, because we had that escalation there, we have that accrued rent liability—as we stated earlier, $4,000—the difference in the cash payments that are escalating in the straight-line expense recognized. So, we take that $177,024 that we just calculated, subtract the $4,000, and we get $173,024. That is the amount that we will record that right-of-use asset at [for the] transition.

To do that, our journal entry would look like we see on the next slide. We establish our new right of use asset: $173,024. We remove that old accrued rent balance with a debit of $4,000. We establish our lease liability based on the amount we calculated, $186,807, and, in this case, you notice we have a debit to retained earnings. That's basically a plug to make this entry balanced because we have specific guidance on calculating the ROU asset, specific guidance on calculating the lease liability, [and] specific guidance on eliminating any accrued rent liabilities we have here, but then, ultimately, to make it balance, that plug is going to go to retained earnings at the beginning of that earliest period to make it balance: $9,783.

So, as you can see, it's a bit more involved where we don't use the practical expedients. Again, we created an example where we went from an operating lease to a finance lease, and that may be the more complex of the situations. [There] could be a case where we don't use practical expedients, and we wouldn't have gone through all that. If the lease in question had been classified as an operating lease under the new [ASC] 842, then we'd just be transitioning an operating [lease] to an operating lease. This one was a bit more complex because of the need to make that change in the classification of the lease because we did not elect those practical expedients.

**Ms. Grove Casey**

We're past the effective date now. Let's look at some situations that are beyond the effective date. How would a new lease be recorded under the new guidance?

**Mr. Madray**

These are going to be, I think, much more straightforward.

**Ms. Grove Casey**

Well, the transitions are always the hard part.

**Mr. Madray**

Yes, the transitions are hard. But, you know, after the effective date, as we enter into new leases, we're just simply going to apply the guidance in [ASC] 842. So, a couple of examples of how that might work.

Let's assume [that on] January 1, 2022, as we see on the slide here, Austin Company enters into a lease for some office space for a 10-year term. The right to use the office space is a lease. There [are] no other components in the contract. And we have some relevant information here—we have the commencement date [and] the fixed lease payments. There's no termination or purchase options in this lease, [and] no residual value guarantee. Let's assume their incremental borrowing rate at the date of this lease is 10%. We would use that if the implicit rate in the lease cannot be determined. And let's assume there's some initial direct costs of $5,000. So, based on that, the contractual payments for the lease would be, as we see on the next slide, over that 10-year period, $14,527, $14,963, and so on, for a total of $166,535.

Based on this information, at the lease commencement date, this lessee would recognize a lease liability of $100,000. That's the present value of those 10 lease payments. Again, they start at $14,527 [and] escalate at 3% per year. [They] would be discounted at the lessee's incremental borrowing rate of 10%, and then that $5,000 of initial direct costs will be part of the initial right-of-use asset as well. The lease liability plus the $5,000 in initial direct costs will give us the right-of-use asset. So, [for] the journal entry to record the commencement of the lease, we would record the asset [at] $105,000; the lease liability at $100,000; and cash paid out for the various types of initial direct costs—whatever those may have been related to the lease—of $5,000.

Going forward—taking that lease and just moving forward—we started with a lease liability of $100,000 and a right-of-use asset of $105,000. Let's assume some additional facts about this case going forward. Let's say the remaining life of this office space is 35 years. Let's say the fair value of the office space is $400,000. Based on that, if you look at the criteria for classification, they would classify this as an operating lease because none of the tests for classification as a finance lease would be met. So, as a result, based on that initial recording of the lease liability and the right-of-use asset, which, by the way, is exactly the same whether it was an operating lease or a finance lease. The classification only affects the subsequent accounting and essentially the income statement impact. So, since it's an operating lease, this lessee would recognize a single lease cost for each of the 10 years of the lease term in an amount of $17,154. That's calculated as we see here. The total lease cost of $171,535, which is the total of the lease payments over the lease term plus that $5,000 initial direct cost, [is divided] over that lease term of 10 years.

And then it would play out, as you see on the next slide, over that 10-year period. The lease expense is the same every year, which is the case with an operating lease. The payment changes each year, escalating at 3%. The interest is the 10% based on the beginning-of-period lease liability. The principal reduction difference in the payment and the interest calculation then gives us our right-of-use amortization, which is the difference in the expense and that interest calculation. That would play out over the entire 10-year period. At the end of each year, this lessee would record a journal entry to record the lease expense; we said $17,154. It remains the same every year. The lease liability [is] reduced by $4,527, as we saw on the previous amortization table. [The] right-of-use asset would be decreased by $7,154, and we record our cash payment for the lease that year. Using the numbers from the amortization table, they would just record the subsequent journal entries at the end of each year.

And that's, again, an example of an operating lease. We could probably take a look at a finance lease, if you like, and see what that looks like as well.

**Ms. Grove Casey**

Yes. I know you mentioned that some parts of it are similar whether they're an operating lease or a finance lease, but I think the subsequent accounting for a finance lease is a little bit different. So, could you go over an example related to the finance leases?

**Mr. Madray**

Sure. Again, we're talking about something post effective date, so we're entering into a new lease. In this case, this lessee enters into a lease for some piece of equipment for a 10-year term [on] January 1, 2022. Again, we're assuming it is a lease; ignore the components in the contract.

And some other relevant facts: we have the lease payments, no renewal option, no termination or purchase option, [and] no residual value guarantee. [The] remaining economic life of the equipment is 12 years. [The] incremental borrowing rate is 10%—important because we don't know what the implicit rate in the lease is. If we did, we would use that. And there's some initial direct costs of $5,000.

The contractual payments, again, start out at $14,527 [and] escalate at 3% each year [for] a total of $166,535. Present value of that—as we saw, because we did this calculation earlier—would be $100,000. So, the present value of those 10 lease payments discounted at 10%. Our lease liability would be $100,000, and our right-of-use asset, like before, would be $105,000 because it's the $100,000 lease liability adjusted for those initial direct costs. So, the initial journal entry—as we enter into the lease, we would establish the right-of-use asset at $105,000; our lease liability of $100,000; and pay out the cash for the various initial direct costs.

Again, there is some guidance that tells us how to amortize the asset, but in most cases, we're going to amortize right-of-use assets over a straight-line basis, assuming the economic benefits are going to be received evenly over that lease term. So, based on that, assuming the lease is not modified in any way, we see the amortization of that—our payments [for] each of the 10 years, our interest calculated at 10% of the beginning-of-period lease liability, the principal reduction, and the right-of-use asset amortization—straight line over that 10-year period.

Let's just back up for a moment; I may have skipped over this. The reason that this would be accounted for as a finance lease, although all the numbers look exactly the same as what we saw before, is [that] the remaining economic life of this equipment is 12 years and it's a 10-year lease, meeting one of the criteria for accounting for this as a finance lease. Once again, the initial entry is the same regardless. We record the asset, the liability, and cash payment for any initial direct costs. The difference is in the subsequent accounting.

So, if you look on the next slide, we see [that] at the end of the first year we would record the reduction of the lease liability from our amortization table; our amortization expense, which is straight line over the 10-year period, [of] $10,500; our interest expense of $10,000, reducing our right-of-use asset by the amount of amortization, [which is] $10,500; and the cash payment in that first year [of] $14,527.

As I said earlier, I'm showing this in a journal entry with separate amounts recorded for amortization expense and interest expense. There's no requirement that those be presented separately or as separate line items, but it needs to be consistent with how we treat other depreciation, amortization, [and] interest on similar types of capital assets.

So, with that, I think we've covered all of those basics: transitioning an operating lease; transitioning a capital lease; dealing with a situation where we did not take advantage of the practical expedients; and then a couple of situations where, after [the] effective date as we enter into new leases going forward, how we're going to handle those and account for those as we move forward under this new guidance in ASC 842.

**Ms. Grove Casey**

Well, thanks, Russ.

**Mr. Madray**

Thanks, Debi. I hope this was helpful for everyone. Look forward to seeing you again soon.

# Journal Entries Associated with the Lease Accounting Standard

By J. Russell Madray, CPA

## Background

In 2016, the Financial Accounting Standards Board (FASB) issued its long-awaited revision to lease accounting, Accounting Standards Update (ASU) 2016-02, *Leases* (codified in ASC 842, *Leases*). After several delays, the standard became effective for private companies (i.e., those not meeting the FASB's definition of a public business entity), in calendar year 2022. Under this guidance, lessees will recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The liability will be equal to the present value of the lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. Classification is based on criteria that are largely similar to those applied in prior lease accounting, but without explicit bright lines.

Lease accounting continues to require significant judgments, including when making estimates related to the lease term, lease payments, and discount rate. Similar to prior guidance, the term of the lease includes the non-cancellable lease term plus renewal periods that are reasonably certain of exercise by the lessee or within the control of the lessor. Variable rent payments are generally excluded, except those based on an index or rate, which are included based on the index or rate at lease commencement.

The following are several common scenarios related to transitioning existing leases to the new guidance, as well as accounting for new leases after the effective date. All examples assume an effective date of January 1, 2022, with one year of comparative financial statements.

## Transition and Practical Expedients

Lessees and lessors are permitted to make an election to apply a package of practical expedients that allow them not to reassess:

1. Whether any expired or existing contracts are or contain leases

2. Lease classification for any expired or existing leases

3. Initial direct costs for any expired or existing leases (i.e., whether those costs qualify for capitalization under ASC 842)

***Observation:*** The FASB noted in the Basis for Conclusions of ASU 2016-02 that the practical expedient that permits entities not to reassess whether any expired or existing contracts contain leases does not grandfather incorrect assessments made under ASC 840, *Leases* (i.e., the practical expedient applies only to arrangements that were appropriately assessed under ASC 840). For example, the practical expedient would not "grandfather" a previous incorrect determination that a lease did not exist in a contract applying the current definition of a lease.

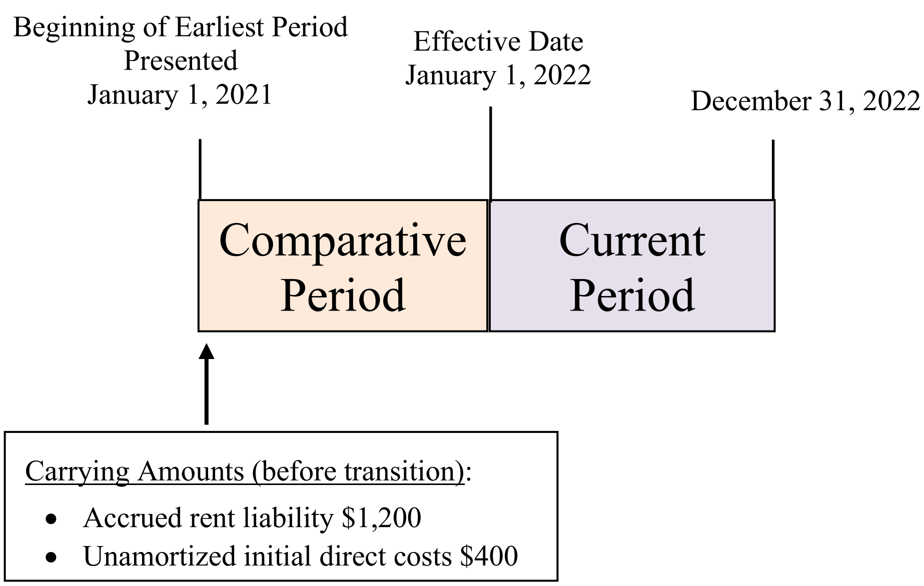
These three practical expedients must be elected as a package and must be consistently applied to all leases. An entity cannot choose which of the individual practical expedients to apply or which leases to apply them to (i.e., an entity must apply all three of these practical expedients to all leases or apply none of them).

Entities also are permitted to make an election to use hindsight when determining lease term (i.e., evaluating a lessee's option to renew or terminate the lease or to purchase the underlying asset) and assessing impairment of right-of-use assets (lessees only). Entities would consider all facts and circumstances that changed, through the effective date, in applying hindsight. However, entities would not consider events that occurred after the effective date, but prior to the first time it issues its financial statements reflecting the adoption of ASC 842 (i.e., hindsight only extends to the effective date). The hindsight practical expedient may be elected separately or in conjunction with the package of practical expedients described above. An entity must apply this practical expedient to all leases or apply it to none of them.

**Existing Operating Lease with Practical Expedients Elected**

Acme Company has an existing office space lease. Relevant information about Acme's lease is as follows:

| | |
|---|---|
| Commencement date: | January 1, 2020 |
| Lease term: | 5 years |
| Annual rental payments (paid in arrears): | $31,000 first two years; $33,000 thereafter |
| Lease classification at inception under ASC 840: | Operating lease |
| Initial direct costs (IDCs), amortized on a straight-line basis over the lease term: | $500 |
| Acme's incremental borrowing rate at January 1, 2021: | 6.0% |




***Observation:*** Because Acme elected the package of practical expedients, it does not reassess whether the contract is or contains a lease, whether classification of the lease would be different under ASC 842, or whether the unamortized initial direct costs at January 1, 2021, would meet the definition of initial direct costs under ASC 842.

Worksheet at January 1, 2021 (beginning of earliest period presented):

| | **Amounts** | **Notes** |
|---|---|---|
| Lease liability | $112,462 | Remaining minimum rental payments ($31,000 for 2021 and $33,000 for each of 2022–2024) discounted at 6.0% |
| ROU asset | 111,662 | Sum of lease liability recognized and $400 of unamortized IDCs, less $1,200 accrued rent liability |
| Accrued rent | 1,200 | Balance at transition due to straight-line expense recognition under ASC 840 |
| Unamortized IDCs | 400 | Balance at transition under ASC 840 |
| Annual lease expense | 32,300 | Total of all rental payments ($31,000 for 2020 and 2021 and $33,000 for each of 2022–2024), plus IDC ($500), divided by 5-year lease term |

To transition to ASC 842, Acme would record the following journal entry at January 1, 2021:

| **Account** | **Debit** | **Credit** |
|---|---|---|
| ROU Asset | 111,662 | |
| Accrued Rent | 1,200 | |
| Lease Liability | | 112,462 |
| Unamortized IDCs | | 400 |

Assuming the lease is not modified and there is no remeasurement of the lease liability, the lease would be amortized as follows:

| **Year End** | **Expense (A)** | **Payment (B)** | **Interest (C)** | **Principal (B) – (C)** | **ROU Amortization (A) – (C)** |
|---|---|---|---|---|---|
| 12/31/21 | 32,300 | 31,000 | 6,748 | 24,252 | 25,552 |
| 12/31/22 | 32,300 | 33,000 | 5,293 | 27,707 | 27,007 |
| 12/31/23 | 32,300 | 33,000 | 3,630 | 29,370 | 28,670 |
| 12/31/24 | 32,300 | 33,000 | 1,867 | 31,133 | 30,433 |
| Totals | 129,200 | 130,000 | 17,538 | 112,462 | 111,662 |

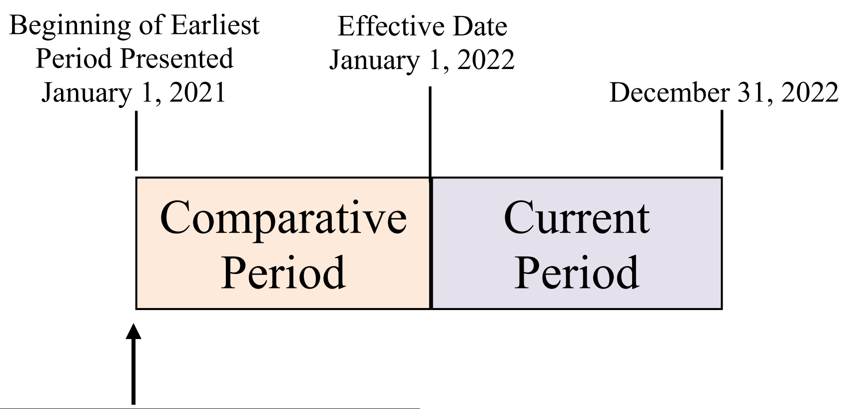
Acme would record the following journal entry at December 31, 2021 (with similar entries throughout the term of the lease):

| **Account** | **Debit** | **Credit** |
|---|---|---|
| Lease Liability | 24,252 | |
| Lease Expense | 32,300 | |
| ROU Asset | | 25,552 |
| Cash | | 31,000 |

**Existing Capital Lease with Practical Expedients Elected**

Coyote Company has an existing equipment lease. Relevant information about Coyote's lease is as follows:

| | |
|---|---|
| Commencement date of the lease: | January 1, 2020 |
| Lease term: | 7 years |
| Annual lease payments (paid in arrears): | $25,000 |
| Residual value guarantee (lessee): | $8,190 |
| Amount probable of being owed under the residual value guarantee (no change throughout lease term): | $5,190 |
| Lease classification at inception under ASC 840: | Capital lease |
| Coyote's incremental borrowing rate at lease inception: | 6.0% |
| Initial direct costs (IDCs), amortized on a straight-line basis over the lease term: | $2,800 |




Carrying Amounts (before transition):

- Capital lease liability $128,707
- Capital lease asset $124,434
- Unamortized initial direct costs $2,400

***Observation:*** Because Coyote elected the package of practical expedients, it does not reassess whether the contract is or contains a lease, whether classification of the lease would be different under ASC 842, or whether the unamortized initial direct costs at January 1, 2021, would meet the definition of initial direct costs under ASC 842.

