

Everything But Tax Update

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Auditing, Attestation and Accounting Update

Title
ARSC Update, Comps, and Reviews
QM Standards
Ethics and Independence, Just a Quick Glance
Audit Standards Update/Workpaper Documentation
FASB Standards
Special Purpose Frameworks

Update on SSARS Engagements

The ARSC is a senior committee of the AICPA with 7 members designated by Council to issue pronouncements in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity

4 – Major Firm Group (Top 100)

2 – Top 100-400 Firms

1 – Small Practitioners

0 – Big Four firms

Learning objectives

- Distinguish among the nature and elements of reviews, compilations, and preparation engagements of financial statements.
- Revisit key provisions in SSARS No. 25, *Materiality in a Review of Financial Statements and Adverse Conclusions*.
- Look at the most recently issued SSARS No. 26, *Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Engagements* and SSARS No. 27, *Applicability of AR-C Section 70 to Financial Statements Prepared as Part of a Consulting Services Engagement*.

What Types of Engagements are Covered Under the SSARS?

Financial statement engagements under the SSARS

	Preparation	Compilation	Review
Level of assurance	None	None	Limited
Understand internal control	Not required	Not required	Not required
Assess fraud risk	Not required	Not required	Not required
Test to obtain evidence	None	None	Inquiry, analytical procedures, management representation letter.
Could be performed	After 2015	After 1978	After 1978

Preparation engagement

- Provides no assurance
- Does not require the accountant to understand internal controls
- Does not require tests to obtain evidence
- Does not require a written report

Preparation engagement

- Purpose: To prepare financial statements in accordance with an applicable financial reporting framework.
- Required when an accountant is engaged to prepare financial statements, including a single statement, supplementary information, or pro forma information.
- When does AR-C section 70 apply? <https://www.aicpa-cima.com/resources/download/is-ar-c-section-70-applicable-yes-or-no>

Preparation standards

- Nonattest service
- Independence does not have to be considered.
- No report is required.
 - Opinion is not issued.
 - Legend noting no assurance is provided on each page of the financial statements.
 - If no legend is provided on the financial statements, accountant must either issue a disclaimer, perform a compilation in accordance with AR-C Section 80 or withdraw from the engagement.

Performance requirements – preparation

- Agree upon the terms of the engagement with the client
- Obtain an understanding of the financial reporting framework and significant accounting policies
 - Sufficient to complete the engagement
 - Gained through inquiry, experience, and consulting relevant guidance
- Prepare the financial statements
 - Statement of no assurance

Documentation for preparation engagements

Required

- Engagement letter (signed)
- Financial statements

Recommended

- Client acceptance form
- Disclosure checklist

Defining a compilation engagement

- Definition

- Apply accounting and financial reporting expertise to assist management in the presentation of financial statements
- Report on the financial statements without undertaking to obtain or provide any assurance

- Required when an accountant is engaged to perform a compilation

- Significant change from previous standards
- New preparation engagement

Compilation – Performance standards

- Standards

- Establish an understanding with the client.

- The engagement letter should be in writing and signed by both parties.

- Have appropriate knowledge and understanding of the entity's financial reporting framework.

- Read the financial statements.

- Obtain additional information if information is incorrect, incomplete, or otherwise satisfactory.

- Bring to management.

- Request additional or revised information.

Documentation for compilation engagements

Purpose

- Compliance with SSARSs & SQCSs
- May vary by client

Required

- Engagement letter (signed)
- Financial statements
- Accountant's report

Recommended

- Client acceptance form (knowledge and understanding of the client)
- Work program (outlines the engagement)
- Bridging documents (captures difference between client's records and compiled statements)
- Disclosure checklist
- Other support

The Objective of a Review

- The objective of a review is to obtain limited assurance **primarily by performing analytical procedures and inquiries**, as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in conformity with the applicable financial reporting framework (i.e. U.S. GAAP, cash-basis, tax-basis).
- Accountant accumulates review evidence to obtain a limited level of assurance
- It is an assurance engagement

Review of Financial Statements

- AR-C section 90 applies to all reviews of historical financial information – excluding:
 - Interim financial information (which is covered by AU-C section 930)
 - Pro-forma financial information (which is covered by AT-C section 310)

Review Performance Procedures

- New SSARS 25 performance requirements:
 - The accountant is required to plan and perform the review with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated.

Review Performance Procedures

- New SSARS 25 performance requirements:
 - Explicit requirement to determine materiality and apply this materiality in designing the procedures and evaluating the results obtained from those procedures.
 - Also required, in obtaining sufficient appropriate review evidence as a basis for a conclusion on the financial statements as a whole, to design and perform the analytical procedures and inquiries to address **all material items in the financial statements, including disclosures.**

Review Performance Procedures

- Review procedures are tailored based on the accountant's:
 - Understanding of the industry
 - Knowledge of the client
 - Awareness of the risk of that the or she may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated

Review Performance Procedures

- The accountant performs primarily analytical procedures and inquiries to obtain sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole.
- In obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, the accountant is required to design and perform the analytical procedures and inquiries to address the following
 - All material items in the financial statements, including disclosures
 - Areas in the financial statements where the accountant believes there are increased risks of material misstatements

Review Performance Procedures

- If the accountant becomes aware of a matter that causes the accountant to believe the financial statements may be materially misstated, *the accountant designs and performs additional procedures, as the accountant considers necessary in the circumstances, to be able to conclude on the financial statements.*

Review Performance Procedures

- SSARS 25 included new required inquiries about:
 - Material commitments, contractual obligations, or contingencies that have affected or may affect the entity's financial statements, including disclosures
 - Material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration

SSARS 25 – Reporting options

- Prior to the issuance of SSARS 25, the accountant was prohibited from modifying the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework (that is, an adverse conclusion).
- ISRE 2400 (Revised) provides for the issuance of an adverse conclusion.

SSARS 25 – New reporting option

- ARSC concluded that it was not in the public interest to prohibit the expression of an adverse conclusion when the accountant is aware that the financial statements are materially and pervasively misstated.
- Although the accountant may withdraw from the engagement, users of the financial statements may not then be made aware of such misstatements.
- Accountant is not precluded from withdrawing.
- SSARS 25 includes an illustrative accountant's review report including an adverse conclusion.

Modified Conclusions in a Review Engagement

- Qualified Conclusion
 - Appropriate when misstatements are ***material, but not pervasive***
 - Modify the conclusion paragraph heading with the word “qualified”
 - Include a separate paragraph describing the reason for the modification, immediately before the conclusion paragraph
- Adverse Conclusion
 - Appropriate when misstatements are ***both material and pervasive***
 - Modify the conclusion paragraph heading with the word “adverse”
 - Include a separate paragraph describing the reason for the modification, immediately before the conclusion paragraph

Insufficient Review Evidence

This situation is rarely encountered

- Client refusal to respond to inquiries
- Client refusal to sign representation letter
- Insufficient data to perform analytical procedures

Accountant must withdraw from the engagement (AR-C 90.45)

- No “disclaimer” report allowed

SSARS 25 – New reporting requirements

- If substantial doubt about the entity's ability to continue as a going concern exists, include a separate section headed "Substantial Doubt About the Entity's Ability to Continue as a Going Concern"
- Replaces required EOM but wording is similar
- Consistent with SAS 134
- No new performance requirements

Required documentation

Purpose:

- Compliance with SSARSs/SQCSs
- May vary by client
- Minimizes liability

Required:

- Signed engagement letter
- Communications with management and other accountants
- Reviewed financial statements and accountant's report
- Analytical and inquiry procedures
- Additional procedure performed in response to unexpected findings
- Any significant findings or issues
- Significant unusual matters
- Management representation letter
- Materiality (at least I think)

New SSARS No. 26, *Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review*

- Background
Services

- Part of a suite of other new standards issued by the AICPA to enhance firm systems of quality management.
 - New Statements on Quality Management Standards
 - New SAS — Quality Management Auditing Standards
- Aligns SSARS with new quality management standards
- Effective date
 - Periods beginning on or after December 15, 2025
 - Except: AR-C section 90 change related to engagement letters effective immediately

Key provisions of SSARS No. 26 on quality management

- Includes revisions to AR-C Section 60
 - Clarify and emphasize engagement partner's responsibility to determine that members of the engagement team have appropriate competence and capabilities.
 - Add explicit guidance for the engagement partner to determine that sufficient and appropriate resources to perform the engagement are made available to the engagement team.
 - Modify guidance that the system of quality management includes establishing a monitoring and remediation process.
- Includes revisions to AR-C Section 90
 - Removes requirement that engagement letter be obtained prior to beginning the engagement

SSARS No. 27 , Applicability of AR-C Section 70 to Financial Statements Prepared as Part of a Consulting Services

- Amends AR-C Section 70 to:

- Explicitly exclude financial statements prepared as part of a consulting services engagement performed in accordance with CS section 100, *Consulting Services: Definitions and Standards*, in AICPA Professional Standards from those engagements in which AR-C section 70 is required to be applied.**
- Address misunderstanding as to the required application of AR-C section 70. The scope paragraphs of the section are amended to clarify that the accountant is not required to apply the section, but application is not precluded, in whole or in part, when an accountant prepares financials statements or prospective financial information as part of consulting services engagement performed in accordance with CS section 100 in which the preparation of financial statements is not the primary objective of the engagement.
- Effective for preparation of financial statements for periods ending on or after December 15, 2026. Early implementation is permitted.

AICPA CS Section 100 – Consulting Services

- Definition of Consulting Services:
 - Very broad, encompassing various activities like consultations, advisory, support, etc.
- General Standards:
 - It emphasizes the importance of professional competence, due professional care, planning and supervision, and sufficient relevant data
- Understanding with the Client:
 - Crucial to establish a written or oral understanding with the client regarding the nature, timing, scope, and limitations of the services to be performed.
- Reporting:
 - Emphasizes the need for clear communications of findings to clients

In essence, CS 100 provides a framework for CPAs to deliver consulting services while adhering to ethical and professional standards. (Effective date 1.1.1992)

Issues to Consider under CS 100 – Consulting Services

- Will your firm use engagement letters?
- How will you disclose framework departures
 - It all starts with the Code – Due professional care under 1.300
- Internal checklists to ensure financial statements are in accordance with the selected Financial Reporting Framework
 - GAAP
 - Income Tax
 - Cash or modified cash
- Will you restrict the use of the financial statements – “Management Use Only”
- **These will not be subjected to peer review (at least not now).**

Practice issues for Engagements Under the SSARS and Some Guidance on Analytical Procedures

Common practice issues – Going concern

- Accounting principles generally accepted in the United States require management to perform evaluation of going concern and consider need for disclosure
 - Management may not have performed evaluation or provided adequate disclosure
 - CPAs who prepare financial statements need to be aware of accounting standards requirements
- Considerations
 - If disclosures are inadequate, the accountant is required to consider whether the modification of the standard report is adequate to disclose the departure from the applicable financial reporting framework.
 - The accountant is not required to include an emphasis-of-matter paragraph in the accountant's review report if the financial statements appropriately disclose uncertainty about the entity's ability to continue as a going concern.
 - However, the accountant may consider it necessary to draw users' attention to the issue.

