

# **2025 ACCOUNTING AND AUDITING UPDATE FOR THE REAL WORLD**

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# 2025 ACCOUNTING AND AUDITING UPDATE FOR THE REAL WORLD

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### **Biography**

James (“Jim”) Martin is a true “general practitioner” in Atlanta, Georgia who, for 39 years, has specialized in both income tax and accounting and audit areas. In addition to serving the accounting and tax needs of 100 clients, Jim performs 75-80 continuing education seminars per year for CPAs and attorneys throughout the United States. To date, he has prepared and presented over 3000 full and half-day seminars on accounting and taxation topics. Jim’s philosophy of CPE is simple: spend the class time on topics of applicability and relevance to all and present the topics in an entertaining and fast moving manner. He also produces self-study videos that have been among the top sellers in the southeastern United States for the past several years.

Jim regularly consults with CPA firms throughout the United States on a variety of accounting and auditing technical issues and serves as expert counsel in litigation matters.

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- **Financial Instruments – Credit Losses (Topic 326) Measurement of Credit Losses for Accounts Receivable and Contract Assets (ASU 2025-05 issued July 2025)**

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.

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.

- **Compensation – Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606) Clarifications to Share-Based Consideration Payable to a Customer (ASU 2025-04 issued May 2025)**

Under current GAAP, the definitions of performance condition and service condition do not explicitly discuss purchases made by a customer or parties that purchase a grantor's goods or services from the grantor's customers. For share-based consideration payable to a customer (including share-based consideration payable to other parties that purchase the grantor's goods or services from the grantor's customers) with a service condition, current GAAP permits the grantor



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to elect to account for the effect of forfeitures as they occur, which may result in a delay in revenue recognition for awards that are not probable of vesting.

In addition, current GAAP also does not explicitly state whether the guidance in Topic 606 on constraining estimates of variable consideration applies to share-based consideration payable to a customer that is measured and classified under the Topic 718 approach.

The amendments in this Update revise the Master Glossary definition of the term performance condition for share-based consideration payable to a customer. The revised definition incorporates conditions (such as vesting conditions) that are based on the volume or monetary amount of a customer's purchases (or potential purchases) of goods or services from the grantor (including over a specified period of time). The revised definition also incorporates performance targets based on purchases made by other parties that purchase the grantor's goods or services from the grantor's customers. The revised definition of the term performance condition cannot be applied by analogy to awards granted to employees and nonemployees in exchange for goods or services to be used or consumed in the grantor's own operations.

Although it is expected that entities will conclude that fewer awards contain service conditions, for those that are determined to have service conditions, the amendments in this Update eliminate the policy election permitting a grantor to account for forfeitures as they occur. Therefore, when measuring share-based consideration payable to a customer that has a service condition, the grantor is required to estimate the number of forfeitures expected to occur.

Separate policy elections for forfeitures remain available for share-based payment awards with service conditions granted to employees and nonemployees in exchange for goods or services to be used or consumed in the grantor's own operations.

The amendments in this Update clarify that share-based consideration encompasses the same instruments as share-based payment arrangements but the grantee does not need to be a supplier of goods or services to the grantor.

Finally, the amendments in this Update clarify that a grantor should not apply the guidance in Topic 606 on constraining estimates of variable consideration to share-based consideration payable to a customer. Therefore, a grantor is required to assess the probability that an award will vest using only the guidance in Topic 718.

Collectively, these changes improve the decision usefulness of a grantor's financial statements, improve the operability of the guidance, and reduce diversity in practice for accounting for share-based consideration payable to a customer.

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Under the amendments in this Update, revenue recognition will no longer be delayed when an entity grants awards that are not expected to vest. This is expected to result in estimates of the transaction price that better reflect the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer and, therefore, more decision-useful financial reporting.

The amendments in this Update are effective for all entities for annual reporting periods (including interim reporting periods within annual reporting periods) beginning after December 15, 2026. Early adoption is permitted for all entities.

The amendments in this Update permit a grantor to apply the new guidance on either a modified retrospective or a retrospective basis.

- **Business Combinations (Topic 805) and Consolidation (Topic 810)**  
**Determining the Accounting Acquirer in the Acquisition of a Variable Interest Entity**  
**(ASU 2025-03 issued May 2025)**

The amendments in this Update require an entity involved in an acquisition transaction effected primarily by exchanging equity interests when the legal acquiree is a VIE that meets the definition of a business to consider the factors in paragraphs 805-10-55-12 through 55-15 to determine which entity is the accounting acquirer.

The amendments in this Update differ from current GAAP because, for certain transactions, they replace the requirement that the primary beneficiary always is the acquirer with an assessment that requires an entity to consider the factors to determine which entity is the accounting acquirer.

The amendments in this Update enhance the comparability of financial statements across entities engaging in acquisition transactions effected primarily by exchanging equity interests when the legal acquiree meets the definition of a business. Specifically, under the amendments, acquisition transactions in which the legal acquiree is a VIE will, in more instances, result in the same accounting outcomes as economically similar transactions in which the legal acquiree is a voting interest entity.

The amendments in this Update do not change the accounting for a transaction determined to be a reverse acquisition or a transaction in which the legal acquirer is not a business and is determined to be the accounting acquiree.

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The amendments in this Update are effective for all entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within those annual reporting periods.

The amendments in this Update require that an entity apply the new guidance prospectively to any acquisition transaction that occurs after the initial application date.

Early adoption is permitted as of the beginning of an interim or annual reporting period.

- **Liabilities (Topic 405) Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 122 (ASU 2025-02 issued March 2025)**

This Accounting Standards Update amends an SEC paragraph pursuant to the issuance of SEC Staff Accounting Bulletin No. 122.

- **Income Statement – Reporting Comprehensive Income – Expense Disaggregation Disclosures (Subtopic 220-40) Clarifying the Effective Date (ASU 2025-01 issued January 2025)**

The amendment in this Update amends the effective date of Update 2024-03 to clarify that all public business entities are required to adopt the guidance in annual reporting periods beginning after December 15, 2026, and interim periods within annual reporting periods beginning after December 15, 2027.

Early adoption of Update 2024-03 is permitted.

- **Debt – Debt with Conversion and Other Options (Subtopic 470-20) Induced Conversions of Convertible Debt Instruments (ASU 2024-04 issued November 2024)**

The amendments in this Update clarify the requirements for determining whether certain settlements of convertible debt instruments should be accounted for as an induced conversion. Under the amendments, to account for a settlement of a convertible debt instrument as an induced conversion, an inducement offer is required to provide the debt holder with, at a minimum, the consideration (in form and amount) issuable under the conversion privileges provided in the terms of the instrument. An entity should assess whether this criterion is satisfied as of the date the inducement offer is accepted by the holder. If, when applying this criterion, the convertible debt instrument had been exchanged or modified (without being

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deemed substantially different) within the one-year period leading up to the offer acceptance date, an entity should compare the terms provided in the inducement offer with the terms that existed one year before the offer acceptance date. The amendments do not change the other criteria that are required to be satisfied to account for a settlement transaction as an induced conversion.

The amendments in this Update also make additional clarifications to assist stakeholders in applying the guidance. Under the amendments, the incorporation, elimination, or modification of a VWAP formula does not automatically cause a settlement to be accounted for as an extinguishment; an entity should instead assess whether the form and amount of conversion consideration are preserved (that is, provided for in the inducement offer) using the fair value of an entity's shares as of the offer acceptance date.

The amendments in this Update also clarify that the induced conversion guidance applies to a convertible debt instrument that is not currently convertible as long as it had a substantive conversion feature as of both its issuance date and the date the inducement offer is accepted.

The amendments in this Update are effective for all entities for annual reporting periods beginning after December 15, 2025, and interim reporting periods within those annual reporting periods.

The amendments in this Update permit an entity to apply the new guidance on either a prospective or a retrospective basis.

- **Income Statement – Reporting Comprehensive Income – Expense Disaggregation Disclosures (Subtopic 220-40) Disaggregation of Income Statement Expenses (ASU 2024-03 issued November 2024)**

The amendments in this Update require disclosure, in the notes to financial statements, of specified information about certain costs and expenses. The amendments require that at each interim and annual reporting period an entity:

1. Disclose the amounts of (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) depreciation, depletion, and amortization recognized as part of oil and gas-producing activities (DD&A) (or other amounts of depletion expense) included in each relevant expense caption. A relevant expense caption is an expense caption presented on the face of the income statement within continuing operations that contains any of the expense categories listed in (a)–(e).

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2. Include certain amounts that are already required to be disclosed under current generally accepted accounting principles (GAAP) in the same disclosure as the other disaggregation requirements.
3. Disclose a qualitative description of the amounts remaining in relevant expense captions that are not separately disaggregated quantitatively.
4. Disclose the total amount of selling expenses and, in annual reporting periods, an entity's definition of selling expenses. An entity is not precluded from providing additional voluntary disclosures that may provide investors with additional decision-useful information.

The amendments in this Update apply to all public business entities.

- **Codification Improvements – Amendments to Remove References to the Concepts Statements**  
**(ASU 2024-02 issued March 2024)**

The amendments in this Update affect a variety of Topics in the Codification. The amendments apply to all reporting entities within the scope of the affected accounting guidance.

This Update contains amendments to the Codification that remove references to various Concepts Statements. Generally, the amendments in this Update are not intended to result in significant accounting change for most entities.

- **Compensation – Stock Compensation (Topic 718) – Scope Application of Profits Interest and Similar Awards**  
**(ASU 2024-01 issued March 2024)**

The amendments in this Update related to the scope application issue apply to all reporting entities that account for profits interest awards as compensation to employees or nonemployees in return for goods or services.

The amendments in this Update that improve the understandability of paragraph 718-10-15-3 apply to all entities that enter into share-based payment transactions.

The amendments in this Update improve GAAP by adding an illustrative example that includes four fact patterns to demonstrate how an entity should apply the scope guidance in paragraph 718-10-15-3 to determine whether a profits interest award should be accounted for in accordance with Topic 718.

The fact patterns in the illustrative example focus on the scope conditions in paragraph 718-10-15-3. The illustrative example is intended to reduce (1)

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complexity in determining whether a profits interest award is subject to the guidance in Topic 718 and (2) existing diversity in practice.

The amendments in paragraph 718-10-15-3 improve its overall clarity and operability without changing the guidance.

For PBEs, the amendments in this Update are effective for annual periods beginning after December 15, 2024, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2025, and interim periods within those annual periods. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance. If an entity adopts the amendments in an interim period, it should adopt them as of the beginning of the annual period that includes that interim period.

The amendments in this Update should be applied either (1) retrospectively to all prior periods presented in the financial statements or (2) prospectively to profits interest and similar awards granted or modified on or after the date at which the entity first applies the amendments. If the amendments are applied retrospectively, an entity is required to provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period of adoption. If the amendments are applied prospectively, an entity is required to disclose the nature of and reason for the change in accounting principle.

- **Income Taxes (Topic 740) – Improvements to Income Tax Disclosures (ASU 2023-09 issued December 2023)**

The amendments in this Update apply to all entities that are subject to Topic 740, Income Taxes.

Certain of the disclosures that are required by the amendments in this Update are not required for entities other than public business entities.

### **Rate Reconciliation**

The amendments in this Update require that public business entities on an annual basis (1) disclose specific categories in the rate reconciliation and (2) provide additional information for reconciling items that meet a quantitative threshold (if the effect of those reconciling items is equal to or greater than 5 percent of the amount computed by multiplying pretax income [or loss] by the applicable statutory income tax rate).

Specifically, public business entities are required to disclose a tabular reconciliation, using both percentages and reporting currency amounts, according to the following requirements:

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1. The following specific categories are required to be disclosed:
  - a. State and local income tax, net of federal (national) income tax effect
  - b. Foreign tax effects
  - c. Effect of changes in tax laws or rates enacted in the current period
  - d. Effect of cross-border tax laws
  - e. Tax credits
  - f. Changes in valuation allowances
  - g. Nontaxable or nondeductible items
  - h. Changes in unrecognized tax benefits.
2. Separate disclosure is required for any reconciling item listed below in which the effect of the reconciling item is equal to or greater than 5 percent of the amount computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory income tax rate.
  - a. If the reconciling item is within the effect of cross-border tax laws, tax credits, or nontaxable or nondeductible items categories, it is required to be disaggregated by nature.
  - b. If the reconciling item is within the foreign tax effects category, it is required to be disaggregated by jurisdiction (country) and by nature, except for reconciling items related to changes in unrecognized tax benefits discussed in (4).
  - c. If the reconciling item does not fall within any of the categories listed in (1), it is required to be disaggregated by nature.
3. For the purpose of categorizing reconciling items, except for reconciling items related to changes in unrecognized tax benefits discussed in (4), the state and local income tax category should reflect income taxes imposed at the state or local level within the jurisdiction (country) of domicile, the foreign tax effects category should reflect income taxes imposed by foreign jurisdictions, and the remaining categories listed in (1) should reflect federal (national) income taxes imposed by the jurisdiction (country) of domicile.
4. For the purpose of presenting reconciling items:
  - a. Reconciling items are required to be presented on a gross basis with two exceptions under which unrecognized tax benefits and the related tax positions and tax effects of certain cross-border tax laws and the related tax credits may be presented on a net basis.
  - b. Reconciling items presented in the changes in unrecognized tax benefits category may be disclosed on an aggregated basis for all jurisdictions.

### **Income Taxes Paid**

The amendments in this Update require that all entities disclose on an annual basis the following information about income taxes paid:

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1. The amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign taxes
2. The amount of income taxes paid (net of refunds received) disaggregated by individual jurisdictions in which income taxes paid (net of refunds received) is equal to or greater than 5 percent of total income taxes paid (net of refunds received).

### **Other Disclosures**

The amendments in this Update require that all entities disclose the following information:

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

The amendments in this Update eliminate the requirement for all entities to (1) disclose the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or (2) make a statement that an estimate of the range cannot be made.

The amendments in this Update remove the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures.

The amendments in this Update replace the term public entity as currently used in Topic 740 with the term public business entity as defined in the Master Glossary of the Codification.

For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2024. For entities other than public business entities, the amendments are effective for annual periods beginning after December 15, 2025.

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

The amendments in this Update should be applied on a prospective basis. Retrospective application is permitted.



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- **Intangibles – Goodwill and Other – Crypto Assets (Subtopic 350-60) – Accounting for and Disclosure of Crypto Assets (ASU 2023-08 issued December 2023)**

The amendments in this Update apply to all entities holding assets that meet certain scope criteria.

The amendments in this Update apply to assets that meet all of the following criteria:

1. Meet the definition of intangible assets as defined in the Codification
2. Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
3. Are created or reside on a distributed ledger based on blockchain or similar technology
4. Are secured through cryptography
5. Are fungible
6. Are not created or issued by the reporting entity or its related parties.

An entity is required to subsequently measure assets that meet those criteria at fair value with changes recognized in net income each reporting period.

The amendments in this Update also require that an entity present (1) crypto assets measured at fair value separately from other intangible assets in the balance sheet and (2) changes from the remeasurement of crypto assets separately from changes in the carrying amounts of other intangible assets in the income statement (or statement of activities for not-for-profit entities).

While the amendments in this Update do not otherwise change the presentation requirements for the statement of cash flows, the amendments require specific presentation of cash receipts arising from crypto assets that are received as noncash consideration in the ordinary course of business (or as a contribution, in the case of a not-for-profit entity) and are converted nearly immediately into cash.

For annual and interim reporting periods, the amendments in this Update require that an entity, including an entity that is subject to industry-specific guidance, disclose the following information:

1. The name, cost basis, fair value, and number of units for each significant crypto asset holding and the aggregate fair values and cost bases of the crypto asset holdings that are not individually significant
2. For crypto assets that are subject to contractual sale restrictions, the fair value of those crypto assets, the nature and remaining duration of the restriction(s), and the circumstances that could cause the restriction(s) to lapse.