Worksheet at January 1, 2021 (beginning of earliest period presented):

| | **Amounts** | **Notes** |
|---|---|---|
| Lease liability | $128,707 | Equal to existing capital lease liability |
| ROU asset | 126,834 | Equal to existing capital asset ($124,434) + existing unamortized IDCs ($2,400) |

To transition to ASC 842, Coyote would record the following journal entry at January 1, 2021, in order to add the unamortized IDCs to the initial ROU asset:

| Account | Debit | Credit |
|---|---|---|
| ROU Asset | 126,834 | |
| Capital Lease Asset | | 124,434 |
| Unamortized IDCs | | 2,400 |

Assuming the lease is not modified and there is no remeasurement of the lease liability, the lease would be amortized as follows:

| Year End | Payment (A) | Interest (B) | Principal (A) – (B) | ROU Amortization |
|---|---|---|---|---|
| 12/31/21 | 25,000 | 7,722 | 17,278 | 20,639 |
| 12/31/22 | 25,000 | 6,686 | 18,314 | 20,639 |
| 12/31/23 | 25,000 | 5,587 | 19,413 | 20,639 |
| 12/31/24 | 25,000 | 4,422 | 20,578 | 20,639 |
| 12/31/25 | 25,000 | 3,187 | 21,813 | 20,639 |
| 12/31/26 | 25,000 | 1,879 | 23,122 | 20,639 |
| Totals | 150,000 | 29,484 | 120,517 | 123,834 |

Coyote would record the following journal entry at December 31, 2021 (with similar entries throughout the term of the lease):

| Account | Debit | Credit |
|---|---|---|
| Lease Liability | 17,278 | |
| Amortization Expense | 20,639 | |
| Interest Expense | 7,722 | |
| ROU Asset | | 20,639 |
| Cash | | 25,000 |

***Observation:*** The interest expense on the lease liability and amortization of the ROU asset are not required to be presented as separate line items; rather, each is presented in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets.

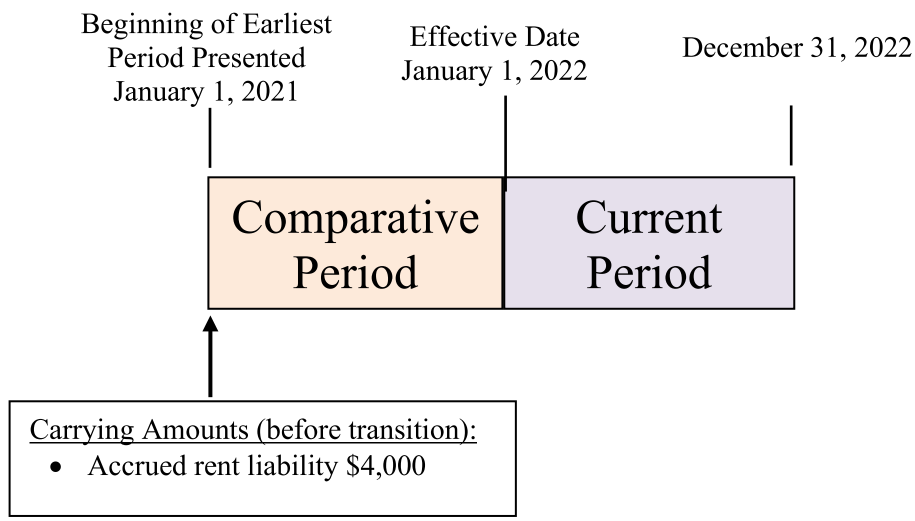
At the end of the lease term, Coyote would record the following journal entries:

| Account | Debit | Credit |
|---|---|---|
| Lease Liability | 23,122 | |
| Amortization Expense | 20,639 | |
| Interest Expense | 1,879 | |
| ROU Asset | | 20,639 |
| Cash | | 25,000 |
| Lease Liability | 8,190 | |
| ROU Asset | | 3,000 |
| Cash | | 5,190 |

**Existing Operating Lease with Practical Expedients NOT Elected**

Richards Company has an existing equipment lease. Relevant information about Richards's lease is as follows:

| | |
|---|---|
| Commencement date of the lease: | January 1, 2018 |
| Lease term: | 6 years |
| Annual lease payments (paid in arrears): | $51,000 first 3 years<br>$55,000 last 3 years |
| Residual value guarantee (lessee): | $6,000 |
| Lease classification at inception under ASC 840: | Operating lease |
| Practical expedients elected: | No |
| Lease classification under ASC 842 (e.g., because the asset meets the new specialized asset criterion): | Finance lease |
| Richards's incremental borrowing rate at January 1, 2021: | 6% |




On January 1, 2021, Richards measures the finance lease liability as $186,807, which is the present value of one payment of $51,000, and three payments of $55,000, discounted at 6%.

Richards determines the carrying amount of the ROU asset at January 1, 2021, using the formula described in ASC 842-10-65-1(o) as follows:

1. Determine the minimum rental payments over the remaining lease term as of the transition date: $51,000 + ($55,000 × 3) = $216,000

2. Determine the lease term at lease commencement: 6 years

3. Determine the remaining lease term as of the transition date: 4 years

4. Divide the amount determined in Step 1 by the amount determined in Step 3: $216,000 / 4 years = $54,000 per year

5. Determine the present value of the periodic payment calculated in Step 4 over the lease term identified in Step 2 using the lessee's incremental borrowing rate at the transition date: $54,000 per year in arrears for 6 years discounted at 6% = $265,536

6. Multiply the amount in Step 5 by the ratio of the remaining lease term calculated in Step 3 divided by the lease term identified in Step 2: $265,536 × (4 / 6) = $177,024

7. Add to the amount calculated in Step 6 the amount of any previously recognized prepaid rental payments (and subtract from that amount any accrued rental payments): $177,024 – $4,000 = $173,024

To transition to ASC 842, Richards would record the following journal entry at January 1, 2021 (the difference between the ROU asset and the lease liability on January 1, 2021, is an adjustment to opening retained earnings at that date):

| Account | Debit | Credit |
|---|---|---|
| ROU Asset | 173,024 | |
| Accrued Rent | 4,000 | |
| Retained Earnings | 9,783 | |
| Lease Liability | | 186,807 |

**Initial Measurement of ROU Asset and Lease Liability**

On January 1, 2022, Austin Company enters into a lease with ABC Realty for office space for a 10-year term. The right to use the office space is a lease and there are no other components of the contract. The following facts are relevant at the lease commencement date:

| | |
|---|---|
| Commencement date of the lease: | January 1, 2022 |
| Lease payments: | Fixed payments of $14,527 per year in arrears, with a 3% increase every year |
| Termination/purchase options: | None |
| Transfer of ownership: | No |
| Residual value guarantee: | None |
| Austin's incremental borrowing rate (implicit rate cannot be determined) | 10% |
| Initial direct costs | $5,000 |

Accordingly, the contractual payments for the non-cancellable lease period are as follows:

| | |
|---|---|
| 2022 | $14,527 |
| 2023 | 14,963 |
| 2024 | 15,412 |
| 2025 | 15,874 |
| 2026 | 16,350 |
| 2027 | 16,841 |
| 2028 | 17,346 |
| 2029 | 17,866 |
| 2030 | 18,402 |
| 2031 | 18,954 |
| Total | $166,535 |

At the lease commencement date, Austin recognizes a lease liability of $100,000. This is the present value of the 10 lease payments (starting at $14,527 and escalating at 3% per year), discounted at Austin's incremental borrowing rate of 10%. Austin recognizes a corresponding ROU asset of $105,000, which is calculated as follows:

$100,000 lease liability + $5,000 initial direct costs

Austin would record the following journal entry at January 1, 2022:

| Account | Debit | Credit |
|---|---|---|
| ROU Asset | 105,000 | |
| Lease Liability | | 100,000 |
| Cash | | 5,000 |

**Subsequent Accounting for an Operating Lease**

In the previous example, Austin Company recognized a lease liability of $100,000 and an ROU asset of $105,000 for its lease of office space with ABC Realty.

Also, assume the following:

| | |
|---|---|
| Remaining economic life of office space: | 35 years |
| Fair value of office space: | $400,000 |

Accordingly, Austin classifies the lease as an operating lease because none of the tests for classification as a finance lease are met. As a result, Austin recognizes a single lease cost of $17,154 each year of the 10-year lease, which is calculated as follows:

Remaining lease cost $171,535 (Total lease payments for the lease term $166,535 + Total IDCs recognized $5,000) / Lease term of 10 years

Assuming the lease is not modified and there is no remeasurement of the lease liability, the lease would be amortized as follows:

| Year End | Expense (A) | Payment (B) | Interest (C) | Principal (B) – (C) | ROU Amortization (A) – (C) |
|---|---|---|---|---|---|
| 12/31/22 | 17,154 | 14,527 | 10,000 | 4,527 | 7,154 |
| 12/31/23 | 17,154 | 14,963 | 9,547 | 5,416 | 7,607 |
| 12/31/24 | 17,154 | 15,412 | 9,006 | 6,406 | 8,148 |
| 12/31/25 | 17,154 | 15,874 | 8,365 | 7,509 | 8,789 |
| 12/31/26 | 17,154 | 16,350 | 7,614 | 8,736 | 9,540 |
| 12/31/27 | 17,153 | 16,841 | 6,741 | 10,100 | 10,412 |
| 12/31/28 | 17,153 | 17,346 | 5,731 | 11,615 | 11,422 |
| 12/31/29 | 17,153 | 17,866 | 4,569 | 13,297 | 12,584 |
| 12/31/30 | 17,153 | 18,402 | 3,239 | 15,163 | 13,914 |
| 12/31/31 | 17,153 | 18,954 | 1,723 | 17,231 | 15,430 |
| Totals | 171,535 | 166,535 | 66,535 | 100,000 | 105,000 |

Austin would record the following journal entry at December 31, 2022 (with similar entries throughout the term of the lease):

| Account | Debit | Credit |
|---|---|---|
| Lease Liability | 4,527 | |
| Lease Expense | 17,154 | |
| ROU Asset | | 7,154 |
| Cash | | 14,527 |

**Accounting for a Finance Lease**

On January 1, 2022, Yosemite Company enters into a lease with XYZ Equipment for a piece of equipment for a 10-year term. The right to use the equipment is a lease and there are no other components of the contract. The following facts are relevant at the lease commencement date:

| | |
|---|---|
| Commencement date of the lease: | January 1, 2022 |
| Lease payments: | Fixed payments of $14,527 per year in arrears, with a 3% increase every year |
| Renewal options: | None |
| Termination/purchase options: | None |
| Transfer of ownership: | No |
| Residual value guarantee: | None |
| Remaining economic life of equipment | 12 years |
| Yosemite's incremental borrowing rate (implicit rate cannot be determined) | 10% |
| Initial direct costs | $5,000 |

Accordingly, the contractual payments for the non-cancellable lease period are as follows:

| | |
|---|---|
| 2022 | $14,527 |
| 2023 | 14,963 |
| 2024 | 15,412 |
| 2025 | 15,874 |
| 2026 | 16,350 |
| 2027 | 16,841 |
| 2028 | 17,346 |
| 2029 | 17,866 |
| 2030 | 18,402 |
| 2031 | 18,954 |
| Total | $166,535 |

At the lease commencement date, Yosemite recognizes a lease liability of $100,000. This is the present value of the 10 lease payments (starting at $14,527 and escalating at 3% per year), discounted at Yosemite's incremental borrowing rate of 10%. Yosemite recognizes a corresponding ROU asset of $105,000, which is calculated as follows:

$100,000 lease liability + $5,000 initial direct costs

Yosemite would record the following journal entry at January 1, 2022:

| Account | Debit | Credit |
|---|---|---|
| ROU Asset | 105,000 | |
| Lease Liability | | 100,000 |
| Cash | | 5,000 |

Yosemite expects to consume the ROU asset's future economic benefits evenly over the lease term. Accordingly,

Yosemite amortizes the ROU asset on a straight-line basis over 10 years.

Assuming the lease is not modified and there is no remeasurement of the lease liability, the lease would be amortized as follows:

| Year End | Payment (A) | Interest (B) | Principal (A) – (C) | ROU Amortization |
|---|---|---|---|---|
| 12/31/22 | 14,527 | 10,000 | 4,527 | 10,500 |
| 12/31/23 | 14,963 | 9,547 | 5,416 | 10,500 |
| 12/31/24 | 15,412 | 9,006 | 6,406 | 10,500 |
| 12/31/25 | 15,874 | 8,365 | 7,509 | 10,500 |
| 12/31/26 | 16,350 | 7,614 | 8,736 | 10,500 |
| 12/31/27 | 16,841 | 6,741 | 10,100 | 10,500 |
| 12/31/28 | 17,346 | 5,731 | 11,615 | 10,500 |
| 12/31/29 | 17,866 | 4,569 | 13,297 | 10,500 |
| 12/31/30 | 18,402 | 3,239 | 15,163 | 10,500 |
| 12/31/31 | 18,954 | 1,723 | 17,231 | 10,500 |
| Totals | 166,535 | 66,535 | 100,000 | 105,000 |

Yosemite would record the following journal entry at December 31, 2022 (with similar entries throughout the term of the lease):

| Account | Debit | Credit |
|---|---|---|
| Lease Liability | 4,527 | |
| Amortization Expense | 10,500 | |
| Interest Expense | 10,000 | |
| ROU Asset | | 10,500 |
| Cash | | 14,527 |

***Observation:*** The interest expense on the lease liability and amortization of the ROU asset are not required to be presented as separate line items; rather, each is presented in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets.

# GROUP STUDY MATERIALS

## A. Discussion Problems

1. Briefly discuss the broad requirements for lessees under ASC 842.

2. Explain the package of practical expedients permitted under ASC 842.

3. Describe how interest expense on the lease liability and amortization of the ROU asset is presented in the income statement.

## B. Suggested Answers to Discussion Problems

1. Under ASC 842, *Leases,* lessees will recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The liability will be equal to the present value of the lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. Classification is based on criteria that are largely similar to those applied in prior lease accounting, but without explicit bright lines.

2. Lessees and lessors are permitted to make an election to apply a package of practical expedients that allow them not to reassess:

   - Whether any expired or existing contracts are or contain leases
   - Lease classification for any expired or existing leases
   - Initial direct costs for any expired or existing leases (i.e., whether those costs qualify for capitalization under ASC 842)

   These three practical expedients must be elected as a package and must be consistently applied to all leases. An entity cannot choose which of the individual practical expedients to apply or which leases to apply them to (i.e., an entity must apply all three of these practical expedients to all leases or apply none of them).

3. The interest expense on the lease liability and amortization of the ROU asset are not required to be presented as separate line items; rather, each is presented in a manner consistent with how the entity presents other interest expense and depreciation or amortization of similar assets.

# PART 2. AUDITING

## Using New Tech in Accounting and Auditing

Many firms are still facing a crunch related to human resources. Part of maximizing a firm's resources means effective use of the technology available. Firms with strong digital workflows and a risk-based audit approach are more likely to adopt advanced technologies like artificial intelligence, machine learning, and analytics.

There is a direct link between an auditor's use of technology in the audit and the entity's use of technology, including the availability of data. It is important to obtain an understanding of the entity's use of technology and consider how that may affect risk assessment, designing the detailed audit plan, and gathering significant and appropriate audit evidence.

For more on the use of emerging technology in accounting and auditing, 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 emerging technology in accounting and auditing. To begin with, how important of a role do you think emerging technology is playing in the world of finance, accounting, and auditing?

**Ms. Louis**

Definitely, technology is a way for any type of organization to stay competitive in an increasingly competitive market, as they maybe can save time and provide deeper insights into their data. Ultimately, there are some studies that estimate that 80 to 90 percent of time that was previously taken by workforces in doing manual repetitive tasks can be replaced by new and emerging technology. So, it is a way of being more efficient. It is a way, also, of just enhancing the quality of the output that we are creating so that we maybe can get higher quality information to apply. And this does include CPA firms, trying to figure out how they can use advanced technology to produce higher quality audits and to be more effective and cost efficient for their clients for the same reasons.

**Ms. Grove Casey**

Certainly, we have seen that the profession has had issues in—I don't want to call it recruiting—but finding staff that are able to do what they need. So, let's talk a little bit about how financial statement audits specifically are being impacted by emerging technology.

**Ms. Louis**

All types and sizes of financial statement audits ultimately can be impacted by IT [information technology]. There is rapid development in technology and opportunities for using data analytics to help auditors with their risk assessments, to help them in leveraging technology to gather audit evidence, and to ensure that they are using technology to add value to the financial statement audit as a whole.

**Ms. Grove Casey**

Is there a link between an audited entity's use of technology and the auditor's use of technology?

**Ms. Louis**

Obviously, there is going to be a linkage in that if the reporting entity, the audited entity, doesn't have a lot of data in electronic form, it is going to put a little limitation on your ability, then, to access the data to use in your technology as an auditor. Things like audit data analytics are going to depend on the level of data that is available from the entity. Regardless, I think that even in situations where data is more limited, there are still ways that you can use technology to help assess risk, design an audit plan, and gather sufficient and appropriate evidence.

**Ms. Grove Casey**

How do you perceive emerging technology, such as artificial intelligence (AI), directly impacting the accounting and finance world?