Documentation of independence considerations

Two basic risks of independence:

- Risk that the practitioner is not independent (independence in mind); and
- Risk that the practitioner is perceived as not being independent (independence in appearance)

Practitioners should use a conceptual framework which involves:

- Identifying threats to independence
- Evaluating the threat that the AICPA member would not be independent or would be perceived by a reasonable and informed third party as not being independent
- Threats must be eliminated or reduced to an acceptable level to be independent

Documentation of independence considerations

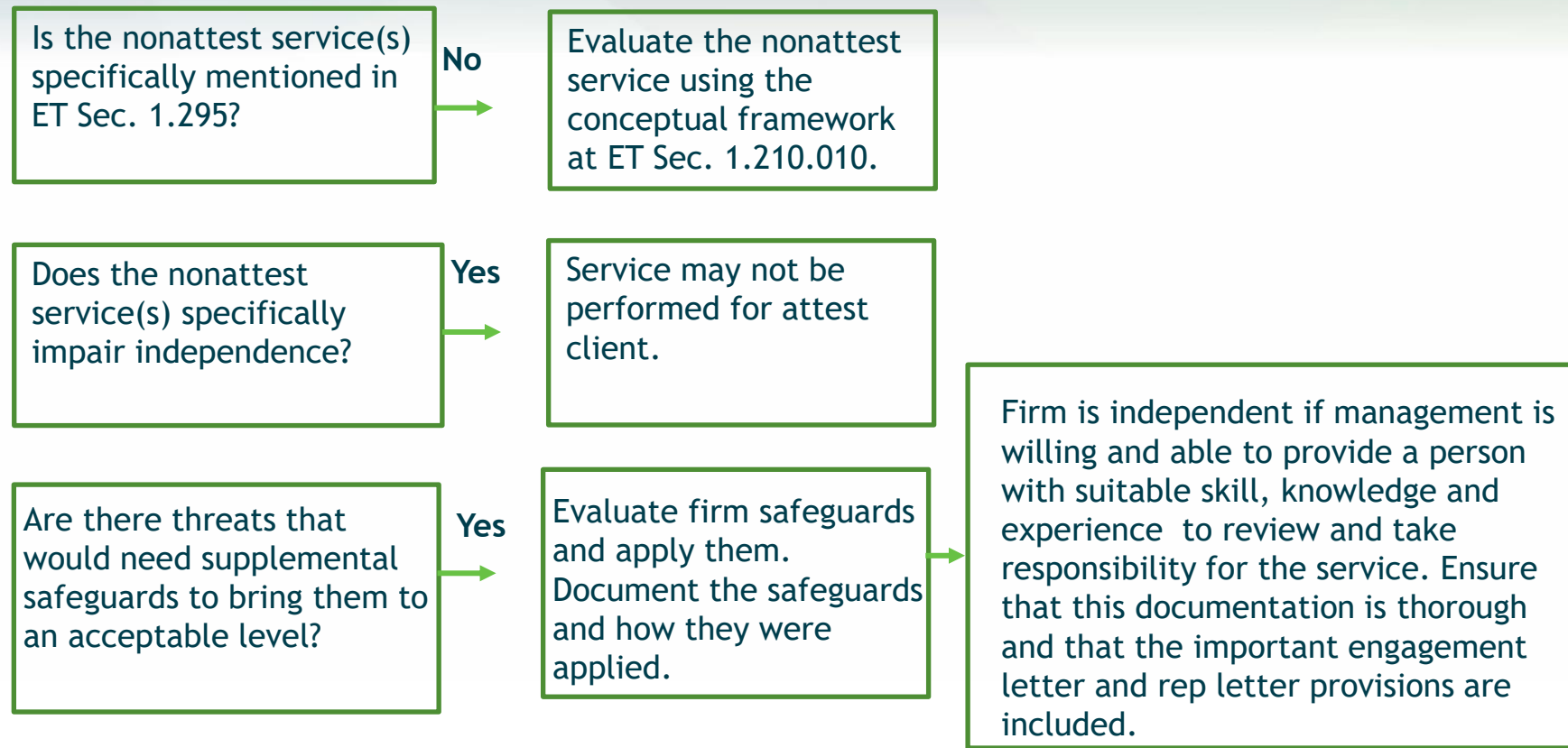
Threats to independence:

- Adverse interest threat;
- Advocacy threat;
- Familiarity threat;**
- Management participation threat;**
- Self-interest threat;
- Self-review threat;** and
- Undue influence threat

Nonattest service rules apply during the period of professional engagement and during the period covered by the financial statements

Documentation of independence considerations

- Independence Conceptual Framework



Safeguards

Safeguards that could applied by the firm are:

- Firm leadership that stresses the importance of independence
- Policies and procedures that are designed to implement and monitor quality control in attest engagements
- Documented independence policies
- Internal policies and procedures that are designed to monitor compliance
- Use of different partners, partner equivalents, and engagement teams that have separate reporting lines
- Training timely communication of a firm's policies and procedures, and any changes to them

Review Engagements: Analytical Procedures Are Not Properly Performed

Peer reviewers have noted that accountants are not:

- Properly documenting the development of expectations of recorded amounts or ratios;
- Evaluating whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- Properly documenting the comparison of recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist, based on the accountant's understanding of the entity and the industry in which the entity operates

New practice aid on analytical procedures in a review engagement

- Section 90 requires the use of analytical procedures in a review engagement

- Analytical procedures are defined as

“evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.”

New practice aid on analytical procedures in a review engagement (continued)

- Two important components
 - Development of an expectation
 - Expectation is a prediction of the recorded accounts or ratios
 - Used to compare expected amount or ratio to what is recorded – difference may be a misstatement
 - Considering the precision of the expectation
 - Closeness to the correct amount (which is not necessarily the recorded amount)

New practice aid on analytical procedures in a review engagement (continued)

- Four steps to performing an analytical procedure
 1. Form an expectation
 2. Compare accountant's expected value with the recorded value and considers the unexpected difference
 3. Inquire of management regarding the difference if the amount exceeds the acceptable threshold
 4. Evaluate the difference between the expected value and the recorded amount and consider implications for the accountant's review report.

New practice aid on analytical procedures in a review engagement (continued)

Four types of methods to develop an expectation

1. **Trend analysis.** This is the analysis of changes in an account balance over time.
2. **Ratio analysis.** This is the comparison of relationships between financial statement accounts (between two periods or over time), the comparison of an account with nonfinancial data (such as revenue per order or sales per square foot), or the comparison of relationships between entities in an industry (for example, gross-profit comparisons).
3. **Reasonableness testing.** This is the analysis of account balances or changes in account balances within an accounting period that involves the development of an expectation based on financial data or nonfinancial data, or both.
4. **Regression analysis.** Regression analysis is the use of statistical models to quantify the accountant's expectation in dollar terms, with measurable risk and precision. In many cases, the entity has developed analytical procedures or internal models, or both, that it uses to monitor and evaluate its business and performance.

Quality Management

The ASB is a senior committee of the AICPA with 19 members designated by Council to issue auditing, attestation, and quality control standards and practical guidance

- 5 - Public members and users (CFO, Academia, Government)
- 5 – Local, Regional, National & Global firms
- 5 – Individuals representing State Regulators
- 4 – Big Four firms

Statements on Quality Management Standards

- Statement on Quality Management Standards (SQMS) 1, *A Firm's System of Quality Management*
- SQMS 2, *Engagement Quality Reviews* (New!)
- SAS No. 146, *Quality Management for Engagements Performed in Accordance with Generally Accepted Auditing Standards*
- Related conforming amendments (SSAE No. 23, SSARS No. 26)

Affects every firm that performs engagements in accordance with SASs, SSAEs or SSARS.

SQMS 1
(supersedes SQCS 8)

SQMS 2
(new)

AU-C 220
(Revised)

**Conforming
amendments: SSAE
No. 23, SSARS No. 26,
SQMS 3**

Setting the Stage – Overall Objective of QM Standards

Establish the quality related requirements for firm accounting and auditing practices

Enable the AICPA to communicate objectives and expectations regarding quality

Adherence is:

- Required through adherence to the Code of Professional Conduct
- Evaluated through peer review, firm monitoring and evaluation, and the performance of engagement quality reviews (as applicable)

The stated objective in the new QM standards explains (consistent with QC standards):

- Design, implement, and operate a system of quality management for engagements performed by the firm in its A&A practice that provides the firm with reasonable assurance that:
 - a) The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and
 - b) Engagement reports issued by the firm are appropriate in the circumstances.

Key Changes

1. New risk-based approach focused on quality management tailored to the firm's circumstances
2. Revised components of the system of quality management, including information and communication
3. More robust leadership and governance requirements
4. Enhanced monitoring and remediation process
5. New! Requirements for networks and service providers

The five key changes clarify and improve existing quality management processes

SQMS No. 1: The system and its components

- New focus on quality management, through risk-based approach
- Evolved from a linear and soloed system, to a system that operated in an iterative and integrated manner
- Proactive approach, with a continual flow of remediation and improvement
- Tailored system, scalable to the nature and circumstances of the firm and the engagements it performs



Understanding effective dates



Important!

Information on Effective Date

Firms must have completed the risk assessment and implemented the risk response, such that the system is operational, **BY December 15, 2025.**

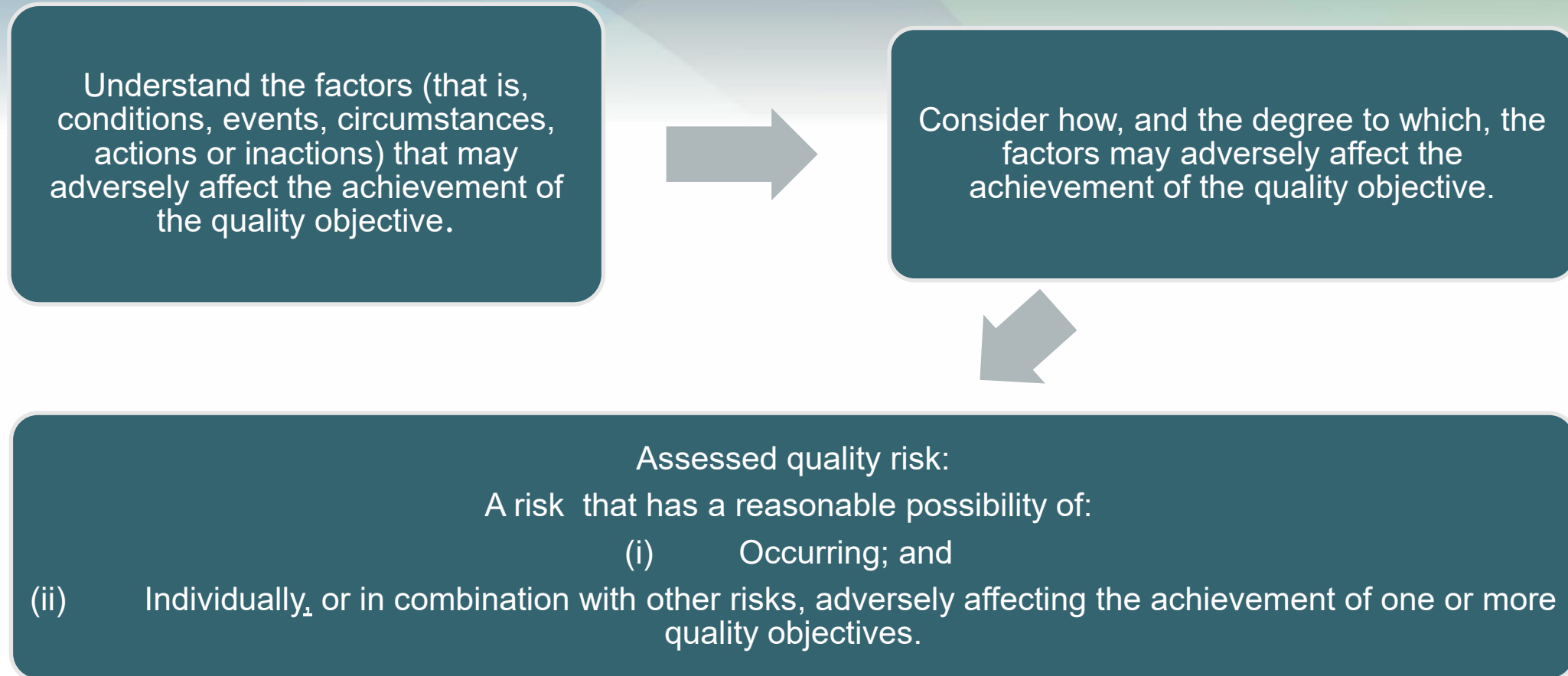
- *If you have not started, need to start now,*
- *Do it right the first time,*
- *Get it done on time*



Firm implementation checklist – deep dive

- ☐ Gain an overall understanding of the QM standards
- ☐ Develop an implementation plan
- ☐ Gain an understanding of the risk assessment process
- ☐ Perform the risk assessment
- ☐ Perform a gap analysis
- ☐ Design and implement new responses for those risks that are not addressed
- ☐ Prepare documentation
- ☐ Establish a process for ongoing monitoring (adjusting for changes) and remediation
- ☐ Evaluate new system

Risk Assessment Process: Identify and Assess Quality Risks



Assigning Responsibilities

Ultimate responsibility and accountability for the SQM

- CEO / managing partner / managing board of partners

Operational responsibility for the SQM

Operational responsibility for:

- Compliance with independence requirements
- The monitoring and remediation process

Operational responsibility for other specific aspects, as determined by the firm

Appropriate experience, knowledge, time, influence and authority

Leadership Responsibilities Under SQMS 1



The managing partner has ultimate responsibility and accountability for the firm's system of quality management.



The managing partner is required to evaluate and conclude about whether the firm's system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved.



The managing partner can obtain information from others in the firm to assist with these responsibilities.

Engagement Team

Who is included in engagement team?

