

JEFF SAILOR'S 2025 ACCOUNTING & AUDITING UPDATE AND REVIEW

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Jeff does a great job of getting us
the most important information
we need to do our best.

I can't wait for the video spoofs!
I've always said Jeff's skits are
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FEATURING

- Accounting Update & Review •
- SQMS IMPLEMENTATION •
- SSARS Update & Review •
- Audit Update & Review •
- Focus on Fraud - 2025 Edition •



Presented by

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FASB Conceptual Framework

FASB Concept 8

Introduction

- Purpose of the Conceptual Framework
- The objective of general purpose financial reporting forms the foundation of the Conceptual Framework
- Other aspects of the framework flow logically from this primary objective
 - Reporting entity
 - Qualitative characteristics
 - Recognition
 - Measurement
 - Presentation
 - Disclosure
- The objective of general purpose financial reporting provides the foundation for the entire financial reporting structure
- It ensures that financial information serves the needs of primary users, whether for-profit or not-for-profit entities, and helps improve decision-making across all stakeholders



Chapter 1

The Objective of General Purpose Financial Reporting

- Primary Goal is to Provide Useful Financial Information
 - The objective is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors
 - This information helps in making decisions about providing resources to the entity

Chapter 2

The Reporting Entity

- Focus
 - The reporting entity as the subject of financial reporting
 - Emphasis on information useful for making resource allocation decisions, not just any entity reporting
- The reporting entity is central to general purpose financial reporting and must provide financial information that helps stakeholders make informed resource allocation decisions

Chapter 3

Qualitative Characteristics of Useful Financial Information

- Introduction
 - Focus on the qualitative characteristics of financial information
 - Aimed at providing useful information to investors, lenders, and other creditors for decision-making
 - Key Objective
 - To identify the types of information that are most useful for financial decision-making based on the entity's financial report
 - Scope of Financial Information

- Includes information on economic resources, claims against the entity, and changes in these over time
- Also encompasses explanatory materials and forward-looking information
- Fundamental Qualitative Characteristics
 - Essential for information to be useful
 - Relevance
 - Faithful Representation
 - Enhanced by characteristics
 - Comparability
 - Verifiability
 - Timeliness
 - Understandability
- Relevance
 - Information must be capable of influencing decision-making by users
 - Predictive Value
 - Information that helps predict future outcomes
 - Revenue data for predicting future earnings
 - Confirmatory Value
 - Provides feedback on previous evaluations and predictions
 - Comparing actual revenue against past predictions to improve future estimates
 - Interrelation of Predictive and Confirmatory Value
 - Information with predictive value often confirms previous predictions
 - Materiality
 - Distinction between relevance and materiality:
 - Relevance
 - What type of information is useful
 - Materiality
 - Whether the omission or misstatement would influence decisions
 - Materiality judgments depend on the reporting entity's context
- Faithful Representation
 - Information must not only be relevant but also faithfully represent the economic phenomena
 - Complete representation includes all necessary details for understanding
 - Full descriptions and numerical depictions of assets
 - Neutrality
 - Information must be free from bias
 - Financial data should not be manipulated to present an overly favorable or unfavorable view
 - Free from Error
 - Not perfect but should be free from errors in representation
 - Estimates should be presented transparently with limitations clearly stated

Chapter 4

Elements of Financial Statements

- Introduction
 - Elements serve as the building blocks of financial statements
 - Definitions shape the content and recognition of financial information

- Key Elements
 - Assets
 - Liabilities
 - Equity (Net Assets)
 - Investments by Owners
 - Distributions to Owners
 - Comprehensive Income
 - Revenues
 - Expenses
 - Gains
 - Losses
- The definitions apply to both business entities and not-for-profit entities
- Two Types of Financial Statement Elements
 - Resource-based Elements
 - At a Specified Date
 - Assets
 - Resources controlled by the entity
 - Liabilities
 - Claims against the entity's assets
 - Equity
 - Residual interest
 - Transaction-based Elements
 - Over a Reporting Period
 - Comprehensive Income
 - Revenues and expenses
 - Gains and losses
 - Investments by Owners
 - Resources provided by the owners
 - Distributions to Owners
 - Resources returned to owners



Chapter 5 Recognition and Derecognition

- Purpose of the Chapter
 - Guide to when an item should be recognized (incorporated) into or derecognized (removed) from the financial statements
 - Builds on concepts from other chapters and applies them to recognition and derecognition decisions
- Definition of Recognition
 - Items are depicted both verbally and numerically, with amounts included in the financial statement totals
 - Recognition Involves
 - Recording the acquisition or incurrence of an item
 - Subsequent changes in the item (measurement changes)
 - Removal of the item when no longer applicable (derecognition)
 - Key Distinction
 - Recognition is different from disclosure
 - Disclosure does not substitute for recognition

- Recognition Criteria
 - Provides guidance for deciding when an item qualifies for recognition in the financial statements
 - The elements of financial statements (assets, liabilities, equity, etc.) are candidates for recognition
 - Three Main Criteria for Recognition
 - The item must meet the definition of a financial statement element
 - The item must be measurable using a relevant measurement attribute
 - The item must be depicted and measured in a way that faithfully represents the economic phenomenon it is meant to represent
 - Recognition decisions must be balanced against the cost constraint and materiality
 - Benefits of recognition should justify the costs of gathering and reporting the information
 - Only material items are recognized
- Derecognition of Items
 - Derecognition is the process of removing an item from the financial statements
 - Derecognition occurs when an item no longer meets any of the recognition criteria
 - An item should be derecognized if it
 - No longer meets the definition of an element
 - No longer satisfies other recognition criteria
 - Measurability or faithful representation

Chapter 6 Measurement

- Measurement Overview
 - Process of assigning numerical depictions to recognized items in financial statements
 - Ensures recoverability for assets and settleability for liabilities
 - Impacts financial statements through recognition of revenues, expenses, gains, or losses
- Measurement is Anchored in Prices
 - Observable entry prices and exit prices from transactions
 - Estimation when prices are not directly observable
 - Prices reflect the financial effects of transactions on the entity
- Measurement Systems
 - Entry Price System
 - Based on acquisition costs
 - Exit Price System
 - Reflects market participant value or entity-specific value
 - Dual systems meet the objective of providing decision-useful information
 - Initial measurements use entry prices
 - Subsequent measurements differ
 - Entry Price
 - Allocation over benefit or obligation periods
 - Exit Price
 - Remeasured to reflect recoverability and settleability at reporting dates
- Entry Price System
 - Initial and Subsequent Measurements
 - Record at cost and allocate systematically

- Depreciation, amortization
 - Adjust for impairment or changes in liability settlement values as needed
- Allocation of Costs
 - Over benefit periods for assets or obligation periods for liabilities
 - Includes necessary actions in the initial entry price
 - Taxes, shipping
 - Adjustments for impairment or modified liabilities ensure conceptual premises are met
- Exit Price System
 - Reflects value an entity would receive or pay in a transaction
 - Commonly referred to as fair value
 - Remeasure assets and liabilities at each reporting date
 - Report differences in comprehensive income
 - Use market comparisons or entity-specific assumptions when direct observation is not possible
 - Acquisition-related costs expensed immediately rather than allocated
- Practical Implications of Measurement Systems
 - Entry Price System
 - Suitable for cost allocation models
 - Recognizes impairment losses and requires remeasurement in certain cases
 - Exit Price System
 - Reflects market dynamics and real-time valuation
 - Eliminates the need for impairment testing but requires ongoing remeasurement
- Estimating Exit Prices Using Cash Flows
 - Market Participant vs. Entity-Specific Perspectives
 - Market participant assumptions reflect fair value
 - Entity-specific assumptions incorporate unique circumstances
 - Consideration of Time Value of Money
 - Integral for accurate cash flow valuation
 - No justification for excluding time value considerations
- Entry and exit prices typically reflect fair value unless evidence suggests otherwise
- Special Cases
 - Related party transactions
 - Prices may not represent fair value
 - Charitable contributions
 - Measured by the donor's fair value
 - Ownership interest exchanges
 - Market-based prices establish values
 - Group asset transactions
 - Allocation based on relative fair values
 - Liabilities without entry prices
 - Exit price system applies
- Choosing the Relevant Measurement System
 - Entry Price System
 - Relevant for unique exit prices
 - Maintains historical cost relationships for predictive purposes
 - Exit Price System
 - Relevant for nonunique exit prices
 - Reflects market conditions and risks



- Relevance and Faithful Representation
 - Measurements must be both relevant and faithfully represented
 - Decision-useful information depends on the nature of the asset or liability
-

Chapter 7

Presentation in Financial Reporting

- Refers to how line items, totals, and subtotals are displayed on financial statements
- Line items represent the elements of financial statements: assets, liabilities, equity, revenues, expenses, gains, losses, and contributions/distributions to/from owners
- Cash flows are also depicted
- Focus of Chapter
 - Discusses the presentation of recognized information in financial statements
 - Does not address recognition decisions or definitions of elements
 - The concepts apply to various formats
 - Single statement of comprehensive income or separate income and OCI statements
 - Future updates to accounting standards may change formats or subtotals
- Articulation of Financial Statements
 - Financial statements are interrelated and derived from the same underlying data
 - Each financial statement contributes to meeting the objective of financial reporting
- Line Items vs. Notes
 - Some financial information is presented as line items, others in the notes or supplementary schedules
 - Notes provide important context, such as significant accounting policies or asset/liability details
- Criteria for Presentation Decisions
 - Information should be presented in the financial statements if it meets recognition criteria
 - Financial information can also be provided through notes, supplementary information, or other reports
- Netting of Line Items
 - Netting involves aggregating debits and credits
 - Sale of an asset netting proceeds against carrying amounts
 - No consistent conceptual basis for netting assets and liabilities on the balance sheet
 - Practices and standards determine when net presentation is appropriate
 - Netting may obscure the underlying details of transactions
 - Standards should clarify when netting is appropriate, especially for gains and losses
- Importance of Line Items, Subtotals, and Totals
 - Full disclosure of every activity detail is impractical and overwhelming
 - Condense data into line items, subtotals, and totals enhances understandability for resource providers
 - Excessive aggregation obscures useful details
 - Examples of overly aggregated statements
 - Total assets, liabilities, and equity without differentiation
 - Total revenues and expenses without context
- Limitations of Summary Data
 - Totals like net assets or net income provide general indicators but lack granular detail
 - Essential for initial comparisons but insufficient for in-depth analysis

- Role of Subtotals
 - Often tied to specific activities or timeframes
 - Subtotals enhance clarity in understanding cash flows, equity changes, and comprehensive income

Chapter 8 Notes to Financial Statements

- There are limits on what can and should be provided in a set of general purpose financial statements
 - This includes the notes
- Information is depicted not only by numbers, but by words on the face of the statements
 - Standards establish the rules for this presentation
- In addition, information should be provided in the notes
- The concept considers three types of entities
 - Businesses
 - Not-for-Profit Entities
 - Employee Benefit Plans
- Business
 - The primary purpose of notes is to supplement the information on the face of the financial statements
 - This will be used by investors, lenders and creditors for decision making
 - The FASB felt that although some information could be suitable, it should NOT be required to be in the notes
 - Assumptions and expectations about future events not in the financial statements
 - Non entity-specific matters that are common knowledge or readily available
- Not-for-Profit Entities
 - Users are more interested in the services provided, the efficiency and ability to continue
 - This differs from business users who are generally interested in cash flows to themselves
 - Some disclosures relevant to investors, lenders and creditors may not be beneficial
- Employee Benefit Plans
 - There is no mention in the Concept Statements specific to employee benefit plans
 - These entities and their users are significantly different from users of businesses and not-for-profit entities
 - They should have different considerations
 - As a result, these concepts will NOT be considered for employee benefit plans



Types of Information in Notes

- In general, disclosures provide information not provided on the face of the statements
- Three categories of information in disclosures
 - Additional information about line items
 - Information about the reporting entity
 - Information about other past events and current conditions that can affect cash

Limitations on Information in Notes

- Relevance
 - Only information that is relevant to users should be required
 - Some useful broad disclosures would be relevant to some entities, but not to others
 - There should be an allowance for materiality judgments

- Cost constraint
 - The benefits should justify the costs
 - The same theory should be followed as it is for financial reporting
 - Common knowledge information should not be required
 - Economy
 - Political
 - Social conditions
 - Other events
 - Common accounting practice should not be disclosed
 - Accounting methods should be disclosed if:
 - There are alternatives
 - Methods are not apparent
 - Methods have changed

Content of Notes

- Additional information about line items
- Information about the reporting entity
- Information about other past events and current conditions that can affect cash flows
- Interim periods

Additional Information About Line Items

- Information affecting the utility of an asset
 - Nature
 - Quality
 - Location
 - Other factors
- How an asset relates to other line items
- Significant restrictions on an asset's use or disposition
 - Contractual
 - Statutory
 - Regulatory
 - Judicial
- For assets or liabilities resulting from financial instruments, contracts or legal documents:
 - Contractual terms
 - Degree of nonperformance or credit risk
 - Effect of inability to pay by the entity or counterparty
 - Methods used to determine timings and amounts of uncertain future cash flows
- Terms and conditions of issued equity instruments
- Potential effect of accounting method changes
- Breakdown of line items when they contain different types of items
- Alternative measurements and information to support them
- How the item relates to other line items

Information About the Reporting Entity

- Information about the entity and its activities
 - The users should be aware of the entity's activities
 - Activities that are readily apparent need not be detailed
 - Complex issue should be explained
- Information about related parties and transactions
 - It is common to have relationships with various related parties
 - Owners

- Managers
- Parents
- Subsidiaries
- Common control entities
- Significant investments
- Information about these relationships would be important if activities are different from what users would expect
- Thus, the nature of the transactions should be disclosed

Information About Other Past Events and Current Conditions that can Affect Cash Flows

- Events
 - Litigation
 - Suspected violations of contractual terms or regulations or similar
 - Commitments expected in future periods
 - Uncertainties with respect to recognition of items
 - Subsequent events prior to the issue date

Interim Periods

- Interim statements are generally issued for different reasons than annual Interim Periods
- Interims should be considered part of the annual periods
 - They are not designed to be complete
 - Some of the information should be obtained from the latest annual
 - Interims are an update of the annual
- Notes should provide an update to the annual reports
 - Differences from the annual
 - How they relate to the annual
 - Seasonal variances



FASB UPDATE & REVIEW

FASB Post-Implementation Review Revenue from Contracts With Customers (Topic 606)

Introduction

- Topic 606- Revenue from Contracts with Customers was issued in 2014
 - It was effective for public entities in 2018
 - It was effective for others in 2020
- Since that time, the FASB conducted a post implementation review (PIR)
- This involved three stages
 - Monitoring
 - Evaluation of costs and benefits
 - Summary of research and reporting
- History
 - Prior to ASC 606, revenue recognition practices were fragmented under multiple industry-specific guidance, leading to inconsistencies and lack of comparability
 - ASC 606 was developed in collaboration with the International Accounting Standards Board (IASB) to align U.S. GAAP with IFRS 15, creating a unified revenue recognition model
 - The new standard sought to eliminate revenue recognition inconsistencies across various sectors
 - Construction
 - Software
 - Telecommunications
 - Manufacturing
- Key Principles of ASC 606
 - Core Principle
 - Recognize revenue in a way that depicts the transfer of goods or services to customers in an amount that reflects the consideration the company expects to receive
 - The Five-Step Model:
 - Identify contracts with customers:
 - Scope of ASC 606 applies only to contracts with customers
 - Clear definitions for "contract" and "customer" that eliminate ambiguity
 - Identify performance obligations:
 - Explicitly identifies distinct goods or services that are promised to the customer
 - Determine the transaction price:
 - Covers variable consideration, such as discounts, rebates, and performance bonuses, with clear guidance on how to estimate
 - Allocate the transaction price:
 - Provides principles on allocating the total transaction price across multiple performance obligations
 - Recognize revenue when (or as) performance obligations are satisfied:



- Revenue is recognized when control of the asset is transferred to the customer, either over time or at a point in time

Results

- Post-Implementation Review Findings
 - Overall Evaluation:
 - Stakeholders generally consider Topic 606 a success
 - Most implementation challenges stemmed from the fundamental changes in revenue recognition and the need for judgment in applying the standard
 - No Immediate Action Required:
 - No urgent changes or new standards are needed based on the PIR findings
 - Next Steps for the Board and Staff:
 - Ongoing support through the Technical Inquiry Service
 - Monitor emerging practice or application issues
 - Assess the need for any targeted improvements in future agenda consultations or requests
- What's Next for Topic 606?
 - Continued Monitoring:
 - The Board and staff will continue to evaluate the effectiveness of Topic 606, incorporating feedback from the PIR process to refine future standards
 - Possible Future Improvements:
 - Targeted improvements may arise from upcoming agenda consultations or new emerging issues in practice
 - Ongoing Stakeholder Engagement:
 - The staff will continue to respond to stakeholder inquiries and provide guidance on the application of the standard

Compensation—Stock Compensation Scope Application of Profits Interest & Similar Awards

Introduction to the Update

- Objective
 - The FASB issued this Accounting Standards Update (ASU) to provide clarity on the application of GAAP regarding profits interest and similar awards under Topic 718 (Compensation—Stock Compensation)
- Purpose
 - The goal is to eliminate diversity in practice and provide clearer guidance on when profits interest awards should be accounted for under Topic 718 versus other compensation-related topics, such as Topic 710 (Compensation—General)

Amendments and Main Provisions

- Addition of Illustrative Example
 - A new illustrative example is added to demonstrate how to apply the scope guidance in 718-10-15-3 to profits interest awards
 - The example includes four fact patterns to help clarify the decision-making process for entities
 - Focuses on scope conditions that determine whether the award is a share-based payment
 - Helps reduce complexity and aligns practice across entities

Effective Date

- Public
 - Effective for annual periods beginning after December 15, 2024, and interim periods within those annual periods
 - Others
 - Effective for annual periods beginning after December 15, 2025, and interim periods within those annual periods
 - Entities can early adopt the amendments in either interim or annual financial statements before the effective date, provided those statements have not yet been issued or made available for issuance
-