**Ms. Louis**

We talked about how technology boosts productivity, it increases the quality of output, it could create better transparency, and it could create enhanced auditability as it gives your auditors more options of using technology to come in and do your audit.

There is a way of looking to see how we can minimize some time-consuming responsibilities, and to look for ways that it can be automated. There are things that can help with creating the financial statements, and there are things that can help with just doing forecasting. Things like machine learning can help in [making] better predictions of future trends that are based on historical data and records. There are ways that algorithms can sift through large volumes of data to find potential fraud and to flag unusual transactions for review. There are ways that we can help generate reports in a more real-time way.

There are lots of options and ways that technology is being used in the accounting and finance departments and will help them be better. Also, it will have benefits as you are trying to focus on auditing those same entities.

**Ms. Grove Casey**

Can you give some practical examples of how AI enables processing and automated authorization of documents in a variety of finance and accounting activities?

**Ms. Louis**

Yes, one of the most time-consuming, labor-intensive parts of accounting might be to, say, process invoices. So, you can have artificial intelligence-based invoice management systems that can help in trying to improve the process, particularly around things like reducing processing errors, improving the ability to interact with vendors as we are sharing information that might be needed. It can help with onboarding suppliers as we figure out how we can minimize the human intervention that might be involved. It can help in looking at how we can reconcile our financial activities quicker, and how to predict future cash requirements as we look at our monthly or quarterly cash flows. It can be how we manage our expenses as we are, maybe, trying to get rid of complex paperwork to reduce opportunities for fraud and other things that also can improve that aspect of things.

**Ms. Grove Casey**

What about the use of emerging technologies, such as robotic process automation and chatbot support?

**Ms. Louis**

The robotic process automation, called RPA, is something that can complete repetitive tasks. I might have certain processes where we can look at document management or data analysis. Is there a way that we can automate repetitive tasks so that our accounting or finance people can focus on more value-added things—things that are more strategic or advisory?

Now, as far as chatbot, it is funny that they can help solve queries that we have, hopefully in an efficient way, including looking for ways to deal with maybe understanding how to account for something. But it also can be used in chatbot support for other factors—and not just with accounting, as we think about answering a customer's routine questions, and providing basic support in our operational areas.

The thing [to keep in mind] as we are dealing with these matters is that anything that is new [may have limitations]. If we think about ChatGPT, for example, my husband is a CFO and was trying to use that to get an answer to an accounting question, and the answer that was given was wrong. So, those are the limitations you are going to have;

it is giving a response based on the best information that it has available, but it has to learn. My husband was querying back and saying, "Well, what is your basis for this? Why isn't it this answer?" And [it replied], "You are right." So, he just helped expand the knowledge of this technology.

Definitely, some of these things, some of the emerging technologies, there are going to be limitations in their usage and their value, but they are a source. They are a tool that we can try and leverage and use, at least to some degree.

**Ms. Grove Casey**

Let's talk a little bit more about how artificial intelligence can be used for auditing purposes. Can an auditor leverage emerging technology, even if the audited entity does not extensively use information technology?

**Ms. Louis**

[The auditor] can, because of the fact that even if we take data and have to import it into our technology so that we can create new reports, or we can slice and dice data differently than what our client's system's capabilities are, yes, we can still do that. Now, obviously, the greater the use of IT by the entity will allow for more sophisticated usages of our technology. But advances in artificial intelligence are, in general, just finding ways to replace things that only humans used to be able to do.

**Ms. Grove Casey**

I would think for trend analysis and data analytics, which I'm about to ask you about, it would be almost invaluable in terms of the time that it takes to scan all of that data versus a human scanning all of that data and processing it. How are audit data analytics specifically defined within the context of generally accepted auditing standards?

**Ms. Louis**

The revamped audit evidence section of the SASs recently was updated, and talked about audit data analytics, or ADAs as they call them, that talk about the analysis of patterns, the identification of anomalies, the extraction of other useful information and data that is underlying whatever the subject matter of audit is. It can be done through modeling, analysis, visualization, and it is anticipated that these techniques are going to be able to, ultimately, be applied in a variety of ways as we think about risk assessment and testing controls and testing details, but also, helping with our substantive analytics, as well.

**Ms. Grove Casey**

How can automation help with identifying and evaluating audit risk?

**Ms. Louis**

If I have a data-driven audit, the common thinking is that you need to have a data-driven risk assessment. So, automation ultimately needs to start with the risk assessment process to use techniques that can help identify anomalies that might be higher risk. It might be that I can use automation to help corroborate work that I have done through inquiry and observation. It is going to help me have new insights into the entity and its environment so that I can provide a more precise risk assessment.

**Ms. Grove Casey**

Yes, I would think from the corroboration standpoint, as well as identification, depending on what is occurring, that it would be almost invaluable in terms of an efficient process. Can automation be used to better identify significant accounts, classes of transactions, and disclosures?

**Ms. Louis**

It can. For example, an entire population of transactions can be analyzed using automation to understand the nature, the source, the size, and the volume, and it could be something even like I may have an account with a zero balance at period end, but it is comprised of a bunch of offsetting transactions, with journal entries occurring during the period. So, because what is flowing through that account might be something of significance for me to pay attention to, even though the balance of the account is zero at period end, by analyzing the flows of the entire population, I may identify a risk that I previously hadn't considered.

**Ms. Grove Casey**

How can an auditor's responsibilities to gain an understanding of an entity and its environment help identify IT-related matters?

**Ms. Louis**

Well, it ultimately needs to be that I have to think about whether or not the management of the reporting entity has a good understanding of their IT environment, the flows of their transactions, and the flows of their data. Do they have a good understanding of how their systems interrelate to each other? Do they have change management controls as they upgrade or replace their systems? These are things that, as we understand the entity and environment including the design of their controls, we may need to make inquiries directly towards IT personnel to get more information about the IT processes, the system changes, and the understanding of new and modified technologies that might have been implemented at the entity so that we know where our opportunities might lie with them.

**Ms. Grove Casey**

Let's talk a little bit more about how an auditor may obtain electronic audit evidence.

**Ms. Louis**

The auditor can use ways to directly access databases and to digitally download databases, as we look at information systems that do electronically store accounting records and transactions. So, by applying these automated tools and techniques, I can do things like tracing journal entries to a particular transaction, or I can look at an entire population from initiation through recording in the journal entry. I can look at large sets of transactions that might help me find things that appear to be variations from the norm.

These are all things that, as I can [access] all this stuff electronically, I need to understand how things are processed in order to know where the opportunities are for me to have points within the process that might have value, as I'm thinking about the evidence that can be obtained from that given population.

**Ms. Grove Casey**

Does the increased use of automation in general increase the likelihood that sufficient appropriate evidence may not be able to be obtained through substantive procedures alone?

**Ms. Louis**

As things are done electronically, as they initiate and process and record and report things, we do need to think about the complexity of the systems, particularly if there is a high volume of activity, if it is a complex model, or if there is the requirement to extensively use IT to get complete and accurate information.

Certainly, it may be that we have to get into understanding the controls. So, when we talk about taking a purely substantive approach, I may need to test the operating effectiveness of controls because it might be harder for me to audit around the system, and I might need to do more auditing through the system. Definitely, we are creating situations where that is a greater likelihood in an audit scenario.

**Ms. Grove Casey**

Is it still possible for an auditor to place less reliance in application and general IT controls when planning an audit?

**Ms. Louis**

Definitely, as audited entities progress in their own use of IT, as they become more mature in the use of data and technology, those controls are going to be more key and more important. But in the early stages when there is a lower IT maturity, I may decide to put less reliance on the application controls and the general IT controls that might not be my key or critical controls.

What is probably going to happen is that organizations of all natures, sizes, and complexity will continue to mature, will continue to have greater IT growth, and they will become more and more automated with their infrastructure, their processes, their monitoring, their innovation, and their investment. So, it will be the case that even in smaller entity-type environments, they still may be mature from an IT point of view.

**Ms. Grove Casey**

There are still benefits to looking for opportunities to use ADAs, even when there is a limited amount of automated data available, correct?

**Ms. Louis**

It might be that it is just general ledger data that is available, but I can still take that general ledger data, I can calculate financial ratios, and I can create visualization reports only using the general ledger data. "Visualization" is a term that is used as we talk about charts, scatter diagrams, trend lines, and tables. I'm creating dashboards; I'm creating graphics for visualization. So, even if I take GL (general ledger) data and turn it into a visualization form, I may find it useful for me to reach conclusions from the application of that. There may be trends that I can see better as I'm looking at possible issues, like looking at sales numbers in some sort of bar chart.

So definitely, we do need to look for opportunities, even if it is in a more limited way at first. Then, as audited entity management starts implementing new systems and doing more, as they become more IT-mature, my opportunities will continue to evolve.

**Ms. Grove Casey**

I know when the profession first started moving towards a technology improvement that there was a substantial amount of investment that was required for CPA firms to get all of their people their own computers, for example. Is the use of automation in an audit going to result in significant investment for a CPA firm, even if we have our stuff in the cloud now?

**Ms. Louis**

There are ways to leverage technologies that we already have, like Microsoft Excel, or ways to just use open-source resources that are available. An example that I'm not that familiar with, but I could get familiar with it, is the AICPA provided an example about how Python can be leveraged to apply things—and that is a programming language used for automating tasks and conducting data analytics. It is something that is an open-source resource. So, when we say investment, sometimes the investment is just the time to learn its application, and to get adept at applying it.

The investment isn't necessarily purchasing software and hardware beyond what we already have. There may be [situations] where we can see where that does make sense, but I do agree that when we talk about investment, a lot of it is just time and resources that could be important for us to leverage, to be able to really see these full benefits.

**Ms. Grove Casey**

Can you give some more specific examples for how automation may be effectively and efficiently used in an audit?

**Ms. Louis**

As we are looking at providing insights, if we are looking at historical patterns, we might be analyzing credit losses with receivables to look at historical situations and to see where current patterns might be inconsistent with historical patterns, and we might be able to compare things to publicly available sources that might be [from] an industry peer group. That could be something that we may be able to access to also try to provide insights that we can take into account.

It can even include things like, just in general, as we are reading things like contracts, that we could use technology to help us try and find key elements by doing keyword searches to process large amounts of data to help do things that we can perhaps do faster and with fewer errors.

**Ms. Grove Casey**

Let's talk a little bit about machine learning and how that emerging technology could be used.

**Ms. Louis**

Machine learning is an advanced form of artificial intelligence that uses algorithms to make predictions. Its name is derived from the fact that the algorithms have an ability to learn from experience by using data sets rather than relying on some sort of rules-based system.

What happens is, the more data I have leads to more examples which help the algorithm more finely tune its output over the course of time. So, the algorithm adjusts. It learns by trial and error. So, it is important as we talk about machine learning and these algorithms, that it is a point in time where we have to wait until they are mature enough to, potentially, be able to better predict the outputs or to make inferences as a result.

**Ms. Grove Casey**

Tell me a little bit more about the robotic process automation and how it could be used by auditors.

**Ms. Louis**

We talked earlier about how robotic process automation can be used to replace repetitive tasks, certain calculations, recording certain transactions, and answering certain repetitive questions. RPA and analytics can be used to extract data from prior periods or from interim financial information to help us determine materiality, maybe on a continuous or real-time basis. There is a set repetitive task of a calculation that has to be done. Real time, can we get a sense around what materiality might be? Could we do it to identify unusual transactions, or things that we might need to set scopes, or where we might want to focus our testing on things that tend to have a greater risk? Calculating scopes—things that are a calculation that might occur—could be something that could be more automated in its approach. We think about sampling as an area that might enable itself to have a more robotic approach to it.

**Ms. Grove Casey**

So, what is an "audit bot," and do they relate to robotic process automation?

**Ms. Louis**

They perform repetitive tasks through RPA so, yes, they are related in that an audit bot ultimately can copy data across different audit files without the risk of human input errors. It can do simple tax calculations to assist in determining your tax provision, it can ensure that things tie out to the prior year, and it can rebuild financial statements from underlying data to have an independent expectation about what financial statements should be. So, there can be audit bots that are used to do these repetitive tasks through the use of RPA.

**Ms. Grove Casey**

Can robotic process automation be used to source information from outside of a reporting entity?

**Ms. Louis**

Absolutely. If there are publicly available information sources, if there are subscription databases that we can use, then that can be useful as we are thinking about generating ratio analysis for a given industry. It might be that you do things like getting a geographical registration of entity names and numbers that are automatically obtained and that we compare to our entity to see if there are related parties, and to see if there are conflicts of interest, [which] could help us with our independence determinations. So, there are ways that we can access data that might be useful, whether it is industry data or other publicly available information that is out there.

**Ms. Grove Casey**

How can optical character recognition be used by an auditor?

**Ms. Louis**

It can be used to extract terms from standard contracts, such as leases, it can be performed to make sure that no changes have been made maybe to certain contract term information, and we can use things like signature verification through digital imaging processing for contract assurance. So, there are ways that we can also use that type of technology to assist.

**Ms. Grove Casey**

How do you specifically see audit data analytics being used to audit the general ledger?

**Ms. Louis**

I think that, in its basic form, is something that auditors are already exploring as they are trying to figure out, [for example] with journal entries, can I do a journal entry query that says look for a specific related party's name? Or look for something that was posted by an unusual source, or an unusual date, or an unusual debit/credit combination? I think that definitely, in the general ledger and even sub-ledgers, we can use Benford's law and other things that can help us analyze and interpret that information.

**Ms. Grove Casey**

What general tips do you have for an auditor who is planning for the use of audit data analytics for a financial statement audit?

**Ms. Louis**

Well, I think in our engagement team discussions, we need to start having conversations about what financial statement line items, what disclosures, and on what assertions do we have the capabilities of using audit data analytics? Have a specific objective, though, in what we are trying to accomplish from using the technology. We shouldn't use technology for the sake of using technology; it should be beneficial. It is going to help us improve the effectiveness or the efficiency of what it is that we are going to do. And make sure that we are using an approach that is going to be best suited for our intended purpose and our intended objectives before we just start diving in.

**Ms. Grove Casey**

Is there anything else you would like to add about leveraging the use of emerging technologies?

**Ms. Louis**

Just keeping in mind that real-time collaboration, cloud-based technologies, those definitely are giving more capabilities of being able to securely access information from anywhere, and enabling teams to work together, like working on the same document at the same time without worrying about version control. Those are things that we want to keep our eye on as we look for future opportunities to leverage technology.

## Using Emerging Technology in Accounting and Auditing

By Jennifer F. Louis, CPA

**Background**

Emerging technology has made a significant impact in the worlds of finance, accounting, and auditing. Technology is a way for enterprises to stay strong contenders in an increasingly competitive market because it saves time and provides deeper insights into data.

Some studies estimate that 80–90 percent of the time previously taken by the workforce in performing disparate and repetitive tasks manually can be replaced by new technology. The increased use of technology also enhances the quality of the output by reducing human error.

CPA firms also need to leverage advanced technologies to produce high-quality audits that are efficient and cost-effective for clients. Firms with strong digital workflows and a risk-based audit approach have superior readiness for adopting advanced technologies like artificial intelligence (AI), machine learning, and analytics.

Audits of the financial statements of entities of all types and sizes may be performed in an environment in which there is pervasive use of information technology (IT). Continuous and rapid developments in technology and data analytics create opportunities for auditors to evolve their risk assessments and other procedures by leveraging technology. Increased use of automated tools and techniques such as audit data analytics (ADAs) is likely to be important in maintaining and enhancing the relevance and value of the financial statement audit.

There is a direct link between an auditor's use of technology in the audit and the entity's use of technology, including the availability of data. In other words, the effectiveness of the use of technology such as ADAs may depend on the level of data available from the entity. Therefore, it is important to obtain an understanding of the entity's use of technology and consider how that may affect risk assessment, designing the detailed audit plan, and gathering significant and appropriate audit evidence.

**Focus on the Use of AI in Accounting and Finance**

The following are benefits of how emerging technologies can impact accounting and finance:

- Technology boosts productivity and output quality even as it results in greater transparency and auditability.
- Technology provides a broad range of opportunities and minimizes the traditional time-consuming responsibilities of the finance team to look at more venues for business growth.
- Technology helps in forecasting accurate financial statements. For example, with machine learning, finance professionals can predict future trends based on historical data and records.
- Technology processes documents using natural language processing and computer vision to generate reports in real time.
- Technology-enabled algorithms can sift through voluminous data, identify potential fraud issues, and flag them for review to avoid loss of revenue.
- Technology-enabled systems support auditing and compliance with corporate, state, and federal regulations by monitoring the pertinent documents and raising alerts where necessary.

AI enables the processing and automated authorization of documents to enhance internal accounting processes, such as procurement and purchasing, invoicing, purchase orders, expense reports, and accounts payable and receivable.

*Payables/Receivables Processing*—Invoice processing is considered one of the more time-consuming and labor-intensive parts of accounting. AI-based invoice management systems help by increasing the volume, performing zero-error processing, and improving vendor relationships.

*Supplier Onboarding*—The AI-based approach helps expand customers' reach, increase revenue, and evaluate the suppliers with minimal human intervention.

*Procurement Processes*—Purchasing and procurement processes often use multiple systems and procedures which must be integrated. With AI-driven workflows, finance teams can process unstructured data while automatically mitigating governance, compliance, and risks.

*Monthly and Quarterly Cash Flows*—AI-based tools empower enterprises to reconcile financial activities quickly, understand historical cash flows, and predict future cash requirements. AI applications also ensure that all financial processes are secure by collecting and integrating data from many sources.