- Partners and staff performing the engagement – includes individuals from the firm's service delivery centers
- Others performing procedures – includes component auditors, other from the network, service providers
 - Includes individuals with expertise in accounting or auditing (i.e., they are not an auditor's expert)
 - Includes an auditor's internal expert (i.e., is a partner or staff of the firm or a network firm)

Who is excluded from engagement team?

- Individuals providing consultation
- Engagement quality reviewer
- Auditor's external expert (i.e., *not* a partner or staff of the firm or a network firm)
- Individuals within the client's internal audit function who provide direct assistance.
- "Referred-to" auditor

Who is Considered a Human Resource?

Individuals in the firm

- Personnel – partners and staff in the firm
 - Staff are professionals, including experts the firm employs
 - Includes partners and staff in other structures of the firm (e.g., a service delivery center in the firm)

Individuals external to the firm

- Individuals external to the firm used in the SOQM or performance of engagements – i.e.:
 - Individuals from within the firm's network
 - Individuals employed by a service provider

Service Providers

- What is a service provider?
 - Individual or organization external to the firm
 - Provides a resource used in the firm's system or engagements; for example, **methodology**
 - Excludes anything from within the firm's network
 - Note! Includes component auditors from other firms (outside firm's network)

Identify the need for external resources

- Individuals are obtained from external sources
- Appropriate technological resources are obtained or developed
- Appropriate intellectual resources are obtained or developed

Resource is appropriate for use

- Other quality objectives relevant to that resource still apply

Q: Does a firm need to start from scratch when designing a SOQM and creating the QM document?

A: No. We suggest firms use the resources it already possesses under the prior QC standards. Review the existing documentation and conduct a gap analysis with knowledge of the new QM standards asking questions such as:

- Why are we doing what we're doing related to quality management?
- What are those existing policies and procedures accomplishing?
- Are they addressing certain risks?
- Do the existing policies and procedures meet the quality objectives?
- Are there some things we are doing that are not related to quality risks?
- Are there policies we are following or procedures we are performing that we don't need to be doing, or should we be doing them differently?



Q: Can the AICPA practice aid templates and tables form the core of a firm's QM documentation?

A: The AICPA practice aid can be a good starting point in helping a firm develop their quality objectives, risk assessment, responses, and implement policies and procedures which would roll into the firm's QM document. The risks and responses in the practice aid need to be customized.





Q: Should a firm have more quality objectives, quality risks, and responses than the ones provided in the QM standards and related AICPA practice aid?

A. Quality objectives: No, the ones in the standard are comprehensive.

Quality risks: Use the risks in the practice aid as a starting point. No need to identify everything that could go wrong.

Quality responses: You will need more responses than are required by the QM standard. The AICPA practice aid provides additional potential responses, not all of which may apply to your firm.



Q: If a firm only performs preparation engagements (i.e., engagements to prepare financial statements) is that firm subject to the QM standards?

A. Yes. Note that if a firm's accounting and auditing practice only consists of preparation engagements, the quality risks would be far less significant than other engagements where the auditor is providing assurance. Its

SOQM and supporting documentation would be much less complex and formalized compared to firms providing audits, reviews, etc..



Q: If a firm only performs preparation engagements (i.e., engagements to prepare financial statements) is that firm subject to the QM standards?

A. Yes. Note that if a firm's accounting and auditing practice only consists of preparation engagements, the quality risks would be far less significant than other engagements where the auditor is providing assurance. Its SOQM and supporting documentation would be much less complex and formalized compared to firms providing audits, reviews, etc..



Q: In a firm's SOQM under the new QM standards, is it acceptable for a firm to define the criteria by which an engagement is subject to an EQ review and determine that no EQ reviews are necessary during the year?

A. Yes, it's possible that no EQ reviews may be performed in a particular period because the criteria established by the firm that determines when an EQ review is appropriate has not been met. However, criteria should not be established with the intent that they never will be met.



Q: Can an individual who performs an inspection of an engagement as part of the monitoring activities of a SOQM be a member of that engagement team or the engagement quality reviewer of that engagement (i.e., can self-reviews be performed)?

A. Yes, the QM standards don't preclude this. Note that such self-reviews may be less effective than compliance inspections by another qualified individual.

Consider outsourcing inspections – perhaps to another firm in a similar situation. Or separate areas of inspection with the firm, so that the person in charge of independence reviews other areas and someone else inspects independence.



Q: If the firm's managing partner is a tax practitioner and not involved in the firm's attest work, can someone else be assigned ultimate responsibility and accountability for the firm's system of quality management?

A. No. Part of being managing partner is accepting responsibility that the firm is providing its services appropriately. Operational responsibility for the system of quality management may be assigned to another individual and the managing partner may further assign roles, procedures, tasks, or actions to other individuals to assist the individual in fulfilling the responsibilities.



Q: Is a peer review required when the firm has completed its adoption of the QM standards? Is a peer review required for a firm to evaluate its system of quality management?

A. There is no requirement in the QM standards about the timing of a firm's peer review. QM 10 does not require the firm to obtain an independent evaluation (for example, a peer review report or report on service organization controls) on its SOQM annually or preclude the firm from doing so.



Q: The QM standards have a new requirement for firms to investigate the root causes of identified deficiencies in a SOQM. How does a firm conduct a root cause analysis?

A. A root cause analysis is about getting to the fundamental cause(s) of a problem. How a root cause analysis is performed is up to the firm. Generally, it is a structured approach to understanding the problem and why it happened.

The PCAOB issued a Spotlight document in April 2024 titled *Root Cause Analysis – An Effective Practice To Drive Audit Quality* that practitioners may find useful in gaining an understanding of how to conduct a root cause analysis.



SQMS No. 3: *Amendments to QM Sections 10, A Firm's Quality Management, and 20, Engagement Quality Review*

- Revises certain definitions related to referred-to auditors to conform to SAS No. 149.
 - Clarifies that referred-to auditors are not members of the engagement team and are not component auditors
 - Distinguishes “resource” and “information source”
 - Component auditors are a “resource”
 - Referred-to auditor is an “information source”
 - Predecessor auditor is an “information source”
 - Service auditors that issues a report on a service organization's controls is an “information source”
 - Replaces references to group “auditor” to be group “engagement team”

SAS No. 146, *Quality management for an engagement conducted in accordance with GAAS*

- Evolving use of varying audit delivery models
- Engagement team may be located together or across different geographic regions
- Revised definition of **engagement team** that includes partner, staff and **any other individuals** who perform audit procedures on the engagement, including those engaged by a network firm
- Requirements have been enhanced to recognize the use of technological resources in the audit

The engagement partner's overall responsibility

- Sufficient and appropriate involvement throughout the engagement
- **Leadership responsibility** – EP is responsible for achieving quality at the engagement level.
- **Stand back** – EP should be satisfied that involvement has been sufficient and appropriate to provide basis for taking overall responsibility.
- **Direction, supervision and review** – EP is responsible for nature, timing, and extent, in view of the engagement circumstances.

Let's Talk Ethics and the AICPA Code of Professional Conduct

Applicability of the code

- **AICPA and state CPA society**
 - Private, voluntary memberships
 - Codes often the same
 - Many are members of both
- **Joint ethics enforcement program**
 - Jointly investigate potential disciplinary matters and arrange for:
 - presentation of cases before the trial board when evidence of violation of an applicable rule of conduct is found, or
 - matter to be settled by a settlement agreement.
- **Range of possible outcomes**

Role of Professional Judgment and Critical Thinking

- Not always bright line – you will navigate complex issues and uncertainty
- Apply professional judgment
- Think critically
- Appearance of independence
- Conflict of interest
- Conceptual framework

Key points of professional judgment

- The importance of an inquiring mind
- Openness to the need for further evaluation or action
- Awareness of the effects of conscious or unconscious bias

Conceptual Framework Approach

- Two frameworks for members in public practice
- One framework for members in business
- A systematic approach for identifying and evaluating threats
- May not override a rule by coming to a different conclusion using the conceptual framework
- Framework is not optional

Steps to Apply the Approach – Identify Threats to Independence (Step 1)

- Adverse interest
- Advocacy
- Familiarity
- Self-interest
- Self-review
- Undue influence
- Management participation

Evaluate the Significance and Apply Safeguards (steps 2 & 3)

- Not all threats are the same.
- Determine if a threat is acceptable.
- Consider both qualitative and quantitative factors.
- Conclude and communicate.
- Apply safeguards, if required.

Ethical Conflicts

Applies when a member in public practice or in business encounters

- obstacles to following an appropriate course of action due to internal or external pressures or
- conflicts in applying relevant professional and legal standards.

Ethical Conflicts – cont.

Consider

- relevant facts and circumstances, including applicable rules, laws, or regulations;
- ethical issues involved; and
- established internal procedures.

Consultation and documentation can be critically important.

Independence Rules for CPAs

Overview of Independence rules

- Independence is the cornerstone of public accounting.
- Understanding independence is important for all members. Includes independence of mind and independence in appearance.
- Definitions are not absolutes. All threats are required to be reduced to an acceptable level.

Definitions

- Attest client — A person or entity with respect to which a member performs an attest engagement.
- Attest engagement — An engagement that requires *independence*, as set forth in the AICPA Statements on Auditing Standards (SASs), Statements on Standards for Accounting and Review Services (SSARSs), and Statements on Standards for Attestation Engagements (SSAEs).

Definitions (Continued)

- Attest engagement team — Those individuals participating in the *attest engagement*, including those who perform concurring and engagement quality reviews. The attest engagement team includes all employees and contractors retained by the *firm* who participate in the *attest engagement*, regardless of their functional classification (for example, audit, tax, or management consulting services).

Which Independence Rules Apply?

- AICPA — All AICPA members and others performing audits under generally accepted auditing standards (GAAS) or other attest services
- State Accountancy Boards — All licensees (including via mobility rules) practicing under a state board's jurisdiction
- SEC and PCAOB
 - Public companies filing reports with the SEC
 - SEC registered broker-dealers, hedge funds, investment advisers

Which Independence Rules Apply? (Continued)

- CFTC — Audits of futures commission merchants comply with independence requirements applicable to non-issuer broker-dealer audits
- GAO — Attest services under government auditing standards
- DOL — Audits of employee benefit plans subject to ERISA

Which Independence Rules Apply? (Continued)

- FDIC or other banking agencies — Policy statements on independence including internal audit, SOX, and indemnification
- NAIC — Model Audit Rule incorporates several aspects of the SEC's independence requirements
- IESBA – Global code that serves as the foundation for member body codes throughout the world
- EC — Audit and independence rules for European Union

When Is Independence Required?

- Independence in fact and appearance
 - Period of the professional engagement
 - Period covered by the financial statements
- Financial Interests — Independence required during the *professional engagement*.
- Nonattest services, business, and employment relationships — Independence required during the *professional engagement* and *period covered by financial statements*.

Conceptual Framework For Independence

- Threats and safeguards approach used for independence for many years.
- Identify threats
 - Are threats significant?
 - If significant, could safeguards reduce or eliminate?
 - Threats must be at “acceptable level” or independence is impaired.
- If a rule applies, do not apply conceptual framework, which is intended to address situations where no rule exists.

Nonattest Services

- Advisory services (**be careful here**)
- Appraisal, valuation, or actuarial services
- Benefit plan administration services
- Bookkeeping, payroll, and other disbursement services
- Business risk consulting services
- Corporate finance consulting services
- Executive or employee recruiting services

Nonattest Services (Continued)

- Forensic accounting services
- Hosting services
- Information systems design, installation, or integration services
- Internal audit services
- Investment advisory or management services
- Tax services

General Requirement 1 – Establish Understanding with Client

Independent CPA responsibilities	The client's responsibilities
<p>Establish and document in writing the understanding with the client regarding:</p> <ul style="list-style-type: none">• Objectives of the engagement,• Services to be performed,• Member's responsibilities,• Client's acceptance of responsibilities, and• Any limitations of the engagement.	<ul style="list-style-type: none">• Accepting responsibility for the services,• Designating an individual, preferably within senior management, who possesses suitable skill, knowledge, or experience to oversee the service,• Evaluating the adequacy and results of the services performed, and• Making management decisions and assuming all management responsibilities.

General Requirement 2

- Management responsibilities involve leading and directing an entity.
- Examples:
 - Setting policy or strategic direction
 - Directing or accepting responsibility for actions of employees
 - Authorizing, executing, or consummating transactions
 - Preparing source documents
 - Having custody of an attest client's assets
 - Deciding which recommendation of the member to implement
 - Reporting to those charged with governance on behalf of management

General Requirement 3

- Before perform nonattest services, establish and document understanding with client
- Engagement letter or another type of document
- Failure to document does not affect independence but would be considered a compliance issue

Note: Routine activities are NOT nonattest services and do not require compliance with the General Requirements

General Impairments of Independence

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so;
- Preparing source documents, in electronic or other form;
- Having custody of client assets;
- Supervising client employees in their normal recurring activities;
- Determining which recommendations should be implemented;
- Reporting to the board of directors on behalf of management;
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent; and
- Establishing, maintaining, or monitoring internal controls.