Common Control Arrangements - Accounting for Leases

Introduction

- The two topics in this update are related to common control lease arrangements
 - Terms and conditions to be considered in a lease
 - Accounting for leasehold improvements
- These issues came up during post implementation with feedback primarily from private companies

Terms and Conditions to be Considered

- Topic 842 requires entities to determine the existence of a lease based on the “legally enforceable terms and conditions of the arrangement”
- This applies to related parties, including those under common control
- This is important because it determines whether or not a lease exists
 - In other words, do you have to capitalize it
- Common control is a term much broader for private companies than for the SEC entities
 - They could include an entity owned by a grandparent and an entity owned by a grandchild
- Under 840, the determining concept for determining a lease was “economic substance”
- Under 842, the determining concept for determining a lease is “legal enforceability”
- For a common control arrangement, determining legal enforceable terms can be difficult, even if the terms are in writing
 - Common owners can amend the terms at will
 - They can also choose not to enforce certain terms
- Thus, the common control poses issues related to what is actually legally enforceable
- These are often not negotiated at arms length
 - Thus, they do not align with other arrangements
- In addition, the arrangements may be unwritten or lack sufficient detail
 - Renewal options are not addressed
- Due to these factors, private companies were afraid that a legal opinion would be required to determine whether or not a lease existed

The Practical Expedient- Terms and Conditions to be Considered

- Who is affected?
 - This practical expedient will be available to private companies and most not-for-profit entities with arrangements under common control
 - It will not be allowed for



- Public business entities
- Not-for-profit conduit bond obligors
- Employee benefit plans that file with the SEC
- It will not apply to other related party arrangements
- The board decided to provide a practical expedient which could be applied on an arrangement by arrangement basis
- Simply put, an entity may use the written terms and conditions of a common control arrangement to determine two issues
 - Does a lease exist?
 - What is the proper classification of the lease?
- If no written terms exist, then the expedient may not be used and an entity must determine the legally enforceable terms and conditions
- Transition
 - If you adopt the practical expedient in conjunction with the adoption of 842, then you must use the same transition method elected for 842
 - Otherwise, you may adopt either
 - Prospectively to all arrangements that commence after the adoption of the standard
 - Retrospectively to the beginning of the earliest period presented
- Effective Date
 - Effective for all entities with fiscal years beginning after December 15, 2023, including interim periods within
 - Early adoption is allowed

Accounting for Leasehold Improvements Associated with Common Control Leases

- Leasehold improvements are improvements made by the lessee to the underlying leased asset
- They are recognized on the lessee's balance sheet only when a lease exists
- Topic 842 requires these to be amortized over the shorter of the useful life of the improvements or the lease term
- Many common control lease arrangements have a short term
 - A term of one year is not uncommon
- A concern was that under the new guidance improvements would be required to be amortized over a much shorter period than their economic life
 - This would not result in a faithful representation
- The board felt that leasehold improvements with common control leases are economically different from other arrangements not under common control
 - Improvements are often made at the direction of the common owners

The Amendment

- Who is affected?
 - This amendment would apply to ALL lessees who are in a lease under a common control arrangement where the lessee is the owner of the leasehold improvements
 - This would include
 - Public entities
 - Private entities
 - NFP entities
- For all leases under common control, leasehold improvements will be amortized over the useful life of the improvement to the common control group as long as the lessee controls the use of the underlying asset through a lease

- If the lessor obtained the underlying asset through a lease with another party not under common control, the amortization period may not exceed the term with lessor's lease with the other entity
- When the lessee no longer controls the use of the underlying asset, the residual amount of the improvements will be accounted for as a transfer between common entities through an adjustment to equity
 - Net assets for NFPs
- Impairment guidance will remain in place
- Effective Date
 - Effective for all entities for fiscal years beginning after December 15, 2023, including interim periods
 - Early adoption is allowed

Business Combinations- Joint Venture Formations Recognition and Initial Measurement

Introduction

- Business combinations occur when one entity gains control over another entity
 - This leads to the consolidation of financial statements
- Joint venture formations involve collaboration between two or more entities while maintaining separate identities
 - This is often done to pursue specific business objectives

Purpose

- Prompted by changes in business practices, regulatory requirements, and feedback from stakeholders
 - They felt a joint venture should measure under a new basis of accounting at formation
 - This should reduce diversity in practice
- Current GAAP does not provide specific guidance
 - Some recognize net assets at the contributor's carrying amount
 - Some recognize them at fair value

FASB Codification Sections Affected

- Joint Venture Formations- 805-60

Who is affected

- All entities engaging in business combinations or joint venture formations, irrespective of industry or size

Provisions

- There can be no accounting acquirer
- Identifiable net assets and goodwill are measured at formation
 - The formation date is the date it meets the definition of a joint venture
- Initial measurement of the total net assets is equal to 100% of the joint venture equity
- A newly formed joint venture should initially measure assets and liabilities at fair value
 - Some exceptions would exist that are consistent with business combination guidance
- Other amendments have been made to various sections for consistency
- All existing guidance will remain the same
 - This includes disclosures

Effective date

- All joint venture formations with a formation date on or after January 1, 2025

Income Taxes- Improvements to Income Tax Disclosures

Introduction

- Investors indicated that they wanted improved disclosures to better assess how tax rates and future cash flows are affected by:
 - Operations
 - Tax risks
 - Tax planning
 - Operational opportunities
- Investors evaluate income tax risks, and opportunities by relying upon
The rate reconciliation table
 - Other disclosures including total income taxes paid
- Investors wanted the following enhancements
 - Understanding of exposure to potential changes in tax legislation
 - Associated risks and opportunities
 - How income tax information affects cash flow forecasts and capital allocation decisions
 - Potential opportunities to increase future cash flows
- This will improve transparency of income tax disclosures by requiring
 - Consistent categories
 - Greater disaggregation of information in the rate reconciliation
 - Taxes paid disaggregated by jurisdiction
- This will improve effectiveness and comparability by
 - Adding disclosures of pre-tax income and tax expense
 - Removing nonbeneficial disclosures



FASB Codification Sections Affected

- Income Taxes- 740

Who is affected

- All entities subject to topic 740
- Certain disclosures are NOT required for non-public business entities

Provisions

- Various disclosures are required
- All entities:
 - On an annual basis disclose
 - The amount of income taxes paid, disaggregated by federal, state and foreign
 - The amount of income taxes paid, disaggregated by jurisdictions in which taxes paid is equal to or greater than 5% of total income taxes paid
 - Income from continuing operations before income tax expense disaggregated between domestic and foreign
 - Income tax expense from continuing operations, disaggregated by federal, state and foreign
- Disclosures eliminated by this update
 - Disclosure of the nature and estimate of the range of reasonably possible change in unrecognized tax benefits balance in the next 12 months or the requirement to make a statement that an estimate cannot be made

- Disclosure of the cumulative amount of each type of temporary difference, when a deferred tax liability is not recognized because of exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures
- Other than public business entities:
 - Qualitative disclosures about specific categories of reconciling items & jurisdictions that result in significant differences between the effective tax rate & statutory tax rate
- Public business entities
 - A tabular reconciliation is required, using both amounts & percentages for various items

Effective date

- Public entities
 - Annual periods beginning after December 15, 2024
- Non public entities
 - Annual periods beginning after December 15, 2025
- Early adoption is allowed
- Applied on a prospective basis
 - Retrospective is allowed



Fair Value Measurement

Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

Purpose

- To clarify the guidance related to measuring the fair value of an equity security subject to contractual restrictions prohibiting the sale
- The stakeholders indicated that the illustrative example was vague leading to diversity in practice
- Many felt that disclosures were inadequate

FASB Codification sections affected

- Fair value measurements- 820

Who is affected

- All entities with investments in equity securities measured at fair value subject to contractual sale restrictions

Provisions

- This does not actually change any GAAP, but clarifies the existing GAAP
- Clarifies that a contractual sale restriction is NOT considered part of the unit of account
 - Thus it is NOT considered in measuring the fair value
- Clarifies that an entity cannot as a separate unit of account recognize and measure a contractual sale restriction
- Updated disclosures
 - Fair value of equity securities in the balance sheet subject to contractual sales restriction
 - Nature and remaining duration of the restrictions
 - Circumstances that could cause a lapse in the restriction

Effective date

- Public

- Fiscal years beginning after December 15, 2023, and interims within
 - Others
 - Fiscal years beginning after December 15, 2024, and interims within
-

Codification Improvements

Amendments to Remove References to the Concepts Statements

Introduction

- Purpose of the Update
 - The Update includes amendments to the FASB Accounting Standards Codification (ASC)
 - Focus on removing references to various FASB Concepts Statements within the Codification
- Removal of References to FASB Concepts Statements
 - Concepts Statements are non-authoritative
 - References to them in authoritative guidance may confuse users by implying they are authoritative
 - The Board decided to remove these references to simplify the Codification and avoid conflicting implications due to outdated Concepts Statements

Who is Affected?

- The amendments apply to all entities within the scope of the affected accounting guidance in the Codification.
- Entities that utilize the affected Topics in the Codification will be impacted by the removal of Concepts Statements references

Main Provisions

- Removal of References to Concepts Statements
 - Concepts Statements are designed to aid in the development of accounting standards but are not authoritative
 - Clarifies the distinction between authoritative and nonauthoritative literature
 - Many references to Concepts Statements in the Codification are not necessary to understand or apply the guidance
 - The removal streamlines the Codification
 - Some references were made to outdated Concepts Statements that could cause diverse interpretations over time

Differences from Current GAAP

- This Update does not represent a significant change in accounting practice but rather an effort to simplify and clarify the Codification
- The key difference is the removal of references that could imply non-authoritative guidance is authoritative

Effective Date

- For Public Business Entities
 - Effective for fiscal years beginning after December 15, 2024
- For All Other Entities
 - Effective for fiscal years beginning after December 15, 2025

- Early adoption is allowed for any fiscal year or interim period for which financial statements have not yet been issued
 - If early adopted in an interim period, the entity must apply the amendments as of the beginning of the fiscal year that includes that interim period

Income Statement - Reporting Comprehensive Income Expense Disaggregation Disclosures (Subtopic 220-40)

Introduction

- Investors want more disaggregated financial reporting information, especially about expenses
- Focus Areas
 - Income statement, statement of cash flows, and notes to financial statements
 - Granular data about specific expense categories
- Importance for Investors
 - Better understanding of an entity's performance
 - Assessing future cash flows and comparing entities
 - Specific request for more detail on
 - Cost of sales
 - Selling, General, and Administrative expenses (SG&A)
 - Employee compensation costs
- Investors emphasized the need for more detailed cost structure information
- Enhanced disaggregation to improve forecasting of expenses
- More accurate assessments of an entity's financial health and future prospects
- Goals of the Update
 - Improve transparency of financial reporting by increasing the granularity of disclosed expenses
 - Provide investors with better insights into an entity's operations and cost structure
 - Help investors make more informed judgments about performance and future cash flows
 - Complement other recent standards on disaggregation of revenue and tax information

Who Is Affected?

- All public business entities that file financial reports in accordance with Generally Accepted Accounting Principles (GAAP)

Main Provisions

- New Disclosure Requirements
 - Disclosure of Specific Costs
 - Purchases of inventory
 - Employee compensation
 - Depreciation
 - Intangible asset amortization
 - Depreciation, depletion, and amortization (DD&A) in oil- and gas-producing activities (or other relevant depletion expenses)
 - Relevance to Expense Captions
 - Disclosures must be included in relevant expense captions (e.g., cost of sales, SG&A, R&D) presented on the face of the income statement
 - Inclusion of Existing Disclosures



- Certain currently required disclosures (under GAAP) must be presented within the same tabular format as the new disaggregated expense information
- Qualitative Descriptions:
 - For amounts not disaggregated quantitatively, entities must provide a qualitative description of remaining expenses
- Disclosure of Selling Expenses:
 - Total selling expenses must be disclosed, and entities must define selling expenses in their annual reports
- Voluntary Additional Disclosures
 - Entities are not prohibited from providing further disclosures that may provide additional decision-useful information to investors

Effective Date

- Annual reporting periods beginning after December 15, 2026
- Interim reporting periods beginning after December 15, 2027
- Early adoption is permitted

Debt- Debt with Conversion and Other Options Induced Conversions of Convertible Debt Instruments

Introduction

- Objective is to improve the relevance and consistency of accounting for induced conversions of convertible debt instruments
- Induced Conversion
 - Occurs when an entity changes the terms of a convertible debt instrument to induce conversion (e.g., offering more favorable terms to encourage debt holders to convert their debt into equity)
- Goal
 - Ensure better guidance on induced conversion accounting, particularly for cash-convertible debt instruments (a relatively newer market trend)

Main Provisions

- Clarification on Induced Conversions
 - Induced Conversion Requirements
 - The inducement offer must provide debt holders at least the consideration (in form and amount) that would be issuable under the original conversion terms
 - Applies to both equity and cash-convertible instruments

Effective Date

- For fiscal years beginning after December 15, 2025
- Early adoption is allowed for entities that have already adopted the amendments in Update 2020-06

Business Combinations (Topic 805) and Consolidation (Topic 810)

Determining the Accounting Acquirer in the Acquisition of a Variable Interest Entity

Introduction

- Purpose of the ASU
 - Objective
 - Improve requirements for identifying the accounting acquirer in business combinations under Topic 805
 - Impact of Determination
 - The identification of the accounting acquirer and acquiree significantly affects the carrying amounts of the combined entity's assets and liabilities
 - Affects post-combination net income due to differences in measurement requirements
 - Measurement Differences
 - Accounting acquiree's assets and liabilities are generally measured at fair value, with specific exceptions in Topic 805
 - Accounting acquirer's existing assets and liabilities are not remeasured under business combinations guidance
- Current Guidance and Issues
 - Non-VIE Business Combinations
 - Entities consider specific factors to identify the accounting acquirer
 - Possible outcomes
 - Transaction may be classified as a reverse acquisition
 - Legal acquirer is the accounting acquiree
 - Transaction may not be accounted for as a business combination if the accounting acquiree is not a business
 - VIE Business Combinations
 - Current guidance mandates that the primary beneficiary (entity consolidating the VIE) is always the accounting acquirer
 - This prevents classification as a reverse acquisition when the legal acquiree is a VIE
 - Stakeholder Concerns
 - Lack of comparability between transactions involving VIEs and non-VIEs
 - Inability to account for transactions as reverse acquisitions when the legal acquiree is a VIE
 - Current guidance impacts both the determination of the accounting acquirer and whether a business combination has occurred

Amendments

- Scope of Amendments
 - Apply to acquisition transactions effected primarily by exchanging equity interests where the legal acquiree is a VIE that meets the definition of a business
- Key Change
 - Replaces the requirement that the primary beneficiary is always the accounting acquirer

- Entities must now consider factors in paragraphs 805-10-55-12 through 55-15 to determine the accounting acquirer, aligning with non-VIE acquisition processes
- Unchanged Aspects
 - No changes to accounting for transactions determined to be reverse acquisitions
 - No changes to transactions where the legal acquirer is not a business and is determined to be the accounting acquiree

Effective Date

- Effective Date
 - Applicable for annual reporting periods beginning after December 15, 2026
 - Includes interim reporting periods within those annual periods
- Transition Requirements
 - Prospective application to acquisition transactions occurring after the initial application date
- Early Adoption
 - Permitted as of the beginning of an interim or annual reporting period

Compensation—Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606) Clarifications to Share-Based Consideration Payable to a Customer

Introduction

- Objective
 - Reduce diversity in practice and enhance decision usefulness and operability of guidance for share-based consideration payable to customers in conjunction with selling goods or services
- Context
 - Entities offer share-based consideration to customers or other parties purchasing goods/services to incentivize purchases
 - Consideration often vests based on customer purchasing a specified volume or monetary amount of goods/services
- Current Guidance (Topic 606)
 - Consideration payable to a customer is accounted for as a reduction of the transaction price unless in exchange for a distinct good or service
- Amendments (ASU 2019-08)
 - Require application of Topic 718 (Compensation—Stock Compensation) to measure and classify share-based consideration payable to customers
 - Vesting conditions must be classified as service or performance conditions, impacting revenue recognition timing

Main Provisions of the Update

- Revised Definition of Performance Condition:
 - Includes vesting conditions based on the volume/monetary amount of customer purchases or potential purchases from the grantor
 - Covers performance targets based on purchases by other parties from the grantor's customers
 - Cannot be applied by analogy to employee/nonemployee awards for goods/services used in the grantor's operations

- Elimination of Forfeiture Election for Service Conditions
 - Grantors must estimate expected forfeitures for share-based consideration with service conditions, removing the option to account for forfeitures as they occur
 - Separate forfeiture policy elections remain for employee/nonemployee awards
- Clarification on Share-Based Consideration
 - Encompasses same instruments as share-based payment arrangements, but grantees are not required to be suppliers of goods/services
- Exclusion of Topic 606 Constraints
 - Grantors assess vesting probability using only Topic 718 guidance, not Topic 606's variable consideration constraints

Improvements

- Enhanced Decision Usefulness
 - Eliminates delayed revenue recognition for unvested awards, aligning transaction price estimates with expected consideration
- Improved Operability
 - Clarifies condition classification and aligns forfeiture treatment, reducing complexity
- Reduced Diversity in Practice
 - Standardized approach to vesting conditions and forfeiture estimates

Expected Outcome

- Fewer awards classified as service conditions, with more consistent revenue recognition timing reflecting the economic substance of transactions

Effective Date

- Effective Date
 - Applicable for annual reporting periods (including interim periods) beginning after December 15, 2026
 - Early adoption permitted for all entities

Intangibles- Goodwill and Other- Crypto Assets

Accounting for and Disclosure of Crypto Assets

Introduction

- Stakeholders expressed concerns that current accounting, does not provide users with decision-useful information
- The current model is a cost-impairment accounting model
 - Thus, when valuing crypto assets, only decreases were accounted
 - Increases were only accounted for when the asset was sold