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For annual reporting periods, the amendments in this Update require that an entity disclose the following information:

1. A rollforward, in the aggregate, of activity in the reporting period for crypto asset holdings, including additions (with a description of the activities that resulted in the additions), dispositions, gains, and losses
2. For any dispositions of crypto assets in the reporting period, the difference between the disposal price and the cost basis and a description of the activities that resulted in the dispositions
3. If gains and losses are not presented separately, the income statement line item in which those gains and losses are recognized
4. The method for determining the cost basis of crypto assets

The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been issued (or made available for issuance). If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

The amendments in this Update require a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets) as of the beginning of the annual reporting period in which an entity adopts the amendments.

- **Segment Reporting (Topic 280) – Improvements to Reportable Segment Disclosures**  
**(ASU 2023-07 issued November 2023)**

The amendments in this Update apply to all public entities that are required to report segment information in accordance with Topic 280, Segment Reporting.

- **Disclosure Improvements – Codification Amendments in Response to the SEC’s Disclosure Update and Simplification Initiative**  
**(ASU 2023-06 issued October 2023)**

The amendments in this Update affect a variety of Topics in the Codification. The amendments apply to all reporting entities within the scope of the affected Topics unless otherwise indicated.

The amendments in this Update modify the disclosure or presentation requirements of a variety of Topics in the Codification. Certain of the amendments represent clarifications to or technical corrections of the current

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requirements. Because of the variety of Topics amended, a broad range of entities may be affected by one or more of those amendments. The amendments are summarized in the Introduction section of the Update.

The amendments in this Update represent changes to clarify or improve disclosure and presentation requirements of a variety of Topics. Many of the amendments allow users to more easily compare entities subject to the SEC's existing disclosures with those entities that were not previously subject to the SEC's requirements. Also, the amendments align the requirements in the Codification with the SEC's regulations.

For entities subject to the SEC's existing disclosure requirements and for entities required to file or furnish financial statements with or to the SEC in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer, the effective date for each amendment will be the date on which the SEC's removal of that related disclosure from Regulation S-X or Regulation S-K becomes effective, with early adoption prohibited. For all other entities, the amendments will be effective two years later.

The amendments in this Update should be applied prospectively.

For all entities, if by June 30, 2027, the SEC has not removed the applicable requirement from Regulation S-X or Regulation S-K, the pending content of the related amendment will be removed from the Codification and will not become effective for any entity.

- **Business Combinations – Joint Venture Formations (Subtopic 805-60)**  
**Recognition and Initial Measurement**  
**(ASU 2023-05 issued August 2023)**

The amendments in this Update affect the accounting for contributions received upon formation by entities that meet the definition of a joint venture or a corporate joint venture, as defined in the Master Glossary of the Codification. Additionally, existing joint ventures have the option to apply the guidance retrospectively.

Requiring a joint venture to recognize and initially measure its assets and liabilities using a new basis of accounting upon formation reduces diversity in practice and provides decision-useful information to a joint venture's investors.

Because the Codification does not contain specific guidance for the accounting by a joint venture for net assets contributed upon formation, there is diversity in practice. Stakeholders observed that, before the amendments in this Update were issued, a joint venture may recognize and initially measure its net assets upon

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formation at the carrying amounts of the venturer that contributed those net assets, and, in certain circumstances, a joint venture may recognize and initially measure its net assets at fair value upon formation.

Feedback from practitioners indicated that (1) there is a lack of guidance for the accounting by a joint venture and (2) the factors used by the joint venture to determine when its net assets should be recognized and initially measured at fair value are nonauthoritative and outdated. Generally, practitioners supported requiring that a joint venture initially measure the contributions at fair value upon formation, citing that they view the formation of the joint venture as a change in control of the contributed net assets that should result in a new basis of accounting.

Feedback from preparers indicated that the venturers are usually, but not always, the primary users of a joint venture's financial statements. Feedback from preparers generally supported fair value measurement, observing that fair value (1) is more relevant than the venturers' carrying amounts of the contributed net assets at the formation date and (2) would reduce equity method basis differences (any difference between the venturer's cost of its investment in a joint venture and the amount of underlying equity in net assets of the joint venture).

In response to the feedback received, the Board decided to require that a joint venture, upon formation, apply a new basis of accounting. As a result, a newly formed joint venture should initially measure its assets and liabilities at fair value (with exceptions to fair value measurement that are consistent with the business combinations guidance). That approach is generally consistent with other new basis of accounting models in GAAP, such as fresh-start reporting in accordance with Topic 852, Reorganizations. It is also broadly consistent with the accounting outcome that would result from treating the joint venture as the acquirer of a business within the scope of Subtopic 805-10, Business Combinations—Overall. The amendments in this Update require that a joint venture apply the following key adaptations from the business combinations guidance upon formation:

1. **A joint venture is the formation of a new entity without an accounting acquirer.** The formation of a joint venture is the creation of a new reporting entity, and none of the assets and/or businesses contributed to the joint venture are viewed as having survived the combination as an independent entity—that is, an accounting acquirer will not be identified.
2. **A joint venture measures its identifiable net assets and goodwill, if any, at the formation date.** The joint venture formation date is the date on which an entity initially meets the definition of a joint venture.
3. **Initial measurement of a joint venture's total net assets is equal to the fair value of 100 percent of the joint venture's equity.** The amendments require that a joint venture measure its total net assets upon formation as the fair value of the joint venture as a whole. The fair value of the joint

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venture as a whole equals the fair value of 100 percent of a joint venture's equity immediately following formation (including any noncontrolling interest in the net assets recognized by the joint venture).

4. **A joint venture provides relevant disclosures.** The purpose of the disclosures is to help a user of a joint venture's financial statements understand the nature and financial effect of the joint venture formation in the period in which the formation date occurs. Joint venture disclosure requirements upon formation are different from the requirements for business combinations.

The amendments in this Update permit a joint venture to apply the measurement period guidance in Subtopic 805-10 if the initial accounting for a joint venture formation is incomplete by the end of the reporting period in which the formation occurs.

Many of the amendments in this Update, other than the addition of Subtopic 805-60, Business Combinations—Joint Venture Formations, are clarifying or conforming amendments.

The amendments in this Update are effective prospectively for all joint venture formations with a formation date on or after January 1, 2025.

Additionally, a joint venture that was formed before January 1, 2025 may elect to apply the amendments retrospectively if it has sufficient information. Early adoption is permitted in any interim or annual period in which financial statements have not yet been issued (or made available for issuance), either prospectively or retrospectively.

- **Liabilities (Topic 405) Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 121 (ASU 2023-04 issued August 2023)**

Only applicable to SEC (and then only very limited).

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- **Presentation of Financial Statements (Topic 205), Income Statement – Reporting Comprehensive Income (Topic 220), Distinguishing Liabilities from Equity (Topic 480), Equity (Topic 505), and Compensation – Stock Compensation (Topic 718). Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 120, SEC Staff Announcement at the March 24, 2002 EITF Meeting, and Staff Accounting Bulletin Topic 6.B, Accounting Series Release 280 – General Revision of Regulation S-X; Income or Loss Applicable to Common Stock (ASU 2023-03 issued July 2023)**

Only applicable to SEC (and then only very limited).

- **Investments – Equity Method and Joint Ventures (Topic 323) : Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method – a consensus of the Emerging Issues Task Force (ASU 2023-02 issued March 2023)**

The amendments in this Update apply to all reporting entities that hold (1) tax equity investments that meet the conditions for and elect to account for them using the proportional amortization method or (2) an investment in a LIHTC structure through a limited liability entity that is not accounted for using the proportional amortization method and to which certain LIHTC-specific guidance removed from Subtopic 323-740 has been applied. Additionally, the disclosure requirements apply to investments that generate income tax credits and other income tax benefits from a tax credit program for which the entity has elected to apply the proportional amortization method (including investments within that elected program that do not meet the conditions to apply the proportional amortization method).

The amendments in this Update permit reporting entities to elect to account for their tax equity investments, regardless of the tax credit program from which the income tax credits are received, using the proportional amortization method if certain conditions are met.

Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the income tax credits and other income tax benefits received and recognizes the net amortization and income tax credits and other income tax benefits in the income statement as a component of income tax expense (benefit). To qualify for the proportional amortization method, if elected in accordance with paragraph 323-740-25-4, all of the following conditions must be met:

1. It is probable that the income tax credits allocable to the tax equity investor will be available.

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2. The tax equity investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying project.
3. Substantially all of the projected benefits are from income tax credits and other income tax benefits. Projected benefits include income tax credits, other income tax benefits, and other non-income-tax-related benefits. The projected benefits are determined on a discounted basis, using a discount rate that is consistent with the cash flow assumptions used by the tax equity investor in making its decision to invest in the project.
4. The tax equity investor's projected yield based solely on the cash flows from the income tax credits and other income tax benefits is positive.
5. The tax equity investor is a limited liability investor in the limited liability entity for both legal and tax purposes, and the tax equity investor's liability is limited to its capital investment.

A reporting entity makes an accounting policy election to apply the proportional amortization method on a tax-credit-program-by-tax-credit-program basis rather than electing to apply the proportional amortization method at the reporting entity level or to individual investments. A reporting entity that applies the proportional amortization method to qualifying tax equity investments must account for the receipt of the investment tax credits using the flow-through method under Topic 740, Income Taxes, even if the entity applies the deferral method for other investment tax credits received.

The amendments in this Update require that all tax equity investments accounted for using the proportional amortization method use the delayed equity contribution guidance in paragraph 323-740-25-3 (which requires that a liability be recognized for delayed equity contributions that are unconditional and legally binding or for equity contributions that are contingent upon a future event when that contingent event becomes probable). LIHTC investments not accounted for using the proportional amortization method will no longer be permitted to use the delayed equity contribution guidance in paragraph 323-740-25-3. In addition, the amendments in this Update remove the equity method impairment example for LIHTC investments in Example 1 in Subtopic 323-740. As a result of this change, LIHTC investments accounted for using the equity method must apply the impairment guidance in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall. Furthermore, the amendments in this Update require that LIHTC investments that are not accounted for using the proportional amortization method or the equity method apply the guidance in Topic 321 on the accounting for equity investments. As a result of these changes, the guidance in Subtopic 323-740 is applicable only to tax equity investments accounted for using the proportional amortization method.

The amendments in this Update require specific disclosures that must be applied to all investments that generate income tax credits and other income tax benefits



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from a tax credit program for which the entity has elected to apply the proportional amortization method in accordance with Subtopic 323-740 (including investments within that elected program that do not meet the conditions to apply the proportional amortization method). The amendments require that a reporting entity disclose certain information in annual and interim reporting periods that enable investors to understand the following information about its investments that generate income tax credits and other income tax benefits from a tax credit program:

1. The nature of its tax equity investments
2. The effect of its tax equity investments and related income tax credits and other income tax benefits on its financial position and results of operations.

In addition, the amendments also provide examples of disclosures that an entity could provide in meeting the disclosure objectives

For public business entities, the amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted for all entities in any interim period. If an entity adopts the amendments in an interim period, it shall adopt them as of the beginning of the fiscal year that includes that interim period.

The amendments in this Update must be applied on either a modified retrospective or a retrospective basis (except as discussed below for LIHTC investments not accounted for using the proportional amortization method). Under a modified retrospective transition, a reporting entity evaluates all investments for which it still expects to receive income tax credits or other income tax benefits as of the beginning of the period of adoption. The assessment of whether the investment qualifies for the proportional amortization method is performed as of the date the investment was entered into. A cumulative-effect adjustment reflecting the difference between the previous method used to account for the tax equity investment and the application of the proportional amortization method since the investment was entered into is recognized in the opening balance of retained earnings as of the beginning of the period of adoption.

Under a retrospective transition, a reporting entity evaluates all investments for which it still expects to receive income tax credits or other income tax benefits as of the beginning of the earliest period presented. The assessment of whether the investment qualifies for the proportional amortization method is performed as of the date the investment was entered into. A cumulative-effect adjustment reflecting the difference between the previous method used to account for the tax equity investment and the application of the proportional amortization method



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since the investment was entered into is recognized in the opening balance of retained earnings as of the beginning of the earliest period presented.

A reporting entity that has LIHTC investments that are no longer permitted to use (1) the cost method guidance in paragraph 323-740-25-2A, (2) the equity method example in paragraphs 323-740-55-8 through 55-9, or (3) the delayed equity contribution guidance in paragraph 323-740-25-3 must either use its general transition method (that is, modified retrospective or retrospective) or apply a prospective approach. This election may be made separately for each of the three transition adjustment types described above. However, a reporting entity shall apply a consistent transition method for each transition adjustment type. Under the prospective transition approach, an adjustment for affected LIHTC investments currently recorded on the date of adoption, is recognized in current-period earnings, or the balance sheet, or both, on the date of adoption.

- **Leases (Topic 842) : Common Control Arrangements (ASU 2023-01 issued March 2023)**

What Are the Main Provisions, How Do They Differ from Current Generally Accepted Accounting Principles (GAAP), and Why Are They an Improvement?

### Issue 1: Terms and Conditions to Be Considered

Topic 842 requires that entities determine whether a related party arrangement between entities under common control (hereinafter referred to as a common control arrangement) is a lease. If the arrangement is determined to be a lease, an entity must classify and account for the lease on the same basis as an arrangement with an unrelated party (on the basis of legally enforceable terms and conditions). That represents a change from the requirements of Topic 840, Leases, which required that an entity classify and account for an arrangement on the basis of economic substance when those terms and conditions were affected by the related party nature of the arrangement. Private company stakeholders observed that determining the enforceable terms and conditions of a common control arrangement to apply Topic 842 often is difficult and costly. Specifically, private company stakeholders stated that determining the enforceable terms and conditions of those arrangements could necessitate obtaining a formal legal opinion in certain cases, which could be challenging because of the common control nature of the arrangement (even for written arrangements).

The amendments in this Update provide a practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement to determine:

1. Whether a lease exists and, if so,

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### 2. The classification of and accounting for that lease.

The practical expedient may be applied on an arrangement-by-arrangement basis. If no written terms and conditions exist (including in situations in which an entity does not document existing unwritten terms and conditions in writing upon transition to the practical expedient), an entity is prohibited from applying the practical expedient and must evaluate the enforceable terms and conditions to apply Topic 842. The practical expedient is expected to reduce (1) the costs associated with implementing and applying Topic 842 to those arrangements and (2) diversity in practice by entities within its scope when applying lease accounting requirements to common control arrangements.

#### Issue 2: Accounting for Leasehold Improvements

Topic 842 generally requires that leasehold improvements have an amortization period consistent with the shorter of the remaining lease term and the useful life of the improvements, which is an approach that is largely consistent with legacy guidance. Lessees recognize leasehold improvements when they are the accounting owner of those improvements. Private company stakeholders noted that amortizing leasehold improvements associated with arrangements between entities under common control determined to be leases (hereinafter referred to as common control leases) over a period shorter than the expected useful life of the leasehold improvements may result in financial reporting that does not faithfully represent the economics of those leasehold improvements, particularly in common control leases with short lease terms. Those stakeholders further noted that this accounting, depending on the salvage value assigned to the leasehold improvements, may fail to recognize the transfer of value between the entities under common control when the lessee no longer controls the use of the underlying asset. Additionally, the Board noted that multiple methods of accounting for those improvements exist, causing diversity in practice.

The amendments in this Update require that leasehold improvements associated with common control leases be:

1. Amortized by the lessee over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset (the leased asset) through a lease. However, if the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same common control group, the amortization period may not exceed the amortization period of the common control group.
2. Accounted for as a transfer between entities under common control through an adjustment to equity (or net assets for not-for-profit entities) if, and when, the lessee no longer controls the use of the underlying asset.

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Additionally, those leasehold improvements are subject to the impairment guidance in Topic 360, Property, Plant, and Equipment.

### Issue 1: Terms and Conditions to Be Considered

The practical expedient is available to entities that are not:

1. Public business entities
2. Not-for-profit conduit bond obligors
3. Employee benefit plans that file or furnish financial statements with or to the U.S. Securities and Exchange Commission (SEC).

### Issue 2: Accounting for Leasehold Improvements

The amendments in this Update affect all lessees that are a party to a lease between entities under common control in which there are leasehold improvements. The amendments apply to all entities (that is, public business entities, private companies, not-for-profit entities, and employee benefit plans).