Primary Threats to Independence

- **Self-review threat** – Members reviewing as part of an attest engagement evidence that results from their own, or their firm's, nonattest work such as, preparing source documents used to generate the client's financial statements.
- **Advocacy threat** – Actions promoting an attest client's interests or position.
- **Adverse interest threat** – Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other.
- **Familiarity threat** – Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.
- **Undue influence threat** - Attempts by an attest client's management or other interested parties to coerce the member or exercise excessive influence over the member.
- **Financial self-interest threat** - Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.
- **Management participation threat** - Taking on the role of client management or otherwise performing management functions on behalf of an attest client.

Recent Interpretations

AICPA – New and Revised

- New “Determining Fees for an Attest Engagement” interpretation (ET sec. 1.230.030)
- New “Fee Dependency” interpretation (ET sec. 1.230.040)
- Revised “Conceptual Framework for Independence” interpretation (ET 1.210.010) – Includes a *self-interest threat* (member could benefit, financially or otherwise from an interest or relationship with an attest client or persons associated with the attest client).
- Revised “Client Affiliates” interpretation (ET sec. 1.224.010)
- Unpaid fees – No more “bright line” test of one year or more. 12/31/2022

Updates related to fees

New “Determining Fees for an Attest Engagement” interpretation (ET sec. 1.230.030)

New “Fee Dependency” interpretation (ET sec. 1.230.040)

Revised “Conceptual Framework for Independence” interpretation (ET sec. 1.210.010)

Revised “Client Affiliates” interpretation (ET sec. 1.224.010)

Determining fees for an attest engagement

Key points in the interpretation include:

- The fees to be charged to an attest client, whether for attest or other services, is a business decision
- The determination takes into account the facts and circumstances relevant to that specific engagement
- The provision of other services to an attest client is not an appropriate consideration in determining the attest engagement fee in most circumstances
- The covered member responsible for setting the fee may consider the cost savings achieved as a result of experience derived from providing the other service

The “Fee Dependency” interpretation

Key points in this new interpretation include the following:

- The dependence on and concern about the potential loss of fees from attest and other services from that client affect the level of the self-interest threat and create an undue influence threat to a covered member’s independence.
- The total fees of the firm should include fees from attest and nonattest services.
- A covered member might use financial information available from the previous financial year to estimate the proportion of total fees.
- A covered member is not required to include fees from attest and nonattest services of other network firms within the firm’s network.
- When the attest client is a financial statement attest client, the covered member should include fees from entities described under item (a) of the definition of *affiliate*.

The “Fee Dependency” interpretation (continued)

Moreover, the interpretation stipulates that one of the following safeguards should be applied to reduce threats to an acceptable level when total fees from an attest client represent or are likely to represent a large proportion of the total fees received by the firm for five consecutive years:

- a. Prior to the attest report being issued for the fifth year, an appropriate reviewer who is not a member of the firm issuing the report reviews the fifth year’s attest work.
- b. After the attest report on the fifth year has been issued, and before the attest report is issued on the sixth year’s attest engagement, an appropriate reviewer who is not a member of the firm issuing the report reviews the fifth year’s attest work.

AICPA – New Under “Professional Qualifications or Competencies”

Any member who knowingly solicits or discloses Uniform CPA Examination questions or answers without the AICPA’s written authorization has violated the “Acts Discreditable Rule.”

A member will also be considered in violation of the “Acts Discreditable Rule” if the member engages in false, misleading, or deceptive acts related to professional qualifications or competencies, including

- soliciting or knowingly disclosing questions or answers of any continuing professional education (CPE) course examination
- falsifying or misrepresenting attendance at a CPE course, and
- tampering with the administration of or examination grading for any CPE course or credential.

Other Guidance, Tools and Aids

Online Code of Professional Conduct

- Online platform
 - Basic and advanced search capability
 - Pop ups
 - Bookmarks
 - Record notes
 - Hyperlinks
- Revision History
- <https://www.aicpa-cima.com/topic/ethics/code-of-professional-conduct>

Non-authoritative Tools and Aids

- **Toolkit: Conceptual Framework for Members in Business and Public**
 - Understanding and flowcharts
 - Examples and worksheet
- **FAQs**
 - Frequently asked and general industry questions
- **Ethics Case Study and Questions**
- **Ethics decision tree for members in business and industry**
- **Ethically Speaking podcasts**
- **Call me BMSS 256.964.9826 or e-mail at mbrand@bmss.com**

Audit Standards Update and Workpaper Documentation

Recently Issued/Effective Statements on Auditing Standards

- Identify the fundamental aspects of the recently issued new SAS No. 149, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.
- **Just as an FYI, there is an exposure draft out with a comment period due date of October 3, 2025 regarding *The Auditor's Responsibilities to Fraud in an Audit of Financial Statements*.**
- **ASB is currently reviewing comment letters received on the proposed SAS *External Confirmations*.**

SAS No. 149, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)

- Background

- The ASB's intent is to converge with IAASB, specifically, International Standard on Auditing (ISA) 600, because
 - the issues that led the IAASB to update its group audit standard are equally present and important in the United States and
 - it is not feasible for firms that perform engagements following IAASB and ASB standards to comply with fundamentally different standards for group audits.

SAS No. 149 (continued)

- Fundamental aspects of the new standard
 - Defining group financial statements as including financial information of more than one entity or business unit through a consolidation process
 - Identifying various ways in which consolidation may occur
 - Providing guidance on whether and how the SAS applies to entities with branches and divisions, shared service centers, and noncontrolled entities
 - Clarifying that all AU-C sections need to be applied in a group audit and establishing stronger links to the other AU-C sections
 - Introducing a risk-based approach to planning and performing a group audit

SAS No. 149 Engagement Partner Responsibilities

- Managing and achieving quality on the group audit engagement
- Reviewing overall audit strategy and audit plan
- Being sufficiently and appropriately involved with the work of the component auditors to determining whether significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group engagement
- Determining whether sufficient appropriate audit evidence can reasonably be obtained, including through involving component auditors to provide a basis for forming an opinion on the financial statements

SAS No. 149 Component Auditor Communications

- Identification of the financial information on which the component auditor has been requested to perform audit procedure
- Whether the component auditor has performed the work requested by the group auditor
- Whether the component auditor has complied with the relevant ethical requirements
- Instances of noncompliance with laws or regulations
- Any corrected or uncorrected misstatements of the component financial information
- Any indicators of possible management bias

SAS No. 149 Component Auditor Communications (cont.)

- Description of deficiencies in the system of internal control identified
- Any fraud or suspected fraud
- Other significant matters that the component auditor has or expects to communicate to component management or those charged with governance
- Overall findings and conclusions

SAS No. 149 Evaluation of Audit Evidence

- Group auditor evaluates whether sufficient appropriate evidence has been obtained from the audit procedures by
 - determining whether, and the extent to which, it is necessary to review additional component auditor audit documentation
 - Nature, timing, and extent of work performed
 - Competence and capabilities
 - Direction, supervision, and review of work performed

Auditor's Report: Referencing the Referred to Auditor

- The new SAS retains the option for the group engagement partner to make reference to the referred-to auditor's report in the group audit report.
- The group engagement partner should take responsibility for ensuring the referred-to auditor is aware of relevant ethical requirements.
- Make reference only when the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with GAAS or PCAOB auditing standards.
- The referred-to auditor's report cannot be restricted as to use.
- The group engagement partner should read the component's financial statements and the referred-to auditor's report

SAS No. 149 Effective Date

- Group audits for financial statements for periods ending on or after December 15, 2026

What are Working Papers?

The Importance of Audit Working Papers

- Records
 - What auditor did
 - What auditor found
 - How auditor responded or concluded
- Enables communication among auditors
- Required by professional standards

AU-C Section 230 Requirements

- Provide a clear understanding of
 - Nature, timing, and extent of audit procedures;
 - Results;
 - Evidence obtained and its source; and
 - Conclusions reached.
- Who performed and who reviewed the work, and when
- The reconciliation of accounting records to the financials

Why the Focus on Documentation?

- It's all we have to 'evidence' your work
- It supports your conclusions on a specific risk/assertion/account balance/disclosure etc..
- It supports your opinion or report and the overall audit objectives (obtain reasonable assurance and issue the appropriate report) were met
- It provides evidence that you complied, in all material respects, with GAAS
- It's a common peer review finding, or a common peer review 'excuse'

Why the focus on documentation? (...cont'd)

- Critical to practice monitoring – both internal and external
- Can be hard to distinguish what you “know” (in your head) versus what you’ve actually documented. (I thought I documented that!)
- Face it, some are better at documenting than others – practicing helps, supervising and reviewing helps, review notes help, inspections (internal and external) help, OTJ training helps.
- No documentation? No credit....

What is it?

- The auditor's record of
 - Procedures performed - what I did
 - Evidence obtained (including disconfirming evidence) – what I saw
 - Conclusions reached – what I thought

What is it? (...cont'd)

- Includes:
 - Planning docs, checklists, memos, analyses, detailed tests, sample calculations, analytical procedures, tests of details, excerpts, images, scanned source documents, confirmations, representation letters, correspondence, 3rd party reports, system generated data, videos, tic marks, initials, dates, firm QC documents etc. etc. etc.
- Excludes:
 - What you didn't document
 - What is not readily determinable by a knowledgeable third party
 - What cannot be inferred from the totality of the documentation
 - Oral explanation when the requirements of AU-C 230 have not been met

Straight out of the standard

.08 The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand(Ref:par..A4—.A7and.A19—.A20)

- a. the nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements;(Ref:par..A8—.A9)
- b. the results of the audit procedures performed, and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.(Ref:par..A10—.A13)

Straight out of the standard (...cont'd)

.09 In documenting the nature, timing, and extent of audit procedures performed, the auditor should record

- a. the identifying characteristics of the specific items or matters tested;(Ref:par..A14)
- b. who performed the audit work and the date such work was completed; and
- c. who reviewed the audit work performed and the date and extent of such review.

What is required?

- Experienced auditor with no connection to the audit should understand:
 - The nature, timing and extent of procedures performed
 - Results and evidence obtained
 - Significant findings, issues and professional judgments

Nature, timing and extent

- Identifying characteristics of the items tested
 - Can the test be reperformed if necessary?
- Who performed and the date of performance
- Who reviewed and the date/extent of review

Results and conclusions

- Were the results in line with expectations?
- Were anomalies investigated?
- Does another course of action need to be taken?
- Is more testing required?
- Are there deficiencies that should be considered?
- Has materiality been considered?
- Has the materiality benchmark used also been considered?

- Did you use assets as your benchmark, but then have material

Significant findings, issues and judgments

- Determining what is significant will require an objective analysis
- To what extent is professional judgment required
- Document relevant discussions – what, who and when
- Inconsistencies
 - Disconfirming evidence should be documented and how resolved
 - Team differences should be documented
 - All documentation should be timely – evidence must be obtained, documented with conclusions and reviewed prior to dating/issuing financial statements.

Documentation requirements – lock down

- File lock down within 60 days (GAAS) following the report release date
 - Audit evidence should NOT be performed or introduced into the wps during the 60-day time performed
 - Largely administrative tasks only
 - After 60 days NO DELETIONS

Documentation errors

- Planning brainstorm, RMM and fraud (peer review indicates that more than 10% of firms are not complying, just going through the motions).
- Understanding the entity and internal control
- RMM at financial statement and relevant assertion level
- Significant risks
- Linkage to and responses to risks (connecting judgements about risk with procedures)
- Results/conclusions/level of effort/RMM are not in synch
- Professional skepticism not demonstrated
- Disconfirming evidence thrown out and not addressed
- Source documents not evaluated for completeness or accuracy

Documentation errors (...cont'd)

- Controls are not tested, but CR is less than the maximum (some control testing is really testing of processes, not controls).
- Significant risk identified but design and implementation of controls not evaluated
- Sample sizes have no basis
- Cannot recreate the work based on the evidence documentation
- No linkage to brainstorm, especially fraud
- No test of details when significant risk identified
- No expectations and basis for those expectations for substantive analytics
- Precision/persuasiveness of the expectation not aligned with risk assessment.