*Expense Management*—When manually done, managing expense-related processes is filled with complex paperwork and is susceptible to fraud and data breaches. Expense management automation ensures almost zero errors and alerts the team to a breach if it occurs.

*Chatbot Support*—AI-driven chatbots help solve user queries quickly and efficiently, including queries on account balance, financial statements, and account status. Tracking outstanding invoices and automating the follow-up collection processes with AI ensures that accounts are kept balanced and closed promptly. AI chatbots can also answer customers' routine questions and provide basic support.

*Robotic Process Automation (RPA)*—RPA can complete repetitive tasks in the enterprise's business processes with amazing efficiency, including document or data analysis. With RPA in place, the finance team can avoid non-value-added tasks. Instead, they can focus on more strategic and advisory responsibilities.

**Focus on Using Automated Tools and Technology for Audits**

AI is a key technological driver that enables continuous audit and data analysis—it is changing the future of auditing. Advances in AI technology are automating tasks that previously only humans could perform, including accounting, tax, and audit data gathering.

ADAs are defined within AU-C Section 500, *Audit Evidence*, as "the analysis of patterns, identification of anomalies, or extraction of other useful information in data underlying or related to the subject matter of an audit through analysis, modeling, or visualization." ADAs are techniques that can be used to perform various audit procedures, including elements of risk assessment, tests of controls, substantive procedures (i.e., tests of details or substantive analytical procedures), or concluding procedures.

Auditors can leverage ADAs regardless of the extent of the entity's use of IT. However, greater use of IT by the entity generally allows auditors to perform more sophisticated ADAs because there may be more organized data available electronically. There are opportunities to leverage technology in any environment. Use of technology is not limited to complex entities and, therefore, it can be useful in audits of less complex entities, as well.

**Focus on Identifying and Evaluating Audit Risk Using Automation**

Automation should play a key role in a data-driven audit. Data-driven audits begin with data-driven risk assessments. Automation can flow the data through the audit from the risk assessment, help auditors define controls or substantive testing to perform, and link those procedures to the risk assessment.

Using automated tools and techniques when performing a risk assessment is another way to be more effective and efficient. The use of automated tools and techniques may help with the following:

- Corroborating work done through inquiry and observation
- Identifying areas in which efficiencies may be gained in the audit
- Discovering new insights into the entity and thereby providing a more precise risk assessment

An auditor may use automated tools and techniques to assist in the identification of significant classes of transactions, account balances, and disclosures. For example, an entire population of transactions may be analyzed using automated tools and techniques to understand its nature, source, size, and volume.

The auditor may identify that an account with a zero balance at period end contained numerous offsetting transactions and journal entries occurring during the period, indicating that the account balance or class of transactions may be significant (e.g., a payroll clearing account). This same payroll clearing account may also identify expense reimbursements to related parties, which could be a significant disclosure. By analyzing the flows of an entire population, the auditor may more easily identify a significant class of transactions that had not been identified previously.

When obtaining an understanding and evaluating an entity's IT environment, the auditor may identify IT-related matters that better inform risk assessment. For example:

- Whether management has a good understanding of the IT environment, flows of transactions, and data flows into the financial statements.
- Whether management has a good understanding of the flow of transactions between systems and interfaces, and the related relevant controls.
- Whether change management controls exist (e.g., upgrading or replacing systems).

Inquiries directed toward IT personnel may provide information about IT processes and system changes, related control failures, or other IT-related risks. Understanding what new or modified technologies have been implemented may help an auditor better understand the risks and opportunities that management is trying to address. This can help in tailoring an approach to the current audit engagement.

**Focus on Obtaining Electronic Audit Evidence About Information Processing**

The auditor may use automated tools and techniques to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying automated tools and techniques to this information, an auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, other digital records related to a particular transaction, or an entire population of transactions from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also assist in the identification of variations from the normal (or expected) processing procedures for these transactions, which may result in the identification of risks of material misstatement.

Substantive procedures alone may not provide sufficient appropriate audit evidence at the relevant assertion level when information supporting one or more assertions is electronically initiated, recorded, processed, or reported. This is likely to be the case when there is a high volume of transactions or data, or a complex model is used, requiring the extensive use of IT to ensure the accuracy and completeness of the information. A complex expected credit loss provision may be required for an account comprised of many small balances resulting from a high volume of transactions. In these circumstances, the auditor may conclude that sufficient appropriate audit evidence cannot be obtained without testing controls around the model used to develop the expected credit loss provision.

**Extent of the Use of Automation on Audit Capabilities**

As the entity progresses in its use of IT, it may become a strategic necessity to also mature in the use of data and technology in the audit. In fact, management and those charged with governance may expect the auditor to leverage data and technology to increase the effectiveness and efficiency of the audit.

The auditor may decide to place less reliance on application controls and general IT controls when the entity has a lower IT maturity. But as the entity's IT maturity grows, the auditor may decide to place more reliance on application controls and general IT controls, and to test controls for operating effectiveness.

Entities with a greater IT maturity will often have a highly automated control infrastructure, process/control validation, continuous, real-time monitoring, and ongoing innovation and investment. For those entities at the lower level of technology maturity, the auditor will often see more manual processes, less technology-driven applications, and less investment in technology with less effective implementation of such technology.

However, there are opportunities to use ADAs even when a limited amount of data, such as general ledger data, is available. For example, the auditor can use ADAs to calculate and visualize financial ratios and some high-level quantitative measures using only general ledger data.

An entity's use of technology may also allow an auditor to engage with management and those charged with governance in focused and productive discussions about audit findings and monitoring of audit progress using data that was obtained for the purposes of the audit. For example, if an entity implemented a new system in its payroll process, work to evaluate the design and implementation of the identified controls and tests of the operating effectiveness of those controls may identify findings that would be relevant to share with management and those charged with governance, including views about whether the data from the system was reliable.

**Specific Examples of Audit Applicability**

There are ways to leverage existing technologies such as Microsoft Excel or to use open-source resources already available for auditors. For example, the AICPA Assurance Services Executive Committee (ASEC) provided an example about how Python (a high-level, general-purpose programming language often used for automated tasks or conducting data analysis) can be leveraged to apply the AICPA's audit data standard guidelines on formatting to a data set and to develop and run routines to further analyze the standardized data set.

There are ADAs available for purchase that can benefit firms that may not have the resources to make a significant investment in building proprietary technology. Although these resources are available to leverage and may decrease the overall investment needed to use technology, an auditor still needs to have the proper expertise to appropriately supervise and review work when technology is used and to determine the ADA is functioning appropriately, in line with a system of quality management.

AI could identify unusual transactions while also providing insights on relevant information the auditor might consider, including the applicable standards (e.g., accounting, disclosure, auditing, or regulatory standards), similar historical situations, or similar outcomes from publicly available sources (including industry peer groups).

AI could analyze board meeting minutes or key communications to assist the auditor in identifying additional risks and requesting relevant supporting information, as well as scheduling meetings with the appropriate individuals to discuss audit matters.

AI could process large amounts of data (such as reading bank statements and legal contracts) and reconcile accounts many times faster than a human auditor can, and with fewer errors.

Due to increased remote auditing, remote observation tools have been leveraged out of necessity. For example, a camera mounted on a drone, or a video transmission, may aid the auditor in performing an inspection or an observation procedure, such as management's physical inventory count.

Machine learning (ML) is an advanced form of AI that uses algorithms to guide its predictions. Its name is derived from the ability of algorithms to "learn" from experience (e.g., by using data sets) rather than relying on a rules-based system. The algorithms create computational models that process large data sets to predict outputs and make inferences. More data leads to more examples, which helps the algorithm finely tune its output over time. The algorithm adjusts—or "learns"—by trial and error.

Robotic process automation (RPA) is a set of software capabilities that can automate high-volume, repeatable tasks, such as answering questions, making calculations, maintaining records, and recording transactions. RPA and analytics can be used to extract data from prior periods or interim financial statements to determine proposed materiality based on a range of benchmarks. The same techniques can be used to determine materiality in a continuous or real-time audit. RPA and analytics can be applied to identify unusual transactions or areas that have not followed the understood course of business to determine scope and focus of testing on accounts or transactions that appear to present a greater risk of misstatement.

"Audit bots" can perform repetitive tasks through RPA, such as the following:

- Copy data across different audit files without risk of human fatigue or input errors.
- Run calculations (e.g., simple tax calculations) to assist in determining financial statement mathematical accuracy, internal consistency, and tie-outs of prior-year amounts.
- Rebuild financial statements from underlying data to form independent expectations of the financial statements for tie-out purposes.

RPAs can be used to source information from subscription databases and publicly available information sources as part of risk assessment or analytics, for example:

- Extraction of information from prior-period financial statements, key financial metrics used in risk assessment, and extraction of bodies of text for natural language processing (NLP).
- Effective categorization and recording of data (e.g., generating ratio analysis appropriate for the given industry or geography).
- Completion of nonjudgmental independence checks (e.g.,
- Obtaining an acquisition of entity listing status across the globe (e.g., geographical registrations of entity names and numbers are automatically obtained and populated in the risk profile of an entity).
- Acquisition of market data on clients (e.g., information on the percentage of an entity's stock that is held in a short position, which can be a leading indicator of potential going concern issues).

Optical character recognition (OCR) can be used to extract terms from standard contracts, such as leases, to perform comparisons and ensure no changes have been made (or to evaluate the changes) or to extract key contract term information. Contract information can be used to substantively test the population as a whole or simply identify riskier areas for targeted review and testing.

Cognitive automation can be used to perform signature verification (through digital image processing) for contract assurance.

ADA can be used to identify general ledger accounts that may have unusual changes from previous years, including unexpected trends in liquidity, leverage, and margin ratios. General ledger ADAs may include the following:

- Journal entry queries for keyword searches like "related party," unusual posters, or unusual dates
- Posting pattern analysis, such as unusual debit/credit combinations, or account posting timing

With access to an entity's subledger transactional data, the auditor may produce a visualization of transaction detail to assist in identifying areas that might represent specific risks relevant to the audit, including the existence of unusual transactions and events, as well as amounts, ratios, and trends that warrant investigation. Subledger ADAs may include the following:

- Many business-rule-based tests
- Outlier detection
- Benford's law
- Regression
- Cluster analyses

Process mining allows the auditor to analyze transaction cycles. Process-mining ADA with access to an entity's enterprise resource planning (ERP—a software system that entities use to manage day-to-day business activities such as accounting, procurement, human resources, and manufacturing) system event logs may help obtain an understanding of the business process, the related transaction flows through the system, and the entity's application controls. This can help with analysis of matters such as where and how employees might circumvent controls or take advantage of gaps in controls to perform unauthorized actions.

Visualization techniques may help an auditor understand or evaluate results of procedures. The term "visualization" may refer to the use of various types of graphics (e.g., charts, scatter diagrams, trend lines, tables) in formats such as dashboards. Graphics may be used as part of an ADA to quickly identify matters that may be significant to performing and reaching conclusions from the ADA (for example, a bar chart or scatter plot showing trends in sales may make it easier to view and identify potential issues than would be possible by reviewing a traditional report of sales numbers).

**Planning for the Use of ADA**

As discussed in the AICPA's *Guide to Audit Data Analytics*, the following should be considered when planning the ADA:

1. Determine the financial statement items, accounts, or disclosures and related assertions, and the nature, timing, and extent of the population to which the ADA will be applied.
2. Determine the overall purpose of the ADA (for example, whether it is used in performing a risk assessment procedure, a test of controls, a substantive analytical procedure, a test of details, or in procedures to help form an overall conclusion from the audit).
3. Determine the specific objectives of the ADA (within the context of its overall purpose which, for this discussion, would be performing a risk assessment procedure).
4. Determine the data population to be analyzed or tested using the ADA including, for planning purposes, preliminary consideration of matters likely to affect the relevance, availability, and reliability of that data.
5. Select the ADA that is likely best suited for the intended purpose and objectives.
6. Select the techniques, tools, graphics, and tables to be used.

It is important to remember that even if the auditor is able to access more data from the entity, the data may require preparation (or cleansing and scrubbing) before the auditor can undertake a meaningful analysis. Evaluate the information to be used as audit evidence, including its relevance and reliability, and whether it is sufficiently precise and detailed for the auditor's purposes.

**Using Technology in Firm and Project Management**

With cloud-based technology, real-time collaboration is possible. An auditor can securely access an audit from anywhere online, with a solution that updates data and stakeholders in real time. Real-time collaboration can enable an audit team to work from the same document at the same time without worrying about version control. With sophisticated, multi-user content, trial balance, engagement management, and document retention management, the entire audit team has up-to-the-minute access to the entire engagement from any location without having to transfer, backup, restore, or refresh the audit files.

Audit teams can access data from across the globe, making it easy to coordinate fieldwork and review processes across multiple locations, and allow remote staff to collaborate in real time. Multi-location audits no longer present a coordination issue because all staff can access the live data simultaneously.

Streamlining the audit confirmation process can increase productivity, reduce cost, enhance customer experience, and combat fraud. Using an electronic confirmation process may provide the following benefits:

- Automated assistance with follow up on nonreplies.
- Validated global network of financial institutions.
- Save time with a single, digital signer authorization accessible from anywhere.
- Eliminate methods prone to errors and reduce confirmation time from weeks to days.
- Manage audit engagements and send confirmations from the same platform.
- Roll over client account information from year to year within a secure system.

With audit automation, expedite engagement management and workflow with a cloud-based organizational hub that offers real-time access to work papers and trial balances.

- Easily manage all engagements with extensive templates, a high level of customization, and the ability to perform several tasks at once.
- Complete work quickly with powerful trial balance capabilities, including fast imports, sophisticated filtering, and tabbing.
- Standardize and organize volumes of documents for an engagement or project.

With full electronic trial balance capabilities, workpaper management, and financial statement reporting functionality, an auditor can manage an entire audit from a single source and communicate relevant information to clients, including the status of work overall, workpaper signoff status, and financial advice.

Robotic process automation can also be used to automate many back-office tasks of a CPA firm, including reporting, moving things from one system to another system, importing data, and more. RPA can help firms lower audit costs for clients while preserving profits. It also helps with professional satisfaction as staff perform fewer mundane tasks and can concentrate their efforts on investigation and analysis.

**Inherent Challenges with Adoption**

Adopting emerging technologies will enable accounting, finance, and auditing to better analyze a tremendous amount of data and identify patterns and trends. They can use the latest technology and tools to take over routine tasks that are better suited to machines. Automating business processes expands an individual's capacity.

Entities must invest not only in technology, but also the workforce required to handle the technology. This means that they must also provide proper training and support for their teams to use emerging technology to optimize productivity efficiently. New skills and expertise will be required as emerging technologies continue to be introduced and leveraged into day-to-day tasks.

# GROUP STUDY MATERIALS

## A. Discussion Problems

1. What are examples of how emerging technologies such as artificial intelligence (AI) may be used in the accounting and finance functions of entities?

2. Explain how the use of automated tools and techniques can help when performing risk assessment.

3. Discuss the benefits of using cloud-based technology in firm or project management.

## B. Suggested Answers to Discussion Problems

1. AI enables the processing and automated authorization of documents to enhance internal accounting processes, such as procurement and purchasing, invoicing, purchase orders, expense reports, and accounts payable and receivable.

   *Payables/Receivables Processing*—Invoice processing is considered one of the more time-consuming and labor-intensive parts of accounting. AI-based invoice management systems help by increasing the volume, performing zero-error processing, and improving vendor relationships.

   *Supplier Onboarding*—The AI-based approach helps expand customers' reach, increase revenue, and evaluate the suppliers with minimal human intervention.

   *Procurement Processes*—Purchasing and procurement processes often use multiple systems and procedures which must be integrated. With AI-driven workflows, finance teams can process unstructured data while automatically mitigating governance, compliance, and risks.

   *Monthly and Quarterly Cash Flows*—AI-based tools empower enterprises to reconcile financial activities quickly, understand historical cash flows, and predict future cash requirements. AI applications also ensure that all financial processes are secure by collecting and integrating data from many sources.

   *Expense Management*—When manually done, managing expense-related processes is filled with complex paperwork and is susceptible to fraud and data breaches. Expense management automation ensures almost zero errors and alerts the team to a breach if it occurs.

   *Chatbot Support*—AI-driven chatbots help solve user queries quickly and efficiently, including queries on account balance, financial statements, and account status. Tracking outstanding invoices and automating the follow-up collection processes with AI ensures that accounts are kept balanced and closed promptly. AI chatbots can also answer customers' routine questions and provide basic support.

   *Robotic Process Automation (RPA)*—RPA can complete repetitive tasks in the enterprise's business processes with amazing efficiency, including document or data analysis. With RPA in place, the finance team can avoid non-value-added tasks. Instead, they can focus on more strategic and advisory responsibilities.

2. Using automated tools and techniques when performing a risk assessment is another way to be more effective and efficient. The use of automated tools and techniques may help with the following:

   - Corroborating work done through inquiry and observation
   - Identifying areas in which efficiencies may be gained in the audit
   - Discovering new insights into the entity and thereby providing a more precise risk assessment

   An auditor may use automated tools and techniques to assist in the identification of significant classes of transactions, account balances, and disclosures. For example, an entire population of transactions may be analyzed using automated tools and techniques to understand its nature, source, size, and volume.