FASB Codification Sections Affected

- Intangibles – Goodwill and Other – Crypto Assets: 350-60

Who is Affected

- Applies to all entities holding assets that meet certain scope criteria

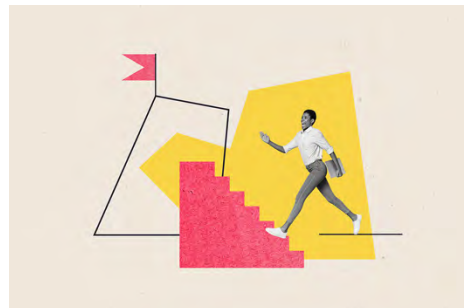
Effective Date

- Effective for all entities for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years
- Early adoption permitted for both interim and annual financial statements that have not yet been issued

Cryptocurrency

- History
 - The first cryptocurrency, Bitcoin, was created in 2009 by Satoshi Nakamoto
 - Nakamoto's concern was that traditional currencies heavily depend on governments to work
- Definition
 - Cryptocurrency is a digital or virtual currency secured by cryptography and based on a network that is distributed across a large number of computers
- Characteristics
 - A key feature is that a central authority does not issue it
 - Many cryptocurrencies are created to encourage work on their specific blockchains
 - Bitcoin on Bitcoin blockchain
 - Ether on Ethereum
 - Unlike fiat currency (i.e. U.S. dollar), cryptocurrencies are not backed by any public or private entities
 - Cryptocurrencies come in a variety of flavors
 - Utility: serve specific functions on their respective blockchains
 - Transactional: designed to be used as a payment method
 - Governance: represent voting or other rights on a blockchain
 - Platform: support applications built to use a blockchain
- Creation of cryptocurrency
 - Cryptocurrency is created primarily through a process known as "mining"
- What is mining?
 - Mining is a process used for confirming and validating transactions on a blockchain
 - Miners use high-powered computers & machines to solve an algorithmic problem
 - The problem is solved by the generation of a hash that matches certain criteria, such as the block hash for the transaction
 - This new hash then validates and adds the transaction to the blockchain
 - Mining is also used to release new cryptocurrency into circulation
 - Thus, mining serves two purposes:
 - Validating transactions (proof-of-work or other)
 - Creating more of a type of cryptocurrency
 - The miner who solves the problem first is given a reward, sometimes newly issued cryptocurrency
 - This is what motivates people to mine for blockchain networks
 - Various factors affect the amount of cryptocurrency rewarded to miners, including the specific blockchain and how long the blockchain has existed
- Who can participate in mining?
 - It's still possible to participate in Bitcoin mining with a regular at-home personal computer if you have some of the latest and fastest hardware, but you are at a disadvantage
 - Many miners now depend on machines with stronger processing abilities, such as ASIC (application-specific integrated circuit)
 - The machines have high costs and high energy usage
 - Electricity for one ASIC can use the same amount of electricity as half a million PlayStation 3 devices
 - Some people have mining farms
 - The more and better resources a miner has, the higher chance they will earn the reward

- Advantages of cryptocurrency
 - Removes single points of failure
 - Easier to transfer funds between parties
 - Removes third parties
 - Can be used to generate returns
 - Remittances are streamlined
- Disadvantages of cryptocurrency
 - Transactions are pseudonymous
 - Pseudonymity allows for criminal uses
 - Have become highly centralized
 - Expensive to participate in a network and earn rewards
 - Off-chain security issues
 - Prices are very volatile
- SEC's take on cryptocurrency
 - SEC Chair Gary Gensler has called on crypto exchanges to register with the agency as securities trading platforms
 - Many crypto issuers have already been subject to SEC enforcement
 - SEC says it made these and other recent crypto-related moves to
 - Prevent further fraud
 - Reduce market manipulation
 - Force more disclosure of relevant information to investors and cryptocurrency holders
- Stablecoins and other tokens are also under heightened regulatory scrutiny
 - Stablecoins are a type of cryptocurrency whose value is tied to another asset, usually a fiat currency like the US dollar



Requirements

- Applies to assets meeting all of the following criteria:
 - Meet the definition of intangible assets as defined in the
 - Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
 - Prevents certain arrangements, such as contracts with customers, guarantees, and insurance contracts, from being included within the scope
 - Prevent other digital intangible assets, such as software and media, from being included within the scope
 - Are created or reside on a distributed ledger based on blockchain or similar technology
 - Are secured through cryptography
 - Are fungible
 - Obtaining market prices for items that are not fungible could be costly and complex and fair value measurement may not be relevant for nonfungible items
 - Are not created or issued by the reporting entity or its related parties
 - Stakeholders broadly agreed that the need to address the issuer's accounting is less pervasive and addressing the accounting for issuers of crypto assets would expand the scope of the project
 - Are not created or issued by the reporting entity or its related parties (cont.)
 - A reporting entity that mines or validates and receives newly created crypto assets is not the creators of the crypto assets that it receives as consideration for performing services if mining or validating is the only involvement that an entity has in the creation of the asset

- An entity is required to measure assets meeting the criteria at fair value
 - Reporting crypto assets at fair value aligns the accounting required for all holders of crypto assets with accounting required for entities that follow certain industry-specific
 - It eliminates the requirement for those entities to test crypto assets for impairment
 - They were previously treated as indefinite-lived intangible assets
- Enhanced disclosures are required for both annual and interim reporting periods
 - Significant holdings
 - Restrictions of crypto assets
 - Reconciliation of assets held during the period
- Presentation
 - Statement of Financial Position
 - An entity must present crypto assets measured at fair value separately from intangible assets measured at historical cost less amortization and impairment
 - This is because they are measured and generate benefits differently from other intangible assets
 - In addition, presenting crypto assets separately adds transparency for investors
 - Income Statement
 - An entity must include all changes from the remeasurement of crypto assets in net income
 - Present aggregate gains and losses on crypto assets separately from amortization expense and impairment losses of other intangible assets
 - Statement of Cash Flows
 - Cash receipts arising from crypto assets that are received as noncash consideration in the ordinary course of business (or as a contribution, in the case of a not-for-profit entity) and are converted nearly immediately into cash should be presented as operating cash flows

Accounting for and Auditing of Digital Assets AICPA Practice Aid - As of June 30, 2024

Introduction

- This presentation is based on the concepts found in the AICPA Practice Aid “Accounting for and Auditing of Digital Assets”
 - As of June 30, 2024
- While this is considered nonauthoritative, the guidance can generally be relied upon with proper professional judgment applied
- The basic format is that of inquiries and responses
- Primary Objective
 - Develop nonauthoritative guidance to assist financial statement preparers and auditors
 - Address accounting under U.S. generally accepted accounting principles (GAAP)
 - Address auditing under generally accepted auditing standards (GAAS)
- Target Audience
 - Nongovernmental entities for accounting purposes
 - Auditors who must comply with GAAS
- Two distinct subgroups
 - Accounting Subgroup – Focuses on how digital assets are accounted for under GAAP
 - Auditing Subgroup – Focuses on how digital assets are audited under GAAS
- Purpose of division

- Each subgroup addresses unique challenges specific to either financial reporting or auditing procedures
- Methodology for developing guidance
 - Identification of relevant topics
 - Prioritization of most critical or applicable topics
 - Continuous updates: Additional topics will be added over time
 - Publication: Practice aid will be posted on aicpa-cima.com
- Accounting Subgroup
 - Purpose and Scope
 - Provide clarity on accounting treatment for digital assets under GAAP
 - The scope of each Q&A explicitly stated within the topic
 - Scope may vary:
 - Some Q&As cover all digital assets
 - Some focus on specific classifications, such as indefinite-lived intangible assets
 - Exclusions
 - Q&As do not cover compliance with laws and regulations
 - Key Considerations in Accounting for Digital Assets
 - Terminology and Colloquialisms
 - Multiple terms may describe similar digital assets or transactions
 - Despite naming variations, accounting treatment is based on substance over form
 - Accounting Treatment Determinants
 - Specific terms
 - Form of the asset
 - Underlying rights and obligations attached to the asset
 - Key Considerations in Accounting for Digital Assets
 - Limitations of Guidance
 - Conclusions in one topic may not apply to all digital assets
 - Practitioners must assess each asset individually to determine appropriate accounting
- Auditing Subgroup
 - Purpose and Scope
 - Primary Focus:
 - Assist auditors in applying GAAS to digital asset engagements
 - Address unique challenges in auditing digital assets
 - Purpose and Scope
 - Scope Limitations
 - PCAOB-jurisdiction audits (i.e., audits under Sarbanes-Oxley Act) not covered
 - Nonaudit attest engagements are also not included
 - Key Considerations for Auditors
 - Auditor Independence and Ethical Requirements:
 - Must be assessed before acceptance or continuance of an engagement
 - Not addressed in the practice aid but can be found in other professional literature
 - Challenges in Auditing Digital Assets
 - Complexity of IT environments used in digital asset ecosystems



- Difficulty in obtaining sufficient, appropriate audit evidence
- Evolving nature of digital asset businesses introduces new risks
- Digital Asset Ecosystem: Unique Risks and Challenges
 - Defining the Digital Asset Ecosystem
 - The term “digital asset ecosystem” is used throughout the guidance
 - Encompasses all entities involved in digital asset transactions
 - Examples of participants:
 - Developers
 - Create blockchain applications and digital assets
 - Maintainers
 - Ensure blockchain functionality
 - Examples of participants
 - Users
 - Engage in purchase, sale, investment, trading, exchange
 - Custodians and security providers
 - Hot/cold wallet providers, qualified custodians
 - Validators
 - Evolving Business Environment
 - Digital asset industry is rapidly evolving
 - New challenges arise for financial statement preparers and auditors
 - The practice aid does not attempt to provide an exhaustive list of risks and recommended procedures
 - Some enterprise use cases are not addressed, such as blockchain applications for supply chain management
 - Variability in Blockchain Design
 - Fundamental principles of blockchain technology:
 - Cryptographic security
 - Decentralization
 - Trust mechanisms
 - Types of blockchains differ significantly
 - Public, permissionless blockchains (accessible to anyone)
 - Private, permissioned blockchains (restricted access, specific use cases)
 - Implications for accounting and auditing:
 - Different blockchain designs impact risk assessment and audit procedures
 - The practice aid does not focus on any specific blockchain
 - Instead, it provides guidance on general blockchain concepts

SYSTEM OF QUALITY MANAGEMENT STANDARDS

How to Develop Your System of Quality Management Using the AICPA Practice Aids

Introduction

- In June 2022, the ASB issued new standards related to quality management
 - SQMS 1- A Firm's System of Quality Management
 - Quality management at the firm level
 - SQMS 2- Engagement Quality Reviews
 - Part of quality management at the firm level
 - SQMS 3- Amendments to QM Sections 10 and 20
- These are codified in the brand new standard set
 - QM Sections 10 and 20
- All firms with an A&A practice will be **REQUIRED** to update their system of quality control
 - Some changes will be minor, while others will be significant
 - That said, the process will be quite time consuming and will require significant time and resources to do a proper job
- The AICPA has released practice aids and we have produced this presentation to make your job a lot easier



Effective Date

- SQMS 1
 - Designed and implemented by December 15, 2025
 - Evaluation performed by December 15, 2026
- SQMS 2
 - Calendar year audits or reviews of financial statements for periods beginning on or after December 15, 2025
 - Other A&A engagements beginning on or after December 15, 2025

Standard Objectives

- Objective of the SQM
 - The firm and personnel fulfill their responsibilities and conduct engagements in accordance with requirements
 - Legal and regulatory
 - Professional standards
 - Engagement reports are appropriate
 - Objective of the firm
 - To design, implement and operate a system of quality management that provides the firm with reasonable assurance that the SQM objectives are achieved
-

QM Section 10

A Firm's System of Quality Management

The New Framework

- This requires that a firm designs, implements and operates a system of quality management
 - It should be customized for their A&A practice

- The system
 - Focus on quality management using a risk-based approach
 - The system components are designed to be integrated rather than linear
 - Continual flow of remediation and improvement
 - Tailored system to meet the needs of any size firm
- The framework contains 8 components
 - These should operate in an integrated manner
- The 8 components
 - Risk assessment process
 - Governance and leadership
 - Relevant ethical requirements
 - Acceptance and continuance
 - Engagement performance
 - Resources
 - Information and communication
 - Monitoring and remediation
- There are other requirements which address the following:
 - Roles and responsibilities for the system
 - Leadership's overall evaluation of the system
 - Network requirements
 - Network services
 - Documentation



Documentation

- QM 10 Paragraph REQUIRES documentation of your SQM
- The documentation of the SQM should be sufficient enough for the following:
 - Sufficient understanding by personnel of the requirements
 - Support consistent implementation and operation of responses
 - Provide evidence of the design, implementation and operation of responses to support the evaluation
- REQUIRED elements
 - Identification of individuals with ultimate responsibility
 - Quality objectives and risks
 - Description of responses to risks
 - Monitoring and remediation
 - Evidence of monitoring
 - Evaluations of findings, deficiencies and root causes
 - Remedial actions
 - Communications about monitoring and remediation
 - The previous elements are also required for any network requirements or network services
 - Conclusion reached for the annual evaluation of the SQM and the basis for conclusion
- The firm should establish a documentation retention period which is sufficient to meet the needs of the firm, peer review and any laws or regulations
- Practical documentation documents
 - System of Quality Management
 - This will be your primary document

- This will be prepared once and adjusted over time
- It should include:
 - Identification of individuals with ultimate responsibility
 - Quality objectives and risks
 - Description of responses to risks
- Your risk assessment process documentation
 - This will be done once and then reassessed based on monitoring
 - This will be a detailed account of your process
 - It should clearly show:
 - The quality objectives
 - The required conditions, events, circumstances, actions and inactions listed in QM 10
 - Identification of quality risks
 - Assessment of the risks
 - Responses to the risks
- Monitoring and remediation documentation
 - This will be performed at least annually
 - Evidence of monitoring
 - Evaluations of findings, deficiencies and root causes
 - Remedial actions
 - Communications about monitoring and remediation
- SQM evaluation
 - This will be done annually
 - It should be performed by the individual with ultimate responsibility
 - It will result in a report expressing a conclusion on the operation of the SQM
- The AICPA has provided resources to assist in the preparation of your new system of quality management
- These may be found at aicpa-cima.com under the Resources topic at subtopic Audit and Assurance
- The most useful tool available is a practice aid entitled
 - “Establishing and Maintaining a System of Quality Management for a CPA Firm’s Accounting and Auditing Practice”



Where to Get the Practice Aids

- Go to AICPA-CIMA.com
- Click on the “Resources” tab at the top
- Select the topic “View by Topics” at the left menu
- Select the subtopic “Audit & Assurance” from the subtopics on the right
- On the “Audit & Assurance” page, select the box labeled “Resources Quality Management”
- On the Quality Management page, scroll down to the “Resources” and select “View all Resources”
- On this page, select either:
 - Free practice aid: Set up you’re A&A quality management system- Sole Practitioners
 - Free practice aid: Set up you’re A&A quality management system- Small and Medium-Sized Firms
- On either page scroll down and download either

- Download the Complete Practice Aid “Establishing and Maintaining a System of Quality Management for Sole Practitioners” and template
- Download the Complete Practice Aid “Establishing and Maintaining a System of Quality Management for Small and Medium-Sized Firms” and template

AICPA Practice Aid

- There are two versions
 - Sole practitioners
 - Small and medium-sized firms
- These are accompanied by a spreadsheet template for risk assessment
 - This is meant to be used in conjunction with the practice aids
- Both practice aids are comprised of four chapters and an appendix
 - Chapter 1- Overview of SQMS 1
 - Chapter 2- Overview of the risk assessment requirements
 - Chapter 3- Library of quality objectives, potential risks and potential responses
 - Chapter 4- Monitoring and remediation process
 - Appendix- QM 10 and 20: SQMS 1, SQMS 2 & SQMS 3
- The practice aids are identical for chapters 1 and 2
- Chapter 3 is expanded to take into account the issues for firms beyond sole practitioners
- Chapter 4 is slightly different for the two as well
- The spreadsheet will apply to either practice aid and is designed to be customized
- Limitations of the practice aid
 - The guide is very clear that it is a tool, not a solution
 - While the guide is extremely comprehensive, many policies and procedures will need to be modified to meet your firm’s needs
 - The guide states that if you do not customize the risks and responses
 - You will NOT be in compliance with the standards
 - You will NOT be doing what is most efficient and effective for your firm
 - If you simply copy the quality risks, policies and procedures from the guide and paste them into your document, you will have problems
 - Your list of risks may be incomplete
 - You may include risks which do not apply to you
 - You may commit to responses which you do not intend to do
 - Your peer reviewer will expect you to do what is in your document



New Risk-Based Approach

- The risk assessment process involves three main tasks
 - Establish quality objectives
 - Identify and assess quality risks
 - Design and implement responses to address the quality risks
- The risk assessment can be made much simpler and better documented by using the Practice Aid
- Establish quality objectives
 - These should be established for each of the 8 components of QM, except for risk assessment and monitoring
 - There are REQUIRED outcome-based quality objectives which MUST be included
 - You may also have additional firm objectives

- The firm may have circumstances which require these
- The Practice Aid indicates on Page 10 that the required objectives are comprehensive such that it is unlikely that a firm will need additional objectives
- Identify and assess quality risks
 - Understand the events, actions or circumstances that could affect quality
 - Focus on the nature and circumstances of the firm and engagements
 - Not all risks are “quality risks”
 - To qualify as a quality risk, both of the following must apply:
 - There is a reasonable possibility of a risk occurring
 - There is a reasonable possibility of it adversely affecting quality objectives
- QM 10 paragraph 26 lists 8 conditions, events, circumstances, actions and inactions that could adversely affect the achievement of the quality objectives
- These 8 items are REQUIRED to be considered as part of the risk assessment process
 - THUS, be sure to document these considerations in your risk assessment documentation
- REQUIRED considerations
 - The complexity and operating characteristics of the firm
 - The strategic and operational decisions and actions, business processes, and business model of the firm
 - The characteristics and management style of leadership
 - The resources of the firm, including the resources provided by service providers
 - Laws, regulations, professional standards, and the environment in which the firm operates
 - The nature and extent of the network requirements and network services
 - The types of engagements performed by the firm and the reports to be issued
 - The types of entities for which engagements are undertaken
- Design and implement responses
 - Responses to the risks
 - The standard includes some specific REQUIRED responses
 - The firm will have to design the others
- Identify information indicating needed change
 - When there are changes in the firm or engagements or if remediation is found to be needed
 - Modify or expand quality objectives
 - Modify or expand the risks and objectives

Using the Practice Aid

- Chapter 3 of the practice aid contains the most useful portion of the guide
- It discusses risk assessment for the 6 required components
- For each component, 4 tables are provided
 - Table 1- Required quality objectives
 - Table 2- Required quality objectives and potential quality risks
 - This table includes drop down menus for assessment and can be used as part of your documentation
 - Table 3- Required and suggested quality responses
 - Table 4- Example of evaluated quality risks and linked responses

- There are a number of ways this could be done, but it might be easiest to create a skeleton of your SQM document along with initial risk assessment
- To do this, first create a Word document and title it appropriately
- Then create an introductory section to explain the purpose of the document which should include who is ultimately responsible for the SQM
- Then add headings for each of the 8 components
- Your risk assessment will need to be clearly documented as well
 - Create a document to cover the entire process
 - This should include documentation that you considered the required considerations
 - One idea would be to add a tab to the spreadsheet to give details of the brainstorming session
 - Attendees
 - Time and date
 - The required considerations
- Overall Game Plan
 - Determine who will be in charge of the overall project
 - Set a date for the risk assessment
 - Include any useful participants
 - Have it at a location other than the office
 - Make the meeting a no cell phone event
 - Have a designated person record the participants and time as well as maintain a transitional document for information to go into the final SOQM
 - Set up a laptop with a large screen to discuss each risk found in Table 2
 - As a risk is identified or dismissed, use the Spreadsheet to document the decision
 - Add each identified risk to a transitional document
 - For each risk, use Table 3 to select both required and chosen responses
 - Add each response to the transitional document
 - After the meeting, have a small team transfer all information to the Spreadsheet for documentation
 - Consider assigning one person to each of the 6 components
 - Have the team and the person with ultimate responsibility review the Spreadsheet
 - Upon approval, have the small team transfer the risks and responses to the SOQM document
 - The person with ultimate responsibility should then review the **document**
 - Have a closing meeting to discuss the document with all staff



Governance and Leadership

- This section addresses the firm's governance and leadership
- It establishes the environment that will support the SQM
- REQUIRED quality objectives
 - The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following:
 - The firm's role in serving the public interest by consistently performing quality engagements
 - The importance of professional ethics, values, and attitudes
 - The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following: (cont.)