The amendments in this Update for both Issue 1 and Issue 2 are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been made available for issuance. If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

### What Are the Transition Requirements?

Issue 1: Terms and Conditions to Be Considered Entities adopting the practical expedient in this Update concurrently with adopting Topic 842 are required to follow the same transition requirements used to apply Topic 842. 4

All other entities are required to apply the practical expedient in this Update either:

1. Prospectively to arrangements that commence or are modified on or after the date that the entity first applies the practical expedient
2. Retrospectively to the beginning of the period in which the entity first applied Topic 842 for arrangements that exist at the date of adoption of the practical expedient. The practical expedient does not apply to common control arrangements no longer in place at the date of adoption of the amendments in this Update.

Regardless of an entity's transition approach, the entity is permitted to document any existing unwritten terms and conditions of a common control arrangement

## SUMMARY OF RECENT ACCOUNTING STANDARDS UPDATES

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before the date on which the entity's first interim (if applicable) or annual financial statements are available to be issued in accordance with the practical expedient in this Update

### Issue 2: Accounting for Leasehold Improvements

Entities adopting the amendments in this Update concurrently with adopting Topic 842 may follow the same transition requirements used to apply Topic 842 or may use either of the prospective approaches described below to avoid retrospectively accounting for leasehold improvements.

All other entities are required to apply the amendments in this Update using one of the following methods:

1. Prospectively to all new leasehold improvements recognized on or after the date that the entity first applies the amendments in this Update
2. Prospectively to all new and existing leasehold improvements recognized on or after the date that the entity first applies the amendments in this Update, with any remaining unamortized balance of existing leasehold improvements amortized over their remaining useful life to the common control group determined at that date
3. Retrospectively to the beginning of the period in which the entity first applied Topic 842, with any leasehold improvements that otherwise would not have been amortized or impaired recognized through a cumulative-effect adjustment to the opening balance of retained earnings (or net assets of a not-for-profit entity) at the beginning of the earliest period presented in accordance with Topic 842.

- **Fair Value Measurement (Topic 820) : Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions**  
**(ASU 2022-03 issued June 2022)**

The amendments in this Update affect all entities that have investments in equity securities measured at fair value that are subject to a contractual sale restriction. The amendments in this Update clarify that a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, is not considered in measuring fair value. The amendments also clarify that an entity cannot, as a separate unit of account, recognize and measure a contractual sale restriction. The amendments in this Update also require the following disclosures for equity securities subject to contractual sale restrictions:

1. The fair value of equity securities subject to contractual sale restrictions reflected in the balance sheet

## SUMMARY OF RECENT ACCOUNTING STANDARDS UPDATES

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2. The nature and remaining duration of the restriction(s)
3. The circumstances that could cause a lapse in the restriction(s).

The amendments in this Update do not change the principles of fair value measurement. The amendments clarify those principles when measuring the fair value of an equity security subject to a contractual sale restriction and improve current GAAP by reducing diversity in practice, reducing the cost and complexity in measuring fair value, and increasing comparability of financial information across reporting entities that hold those investments.

For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2024, and interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance.

For all entities except investment companies as defined under Topic 946, Financial Services—Investment Companies, the amendments in this Update should be applied prospectively with any adjustments from the adoption of the amendments recognized in earnings and disclosed on the date of adoption. An entity that qualifies as an investment company under Topic 946 should apply the amendments in this Update to an investment in an equity security subject to a contractual sale restriction that is executed or modified on or after the date of adoption. An investment company with an equity security subject to a contractual sale restriction that was executed before the date of adoption should continue to account for the equity security until the contractual restrictions expire or are modified using the accounting policy applied before the adoption of the amendments (that is, if an investment company was incorporating the effects of the restriction in the measurement of fair value, it would continue to do so).



# ACCOUNTING STANDARDS UPDATE

No. 2023-08  
December 2023

## Intangibles—Goodwill and Other— Crypto Assets (Subtopic 350-60)

Accounting for and Disclosure of Crypto Assets

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

*The FASB Accounting Standards Codification® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.*

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## Accounting Standards Update

No. 2023-08  
December 2023

### Intangibles—Goodwill and Other— Crypto Assets (Subtopic 350-60)

#### Accounting for and Disclosure of Crypto Assets

An Amendment of the *FASB Accounting Standards Codification*®

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Financial Accounting Standards Board  
801 Main Avenue • Norwalk, CT • 06851



Accounting Standards Update 2023-08

Intangibles—Goodwill and Other—Crypto Assets  
(Subtopic 350-60)

Accounting for and Disclosure of Crypto Assets

December 2023

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## Summary

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### Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing the amendments in this Update to improve the accounting for and disclosure of crypto assets. Stakeholder feedback, including from respondents to the 2021 FASB Invitation to Comment (ITC), *Agenda Consultation*, indicated that improving the accounting for and disclosure of crypto assets should be a top priority for the Board. Stakeholders stated that the current accounting—except as provided in generally accepted accounting principles (GAAP) for certain specialized industries—for holdings of crypto assets as indefinite-lived intangible assets, which is a cost-less-impairment accounting model, does not provide investors, lenders, creditors, and other allocators of capital (collectively, “investors”) with decision-useful information. Specifically, accounting for only the decreases, but not the increases, in the value of crypto assets in the financial statements until they are sold does not provide relevant information that reflects (1) the underlying economics of those assets and (2) an entity’s financial position. Investors also requested additional disclosures about the types of crypto assets held by entities and the changes in those holdings.

In addition to better reflecting the economics of crypto assets, measuring those assets at fair value will likely reduce cost and complexity associated with applying the current cost-less-impairment accounting model for many entities.

### Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all entities holding assets that meet certain scope criteria.

### What Are the Main Provisions?

The amendments in this Update apply to assets that meet all of the following criteria:

1. Meet the definition of *intangible assets* as defined in the Codification
2. Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
3. Are created or reside on a distributed ledger based on blockchain or similar technology
4. Are secured through cryptography
5. Are fungible
6. Are not created or issued by the reporting entity or its related parties.

An entity is required to subsequently measure assets that meet those criteria at fair value with changes recognized in net income each reporting period.

The amendments in this Update also require that an entity present (1) crypto assets measured at fair value separately from other intangible assets in the balance sheet and (2) changes from the remeasurement of crypto assets separately from changes in the carrying amounts of other intangible assets in the income statement (or statement of activities for not-for-profit entities).

While the amendments in this Update do not otherwise change the presentation requirements for the statement of cash flows, the amendments require specific presentation of cash receipts arising from crypto assets that are received as noncash consideration in the ordinary course of business (or as a contribution, in the case of a not-for-profit entity) and are converted nearly immediately into cash.

For annual and interim reporting periods, the amendments in this Update require that an entity, including an entity that is subject to industry-specific guidance, disclose the following information:

1. The name, cost basis, fair value, and number of units for each significant crypto asset holding and the aggregate fair values and cost bases of the crypto asset holdings that are not individually significant
2. For crypto assets that are subject to contractual sale restrictions, the fair value of those crypto assets, the nature and remaining duration of the restriction(s), and the circumstances that could cause the restriction(s) to lapse.

For annual reporting periods, the amendments in this Update require that an entity disclose the following information:

1. A rollforward, in the aggregate, of activity in the reporting period for crypto asset holdings, including additions (with a description of the activities that resulted in the additions), dispositions, gains, and losses
2. For any dispositions of crypto assets in the reporting period, the difference between the disposal price and the cost basis and a description of the activities that resulted in the dispositions
3. If gains and losses are not presented separately, the income statement line item in which those gains and losses are recognized
4. The method for determining the cost basis of crypto assets.

## **How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?**

Under current GAAP, unless otherwise provided in industry-specific GAAP, crypto assets that are within the scope of the amendments in this Update are accounted for as indefinite-lived intangible assets. Those assets are tested for impairment annually and more frequently if events or circumstances indicate that it is more likely than not that an asset is impaired. If the carrying amount of the asset exceeds its fair value, an entity is required to recognize an impairment loss and reduce the carrying amount of the asset to its fair value. Subsequent increases in the carrying amount of the asset and reversal of an impairment loss are prohibited.

The amendments in this Update require that an entity measure crypto assets at fair value in the statement of financial position each reporting period and recognize changes from remeasurement in net income. The amendments also require that an entity provide enhanced disclosures for both annual and interim reporting periods to provide investors with relevant information to analyze and assess the exposure and risk of significant individual crypto asset holdings.

In addition, fair value measurement aligns the accounting required for holders of crypto assets with the accounting for entities that are subject to certain industry-specific guidance (such as investment companies) and eliminates the

requirement to test those assets for impairment, thereby reducing the associated cost and complexity of applying the current guidance.

## **When Will the Amendments Be Effective and What Are the Transition Requirements?**

The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been issued (or made available for issuance). If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

The amendments in this Update require a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets) as of the beginning of the annual reporting period in which an entity adopts the amendments.

# Amendments to the *FASB Accounting Standards Codification*<sup>®</sup>

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## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–13. Terms from the Master Glossary are in **bold type**. Added text is underlined, and deleted text is ~~struck out~~.

## Addition of Subtopic 350-60

2. Add Subtopic 350-60, with a link to transition paragraph 350-60-65-1, as follows:

**[For ease of readability, the new Subtopic is not underlined.]**

### **Intangibles—Goodwill and Other—Crypto Assets**

#### **Overview and Background**

##### **General**

**350-60-05-1** This Subtopic provides guidance on the subsequent measurement, presentation, and disclosure of crypto assets that are within the scope of this Subtopic.

**350-60-05-2** This Subtopic does not address the initial measurement, recognition, and derecognition of crypto assets. Reporting entities shall account for the initial measurement, recognition, and derecognition of crypto assets in accordance with other generally accepted accounting principles (GAAP).

#### **Scope and Scope Exceptions**

##### **General**

##### **> Overall Guidance**

**350-60-15-1** The guidance in this Subtopic applies to holdings of assets that meet all of the following criteria:

- a. Meet the definition of **intangible assets** as defined in the Codification
- b. Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
- c. Are created or reside on a distributed ledger based on blockchain or similar technology
- d. Are secured through cryptography
- e. Are fungible
- f. Are not created or issued by the reporting entity or its **related parties**.

## **> Entities**

**350-60-15-2** The guidance in this Subtopic applies to all entities that hold crypto assets.

## **Glossary**

### **Contribution**

An unconditional transfer of cash or other assets, as well as **unconditional promises to give**, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from:

- a. Exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately commensurate value
- b. Investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners
- c. Other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers.

In a contribution transaction, the resource provider often receives value indirectly by providing a societal benefit although that benefit is not considered to be of commensurate value. In an exchange transaction, the potential public benefits are secondary to the potential direct benefits to the resource provider. The term *contribution revenue* is used to apply to transactions that are part of the entity's ongoing major or central activities (revenues), or are peripheral or incidental to the entity (gains). See also **Inherent Contribution and Conditional Contribution**.

**Conditional Contribution**

A contribution that contains a **donor-imposed condition**.

**Customer**

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

**Donor-Imposed Condition**

A donor stipulation (donors include other types of contributors, including makers of certain grants) that represents a barrier that must be overcome before the recipient is entitled to the assets transferred or promised. Failure to overcome the barrier gives the contributor a right of return of the assets it has transferred or gives the promisor a right of release from its obligation to transfer its assets.

**Fair Value (second definition)**

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction between market participants** at the measurement date.

**Inherent Contribution**

A contribution that results if an entity voluntarily transfers assets (or net assets) or performs services for another entity in exchange for either no assets or for assets of substantially lower value and unstated rights or privileges of a commensurate value are not involved.

**Intangible Asset Class**

A group of intangible assets that are similar, either by their nature or by their use in the operations of an entity.

**Intangible Assets**

Assets (not including financial assets) that lack physical substance. (The term intangible assets is used to refer to intangible assets other than goodwill.)



## **Market Participants**

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
- c. They are able to enter into a transaction for the asset or liability
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

## **Not-for-Profit Entity**

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

## **Orderly Transaction**

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

## **Promise to Give**

A written or oral agreement to contribute cash or other assets to another entity. A promise carries rights and obligations—the recipient of a promise to give has a right to expect that the promised assets will be transferred in the future, and the maker has a social and moral obligation, and generally a legal obligation, to make the promised transfer. A promise to give may be either conditional or unconditional.

## **Related Parties**

Related parties include:

- a. Affiliates of the entity
- b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
- c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
- d. Principal owners of the entity and members of their immediate families
- e. Management of the entity and members of their immediate families
- f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
- g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

## **Unconditional Promise to Give**

A **promise to give** that depends only on passage of time or demand by the promisee for performance.

## **Subsequent Measurement**

### **General**

**350-60-35-1** An entity shall measure crypto assets at **fair value** in the statement of financial position. Gains and losses from the remeasurement of crypto assets shall be included in net income.

## **Other Presentation Matters**

### **General**

#### **> Statement of Financial Position**

**350-60-45-1** Crypto assets shall be presented separately from other **intangible assets** in the statement of financial position. An entity is permitted to present crypto assets on a more disaggregated basis (for example, by individual crypto asset holding or **intangible asset class**).

#### **> Income Statement**

**350-60-45-2** Gains and losses from the remeasurement of crypto assets shall be included in net income and presented separately from changes in the carrying amount of other intangible assets.

#### **> Statement of Cash Flows**

**350-60-45-3** For guidance related to the presentation of cash receipts arising from the sale of crypto assets that are received as noncash consideration in the ordinary course of business (or as a **contribution**, in the case of a **not-for-profit entity**) and are converted nearly immediately into cash, see paragraphs 230-10-45-21A and 230-10-45-27A.

## **Disclosure**

### **General**

**350-60-50-1** At interim and annual reporting periods, an entity shall disclose the following for each significant (as determined by the **fair value**) crypto asset holding:

- a. Name of the crypto asset
- b. Cost basis
- c. Fair value
- d. Number of units held.

An entity shall disclose the aggregated cost bases and fair values of the crypto asset holdings that are not individually significant.

**350-60-50-2** At annual reporting periods, an entity shall disclose both of the following:

- a. The method used to determine its cost basis for computing gains and losses (for example, first-in, first-out; specific identification; average cost; or other method used)
- b. If not presented separately, the line item in which gains and losses are reported in the income statement.

**350-60-50-3** At annual reporting periods, an entity shall provide a reconciliation, in the aggregate, of activity from the opening to the closing balances of crypto assets, separately disclosing changes during the period attributable to the following:

- a. Additions.
- b. Dispositions.
- c. Gains included in net income for the period, determined on a crypto-asset-by-crypto-asset basis. Each crypto asset holding that has a net gain from remeasurement as included in net income for the period shall be included in the gains line.
- d. Losses included in net income for the period, determined on a crypto-asset-by-crypto-asset basis. Each crypto asset holding that has a net loss from remeasurement as included in net income for the period shall be included in the losses line.

**350-60-50-4** An entity shall disclose the following information about the reconciliation in paragraph 350-60-50-3:

- a. A description of the nature of activities that result in additions (for example, purchases, receipts from **customers**, or mining activities) and dispositions (for example, sales or use as payment for services)
- b. Total amount of cumulative realized gains and cumulative realized losses from dispositions that occurred during the period.

**350-60-50-5** An entity that receives crypto assets as noncash consideration in the ordinary course of business (or as a **contribution**, in the case of a **not-for-profit entity**) that are converted nearly immediately into cash need not include that activity in the disclosures required by paragraphs 350-60-50-3 through 50-4.

**350-60-50-6** For interim and annual reporting periods, an entity shall disclose the following information for crypto assets subject to contractual sale restrictions at the balance sheet date:

- a. The fair value of the crypto assets that are subject to contractual sale restrictions
- b. The nature and remaining duration of the restriction(s)
- c. Circumstances that could cause the restriction(s) to lapse.

**350-60-50-7** In providing the required disclosures in paragraph 350-60-50-6, an entity with multiple crypto assets subject to contractual sale restrictions shall consider all of the following:

- a. The level of detail necessary to satisfy the required disclosures
- b. How much emphasis to place on each of the required disclosures
- c. How much aggregation or disaggregation to undertake
- d. Whether users of financial statements need additional information to evaluate the quantitative information disclosed.