3. With cloud-based technology, real-time collaboration is possible. An auditor can securely access an audit from anywhere online, with a solution that updates data and stakeholders in real time. Real-time collaboration can enable an audit team to work from the same document at the same time without worrying about version control.

   With sophisticated, multi-user content, trial balance, engagement management, and document retention management, the entire audit team has up-to-the-minute access to the entire engagement from any location without having to transfer, backup, restore, or refresh the audit files.

   Audit teams can access data from across the globe, making it easy to coordinate fieldwork and review processes across multiple locations, and allow remote staff to collaborate in real time. Multi-location audits no longer present a coordination issue because all staff can access the live data simultaneously.

# PART 3. SMALL BUSINESS

## Implementing CECL

In 2008, the financial markets crashed. Concerns were raised that current GAAP only allowed expected losses to be recorded once they were probable and financial statement users leveraged forward-looking information in their decision making. As a result of the work of the Financial Crisis Advisory Group formed in the aftermath of the crisis, the FASB took on a project to look at faster recognition of credit losses.

In 2016, the FASB issued new guidance that moved GAAP from an incurred loss model to an expected loss model to improve financial reporting to more accurately meet the informational needs of stakeholders. ASU 2016-13 became effective for fiscal years beginning after December 15, 2019 for public entities, and for nonpublic entities for periods beginning after December 15, 2022.

For more on implementing the current expected credit loss standard and its implications for your clients, let's join Kurt Oestriecher, a CPA and a partner with Oestriecher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

**Ms. Casey**

Today we want to talk about a topic that has been in the news for the last several years, and that's CECL, which is the current expected credit loss standard. Now, the biggest thing that it affects, for most businesses, is their receivables. So, to begin with, let's talk a little bit about why CECL was introduced instead of our incurred loss model that we have used for so many years, and then we'll take it from there.

**Mr. Oestriecher**

People need to remember—and again, I don't have any financial institution clients—I think hearing from people and the intent of the standard, this is going to be much more impactful to financial institutions than it is to entities that hold receivables. But it's the same standard that's applied; you're just going to use different data. I think it's important [that] we can help understand the concepts and why the FASB [Financial Accounting Standards Board] is asking us to do some of this stuff when a normal person like me might think, "Were they overthinking this a little bit for receivables?" Remember, this standard was issued in 2016. That's when you had the original standard, but it was delayed. They gave us a long runway to begin with, and then with COVID, and then with leases and [revenue recognition], it just kept getting delayed and delayed.

And to give you a concept of how long this has taken, when this standard was first issued, my daughter was a sophomore at the University of South Carolina, hoping to get into nursing school and working very hard. Between then and now, when it's effective, Liesl did in fact get into nursing school; graduated; passed the nursing exam; became a nurse in Jacksonville, Florida; got married; moved to South Carolina; she and her husband had a child; and they moved back home. That's how much has happened between the time they issued the standard. That's a lot of things to happen—going [from] a carefree college girl [to] now she's a mom with a job and, as she says, she has to "adult."

I don't know that we've ever had this long of a runway. Because we've had that long of a runway and because of the delays in developing this standard, we tend to forget that the driving force behind the narrative happened in 2008. There were two things that happened. One, Christopher Cox introduced his Memorandum of Understanding that public companies would use IFRS [International Financial Reporting Standards] as long as IFRS and [the] FASB agreed on three major topics: revenue [recognition], leases, and financial instruments. The current expected credit loss was one of three subsets of financial instruments, so it's the last thing that they got to. But if any of us can remember the financial crisis of 2008, it was largely triggered by these investment banks and other people having debt securities on their balance sheet that turned out to be not nearly worth what everyone thought they were worth. Initially, the question was, “Okay, should this impact all debt securities or debt securities that are at amortized cost?” Because remember these collateralized mortgage obligations, they’re measured at fair value.

And I’ll tell you, if you ever want to understand what happened there, there’s a great movie out there, *Margin Call*, that’s about 10 or 12 years old. When I’m watching that movie, I may be the only person that was watching it going, “Oh, well, that’s part of this standard,” rather than just enjoying the narrative.

But when you understand that the pressure that the FASB was under from the SEC [Securities and Exchange Commission], because no one wanted what happened in 2008 to ever happen again, and the targeted blame was, “Hey, you had billions of dollars of assets on your books when they were only worth millions instead of billions.” And, quite frankly, that is why there was divergence. The IFRS model did not come up with current expected credit loss. They used the three-bucket approach. So, there’s a very interesting backstory here as to the pressures that were put on the FASB. Even though they’re supposed to operate independently—and for the most part they do—we do have to understand there are pressures involved because their funding only now comes from the SEC, and this is what the SEC wanted. So, understanding that context [is important] now as we start to talk through the type of data that is going to be used in order to determine what are our credit losses.

We’ve always had that concept; that’s your allowance for doubtful accounts for receivables. And I think it’s fair. Most of the time we spend—we don’t have a lot of time on these topics. These are kind of quick-hitting topics. We are going to focus more on receivables and notes—accounts receivable, trade receivables, and notes receivable. I can tell you that financial institutions, they’ve been all over this for quite some time. So, we might, every now and then, talk about how it might impact a smaller credit union or something, but trust me, Chase Bank, all the big [banks], Bank of America, they are on top of this. So, that is how we got this model. As you and I discuss it, let’s keep that in mind, and it will help explain some of the things we have to do.

**Ms. Casey**

Well, I want to talk about who this impacts, but what you mentioned about the FASB and their objectivity—they don’t exist in a vacuum as much as there are occasions where we would like them to. They’re in an environment, just like every other organization, so they have to respond to the pressures that are put upon them. The other thing is that the board changes over time, so the way they may respond to something changes over time as well.

Let’s talk about who this particular standard is going to impact. You mentioned financial institutions, but what about others?

**Mr. Oestriecher**

Right—it’s any entity. It will impact any entity that holds debt instruments that are held on an amortized cost basis. So, by definition, that is your accounts receivable; that is a debt instrument. Now, understand it may not be a formal note. In fact, if it is routine accounts receivable, it’s not a formal note. There might be some sort of an engagement letter or some sort of other agreement between the parties as far as the terms of the credit granted, but it’s nothing like the formal note receivable that you would have.

So, accounts receivable are the biggest ones, but, of course, a lot of my smaller clients have loans to officers, loans to family members, [or] loans to other people. In the very low interest rate environment—which obviously we’re coming out of that now—there were companies that had excess cash, so they were doing private home mortgages. They’re like, “Well, we’ve got all this extra cash here that we don’t need. We used to put [it] in CDs that earned 4½ or 5%, so we might even do some private mortgages.” And again, a lot of times those were with family members—they weren’t out there giving them to just anybody—or maybe very key employees. So, those are the types of debt instruments that we see [in] small businesses.

Now, certainly, if you’re a financial institution, you’re talking about your entire loan portfolio also, but what it does not include is, let’s say that you have excess cash, and you decide, “Oh, you know what? I’m going to purchase this nice little Exxon [ExxonMobil] bond out there—a little $100,000 Exxon bond.” That is not going to be impacted [by

CECL] because you're measuring it at fair value if it is trading or available for sale. If you're holding it to maturity, now it's at amortized cost, so you'd have to consider it. Again, generally, you can look at fair value, even though you're not measuring it at fair value. If, all of a sudden, the price of that bond dropped—remember, interest rates impact bond prices also. While the standard requires it, I don't think that I would be sitting there looking at future economic forecasts for the next eight years that this Exxon bond is out there. There's enough general knowledge out there. You can look at the earnings of Exxon and say, "Yeah, oil prices might go up or down." When you look at the balance sheet and the fact that they've never defaulted, which, again, is where you always start is historical information. So, it is possible that you could have a publicly traded security if you're having it as held to maturity, but most people have those in available for sale or trading. Once you're measuring it at fair value, this standard doesn't apply because there's an assumption that any credit losses are already baked into the fair value. In other words, people trading the security understand that there's some credit risk and will discount the security based on that credit risk that exists.

**Ms. Casey**

Let's talk about what happens past our initial application of [this standard]—the subsequent measurement of those assets that are being impacted by this standard.

**Mr. Oestriecher**

Right, so that's the issue. We put receivables on our balance sheet throughout the period, and, of course, we're not going to be doing this exercise every day, and probably, quite frankly, not even every month for interim financial statements. It's typically at the end of an accounting reporting period [when] an entity will evaluate whether or not there needs to be an allowance of some sort for their receivables.

Let's first talk about this in the context of accounts receivable because I think that's the scariest thing for most people out there. We used to call it an allowance for doubtful accounts, now it would be an allowance for credit losses. But previous terminology—why was an allowance doubtful? Because there was credit risk. We felt like they weren't going to pay us. In my mind, the entire reason it was doubtful was because of the credit risk. Again, they may have wanted to pay, but they couldn't for whatever various reasons. So, we were subject to risk because we granted credit to someone that eventually could not pay it. While the terminology changes, the reasons why we're not going to get paid or the reasons why we have a valuation allowance remain the same.

Then, once we say, "Okay, we have to establish this," what information do we use? This is where current expected credit loss changes from where we used to be. We used to just look at historical losses. If I were auditing somebody and I'm obtaining audit evidence—and, by the way, I'm segueing here. It's no coincidence that a new auditing standard on auditing accounting estimates came out and is effective at the same time [as] [the CECL standard] because this is a very big estimate, and we have to understand it as an estimate. As long as the client was using data that historically was pretty good at predicting what their write-offs would be, then we were good. That's where we would stop. There was no thought process as to, "Well, has anything changed in the last few days or couple of months, or are we expecting anything to change in the near term that would make our historical data not be a good predictor?" That's the heart and soul of CECL.

The first thing they want us to do is look at relevant information about past events with an emphasis on *relevant*. Because if things have changed that we are aware of that make some of our historical information irrelevant, then we shouldn't use it. That being said, I think the vast, vast, vast majority of the time, everything that was in the past is relevant. In other words, it's very rare that you would have information that has happened historically that you can now say, "You know what, we can ignore [that]." So, you could have some extraneous circumstances out there, but in most cases—and in everything that I've read on this, that's still the starting point. We're still going to start with [the historical information] because what's happened in the past is a very good predictor of the future. So, that's where we start.

But now we enter into a couple of different ones. We look at current conditions, and the example that I always use for current conditions is coming from Louisiana. For those of us here, especially in South Louisiana—I'm kind of on the Mason-Dixon line in Louisiana; we're in central Louisiana—the further south you get, the more dependent the economy is on oil prices. So, let's say that I'm an oil field supply company, and oil has been up in the $130 or $140 a barrel [range]. Trust me, you've had no write-offs because your clients have the money to pay you. They want to pay you because if they don't, they're not going to get their supplies out to their rigs, and if they don't have supplies at the rigs, then their people don't eat, or they can't drill, or they can't do anything they have to do. So, there is very, very little problem getting paid in the oil field industry from the vast majority of your clients. But let's say, all of a sudden, oil drops down to $46 a barrel. That's the thing. Now it's like, okay, we've had very little write-offs in the past, but now that we know in the last month oil has taken a nosedive—and we have seen times when that happened—then how does that impact us? So, we think about those current conditions.

Interest rates are another issue. We know that [with] rising interest rates, now the people that we issue credit to, especially if they have variable loans—and, again, we don't have a lot of knowledge on our specific clients. But in general, when we have rising interest rates and borrowing costs are higher, entities that have debt, especially with variable rate loans, now they've got to say, "Hmm. Am I going to pay this bank note that has collateral, or am I going to pay this receivable?" And I think it's fair to say that, in a rising-interest-rate environment, that could be it. Same thing with inflationary costs. We have seen the pressure that we have on wages and how wages have increased. So again, as a business owner, [they're] going to try to stretch their receivables longer because now they're having to pay more in wages.

These are the types [of] things about current conditions and how [they] could impact it. And you need to now bake that into your model. Do I expect a small business to hire some Harvard graduate and come up with algorithms to look at these relationships? No. But it is something we need to consider and be aware of.

The third element is reasonable and supportable forecast of the future. Now, this is Kurt's opinion: this is much, much, much more relevant to notes payable or notes receivable that you may hold. So, this is much more relevant for financial institutions that have three to five years before they expect to collect the principal on the note that they're holding. For a non-financial institution, if you do have shareholder loans or other notes from key employees, then it might come into play. But when you're talking about reasonable and supportable forecasts, in most of my receivables, I expect to collect within 90 days. So, what could change? What am I going to look at? A forecast of GDP [gross domestic product], or CPI [the Consumer Price Index], or inflation rates, or whatever it is? I don't see that as being a very relevant factor for our accounts receivable, but obviously, it's very relevant if you have notes receivable.

The standard actually tells us specifically [that] you don't have to have forecasts for the entire life of the asset. So, if you have a 10-year loan, first of all, we know that any person trying to predict what's going to happen 10 years from now, that's a fool's errand. Quite frankly, even two years from now, you might say, "Hey, that's kind of crazy." But it's still the data that we are going to use when you're looking at what is a reasonable and supportable forecast.

**Ms. Casey**

Let's look a little deeper at that reasonable and supportable forecast. You mentioned that you're not required to forecast over the entire life of the loan or the asset. What other things should we be looking at as we try to determine that reasonable and supportable portion?

**Mr. Oestriecher**

Well, you have to identify a relationship between whatever it is that you're forecasting and the credit risk. That's the first linkage you have to have. The best example that I've seen of this [was] in one of the classes that I was teaching. There's someone that worked for a credit union. As they were working through the process of developing their models, and, by the way, no one's sharing those because this is the same model they used in determining the creditworthiness of people. I think at one point the FASB said, "Oh, we're all going to share this in a public forum," and the financial institutions said, "No, we're not." But in this particular course, attendees said they had found a direct relationship between [the] unemployment rate and their ability to collect on unsecured notes receivable. And the reason is—and it makes sense—as people lose their jobs and as it's harder to get a job, you're going to choose to pay your mortgage first. You're going to choose to eat first. The unsecured loan at your local credit union just got to the bottom of the list.

Make sure you have that linkage. You can't just throw out numbers. I mean, [for] some of my clients, unemployment rate would be completely irrelevant to their ability to collect receivables, where oil prices might be more relevant, [or] interest rates. So again, those are the types of things that you would need to be concerned about.

And there's a very interesting discussion I've had with folks. Okay, what if you're holding a variable rate loan and that impedes people's ability to pay in the future? Remember, it's only the principal that's on the balance sheet, so, in the future, if they can't make all their interest payments, then maybe you say, "Well, now they can't pay their principal." So, there could be some relationship there. But remember, we're not trying to say, "Oh, future interest won't be collected," because as the interest rate goes up on this loan, can they afford it? But what will the impact be on your ability to eventually collect the principal? That's what you're asking for there. So, make sure there's a relationship, and [that] it's a reasonable relationship when you're looking at reasonable and supportable forecasts.

**Ms. Casey**

That doesn't seem like it's very relatable to accounts receivable, but more like notes receivable, as you mentioned before. So, let's look at some of the specific issues related to accounts receivable because more businesses have those.

**Mr. Oestriecher**

Right. This is a discussion that I've already had with my clients, and remember, I'm speaking from the perspective [of] an independent auditor. I'm in public accounting. I can't make these decisions for my clients.

**Ms. Casey**

Right.

**Mr. Oestriecher**

I did not want to wait until we got to their audit, and this is effective for—I can't remember these fiscal years, beginning after or ending after, but December 31st, 2023. Those are the first balance sheets that are going to be impacted by this. I don't want to wait until February or March of [20]24 to have this discussion with them, and I don't want to leave them. But I've told them, I said, "If I ask how management came up with an estimate for the allowance for doubtful accounts, and you tell me the same thing you've told me for the last 27 years, then I will know that you have not considered all the things that CECL wants you to consider."

Again, what are the three things we're going to look at? Historical events, which is still [a] very relevant starting point; current economic conditions; and reasonable and supportable forecasts. What I expect and what I hope my clients would say is, "We started with all the historical data we used to. Then we considered the current conditions to say, would that change our model?" Many of my clients are going to say, "You know what? Even though I know we have higher interest rates and, you know, there's nothing out there that we are aware of today that would change this model." Now, some of them might say, "Nope, oil prices." Or there might be something out there, and it may not be something that's observable on a market.

Another great example is, let's say that all of your contracts are with the state. Maybe you provide certain services to universities in your state, and your state legislature just cut funding to colleges and universities by 27%. And, by the way, we've seen that happen in Louisiana. Now, all these colleges and universities are going to have to say, "All right, do we pay our professors? Do we pay our light bill? Or do we pay this vendor, and stretch them out? Or say, 'Sorry, we just can't pay you?'"

So, it could be something like that—a funding source, a grant source that your clients have that grant goes away. It's not just ratios. It's anything else within their current environment: the things that the client would read in the newspaper or look on the internet [and] go, "Oh crap! I may not collect all my money." That's exactly what I told them to say. Are you aware of anything that has given you that "oh crap" moment? And if the answer is no, then you considered it, but then you said there's nothing that would influence this model. I think that's what most of my clients are going to come up with.