- The responsibility of all personnel for quality relating to the performance of engagements or activities within the SQM and their expected behavior
- The importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities
- Leadership is responsible and accountable for quality
- Leadership demonstrates a commitment to quality through its actions and behaviors
- The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm's SQM
- Resource needs, including financial resources, are planned for, and resources are obtained, allocated, or assigned in a manner that is consistent with the firm's commitment to quality

Ethical Requirements

- This is a principles-based approach
- The purpose is to provide reasonable assurance of compliance with relevant ethical requirements when performing professional responsibilities
- These ethics apply to
 - The firm
 - The Personnel
 - Others within the network
- REQUIRED quality objectives
 - The firm and its personnel
 - Understand the relevant ethical requirements to which the firm and the firm's engagements are subject
 - Fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject
 - Others, including the network, network firms, individuals in the network or network firms, or service providers, who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject
 - Understand the relevant ethical requirements that apply to them, and
 - Fulfill their responsibilities in relation to the relevant ethical requirements that apply to them



Acceptance and Continuance

- Quality objectives should address the acceptance and continuance of engagements and client relations
- These judgments should be based on
 - Information about the
 - Nature and circumstances of the engagement
 - Integrity and ethical values of the client
- The system should ensure that the financial and operational priorities of the firm do not lead to inappropriate judgments
- REQUIRED quality objectives
 - Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client

(including management and, when appropriate, those charged with governance) that is sufficient to support such judgments

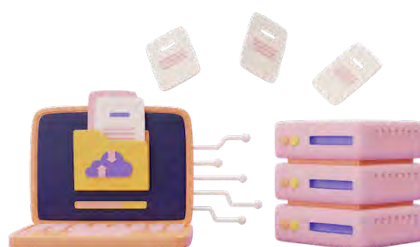
- Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements
 - The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement
-

Engagement Performance

- Provide reasonable assurance that engagements are consistently performed in accordance with standards and requirements
 - REQUIRED quality objectives
 - Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement
 - The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members
 - Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, maintain professional skepticism
 - Consultation on difficult or contentious matters is undertaken and the conclusions agreed upon are implemented
 - Differences of opinion within the engagement team, or between the engagement team and the EQ reviewer or individuals performing activities within the firm's SQM, are brought to the attention of the firm and resolved
 - Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or professional standards
-

Resources

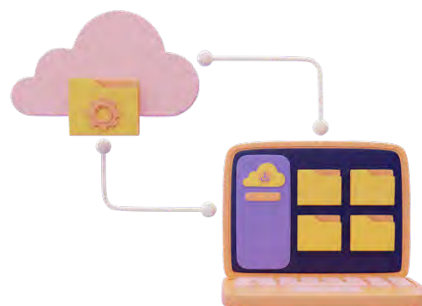
- Resources has been expanded to include:
 - Technology
 - Intellectual resources
 - Tools
 - Templates
 - Methodologies
 - Human resources
- Requirements
 - Consideration of appropriateness of resources
 - Obtaining resources
 - Developing
 - Implementing



- Maintaining
- Use
- Accountability of personnel and commitment to quality
- Considerations for external service providers
 - Component auditors from outside the firm's network
 - Determination of service provider's resources
- REQUIRED quality objectives
 - Personnel are hired, developed, and retained and have the competence and capabilities to
 - Consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or
 - Perform activities or carry out responsibilities in relation to the operation of the firm's systems of quality management
 - Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives
 - Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of the firm's SQM or performance of engagements
 - Engagement team members are assigned to each engagement, including an engagement partner, who have appropriate competence and capabilities, including being given sufficient time to consistently perform quality engagements
 - Individuals who have appropriate competence and capabilities, including sufficient time, are assigned to perform activities within the SQM
 - Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's SQM and the performance of engagements
 - Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's SQM and the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable
 - Human, technological, or intellectual resources from service providers are appropriate for use in the firm's SQM and in the performance of engagements, taking into account preceding quality objectives RES QO-4 through RES QO-7

Information and Communication

- This is a new component
 - There was a lack of guidance
- This is meant to be a continuous flow
- Information must be relevant and reliable
 - Establish a system
 - Information exchange is part of firm culture
- Internal information
 - Two-way communication is required
- REQUIRED quality objectives



- The information system identifies, captures, processes, and maintains relevant and reliable information that supports the SQM, whether from internal or external sources
- The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another
- Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following:
 - Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the SQM or engagements
 - Personnel and engagement teams communicate information to the firm when performing activities within the SQM or engagements
- Relevant and reliable information is communicated to external parties, including the following:
 - Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them
 - Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the SQM

Monitoring and Remediation

- Monitor
 - Monitor the system as a whole
 - This is a shift from engagement level monitoring
 - Activities should be tailored to meet the needs of the firm
 - Nature, timing and extent of the monitoring is tailored to the firm
 - The design of the system
 - Nature of the firm and its engagements
 - Extent of system changes
 - Prior inspection results
 - Requires the inspection of completed engagements
 - Selection is based on risk and other monitoring activities
 - Requires engagement partners to be inspected on a cyclical basis
 - Risk-based inspection of completed engagements
 - Discouragement of self-inspection
- Evaluate findings and identify deficiencies
 - The standard has a framework
 - The root causes must be investigated
- Design and implement responses
 - Remediate deficiencies responsive to the root cause
 - Leadership must evaluate the remedial actions
 - The deficiencies and root causes must be considered in the risk assessment



SSARS UPDATE & REVIEW

SSARS AR-C Section 60

General Principles for Engagements Performed in Accordance with SSARS

Introduction

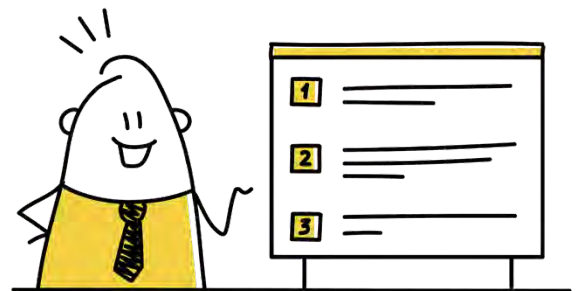
- Establishes general principles for engagements performed under SSARSs issued by the AICPA's Accounting and Review Services Committee (ARSC)
 - Clarifies professional requirements and terminology used in SSARSs
 - Does not override legal or regulatory responsibilities but provides guidance for compliance
- Purpose
 - To help accountants understand their responsibilities and ensure consistent application of SSARSs.

Scope

- Applies to engagements performed under SSARSs, including preparation, compilation, and review engagements
- Sets foundational principles that underpin specific performance and reporting requirements in other AR-C sections
- Objective
 - The objective of the accountant is to obtain an understanding of the general principles for engagements performed in accordance with SSARSs
- Key Considerations
 - SSARSs focus on financial statements of the entity, not management's responsibilities
 - Accountants must ensure compliance with relevant legal, regulatory, or professional obligations outside SSARSs
- Relevance
 - Provides a framework for understanding professional responsibilities
 - Does not address responsibilities imposed by external legislation or regulations

Standards

- Basic standard comes from SSARS 21
- Amendments
 - SSARS No. 23
 - October 2016
 - Clarified scope and responsibilities
 - SSARS No. 24
 - Effective June 15, 2019
 - Updated definitions and requirements
 - SSARS No. 25
 - Effective December 15, 2021
 - Enhanced ethical and quality management provisions
 - SSARS No. 26
 - Effective December 15, 2025
 - Strengthened engagement quality and ethical compliance



Definitions

- Applicable Financial Reporting Framework
 - Framework adopted by management for financial statement preparation
- Designated Accounting Standard Setter
 - AICPA-designated body for promulgating U.S. GAAP under AICPA Code of Professional Conduct
- Engagement Partner
 - Individual responsible for the engagement, its performance, and the issued report
- Engagement Quality Review
 - Objective evaluation of significant judgments and conclusions before report release
- Engagement Team
 - All personnel performing the engagement, including external individuals engaged by the firm
- Fair Presentation Framework
 - Framework requiring compliance and allowing additional disclosures or rare departures for fair presentation
- Financial Reporting Framework
 - Criteria for measurement, recognition, presentation, and disclosure in financial statements
- Financial Statements
 - Structured representation of historical financial information per the applicable framework
- Firm
 - Organization engaged in public accounting, as permitted by AICPA resolutions
- General Purpose Framework
 - Framework meeting common financial information needs of a wide range of users
- Special Purpose Framework
 - Non-GAAP frameworks
 - Cash basis
 - Tax basis
 - Regulatory basis
 - Contractual basis
 - Other comprehensive bases
- Professional Judgment
 - Application of training, knowledge, and experience within SSARSs and ethical standards
- Relevant Ethical Requirements
 - AICPA Code of Professional Conduct and applicable state or regulatory ethical rules

Requirements

Ethical Requirements

- Compliance
 - Accountants must adhere to relevant ethical requirements, including AICPA Code of Professional Conduct and state regulations
 - Responsibilities
 - Public Interest



- Integrity
- Objectivity and Independence
- Due Care
- Scope and nature of services

- Independence
 - Critical for review engagements; accountants must evaluate and address threats to independence

Professional Judgment

- Requirement
 - Accountants must exercise professional judgment in all SSARS engagements
- Application
 - Involves applying training, knowledge, and experience to make informed decisions
 - Ensures appropriate actions based on engagement circumstances

Conduct of the Engagement

- Compliance with SSARSs
 - Engagements (preparation, compilation, review) must follow SSARSs, except for certain interim financial information reviews
- AR-C Section Compliance
 - Accountants must comply with all relevant AR-C sections in effect and applicable to the engagement
 - Requires understanding the full text of AR-C sections, including explanatory material
- Representation
 - Accountants should not claim SSARS compliance unless all relevant requirements are met

Complying with Relevant Requirements

- Unconditional Requirements
 - Indicated by “must”
 - Mandatory in all relevant cases
- Presumptively Mandatory Requirements
 - Indicated by “should”
 - Mandatory except in rare circumstances where alternative procedures achieve the requirement’s intent
- Departure from Requirements
 - In rare cases, accountants may depart from presumptively mandatory requirements but must document justification and alternative procedures

Interpretive and Other Publications

- Interpretive Publications
 - Include AICPA guides, interpretations, and statements
 - Accountants should consider these in engagements
- Other Publications
 - Non-authoritative guidance
 - Accountants must assess relevance and appropriateness using professional judgment

Engagement Level Quality Management

- Engagement Partner Responsibilities
 - Ensure team competence and sufficient time for engagement
 - Oversee quality management, including direction, supervision, and review of work
 - Ensure the accountant’s report is appropriate
 - Adhere to firm policies on client acceptance, resource allocation, and documentation

- Quality Management Actions
 - Create an environment emphasizing firm culture and ethical behavior
 - Assign appropriate resources and maintain engagement documentation
- Relevant Considerations After Engagement Acceptance
 - Post-Acceptance Issues
 - If information arises that would have led to declining the engagement, the partner must promptly inform the firm for necessary action
- Compliance with Ethical Requirements
 - Engagement Partner's Role
 - Understand and communicate ethical requirements, including independence, to the team
 - Identify, evaluate, and address threats to ethical compliance
 - Remain alert for breaches and take appropriate action if breaches occur
 - Pre-Report Review
 - Before dating the report, confirm that ethical requirements, including independence (for reviews), are fulfilled
- Monitoring and Remediation
 - Engagement Partner Responsibilities
 - Understand firm's monitoring and remediation processes, including network-level processes
 - Assess relevance of monitoring information and take appropriate action
 - Communicate engagement-related information to those responsible for monitoring

Acceptance and Continuance of Client Relationships

- Conditions for Non-Acceptance
 - Inability to satisfy ethical requirements, including independence
 - Unavailable or unreliable information needed for the engagement
 - Doubts about management's integrity affecting engagement performance
- Preconditions for Acceptance
 - Ensure the financial reporting framework is acceptable
 - Obtain management's agreement on its responsibilities, including
 - Selecting the financial reporting framework
 - Maintaining internal controls
 - Preventing and detecting fraud
 - Ensuring compliance with laws and regulations
 - Providing accurate and complete information
 - Granting access to relevant records, additional information, and personnel

Documentation

- Engagement Letter
 - Clearly state
 - Engagement objectives and scope
 - Client and accountant responsibilities
 - Limitations of services
 - No assurance for preparation and compilation
- Workpapers
 - Document evidence supporting conclusions and decisions
 - Ensure sufficient detail to enable a knowledgeable reviewer to understand
 - Work performed

- Results obtained
- Significant professional judgments
- Retention Policies
 - Maintain engagement documentation for the required period
 - Generally five years or as applicable by regulation
 - Implement procedures to ensure proper storage and accessibility

Communicating with Clients

- Clear and Transparent Communication
 - Explain the purpose and scope of the engagement
 - Use plain language to clarify non-assurance nature where applicable
- Establishing Client Understanding
 - Engagement letters as the primary tool for setting expectations
 - Avoid technical jargon that may confuse clients
 - Highlight key differences between preparation, compilation, and review engagements

Challenges and Common Pitfalls

- Independence Issues
 - Recognize independence is not required for preparation engagements (AR-C 70)
 - Independence must be addressed and disclosed for compilation and review engagements
- Miscommunication with Clients
 - Example
 - Clients expecting an audit-level opinion in a review engagement
 - Prevent issues by consistently reiterating the engagement's scope and limitations
- Documentation Deficiencies
 - Risks include regulatory scrutiny or inability to defend professional decisions
 - Ensure documentation reflects all material judgments and procedures



AR-C Section 70

Preparation of Financial Statements

Introduction

- Applies to accountants in public practice engaged to prepare financial statements or prospective financial information
- May be adapted for other historical financial information
- Nonattest service
 - No independence determination required
- Exclusions
 - Engagements involving audits, reviews, or compilations
 - Statements for taxing authorities, personal financial plans, litigation services, or business valuations
- Scope
 - Preparation of financial statements or prospective financial information
 - Requires professional judgment to distinguish from bookkeeping services
- Limitations
 - No verification of accuracy or completeness of management-provided information
 - No opinion or conclusion expressed on financial statements
- Definitions
 - Management
 - Person(s) with executive responsibility for entity operations
 - May include those charged with governance
 - Those Charged with Governance
 - Person(s) or organization(s) overseeing strategic direction and financial reporting

General Principles

- Compliance
 - Must comply with AR-C Section 60 (General Principles for Engagements)
 - Adherence to professional standards and ethical requirements
- Key Requirement
 - Accountants must evaluate preconditions for accepting engagements

Acceptance and Continuance of Client Relationships

- Preconditions
 - Evaluate matters in AR-C Section 60
 - Management's integrity
 - Reporting framework suitability
 - Discuss unsatisfactory matters with management or governance
 - Do not accept engagement if preconditions are not met

Agreement on Engagement Terms

- Requirements
 - Document terms in an engagement letter or written agreement
 - Include
 - Objective of the engagement
 - Management's responsibilities
 - Statement on each page of financial statements indicating "no assurance is provided" or a disclaimer

- Accountant’s responsibilities and engagement limitations
- Identification of financial reporting framework
- Disclosure of known departures or omission of disclosures
- Signed by accountant/firm and management/governance

Accountant’s Knowledge of Financial Reporting Framework

- Requirement
 - Obtain understanding of the financial reporting framework and significant accounting policies
- Purpose
 - Ensure accurate preparation of financial statements