## **Transition and Open Effective Date Information**

### **General**

**> Transition Related to Accounting Standards Update No. 2023-08, *Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets***

**350-60-65-1** The following represents the transition and effective date information related to Accounting Standards Update No. 2023-08, *Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets*:

- a. The pending content that links to this paragraph shall be effective for all entities for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been issued (or made available for issuance). If an entity adopts the pending content that links to this paragraph in an interim period, it must adopt the content as of the beginning of the fiscal year that includes that interim period.

- b. An entity shall recognize the cumulative effect of initially applying the pending content that links to this paragraph as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the annual reporting period in which the entity first applies the pending content that links to this paragraph.
- c. The adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) shall be calculated as the difference between the carrying amount of crypto assets as of the end of the prior annual reporting period and the **fair value** of those crypto assets as of the beginning of the annual reporting period in which the entity first applies the pending content that links to this paragraph.

## Amendments to Subtopic 230-10

3. Amend paragraph 230-10-45-21A and its related heading and add paragraph 230-10-45-27A and its related heading, with a link to transition paragraph 350-60-65-1, as follows:

### **Statement of Cash Flows—Overall**

#### **Other Presentation Matters**

##### **> Classification**

##### **• > Acquisitions and Sales of Certain Securities Securities, and Loans, and Crypto Assets**

**230-10-45-21A** Cash receipts resulting from the sale of donated **financial assets** (for example, donated debt or equity instruments) or crypto assets accounted for in accordance with Subtopic 350-60 by NFPs that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash shall be classified as operating cash flows. If, however, the donor restricted the use of the contributed resource to a long-term purpose of the nature of those described in paragraph 230-10-45-14(c), then those cash receipts meeting all the conditions in this paragraph shall be classified as a financing activity.

• **> Crypto Assets Received as Noncash Consideration**

**230-10-45-27A** If crypto assets accounted for in accordance with Subtopic 350-60 are received as noncash consideration in the ordinary course of business (for example, in exchange for goods and services transferred to a customer) and converted nearly immediately into cash, the cash received shall be classified as operating activities. In this context, the term *nearly immediately* refers to a short period of time that is expected to be within hours or a few days, rather than weeks.

## Amendments to Subtopic 270-10

4. Amend paragraph 270-10-50-7 by adding item p, with a link to transition paragraph 350-60-65-1, as follows:

### Interim Reporting—Overall

#### Disclosure

**> Guidance Related to Disclosure of Other Topics at Interim Dates**

**270-10-50-7** The following may not represent all references to interim disclosure:

- p. For disclosure requirements for crypto assets, see paragraphs 350-60-50-1 and 350-60-50-6 through 50-7.

## Amendments to Subtopic 350-10

5. Amend paragraphs 350-10-05-3 and 350-10-40-3, with a link to transition paragraph 350-60-65-1, as follows:

### Intangibles—Goodwill and Other—Overall

#### Overview and Background

**350-10-05-3** This Topic includes the following Subtopics:

- a. Overall.

- b. Goodwill—Subtopic 350-20 provides guidance on the measurement of goodwill after acquisition, derecognition of some or all of goodwill allocated to a reporting unit, other presentation matters, and disclosures.
- c. General Intangibles Other Than Goodwill—Subtopic 350-30 provides guidance on the initial recognition and measurement of intangible assets other than goodwill that are either:
  - 1. Acquired individually or with a group of assets in a transaction that is not a business combination or an acquisition by a not-for-profit entity
  - 2. Internally generated.
- d. Internal-Use Software—Subtopic 350-40 provides guidance on the accounting for the cost of computer software that is developed or obtained for internal use and **hosting arrangements** obtained for internal use.
- e. Website Development Costs—Subtopic 350-50 provides guidance on whether to capitalize or expense costs incurred to develop a website.
- f. Crypto Assets—Subtopic 350-60 provides guidance on the subsequent measurement, presentation, and disclosure of crypto assets.

**In addition, amend the following pending content for paragraph 350-10-05-3, with a link to transition paragraph 805-60-65-1:**

Pending Content

**Transition Date:** (P) January 1, 2025; (N) January 1, 2025 | **Transition Guidance:** 805-60-65-1

**350-10-05-3** This Topic includes the following Subtopics:

- a. Overall.
- b. Goodwill—Subtopic 350-20 provides guidance on the measurement of goodwill after acquisition, derecognition of some or all of goodwill allocated to a reporting unit, other presentation matters, and disclosures.
- c. General Intangibles Other Than Goodwill—Subtopic 350-30 provides guidance on the initial recognition and measurement of intangible assets other than goodwill that are either:
  - 1. Acquired individually or with a group of assets in a transaction that is not a business combination, an acquisition by a not-for-profit entity, or a joint venture formation



2. Internally generated.
- d. **Internal-Use Software**—Subtopic 350-40 provides guidance on the accounting for the cost of computer software that is developed or obtained for internal use and **hosting arrangements** obtained for internal use.
- e. **Website Development Costs**—Subtopic 350-50 provides guidance on whether to capitalize or expense costs incurred to develop a website.
- f. **Crypto Assets**—Subtopic 350-60 provides guidance on the subsequent measurement, presentation, and disclosure of crypto assets.

## **Derecognition**

### **> Transfer or Sale of Intangible Assets**

**350-10-40-3** If an entity transfers a nonfinancial asset in accordance with paragraph 350-10-40-1, and the contract does not meet all of the criteria in paragraph 606-10-25-1, the entity shall not derecognize the nonfinancial asset and shall follow the guidance in paragraphs 606-10-25-6 through 25-8 to determine if and when the contract subsequently meets all of the criteria in paragraph 606-10-25-1. Until all of the criteria in paragraph 606-10-25-1 are met, the entity shall continue to do all any of the following, as applicable:

- a. Report the nonfinancial asset in its financial statements
- b. Recognize amortization expense as a period cost for those assets with a finite life
- c. Apply the impairment guidance in Section 350-30-35 ~~350-30-35~~.
- d. For crypto assets accounted for in accordance with Subtopic 350-60, recognize gains and losses from remeasurement.

## **Amendments to Subtopic 350-30**

6. Amend paragraph 350-30-15-4, with a link to transition paragraph 350-60-65-1, as follows:

### **Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill**

#### **Scope and Scope Exceptions**

##### **> Transactions**

**350-30-15-4** The guidance in this Subtopic does not apply to the following:

- a. Subparagraph not used.
- b. Subparagraph superseded by Accounting Standards Update No. 2010-07.
- c. Except for certain disclosure requirements as noted in paragraph 350-30-15-3, capitalized software costs
- d. Except for disclosures required by paragraph 944-805-50-1 (however, an insurance entity need not duplicate disclosures that also are required by paragraphs 944-30-50-2A through 50-2B), intangible assets recognized for acquired insurance contracts under the requirements of Subtopic 944-805 944-805.
- e. Crypto assets accounted for in accordance with Subtopic 350-60, except for recognition and initial measurement of crypto assets.

## Amendments to Subtopic 958-230

7. Amend paragraph 958-230-55-3, with a link to transition paragraph 350-60-65-1, as follows:

### **Not-for-Profit Entities—Statement of Cash Flows**

#### **Implementation Guidance and Illustrations**

##### **> Implementation Guidance**

##### **• > Cash Received with a Donor-Imposed Restriction That Limits Its Use to Long-Term Purposes**

**958-230-55-3** When an NFP reports cash received (or cash receipts from the sale of donated **financial assets or crypto assets accounted for in accordance with Subtopic 350-60** that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash as discussed in paragraph 230-10-45-21A) with a **donor-imposed restriction** that limits its use to long-term purposes in conformity with paragraph 958-210-45-6, an adjustment to the change in net assets to reconcile to net cash flows from operating activities is necessary when using the indirect method of reporting cash flows in order to present those cash receipts as cash inflows from financing activities as required by paragraph 230-10-45-14(c).

No. 2023-09  
December 2023

## Income Taxes (Topic 740)

### Improvements to Income Tax Disclosures

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

*The FASB Accounting Standards Codification® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.*

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## Accounting Standards Update

No. 2023-09  
December 2023

### Income Taxes (Topic 740)

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Financial Accounting Standards Board  
801 Main Avenue • Norwalk, CT • 06851

Accounting Standards Update 2023-09

Income Taxes (Topic 740)

Improvements to Income Tax Disclosures

December 2023

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## Summary

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### Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing the amendments in this Update to enhance the transparency and decision usefulness of income tax disclosures. Investors, lenders, creditors, and other allocators of capital (collectively, “investors”) indicated that the existing income tax disclosures should be enhanced to provide information to better assess how an entity’s operations and related tax risks and tax planning and operational opportunities affect its tax rate and prospects for future cash flows. Investors currently rely on the rate reconciliation table and other disclosures, including total income taxes paid, to evaluate income tax risks and opportunities. While investors find these disclosures helpful, they suggested possible enhancements to better (1) understand an entity’s exposure to potential changes in jurisdictional tax legislation and the ensuing risks and opportunities, (2) assess income tax information that affects cash flow forecasts and capital allocation decisions, and (3) identify potential opportunities to increase future cash flows.

The amendments in this Update address investor requests for more transparency about income tax information through improvements to income tax disclosures primarily related to the rate reconciliation and income taxes paid information.

This Update also includes certain other amendments to improve the effectiveness of income tax disclosures.

### Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all entities that are subject to Topic 740, Income Taxes.

Certain of the disclosures that are required by the amendments in this Update are not required for entities other than public business entities.

# What Are the Main Provisions?

## Rate Reconciliation

The amendments in this Update require that public business entities on an annual basis (1) disclose specific categories in the rate reconciliation and (2) provide additional information for reconciling items that meet a quantitative threshold (if the effect of those reconciling items is equal to or greater than 5 percent of the amount computed by multiplying pretax income [or loss] by the applicable statutory income tax rate).

Specifically, public business entities are required to disclose a tabular reconciliation, using both percentages and reporting currency amounts, according to the following requirements:

1. The following specific categories are required to be disclosed:
  - a. State and local income tax, net of federal (national) income tax effect
  - b. Foreign tax effects
  - c. Effect of changes in tax laws or rates enacted in the current period
  - d. Effect of cross-border tax laws
  - e. Tax credits
  - f. Changes in valuation allowances
  - g. Nontaxable or nondeductible items
  - h. Changes in unrecognized tax benefits.
2. Separate disclosure is required for any reconciling item listed below in which the effect of the reconciling item is equal to or greater than 5 percent of the amount computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory income tax rate.
  - a. If the reconciling item is within the effect of cross-border tax laws, tax credits, or nontaxable or nondeductible items categories, it is required to be disaggregated by nature.
  - b. If the reconciling item is within the foreign tax effects category, it is required to be disaggregated by jurisdiction (country) and by nature, except for reconciling items related to changes in unrecognized tax benefits discussed in (4).
  - c. If the reconciling item does not fall within any of the categories listed in (1), it is required to be disaggregated by nature.
3. For the purpose of categorizing reconciling items, except for reconciling items related to changes in unrecognized tax benefits discussed in (4),



the state and local income tax category should reflect income taxes imposed at the state or local level within the jurisdiction (country) of domicile, the foreign tax effects category should reflect income taxes imposed by foreign jurisdictions, and the remaining categories listed in (1) should reflect federal (national) income taxes imposed by the jurisdiction (country) of domicile.

4. For the purpose of presenting reconciling items:
  - a. Reconciling items are required to be presented on a gross basis with two exceptions under which unrecognized tax benefits and the related tax positions and tax effects of certain cross-border tax laws and the related tax credits may be presented on a net basis.
  - b. Reconciling items presented in the changes in unrecognized tax benefits category may be disclosed on an aggregated basis for all jurisdictions.

For the state and local category, a public business entity is required to provide a qualitative description of the states and local jurisdictions that make up the majority (greater than 50 percent) of the effect of the state and local income tax category.

A public business entity is required to provide an explanation, if not otherwise evident, of the individual reconciling items disclosed, such as the nature, effect, and underlying causes of the reconciling items and the judgment used in categorizing the reconciling items.

For entities other than public business entities, the amendments in this Update require qualitative disclosure about specific categories of reconciling items and individual jurisdictions that result in a significant difference between the statutory tax rate and the effective tax rate.

## Income Taxes Paid

The amendments in this Update require that all entities disclose on an annual basis the following information about income taxes paid:

1. The amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign taxes
2. The amount of income taxes paid (net of refunds received) disaggregated by individual jurisdictions in which income taxes paid (net of refunds received) is equal to or greater than 5 percent of total income taxes paid (net of refunds received).

## Other Disclosures

The amendments in this Update require that all entities disclose the following information:

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

The amendments in this Update eliminate the requirement for all entities to (1) disclose the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or (2) make a statement that an estimate of the range cannot be made.

The amendments in this Update remove the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures.

The amendments in this Update replace the term *public entity* as currently used in Topic 740 with the term *public business entity* as defined in the Master Glossary of the Codification.

## How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update related to the rate reconciliation and income taxes paid disclosures improve the transparency of income tax disclosures by requiring (1) consistent categories and greater disaggregation of information in the rate reconciliation and (2) income taxes paid disaggregated by jurisdiction. The amendments allow investors to better assess, in their capital allocation decisions, how an entity's worldwide operations and related tax risks and tax planning and operational opportunities affect its income tax rate and prospects for future cash flows.

The other amendments in this Update improve the effectiveness and comparability of disclosures by (1) adding disclosures of pretax income (or loss) and income tax expense (or benefit) to be consistent with U.S. Securities and Exchange Commission (SEC) Regulation S-X 210.4-08(h), *Rules of General Application—General Notes to Financial Statements: Income Tax Expense*, and (2) removing disclosures that no longer are considered cost beneficial or relevant.

## When Will the Amendments Be Effective and What Are the Transition Requirements?

For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2024. For entities other than public business entities, the amendments are effective for annual periods beginning after December 15, 2025.

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

The amendments in this Update should be applied on a prospective basis. Retrospective application is permitted.

# Amendments to the *FASB Accounting Standards Codification*<sup>®</sup>

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## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–10. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold type**. Added text is underlined, and deleted text is ~~struck out~~.

## Amendments to Master Glossary

2. Supersede the following Master Glossary terms from Subtopic 740-10, with a link to transition paragraph 740-10-65-9, as follows:

### **~~Nonpublic Entity (Definition 5)~~**

~~An entity that does not meet any of the following criteria:~~

- ~~a. Its debt or equity securities are traded in a public market, including those traded on a stock exchange or in the over the counter market (including securities quoted only locally or regionally).~~
- ~~b. It is a conduit bond obligor for **conduit debt securities** that are traded in a public market (a domestic or foreign stock exchange or an over the counter market, including local or regional markets).~~
- ~~c. Its financial statements are filed with a regulatory agency in preparation for the sale of any class of securities.~~

### **~~Public Entity (Definition 2)~~**

~~An entity that meets any of the following criteria:~~

- ~~a. Its debt or equity securities are traded in a public market, including those traded on a stock exchange or in the over the counter market (including securities quoted only locally or regionally).~~
- ~~b. It is a conduit bond obligor for **conduit debt securities** that are traded in a public market (a domestic or foreign stock exchange or an over the counter market, including local or regional markets).~~

- ~~c. Its financial statements are filed with a regulatory agency in preparation for the sale of any class of securities.~~

## Amendments to Subtopic 740-10

3. Amend paragraphs 740-10-50-5 through 50-8 and the related headings and 740-10-50-11 through 50-16 and their related headings and add paragraphs 740-10-50-1A, 740-10-50-10A through 50-10B, 740-10-50-11A, 740-10-50-12A through 50-12C, and 740-10-50-22 through 50-23 and their related heading, with a link to transition paragraph 740-10-65-9, as follows:

### **Income Taxes—Overall**

#### **Disclosure**

**740-10-50-1** This Section provides guidance on the financial statement disclosure requirements relating to **income taxes** applicable to all entities.

**740-10-50-1A** Nothing in this Subtopic is intended to discourage an entity from reporting additional information specific to its income tax rate reconciliation or income taxes paid to further an understanding of the entity and the related disclosures.

#### **> Statement of Financial Position Related Disclosures**

**740-10-50-5** An entity's **temporary difference** and carryforward information requires additional disclosure. The additional disclosure differs for ~~public~~**public business entities** and ~~nonpublic entities~~ other than public business entities.