Connection to risk assessment

Lower RMM	←-----→	higher RMM
Less documentation	←-----→	more documentation
Less review	←-----→	more review
Less persuasive	←-----→	more persuasive
Less precise	←-----→	more precise
Fewer items (less coverage)	←-----→	more items (more coverage)
Less reliable	←-----→	more reliable

Is your risk assessment, evidence and documentation aligned?

What documentation do we need?

- Goodwill impairment considerations
- Asset subject to FV accounting
- Inventory price testing
- Search for Unrecorded liabilities
- Minutes of meetings
- Risk assessment

How much documentation do we need?

- Substantive analyticals
- Fixed asset additions
- Inventory observations
- New note receivable from related party
- New long term bank debt to acquire an asset
- Debt covenant compliance

How can you move the needle?

- Take wp documentation seriously
- Review and supervise carefully and use as a teaching tool
- Use practice monitoring as a teaching tool
- Use review notes as a teaching tool
- Timely prepare, timely review
 - Not the same as “as soon as I can”
- Institute an EQR program that’s robust
- Question what’s new, what’s different, what’s missing

Clear Understanding

Sufficient to enable an experienced auditor with no previous connection on the audit to understand

- The scope of audit testing and results;
- Auditor conclusions; and
- The reconciliation of the underlying accounting records with the financial statements.

Other Guidance (partial listing only)

- Engagement Letter (AU-C sec. 210)
- Quality control conclusions (AU-C sec. 220)
- Auditor's consideration of fraud and communication with the entity about any discovered fraud (AU-C sec. 240)
- Identified or suspected noncompliance with laws (AU-C sec. 250)
- Required communications with those charged with governance (AU-C sec. 260)
- Communications related to control weaknesses (AU-C sec 265)
- Overall audit strategy (AU-C sec. 300)

Engagements that Require Working Papers

Service	Applicable Standard
Preparation of Financial Statements	Statements on Standards for Accounting and Review Services (SSARS)
Compilation of Financial Statements	Statements on Standards for Accounting and Review Services (SSARS)
Review of Financial Statements	Statements on Standards for Accounting and Review Services (SSARS)
Attestation Engagements	Statements on Standards for Attestation Engagements (SSAE)
Valuation Services	Statement on Standards for Valuation Services (SSVS)

How “good” is the Evidence – Sufficient (enough) and Appropriate (relevant and reliable)

- Source / type – is 3rd party evidence really more reliable?
- Determining the impact of management bias considering
 - The ability of the entity to influence the external information source
 - Management’s selection of information from an external source known to be favorably biased toward corroborating management’s assertions or information
- Quantity (this cant overcome a lack of appropriateness)
- Corroborate or contradict
- Precision / susceptibility to bias
- Level of detail - disaggregation

How “good” is the Evidence – Sufficient (enough) and Appropriate (relevant and reliable) (continued)

- Accuracy / authenticity
- Complete
- Recent
- Previous experience
- Is the evidence persuasive? HOW persuasive is it? Minimal... to ... compelling.
- How good does it need to be? What is your RMM?
- MUST REMAIN SKEPTICAL – WHAT DOES THAT MEAN TO YOU?

Nature of Working Papers

- Working papers should be adaptable to needs of engagement.
- Documentation refers to anything enabling the auditor to render an opinion.
 - Work programs and checklists
 - Confirmations
 - Contracts
 - BOD minutes
 - Memos
 - Correspondence (including e-mail)

Extent of Documentation

- Factors to consider include
- Risk of material misstatement in the account;
- Extent of judgment necessary;
- Nature of audit procedure;
- Significance of evidence;
- Nature and extent of exceptions; and
- Whether evidence or conclusion previously documented.

What Should be in the Working Paper File?

- All working papers for a specific audit should be assembled in an audit file.
- May be stored separately or in different offices
- Cross-referenced if used on multiple engagements
- Engagement-specific quality control or engagement matters should be included
- Question? How should conclusions regarding the success of tests be documented in the working papers?

Types of Working Paper Files

- Permanent files
 - Extracts of articles of incorporation and bylaws
 - Current contracts and agreements
- Current files
 - Working trial balance
 - Planning documents
 - Lead schedules
 - Detail schedules

Types of Working Paper Files (continued)

- Other (confirmations, memorandums describing the testing, relevant correspondence)
- Correspondence as evidence obtained concerning significant issues or findings
 - Whether written, oral or electronic (for example, email)

What Every Working Paper Should Contain

- Name of client
- Title describing contents
- Date of financials being audited
- Who prepared and when
- Who reviewed and when
- Source of information
- Resolution of exceptions
- Recommended but not required: purpose of working paper; conclusion of test

Completing the File

- Documentation of report release date
- Documentation completion date (complete assembly of audit file) must be within 60 days of the report release date
- Must not delete or discard documentation until five years after report release date

Between the report release date and documentation completion date, the auditor is allowed to:

- Complete documentation of audit evidence obtained before report date;
- Perform routine file assembly procedures;
- Sign off on file completion checklists; and
- Add information received after report date.

Modifications and Additions to the File After the Report Release and/or Documentation Completion Date

When new information comes to the auditor's attention after the report release date that requires additional audit procedures or draws new conclusions, document the following:

- The circumstances encountered
- The new or additional audit procedures performed, evidence obtained, conclusions reached, and effect on the auditor's report
- When and by whom performed and reviewed

Modifications and Additions to the File After the Report Release and/or Documentation Completion Date (continued)

In circumstances other than those described on the previous tab, when an auditor finds it necessary to modify existing audit documentation or add new documentation after the documentation completion date, the auditor should, regardless of the nature of the modifications or additions, document

- The circumstances encountered;
- The new or additional audit procedures performed, evidence obtained, conclusions reached, and effect on the auditor's report; and
- When and by whom performed and reviewed.

AICPA Focus Areas and Peer Review Issues Identified

- Top issue identified – **Risk assessment**
- **Documentation** – 25% of engagements subject to review were materially nonconforming due to failure to comply with documentation standards
- **Single Audits** – Remain a significant focus area

FASB Accounting Standards Updates

Learning objective

- Identify recently issued FASB Accounting Standards Updates (ASUs) that cover broad issues, other than those related to the “big three” of revenue recognition, financial instruments, and leases.

ASU's Issued

Year	ASU's Issued
2024	4
2023	6
2022	6
2021	10
2020	11
2019	12
2018	20
2017	15

ASU No. 2022-03, Fair Value Measurement (*Topic 820*): *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*

- Applies to entities that are required to account for equity securities at fair value and those securities are subject to a contractual sales restriction.
- Do not account for any contractual restriction of an equity security in determining the fair value of the equity security.
- Transition
 - Include in income any increase in fair value due to the exclusion of the discount that had been recognized due to the contractual restriction.

Required disclosures and effective date

- The fair value of equity securities subject to contractual sales restrictions reflected in the balance sheet
- The nature and remaining duration of the restrictions
- The circumstances that could cause a lapse in the restrictions

Public business entities:

- Fiscal years beginning after December 15, 2023, and interim periods within those years

All other entities:

- Fiscal years beginning after December 15, 2024, and interim periods within those years.

Early adoption is permitted for financial statements that have not been issued or made available for issuance.

ASU No. 2023-05: *Business Combinations-Joint Venture Formations – (Subtopic 805-60): Recognition and Initial Measurement*

Codifies accounting for the newly formed joint venture for the initial contribution of asset and assumption of liabilities

Current ASC does not provide guidance and specifically excluded joint ventures from Topic 805 and Topic 845

ASU No. 2023-05: *Business Combinations-Joint Venture Formations* – (Subtopic 805-60: *Initial Measurement*)

- Overarching principle is this is a new entity and acquisition method of accounting will be followed with no acquiring entity (with exceptions)
- Measure identifiable contributed assets and liabilities at fair value, including goodwill, if any
- Equity at formation will be equal to 100% of fair value of identified net assets

ASU No. 2023-05: *Business Combinations-Joint Venture Formations* – (Subtopic 805-60: *Disclosures*)

The financial statements of the joint venture will disclose relevant information

- Nature and effect of formation
- Date of formation

ASU No. 2023-05: *Business Combinations-Joint Venture Formations* – (Subtopic 805-60: *Effective Date*)

- Joint venture formations on or after January 1, 2025
- Early adoption permitted
- Retrospective application can be applied for existing joint venture if relevant information is available.

FASB ASU No. 2023-08, *Intangibles – Goodwill and Other – Crypto Assets – (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets*

Characteristics of a crypto asset

- Meets ASC definition of an intangible asset
- Does not provide enforceable rights
- Created by blockchain or similar technology
- Secured through cryptography
- Fungible
- Not created or issued by the reporting entity or related party

Measurement of Crypto Assets

Measured at fair value on balance sheet date

May be level 1, 2, or 3 inputs

Gain or loss reported on the income statement or statement of activities

Presentation of Crypto Assets

Present on balance sheet separately from other intangible assets

May be current or non-current

Report as cash transaction on Statement of Cash Flows if Crypto is received for the sale of goods or services and immediately converted to cash

Gain or loss is reported or disclosed separately from gains or losses from other intangible assets

Disclosure of Crypto Assets

Interim and annual disclosures

- Name, cost basis, fair value, and number of units for each significant crypt holding
- May aggregate information for holdings that are not individually significant
- Any contractual sales restrictions for crypto assets and circumstances that could cause the restrictions to lapse

Disclosure of Crypto Assets (continued)

Annual disclosures

- Aggregate rollforward of crypto holdings (beginning balance, additions, dispositions, and gains and losses)
- Gain or loss on disposals and line item on income statement where reported (if not reported separately)
- Method for determining cost basis

Effective Date and Transition

All entities for fiscal periods ending after December 15, 2024, and interim periods within that fiscal period

Early adoption permitted

Record a cumulative-effect adjustment to adjust the recorded value of any crypto asset to fair value on the first day of the fiscal year of adoption

ASU No. 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*

- Enhances and adds specific disclosures
- Most changes relate to public business entities
- Eliminates some disclosures

Rate reconciliation – Public entities

Tabular reconciliation with the following categories:

- State and local, net of federal
- Foreign tax effects
- Effect of changes in tax laws, current
- Effect of cross-border tax laws
- Tax credits
- Changes in valuation allowance
- Nontaxable or deductible items
- Changes in unrecognized tax benefits

Rate reconciliation (continued)

- Certain items must be further disaggregated if the effect of the reconciling items is equal to or greater than 5% of income or loss from continuing operations before income taxes by the applicable statutory income tax rate
- Explanations, if not otherwise evident, of individual reconciling items disclosed (nature, effect, and underlying causes of the reconciling items)
- Judgment used in categorizing reconciling items

Rate reconciliation – Non-public entities

Qualitative disclosures about the following items that cause a difference between the statutory tax rate and the effective tax rate

- Specific categories of reconciling items
- Individual jurisdictions

Disclosures – Income taxes paid

- The amount of income taxes paid (net of refunds), disaggregated by federal, state, and foreign taxes
- The amount of income taxes paid (net of refunds) disaggregated by individual jurisdictions in which income taxes is equal to or greater than 5% of total income taxes paid (net of refunds)

Other disclosures

- Income or loss from continuing operations before income tax expense (or benefit) disaggregated between foreign and domestic
- Income tax expense (or benefit) from continuing operations disaggregated by federal, state, and foreign

Eliminated disclosures

- Nature and estimate of the range of reasonably possible change in the unrecognized tax benefits balance in the next 12 months or a statement that such an estimate of the range cannot be made
- Cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of certain exceptions

Effective date of ASU No. 2023-09

Public business entities

Periods beginning after December 15, 2024

Other than public business entities

Periods beginning after December 15, 2025

Early adoption permitted

ASU No. 2024-01, *Compensation – Stock Compensation*

(Topic 718): Scope Application of Profits Interest and Similar Awards

- Aims to improve clarity and lead to consistent application
- Provides illustrative examples to help practitioners apply scope guidance in determining whether profits interest and similar awards should be accounted for under Topic 718, Compensation – Stock Compensation
- Issued in response to complexities and diversity in practice (even for similar fact patterns) identified by the PCC regarding the accounting of profits interest awards, which are used by entities to align compensation with performance and provide participants with future profits and/or equity appreciation

Effective date of ASU No. 2024-01

For public business entities (PBEs), the amendments are effective for annual periods beginning after December 15, 2024, including interim periods within those annual periods

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

Early adoption is permitted for both interim and annual financial statements not yet issued or available for issuance

Entities can apply the amendments retrospectively to all prior periods presented or prospectively to awards granted or modified after the first application date

ASU No. 2024-02, Codification Improvements – Amendments to Remove References to the Concepts Statements

- Introduces amendments to the Codification to remove all references to the Concepts Statements, which are nonauthoritative
- Ensures the Codification only reflects authoritative U.S. GAAP
- The update is expected to streamline the application of GAAP by eliminating potential confusion over the role of Concepts Statements in preparing financial statements

Effective date of ASU No. 2024-02

Effective for public entities for fiscal years beginning after December 15, 2024; for private entities, the effective date is after December 15, 2025

Early adoption is permitted for any fiscal year or interim period within

The transition can be applied either prospectively to all new or modified transactions recognized on or after the date of first application or retrospectively to the beginning of the earliest comparative period presented

ASU No. 2025-05, Measurement of Credit Losses for Accounts Receivable and Contract Assets

- Introduces a practical expedient for all entities and an accounting policy election for entities other than public business entities related to applying Subtopic 326-20 to current accounts receivable and current contract assets arising from transactions accounted for under Topic 606.
- Stakeholders observed that estimating expected credit losses for current accounts receivable and current contract assets that were collected before the date that the financial statements were available to be issued can require significant effort and documentation and can result in recording expected credit losses for amounts that have been subsequently collected.