Preparing Financial Statements

- Process
 - Use records, documents, and information provided by management
 - Include “no assurance” statement on each page or issue a disclaimer
- Options if “No Assurance” Statement Cannot Be Included
 - Issue a disclaimer
 - Perform a compilation engagement
 - Withdraw from the engagement and inform management
- Special Purpose Framework
 - Include description of framework on financial statements or in notes

Handling Significant Judgments and Misstatements

- Significant Judgments
 - Discuss with management to ensure they understand and accept responsibility
- Incomplete or Inaccurate Information
 - Request additional or corrected information from management
 - Disclose material misstatements or withdraw if unresolved
- Known Departures
 - Disclose material misstatements in financial statements after discussions with management

Prospective Financial Information

- Requirements
 - Do not exclude summary of significant assumptions
 - For financial projections, include
 - Identification of hypothetical assumptions
 - Description of limitations on usefulness



Omitting Disclosures

- Omission of Disclosures
 - Disclose omission in financial statements or an accompanying disclaimer
- Prohibition
 - Do not prepare financial statements omitting substantially all disclosures if misleading to users

Documentation Requirements

- Purpose
 - Provide clear understanding of work performed
- Minimum Documentation
 - Engagement letter or written agreement
 - Copy of prepared financial statements
- Departure from Requirements

- Document justification and alternative procedures if departing from presumptively mandatory requirements

Preparation Peer Review Issues

- Lack of Engagement Letters
 - Missing or incomplete engagement letters
 - Failure to include required elements, such as:
 - Management responsibilities
 - Statement of no assurance provided
 - Intended use of financial statements
- Tips
 - Implement standard engagement letter templates
 - Train staff on the required elements of engagement letters
 - Regularly review and update templates for compliance
- Disclosure Omissions
 - Absence of disclosures required by the applicable financial reporting framework
 - Financial statements missing clarity regarding lack of assurance
- Inconsistent Application of Accounting Framework
 - Misapplication or incorrect selection of financial reporting frameworks (e.g., GAAP, cash basis)
 - Errors in adapting frameworks to client-specific needs
- Inaccurate Financial Statements
 - Incorrect or incomplete presentation of financial data
 - Errors in classification or formatting
 - Missing required notes to financial statements
- Independence Issues
 - Misunderstanding independence requirements for preparation engagements
 - Failing to document independence considerations in cases where other services are also provided
- Tips
 - Document independence evaluation in engagement files
 - Separate preparation services from assurance or other engagements, as necessary
- Use of Incorrect Reporting Language
 - Mislabeling prepared financial statements as "compiled" or "audited"
 - Misleading terminology implying assurance when none is provided
- Tips
 - Verify all financial statements use compliant language
 - Educate staff on the importance of using correct terminology
- Documentation Deficiencies
 - Insufficient documentation supporting financial statement preparation
 - Lack of evidence showing management approval of the final financial statements
 - Missing or unclear notes on significant judgments or decisions
- Tips
 - Develop checklists to ensure comprehensive documentation
 - Require management sign-off on all prepared financial statements



Decision Tree for Preparation Engagements When Does AR-C 70 Apply?

- ARC-70 is NOT required unless the practitioner has been engaged (hired) to perform the engagement
- In August 2023, the AICPA Center for Plain English Accounting issued a report for FAQs using the new decision tree to address five typical questions related to applicability of AR-C 70

The Decision Tree for Preparation Engagements

- Q1- Is the practitioner in public practice?
 - No- AR-C 70 is NOT required
 - Yes- Continue Q2
- Q2- What is the highest level of service provided?
 - Compilation- AR-C 70 is NOT required regardless of who prepared the financial statements
 - Review or Audit- AR-C 70 is NOT required regardless of who prepared the financial statements
 - Nonattest services-Continue to Q3
- Q3- Is the practitioner clearly engaged to prepare financial statements?
 - Yes- AR-C 70 IS required
 - No- Continue Q4
- Q4- Is the practitioner engaged to perform an audit, review, or compilation on the financial statements that he or she prepared?
 - Yes- AR-C 70 is NOT required
 - No- Continue to Q5
- Q5- Are the financial statements prepared as part of another nonattest engagement? (Tax return, Written financial plan, Litigation services, Valuation services)
 - Yes- AR-C 70 is NOT required
 - No- Continue to Q6
- Q6- Did, or will, the practitioner perform bookkeeping work using the client's software and did, or will, the client independently generate financial statements from that accounting software?
 - Yes- Discuss the expectation with the client
 - Preparation-AR-C 70 IS required
 - No Preparation- AR-C 70 is NOT required
 - No- Continue to Q7
- Q7- Did, or will, the practitioner perform bookkeeping work using accounting software they own and generate financial statements from that software?
 - Yes or No- Discuss the expectation with the client
 - Preparation-AR-C 70 IS required
 - No Preparation- AR-C 70 is NOT required
- Q8- Did the practitioner voluntarily apply certain aspects of AR-C 70 to reduce the risk of user's being misled by the perceived association?
 - Yes or No- AR-C 70 is NOT required

Center for Plain English FAQs related to AR-C 70

Inquiry 1

- Scenario
 - Client engages the practitioner to perform monthly services, including the following
 - Posting transactions and journal entries to the general ledger system
 - Paying vendor invoices
 - Payroll services
 - Reconciling accounts
 - Cleaning up data in the software
 - The client also requests that the practitioner send the client monthly financial statements
 - These are generated by the client's accounting software
- Would this qualify as a preparation of financial statements engagement under AR-C 70?
- Decision tree steps
 - 1. Is the practitioner in public practice?
 - Yes
 - 2. What is the highest level of service being requested?
 - Other nonattest
 - 3. Is the practitioner clearly engaged to prepare financial statements?
 - No
 - 4. Is the practitioner engaged to perform an audit, review or compilation on the financial statements they prepared?
 - No
 - 5. Are the financial statements prepared for inclusion in another service?
 - No
 - 6. Did the practitioner perform bookkeeping work using the client accounting software and will the client independently generate financial statements from the software?
 - No
 - 7. Did the practitioner perform bookkeeping work using accounting software they own, and generate financial statements from that software?
 - No
- Conclusion
 - The practitioner will need to discuss with the client to determine expectation



Inquiry 2

- Scenario
 - The practitioner uses their own software to input client, financial information
 - The practitioner then uses the software to prepare financial statements
- Decision tree steps
 - 1. Is the practitioner in public practice?
 - Yes
 - 2. What is the highest level of service being requested?
 - Other nonattest
 - 3. Is the practitioner clearly engaged to prepare financial statements?
 - No
 - 4. Is the practitioner engaged to perform an audit, review or compilation on the financial statements they prepared?

- No
- 5. Are the financial statements prepared for inclusion in another service?
 - No
- 6. Did the practitioner perform bookkeeping work using the client accounting software and will the client independently generate financial statements from the software?
 - No
- 7. Did the practitioner perform bookkeeping work using accounting software they own, and generate financial statements from that software?
 - Yes
- Conclusion
 - The practitioner will need to discuss with the client to determine expectation

Inquiry 3

- Scenario
 - Does AR-C 70 apply to an accountant in public practice, who is performing controllership or management services for a client and prepares financial statements?
- Decision tree steps
 - 1. Is the practitioner in public practice?
 - Yes
 - 2. What is the highest level of service being requested?
 - Other nonattest
 - 3. Is the practitioner clearly engaged to prepare financial statements?
 - Yes
- Conclusion
 - AR-C 70 is required
 - This is being performed as a part of an engagement to act as CFO or controller

Inquiry 4

- Scenario
 - Can the practitioner perform a preparation engagement on the same set a financial statements that they has already performed an audit?
- Decision tree steps
 - 1. Is the practitioner in public practice?
 - Yes
 - 2. What is the highest level of service being requested?
 - Audit
- Conclusion
 - AR-C 70 is NOT required
 - Independence will still need to be considered with respect to the audit

Inquiry 5

- Scenario
 - Your financial statements are prepared as a byproduct of another engagement is the practitioner required to apply AR-C 70?
- Decision tree steps
 - 1. Is the practitioner in public practice?
 - Yes
 - 2. What is the highest level of service being requested?
 - Other nonattest

- 3. Is the practitioner clearly engaged to prepare financial statements?
 - No
- 4. Is the practitioner engaged to perform an audit, review or compilation on the financial statements they prepared?
 - No
- 5. Are the financial statements prepared for inclusion in another service?
 - Yes
- Conclusion
 - AR-C 70 is NOT required

Other Questions Related to Application of AR-C 70

- Question 1
 - Where and how should the “no assurance” be placed?
 - Answer- Anywhere by any means
- Question 2
 - Are cover letters allowed?
 - Answer- Yes
- Question 3
 - Can prepared FS be issued on firm letterhead?
 - Answer- Yes
- Question 4
 - Is a management representation letter required?
 - Answer- No
- Question 5
 - If the accountant disclose the lack of disclosures in a selected note, does a reference to the note need to be on the face of the financial statements?
 - Answer- No
- Question 6
 - Can engagement letter signatures be other than manual?
 - Answer- Yes
- Question 7
 - For comparative prepared financial statements, does a compilation report on the prior year need to be re-issued?
 - Answer- No
- Question 8
 - If an accountant is unable to include a no assurance statement and issues a disclaimer, do they have to refer to the disclaimer in the financial statements?
 - Answer- No
- Question 9
 - If the practitioner is aware of a departure from the framework, does that need to be disclosed and where?
 - Answer- Yes on the face or in a selected note
- Question 10
 - If all disclosures are omitted, where does the accountant disclose that fact?
 - Answer- On the face or in a selected note



AR-C 80

Compilation Engagements

Introduction

- SSARS provides guidance for CPAs performing compilation for nonpublic entities
- AR-C 80 focuses exclusively on compilation engagements, which involve assisting management in preparing and presenting financial statements without performing assurance procedures
- Definition and Scope
 - AR-C 80 applies when an accountant is engaged to prepare financial statements and issue a report without providing assurance
 - Includes situations involving financial statements prepared in accordance with a framework such as GAAP, cash basis, or special-purpose frameworks
- Objective
 - Apply accounting and financial reporting expertise to assist management in presenting financial statements
 - Report in accordance with AR-C Section 80 without providing assurance
- Key Focus
 - No material modifications needed for conformity with applicable financial reporting framework
 - Management's responsibility for preparation and fair presentation

General Principles and Independence

- General Principles
 - Comply with AR-C Section 60 and Section 80
 - Professional judgment and ethical standards apply
- Independence
 - Accountant must determine independence from the entity
 - If not independent, disclose in the compilation report



Requirements

- Acceptance and Continuance of Engagements
 - The accountant must assess
 - Management's integrity and ability to provide accurate information
 - Whether the engagement is consistent with the firm's expertise and ethical requirements
 - Documentation of the client relationship and engagement understanding is mandatory
- Engagement Letter
 - The letter must explicitly state
 - The compilation engagement's nature and limitations
 - Management's responsibility for the accuracy of financial statements and the provision of necessary information
 - The accountant's responsibilities, including preparation of the report
- Knowledge of the Entity
 - AR-C 80 requires understanding the client's
 - Industry environment, key business operations, and financial reporting framework
 - This understanding ensures that the financial statements are not misleading

Execution of a Compilation Engagement

- Read financial statements to ensure they are appropriate in form and free from obvious material misstatements
 - Request additional/corrected information if records or judgments are incomplete or inaccurate
 - Propose revisions if financial statements are misleading or non-compliant
- No Assurance Provided
 - AR-C 80 requires a disclaimer of assurance to be included in the compilation report
 - This is to avoid confusion with review or audit engagements, which involve assurance
- Documentation Requirements
 - Include a record of the work performed, including
 - The engagement letter
 - Copies of the financial statements prepared
 - Communications with management and significant judgments applied

Reporting Requirements

- Compilation Report
 - A written report is required for all compilation engagements
 - The report must include
 - A title identifying it as a compilation report
 - Identification of financial statements and entity and period covered
 - Compliance with SSARS
 - A statement of management's responsibility for the financial statements
 - A description of the compilation engagement and limitations
 - A clear disclaimer of assurance
- Disclosures in the Report
 - Departures from the applicable financial reporting framework must be disclosed
 - When financial statements are prepared using a special purpose framework the report must indicate this
 - Disclose lack of independence in a final report paragraph
 - If disclosing reasons, include all reasons for impaired independence
 - For financial statements omitting disclosures
 - Include a paragraph stating management's election to omit disclosures Note potential impact on users' conclusions
 - Clarify statements are not designed for uninformed users
 - Withdraw if omissions make statements misleading
 - Indicate responsibility for supplementary information in a separate paragraph or report
 - If compiled
 - State it's for additional analysis, management's responsibility, and no assurance provided
 - If not compiled
 - Clarify it's not part of the engagement and no assurance provided

Practical Considerations

- Ethical Considerations
 - Independence is not required in a compilation engagement, but any lack of independence must be disclosed in the report
 - Objectivity and integrity are critical even if assurance is not provided
- Challenges in Implementation
 - Incomplete data from management can delay or complicate the engagement

- Misunderstandings about the accountant's role can arise when management assumes assurance is provided
- Best Practices
 - Regular client communication to ensure clarity on roles and responsibilities
 - Detailed documentation to demonstrate compliance with AR-C 80 and safeguard against misunderstandings

Compilation Peer Review Issues

- Engagement Letter Deficiencies
 - Absence of a signed engagement letter outlining the scope and terms of the engagement
 - Lack of clarity on the specific responsibilities of both the CPA and the client
 - Missing or vague statements regarding the CPA's role in preparing the financial statements
- Tip
 - Copy one of the sample letters
- Noncompliance with Compilation Reporting Requirements
 - Failure to include the appropriate compilation report
 - Inaccurate or incomplete reporting of significant assumptions or disclaimers
- Tip
 - Use one of the sample reports
- Improper Use of Accounting Principles
 - Incorrect or inconsistent application of accounting principles
 - Failure to disclose accounting policies or changes in accounting policies, if applicable
 - Use of non-compliant financial statement formats or disclosures, such as missing or incorrect footnotes
- Lack of Client Understanding of Financial Statements
 - No evidence of communication between the CPA and the client regarding the financial statement presentation
 - Failure to ensure that clients understand the limitations of the compilation engagement and the potential impact of their financial data being represented
- No Consideration of Going Concern
 - Inability to assess and evaluate the client's ability to continue as a going concern when relevant
 - Failure to disclose significant doubt about the client's going concern status, when applicable
 - Lack of sufficient procedures to assess financial statement presentation in light of going concern risks
- Lack of Work Papers or Incomplete Documentation
 - Missing work papers that should support the decisions made during the compilation process
 - Work papers not adequately documenting professional judgment and procedures performed



AR-C 90

Review of Financial Statements

Introduction

- Review standards are found in SSARS section AR-C 90
- Purpose
 - Provide limited assurance on financial statements through a review engagement
- Scope
 - Applies to reviews of historical financial statements or other historical financial information
 - Including specified elements, accounts, or items
- Definitions
 - Review Engagement
 - An engagement to obtain limited assurance that there are no material modifications needed to the financial statements for conformity with the applicable financial reporting framework
 - Limited Assurance
 - A level of assurance less than an audit but more than a compilation, based primarily on inquiries and analytical procedures

Objectives of a Review Engagement

- Primary Objective
 - Obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications needed to the financial statements
- Scope of Work
 - Perform procedures (primarily inquiry and analytical procedures) to support the limited assurance conclusion
 - Evaluate whether financial statements are free of material misstatement based on the accountant's understanding of the entity and its environment
- Application Guidance
 - Limited assurance is less than reasonable assurance but sufficient to provide a meaningful conclusion for users
 - The accountant is not required to perform procedures as extensive as an audit
 - No testing of internal controls
 - No substantive testing

Professional Requirements and Responsibilities

- Compliance with SSARS
 - Accountants must comply with AR-C Section 60 (General Principles) and AR-C 90 for review engagements
 - Adherence to the AICPA Code of Professional Conduct, including ethical principles
 - Integrity
 - Objectivity
 - Due care
- Independence
 - Accountants must be independent when performing a review engagement, as required by the AICPA Code of Professional Conduct

- Application guidance (.A7–.A8): Independence is not required for preparation or compilation engagements under AR-C 70 or 80 but is mandatory for reviews
- Professional Skepticism and Judgment
 - Exercise professional skepticism to identify conditions that may indicate material misstatements
 - Apply professional judgment in designing and performing review procedures
- Engagement-Level Quality Control
 - Ensure engagement complies with quality control standards
 - Assign personnel with appropriate competence and capabilities
 - Quality control includes acceptance and continuance of client relationships and supervision of engagement team members

Acceptance and Continuance of Client Relationships

- Preconditions for Acceptance
 - Determine whether the financial reporting framework is acceptable
 - Ensure management acknowledges its responsibility for
 - Preparing and fairly presenting financial statements
 - Designing, implementing, and maintaining internal controls
 - Providing access to all relevant information and personnel
- Engagement Letter
 - Document the agreed-upon terms in a written engagement letter signed by both the accountant and management/those charged with governance
 - Include objectives, scope, responsibilities of management, and limitations of the engagement



Performing the Review Engagement

Understanding the Entity and Its Environment

- Purpose and Requirement
 - Obtain a sufficient understanding of the entity's to design effective review procedures
 - Industry
 - Business operations
 - Accounting practices
 - Focus on areas susceptible to material misstatement, such as revenue recognition, inventory valuation, or significant estimates
 - Update knowledge from prior engagements to reflect changes in the entity's operations or environment
- Key Areas of Understanding
 - Industry-specific factors
 - Nature of the entity's operations, including its organizational structure, key personnel, and revenue streams
 - Accounting policies and procedures, including any changes in the applicable financial reporting framework
 - Internal controls relevant to financial reporting, though not tested as in an audit
- Practical Considerations
 - For a new client, conduct discussions with management and review industry publications or prior financial statements

- For recurring engagements, confirm that prior knowledge remains relevant through inquiries about changes in operations, personnel, or accounting policies
- Example
 - For a retail business, understand seasonal sales patterns or inventory management practices to tailor analytical procedures
- Application Guidance
 - The depth of understanding varies based on the entity's complexity
 - Use professional judgment to determine the extent of knowledge needed, focusing on areas with higher risk of misstatement
 - Documentation of this understanding supports the design of review procedures