#### **• > Public Business Entities**

**740-10-50-6** A ~~public entity~~public business entity shall disclose the approximate tax effect of each type of temporary difference and carryforward that gives rise to a significant portion of deferred tax liabilities and deferred tax assets (before allocation of valuation allowances).

**740-10-50-7** See paragraph 740-10-50-16 for disclosure requirements applicable to a public business entity that is not subject to income taxes.

#### **• > ~~Nonpublic~~ Entities Other Than Public Business Entities**

**740-10-50-8** ~~A nonpublic entity~~ An entity other than a public business entity shall disclose the types of significant temporary differences and carryforwards but may omit disclosure of the tax effects of each type.

**> Income Statement Related Disclosures**

**740-10-50-9** The significant components of income tax expense attributable to continuing operations for each year presented shall be disclosed in the financial statements or notes thereto. Those components would include, for example:

- a. **Current tax expense (or benefit)**
- b. **Deferred tax expense (or benefit)** (exclusive of the effects of other components listed below)
- c. Investment tax credits
- d. Government grants (to the extent recognized as a reduction of income tax expense)
- e. The benefits of operating loss carryforwards
- f. Tax expense that results from allocating certain tax benefits directly to contributed capital
- g. Adjustments of a deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the entity
- h. Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related **deferred tax asset** in future years. For example, any acquisition-date income tax benefits or expenses recognized from changes in the acquirer's valuation allowance for its previously existing deferred tax assets as a result of a business combination (see paragraph 805-740-30-3).

**740-10-50-10** The amount of **income tax expense (or benefit)** allocated to continuing operations and the amounts separately allocated to other items (in accordance with the intraperiod tax allocation provisions of paragraphs 740-20-45-2 through 45-14 and 852-740-45-3) shall be disclosed for each year for which those items are presented.

**740-10-50-10A** Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign shall be disclosed for each annual reporting period.

**740-10-50-10B** Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign shall be disclosed for each annual reporting period. Income taxes on foreign earnings that are

imposed by the jurisdiction of domicile shall be included in the amount for that jurisdiction of domicile (that is, the jurisdiction imposing the tax).

**> Rate Reconciliation between Income Tax Expense Compared to (or Benefit) and Statutory Expectations**

**740-10-50-11** The reported amount of income tax expense (or benefit) may differ from an expected amount based on statutory tax rates. The following guidance establishes the disclosure requirements for such situations and differs for public business entities and ~~nonpublic entities other than public business entities~~.

**740-10-50-11A** The objective of these disclosure requirements is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the statutory tax rate.

**• > Public Business Entities**

**740-10-50-12** A public business entity shall disclose a reconciliation for each annual reporting period, in accordance with paragraphs 740-10-50-12A through 50-12C, between the amount of reported income tax expense (or benefit) from continuing operations and the amount computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the jurisdiction (country) of domicile. In circumstances in which a public business entity, as the parent entity, is not domiciled in the United States, the federal (national) income tax rate in that entity's jurisdiction (country) of domicile shall normally be used in the reconciliation, and different rates shall not be used for subsidiaries or segments of the public business entity. When the rate used by a public business entity is other than the United States federal corporate income tax rate, the public business entity shall disclose the rate used and the basis for using that rate. ~~using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The statutory tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed.~~

**740-10-50-12A** For each annual reporting period, a public business entity shall disclose a tabular reconciliation, using both percentages and reporting currency amounts, according to the following requirements:

- a. The following specific categories shall be disclosed:
  - 1. State and local income tax, net of federal (national) income tax effect
  - 2. Foreign tax effects
  - 3. Effect of changes in tax laws or rates enacted in the current period
  - 4. Effect of cross-border tax laws
  - 5. Tax credits
  - 6. Changes in valuation allowances
  - 7. Nontaxable or nondeductible items
  - 8. Changes in unrecognized tax benefits.
- b. Separate disclosure shall be required for any reconciling item listed below in which the effect of the reconciling item is equal to or greater than 5 percent of the amount computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the jurisdiction (country) of domicile. When disaggregating the following reconciling items by nature, an entity should consider the reconciling item's fundamental or essential characteristics, such as the event that caused the reconciling item and the activity with which the reconciling item is associated. Reconciling items shall be presented on a gross basis unless specific guidance in (c) permits net presentation with a related reconciling item.
  - 1. If the reconciling item is within the effect of cross-border tax laws, tax credits, or nontaxable or nondeductible items categories, it shall be disaggregated by nature.
  - 2. If the reconciling item is within the foreign tax effects category, it shall be disaggregated by jurisdiction (country) and by nature, except for reconciling items related to changes in unrecognized tax benefits discussed in (c). If a foreign jurisdiction meets the 5 percent threshold, it shall be separately disclosed as a reconciling item. Within any foreign jurisdiction (regardless of whether it meets the 5 percent threshold), the reconciling item shall be separately disclosed by nature if its gross amount (positive or negative) meets the 5 percent threshold.
  - 3. If the reconciling item is not within any of the categories listed in (a), it shall be disaggregated by nature.
- c. For the purpose of categorizing and presenting reconciling items:



1. Except for reconciling items related to changes in unrecognized tax benefits discussed in (c)(2), the state and local income tax category reflects income taxes imposed at the state or local level within the jurisdiction (country) of domicile, the foreign tax effects category reflects income taxes imposed by foreign jurisdictions, and the remaining categories listed in (a) reflect federal (national) income taxes imposed by the jurisdiction (country) of domicile.
2. For reconciling items related to changes in unrecognized tax benefits:
  - i. Reconciling items resulting from changes in judgment related to tax positions taken in prior annual reporting periods (such as subsequent recognition, derecognition, and change in measurement of unrecognized tax benefits) are reflected in the changes in unrecognized tax benefits category.
  - ii. When an unrecognized tax benefit is recorded in the current annual reporting period for a tax position taken or expected to be taken in the same reporting period, the unrecognized tax benefit and its related tax position may be presented on a net basis in the category where the tax position is presented.
  - iii. Reconciling items presented in the changes in unrecognized tax benefits category may be disclosed on an aggregated basis for all jurisdictions.
3. The effect of cross-border tax laws category reflects the effect of incremental income taxes imposed by the jurisdiction (country) of domicile on income earned in foreign jurisdictions. When the jurisdiction (country) of domicile taxes cross-border income but also provides a tax credit on the same income during the same reporting period, the tax effect of both the cross-border tax and its related tax credit may be presented on a net basis in the effect of cross-border tax laws category. For example, the tax effect related to the global intangible low-taxed income and its related foreign tax credits may be presented on a net basis as one reconciling item in the effect of cross-border tax laws category.
4. The effect of changes in tax laws or rates enacted in the current period category reflects the cumulative tax effects of a change in enacted tax laws or rates on current or deferred tax assets and liabilities at the date of enactment.

See paragraph 740-10-55-231 for an illustration of a tabular rate reconciliation disclosure.

**740-10-50-12B** A public business entity shall provide a qualitative description of the states and local jurisdictions that make up the majority (greater than 50 percent) of the effect of the state and local income tax category. For the purpose of identifying the states and local jurisdictions that make up the majority of the effect, a public business entity shall begin with the state or local jurisdiction that has the largest effect and in descending order add states or local jurisdictions with the next largest effect until the aggregated effect is greater than 50 percent.

**740-10-50-12C** A public business entity shall provide an explanation, if not otherwise evident, of individual reconciling items required by paragraph 740-10-50-12A, such as the nature, effect, and underlying causes of the reconciling items and the judgment used in categorizing the reconciling items.

• > **Nonpublic-Entities Other Than Public Business Entities**

**740-10-50-13** ~~A nonpublic~~An entity other than a public business entity shall qualitatively disclose the nature and effect of specific categories of significant reconciling items listed in paragraph 740-10-50-12A(a) and individual jurisdictions that result in a significant difference between the statutory tax rate and the effective tax rate, but ~~may omit~~ a numerical reconciliation is not required. See paragraphs 740-10-55-232 through 55-233 for an illustration of a qualitative disclosure of rate reconciling items.

• > **All Entities**

**740-10-50-14** If not otherwise evident from the disclosures required by this Section, ~~all entities~~an entity shall disclose the nature and effect of any other significant matters affecting comparability of information for all periods presented.

> **Unrecognized Tax Benefit Related Disclosures**

**740-10-50-15** ~~An entity~~All entities shall disclose all of the following at the end of each annual reporting period presented:

- a. Subparagraph superseded by Accounting Standards Update No. 2009-06.

- b. Subparagraph superseded by Accounting Standards Update No. 2009-06.
- c. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position
- d. ~~Subparagraph superseded by Accounting Standards Update No. 2023-09. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:~~
  - ~~1. The nature of the uncertainty~~
  - ~~2. The nature of the event that could occur in the next 12 months that would cause the change~~
  - ~~3. An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made.~~
- e. A description of tax years that remain subject to examination by major tax jurisdictions.

**740-10-50-15A** ~~Public entities~~ A public business entity shall disclose both of the following at the end of each annual reporting period presented:

- a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:
  - 1. The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period
  - 2. The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period
  - 3. The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities
  - 4. Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations.
- b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate.

See Example 30 (paragraph 740-10-55-217) for an illustration of disclosures about uncertainty in income taxes.

#### **> Public Business Entities Not Subject to Income Taxes**

**740-10-50-16** A public business entity that is not subject to income taxes because its income is taxed directly to its owners shall disclose that fact and the net difference between the tax bases and the reported amounts of the entity's assets and liabilities.

## **> Statement of Cash Flows Related Disclosures**

**740-10-50-22** For each annual reporting period, all entities shall disclose the amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign.

**740-10-50-23** For each annual reporting period, all entities shall disclose the amount of income taxes paid (net of refunds received) to each individual jurisdiction in which income taxes paid (net of refunds received) is equal to or greater than 5 percent of total income taxes paid (net of refunds received).

4. Amend paragraph 740-10-55-217 and add paragraphs 740-10-55-230 through 55-233 and their related headings, with a link to transition paragraph 740-10-65-9, as follows:

## **Implementation Guidance and Illustrations**

### **> Illustrations**

#### **• > Example 30: Disclosure Relating to Uncertainty in Income Taxes**

**740-10-55-217** This Example illustrates the guidance in paragraph 740-10-50-15 for disclosures about uncertainty in income taxes.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 20X1. The Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax returns for 20X2 through 20X4 in the first quarter of 20X7 that is anticipated to be completed by the end of 20X8. ~~As of December 31, 20X7, the IRS has proposed certain significant adjustments to the Company's transfer pricing and research credits tax positions. Management is currently evaluating these proposed adjustments to determine if it agrees, but if accepted, the Company does not anticipate the adjustments would result in a material change to its financial position. However, the Company anticipates that it is reasonably possible that an additional payment in the range of \$80 to \$100 million will be made by the end of 20X8. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows.~~

	20X7	20X6 (in thousands)	20X5
Balance at January 1	\$ 370,000	\$ 380,000	\$ 415,000
Additions based on tax positions related to the current year	10,000	5,000	10,000
Additions for tax positions of prior years	30,000	10,000	5,000
Reductions for tax positions of prior years	(60,000)	(20,000)	(30,000)
Settlements	(40,000)	(5,000)	(20,000)
Balance at December 31	<u>\$ 310,000</u>	<u>\$ 370,000</u>	<u>\$ 380,000</u>

At December 31, 20X7, 20X6, and 20X5, there are \$60, \$55, and \$40 million of unrecognized tax benefits that if recognized would affect the annual effective tax rate.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. During the years ended December 31, 20X7, 20X6, and 20X5, the Company recognized approximately \$10, \$11, and \$12 million in interest and penalties. The Company had approximately \$60 and \$50 million for the payment of interest and penalties accrued at December 31, 20X7, and 20X6, respectively.

**• > Example 39: Rate Reconciliation between Income Tax Expense (or Benefit) and Statutory Expectations**

**740-10-55-230** The following Cases illustrate the rate reconciliation disclosure for a public business entity (Case A) and for an entity other than a public business entity (Case B).

**• • > Case A: Public Business Entity**

**740-10-55-231** The following illustrates the specific categories and the reconciling items disclosed by a public business entity in its tabular rate reconciliation in accordance with paragraphs 740-10-50-12A through 50-12B. The entity is domiciled in the United States and presents comparative financial statements. For the disclosure of foreign tax effects in accordance with paragraph 740-10-50-12A(b)(2), it is assumed that the 5 percent threshold, computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the United States, is met:

- a. For Ireland, both at the jurisdiction level and for certain individual reconciling items of the same nature within Ireland
- b. For the United Kingdom, for certain individual reconciling items of the same nature within the United Kingdom, but not at the jurisdiction level

c. For Switzerland and Mexico, at the jurisdiction level, but not for any individual reconciling items of the same nature within each jurisdiction.

[For ease of readability, the new table is not underlined.]

	Year Ended December 31, 20X2			Year Ended December 31, 20X1			Year Ended December 31, 20X0		
	Amount	Percent		Amount	Percent		Amount	Percent	
U.S. Federal Statutory Tax Rate	\$ AA	aa %		\$ BB	bb %		\$ CC	cc %	
State and Local Income Taxes, Net of Federal Income Tax Effect <sup>(a)</sup>	AA	aa		BB	bb		CC	cc	
Foreign Tax Effects									
United Kingdom									
Statutory tax rate difference between United Kingdom and United States	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Share-based payment awards	AA	aa		BB	bb		CC	cc	
Research and development tax credits	(AA)	(aa)		(BB)	(bb)		CC	cc	
Other	(AA)	(aa)		BB	bb		(CC)	(cc)	
Ireland									
Statutory tax rate difference between Ireland and United States	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Changes in valuation allowances	(AA)	(aa)		(BB)	(bb)		CC	cc	
Enacted changes in tax laws or rates	-	-		BB	bb		-	-	
Other	AA	aa		(BB)	(bb)		(CC)	(cc)	
Switzerland	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Mexico	AA	aa		BB	bb		CC	cc	
Other foreign jurisdictions	(AA)	(aa)		(BB)	(bb)		CC	cc	
Effect of Changes in Tax Laws or Rates Enacted in the Current Period	-	-		-	-		(CC)	(cc)	
Effect of Cross-Border Tax Laws									
Global intangible low-taxed income	AA	aa		BB	bb		CC	cc	
Foreign-derived intangible income	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Base erosion and anti-abuse tax	AA	aa		BB	bb		CC	cc	
Other	AA	aa		-	-		-	-	
Tax Credits									
Research and development tax credits	-	-		(BB)	(bb)		(CC)	(cc)	
Energy-related tax credits	(AA)	(aa)		-	-		-	-	
Other	-	-		(BB)	(bb)		-	-	
Changes in Valuation Allowances	AA	aa		(BB)	(bb)		(CC)	(cc)	
Nontaxable or Nondeductible Items									
Share-based payment awards	AA	aa		BB	bb		CC	cc	
Goodwill impairment	AA	aa		BB	bb		-	-	
Other	AA	aa		(BB)	(bb)		CC	cc	
Changes in Unrecognized Tax Benefits	(AA)	(aa)		BB	bb		(CC)	(cc)	
Other Adjustments	AA	aa		(BB)	(bb)		(CC)	(cc)	
Effective Tax Rate	\$ AA	aa %		\$ BB	bb %		\$ CC	cc %	

<sup>(a)</sup> State taxes in California and New York made up the majority (greater than 50 percent) of the tax effect in this category.

**• • > Case B: Entity Other Than Public Business Entity**

**740-10-55-232** The following illustrates significant reconciling items disclosed by an entity other than a public business entity in accordance with paragraph 740-10-50-13.

**740-10-55-233** The difference between Entity W's effective tax rate and its statutory tax rate is primarily attributed to tax credits, state taxes, and foreign taxes. More specifically, the foreign tax effects of Entity W's operations in Ireland had a decreasing effect on its effective tax rate, while the foreign tax effects of Entity W's operations in France had an increasing effect on its

effective tax rate. Entity W received federal research and development tax credits, which decreased its effective tax rate, while state taxes in California increased its effective tax rate.