Then, the last thing is the reasonable and supportable forecast. As I've said, for a receivable that's going to be collected in 30, 60, or maybe 90 days, I have not yet found out how that [kind of forecast] is relevant to receivables. Somebody else might have. I think what you're most concerned about there is notes receivable. You may have had a bad account receivable that your client said, "Yeah, I'll sign a note for three years." That's very common in small businesses. So now I've got to say, "Okay, first of all, is there a reasonable and supportable forecast—something out there that I can link to the collectability of this note? And then, if so, how would it impact?" I truly believe that for most of my clients, there's not going to be a significant or let's say material difference applying CECL model versus what they've historically been doing to determine their credit losses. I do not see that in a small business world, but they have to answer the questions correctly, otherwise, we have to go dig further. So, I've been coaching them [that] this is what you need to do.

Again, financial institutions, completely different story. It's a whole different animal because their credit risk is in their loan portfolio, [in] which there absolutely could be reasonable and supportable forecast and things where they have said, "Uh-oh, we've got a problem."

**Ms. Casey**

Before we look at the unit of account and, like, how you would go about calculating or making the evaluation related to the credit risk, I wanted to ask you, when it comes to management documenting their thought process, is it like the auditor, where we kind of need to be able to have somebody follow that in the event that we're not there to explain it to them? Would management want to do something similar—documenting their considerations as to how they came up with this credit loss?

**Mr. Oestriecher**

Obviously, as an auditor, I would love that.

**Ms. Casey**

Yes.

**Mr. Oestriecher**

If they're using an Excel spreadsheet as most people do, if they would have a little comment on a cell that says, "Okay, this is the number we're using; these are the things that we considered," as an auditor, I would fall on my knees and just bow to these people. There's nothing in the standard that requires that, but obviously I would make inquiries if they don't have any documentation as to how they came up with certain assumptions. I would ask them, but the more documentation, the better.

**Ms. Casey**

Let's talk a little bit about unit of account and what it is that we're going to be evaluating. Are we looking at these individually, or are we looking at them as a group?

**Mr. Oestriecher**

That's key because when the FASB was going through this process, people said, "Do we have to evaluate…?" No, no, you can put them in a pool. In other words, there are similar risk characteristics. You can pool these. Obviously, when you're talking about financial institutions, home mortgages would be a pool. Again, I'm thinking in terms of, like, a smaller credit union—they do home mortgages. So, home mortgages, business loans, car loans, boat and RV loans. You might put vehicle loans and car all together. So, you're going to evaluate them if they have similar risk characteristics at the pool level.

However, if you have certain assets out there that have singular risks that aren't part of a pool, then you will evaluate that individually, and I think that's a big one. Just thinking [about] the top of the Rolodex of our clients, a lot of them do have shareholder loans on the books, and those are the ones that I'm going to have to evaluate separately. When the shareholder hasn't repaid principal for the last 12 years on this, then you have to start saying, "Okay, is there ever going to be a repayment?" And, in most cases, the shareholder, just for tax and other reasons, does not repay the loan. But if they needed to, I can look at their personal financial statement and go, "Yeah, they have the ability to do that. There's no credit risk there."

One interesting thing that did come up. What happens if the—maybe it's a 92-year-old owner of a business—if that person passes away, now that's a debt on their side [and] it's an asset on our side? What are the chances that the estate would have the ability to pay it or the executor of the estate would say, "Well, just take this to court. Grandpa didn't want us to ever repay that. We get all this money. We don't have to repay it back to his company"? So, the age of the person holding the note—and again, I don't think you're going to get into medical records—but just as your mind goes through these things, you have to think about, is there a credit risk? Because while Mr.—and this is a made-up name—while Mr. Jones may intend to pay it, do his heirs intend to pay it? Is there credit risk if it goes through an estate? So, that is something I think would probably also be considered.

**Ms. Casey**

When we talk about that, you mentioned earlier that collateral-dependent financial, well, liabilities from one side, assets from the other, are more likely to be paid. Do we want to talk about that a little bit?

**Mr. Oestriecher**

That gets back to the concept of, as far as the FASB is concerned, if I have a $185,000 note receivable on my books, they don't care whether the money comes from—whether it comes from, voluntarily, the person issuing the note writes a check, or they default, and you go through the process, and you recover the collateral, and eventually you get the money from the courts. Now, probably quit accruing interest on the loan, but certainly if you have a $185,000 loan and it's secured by collateral, which is reasonably expected to fetch let's say $250,000 after selling costs, then you don't have a credit loss risk because it is adequately secured. But if you only think you'll get $100,000 from it, then you can go there. Whatever you think that you will receive after selling costs, think of that as a floor because there's no credit risk there. Again, that could change year to year depending on what the value of the asset [is], but you can, in fact, account for the expected incoming cash flow for collateral-dependent assets.

**Ms. Casey**

Let's talk about the disclosures that are required because that's always a key note of interest.

**Mr. Oestriecher**

Yeah, that's going to be the difficult one because, first of all, make sure your summary of significant accounting policies is updated [to say] that you first adopted this standard at the end of the year. Any time you adopt a new standard, you disclose that. There are many publicly traded companies that have already adopted this standard, so just look. Again, you're going to cite the accounting standards, codification section, and some of the specifics of the ASUs that were issued. You've adopted, so make sure you do that.

And remember, in your summary of significant accounting policies, generally there is a blurb about your *allowance for doubtful accounts*, so you might want to change that [to] *allowance for credit losses*. Look at your verbiage there to make sure that it explains how the process works now because it has changed.

Some of the things that, when you look at the standard, they also want is just what is the credit risk, and how does management handle that credit risk or that credit quality? Again, for accounts receivable, there's not much to do there. I think this is a disclosure that you're going to have more in financial institutions. That's where you may do credit default swaps. That's where it gets into some very complex disclosures that I do not think we will see from a receivable standpoint.

Obviously, [consider] your estimate of the credit losses, and generally that's not going to be disclosed. Some people disclose it in the note, but a lot of times they just put [it] net on the face of the balance sheet. No matter where you want to put it, just make sure it's disclosed.

And then [consider] any changes in the estimate during the period—and remember, it can go the other way. Like last year, you really deemed yourself bad because you looked at current events and conditions and said, "Wow, we're going to have pretty large credit losses," but then it didn't come to fruition. So, at the end of this year, you write that allowance either back down or whichever direction you want to save it. You can have a credit on the other side, so rather than bad debt expense, you'd have a recovery for your credit loss. I think what most people will do is have a beginning balance for that allowance account—anything, any adjustments based on your estimates, any direct write-offs against it—because we all know that still works the same way. Once you identify a specific receivable or a loan loss, then you write it off against that allowance account. It will just be a roll forward so that everyone understands what hit that account during the period.

**Ms. Casey**

Let's talk about any final thoughts that you have about the implementation of this standard because, as you mentioned, it's becoming effective. Obviously, hopefully people have been thinking about it before now because we have had a long time to implement. But sometimes that's more to our detriment than our help because we forget about it, because there's other stuff that's more top of mind.

**Mr. Oestriecher**

Yeah, I think we have a little bit of standards fatigue with [revenue recognition] and leases. But again, everyone that I've talked to that worked with financial institutions, they've been on top of this because they were ready two or three years ago to implement this. So, they seem to be there.

For the people that are not financial institutions, there's no reason to hit the panic mode. Just read through it. There is some guidance when you look at the implementation group. If you go to the FASB website, there's some pretty good information there. [I've] also seen some pretty good articles in the *Journal of Accountancy*.

I think what many small companies are going to have to do is get comfortable with the fact that this isn't going to change our numbers a lot. This isn't going to have the impact on our balance sheet that leases had or, for some entities, [that revenue recognition] had. It'll change, like I said, your methodology a little bit. You'll think about a few different things. But again, my expectation is fully that you're going to come out with, if not the same number, nothing that's materially different.

## Current Expected Credit Losses

By Kurt G. Oestriecher, CPA

### Introduction

The Financial Accounting Standards Board issued ASU 2016-13 in an attempt to provide better standards for determining credit losses related to financial assets. Extant GAAP required an "incurred loss" methodology for recognizing credit losses that delays recognition of the loss until it is probable that a loss has been incurred. Both financial institutions and users of their financial statements expressed concern that extant GAAP restricted the ability of an entity to record credit losses that are expected but do not yet meet the "probable" threshold.

The main objective of ASU 2016-13 was to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in this update replaced the incurred loss impairment methodology in extant GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.

### Convergence

This update resulted from the joint efforts of both the FASB and the IASB, but the final standard from the two bodies contained significant differences and did not achieve the convergence that was desired. The IASB standard incorporated the "three bucket approach," while the FASB standard did not include those concepts. Many of the concepts that were discussed by both Boards reflected the concerns related to overvalued debt instruments that fueled the 2008 financial crisis.

### Applicability

The amendments of this update affect entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. Obviously, financial institutions will be impacted more than any other industry due to the size of their receivable portfolios, but they also affect any company that has trade receivables, loans, debt securities, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial asset not excluded from the scope that has the contractual right to receive cash. The amendments in this update affect an entity to varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. There is significant diversity in practice in applying the incurred loss methodology which means that before transition, some entities may be more aligned than others, under current GAAP, to the new measure of expected credit losses.

### Measuring Credit Losses under ASU 2016-13

#### *Assets Measured at Amortized Cost*

The amendments of this update will require financial assets measured at amortized cost basis to be presented on the balance sheet at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The income statement will reflect the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period (FASB ASC 326-20-30-1).

When calculating the valuation allowance, the measurement is based on relevant information about past events (including historical loss experience), current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. Entities will be required to use a great deal of judgment in determining the relevant information and estimation methods that are appropriate in their circumstances. Note that although historical loss ratios are the appropriate place to start the analysis, current events and conditions at the balance sheet date must also be considered. Management must also evaluate how conditions that existed during the historical charge-off period might differ from their current expectations and must revise loss ratios appropriately. Although management must estimate losses expected to be incurred during the entire life of the contract, they are not required to forecast conditions over that contractual life. Forecasts should only be made for the period for which the entity can make reasonable and supportable forecasts. For periods beyond that time frame, the entity reverts to historical credit loss experience (paragraphs 7–10 of FASB ASC 326-20-30).

Implementation guidance in FASB ASC 326-20-55 provides a discussion of methods and information to be considered in estimating the allowance for credit losses.

***Accounts Receivable***

The guidance in ASU 2016-13 does not contain any specific reference to accounts receivable nor does it dictate any specific measurement procedures. However, based on the overall guidance, the following issues should be considered when establishing an allowance for credit losses:

- It is very likely that the most relevant information for determining the allowance for credit losses will be information related to past events (collections)
- If an entity collects the majority of its accounts receivable within 90 days, it is likely that forecasted information will not provide relevant data in determining the allowance account.
- It is likely that there will be no material differences when an entity applies the current expected credit loss model to establish an allowance account as compared to the current model that an entity is using.

***Available-for-Sale Debt Securities***

The CECL model does not apply to available-for-sale debt securities and measurement has not changed from current GAAP. However, the amendments in this update require that credit losses be presented as an allowance rather than as a write-down. This approach is an improvement of current GAAP because an entity will be able to record reversals of credit losses in current-period net income. Therefore, it allows for a recovery of the charge when conditions improve. The allowance is limited to the amount at which the security's fair value is less than its amortized cost.

***Unit of Account***

The CECL model does not prescribe a unit of account. However, an entity is required to evaluate financial assets on a collective (that is, pool) basis when assets share similar risk characteristics (FASB ASC 326-20-30-2). Otherwise, the financial assets are to be evaluated individually. If an individual asset is evaluated for credit losses, available external information such as credit ratings and other credit loss statistics must be considered.

For many entities, this will not require a change in methodology because most companies evaluate credit losses on a pool method now. However, entities will need to consider whether their current data-capturing processes comply with the requirements of the CECL model.

***Collateral-dependent Financial Assets***

An entity will continue to be permitted to measure its estimate of the expected credit loss on collateral-dependent financial assets as the difference between the asset's amortized cost and the collateral's fair value, adjusted for selling costs (FASB ASC 326-20-35-4).

**Disclosures**

Financial institutions (and others with significant lending portfolios) will have extensive disclosures to make regarding the allowance and the methodology used in developing that allowance. However, most companies that have only trade accounts receivable (with a term of less than one year) will not see a significant increase from the disclosures currently required under GAAP.

The objective of required disclosures is to enable a user of the financial statements to understand:

- The credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio,
- Management's estimate of expected credit losses, and
- Changes in the estimate of expected credit losses that have taken place during the period.

It is likely that companies will need to provide a more robust policy discussion in the summary of significant accounting policies than is currently disclosed.

**Transition Resources**

The FASB has established a transition resource group (TRG) to assist entities in applying the current expected credit loss model. The resources are located at https://www.fasb.org/page/index?pageId=standards/Transition.html.

The group has issued the following memos:

- Memo No. 1 Discounting Expected Cash Flows at the Effective Interest Rate
- Memo No. 1A Discounting Expected Cash Flows at the Effective Interest Rate—Appendix A
- Memo No. 2 Scope of PCD Assets for Beneficial Interests
- Memo No. 3 Transition Guidance for PCD Assets
- Memo No. 4 Accounting for Troubled Debt Restructurings
- Memo No. 5 Determining the Estimated Life of a Credit Card Receivable
- Memo No. 5A Determining the Estimated Life of a Credit Card Receivable—Appendix A
- Memo No. 6 June 2017 Meeting—Summary of Issues Discussed and Next Steps
- Memo No. 6A Addendum to Memo No. 6—Accounting for Troubled Debt Restructurings
- Memo No. 6B Addendum to Memo No. 6—Determining the Estimated Life of a Credit Card Receivable
- Memo No. 6C Addendum to Memo No. 6—EIR for TDR Transition
- Memo No. 7 Cover Memo
- Memo No. 8 Capitalized Interest
- Memo No. 9 Accrued Interest
- Memo No. 10 Transfer of Loans from Held for Sale to Held for Investment and Transfer of Credit Impaired Debt Securities from Available-for-Sale to Held-to-Maturity
- Memo No. 11 Recoveries

- Memo No. 12 Refinancing and Loan Prepayments
- Memo No. 13 June 2018 Meeting—Summary of Issues Discussed and Next Steps
- Memo No. 14 Cover Memo
- Memo No. 15 Contractual Term: Extensions and Measurement Inputs
- Memo No. 16 Vintage Disclosures for Revolving Loans
- Memo No. 17 Recoveries

In addition to the memos that have been issued, the FASB staff has issued the following two Q&As to assist in implementation:

- FASB Staff Q&A—Topic 326, No. 1: Whether the Weighted-Average Remaining Maturity Method Is an Acceptable Method to Estimate Expected Credit Losses
- FASB Staff Q&A—Topic 326, No. 2: Developing an Estimate of Expected Credit Losses on Financial Assets

**Summary**

The effective date for the implementation of CECL has been delayed several times but will be effective for all entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Members of management that are responsible for financial reporting should familiarize themselves with the CECL requirements and develop models for estimated credit losses consistent with the guidance. Audit and review firms should take into account the implementation dates when considering risk assessment for audits and appropriate review inquiry and analytical procedures.

# GROUP STUDY MATERIALS

## A. Discussion Problems

1. Discuss the applicability and the types of entities and assets affected by the amendments in this update.

2. Explain if and how the CECL model and amendments in this update apply to available-for-sale debt securities when measuring credit losses under ASU 2016-13.

3. Discuss potential changes to any disclosure requirements and the disclosures objectives.

## B. Suggested Answers to Discussion Problems

1. The amendments of this update affect entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. Obviously, financial institutions will be impacted more than any other industry due to the size of their receivable portfolios, but they also affect any company that has trade receivables, loans, debt securities, net investments in leases, off-balance sheet credit exposures, reinsurance receivables, and any other financial asset not excluded from the scope that has the contractual right to receive cash. The amendments in this update affect an entity to varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. There is significant diversity in practice in applying the incurred loss methodology which means that before transition, some entities may be more aligned than others, under current GAAP, to the new measure of expected credit losses.

2. The CECL model does not apply to available-for-sale debt securities and measurement has not changed from current GAAP. However, the amendments in this update require that credit losses be presented as an allowance rather than as a write-down. This approach is an improvement of current GAAP because an entity will be able to record reversals of credit losses in current-period net income. Therefore, it allows for a recovery of the charge when conditions improve. The allowance is limited to the amount at which the security's fair value is less than its amortized cost.

3. Financial institutions (and others with significant lending portfolios) will have extensive disclosures to make regarding the allowance and the methodology used in developing that allowance. However, most companies that have only trade accounts receivable (with a term of less than one year) will not see a significant increase from the disclosures currently required under GAAP. The objective of required disclosures is to enable a user of the financial statements to understand:

   - The credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio,
   - Management's estimate of expected credit losses, and
   - Changes in the estimate of expected credit losses that have taken place during the period.

   It is likely that companies will need to provide a more robust policy discussion in the summary of significant accounting policies than is currently disclosed.

# GLOSSARY OF KEY TERMS

**CECL—**Current Expected Credit Loss

**Chatbot—**a computer program designed to simulate conversation with humans

**Finance Lease—**a lease (contract) that transfers the asset or the right to use the asset along with the risks to the lessee

**Operating Lease—**ownership of the asset remains with the lessor

**RPA—**Robotic Process Automation

**Valuation Allowance—**reserve that is used to offset the amount of an asset

# CUMULATIVE INDEX 2023

## BY TOPIC

## BY CITATION



## BY SPEAKER

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

1. According to Russ Madray, which of the following occurs under ASC 842?

   A. Lessees recognize right-of-use assets and lease liabilities.
   B. Lessees recognize short-term leases in the same way as other types of leases.
   C. The criteria used for classifying leases was overhauled and different bright lines are used.
   D. Lease accounting was simplified so very little judgment is needed.