Analytical Procedures

- Purpose and Requirement
 - Perform analytical procedures to identify relationships or trends that may indicate material misstatements in the financial statements
 - Develop expectations of financial statement amounts or ratios based on the accountant's understanding of the entity and compare them to recorded amounts
 - Investigate significant differences or unexpected relationships through additional inquiries or procedures
- Types of Analytical Procedures
 - Ratio Analysis
 - Evaluate financial ratios for consistency with expectations
 - Trend Analysis
 - Compare current-period amounts to prior periods or budgets to identify unusual fluctuations
 - Reasonableness Tests
 - Assess whether account balances align with operational or industry data
 - Comparative Analysis
 - Compare financial statement amounts to industry benchmarks or peer data, if available
- Designing Analytical Procedures
 - Tailor procedures to the entity's specific circumstances, considering factors like size, industry, and complexity
 - Develop expectations before performing procedures to avoid bias from recorded amounts
 - Example
 - For a construction company, compare current-year project revenue to contract milestones and prior-year performance
- Investigating Significant Differences
 - If analytical procedures reveal unexpected results, inquire with management to understand the cause
 - Perform additional procedures if management's explanations are inadequate or inconsistent
- Practical Considerations
 - Use software tools to calculate ratios or visualize trends, ensuring efficiency and accuracy
 - Document expectations, actual results, and explanations for significant differences to support the review conclusion
 - Example

- A sudden increase in accounts receivable turnover may prompt inquiries about changes in credit policies or customer payment behaviors
- Application Guidance
 - Analytical procedures should be customized, not generic
 - Expectations may be based on prior financial statements, budgets, forecasts, or industry data, adjusted for known changes
 - Significant fluctuations may indicate errors, fraud, or changes in business conditions, requiring professional skepticism

Inquiries

- Purpose and Requirement
 - Make inquiries of management and others within the entity with relevant knowledge to obtain information about the financial statements and potential misstatements
 - Inquiries focus on understanding the preparation process, significant transactions, and any unusual or complex matters
- Required Inquiries
 - How the financial statements were prepared and whether they conform to the applicable financial reporting framework
 - Unusual or complex transactions, including related-party transactions or significant estimates
 - Changes in accounting policies or procedures since the prior period
 - Events or conditions affecting the entity's ability to continue as a going concern
 - Subsequent events that may require adjustment or disclosure
 - Suspected fraud or noncompliance with laws and regulations affecting the financial statements
- Who to Inquire
 - Primarily management or those charged with governance
 - Owners
 - CFO
 - Board members
 - Other personnel with relevant knowledge, such as accounting staff, internal auditors, or operational managers
 - Example
 - Inquire with the controller about the methodology for calculating inventory reserves or with the CEO about new financing arrangements
- Evaluating Responses
 - Assess the reasonableness and consistency of responses with other evidence obtained
 - If responses are inconsistent or incomplete, perform additional inquiries or procedures to resolve discrepancies
- Practical Considerations
 - Prepare a structured inquiry checklist to ensure all required topics are covered
 - Document inquiries and responses in detail, including the date, individuals involved, and any follow-up actions
 - Example
 - If management reports a significant increase in sales due to a new customer, inquire about the customer's creditworthiness and review related sales contracts
- Application Guidance
 - Inquiries should be directed to individuals with sufficient authority and knowledge to provide reliable information



- The accountant may need to corroborate responses with other evidence
- Professional skepticism is critical, especially when responses appear inconsistent with the accountant's understanding

Reading the Financial Statements

- Purpose and Requirement
 - Read the financial statements and accompanying notes to identify items that appear unusual, inconsistent, or noncompliant with the applicable financial reporting framework
 - Ensure the financial statements align with the accountant's understanding of the entity and evidence obtained from analytical procedures and inquiries
- Key Considerations
 - Check for completeness and clarity of disclosures, including accounting policies, contingencies, and related-party transactions
 - Identify inconsistencies between the financial statements and other information
 - Example
 - Verify that a significant lease disclosed in the notes is consistent with inquiry responses about new financing arrangements
- Practical Considerations
 - Use a financial statement review checklist to ensure all required disclosures are present
 - Compare financial statement presentation to prior periods to identify changes in format or omitted disclosures
 - Example
 - If the balance sheet shows a new long-term debt, ensure the notes disclose the terms and covenants
- Application Guidance
 - Reading is a critical step to confirm that the financial statements are consistent with the accountant's knowledge and free of obvious errors
 - The accountant is not required to perform detailed testing but should note any glaring inconsistencies for further inquiry

Evaluating Evidence Obtained

- Purpose and Requirement
 - Evaluate whether the evidence obtained from analytical procedures, inquiries, and reading suggests material misstatements in the financial statements
 - Consider whether the financial statements are fairly presented in accordance with the applicable framework
- Process
 - Compare evidence to the accountant's expectations and understanding of the entity
 - Investigate significant fluctuations, inconsistencies, or unusual matters through additional inquiries or procedures
 - Example
 - If analytical procedures show a decline in profitability, but inquiries reveal no operational changes, request supporting documentation
- Professional Judgment
 - Use professional judgment to determine whether additional procedures are necessary to achieve limited assurance
 - Assess whether unresolved issues warrant a modification to the review report or withdrawal from the engagement
- Practical Considerations
 - Maintain a summary of significant findings to track issues and their resolution

- If evidence suggests a material misstatement, communicate promptly with management to request corrections
- Example
 - A significant variance in inventory turnover may lead to inquiries about obsolete inventory, followed by a review of inventory aging reports
- Application Guidance
 - The accountant is not required to obtain audit-level evidence but must have a reasonable basis for the limited assurance conclusion
 - Additional procedures may include reviewing supporting documents or consulting with external sources if permitted by the engagement's scope

Going Concern Considerations

- Purpose and Requirement
 - Inquire about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern for a reasonable period
 - Evaluate management's assessment of going concern and whether it is appropriately reflected in the financial statements
- Key Procedures
 - Ask management about
 - Financial difficulties
 - Negative trends
 - External factors
 - Management's plans to address going concern issues
 - Assess whether financial statement disclosures about going concern are adequate
- Reporting Implications
 - If going concern uncertainties exist, consider including an emphasis-of-matter paragraph in the review report
 - If management's assessment is unreasonable or disclosures are inadequate, modify the report or withdraw
- Practical Considerations
 - Use a going concern checklist to identify indicators
 - Example
 - For a company with recurring losses, inquire about cash flow projections and financing plans, and review related disclosures
 - Document management's responses and the accountant's evaluation to support the review conclusion



Subsequent Events and Subsequently Discovered Facts

- Purpose and Requirement
 - Inquire about events occurring after the financial statement date (up to the review report date) that may require adjustment or disclosure
 - Address facts discovered after the report date that, had they been known, would have affected the financial statements or report

Written Representations

- Purpose and Requirement
 - Obtain a written representation letter from management, dated as of the review report date, to confirm their responsibilities and the accuracy of information provided
 - The letter supports the accountant's limited assurance conclusion and reduces the risk of misunderstandings
- Some Required Representations

- Management’s responsibility for
 - Preparing and fairly presenting the financial statements in accordance with the applicable framework
 - Designing, implementing, and maintaining internal controls relevant to financial reporting
- Completeness and accuracy of information provided to the accountant
- Disclosure of all material matters, including
 - Known instances of fraud or noncompliance with laws and regulations
 - Significant estimates and assumptions
 - Going concern uncertainties or subsequent events
- Any other matters specific to the engagement
- Procedures for Obtaining Representations
 - Request the letter from management or those charged with governance with appropriate authority
 - If management refuses to provide the letter, consider withdrawing from the engagement, as this constitutes a scope limitation

Procedures to Address Specific Circumstances

- Related Parties
 - Remain alert for arrangements or information indicating undisclosed related party relationships or transactions during the review
 - Related parties include affiliates, owners, or entities under common control, which may impact financial statement disclosures
 - If significant transactions outside the entity’s normal course of business are identified, inquire about
 - The nature of the transactions
 - Whether related parties could be involved
 - Example
 - A large, non-recurring sale to an unfamiliar customer may prompt inquiries to confirm if the customer is a related party
 - Review transactions with unusual terms for related party indicators
 - Document inquiries and findings, including management’s explanations and any corroborating evidence
- Fraud and Noncompliance with Laws or Regulations
 - Communicate identified or suspected fraud to senior management or those charged with governance as soon as practical
 - Communicate suspected noncompliance with laws and regulations to management, unless the matters are clearly inconsequential
 - Request management’s assessment of the effects on the financial statements
 - Evaluate the impact of management’s assessment on the accountant’s conclusion and review report
 - Determine if there is a responsibility to report fraud or noncompliance to external parties, based on legal or professional obligations
 - If fraud or noncompliance involves senior management or results in material misstatements, communicate directly to those charged with governance
 - If management or those charged with governance fail to provide sufficient information to confirm that the financial statements are not materially misstated or that the entity complies with relevant laws, consider
 - Obtaining legal advice to assess the accountant’s responsibilities

- Withdrawing from the engagement if the lack of information undermines the review
- Using the Work of Others
 - When using work performed by other accountants or experts, ensure the work is adequate for the review's purposes
 - Evaluate the competence, objectivity, and relevance of the work performed by others
 - Obtain and read reports from other accountants who reviewed or audited significant components
 - The accountant remains responsible for the review conclusion, even when using others' work
- Reconciling Financial Statements to Accounting Records
 - Obtain evidence that the financial statements agree or reconcile with the underlying accounting records (general ledger, trial balance)
 - Compare financial statement amounts to the entity's accounting records
 - Investigate and resolve any discrepancies
 - Example
 - Reconcile the balance sheet cash account to the general ledger and bank statements to confirm accuracy
- Additional Procedures for Potential Material Misstatements
 - If the accountant believes the financial statements may be materially misstated, design and perform additional procedures to conclude whether
 - The financial statements are not likely materially misstated
 - The financial statements are materially misstated, requiring report modification or withdrawal
 - Procedures
 - Expand inquiries or analytical procedures to investigate the matter
 - Request additional documentation or corroborative evidence from management
 - Example
 - If inventory balances appear overstated, inquire about valuation methods and review inventory count records

Documentation Requirements

- Documentation serves as evidence of the accountant's compliance with requirement
- Provides a record of the nature, timing, and extent of procedures performed to support the limited assurance conclusion
- Enables an experienced accountant, with no prior connection to the engagement, to understand
 - The procedures performed and evidence obtained
 - Significant findings or issues and how they were resolved
 - The basis for the accountant's conclusion in the review report
- Facilitates engagement quality control, peer reviews, and regulatory inspections
- Required Elements
 - Engagement letter or written agreement, signed by both the accountant and management/those charged with governance
 - A description of the analytical procedures performed, including
 - The expectations developed and the basis for those expectations
 - Comparisons of recorded amounts to expectations and any significant differences identified

- Additional procedures performed to investigate significant fluctuations or inconsistencies
- A summary of inquiries made, including:
 - Individuals questioned
 - Responses received and their relevance to the financial statements
- Significant findings or issues, such as
 - Indications of material misstatements or fraud
 - Matters related to going concern or subsequent events
 - Resolution of inconsistencies or unusual matters
- The management representation letter, dated as of the review report date
- The accountant's review report, including any modifications or emphasis-of-matter paragraphs
- Additional Documentation Considerations
 - Document the accountant's understanding of the entity and its environment
 - Record any communications with management or those charged with governance regarding significant matters
 - If the accountant expands procedures beyond standard inquiries and analytical procedures, document the nature, timing, and results of those procedures
 - Document any scope limitations, including reasons and the accountant's response

Reporting on the Review Engagement

- Review Report Requirements
 - Issue a written review report unless the accountant withdraws from the engagement
 - Include
 - Title
 - Addressee
 - Identification of the financial statements reviewed
 - Statement of limited assurance and no material modifications needed (or modifications required)
 - Accountant's signature and date
 - Sample reports are provided in AR-C 90
- Modifications to the Report
 - Modify the report for
 - Departures from the applicable financial reporting framework
 - Inadequate disclosures
 - Scope limitations
 - Use emphasis-of-matter or other-matter paragraphs for significant issues
- Reporting on Supplementary Information
 - Address supplementary information in the review report if included with the financial statements
 - State whether supplementary information was reviewed or not and the level of assurance provided
- Special Purpose Frameworks
 - When financial statements are prepared under a special purpose framework, the report must identify the framework and describe its differences from GAAP

Additional Reporting Considerations

- Emphasis-of-Matter and Other-Matter Paragraphs
 - Use for matters requiring emphasis
 - Going concern



- Significant transactions
- Other matters (e.g., scope clarification)
- These paragraphs do not modify the limited assurance conclusion
- Known Departures from the Framework
 - If material misstatements are identified, request management to correct them
 - If uncorrected, modify the report to describe the departure and its effects, if known
- Fraud or Noncompliance with Laws and Regulations
 - Communicate suspected fraud or noncompliance to management or those charged with governance
 - Consider the impact on the review report

Review Peer Review Issues

- Inappropriate Engagement Acceptance
 - Firms failing to properly assess whether they are capable of performing the review engagement
 - Acceptance of engagements without proper evaluation of client risks or conflicts of interest
 - Missing or inadequate disclosures of the limitations of a review engagement
 - Ambiguities in the engagement letter about the scope of the review, responsibilities of the parties, and the level of assurance provided
- Insufficient Understanding of Entity and Industry
 - Inadequate understanding of the client's business, industry, or environment
 - Failure to document inquiries about key aspects of the entity's operations
 - Insufficient industry-specific knowledge leading to inaccurate or misleading reviews
- Incomplete Procedures
 - Failure to adhere to AICPA and GAAP standards during the review
 - Incorrect application of SSARS requirements due to lack of familiarity with the latest updates or interpretations
 - Failure to perform required procedures under SSARS, particularly for inquiries and analytical reviews
- Misapplication of Review Procedures
 - Lack of appropriate analytical procedures
 - Use of insufficient or overly generalized inquiries during the review process
 - Missing or incomplete evaluations of financial statement presentation and disclosure
- Deficient Client Communications
 - Failure to communicate material issues or concerns identified during the review
 - Inadequate representation of management's responsibility for financial statements in the engagement letter
- Inadequate Documentation
 - Lack of sufficient documentation to support conclusions
 - Insufficient records of analytical procedures and inquiries performed
 - Missing or incomplete workpapers

AUDIT UPDATE & REVIEW

The COSO Internal Control Integrated Framework

Introduction

- The COSO is a coalition of five major professional associations dedicated to improving organizational governance, risk management, and internal controls
- The original framework
 - The Committee of Sponsoring Organizations of the Treadway Commission released the original “Internal Control- Integrated Framework” in 1992
 - This is used worldwide as the basis for all aspects of internal control

Definition of Internal Control

- “Internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance

The Basic Framework

- The framework consists of five components and seventeen principles that guide organizations in designing and implementing effective internal controls
- Designed to be flexible and applicable to all types of entities, including
 - Public
 - Private
 - Non-profit
 - Governmental organizations
- Five components
 - Control environment
 - Standards, processes and structures
 - Sets the tone for the organization
 - Influences the control consciousness of its people
 - Risk assessment
 - Process for identifying and assessing risks
 - Identifies and analyzes relevant risks to achieving objectives
 - Forms a basis for determining how risks should be managed
 - Control activities
 - Policies and procedures
 - Represents the policies and procedures that help ensure management directives are carried out
 - Includes approvals, authorizations, verifications, reconciliations, and segregation of duties
 - Information and communication
 - Providing and sharing the necessary information for internal control
 - Facilitates the flow of relevant information to ensure effective internal control
 - Ensures that communication occurs in a timely and efficient manner
 - Monitoring activities
 - Ongoing evaluation
 - Assesses the quality of internal control performance over time
 - Ensures that controls are functioning as intended and are adjusted as necessary



- Seventeen principles
 - These are contained within the components
 - They are the fundamental concepts related to the components

Component 1- Control Environment

- Significance
 - The control environment establishes the foundation for all other components of internal control and reflects the organization's values
- Principles
 - 1. Commitment to integrity and ethical values
 - Establishing and promoting an ethical culture
 - Setting the tone at the top
 - 2. Board of directors is independent from management
 - They properly oversee internal control development and performance
 - Effective oversight by the board.
 - Board independence and involvement.
 - Influence on the control environment and risk management
 - 3. Management establishes the following with board oversight to achieve objectives:
 - Structures
 - Defining roles and responsibilities
 - Reporting lines
 - Appropriate authorities and responsibilities
 - 4. Commitment to attract, develop and retain competent individuals
 - Recruitment, training, performance evaluation, and retention policies
 - 5. Individuals are held accountable for internal control responsibilities
 - Establishing clear authority and responsibility
 - Proper delegation of authority

Component 2- Risk Assessment

- Purpose
 - Organizations should employ various techniques to identify potential risks
- Principles
 - 6. Objectives are clear enough to identify and assess risks
 - Clear, measurable objectives help identify relevant risks and set the framework for assessing their impact
 - Identifying specific objectives for business processes
 - 7. Identify risks to objectives across the entity and analyzes those risk for proper management of them
 - A comprehensive risk identification process should consider internal and external factors affecting the organization
 - Identifying risks that affect the achievement of objectives
 - Analyzing the likelihood and impact of risks
 - 8. Consider the potential for fraud in risk assessment
 - 9. Identify and assess changes that could impact the system of internal control
 - Risk assessment involves evaluating the likelihood and potential impact of identified risks
 - Identifying and managing changes that could impact the internal control system

Component 3- Control Activities

- Types of control activities
 - Control activities can be
 - Preventive
 - Segregation of duties
 - Detective
 - Reconciliations
 - Corrective
 - Error correction procedures
- Principles
 - 10. Control activities are selected and developed to mitigate the risks
 - Control activities should be tailored to the specific risks identified, ensuring they are effective and efficient
 - Developing and implementing control activities through policies
 - 11. Control activities are selected and developed for risks related to technology
 - Organizations must implement appropriate technological solutions to enhance control activities and protect data
 - 12. Policies describe what is expected and procedures put policies in action
 - Clear documentation of policies and procedures helps ensure that control activities are understood and consistently applied
 - Implementing controls to ensure accuracy in financial reporting