5. Add paragraph 740-10-65-9 and its related heading as follows:

### **Transition and Open Effective Date Information**

#### **> Transition Related to Accounting Standards Update No. 2023-09, Income Taxes (Topic 740): Improvements to Income Tax Disclosures**

**740-10-65-9** The following represents the transition and effective date information related to Accounting Standards Update No. 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*:

- a. The pending content that links to this paragraph shall be effective for public business entities for annual periods beginning after December 15, 2024.
- b. For entities other than public business entities, the pending content that links to this paragraph shall be effective for annual periods beginning after December 15, 2025.
- c. Early adoption of the pending content that links to this paragraph is permitted for annual financial statements that have not yet been issued (or made available for issuance).
- d. An entity shall apply the pending content that links to this paragraph on a prospective basis to financial statements for annual periods beginning after the effective date. Retrospective application to each period presented in the financial statements is permitted.

### **Amendments to Subtopic 740-30**

6. Amend paragraph 740-30-50-2, with a link to transition paragraph 740-10-65-9, as follows:

#### **Income Taxes—Other Considerations or Special Areas**

##### **Disclosure**

##### **> Undistributed Earnings of Subsidiaries and Corporate Joint Ventures**

**740-30-50-2** ~~All of the~~ The following information shall be disclosed whenever a **deferred tax liability** is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures:

- a. A description of the types of temporary differences for which a deferred tax liability has not been recognized and the types of events that would cause those temporary differences to become taxable
- b. Subparagraph superseded by Accounting Standards Update No. 2023-09. The cumulative amount of each type of temporary difference
- c. The amount of the unrecognized deferred tax liability for {add glossary link}temporary differences{add glossary link} related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable. While paragraph 740-30-25-14 prohibits recognition of a tax **benefit** for tax deductions or favorable tax rates attributable to future dividends of undistributed earnings for which a deferred tax liability has not been recognized, favorable tax treatment would be reflected in measuring that unrecognized deferred tax liability for disclosure purposes.
- d. The amount of the deferred tax liability for temporary differences other than those in (c) (that is, undistributed domestic earnings) that is not recognized in accordance with the provisions of paragraph 740-30-25-18.

## Amendments to Subtopic 230-10

7. Amend paragraphs 230-10-50-2 and 230-10-55-14 and add paragraph 230-10-50-2A, with a link to transition paragraph 740-10-65-9, as follows:

### Statement of Cash Flows—Overall

#### Disclosure

##### > Interest and Income Taxes Paid

**230-10-50-2** If the indirect method is used, amounts of interest paid (net of amounts capitalized), including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt



instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount, ~~and income taxes paid during the period~~ shall be disclosed.

**230-10-50-2A** Income taxes paid (net of refunds received) shall be disclosed in accordance with paragraphs 740-10-50-22 through 50-23.

## Implementation Guidance and Illustrations

### > Illustrations

#### • > Example 1: Direct and Indirect Method for a Manufacturing Entity

**230-10-55-14** The following table illustrates the supplemental disclosures of cash flow information.

Cash paid during the year for:

Interest (net of amount capitalized)	\$220
Income taxes	325

**Note:** This Example does not illustrate the disclosures of income taxes paid required by paragraphs 740-10-50-22 through 50-23, for the year ended December 31, 19X1.

## Amendments to Status Sections

8. Amend paragraph 230-10-00-1, by adding the following items to the table, as follows:

**230-10-00-1** The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
230-10-50-2	Amended	2023-09	12/14/2023
230-10-50-2A	Added	2023-09	12/14/2023
230-10-55-14	Amended	2023-09	12/14/2023

9. Amend paragraph 740-10-00-1, by adding the following items to the table, as follows:

**740-10-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
<b>Conduit Debt Securities</b>	Superseded	2023-09	12/14/2023
<b>Nonpublic Entity (5<sup>th</sup> def.)</b>	Superseded	2023-09	12/14/2023
<b>Public Entity (2<sup>nd</sup> def.)</b>	Superseded	2023-09	12/14/2023
740-10-50-1A	Added	2023-09	12/14/2023
740-10-50-5 through 50-8	Amended	2023-09	12/14/2023
740-10-50-10A	Added	2023-09	12/14/2023
740-10-50-10B	Added	2023-09	12/14/2023
740-10-50-11 through 50-16	Amended	2023-09	12/14/2023
740-10-50-11A	Added	2023-09	12/14/2023
740-10-50-12A through 50-12C	Added	2023-09	12/14/2023
740-10-50-22	Added	2023-09	12/14/2023
740-10-50-23	Added	2023-09	12/14/2023
740-10-55-217	Amended	2023-09	12/14/2023
740-10-55-230 through 55-233	Added	2023-09	12/14/2023
740-10-65-9	Added	2023-09	12/14/2023

10. Amend paragraph 740-30-00-1, by adding the following item to the table, as follows:

**740-30-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
740-30-50-2	Amended	2023-09	12/14/2023

*The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:*

Richard R. Jones, *Chair*  
James L. Kroeker, *Vice Chairman*  
Christine A. Botosan  
Frederick L. Cannon  
Susan M. Cospers  
Marsha L. Hunt  
Dr. Joyce T. Joseph

Financial Statement Account	Description of Fraud	Audit Techniques
Cash	<p>Skimming (cash receipts theft)</p> <p>Very easy in system where general ledger is not integrated with cash register (cash receipts) system</p>	<ul style="list-style-type: none"> <li>• Compare deposit slips to detail entries in cash and system reports</li> <li>• Look hard at cash over and short accounts</li> <li>• Evaluate segregation of duties</li> <li>• Compensation if customer doesn't receive receipt</li> </ul>
	Overstated (cash per general ledger doesn't agree with bank reconciliation)	<ul style="list-style-type: none"> <li>• Compare bank rec balance to general ledger amount</li> <li>• Evaluate segregation of duties on bank reconciliations</li> </ul>
	<p>Unauthorized payments to employees/officers/owners:</p> <ul style="list-style-type: none"> <li>• Loans</li> <li>• Bonuses</li> <li>• Payments of personal expenses</li> </ul>	<ul style="list-style-type: none"> <li>• Perform related party disbursement test</li> <li>• Examine authorization for all checks or disbursements to related parties</li> <li>• Review all credit card statements to support and vendor for reasonableness</li> <li>• Evaluate appropriate approvals for independence of reviewer</li> </ul>
	Unauthorized salary payments to employees	<ul style="list-style-type: none"> <li>• Use outside payroll provider</li> <li>• Occasionally, put paycheck statements in employee hands</li> <li>• Management should do surprise reviews of payroll bank statements</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
		<ul style="list-style-type: none"> <li>• Compare salary expense per g/l to payroll reports</li> <li>• Unusual age/position combinations</li> <li>• Review time cards and compare to number of employees on payroll</li> <li>• Compare payroll recipients to terminated employee list</li> <li>• Watch message boards</li> </ul>
	<p>Expense reimbursement fraud/abuse:</p> <ul style="list-style-type: none"> <li>• Purchase of personal items at the pro shop</li> <li>• Multiple submissions of the same receipts</li> <li>• Multiple submissions of the same expense report</li> <li>• Fraudulent first class travel</li> <li>• In-room items abuse</li> <li>• Mini-bar abuse</li> </ul>	<ul style="list-style-type: none"> <li>• All expense reports should be accompanied by original receipts</li> <li>• Submit within 30 days of incurrence of expense</li> <li>• Compare receipts to expense report for agreement and “sanity”</li> <li>• Individual employees expense reports should be consistently reviewed by the same persons</li> <li>• Avoid paying travel advances</li> <li>• Have boarding passes attached to the expense reports</li> <li>• Consider having accommodation policies for out-of-town travel</li> <li>• Consider utilizing an outside expense reimbursement service</li> </ul>
	Restrictions on cash not disclosed in the financial	<ul style="list-style-type: none"> <li>• Still important to get bank confirmations</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
	statements:  <ul style="list-style-type: none"> <li>• Debt cross-collateralized by owner</li> </ul>	<ul style="list-style-type: none"> <li>• Confirm orally with bank officer or individual signing bank confirm the representations made on the confirm</li> </ul>
	Cash doesn't exist	<ul style="list-style-type: none"> <li>• Confirm all cash accounts, no matter how insignificant</li> <li>• Consider calling banks and talking with signer</li> </ul>
	Deposit issues  <ul style="list-style-type: none"> <li>• Cash deposits in small amounts</li> <li>• Deposits in transit</li> <li>• Checks in drawer not deposited</li> </ul>	<ul style="list-style-type: none"> <li>• Trace ALL deposits in transit to timely clearance</li> <li>• Question cash deposits in a non-cash receipts business</li> <li>• Look for/inquire about undeposited checks and inquire about reason for delays</li> </ul>
	Fraudulent outstanding checks (Unauthorized checks cut at month-end to pay fraudulent invoices. Wait for the period to be audited. Re-cut checks with different payee)	<ul style="list-style-type: none"> <li>• Look for significant amounts of checks written right at year-end and trace to clearance.</li> <li>• Look at actual check for proper dating</li> <li>• Compare a sample of outstanding checks that haven't cleared to the underlying invoice</li> <li>• Consider confirming o/s check or calling recipient</li> </ul>
	Payee change (Fraudulent invoice, paid with check, payee is altered, check cashed or deposited, fraudster interrupts check coming back from bank or bank doesn't return check copy)	<ul style="list-style-type: none"> <li>• Perform a full debit test on bank statement</li> <li>• (trace all debits to their original source documents)</li> <li>• Scan the checks returned with the bank statement for evidence of inappropriate payee</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
		changes
	Presentation of overdraft	<ul style="list-style-type: none"> <li>• True overdraft should be labeled as such; otherwise its “outstanding checks in excess of bank balance”</li> <li>• Look at actual bank statements and confirm the balances!!</li> </ul>
	Credit risk disclosures	<ul style="list-style-type: none"> <li>• Still required to be considered if amounts routinely on deposit exceed federally insured limits</li> </ul>
<b>Prepaid Items</b>	Intentional overstatement	<ul style="list-style-type: none"> <li>• Trace to underlying invoice AND cancelled check</li> </ul>
	Failure to amortize	<ul style="list-style-type: none"> <li>• Prepaids must be amortized over their useful life</li> </ul>
	Amortize over incorrect life	<ul style="list-style-type: none"> <li>• Compare useful life to actual invoice terms</li> </ul>
	Barter “parking”	<ul style="list-style-type: none"> <li>• Evaluate fair-market value on all barter transactions</li> <li>• Add inquiry related to “barter transactions” to questions to be asked of management</li> </ul>
<b>Accounts receivable</b>	Allowance reserves (cookie jars)	<ul style="list-style-type: none"> <li>• Compare acquisition document details to general ledger entries</li> <li>• Review allowance accounts for any unusually large round amounts. Examine supporting documentation</li> <li>• Examine bad debt expense for credit entries</li> <li>• Examine sales</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
		accounts for manual credit (or debit) entries
	Employee receivables	<ul style="list-style-type: none"> <li>• Document ALL loans to employees</li> <li>• Document resolution of employee unauthorized credit card use</li> </ul>
	Aging frauds (changing invoice dates)	<ul style="list-style-type: none"> <li>• Inquire as to the potential to override system assigned invoice dates</li> <li>• Trace out interim months past dues to collection or continued inclusion on list for a sample of past dues</li> <li>• Compare past due %'s to prior years</li> </ul>
	Side letters (agreement to transact business at other than the organizations standard terms)	<ul style="list-style-type: none"> <li>• Confirm all material terms of the receivable (date, invoice number, amount of original invoice, amount outstanding, payment terms, etc.)</li> </ul>
	"Insured loss" receivables	<ul style="list-style-type: none"> <li>• Be very skeptical of any insurance policy that reimburses for operating losses</li> </ul>
	Related party issues	<ul style="list-style-type: none"> <li>• High level of professional skepticism required</li> <li>• Confirm the terms of the transactions with the related parties</li> <li>• High level staff area of audit</li> <li>• Consider amount of these transactions that are occurring, when they are occurring</li> </ul>



<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
	Channel stuffing	<ul style="list-style-type: none"> <li>• Look for distributor arrangements</li> <li>• Look for significant amounts of “last week of the period” sales to distributors</li> <li>• Look for a high degree of returned merchandise</li> </ul>
	Sales-type lease issues	<ul style="list-style-type: none"> <li>• Evaluate discount rate closely</li> <li>• Determine that revenue recognition of service agreements is also being done appropriately</li> <li>• Make sure term of receivable is consistent with document</li> </ul>
	Top-side adjustments	<ul style="list-style-type: none"> <li>• Consolidations of divisions requires a high level staff</li> <li>• Look for any excel spreadsheet consolidations</li> <li>• Inquiry and do follow-up procedures relating to any combining entries that materially change any accounts on the consolidation</li> </ul>
	Multiple sets of books	<ul style="list-style-type: none"> <li>• Inquiry if client has an investor or creditor reporting package</li> <li>• Compare reporting package to internal financial statements for any differences</li> <li>• Consider discussions with significant creditors (with client approval of course)</li> </ul>
	In general	<ul style="list-style-type: none"> <li>• Look for receipts that are held</li> <li>• Look for significant</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
		<p>past dues where the customer has not been notified of the past due balance</p> <ul style="list-style-type: none"> <li>• Who grants credit to customers</li> <li>• Who is authorized to write-off a/r</li> <li>• Review rationale for write-offs</li> </ul>
<b>Deferred income taxes</b>	Manipulation of deferred tax rate	<input type="checkbox"/> Evaluate average income tax rate versus actual tax return results
	“More likely than not” interpretations	<input type="checkbox"/> Basically means 51% <input type="checkbox"/> Amount of valuation allowance needs to be disclosed
	Net operating loss valuations	<input type="checkbox"/> Valuation is how much is more likely than not to be utilized to offset taxable income in the future. Be very careful to document rationales for conclusions
	Income tax refunds and interest	<input type="checkbox"/> Determine if tax refunds received and interest income associated with them has been immediately recorded in income
	Uncertainty in income taxes	<input type="checkbox"/> Client receive any tax notices? Any known mistakes?