2. According to Russ Madray, leases can be classified as which of the following under ASC 842?

   A. Capital leases and operating leases.
   B. Capital leases and finance leases.
   C. Finance leases and operating leases.
   D. Finance leases and short-term leases.

3. According to Russ Madray, which of the following statements best describes the package of three practical expedients outlined in ASC 842?

   A. Incorrect lease classifications made under Topic 840 are grandfathered in under ASC 842 if the practical expedients are elected.
   B. All three practical expedients must be elected as a package and consistently applied to all leases; entities cannot pick and choose.
   C. The practical expedient of using hindsight to determine a lease term can only be used if all three other practical expedients are also elected.
   D. The practical expedients described in ASC 842 are only available for lessees; there are no practical expedients for lessors.

4. According to Russ Madray, how should interest expense on lease liabilities and the amortization of right-to-use assets be presented in journal entries for leases that use the practical expedients?

   A. As separate line items.
   B. As a single line item.
   C. Aggregated with similar items for other leases.
   D. Consistently with how the entity presents other interest expense and amortization.

5. According to Russ Madray, which of the following circumstances means that a lease must be accounted for as a finance lease?

   A. The right-of-use asset is accounted for on a straight-line basis.
   B. The lease term is 75% or more of the remaining economic life of the asset.
   C. The lease was originally accounted for under Topic 840.
   D. The amounts involved reach a higher threshold than allowed for operating leases.

*Continued on next page*

6. According to Jennifer Louis, how much of the time accountants and auditors previously devoted to manual repetitive tasks can be replaced by new and emerging technology?

   A. 50 to 60 percent.
   B. 60 to 70 percent.
   C. 70 to 80 percent.
   D. 80 to 90 percent.

7. According to Jennifer Louis, what is the purpose of robotic process automation (RPA)?

   A. To answer queries.
   B. To complete repetitive tasks.
   C. To decrease transparency.
   D. To identify anomalies.

8. According to Jennifer Louis, artificial intelligence (AI) can be used to do which of the following during an audit?

   A. Analyze an entire population of transactions.
   B. Perform inquiries and make observations.
   C. Provide a less precise risk assessment.
   D. Lower reliance on trend analysis.

9. According to Jennifer Louis, what is *visualization*?

   A. The progress of entities from a lower to a higher level of IT maturity.
   B. The ability to digitally download databases and store records electronically.
   C. The need for CPA firms to make significant investments in IT.
   D. The use of charts, scatter diagrams, trend lines, and tables.

10. According to Jennifer Louis, how might auditors use optical character recognition (OCR)?

    A. To copy data across different files without the risk of human input errors.
    B. To use simple tax calculations to determine a client's tax provision.
    C. To extract terms from standard contracts and make sure no changes have been made.
    D. To maximize auditors' abilities for real-time collaboration.

*Continued on next page*

11. According to Kurt Oestriecher, what type of entity will be *most* impacted by the changes required in the current expected credit loss (CECL) standard?

    A. Small businesses.
    B. Financial institutions.
    C. Nonprofit entities.
    D. Automobile dealerships

12. According to Kurt Oestriecher, when do entities normally evaluate the amount needed for their credit loss allowance?

    A. Daily.
    B. Monthly.
    C. Quarterly.
    D. At the end of the accounting period.

13. According to Kurt Oestriecher, what information should entities look at when creating an allowance for credit losses?

    A. As under previous guidance, entities should focus this decision on relevant historical events.
    B. Entities should focus on current events, such as changes in the economy and interest rates.
    C. Entities should focus on creating reasonable and supportable forecasts of the future.
    D. Entities should consider historical events, current conditions, and reasonable and supportable forecasts of the future.

14. According to Kurt Oestriecher, how should units of account be evaluated for CECL purposes?

    A. Each unit of account should be evaluated separately.
    B. They can be evaluated separately if needed, but those with similar risk characteristics can be pooled.
    C. They must be categorized and put into pools; they are never evaluated separately.
    D. They should be aggregated and evaluated together in one large pool.

15. According to Kurt Oestriecher, how does the CECL standard affect most small businesses?

    A. Though it will not change their methodology, it will have a material impact on their balance sheets.
    B. It will change their methodology and also have a material impact on their balance sheets
    C. It will change their methodology but should have little to no effect on their balance sheets.
    D. It will change their methodology and have a significant affect on their balance sheets.

*CPE Network®*
**Accounting & Auditing Report**
**Volume 36, Issue 9** **October 2023**

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

How would you rate the topics covered in the October 2023 **CPE Network® A&A Report?** Rate each topic on a scale of 1–5 (5=highest):

| | Topic Relevance | Topic Content/ Coverage | Topic Timeliness | Video Quality | Audio Quality | Written Material |
|---|---|---|---|---|---|---|
| Journal Entries for Leases Under ASC 842 | \|______\| | \|______\| | \|______\| | \|______\| | \|______\| | \|______\| |
| Using New Tech in Accounting and Auditing | \|______\| | \|______\| | \|______\| | \|______\| | \|______\| | \|______\| |
| Implementing CECL | \|______\| | \|______\| | \|______\| | \|______\| | \|______\| | \|______\| |

Which segments of the October 2023 issue of **CPE Network® A&A Report** did you like the most, and why?

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Which segments of the October 2023 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 October 2023 **CPE Network® A&A Report?** Rate each speaker on a scale of 1–5 (5 highest):

| | Overall | Knowledge of Topic | Presentation Skills |
|---|---|---|---|
| Russ Madray | \|______\| | \|______\| | \|______\| |
| Jennifer Louis | \|______\| | \|______\| | \|______\| |
| Kurt Oestriecher | \|______\| | \|______\| | \|______\| |

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Were program materials accurate? Yes ☐ No ☐ ____________________

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

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

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**Once Again, Thank You…**

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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.

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| **Moderator Name, Credentials, and Signature Attestation of Attendance:** | |
| **Delivery Method:** | Group Internet Based |
| **Total CPE Credit:** | 3.0 |
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CHECKPOINT LEARNING NETWORK

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**REVISED August 29, 2023**

**Welcome to CPE Network!**

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

This User Guide has the following sections:

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

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

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

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

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

**Copyrighted Materials**

# “Group Live” Format

**CPE Credit**

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

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

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

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

**Advertising / Promotional Page**

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

**Monitoring Attendance**

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

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

**Real Time Instructor During Program Presentation**

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

**Elements of Engagement**

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

**Make-Up Sessions**

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

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

## Awarding CPE Certificates

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

## Subscriber Survey Evaluation Forms

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

## Retention of Records

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

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

**Finding the Transcript**

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

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

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

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

**Requesting Participant CPE Certificates**

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

**Email: CPLgrading@cerifi.com**

**When sending your package to CeriFi, you must include ALL of the following items:**

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

**Incomplete submissions will be returned to you.**

# “Group Internet Based” Format

**CPE Credit**

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

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

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

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

**Advertising / Promotional Page**

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

**Monitoring Attendance in a Webinar**

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

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

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

Examples of polling questions:

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

**Additional Notes on Monitoring Mechanisms:**

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

**Real Time Moderator During Program Presentation**

"Group internet based" programs must have a **qualified, real time moderator while the program is being presented.** Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers during the  presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

**Make-Up Sessions**

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

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

**Awarding CPE Certificates**

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

**Subscriber Survey Evaluation Forms**

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

**Retention of Records**

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

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

**Finding the Transcript**

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

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

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

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

**Requesting Participant CPE Certificates**

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

**Email: CPLgrading@CeriFi.com**

**When sending your package to CeriFi, you must include ALL the following items:**

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

**Incomplete submissions will be returned to you.**

# “Self-Study” Format

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

**Self-Study—Print**

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

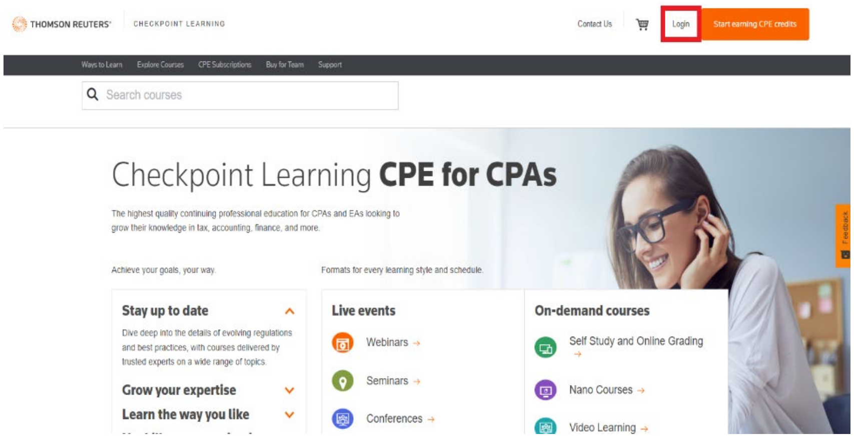
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.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

  **CPLgrading@cerifi.com**

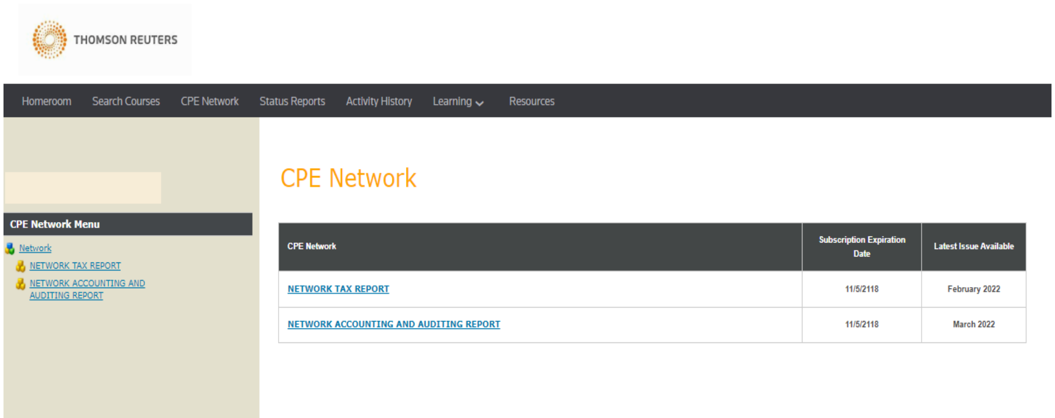
**Self-Study—Online**

Follow these simple steps to use the online program:

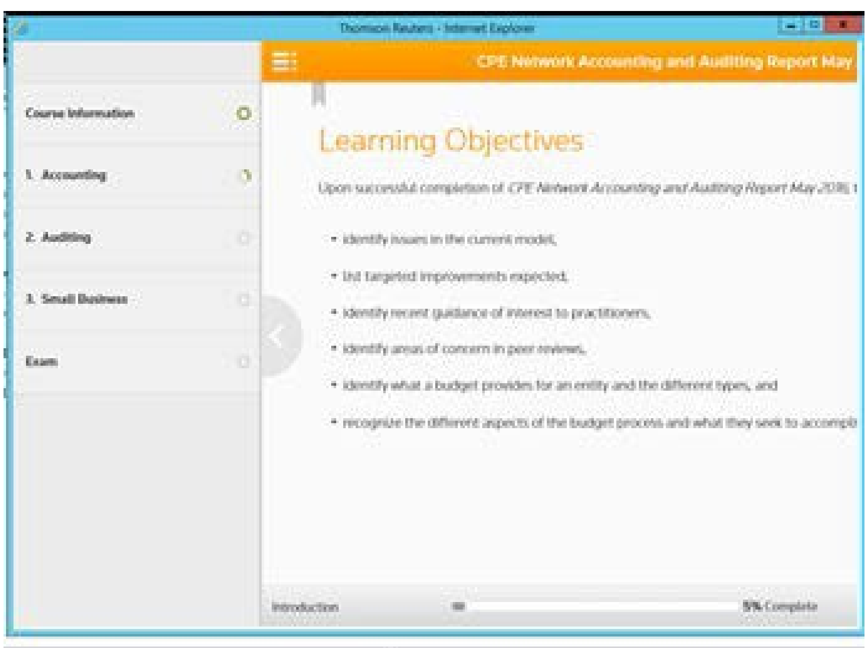
- Go to [www.checkpointlearning.thomsonreuters.com](www.checkpointlearning.thomsonreuters.com) .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



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

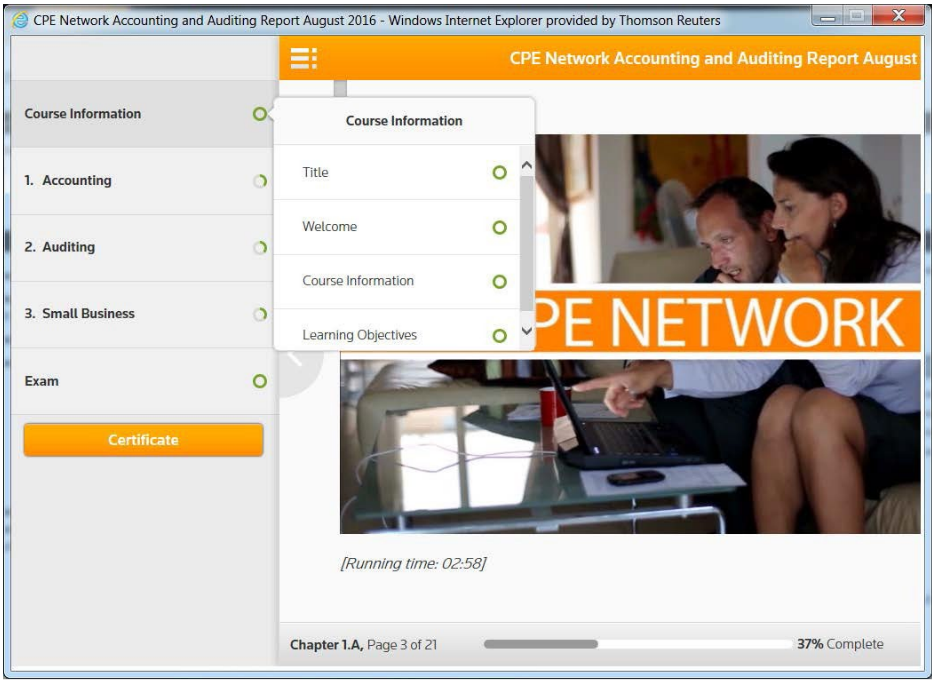



The Chapter Menu is in the gray bar at the left of your screen:

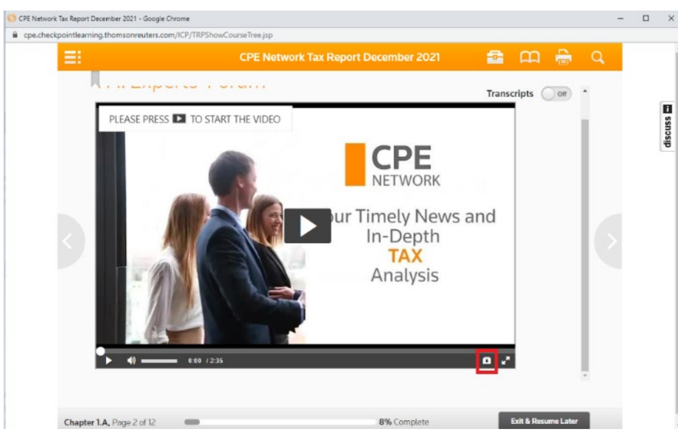



Click down to access the dropdown menu and move between the program Chapters.