ASU No. 2025-05, Measurement of Credit Losses for Accounts Receivable and Contract Assets (cont.)

- Stakeholders noted that the ability to consider collection activity after the balance sheet date when estimating expected credit losses would provide investors and other financial statement users with decision-useful information while significantly reducing complexity for preparers.
- The amendments in this Update affect entities that apply the practical expedient and accounting policy election (if applicable) when estimating expected credit losses on current accounts receivable and/or current contract assets arising from transactions under Topic 606, including those assets acquired in a transaction accounted for under Topic 805, Business Combinations.

ASU No. 2025-05, Measurement of Credit Losses for Accounts Receivable and Contract Assets (cont.)

- The amendments in this Update provide (1) all entities with a practical expedient and (2) entities other than public business entities with an accounting policy election when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606, as follows:
 1. Practical expedient. In developing reasonable and supportable forecasts as part of estimating expected credit losses, all entities may elect a practical expedient that assumes that current conditions as of the balance sheet date do not change for the remaining life of the asset.
 2. Accounting policy election. An entity other than a public business entity that elects the practical expedient is permitted to make an accounting policy election to consider collection activity after the balance sheet date when estimating expected credit losses.

ASU No. 2025-05, Effective Date

- An entity that elects the practical expedient and the accounting policy election, if applicable, should apply the amendments in this Update prospectively.
- The amendments will be effective for annual reporting periods beginning after December 15, 2025, and interim reporting periods within those annual reporting periods. Early adoption is permitted in both interim and annual reporting periods in which financial statements have not yet been issued or made available for issuance.
- An entity other than a public business entity that elects the practical expedient and, if applicable, the accounting policy election after the effective date would not need to perform a preferability assessment in accordance with paragraph 250-10-45-2.

PCC and FASB Technical Agenda

Purpose and Composition of PCC

- Two primary responsibilities:
 - To determine whether exceptions or modifications to existing non-governmental U.S. GAAP are required to address the needs of users of private company financial statements; and
 - To serve as the primary advisory body to the FASB on the appropriate treatment for private companies for items under active consideration on the FASB's technical agenda
- The PCC has completed this first responsibility and is now generally serving in a consulting and advisory role to the FASB as the FASB progresses on its technical agenda
- Influence of PCC seen in recently issued FASBs on consolidation, etc..

Composition of PCC

- Between 9–12 members, including a Chairman
- Appointed by FAF Board of Trustees
- Represent broad constituencies:
 - Financial statement users
 - Financial statement preparers
 - Accounting practitioners

Items on Which the PCC is Consulting

- Accounting for and Disclosure of Crypto Assets project;
- Accounting for and Disclosure of Software Costs project;
- Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method project;
- Accounting for Environmental Credit Programs project;
- Stock-Based Compensation project;
- Profits Interests and Their Interrelationship with Partnership Accounting project;
- FASB's Agenda consultation;
- Implementation issues related to ASC 606, 842 and 326; and
- Targeted Improvements to Income Tax Disclosures project

FASB Technical Agenda

- 14 active projects as of March 2024:
 - Framework Projects (1)
 - Recognition and Measurement: Narrow Projects (10)
 - Presentation and Disclosure Projects (3)
- Details available at [FASB.org](https://www.fasb.org)

FASB Framework Projects

- Consist of updating FASB Concepts Statements
- 1 current projects:
 - Measurement Framework
- Two updates to the Concepts Statements were issued in December 2021
 - Presentation Framework
 - Elements Framework

Disclosure framework project is completed, with two ASUs issued and three more proposed

Other Active Projects

- Recognition Projects – Narrow (10):
 - Accounting for government grants
 - Accounting and disclosure of software costs
 - Accounting for environmental credit programs
 - Financial instruments – CECL – Purchased financial assets
- Presentation and Disclosure Projects (3)
 - Disaggregation – Income statement expenses
 - Interim reporting – Narrow-scope improvements
 - Statement of cash flows targeted improvements

Where are we at with the “Big 3”?

FASB ASU No. 2016-13, *Financial Instruments – Credit Losses*

- Second phase of financial instruments project
- Introduces the CECL model
- Replaces the incurred loss model
- Does not converge with International Financial Reporting Standards® (IFRS)

FASB ASU No. 2016-13, *Financial Instruments – Credit Losses*

■ Scope

- Entities holding financial assets and net investments in leases that are not accounted for at fair value (i.e., accounted for at amortized cost):
 - Loans
 - Held-to-maturity (HTM) debt securities
 - Trade and reinsurance receivables
 - Off-balance sheet credit exposures
 - Loan commitments, including lines of credit
 - Other financial assets not excluded from standard and have a contractual right to receive cash

FASB ASU No. 2016-13, *Financial Instruments – Credit Losses*

- The following are excluded from the CECL model:
 - Available-for-sale debt securities – Separate guidance
 - Financial assets accounted for at fair value through NI
 - Loans made to participants by defined contribution EBPs
 - Policy loan receivables of an insurance entity
 - Promises to give (pledge receivables) of a not-for-profit entity
 - Loans and receivables between common-control entities

The CECL Model

- Forward-looking analysis used to estimate expected credit losses
- Replaces the current five models used to measure impairment
- Requires impairment (allowance) of existing financial assets on basis of current estimate of contractual cash flows not expected to be collected at reporting date
- Removes existing “probable” threshold in U.S. GAAP for recognizing credit losses
- Broadens range of information considered in measuring allowance for expected credit losses
- Prohibits estimating expected credit losses solely on basis of most likely outcome approach
- CECL Model was effective for nonpublic business entities on reporting years beginning after December 15, 2022. Early adoption was allowed

Measuring Expected Credit Losses (ECL)

- Must be estimated over the life of the exposure, or pool of exposures with similar characteristics
- Derived using:
 - Historical information
 - Current information
 - Reasonable and supportable forecasts
 - Estimates of prepayments
- ASU No. 2016-13 prescribes no method to use

FASB ASU No. 2019-11, *Codification Improvements – Credit Losses*

- Addresses minor issues for the following:
 - Expected recoveries for purchased financial assets with credit deterioration
 - Transition relief for troubled debt restructuring
 - Disclosures related to accrued interest receivables
 - Financial assets secured by collateral maintenance provisions
 - Conforming amendments to FASB ASC 805-20

FASB Post-Implementation Reviews

- FASB has begun Post-Implementation Reviews (PIRs) for the following standards:
 - ASC 606 – *Revenue from Contracts with Customers*
 - ASC 842 – *Leases*
 - ASC 326 – *Credit Losses*
- Purpose of PIR process
 - An evaluation of whether a standard is achieving its objective by providing financial statement users with relevant information in ways that justify the cost of providing it
 - During the PIR process, the FASB solicits and considers diverse stakeholder input and other research to evaluate the standards that are issued and determine whether there are areas of improvements that the FASB should address

Stages of PIR Process

- Stage 1 – Post-issuance date implementation monitoring
 - Actively monitor practice as stakeholders prepare for initial implementation
 - Develop and disseminate implementation guidance and educational material
 - Communicate and perform outreach with stakeholder organizations
- Stage 2 – Post-effective date evaluation of costs and benefits
 - Understand the costs that an entity incurred in applying the standard, as well as the costs that investors and other users incurred in analyzing and interpreting the information that the standard provides
 - Understand the benefits of the standard to investors and other users as well as to entities
 - Monitor the ongoing application of the standard
- Stage 3 – Summary of research and reporting

ASC 606 PIR – Stage 1 Activities

- Status of PIR activities
 - Six meetings of the TRG
 - Variety of standard-setting activity
 - Issuance of ASU No. 2021-03 and ASU No. 2021-09
 - Responses to over 250 technical inquiries
 - Dissemination of technical materials
 - Held webcasts and other communication events

ASC 606 PIR – Stage 2

- Public company-focused activities
 - 42 company preparer surveys
 - Outreach to auditors and regulators
 - Accounting system focus
 - Gathering of feedback for advisory meetings
 - Performed analysis of XBRL
 - Stakeholder feedback
 - Investor focus
 - Feedback on cost-benefit analysis
 - Academic research
- Similar feedback will be obtained related to private companies and NFPs following their ASC 606 implementation date
- Stage 3 report issued in 4th quarter of 2024: <https://www.fasb.org/news-and-meetings/in-the-news/fasb-issues-post-implementation-review-report-for-its-revenue-recognition-standard-420135>

Areas Discussed in the 606 PIR

- Overall feedback on ASC 606 is favorable
 - Most found little to no material impact on reported financial results
 - ASC 606 provides more useful and transparent information
 - ASC generally improved comparability across industries, with certain exceptions
 - Incremental costs were generally related to adoption
 - Comparability decreased in certain industries where participants have different revenue models
 - I.e., Software license vs. usage-based models
 - Healthcare

Summary of Key Themes from the PIR Process

- Considerations for additional research by the FASB
 - Principal vs. agent and related consideration payable to a customer
 - Licensing
 - Variable consideration
 - Disclosures
 - Short-cycle contract manufacturing
 - Standalone selling price
 - Identifying performance obligations
 - Incremental cost of obtaining a project

Lease Accounting

FASB ASU No. 2016-02, *Leases (Topic 842)*

- Applies to all entities that enter into leases and subleases except for certain nondepreciable assets accounted for under other FASB ASC topics
- Applies to all leases of over 12 months except for the following:
 - Intangible assets
 - Exploration of nonregenerative resources
 - Biological assets such as timber
 - Inventory
 - Assets under construction

ASC 840 to ASC 842: Differences and Similarities

Differences	Similarities
<ul style="list-style-type: none">• Operating leases on balance sheet• Capital leases are not finance leases• Lease classification• No deferred or prepaid expense• Initial direct costs• Footnote disclosure• Centralized recordkeeping	<ul style="list-style-type: none">• Income statement unchanged• Capital and finance lease calculation• Renewal criteria: Reasonably assured = reasonably certain• Remeasurement and modification accounting

Accounting for Leases –Post Effective Date

- Post-effective date for all new or amended leases
 - Lease classification as to finance vs. operating (five criteria)
 - Contracts that contain a lease (five criteria)
 - Assessment of material direct costs
 - Associated non-lease cost assessment
 - New SOX controls/footnote disclosures/continuous updating of leases database for change

You Mean There Are More Options Than Just U.S. GAAP?

Overall Learning Objectives

- What a “special purpose framework” is
- The types of businesses that might consider issuing special purpose framework financial statements
- The authoritative and nonauthoritative guidance generally used to prepare special purpose framework financial statements
- Some of the more common issues in preparing special purpose framework financial statements
- How to prepare special purpose framework financial statements using the cash, modified cash, and income tax bases of accounting
- The AICPA’s special purpose framework – *Financial Reporting Framework for Small- and Medium-sized Entities*

Special Purpose Framework Financial Statements

- “Special purpose framework” – Old “OCBOA”
 - Cash basis
 - Tax basis (also referred to as income tax basis)
 - Regulatory basis
 - Contractual basis
 - Other basis

Why Use a Special Purpose Framework?

- GAAP has become increasingly complex and not cost beneficial for private companies.
- Many of these private companies are small and medium sized entities that report to a narrow group of users. Those users typically have access to company management and additional financial information beyond what the financial statements provide.
- Many of these smaller entities maintain their records on a cash or tax basis.
- Accounting personnel at these companies can more easily understand the concepts of these special purpose frameworks.
- Many users of smaller entity financial statements find these frameworks to be more understandable than GAAP based financial statements.

Why Use a Special Purpose Framework?