Component 4- Information and Communication

- Role of effective communication in controls
 - Effective communication ensures that relevant information flows throughout the organization and is available to those who need it
- Principles
 - 13. Obtains or creates and uses relevant, quality information to support the internal control function
 - Generating relevant and high-quality information to support internal control
 - 14. The objectives, responsibilities and other information is communicated to facilitate internal control
 - Organizations should ensure communication is concise and relevant, supporting decision-making at all levels
 - Effective communication within the organization
 - Ensuring information flows up, down, and across the entity
 - 15. Communication with outside parties on matters related to internal control
 - Regular communication with external stakeholders, including auditors and regulators, is essential for maintaining transparency and compliance

Component 5- Monitoring Activities

- Organizations should conduct both
 - Ongoing monitoring
 - Integrated into daily operations
 - Separate evaluations
 - Periodic reviews

- Principles
 - 16. Evaluations are selected, developed and performed to ensure the components are present and working
 - Regular evaluations help assess the effectiveness of controls and identify areas for improvement
 - Continuous monitoring and periodic reviews
 - 17. Deficiencies are communicated on a timely basis to those responsible for taking corrective action
 - Establish procedures for reporting control deficiencies to management and tracking corrective actions
 - Ensuring that deficiencies are communicated in a timely manner
-

Evaluation Requirements Under SAS 145

- SAS 145 Overview
 - Statement on Auditing Standards (SAS) No. 145, issued by the AICPA, addresses how auditors should assess the design and effectiveness of internal controls
 - Objective
 - To ensure auditors understand and evaluate the internal control environment in relation to the risk of material misstatement due to fraud or error
 - SAS 145 became effective for audits of financial statements for periods ending on or after December 15, 2023
- Relevance to the Audit Process
 - Impact on Risk Assessment
 - SAS 145 requires auditors to perform a risk assessment that includes evaluating internal controls, particularly in relation to fraud risks
 - Emphasis on identifying and responding to risks in a risk-based audit approach
- Control Risk
 - The risk that a material misstatement will not be prevented or detected by the internal control system
 - Auditors must evaluate internal control systems to determine the control risk and adjust their audit procedures accordingly

introduction

- The accounting for financial instruments covers a broad group of both assets and liabilities

The Role of Internal Control in Risk Assessment

- Audit Risk Model
 - $\text{Audit Risk} = \text{Inherent Risk} \times \text{Control Risk} \times \text{Detection Risk}$
 - Control Risk
 - The risk that a material misstatement will not be prevented or detected by the entity's internal controls
- Types of Risks and Their Connection to Internal Control
 - Financial Risks
 - Risk of material misstatement in the financial statements due to fraud or error
 - Example
 - A company might lack controls over revenue recognition, leading to fraudulent reporting
 - Operational Risks

- Risk related to the efficiency and effectiveness of operations, such as the risk of system failure or lack of adequate training
- Example
 - Inadequate controls over inventory could lead to significant losses or inaccuracies
- Compliance Risks
 - Risks related to non-compliance with laws and regulations
 - Example
 - A company failing to comply with tax laws could face penalties and reputational damage
- How Internal Controls Mitigate Risks
 - Effective internal controls address these risks by preventing, detecting, or correcting issues before they become material misstatements in financial reporting
- Evaluating Control Risk
 - Steps to Assess Control Risk
 - Obtain an understanding of the internal control system through interviews, documentation review, and observation
 - Identify significant controls that address identified risks
 - Test the controls to assess whether they are effective in mitigating risk
 - Evaluate the effectiveness of controls and determine the level of control risk
 - If controls are weak or ineffective, auditors adjust their assessment of control risk upward, which may lead to more substantive testing

Key Steps in Evaluating Internal Control

- Understanding the Entity and Its Environment
 - Entity's Operations
 - Review organizational charts, roles and responsibilities, and understand the entity's structure
 - Understand the business environment and the industry-specific risks that may affect internal control design
 - Interviews with Management
 - Conduct interviews with key personnel to assess their understanding of risks and internal controls
 - Management
 - Internal Auditors
 - Discuss the risk environment and control procedures in place
 - Reviewing Policies and Procedures
 - Analyze written policies and procedures to ensure that internal controls are documented and reflect actual practices
 - Perform walkthroughs of key business processes to identify any discrepancies or gaps in controls
- Assessing the Control Environment
 - Tone at the Top
 - Evaluate leadership's commitment to internal control by reviewing management's attitude towards internal control
 - Whether they prioritize compliance, ethics, and controls
 - Segregation of Duties
 - Assess whether critical duties are segregated to prevent conflicts of interest

- The person responsible for recording transactions should not also be responsible for approving them
- Risk Assessment Process
 - Identifying Significant Risks
 - Assess which areas of the business pose the most significant risks to financial reporting, such as areas with high complexity, judgment, or susceptibility to fraud
 - Use risk assessments to identify control points in the process and match them with relevant risks
 - Evaluating Risk Impact
 - Determine the likelihood and impact of risks on financial statements
 - Evaluate how management has assessed and responded to these risks
- Testing of Controls
 - Types of Tests
 - Inquiry
 - Ask personnel about controls and procedures
 - Observation
 - Watch how processes are performed in practice
 - Reperformance
 - Reperform control procedures to verify their accuracy
 - Inspection of Documentation
 - Review records to ensure controls were followed
 - Operational Effectiveness
 - Assess whether the controls are operating effectively over time, not just as designed
 - Test them under varying conditions
- Documenting Internal Controls
 - The auditor must document the assessment of internal controls, including
 - The nature of the controls evaluated
 - The methods used to test their effectiveness
 - The results of the testing, including any deficiencies or weaknesses identified
 - Specifically document the fraud risks identified during the internal control evaluation process and the related controls in place to address those risks
 - Methods for Documentation
 - Use flowcharts to visualize the flow of transactions and control points
 - Write narratives or procedures to describe how transactions are processed and what controls are in place
 - Create process maps to link the flow of information and controls in various processes
 - Identify Key Control Activities
 - Document key control points and identify where segregation of duties is crucial
 - Ensure that approval processes, reconciliations, and authorization procedures are clearly documented
- Communicating Internal Control Deficiencies
 - Communication with Management
 - Auditors must communicate identified deficiencies in internal controls to management and those charged with governance
 - The auditor should provide recommendations for remediation where appropriate



- Report on Internal Control
 - When deficiencies are identified, auditors may need to provide a formal report outlining the nature of the weaknesses and their potential impact on the financial statements
- Impact on Audit Opinion
 - If the auditor identifies a material weakness in internal controls, it could impact the audit opinion
 - A clean opinion on financial statements does not necessarily imply an effective internal control system

Control Activities and Their Role in Risk Mitigation

- Key Control Activities
 - Segregation of Duties
 - Ensuring that no single individual has control over both the authorization and execution of a transaction
 - Approvals, Authorizations, and Reconciliations
 - Ensure that transactions are properly approved and that periodic reconciliations are conducted to detect discrepancies
 - Physical Controls
 - Examples include locks, security cameras, inventory counts, and restricted access to cash
 - System Controls
 - Implementing IT controls such as password protection, encryption, and access monitoring for electronic systems
- IT and Automated Controls
 - Challenges in IT Controls
 - Automated controls are often more efficient but require regular updates and testing to ensure they remain effective
 - Cybersecurity Risks
 - Evaluate the entity's approach to IT security, data protection, and disaster recovery plans
- Monitoring Activities
 - Continuous Monitoring
 - Management should have a process to monitor the effectiveness of controls, including internal audit and external audit reviews
 - Auditor's Role in Monitoring
 - External auditors perform an evaluation of internal controls as part of the risk assessment and testing process

Common Issues in Internal Control Evaluations

- Challenges in Identifying and Evaluating Effective Controls
 - Complexity of Controls
 - As organizations grow, so do the complexity and scale of their operations, which can make it harder to maintain effective controls
 - Rapid Changes in Business Environment
 - Mergers, acquisitions, or new regulations can change the control environment and require a reevaluation of internal controls
- Evaluating Weaknesses and Material Deficiencies
 - Material Weaknesses

- A material weakness in internal control is a deficiency, or a combination of deficiencies, that results in a reasonable possibility that a material misstatement will not be prevented or detected
- Reporting Deficiencies
 - When auditors identify control deficiencies, they must report these to management and, if necessary, to audit committees



Risk Assessment of IT Systems Based on SAS 145 Requirements and Guidance

Identifying Relevant IT Risks

- Inherent Risk in IT Systems
 - Complexity of the IT environment
 - legacy systems
 - cloud infrastructure
 - third-party services
 - Risks associated with digital transformation, integration, and customization
- Control Risk
 - Weaknesses in IT general controls (ITGCs) and application controls
 - Insufficient segregation of duties within IT functions.
 - Inadequate system security
 - unauthorized access
 - data breaches
- Fraud Risk Factors in IT
 - Potential for fraudulent activities using IT systems
 - Manipulation of financial data
 - Unauthorized transactions
 - IT systems as a vector for cybercrime, including ransomware and phishing attacks

Key IT Controls to Assess

- IT General Controls (ITGCs)
 - Access Control
 - Mechanisms to restrict and monitor system access
 - Role-based access control
 - Authentication mechanisms
 - Management's changes
 - Processes around system updates, patches, and configuration changes to ensure integrity and consistency
 - Backup and Recovery
 - The adequacy of disaster recovery and business continuity plans
 - System Development and Maintenance
 - Risk of errors or fraud in the development process, including inadequate testing or oversight
- Application Controls
 - Input Controls
 - Validation procedures to ensure data accuracy and completeness

- Processing Controls
 - Safeguards to ensure data is processed accurately, completely, and in a timely manner
- Output Controls
 - Ensuring generated reports and outputs are accurate and stored securely
- Monitoring Controls
 - Regular monitoring of IT systems to detect irregularities
 - Unusual access patterns
 - Failed transactions
 - Use of automated tools for continuous auditing and monitoring

Assessing IT Risks in the Context of Financial Reporting

- Interaction Between IT Systems and Financial Processes
 - Understanding how IT systems interact with accounting systems
 - ERP (Enterprise Resource Planning)
 - Payroll
 - Accounts payable/receivable
 - Risks arising from automation of financial transactions
 - AI-driven systems
 - Robotic process automation
- Impact of IT Risks on Material Misstatement
 - Identifying potential sources of financial misstatements arising from IT failures
 - Inaccurate processing of financial transactions
 - Risks associated with data integrity, such as incomplete or incorrect data entry
- Cybersecurity and Fraud Risks
 - Evaluating the risk of cyberattacks affecting financial reporting or internal control systems
 - Identifying vulnerabilities that may lead to unauthorized data manipulation

Performing the IT Risk Assessment

- Preliminary Risk Assessment
 - Gathering background information on the IT systems in place
 - Hardware
 - Software
 - Network infrastructure
 - Initial interviews with IT staff to understand controls and processes
- Detailed Risk Assessment
 - Conducting walkthroughs of key IT processes to identify potential points of failure or control weaknesses
 - Reviewing system documentation, including
 - Policies
 - Procedures
 - Configurations
 - Evaluating system logs, access records, and audit trails
- Use of IT Audit Tools
 - Leveraging IT audit software to
 - Assess system vulnerabilities
 - Perform penetration testing
 - Identify control gaps
 - Conducting network security assessments to evaluate threats such as



- Hacking
- Malware
- Unauthorized data access

Evaluating the Impact of Identified IT Risks

- Assessing the Likelihood and Impact
 - Using a risk matrix to determine the probability and impact of each identified risk
 - Prioritizing risks based on their potential effect on financial reporting
- Impact on Financial Statements
 - Determining how IT-related risks could lead to material misstatements in financial reporting
 - Incorrect financial data
 - Lack of audit trails
- Considering External and Internal Factors
 - Internal controls such as management’s oversight of IT processes and the adequacy of training for IT and accounting personnel
 - External factors such as regulatory changes that affect IT governance and compliance requirements

Documentation and Reporting

- Documentation Requirements Under SAS 145
 - Ensuring the risk assessment process is well-documented, including findings from interviews, system reviews, and test results.
 - Documentation of the IT controls evaluated, risks identified, and mitigating factors considered
- Reporting Findings
 - Communicating identified IT risks to key stakeholders
 - Management
 - Audit committees
 - External auditors
 - Recommendations for improving controls, such as
 - Strengthening cybersecurity measures
 - Improving access controls
 - Enhancing management’s change procedures



SAS 145 Appendix E

Considerations for Understanding IT

Overview of IT in Internal Control

- Manual vs. Automated Elements
 - Manual controls and automated controls both play roles in an entity’s internal control system
 - Nature & Complexity
 - The mix of manual and automated controls varies based on the entity’s use of IT and its complexity
 - Impact on Financial Reporting
 - IT affects how financial information is processed, stored, and communicated, influencing internal control design
 - Every internal control component may involve some form of IT

- Benefits of IT in Internal Control
 - Predefined business rules
 - IT automates complex calculations and transaction processing
 - Timeliness, accuracy, availability
 - Enhances information quality
 - Facilitates analysis
 - Improves decision-making with more data analysis capabilities
 - Monitoring and performance tracking
 - Improves oversight of policies and procedures
 - Reduces risk of circumvention
 - Automated controls are harder to bypass
 - Segregation of duties
 - IT controls help enforce proper segregation, especially in databases and applications

Characteristics of Manual vs. Automated Controls

- Automated controls are typically more reliable than manual ones due to lower susceptibility to human error or override
- High volume/recurring transactions
 - Automation works well in environments with frequent or predictable transactions
- Control design
 - Automated controls are particularly effective when tasks can be clearly defined and programmed

IT in Information Systems

- Role of IT in Transaction Processing
 - IT applications and systems affect how transactions are initiated, recorded, processed, and reported in financial statements
 - Manual & Automated Flow
 - Procedures for handling transactions may involve both manual and IT-enforced processes
 - Digital vs. Paper Records
 - Digital records may replace or supplement traditional paper documents
- Auditor's Focus
 - The auditor gathers information about IT applications, infrastructure, and configuration settings relevant to financial reporting
 - Key Areas
 - Complexity
 - Customization
 - Outsourcing
 - Use of interfaces or data warehouses

Emerging Technologies

- Emerging technologies (blockchain, AI, robotics) offer opportunities for operational efficiency and improved financial reporting
- Auditors must include these technologies when assessing the IT environment for risks
- Auditor's Responsibilities
 - Despite the sophistication of emerging technologies, the auditor's responsibilities regarding IT applications and general IT controls remain the same

Scalability in IT Environments

- Less Complex Entities

- Smaller or less complex entities often use commercial software and may have minimal IT resources
 - One person responsible for IT administration
- Key Considerations
 - Reputation and reliability of software
 - Modification capabilities
 - Ability to modify source code or add-on modules
 - Data access
 - Direct access to databases and potential risks associated with large volumes of data
- Complex IT Environments
 - Larger or more complex organizations may have highly customized or integrated IT applications
 - Integration Risks
 - Systems used across business operations may affect financial reporting
 - Dedicated IT Departments
 - Entities may require skilled IT teams or rely on third-party service providers

Identifying IT Applications Subject to Risks

- Understanding IT Environment
 - The auditor needs to understand the IT applications that process financial data and their associated risks
 - Automated Controls
 - Identifying automated controls within IT applications that help address material misstatement risks
 - Application Reliability
 - Automated controls are more effective if the entity relies on the IT application to process transactions accurately
- Auditor Considerations
 - Access to Source Code
 - Whether management can modify the software may affect the integrity of financial data
 - Changes to Data
 - Monitoring the risk of unauthorized changes to financial data
- System-Generated Reports
 - The auditor assesses the accuracy and completeness of reports generated by IT applications, like trade receivables or inventory valuation reports
 - Tests may focus on the inputs and outputs of the report process, the operating effectiveness of the controls, and general IT controls
- Report-Writing Applications
 - The auditor should identify whether reports are generated by internal systems or separate report-writing applications and the data sources used

End-User Computing (EUC) Considerations

- Challenges with EUC
 - EUC tools may not be classified as full-fledged IT applications
 - Spreadsheets
 - Simple databases
 - Control Weaknesses
 - End-user tools often lack the robust controls present in fully automated systems

- Controls over EUC
 - Source Data Processing
 - Ensure proper controls over how data is input, processed, & output in EUC tools
 - Logic Validation
 - Controls to ensure formulas, macros, and logic work as intended
 - Validation Tools
 - Use of software tools to check for spreadsheet or formula errors

Scalability and Complexity

- Larger volumes of data or more complex transactions may require more sophisticated controls beyond simple input/output or review controls
- Substantive Procedures
 - When complexity and volume increase, relying solely on substantive procedures may not suffice
- General IT Controls
 - As transaction volume and complexity grow, reliance on general IT controls increases, and so does the risk of misstatement

Identifying IT Application Risks

- Less Likely to be Subject to IT Risks
 - Stand-alone applications
 - Low transaction volumes
 - Manual verification or reliance on hard-copy documentation
- More Likely to be Subject to IT Risks
 - Interfaced applications
 - High transaction volumes
 - Complex applications that initiate transactions and perform automated calculations



Risks Arising from IT

- General IT Risks
 - Unauthorized Access
 - Risk of data manipulation or destruction, especially in shared databases
 - Segregation of Duties
 - IT personnel accessing data outside of their responsibilities
 - Unauthorized Changes
 - Risk of unauthorized changes to data or applications
 - Data Loss
 - Potential loss of data or inaccessibility
- Cybersecurity and Compliance Risks
 - Cybersecurity Risks
 - The auditor must assess the risk of cybersecurity breaches and their potential impact on financial reporting
 - Compliance with Laws
 - Understanding how data protection regulations affect financial reporting