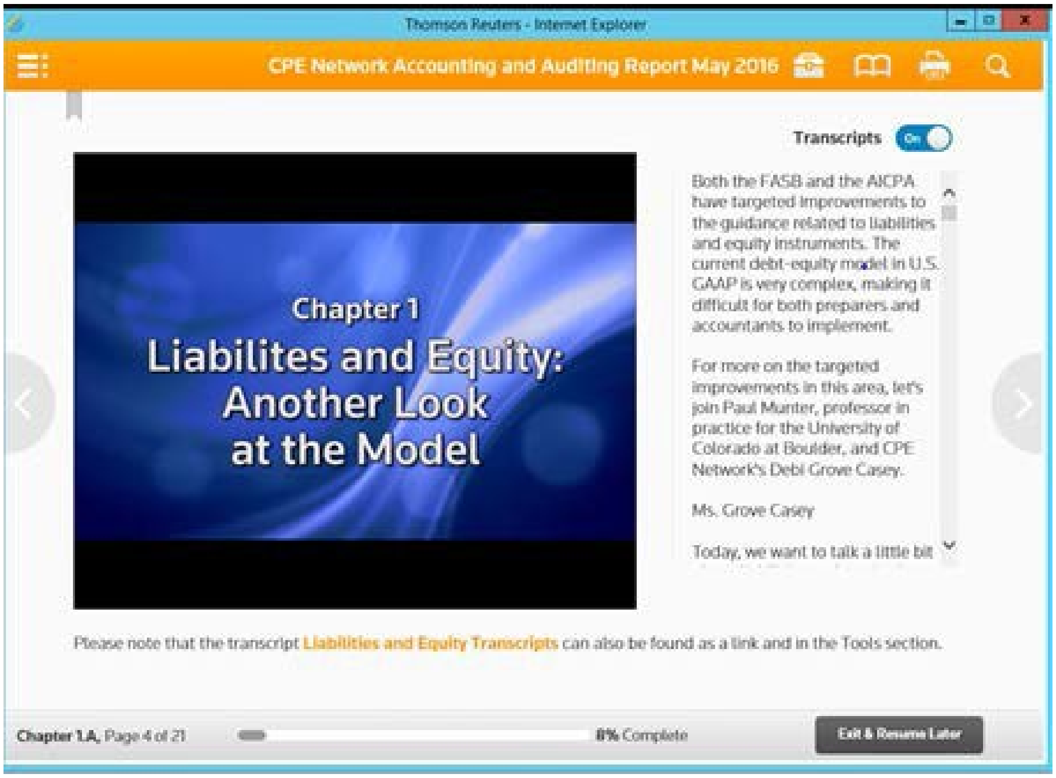
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



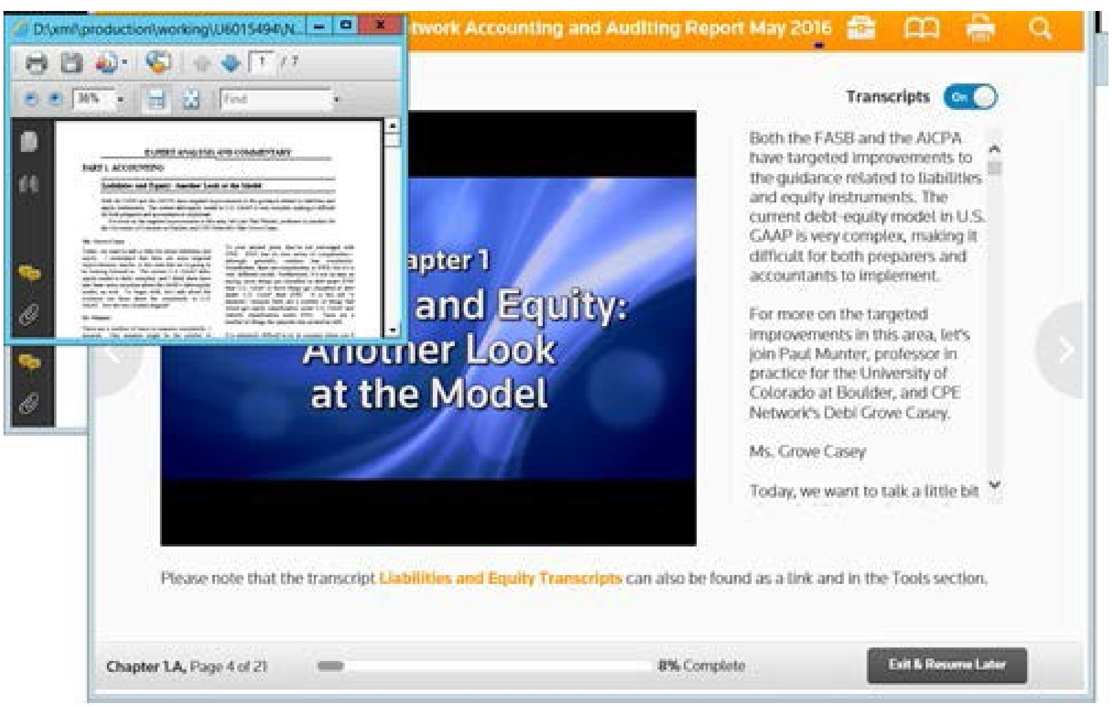

- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access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



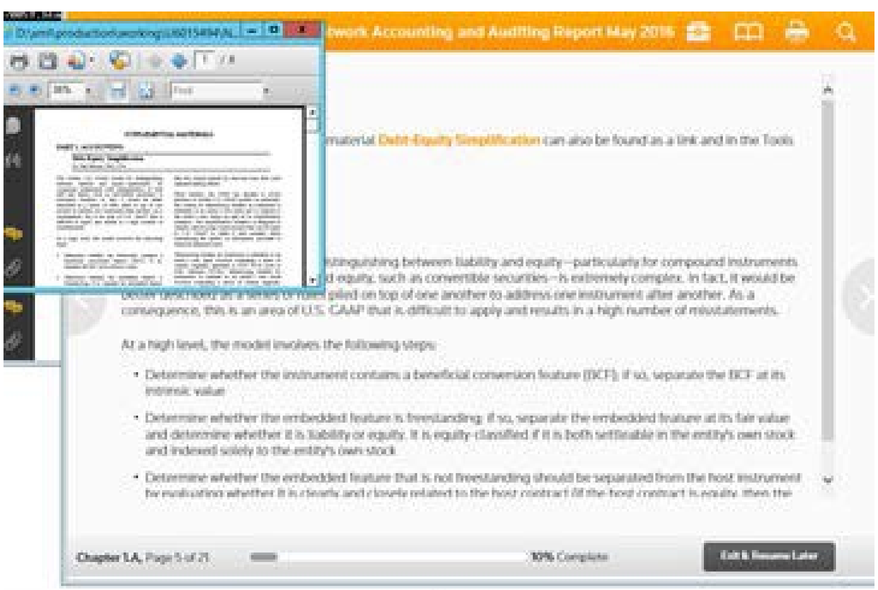

Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.




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



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


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

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



## Suggested Answers to Discussion Problems

1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories:

   - Held-to-maturity
   - Trading
   - Available-for-sale

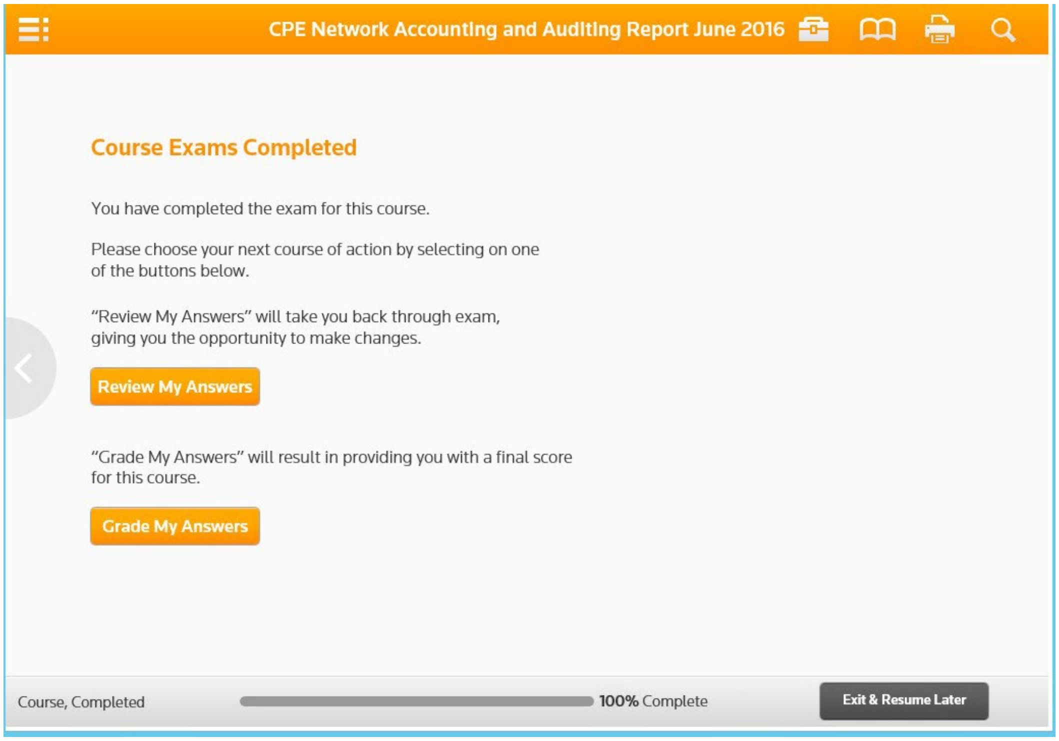
   An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions should be made at acquisition and, preferably, formally documented. It is not appropriate to use "hindsight" to classify securities transactions, perhaps by considering changes in value after acquisition.

2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price. "Short-term," in this context, is intended to be measured in hours and days, rather than in months or years, according to ASC 320. However, an entity is not precluded from classifying as trading a security it plans to hold for a longer period, as long as that designation occurs at acquisition.

3. Impairment is recognized in earnings when a decline in value has occurred that is deemed to be other than temporary, and the current fair value becomes the new cost basis for the security. An investment is considered to be impaired if the fair value of the investment is less than its cost basis. Cost includes adjustments made for

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

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




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

**Additional Features Search**

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

**Search Results** are displayed with the number of hits.

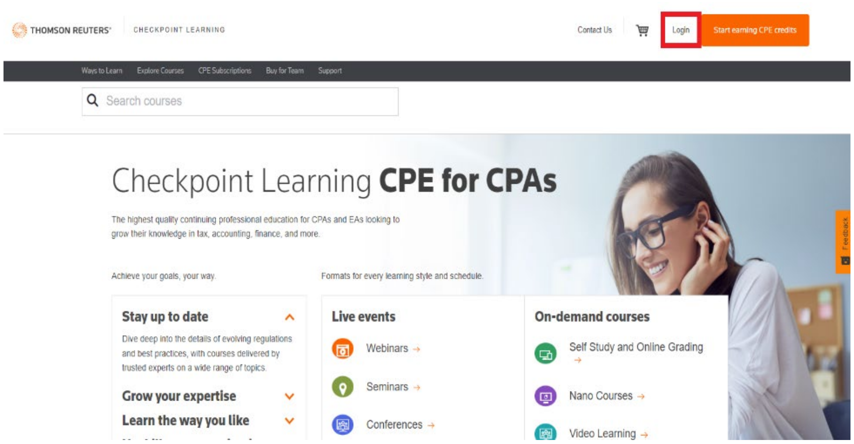
**Print**

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

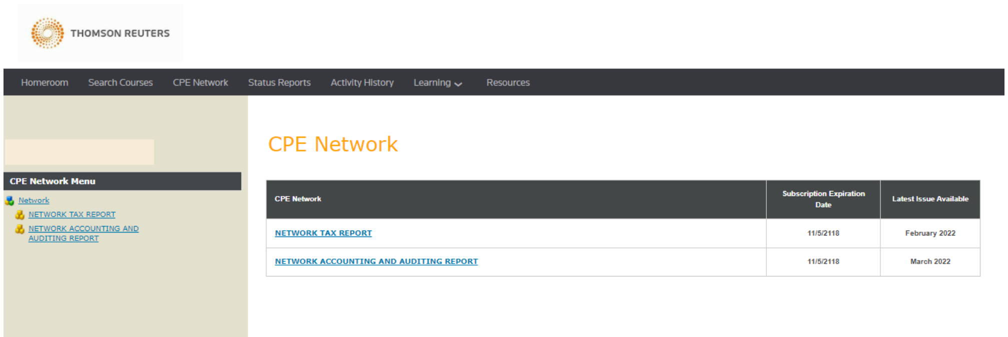
# Transitioning From DVDs

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

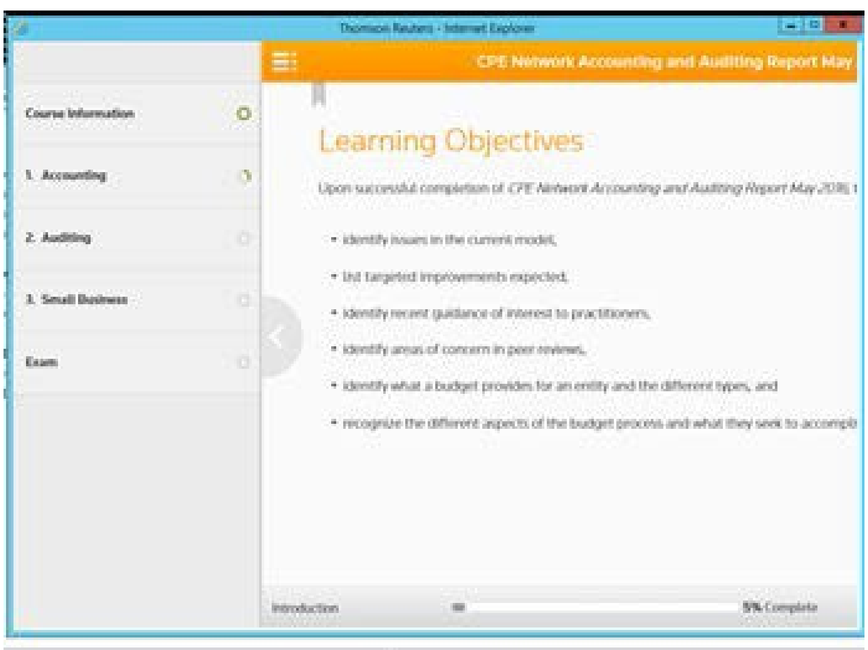
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



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

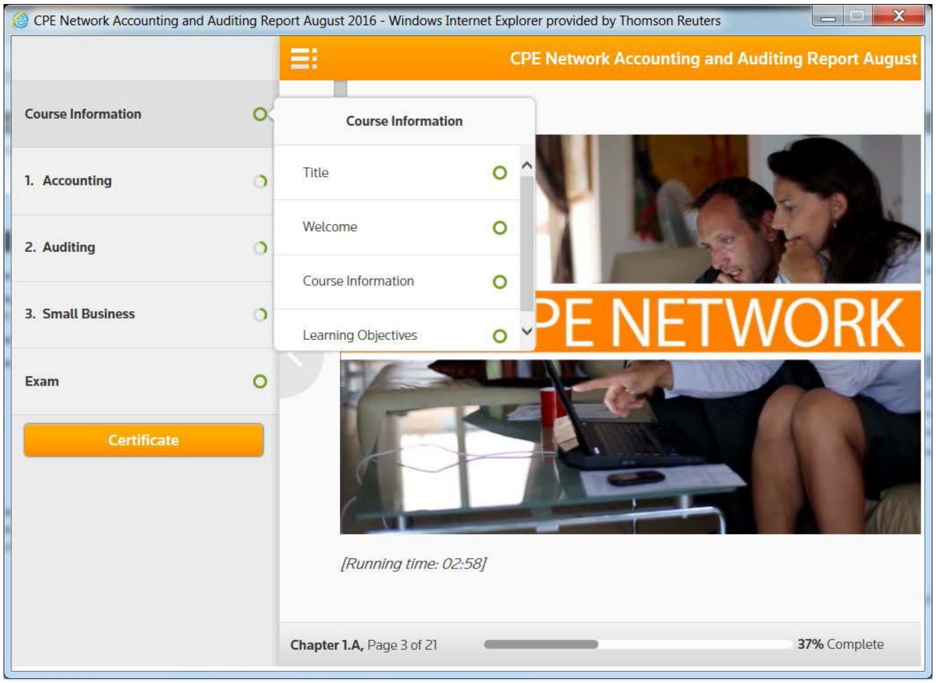



The Chapter Menu is in the gray bar at the left of your screen:

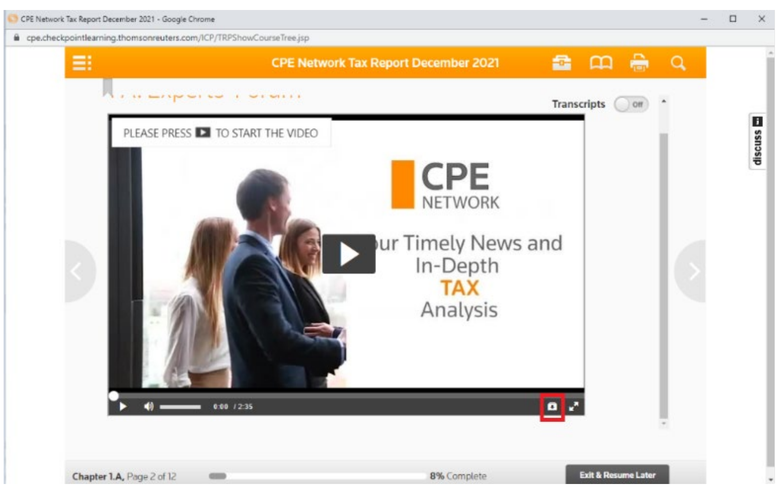



Click down to access the dropdown menu and move between the program Chapters.

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




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




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

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent to administrators with each release.

# What Does It Mean to Be a CPE Sponsor?

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

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

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

## CPE Sponsor Requirements

**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.

**<u>Real Time Instructor During Program Presentation</u>**

"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).

**<u>Awarding CPE Certificates</u>**

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

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

**<u>Seminar Quality Evaluations for Firm Sponsor</u>**

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

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

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

**Retention of Records**

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

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

# Appendix: Forms

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

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

# Getting Help

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

| Support Group | Phone Number | Email Address | Typical Issues/Questions |
|---|---|---|---|
| Technical Support | 844.245.5970 | Cplsupport@cerifi.com | • Browser-based<br>• Certificate discrepancies<br>• Accessing courses<br>• Migration questions<br>• Feed issues |
| Product Support | 844.245.5970 | Cplsupport@cerifi.com | • Functionality (how to use, where to find)<br>• Content questions<br>• Login Assistance |
| Customer Support | 844.245.5970 | Cplsupport@cerifi.com | • Billing<br>• Existing orders<br>• Cancellations<br>• Webinars<br>• Certificates |