- The entity's creditors do not need or require financial statements prepared in accordance with GAAP.
- The owners are closely involved in the day-to-day operations of the business and have a good “finger on the pulse” of the entity's financial position.
- The owners are primarily interested in cash flow (for consideration of distributing cash-basis earnings through salaries, bonuses, retirement plan contributions).
- Owners are primarily interested in the tax implications of transactions.
- A word of caution would be that a SPF might not be appropriate if the entity will soon be required to issue GAAP-based financial statements.

What are the Typical Entities that Might Consider a SPF?

- Professional services
- Retail services
- Medical
- Real estate
- Construction
- Not-for-profit
- Agricultural/farming
- Trusts
- Student activity funds
- Any others that do not require GAAP based financial statements.

What is the Authoritative Guidance for Financial Statements Prepared Under a Special Purpose Framework?

While U.S. GAAP includes pages of authoritative guidance, including implementation guidance, interpretations, etc., that is not the case for special purpose frameworks. The primary sources of guidance are:

- AU-C 210, Terms of Engagement, which require auditors to determine the acceptability of the financial reporting framework
- AU-C 800, Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks, which is the primary auditing resource
- SSARS 21, Statements on Standards for Accounting and Review Services: Clarification and Recodification, which is the primary review resource

Applying AU-C Section 800 to Special Purpose Frameworks

- Just as an auditor is required to do in the context of a special purpose framework, the preparer of SPF financial statements should understand:
 - The purpose for which the financial statements are being prepared
 - The intended users of the financial statements
 - Whether an SPF is acceptable in the particular circumstances
- A description of the SPF, a summary of its significant accounting policies, and how it differs from U.S. GAAP:
 - Effects of the differences do not need to be quantified
- Disclosures similar to those required by U.S. GAAP for items in SPF financial statements that are the same as, or similar to, those in U.S. GAAP financial statements
- Any additional disclosures that help the SPF financial statements to be fairly presented

Applying SSARS 21 to Special Purpose Frameworks

- SPF financial statements must include:
 - A description of the SPF, including:
 - A summary of significant accounting policies; and
 - A description of the primary differences from U.S. GAAP
 - Effects of the differences need not be quantified
 - Disclosures similar to those required by U.S. GAAP if the SPF financial statements contain items that are the same as, or similar to, those in U.S. GAAP financial statements
 - SSARS 21 was effective for year ends after 12/15/15

Amendments to AR-C Section 60

- The amendments to AR-C Section 60 include the following:
 - Adds a definition for the term “fair presentation framework” and amends the definition “financial reporting framework” included in AR-C Section 60 paragraph .07
 - Adds paragraph .51 to make clear that while the accountant may accept responsibility for the design, implementation and maintenance of internal control, such an activity is a management responsibility and, as such, impairs independence if performed for an attest client. If an accountant accepts such responsibility, the accountant is precluded from performing a review of financial statements

Definition of Fair Presentation Framework

- A financial reporting framework that requires compliance with the requirements of the framework and acknowledges both of the following:
 - Explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; and
 - Explicitly it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be only in rare circumstances
- The financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgments of the above is not a fair presentation framework

AICPA Technical Practice Aids

- Section 1310 – Statement of Cash Flows not required
- Section 1500 – No U.S. GAAP financial statement titles:
 - Statement of Cash Receipts and Cash Disbursements
 - Income Statement – Modified Cash Basis
 - Statement of Cash Flows – Income Tax Basis
- Section 1800 – Fair value disclosure requirements apply:
 - FASB ASC 820, *Fair Value Measurement*, is applicable to SPF financial statements that include accounts measured at fair value

What is the Authoritative Guidance for Financial Statements Prepared Under a Special Purpose Framework?

As you can see, the guidance deals with how practitioners should approach an engagement under a special purpose framework opposed to providing guidance on how transactions should be accounted for in accordance with a special purpose framework. This is due to the lack of authoritative guidance on either the tax or cash basis of accounting.

Practice aids can be helpful and are suggested when preparing special purpose financial statements. The AICPA and other organizations have produced practice aids. It is recommended that a high-quality practice aid is used to assist in ensuring the framework is being applied appropriately.

AICPA – FRF for SMEs™ does include a framework that is 206 pages that includes 31 separate chapters of materials. It does not have official or authoritative status.

Special Purpose Framework Presentation Issues

- When preparing SPF financial statements:
 - Consideration should be given to the overall presentation of the financial statements and whether they provide a fair presentation
 - Fair presentation = Including all disclosures appropriate for the SPF being used:
 - Particularly those that can help a user better understand and interpret the financial statements

Statement of Cash Flows

- Not a required SPF financial statement
- If presented – it should conform to U.S. GAAP requirements:
 - Or communicate the substance of those requirements
- Many SPF financial statement presentations do not include a statement of cash flows:
 - Particularly for small closely held businesses where the owner is fully engaged in running the day-to-day operations of the business

SPF Financial Statement Titles

- Do not use U.S. GAAP titles
- Modify titles – To help users clearly understand financial statements are not prepared in accordance with U.S. GAAP:
 - Statement of Assets and Liabilities – Modified Cash Basis
 - Statement of Cash Receipts and Disbursements
 - Statement of Cash Flows – Income Tax Basis

SPF Financial Statement Captions

- No authoritative literature regarding captions
- So unlike titles issue, no need to modify the standard U.S. GAAP captions when preparing SPF financial statements

Making a Change from GAAP to an SPF

- Current year financial statements only:
 - Present effect of change by showing beginning retained earnings as previously reported with an adjustment to convert to new basis
- Comparative financial statements:
 - Prior years should be restated and presented under the basis to which the entity has changed
- Disclose such changes in the notes to the financial statements
- Change in accounting basis does not represent lack of consistency:
 - Audit report modification is not required
 - Emphasis-of-matter paragraph may be appropriate

SPFs and Consolidation Accounting

- Use your professional judgment as to what is best
- But – For tax basis of accounting:
 - If tax return is on consolidated basis, also prepare consolidated SPF financial statements using that same tax basis
- Consider the need to disclose items required under GAAP, even if not a required disclosure under OCBOA

SPFs Disclosure Issues – Fair Presentation

- “Fairly presented” includes all disclosures appropriate for SPF being used:
 - Particularly information that can help users better understand and interpret the financial statements
 - Impact of amendments to AR-C 60 due to issuance of SSARS No. 24
- Advantages of SPF:
 - Disclosures can be a little less demanding than those required by U.S. GAAP
 - Substitute qualitative information for some of the quantitative information required by U.S. GAAP or simply provide information that communicates the substance of those requirements

SPFs Financial Statement Disclosures

- Summary of significant accounting policies including a description of the SPF used and how it differs from U.S. GAAP
- Disclosures similar to those required by U.S. GAAP for items in SPF financial statements that are same as, or similar to, those in U.S. GAAP financial statements
- Any additional disclosures that may be necessary for the SPF financial statements to be fairly presented

Summary of Significant Accounting Policies

- Keep it simple...
 - *The accompanying financial statements have been prepared on the accrual basis of accounting used for federal income tax reporting*
- And only major differences from U.S. GAAP discussed:
 - *Depreciation of property and equipment is computed based on recovery periods used for federal income tax purposes rather than the estimated useful lives of the individual assets*

Disclosure Checklist

- Best practice to use a disclosure checklist:
 - Helps to remind you to consider various disclosures that could be applicable to particular circumstances
- Guide for determining whether the financial statements include the disclosures and key presentation requirements under the SPF being used to prepare the statements
- Helps to make sure nothing important slips through the cracks

Special Purpose Framework Financial Statements

- Most widely used SPFs:
 - “Pure” cash; modified cash; and income tax basis
- AICPA developed another SPF – FRF for SMEs™
 - Financial Reporting Framework for Small- and Medium-Sized Entities

Pure Cash Basis

- Simplest SPF – Basically just a checkbook
- Only transactions that actually increase or decrease cash are included in the financial statements
- Cash receipts are revenue and cash disbursements are expenses
- Smaller, less complex organizations:
 - Mom and pop retail stores
 - Home-based startups
 - Many sole proprietorships

Pure Cash Basis vs. U.S. GAAP

- Under the pure cash basis:
 - No capitalizing long-term fixed asset purchases
 - So, no recording depreciation
- No period-end AJEs:
 - No unearned or accrued revenues
 - No prepaid or accrued expenses
- Does it get any easier than that?

Pure Cash Basis

When applying the pure cash basis of accounting, transactions are recognized based on the timing of cash receipts and disbursements. That means,

- revenues are recognized only when cash is received rather than when earned.
- expenses are recognized only when cash is paid rather than when an obligation is incurred.
- Purchased “assets” are not capitalized but are recorded as a disbursement so there is no amortization or depreciation.
- Neither prepaids or accruals are recorded.

Pure Cash Basis

Cash basis in this form is not widely used but may be appropriate whenever the entity

- has a limited number of financial statement users.
- is interested primarily in sources and uses of cash.
- does not have significant debt, capital assets or other items typically recognized in accordance with the accrual basis.
- has relatively simple operations and/or is engaged in one primary activity.

Pure Cash Basis Disclosures

- Description of SPF and how it differs from U.S. GAAP
- Summary of significant accounting policies
- U.S. GAAP disclosures (or similar to them) for items that are the same as, or similar to, those in U.S. GAAP financial statements
- Any additional disclosures that might help the users of the financial statement(s) better understand and interpret them:
 - Related-party transactions, subsequent events, and significant uncertainties

Pure Cash Basis Financial Statements

When applying the cash-basis of accounting, because the only assets of the entity would be cash and cash equivalents and there would be no liabilities, a balance sheet equivalent is often not presented. The income statement equivalent would report cash receipts and disbursements and other changes in cash and cash equivalents and disclose any restrictions on ending cash and cash equivalents.

Any departure from this presentation requires evaluation regarding whether they are appropriate modifications of the cash-basis of accounting. We will cover the modified cash basis next.

Modified Cash Basis of Accounting

Defined in the Statement on Standards for Accounting and Review Services (SSARS) as “a basis of accounting that the entity uses to record cash receipts and disbursements and modifications to the cash basis having substantial support”. **A modification to the cash basis is considered to have substantial support if it is equivalent to GAAP and is not illogical.**

Determining what is illogical requires judgment. A balance sheet that includes accrued receivables but not accrued payables is illogical. That makes the financials *appear* to be stronger than it is. It does not make sense to accrue an asset and not accrue a liability.

A modification to the cash basis to report capital assets should involve the recording and depreciating only those capital assets that result from cash transactions or events.

An easy way to think about whether a modification is appropriate is to consider whether the transaction would have been recorded if the entity was preparing pure cash basis and cash is part of the journal entry.

Modified Cash Basis of Accounting

Modifications to the cash-basis of accounting generally result when cash receipts or cash disbursements provide a benefit or an obligation that covers multiple reporting periods. Preparers may conclude that financial statement users would be misled if cash purchases of capital assets are recorded as disbursements or expenditures in the period in which assets are purchased. Instead, the preparer may elect to modify the cash basis to record the asset on the balance sheet equivalent and depreciate it over the estimated useful life of the asset. That would have substantial support and is logical and consistent.

An appropriate accounting policy should be developed when preparing modified cash basis financial statements. This can be challenging to say the least. Because there is no single accepted method of applying a modified cash basis of accounting, it can be seen as a “free-for-all” proposition. Remember that the Code of Professional Conduct tells accountants not to be associated with knowingly misleading financial statements.

It is important for preparers to avoid attempting to make certain modifications to GAAP statements and then referring to them as modified cash basis.

Modified Cash Basis of Accounting

- Modified cash basis = pure cash basis + modifications:
 - Modifications that are “logical and consistent”
- Most frequent modifications include:
 - Fixed assets are capitalized and depreciated
 - Liabilities are recorded for short- and long-term debt
 - Inventory expenditures are capitalized
 - Current income tax and payroll tax liabilities are accrued

Modified Cash Basis of Accounting

Appropriate Modifications	Inappropriate Modifications
Receivables resulting from a cash disbursement.	Receivables from credit transactions.
Investments in marketable securities acquired with cash.	Investments for which cash was not disbursed.
Inventories acquired with cash.	Donated capital assets.
Capital assets arising from cash transactions, and where appropriate, depreciation of those assets.	Capital assets arising from cash transactions, but not recording depreciation where appropriate.
Deferred revenue resulting from cash receipts.	Accounts payable for goods or services received without a cash disbursement.
Liabilities resulting from short-term cash borrowings.	Accrued liabilities without a cash disbursement.
Long-term notes and other debt arising from cash transactions.	Subsequent write-ups or write-downs to fair value to recognize unrealized gains and losses on marketable investments.
Other material assets, liabilities, revenues, and expenses resulting from cash transactions.	Derivative instruments without cash receipts or disbursements and mark to market for fair value changes.