General IT Controls

- Overview
 - General IT controls address risks related to the IT infrastructure that support IT applications
 - Databases
 - Operating systems
 - Networks

- Areas of Concern
 - Databases
 - Risks of data manipulation or unauthorized access
 - Operating Systems
 - How the OS manages communication between hardware, applications, and databases
 - Networks
 - Security risks associated with network access to IT systems
- Common General IT Controls
 - Controls over access to systems, data, and program changes
 - Ensuring the integrity of the IT environment as a whole

Conclusion: Integrated IT and General IT Controls

- The auditor must evaluate both the specific IT applications used in financial reporting and the broader IT environment
- A comprehensive understanding of the IT systems, their risks, and relevant general IT controls is essential for effectively assessing the risks of material misstatement due to the use of IT

FOCUS ON FRAUD 2025

Using Internal Controls to Prevent Fraud



Introduction

- Prevalence of Fraud
 - Fraud remains a persistent challenge for businesses of all sizes
 - The cost of fraud can be significant, both financially and reputationally
- Role of Internal Controls
 - Internal controls serve as a first line of defense against fraudulent activities
 - These controls help identify, prevent, and mitigate the risks of fraud
- Businesses need to
 - Continually evaluate and strengthen their internal controls to stay ahead of evolving fraud schemes
 - Find practical strategies for designing and improving internal controls to reduce the risk of fraud
 - Take a proactive approach **in** safeguarding an organization's assets and reputation

Understanding Internal Controls

- Definition of Internal Controls
 - Internal controls are policies, procedures, and mechanisms put in place by an organization to safeguard assets, ensure reliable financial reporting, and comply with laws and regulations
 - They are critical for both preventing and detecting fraud
- Key Objectives of Internal Controls
 - Prevent Fraud
 - Reduce opportunities for fraud to occur by establishing clear procedures and safeguards
 - Ensure Financial Accuracy
 - Maintain the integrity of financial data by preventing errors and misreporting
 - Compliance with Regulations
 - Ensure the organization adheres to applicable laws, such as tax regulations and industry standards
 - Operational Efficiency
 - Optimize operations by ensuring resources are used effectively and in line with organizational goals

Types of Fraud Targeted by Internal Controls

- Financial Statement Fraud
 - Manipulation or misrepresentation of financial statements to deceive stakeholders
 - Common tactics include inflating revenues, underreporting liabilities, or falsifying financial data to appear more profitable than the company truly is
- Asset Misappropriation
 - Employees or others misappropriating company assets for personal gain, such as stealing cash or inventory
 - Often involves manipulation of company records, improper reimbursements, or outright theft
- Corruption

- Involves employees engaging in illegal or unethical behavior for personal gain
- Examples include accepting bribes, kickbacks, and conflicts of interest that benefit the employee at the organization's expense

Key Internal Control Principles for Fraud Prevention

- Segregation of Duties
 - This principle ensures that no single employee is responsible for all aspects of a financial transaction, such as authorizing, recording, and reviewing it
 - Example
 - One employee may handle cash receipts, while another is responsible for accounting for those receipts
 - Purpose
 - Reduces the opportunity for fraud or errors because collusion is required to bypass controls
- Authorization and Approval Controls
 - Require specific approvals before certain transactions can proceed
 - Example
 - Purchases over a certain dollar amount may require approval from a department head or a higher-level manager
 - Purpose
 - Prevents unauthorized actions, such as fraudulent spending or payment approvals
- Access Controls
 - Limiting access to assets, information, or systems to those with a legitimate need to know or use them
 - Example
 - Restricting access to financial records, customer data, or physical assets to authorized personnel only
 - Purpose
 - Protects against theft or unauthorized transactions by limiting who can access critical resources
- Documentation and Recordkeeping
 - Ensure all transactions are properly documented and recorded
 - Example
 - Maintain receipts, invoices, and other supporting documents for all financial transactions
 - Purpose
 - Establishes an audit trail that can be reviewed to detect and prevent fraud, ensuring that every action taken is traceable and supported by valid documentation
- Reconciliation Procedures
 - Regularly compare records with actual results to identify discrepancies
 - Example
 - Monthly bank reconciliations ensure that recorded cash balances match actual bank statements
 - Purpose
 - Identifies discrepancies or suspicious activities early, before they escalate into significant fraud

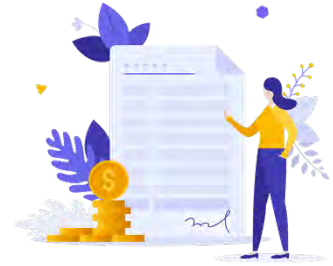
Risk Assessment and Fraud Prevention

- Identifying Fraud Risks
 - Conduct regular risk assessments to identify where fraud could occur in the organization
 - Look for high-risk areas such as cash handling, payroll, procurement, or management of inventory
 - Pay close attention to processes that involve a high volume of transactions or those that lack adequate oversight
- Fraud Risk Assessment Techniques
 - Employee Surveys
 - Gather input from employees about perceived vulnerabilities or potential fraud risks within the organization
 - Data Analytics
 - Use analytics to detect unusual patterns or transactions that might indicate fraudulent activity
 - Analyzing purchasing data to detect duplicate orders or payments
 - Fraud Risk Mapping
 - Visualize areas within the organization where fraud risks are highest and map control procedures to mitigate those risks
- Responding to Identified Risks
 - Designing Control Responses
 - For identified fraud risks, design specific internal controls to address the risk
 - If cash theft is a concern, implement dual controls for cash handling and increase surprise cash counts
 - Reevaluating Existing Controls
 - Existing controls may need to be strengthened or modified in response to new or evolving fraud risks

Monitoring and Auditing Internal Controls

- Ongoing Monitoring Activities
 - Regular monitoring is essential for ensuring the continued effectiveness of internal controls
 - Examples
 - Random or surprise audits to assess if employees are following the organization's controls
 - Continuous tracking of key performance indicators (KPIs) related to fraud prevention
- Internal Audits
 - Internal auditors play a crucial role in evaluating whether internal controls are functioning as intended
 - Auditors should examine areas where fraud risks are highest and provide recommendations for improvements in controls
- Third-Party Audits and Reviews
 - External auditors provide an independent perspective on the strength of an organization's internal controls
 - They can offer specialized knowledge to detect control weaknesses or suggest more effective fraud-prevention strategies
- Whistleblower Mechanisms

- Providing employees with confidential ways to report suspected fraud can uncover potential fraudulent activities early
- Examples
 - Whistleblower hotlines
 - Email submissions
 - Anonymous reporting systems



Best Practices for Strengthening Internal Controls

- Building a Culture of Integrity
 - Leadership Commitment
 - Leaders must emphasize the importance of ethics and internal controls
 - Employee Training
 - Regular training and clear communication on fraud prevention help employees understand their role in maintaining strong internal controls
 - Promoting Accountability
 - Foster an environment where employees are encouraged to take ownership of their actions and responsibilities
- Use of Technology in Fraud Detection
 - Automated Transaction Monitoring
 - Implement software solutions to flag suspicious transactions in real-time
 - AI and Data Analytics
 - Use AI tools to detect fraud patterns or anomalies that might not be immediately obvious to human auditors

Focus on Fraud 2025- Recent Fraud Cases

Americanas S.A.

- Overview
 - Founded in 1929, Americanas S.A. is a major Brazilian retailer operating across multiple platforms, including brick-and-mortar stores and e-commerce
 - The company has long been a symbol of stability in Brazil's retail industry, making the revelations of fraud particularly shocking
- Significance of the Case
 - In January 2023, Americanas disclosed a staggering R\$20 billion (approximately \$3.88 billion) in accounting inconsistencies
 - The case has had significant implications for Brazilian corporate governance, regulatory frameworks, and global investor confidence in Brazilian markets
- Timeline of Events
 - Early Warning Signs
 - Concerns about discrepancies in financial reporting were dismissed as misinterpretations by the company's auditors and executives
 - Discovery and Disclosure
 - January 11, 2023: CEO Sergio Rial, who had taken office less than two weeks earlier, announced the discovery of accounting inconsistencies during a routine review
 - The irregularities related primarily to supply-chain financing arrangements, which were improperly accounted for as off-balance-sheet transactions
- Methods Used to Perpetrate the Fraud
 - Misrepresentation of Supply-Chain Financing
 - Financial transactions related to supplier payments were treated as trade payables rather than loans, significantly understating liabilities
 - Artificial Supplier Rebates
 - False advertising rebates were used to overstate income and reduce reported expenses
 - Dual Financial Records
 - Internal and external financial statements were maintained separately to hide the extent of the fraud from regulators and investors
 - Obscuring of Audit Trails
 - Manipulated IT systems and deliberately altered financial data to avoid detection during audits
- Audit Firms
 - PricewaterhouseCoopers (PwC)
 - Served as the auditor after KPMG's tenure
 - Allegedly failed to detect discrepancies in supply-chain financing arrangements despite red flags
 - KPMG
 - Audited Americanas from 2016 to 2019
 - Accused of watering down internal reports that flagged significant control deficiencies

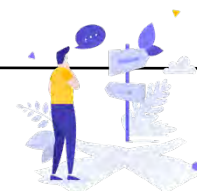
- Allegations Against Auditors
 - Both firms are under scrutiny for either complicity or gross negligence, with regulatory investigations ongoing
- Closing Thought
 - The Americanas scandal serves as a stark reminder of the critical role corporate integrity plays in maintaining market trust and economic stability



Patisserie Valerie

- Introduction
 - Patisserie Valerie was a prestigious café chain in the UK, founded in 1926 by Madame Valerie
 - Known for its handcrafted cakes and pastries, it expanded significantly under the leadership of Luke Johnson after his acquisition in 2006
 - Listed on the AIM (Alternative Investment Market) in 2014, the company was valued at £170 million
- Methods Used in the Fraud
 - Inflated Cash Balances
 - Bank accounts were falsified to show cash reserves exceeding £10 million
 - Fake bank statements created to mislead auditors and board members
 - Fictitious Revenue
 - Non-existent sales were recorded to inflate profit margins
 - Fabricated invoices presented as genuine transactions
 - Hidden Liabilities
 - Significant debts and unpaid taxes were deliberately excluded from financial statements
 - Tax liabilities of £1.14 million triggered the initial red flag
 - Loan Fraud
 - Misrepresented financial health to secure loans and credit facilities
 - An overdraft facility of £9.7 million was fraudulently obtained
- Discovery of the Fraud
 - The Red Flags
 - HMRC (His Majesty's Revenue & Customs) issued a winding-up petition due to unpaid VAT
 - CFO Chris Marsh's inability to provide coherent explanations for discrepancies
 - Investigative Actions
 - External forensic accountants identified falsified accounts and missing funds
 - Immediate notification of authorities, including the Serious Fraud Office (SFO)
- Auditor Firms
 - Grant Thornton LLP
 - Audited Patisserie Valerie's accounts from 2007 to 2018
 - Did not detect the fabricated bank statements or fictitious transactions
 - Auditing Failures
 - Failure to independently verify cash balances with banks
 - Insufficient skepticism and reliance on management-provided documents
 - Inadequate risk assessment and detection of fraudulent activities

- Consequences
 - Grant Thornton fined £4 million in 2021 by the Financial Reporting Council (FRC)
 - Criticism of their audit procedures highlighted systemic issues in the profession
- The Collapse and Aftermath
 - Administration and Job Losses
 - January 2019: Administrators took control
 - Immediate closure of 70 stores and loss of 900 jobs
 - Remaining outlets sold to Recapital Limited to repay creditors
- Conclusion
 - The Patisserie Valerie case demonstrates how internal fraud, combined with audit failures, can devastate a once-successful company
 - It underscores the critical importance of strong governance, ethical practices, and vigilant auditing



Kraft Heinz

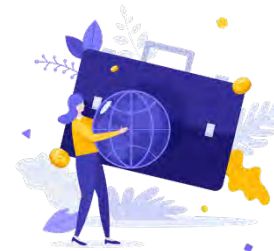
- Background of Kraft Heinz
 - Company Overview
 - Formed in 2015 through a merger led by 3G Capital, a private equity firm known for aggressive cost-cutting, and Berkshire Hathaway, one of the largest conglomerates in the world
 - Known for brands like Kraft Singles, Velveeta, Jell-O, and Heinz Ketchup
 - Industry Context
 - Intense competition in the packaged food industry
 - Growing consumer preference for fresh and organic products challenged traditional processed food companies
 - Pressure to meet earnings targets amplified by 3G Capital's zero-based budgeting model
- Discovery of Fraud
 - Initial Signs
 - February 2019: Kraft Heinz reported a massive \$15.4 billion write-down on the value of its Kraft and Oscar Mayer brands and goodwill, triggering investor concerns
 - This write-down raised questions about the company's financial reporting practices
 - SEC Investigation
 - SEC launched an inquiry into Kraft Heinz's procurement and accounting practices following the write-down
 - Public Disclosure
 - In June 2021, the SEC concluded its investigation, revealing years of accounting misconduct
- Methods of Fraud
 - Procurement Accounting Manipulations
 - Recording Fictitious Cost Savings
 - Staff falsely recorded supplier rebates and discounts as cost reductions, inflating reported profits

- Improper Accruals
 - Recognized rebates and discounts that were not yet earned or even agreed upon with suppliers
- Purpose
 - Boost earnings to meet quarterly and annual financial targets set by management
- Impact on Financial Statements
 - Overstated Kraft Heinz's profits by approximately \$208 million between 2015 and 2018
 - Misleading financial reports painted an inaccurately positive picture of the company's performance
- SEC Investigation and Settlement
 - Settlement
 - Kraft Heinz agreed to pay a \$62 million penalty
 - The settlement did not include admission of guilt but required the company to strengthen its internal controls
 - Former CFO Paulo Basilio and Chief Operating Officer Eduardo Pelleissone agreed to repayment and fines totaling over \$300,000
- Audit Firm
 - Responsibilities
 - As external auditors, PwC was tasked with verifying the accuracy of Kraft Heinz's financial statements and ensuring compliance with accounting standards
 - Criticisms
 - PwC failed to detect procurement fraud despite audit trails indicating irregularities
 - The firm's lack of professional skepticism and insufficient scrutiny allowed the fraud to persist for years
- Conclusion
 - The Kraft Heinz accounting fraud case serves as a cautionary tale about the dangers of prioritizing financial targets over ethical decision-making
 - It underscores the need for collaboration among companies, auditors, and regulators to uphold financial transparency and accountability

IRS Practitioner Priority Service Line

- Introduction
 - What is the Practitioner Priority Service Line?
 - A hotline that provides tax professionals with prioritized assistance
 - Access requires secure credentials but also relies on the integrity of caller identification
 - Fraud in Numbers
 - Over 4,800 fraudulent returns filed during the fraud period
 - Claims for \$462 million in refunds—a staggering misuse of taxpayer funds
 - \$47 million in losses occurred despite detection of most fraudulent attempts
- Understanding the Fraud Scheme
 - Operational Mechanics of the Scheme
 - Fraudsters posed as tax professionals to gain access to the PPS Line

- Exploited authentication gaps to submit false returns
- Leveraged stolen or fraudulent identities to claim refunds
- Timeline of the Fraud
 - August 12, 2023: Fraudulent activity begins
 - February 8, 2024: TIGTA issues an urgent alert to the IRS
 - April 8, 2024: IRS implements enhanced authentication controls
 - April 16, 2024: Fraudulent activity ends, but damage is already done
- Lessons Learned
 - Importance of Timely Action
 - Delays exacerbate losses and erode public trust
 - Need for real-time fraud detection mechanisms
 - Investment in Technology
 - Deploy advanced analytics and machine learning tools
 - Improve digital identity verification systems



Prager Metis- The Final Chapter

- Background Information
 - Who is Prager Metis
 - A professional services firm providing auditing, tax, and consulting services
 - Notable clients include FTX, a crypto trading platform that collapsed in 2022
 - FTX and Its Collapse
 - Founded by Sam Bankman-Fried, FTX was a major player in the cryptocurrency market
 - Collapsed after revelations of fraudulent financial practices and misuse of customer funds
 - Billions of dollars in investor losses, prompting scrutiny of those tasked with auditing FTX
- Allegations Against Prager Metis
 - Misrepresentation
 - Prager Metis falsely claimed compliance with Generally Accepted Auditing Standards (GAAS) in audits conducted from February 2021 to April 2022
 - Negligence
 - Failure to evaluate whether the firm had the competency and resources to audit FTX effectively
 - Overlooked significant risks, including the relationship between FTX and Alameda Research LLC (a hedge fund controlled by FTX's CEO)
 - Fraud Charges
 - The SEC labeled Prager Metis's actions as negligence-based fraud due to lack of due professional care and skepticism
- Violations of Auditor Independence
 - Between 2017-2020, engagement letters for over 200 audits included indemnification provisions
 - Violated auditor independence rules by creating conflicts of interest
 - Contributed to clients' violations of federal securities laws

- Legal and Financial Consequences
 - Settlement Agreement
 - Total Penalty: \$1.95 million
 - \$745,000 civil penalty for FTX-related negligence
 - \$1 million penalty for auditor independence violations
 - Additional disgorgement with interest: \$205,000
 - Court-Ordered Remedial Actions
 - Permanent injunctions against further violations
 - Retention of an independent compliance consultant
 - Tasked with reviewing audit and quality control policies
 - Implementation of best practices for future engagements
 - Restrictions on accepting new audit clients to mitigate risks of repeat violations
 - Censure
 - Prager Metis formally censured, tarnishing its reputation in the professional services industry
- Lessons Learned and Implications
 - Key Takeaways for Auditors
 - Strict adherence to GAAS and independence standards is non-negotiable
 - Comprehensive risk assessments are critical, particularly for high-risk clients like FTX
 - Internal controls and policies must be robust and regularly reviewed
- Conclusion
 - Summary
 - Prager Metis failed to meet professional obligations, resulting in penalties and reputational damage
 - The SEC's actions underscore the critical role of auditors in safeguarding investor trust
 - Call to Action
 - Audit professionals must prioritize compliance, integrity, and risk management
 - Industry leaders should proactively improve practices to prevent future violations

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