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
<b>Inventories</b>	Obsolescence reserves	<ul style="list-style-type: none"> <li>❑ Determine and evaluate reasonability of methodology</li> <li>❑ Observe inventory listed as obsolete</li> <li>❑ Determine that all obsolete inventory has been included in calculation</li> <li>❑ Look for material entries into the reserve accounts immediately preceding or following a year-end</li> <li>❑ Who is authorized to write items off as obsolete</li> <li>❑ Does obsolete inventory have a book value?</li> </ul>
	Cookie jar acquisitions schemes	<ul style="list-style-type: none"> <li>❑ Compare inventory valuation amounts between asset acquisition documents and entries into the general ledger</li> <li>❑ Look for significant adjustments made to any contra-inventory accounts soon after business acquisition</li> <li>❑ Look for spikes in gross margin within 90 days of business acquisition</li> </ul>
	Intentional double counting	<ul style="list-style-type: none"> <li>❑ Make sure there is no movement of inventory quantities during the physical inventory count or during test counts</li> <li>❑ Consider dropping inventory numbers into a sort program and look for same inventory numbers</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
		<p>appearing</p> <ul style="list-style-type: none"> <li>❑ Consider dropping inventory quantity value extensions into a sort program and look for the exact same inventory extended amounts</li> </ul>
	Costing errors (decimal issues)	<ul style="list-style-type: none"> <li>❑ Look for obviously unreasonable cost extensions</li> <li>❑ Expand cost testing scope</li> <li>❑ Assign cost test to high level audit staff</li> <li>❑ Look at all manually entered adjustments to inventory right before and after year-end and physical inventory</li> </ul>
	Bill-and-hold sales	<ul style="list-style-type: none"> <li>❑ Does client understand bill-and-hold accounting?</li> <li>❑ Has client requested it?</li> <li>❑ Is there a reasonable rationale for the request by customer?</li> <li>❑ Is inventory complete, ready to ship and segregated for the bill-and-hold sale?</li> <li>❑ Has client invoiced bill-and-hold inventory to customer</li> </ul>
	Consigned items	<ul style="list-style-type: none"> <li>❑ Confirm consigned inventory</li> <li>❑ Do not mail confirm to a P.O. box</li> <li>❑ Strongly consider visually inspecting consigned inventory</li> <li>❑ Speak directly with individual(s) signing the consigned</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
		inventory confirmation
	Sham sales to related parties	<ul style="list-style-type: none"> <li>❑ Professional skepticism on ALL related party transactions</li> <li>❑ Confirm the terms of all related party transactions</li> <li>❑ Make sure all related party transactions, unless CLEARLY insignificant, are disclosed</li> <li>❑ Compare margins on all related party transactions to margins from arms-length customers</li> <li>❑ Look for sales returns or lack of repayment on related party transactions</li> </ul>
	Fixed asset versus inventory issues	<ul style="list-style-type: none"> <li>❑ Any inventory of a long-lived nature used in the ordinary course of the clients business should be removed from inventory and expensed or depreciated (i.e., loaner cars in an auto dealership)</li> </ul>
	Distributor frauds	<ul style="list-style-type: none"> <li>❑ Examine all distributorship agreements for reasonableness</li> <li>❑ Look for any significant “dumping” of inventory into distributor channels at or near year-end</li> <li>❑ Look at margins of inventory sold to distributors versus sold in the ordinary</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
		<ul style="list-style-type: none"> <li>course of business</li> <li>❑ Pay close attention to past due receivables from distributors</li> </ul>
	Obsolescence theft	<ul style="list-style-type: none"> <li>❑ What are controls over obsolete inventory</li> <li>❑ Who has capability to write off inventory as obsolete?</li> <li>❑ What are physical safeguards over obsolete inventory</li> <li>❑ Ask to view obsolete inventory</li> </ul>
<b>Costs and estimated earnings in excess of billings on uncompleted contracts, and Billings in excess of costs and estimated earnings on uncompleted contracts</b>	Estimation of percentage complete on work in progress	<ul style="list-style-type: none"> <li>❑ Consider having a construction expert at your disposal</li> <li>❑ Most CPAs are not good at determining accurate percentages of completion</li> <li>❑ Strongly suggest visiting all construction sites at or near (within a week or two) of year-end</li> </ul>
	Estimation of profit or loss on jobs	<ul style="list-style-type: none"> <li>❑ Consider having a construction expert at your disposal</li> <li>❑ These engagements require a technically strong staff</li> <li>❑ Create a database in your records on profit/loss of all jobs to continually refer to in future engagements</li> <li>❑ Spend a lot of time in follow-up of last years actual jobs profits and losses</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
<b>Investments</b>	ASC classifications (trading, AFS, HTM)	<ul style="list-style-type: none"> <li>• Refresh yourself on requirements before every job where they are applicable</li> <li>• Be very skeptical of any client changes between the three classifications</li> <li>• Remember available for sale securities unrealized gains and losses are in the equity section of the balance sheet</li> <li>• Be familiar with overall stock market performance so that you can judge reasonableness of the reported portfolio results</li> </ul>
	Valuations of non-publicly traded equity securities	<ul style="list-style-type: none"> <li>❑ Should mainly utilize cost as a basis. Look closely for impairment of that amount however</li> </ul>
	Ownership/custody issues	<ul style="list-style-type: none"> <li>❑ Consider calling broker or custody agent to orally follow- up on confirmed amounts</li> <li>❑ View securities if not held by broker</li> </ul>
	Disclosures inadequate	<ul style="list-style-type: none"> <li>❑ Derivative disclosures are very complicated</li> <li>❑ Unrealized gain/loss disclosures</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
<b>Property and equipment and long-lived physical assets</b>	Capitalization of expenses	<ul style="list-style-type: none"> <li>❑ Examine supporting documentation for all acquisitions over a reasonable threshold amount</li> <li>❑ Examine actual asset for reasonableness and “sanity”</li> <li>❑ Expand scope if multiple additions are just under the scope amount</li> </ul>
	Failure to depreciate	<ul style="list-style-type: none"> <li>❑ Make sure all client long-lived assets are being depreciated or amortized</li> <li>❑ Closely examine depreciation schedule for “exempt” assets</li> </ul>
	Inappropriate changing of assets useful lives	<ul style="list-style-type: none"> <li>❑ Useful life changes should be rare</li> <li>❑ All assets in the classification should be changed</li> <li>❑ Changes should be accounted for prospectively</li> </ul>
	Personal versus business assets (contribution of fixed assets)	<ul style="list-style-type: none"> <li>❑ Trace contributions of fixed assets by owners to written, supporting documentation</li> <li>❑ Be very skeptical of the amount any non-cash contributions are valued</li> <li>❑ View any written title documents or deeds</li> </ul>
	Sale of assets to related parties	<ul style="list-style-type: none"> <li>❑ Determine if transaction is consummated on arms length terms</li> <li>❑ Scrutinize very carefully any such transaction that results in income to the seller</li> </ul>
	Decentralization security	<ul style="list-style-type: none"> <li>❑ Touch every asset,</li> </ul>



Financial Statement Account	Description of Fraud	Audit Techniques
	issues	<p>every year that has a title associated with it</p> <ul style="list-style-type: none"> <li>❑ Visit at least some of the decentralized locations on an annual basis as part of system understanding and testing work</li> </ul>
	Section 179 depreciation on books	<ul style="list-style-type: none"> <li>❑ Depreciation should be “over the useful life of the assets”</li> <li>❑ Using Section 179 for books results in an overstatement of depreciation in one year and an understatement the next</li> </ul>
	Land valuation (it’s not a marketable security!)	<ul style="list-style-type: none"> <li>❑ Land (and real property improvements) is held at cost, unless impaired</li> </ul>
	Salvage value issues	<ul style="list-style-type: none"> <li>❑ Salvage value is somewhat rare in the 21<sup>st</sup> century</li> <li>❑ Be very skeptical of changes in salvage value or the recording of salvage value at purchase of an asset</li> <li>❑ Changes in salvage value are accounted for prospectively</li> </ul>
	Landfill accounting	<ul style="list-style-type: none"> <li>❑ Landfills are depreciable</li> </ul>
<b>Intangibles</b>	Impairment issues	<ul style="list-style-type: none"> <li>❑ Is carrying value greater than implied fair value?</li> <li>❑ Is the fair market value of the business greater than equity = no impairment</li> </ul>
	Cookie jar initial recording	<ul style="list-style-type: none"> <li>❑ Compare the acquisition documents</li> </ul>

Financial Statement Account	Description of Fraud	Audit Techniques
		<p>to the entries in the general ledger</p> <ul style="list-style-type: none"> <li>❑ Make sure appropriate lives are attached</li> <li>❑ Look for intangibles other than goodwill</li> </ul>
	Failure to amortize	<ul style="list-style-type: none"> <li>❑ Understand amortization rules</li> <li>❑ Most intangibles, other than goodwill, are amortizable</li> </ul>
	Failure not to amortize	<ul style="list-style-type: none"> <li>❑ Goodwill can be amortized</li> </ul>
	Revaluation timing (once a year)	<ul style="list-style-type: none"> <li>❑ Client must document impairment testing of goodwill on an annual basis at the same time each year</li> </ul>
<b>Accounts payable</b>	Cookie jar acquisition schemes	<ul style="list-style-type: none"> <li>❑ Compare detail per asset acquisition agreement to what is recorded in the general ledger</li> <li>❑ Look for manual adjustments to general ledger accounts within 90 days of an acquisition</li> </ul>
	Aging frauds	<ul style="list-style-type: none"> <li>❑ Test aging of accounts payable for proper “rolling forward” by tracing accounts payable in one month to payment in the next or proper presentation in accounts payable detail report</li> </ul>
	Classification as long-term	<ul style="list-style-type: none"> <li>❑ Be very skeptical of any account payable classified as long-term. Should have written agreement</li> <li>❑ Consider these items for confirmation</li> </ul>
	Fraudulent vendor invoices	<ul style="list-style-type: none"> <li>❑ Confirm history</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
<b>Compensated absences</b>	Cookie jar schemes, especially in business acquisitions	<ul style="list-style-type: none"> <li>❑ Look for any unsubstantiated debits or credits in reserve accounts</li> <li>❑ Study substantiation for significant changes in reserve accounts</li> <li>❑ Look for consistency of calculation</li> </ul>
	Discount rate manipulation	<ul style="list-style-type: none"> <li>❑ Discount rate should be the borrowing rate of the entity</li> <li>❑ Anything below a prime rate should have appropriate substantiation</li> <li>❑ Anything above prime plus 3% should also have substantiation (may also give rise to going concern concerns)</li> </ul>
	Salary rate manipulation	<ul style="list-style-type: none"> <li>❑ Salary rate used should be rate that will be due upon utilization of the compensated absence time</li> </ul>
<b>Environmental liabilities</b>	Cookie jar schemes (typically overstated)	<ul style="list-style-type: none"> <li>❑ Most calculations should be substantiated by an expert report</li> <li>❑ The calculation should be updated year by year</li> <li>❑ There should be written documentation underlying any changes in the reserve balances</li> </ul>
	Discount rate manipulation	<ul style="list-style-type: none"> <li>❑ Discount rate should be the borrowing rate of the entity</li> <li>❑ Anything below a prime rate should have appropriate</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
		substantiation <input type="checkbox"/> Anything above prime plus 3% should also have substantiation (may also give rise to going concern concerns)
<b>Branch/factory closing reserves</b>	Cookie jar schemes (almost always overstated)	<input type="checkbox"/> There should be written, board approved documentation as to how the calculation is derived <input type="checkbox"/> There should be written documentation as to how any changes are calculated <input type="checkbox"/> Look for substantiation for any significant manual entries to this account
<b>Accrued payroll</b>	Failure to record accrued payroll taxes (mainly related to booked bonuses payable)	<input type="checkbox"/> Make sure bonus accruals include payroll tax accruals
	Bonuses not approved	<input type="checkbox"/> Check for substantiation of approval for all bonuses in the minutes of the enterprise (big problem in non-owner run enterprises and decentralized enterprises)
<b>Current maturities of long-term debt</b>	5-year maturity errors	<input type="checkbox"/> Reviewer should look at documentation supporting 5 year maturities schedule <input type="checkbox"/> Have to have agreement approved to refinance in order to refinance current to long-term
	Lack of 5-year maturity	<input type="checkbox"/> 5 year maturities have

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
	disclosure	got to be disclosed in accrual or cash basis statements that purport to have full disclosure
	Rate disclosure errors (what is prime?)	<input type="checkbox"/> What is the current prime rate in most banks? <input type="checkbox"/> LIBOR is a very popular benchmark rate as well
	Collateral disclosures (mainly cross collateralization)	<input type="checkbox"/> Many times there will be cross-collateralization “sweep” agreements where one entity has many loans with the same bank. These cross collateralizations must be disclosed
<b>Income taxes payable</b>	Deferred taxes	<input type="checkbox"/> Long-term amounts only
	Payroll versus income tax deposits	<input type="checkbox"/> Should inquire as to whether the organization has had any types of notices or communications with the IRS <input type="checkbox"/> Examine payment documentation to insure that what the client represents as income tax deposits were actually credited as income tax deposits and not payroll tax deposits
	Undisclosed litigation	<input type="checkbox"/> Should inquire as to whether the organization has had any types of notices or communications with the IRS
		<input type="checkbox"/> Look for any evidence

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
		of illegal acts committed by the entity or it's management
<b>Long-term debt</b>	5-year maturity errors	<ul style="list-style-type: none"> <li>❑ Reviewer should look at documentation supporting the 5-year maturity schedule</li> </ul>
	Covenant violation disclosures	<ul style="list-style-type: none"> <li>❑ Hitting the covenant amounts "right on the numbers" should be a cause for concern"</li> <li>❑ Violations of covenants need to be documented by a "cure" letter or be disclosed</li> <li>❑ Covenant violations have got to be documented in the workpapers as to how they are resolved</li> </ul>
	Collateralization issues	<ul style="list-style-type: none"> <li>❑ Cross-collateralization issues described above under "current maturities"</li> </ul>
<b>Equity</b>	Failure to disclose classes of common stock	<ul style="list-style-type: none"> <li>❑ All classes of common stock need to be disclosed</li> </ul>
	Notes receivable issued in exchange for common stock	<ul style="list-style-type: none"> <li>❑ Notes receivable issued in exchange for common stock need to be shown as a reduction of equity</li> </ul>
	Stock option accounting/valuation	<ul style="list-style-type: none"> <li>❑ New FASB out calling for fair value accounting</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
<b>Income statement items</b>	Round-trip transactions (multiple varieties)	<ul style="list-style-type: none"> <li>❑ Be on the look out for vendors who are also customers and conduct significant transactions near a period-end</li> </ul>
	Revenue recognition	<ul style="list-style-type: none"> <li>❑ Inquire of multiple firm personnel about revenue recognition techniques</li> </ul>
	Excessive valued bartering	<ul style="list-style-type: none"> <li>❑ Be very skeptical of any bartering transactions</li> <li>❑ Bartering transactions should be accounted for at fair market value</li> <li>❑ A transaction value at greater than the normal arms length cash transaction value should be reduced to the cash transaction value</li> </ul>
	“Insured losses”	<ul style="list-style-type: none"> <li>❑ Be very skeptical of any insurance policies that guarantee return of an operating loss</li> <li>❑ What is premium on these policies?</li> </ul>
	False sales	<ul style="list-style-type: none"> <li>❑ Do extensive testing of sales transaction documentation for sales in the last two weeks of the fiscal period, especially if the related receivable is still outstanding or was written off prior to your fieldwork</li> </ul>
	Bartering for long-lived assets	<ul style="list-style-type: none"> <li>❑ Be very skeptical of any bartering transactions</li> <li>❑ Bartering transactions should be at their fair market value</li> </ul>

<b>Financial Statement Account</b>	<b>Description of Fraud</b>	<b>Audit Techniques</b>
		<ul style="list-style-type: none"> <li>❑ A transaction value at greater than the normal arms length cash transaction value should be reduced to the cash transaction value</li> </ul>
	Expense acceleration	<ul style="list-style-type: none"> <li>❑ Look for unusual expense payments at or near year-end for amounts that should have been classified as prepaids</li> </ul>
	Margin normalization techniques	<ul style="list-style-type: none"> <li>❑ Look for topside adjustments that have no paper substantiation or documentation</li> <li>❑ Margins each period that are exactly, or near exactly the same, should be investigated by looking closely at cost of sales or revenue manual entries at or near year-end</li> </ul>
	Classification offsets	<ul style="list-style-type: none"> <li>❑ It is not appropriate for expense errors to offset income errors or vice versa</li> </ul>
<b>Detail General ledger tests</b>		<ul style="list-style-type: none"> <li>❑ Aje's are highest risk</li> <li>❑ AJes in non-aje accounts</li> <li>❑ Large rounded aje amounts</li> <li>❑ Ajes made at odd times</li> <li>❑ Ajes made by unusual persons</li> <li>❑ Ajes that are on the "wrong" side of the T-account</li> <li>❑ Unusual payees for the account type</li> <li>❑ Item labeled "plug" or</li> </ul>



Financial Statement Account	Description of Fraud	Audit Techniques
		<p>“to balance”</p> <ul style="list-style-type: none"> <li>❑ AJE with no explanation</li> <li>❑ AJE for significant amount</li> <li>❑ Reversing entries posted early in the year or posted right after y/e of current year</li> <li>❑ Others?</li> <li>❑ Benford testing</li> </ul>
<b>General</b>	Materiality reliance	<ul style="list-style-type: none"> <li>❑ Know definition of materiality</li> <li>❑ Can you sleep at night?</li> </ul>

### **TYPICAL LEASE (NO ISSUES)**

Company signs an office space lease which commences on January 1, 2022 for 60 months with the following payments for the next 60 months:

2022 Calendar year: \$5,000 per month

2023 Calendar year: \$6,000 per month

2024 Calendar year: \$7,000 per month

2025 Calendar year: \$8,500 per month

2026 Calendar year: \$9,000 per month

The discount rate at January 1, 2022 was 5.00%

The lease contains an option to extend for two years (2027 and 2028) at \$9,000 per month. At January 1, 2022 the company is not reasonably certain it will extend.