When is the Modified Cash Basis of Accounting Really GAAP?

- When does the modified cash basis “cross the line” and become U.S. GAAP?
 - Left to your professional judgment
 - Use of A/R and A/P may be indicative
- Key – Look at the financial statements as a whole and ask:
 - Would reasonable person see as U.S. GAAP?

Modified Cash Basis of Accounting Advantages and Disadvantages

Advantages:

- Can be simpler to prepare than tax-basis
- Not affected by tax laws
- Interim financial statements are easy to prepare

Disadvantages:

- Principles are not well defined
- Not well suited for entities that have inventory or complex operations.

The opposite is true for using the tax basis.

Modified Cash Basis Disclosures

- There is no specific authoritative accounting guidance that details the disclosure requirements for SPF financial statements
- Instead, we look to the authoritative auditing literature and adapt its guidance for our SPF use

Tax Basis of Accounting

The tax basis is a basis of accounting that the entity uses to file its federal income tax or federal information return for the period covered by the financial statements.

The tax-basis of accounting is based on the principles and rules for accounting for transactions under the federal income tax laws and regulations. Few new measurement guidelines need to be established because the method is based on tax laws. The tax-basis of accounting covers a range of alternative bases, from cash to full accrual, depending on the nature of the taxpayer, and in some circumstances, the taxpayer's elections.

The transaction recognition criteria under this framework is generally simpler than that of the modified cash basis of accounting. Preparers should consider, **is this transaction recognized on the tax return?**

Tax Basis of Accounting

Any entity that files a return with the IRS, either an income tax return or an information return, may prepare tax-basis financial statements. Therefore, not-for-profit organizations, C corporations, S corporations, partnerships, limited liability partnerships, limited liability companies, and sole proprietors may all use the tax-basis of accounting.

If you prepare a tax or information return for a client, then the tax basis is the most efficient way to deliver financial statements.

It is most useful for small, nonpublic entities whose financial statement users are interested primarily in the tax aspects of their relationship with the entity.

IRS Accounting Methods

- The IRS defines an accounting method as:
 - A set of rules used to determine when income and expenses are reported, including the overall method of accounting and the accounting treatment used for any material item
- IRS allows several different accounting methods to compute taxable income:
 - The cash method and the accrual method are the most widely used in practice

Cash Method Accounting

- From a tax perspective, many sole proprietors and small businesses use the cash method of tax basis accounting because they find it easier to keep cash method records
- However, if a business produces, purchases, or sells merchandise, it must keep an inventory and use an accrual method for sales and purchases of merchandise

Excluded Entities

- The following entities cannot use the cash method, including any combination of methods that includes the cash method:
 - A corporation (other than an S corporation) with average annual gross receipts exceeding \$25 million
 - Threshold increased by Tax Cuts and Jobs Act
 - A partnership with a corporation (other than an S corporation) as a partner, and with the partnership having average annual gross receipts exceeding \$25 million
 - A tax shelter

Exceptions

- A qualified personal service corporation (PSC) meeting both:
 - **Function test** – 95% of its activities are in the performance of services in the fields of health, veterinary services, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting
 - **Ownership test** – 95% of its stock is owned, directly or indirectly, at all times during the year by PSC employees, retired employees, their estates (or heirs for two years after death)

Accrual Method of Accounting

- From a tax perspective, under an accrual method of accounting a business generally reports income in the year earned and deducts or capitalizes expenses in the year incurred
- The purpose of an accrual method of accounting is to match income and expenses in the correct year

Accrual Method Tax Basis Financial Statements

- Accounts receivable are reported at the principal amount outstanding. Bad debts are recognized using the specific charge-off method instead of an allowance method.
- Depreciation of property and equipment is computed based on recovery periods used for federal income tax purposes rather than the estimated useful lives of the individual assets.
- Contract revenues and costs are recognized using the completed-contract method instead of the percentage-of-completion method of accounting.

Inventory

- Under the tax laws, an inventory is necessary to clearly show income when the production, purchase, or sale of merchandise is an income-producing factor
- If a business must account for an inventory, it must use an accrual method of accounting for its purchases and sales
- Standard inventory accounting concepts apply

Other Issues

- Nondeductible items:
 - Nontaxable revenues and nondeductible expenses are probably the most widely seen issues that arise when preparing income tax basis financial statements
 - Report as separate line items in statement of revenues and expenses
 - Additions to, or deductions from, net income
 - Or disclosed in the notes to the financial statements

Other Issues

- Results of IRS Examinations:
 - Current period expense
 - Assessment does not affect balance sheet amounts and amount does not result from a clear error in prior year tax return
 - Prior period adjustment
 - Assessment affects balance sheet amounts or amount results from a clear error in prior year tax return
- Since IRS examinations can result in adjustments, practitioners should consider including a note to the financial statements alerting users to such a possibility

Other Issues

- U.S. GAAP Accrual vs. IRS Accrual:
 - Accrual method of accounting under U.S. GAAP and accrual methods under tax laws are NOT the same
 - U.S. GAAP measures revenue and expenses, tax laws measure gross income and deductions
 - U.S. GAAP typically does not allow for a lot of exceptions, but tax laws typically allow for numerous exceptions
- Changes to IRS Rules and Regulations

Regulatory Basis of Accounting

The regulatory basis of accounting is a basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject.

Regulatory basis accounting rules and guidelines vary from one regulatory agency to another.

These can include licensing agencies, insurance commissions, governmental agencies and any other regulatory agency. For example, the State Licensing Board for General Contractors formerly included the regulatory basis in the annual license renewal packages.

Contractual Basis of Accounting

The contractual basis of accounting is the basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.

Contractual basis accounting rules and guidelines vary from one contract to another.

“Other” Basis of Accounting

The other basis of accounting is the basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in the financial statements.

The most widely known is the AICPA – FRF for SMEs™ that we will cover in the next slides.

FRF for SMEs™

- Released in June 2013 – Became available for use upon issuance
- 206 pages; includes 31 separate chapters of material:
 - From basic financial statement concepts through foreign currency translation
- AICPA – FRF for SMEs™ largely parallels accrual method under tax basis of accounting
- No official or authoritative status:
 - Not approved by the FASB, Private Company Council (PCC), or any senior technical committee of the AICPA

FRF for SMEs™

- Does not define what an SME is
- Intended to be used by SMEs that do not have to prepare U.S. GAAP financial statements
- Users are assumed to have direct access to business owner or manager
- Not intended for entities that expect to broaden ownership interests in the business or take it public someday
- Not intended to be used by not-for-profits
- Unlike other SPFs, a complete set of financial statements includes a statement of cash flow.

What is a SME?

- FRF for SMEs™ does not define what a small- or medium-sized entity is
- AICPA – There “is no standard definition of [a SME] in the United States and the AICPA does not define the term either”
- *IFRS for SMEs* defines SMEs as entities that:
 - Do not have public accountability, and publish general purpose financial statements for external users

Keep It Simple

- FRF for SMEs™ is purposefully meant to be a less complicated framework that draws upon a blend of traditional accounting methods and the accrual basis of income tax accounting
- In this respect:
 - Topics not relevant to privately held SMEs are omitted
 - Historical cost is used as the primary measurement basis
 - Adjustments needed to reconcile book income to tax return income are reduced

Comparison With GAAP

- **Fair Value** – FRF for SMEs™ uses the term “market value” instead of “fair value” but basically same definition:
 - FRF for SMEs™ requires the use of market value in connection with marketable equity and debt securities held for sale, business combinations, and certain nonmonetary transactions
 - U.S. GAAP requires the use of fair value in connection with marketable equity and debt securities held for sale, business combinations, and certain nonmonetary transactions
 - **U.S. GAAP also exempts nonpublic entities from many of the fair value disclosures (the most complex) required for public entities**

Comparison With GAAP

- **Going Concern:**

- FRF for SMEs™ requires management to assess whether using the going concern basis of accounting is appropriate; disclosures are required if certain conditions are met
- U.S. GAAP requires management to assess an entity's ability to continue as a going concern
 - See ASU No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*

Comparison With GAAP

- **Impairment:**

- FRF for SMEs™ does not explicitly require the assessment for impairment of long-lived assets
- U.S. GAAP requires long-lived assets to be tested for impairment either annually or whenever a “triggering event” occurs

Comparison With GAAP

- **Other Comprehensive Income:**
 - FRF for SMEsTM does not recognize the concept of other comprehensive income found in U.S. GAAP
- **Industry-Specific Guidance:**
 - FRF for SMEsTM does not contain any industry-specific guidance
 - U.S. GAAP includes extensive industry-specific guidance
 - Although much of the industry-specific guidance related to revenue will soon be replaced by the FASB's new revenue recognition model

Comparison With GAAP

- **Consolidation of Subsidiaries:**

- FRF for SMEsTM allows a parent entity the policy choice to either consolidate subsidiaries or account for them using the equity method
- Current U.S. GAAP requires subsidiaries to be consolidated

- **Variable Interest Entities:**

- FRF for SMEsTM does not recognize the concept of variable interest entities
- U.S. GAAP permits a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity

Comparison With GAAP

- **Income Taxes:**

- FRF for SMEsTM allows an entity the policy choice to account for income taxes using either the taxes payable method or the deferred income taxes method, and there is no requirement to evaluate or accrue uncertain tax positions
- U.S. GAAP – Income taxes are accounted for using the deferred income taxes method, and if certain conditions are met, uncertain income tax positions are evaluated and accrued

Comparison With GAAP

- **Leases:**

- FRF for SMEsTM follows traditional lease accounting approach (operating lease vs. capital lease)
- FASB has rebuilt lease accounting approach

- **Intangible Assets:**

- FRF for SMEsTM considers all intangible assets to have finite useful lives. Accounting policy options to expense or capitalize certain expenditures
- U.S. GAAP – Intangible assets can have either finite or indefinite useful lives. Certain costs are expensed as incurred

Comparison With GAAP

- **Goodwill:**

- FRF for SMEsTM amortizes goodwill over the same period used for federal income tax purposes, or over a period of 15 years if not amortized for federal income tax purposes
- U.S. GAAP allows private companies to amortize goodwill on a straight-line basis over 10 years, or less than 10 years if the entity demonstrates that another useful life is more appropriate

Comparison With GAAP

- **Financial Assets and Liabilities:**

- FRF for SMEsTM accounts for most financial assets and liabilities using historical cost. Investments held for sale are accounted for using the market value method with unrealized holding gains and losses included in net income
- U.S. GAAP accounts for most financial assets and liabilities using fair value. Investments in debt securities classified as held to maturity are accounted for using the amortized cost method. Changes in fair value are accounted for depending on how the financial instruments are classified

Transitioning to FRF for SMEs™

- Chapter 3 of FRF for SMEs™, *Transition*
- Entity using FRF for SMEs™ stops using; decides to again use – exemptions from certain principles in chapter 3 do not apply
- Chapter 3 topics include:
 - Opening statement of financial position
 - Prohibited retrospective application
 - Disclosures
- Date of transition to FRF for SMEs™:
 - Beginning of earliest period for which entity presents financial statements using FRF for SMEs™

Transitioning to FRF for SMEs™ Disclosures

- In year of adoption of FRF for SMEs™ disclose:
 - Amount of each charge or credit to equity at date of transition to FRF for SMEs™ and reasons for them
 - Exemptions used (if any) to principles in FRF for SMEs™ allowed at transition
- Disclosures should give sufficient detail to enable users to understand material adjustments to each financial statement

Other Issues with Special Purpose Frameworks

What is required to be disclosed in financial statements prepared under a special purpose framework?

When special purpose financial statements contain items that are the same as, or similar to, those in U. S. GAAP financial statements, practitioners need to evaluate whether the financial statements include informative disclosures similar to those required by U. S. GAAP. There should be a policy note disclosure clearly stipulating the primary substantive differences between U.S. GAAP and the special purpose framework, as well as describing the basis of accounting used within the financial statements. There may not necessarily be a substantial reduction in disclosure requirements when compared with U.S. GAAP

Other Issues with Special Purpose Frameworks

What about titles to SPF financial statements and reporting modifications?

AU-C 700 requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. The auditor should evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from U. S. GAAP. The effects of the difference need not be quantified.

For special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should also evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based.

Both the SASs and the SSARS require an additional paragraph when reporting on special purpose financial statements.

Thank You!

Any questions, just e-mail me at mbrand@bmss.com