Set up this lease under ASC 842 and run the aje schedules through its life so you can trace journal entries and ending balances every month for the 5 year life of the lease.

Compound Period: Monthly  
Nominal Annual Rate: 5.000%

CASH FLOW DATA

Event	Date	Amount	Number	Period	End Date
1 Loan	1/1/2022	372,225.71	1		
2 Payment	1/1/2022	5,000.00	12	Monthly	12/1/2022
3 Payment	1/1/2023	6,000.00	12	Monthly	12/1/2023
4 Payment	1/1/2024	7,000.00	12	Monthly	12/1/2024
5 Payment	1/1/2025	8,500.00	12	Monthly	12/1/2025
6 Payment	1/1/2026	9,000.00	12	Monthly	12/1/2026
		Term	60		

AMORTIZATION SCHEDULE - Normal Amortization

Date	Payment	Interest	Principal	Balance
Loan 1/1/2022				372,225.71
1 1/1/2022	5,000.00	0.00	5,000.00	367,225.71
2 2/1/2022	5,000.00	1,530.11	3,469.89	363,755.82
3 3/1/2022	5,000.00	1,515.65	3,484.35	360,271.47
4 4/1/2022	5,000.00	1,501.13	3,498.87	356,772.60
5 5/1/2022	5,000.00	1,486.55	3,513.45	353,259.15
6 6/1/2022	5,000.00	1,471.91	3,528.09	349,731.06
7 7/1/2022	5,000.00	1,457.21	3,542.79	346,188.27
8 8/1/2022	5,000.00	1,442.45	3,557.55	342,630.72
9 9/1/2022	5,000.00	1,427.63	3,572.37	339,058.35
10 10/1/2022	5,000.00	1,412.74	3,587.26	335,471.09
11 11/1/2022	5,000.00	1,397.80	3,602.20	331,868.89
12 12/1/2022	5,000.00	1,382.79	3,617.21	328,251.68
2022 Totals	60,000.00	16,025.97	43,974.03	
13 1/1/2023	6,000.00	1,367.72	4,632.28	323,619.40
14 2/1/2023	6,000.00	1,348.41	4,651.59	318,967.81
15 3/1/2023	6,000.00	1,329.03	4,670.97	314,296.84
16 4/1/2023	6,000.00	1,309.57	4,690.43	309,606.41
17 5/1/2023	6,000.00	1,290.03	4,709.97	304,896.44
18 6/1/2023	6,000.00	1,270.40	4,729.60	300,166.84
19 7/1/2023	6,000.00	1,250.70	4,749.30	295,417.54
20 8/1/2023	6,000.00	1,230.91	4,769.09	290,648.45
21 9/1/2023	6,000.00	1,211.04	4,788.96	285,859.49
22 10/1/2023	6,000.00	1,191.08	4,808.92	281,050.57
23 11/1/2023	6,000.00	1,171.04	4,828.96	276,221.61
24 12/1/2023	6,000.00	1,150.92	4,849.08	271,372.53

2023 Totals		72,000.00	15,120.85	56,879.15	
25	1/1/2024	7,000.00	1,130.72	5,869.28	265,503.25
26	2/1/2024	7,000.00	1,106.26	5,893.74	259,609.51
27	3/1/2024	7,000.00	1,081.71	5,918.29	253,691.22
28	4/1/2024	7,000.00	1,057.05	5,942.95	247,748.27
29	5/1/2024	7,000.00	1,032.28	5,967.72	241,780.55
30	6/1/2024	7,000.00	1,007.42	5,992.58	235,787.97
31	7/1/2024	7,000.00	982.45	6,017.55	229,770.42
32	8/1/2024	7,000.00	957.38	6,042.62	223,727.80
33	9/1/2024	7,000.00	932.20	6,067.80	217,660.00
34	10/1/2024	7,000.00	906.92	6,093.08	211,566.92
35	11/1/2024	7,000.00	881.53	6,118.47	205,448.45
36	12/1/2024	7,000.00	856.04	6,143.96	199,304.49
2024 Totals		84,000.00	11,931.96	72,068.04	
37	1/1/2025	8,500.00	830.44	7,669.56	191,634.93
38	2/1/2025	8,500.00	798.48	7,701.52	183,933.41
39	3/1/2025	8,500.00	766.39	7,733.61	176,199.80
40	4/1/2025	8,500.00	734.17	7,765.83	168,433.97
41	5/1/2025	8,500.00	701.81	7,798.19	160,635.78
42	6/1/2025	8,500.00	669.32	7,830.68	152,805.10
43	7/1/2025	8,500.00	636.69	7,863.31	144,941.79
44	8/1/2025	8,500.00	603.92	7,896.08	137,045.71
45	9/1/2025	8,500.00	571.02	7,928.98	129,116.73
46	10/1/2025	8,500.00	537.99	7,962.01	121,154.72
47	11/1/2025	8,500.00	504.81	7,995.19	113,159.53
48	12/1/2025	8,500.00	471.50	8,028.50	105,131.03
2025 Totals		102,000.00	7,826.54	94,173.46	
49	1/1/2026	9,000.00	438.05	8,561.95	96,569.08
50	2/1/2026	9,000.00	402.37	8,597.63	87,971.45
51	3/1/2026	9,000.00	366.55	8,633.45	79,338.00
52	4/1/2026	9,000.00	330.58	8,669.42	70,668.58
53	5/1/2026	9,000.00	294.45	8,705.55	61,963.03
54	6/1/2026	9,000.00	258.18	8,741.82	53,221.21
55	7/1/2026	9,000.00	221.76	8,778.24	44,442.97
56	8/1/2026	9,000.00	185.18	8,814.82	35,628.15
57	9/1/2026	9,000.00	148.45	8,851.55	26,776.60
58	10/1/2026	9,000.00	111.57	8,888.43	17,888.17
59	11/1/2026	9,000.00	74.53	8,925.47	8,962.70
60	12/1/2026	9,000.00	37.30	8,962.70	0.00
2026 Totals		108,000.00	2,868.97	105,131.03	
Grand Totals		426,000.00	53,774.29	372,225.71	
Term		60			
Lease expense p/m		7,100.00			

2022 entries and balances									
		0.00		Def rent eliminated		60.00		Term remaining at 1/1/22	
	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(7,100.00)	5,000.00	0.00	365,125.71	367,225.71
2/28/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,569.89)	3,469.89	0.00	359,555.82	363,755.82
3/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,584.35)	3,484.35	0.00	353,971.47	360,271.47
4/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,598.87)	3,498.87	0.00	348,372.60	356,772.60
5/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,613.45)	3,513.45	0.00	342,759.15	353,259.15
6/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,628.09)	3,528.09	0.00	337,131.06	349,731.06
7/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,642.79)	3,542.79	0.00	331,488.27	346,188.27
8/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,657.55)	3,557.55	0.00	325,830.72	342,630.72
9/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,672.37)	3,572.37	0.00	320,158.35	339,058.35
10/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,687.26)	3,587.26	0.00	314,471.09	335,471.09
11/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,702.20)	3,602.20	0.00	308,768.89	331,868.89
12/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,717.21)	3,617.21	0.00	303,051.68	328,251.68
	85,200.00	0.00	85,200.00	(60,000.00)	(69,174.03)	43,974.03	0.00		
2023 entries and balances									
	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,732.28)	4,632.28	0.00	297,319.40	323,619.40
2/28/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,751.59)	4,651.59	0.00	291,567.81	318,967.81
3/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,770.97)	4,670.97	0.00	285,796.84	314,296.84
4/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,790.43)	4,690.43	0.00	280,006.41	309,606.41
5/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,809.97)	4,709.97	0.00	274,196.44	304,896.44
6/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,829.60)	4,729.60	0.00	268,366.84	300,166.84
7/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,849.30)	4,749.30	0.00	262,517.54	295,417.54
8/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,869.09)	4,769.09	0.00	256,648.45	290,648.45
9/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,888.96)	4,788.96	0.00	250,759.49	285,859.49
10/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,908.92)	4,808.92	0.00	244,850.57	281,050.57
11/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,928.96)	4,828.96	0.00	238,921.61	276,221.61
12/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,949.08)	4,849.08	0.00	232,972.53	271,372.53
	85,200.00	0.00	85,200.00	(72,000.00)	(70,079.15)	56,879.15	0.00		
2024 entries and balances									
	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(5,969.28)	5,869.28	0.00	227,003.25	265,503.25
2/29/2024	7,100.00	0.00	7,100.00	(7,000.00)	(5,993.74)	5,893.74	0.00	221,009.51	259,609.51
3/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,018.29)	5,918.29	0.00	214,991.22	253,6

TYPICAL LEASE (NO ISSUES) AJES  
FUTURE AJES AND BALANCES BY MONTH

7/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,117.55)	6,017.55	0.00	190,670.42	229,770.42
8/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,142.62)	6,042.62	0.00	184,527.80	223,727.80
9/30/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,167.80)	6,067.80	0.00	178,360.00	217,660.00
10/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,193.08)	6,093.08	0.00	172,166.92	211,566.92
11/30/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,218.47)	6,118.47	0.00	165,948.45	205,448.45
12/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,243.96)	6,143.96	0.00	159,704.49	199,304.49
	85,200.00	0.00	85,200.00	(84,000.00)	(73,268.04)	72,068.04	0.00		

2025 entries and balances

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,269.56)	7,669.56	0.00	153,434.93	191,634.93
2/28/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,301.52)	7,701.52	0.00	147,133.41	183,933.41
3/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,333.61)	7,733.61	0.00	140,799.80	176,199.80
4/30/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,365.83)	7,765.83	0.00	134,433.97	168,433.97
5/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,398.19)	7,798.19	0.00	128,035.78	160,635.78
6/30/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,430.68)	7,830.68	0.00	121,605.10	152,805.10
7/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,463.31)	7,863.31	0.00	115,141.79	144,941.79
8/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,496.08)	7,896.08	0.00	108,645.71	137,045.71
9/30/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,528.98)	7,928.98	0.00	102,116.73	129,116.73
10/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,562.01)	7,962.01	0.00	95,554.72	121,154.72
11/30/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,595.19)	7,995.19	0.00	88,959.53	113,159.53
12/31/2025	7,100.00	0.00	7,100.00	(8,500.00)	(6,628.50)	8,028.50	0.00	82,331.03	105,131.03
	85,200.00	0.00	85,200.00	(102,000.00)	(77,373.46)	94,173.46	0.00		

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,561.95)	8,561.95	0.00	75,669.08	96,569.08
2/28/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,697.63)	8,597.63	0.00	68,971.45	87,971.45
3/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,733.45)	8,633.45	0.00	62,238.00	79,338.00
4/30/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,769.42)	8,669.42	0.00	55,468.58	70,668.58
5/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,805.55)	8,705.55	0.00	48,663.03	61,963.03
6/30/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,841.82)	8,741.82	0.00	41,821.21	53,221.21
7/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,878.24)	8,778.24	0.00	34,942.97	44,442.97
8/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,914.82)	8,814.82	0.00	28,028.15	35,628.15
9/30/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,951.55)	8,851.55	0.00	21,076.60	26,776.60
10/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(6,988.43)	8,888.43	0.00	14,088.17	17,888.17
11/30/2026	7,100.00	0.00	7,100.00	(9,000.00)	(7,025.47)	8,925.47	0.00	7,062.70	8,962.70
12/31/2026	7,100.00	0.00	7,100.00	(9,000.00)	(7,062.70)	8,962.70	0.00	0.00	0.00
	85,200.00	0.00	85,200.00	(108,000.00)	(82,331.03)	105,131.03	0.00		

## **Problem 1**

### **Escalating Rents Change of Mind of Reasonably Certain**

Company signs an office space lease which commences on January 1, 2022 for 60 months with the following payments for the next 60 months:

2022 Calendar year: \$5,000 per month  
2023 Calendar year: \$6,000 per month  
2024 Calendar year: \$7,000 per month  
2025 Calendar year: \$8,500 per month  
2026 Calendar year: \$9,000 per month

The discount rate at January 1, 2022 was 5.00%

The lease contains an option to extend for two years (2027 and 2028) at \$9,000 per month. At January 1, 2022 the company is not reasonably certain it will extend.

At December 31, 2024, the company decides it is reasonably certain that it will exercise both options to extend. The discount rate at December 31, 2024 is 6.00%.

### **ASC sections on topic:**

#### **842-10-35-1**

A lessee shall reassess the lease term or a lessee option to purchase the underlying asset only if and at the point in time that any of the following occurs:

- (c) The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.

#### **842-10-35-4**

A lessee shall remeasure the lease payments if any of the following occur:

- (c) There is a change in any of the following:
  - (1) The lease term, as described in paragraph 842-10-35-1. A lessee shall determine the revised lease payments on the basis of the revised lease term.

#### **842-20-35-4**

After the commencement date, a lessee shall remeasure the lease liability to reflect changes to the lease payments as described in paragraphs 842-10-35-4 through 35-5. A lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

#### **842-20-35-5**

If there is a remeasurement of the lease liability in accordance with paragraph 842-20-35-4, the lessee shall update the discount rate for the lease at the date of remeasurment on the basis of the remaining lease term and the remaining lease payments....

**PROBLEM 1 INITIAL RECOGNITION AMORT SCHEDULE**

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Compound Period: Monthly

Nominal Annual Rate: 5.000%

**CASH FLOW DATA**

Event	Date	Amount	Number	Period	End Date
1 Loan	1/1/2022	372,225.71	1		
2 Payment	1/1/2022	5,000.00	12	Monthly	12/1/2022
3 Payment	1/1/2023	6,000.00	12	Monthly	12/1/2023
4 Payment	1/1/2024	7,000.00	12	Monthly	12/1/2024
5 Payment	1/1/2025	8,500.00	12	Monthly	12/1/2025
6 Payment	1/1/2026	9,000.00	12	Monthly	12/1/2026
	Term		60		

**AMORTIZATION SCHEDULE - Normal Amortization**

	Date	Payment	Interest	Principal	Balance
Loan	1/1/2022				372,225.71
1	1/1/2022	5,000.00	0.00	5,000.00	367,225.71
2	2/1/2022	5,000.00	1,530.11	3,469.89	363,755.82
3	3/1/2022	5,000.00	1,515.65	3,484.35	360,271.47
4	4/1/2022	5,000.00	1,501.13	3,498.87	356,772.60
5	5/1/2022	5,000.00	1,486.55	3,513.45	353,259.15
6	6/1/2022	5,000.00	1,471.91	3,528.09	349,731.06
7	7/1/2022	5,000.00	1,457.21	3,542.79	346,188.27
8	8/1/2022	5,000.00	1,442.45	3,557.55	342,630.72
9	9/1/2022	5,000.00	1,427.63	3,572.37	339,058.35
10	10/1/2022	5,000.00	1,412.74	3,587.26	335,471.09
11	11/1/2022	5,000.00	1,397.80	3,602.20	331,868.89
12	12/1/2022	5,000.00	1,382.79	3,617.21	328,251.68
2022 Totals		60,000.00	16,025.97	43,974.03	
13	1/1/2023	6,000.00	1,367.72	4,632.28	323,619.40
14	2/1/2023	6,000.00	1,348.41	4,651.59	318,967.81
15	3/1/2023	6,000.00	1,329.03	4,670.97	314,296.84
16	4/1/2023	6,000.00	1,309.57	4,690.43	309,606.41
17	5/1/2023	6,000.00	1,290.03	4,709.97	304,896.44
18	6/1/2023	6,000.00	1,270.40	4,729.60	300,166.84
19	7/1/2023	6,000.00	1,250.70	4,749.30	295,417.54
20	8/1/2023	6,000.00	1,230.91	4,769.09	290,648.45
21	9/1/2023	6,000.00	1,211.04	4,788.96	285,859.49
22	10/1/2023	6,000.00	1,191.08	4,808.92	281,050.57
23	11/1/2023	6,000.00	1,171.04	4,828.96	276,221.61
24	12/1/2023	6,000.00	1,150.92	4,849.08	271,372.53



<b>2023 Totals</b>	<b>72,000.00</b>	<b>15,120.85</b>	<b>56,879.15</b>	
25 1/1/2024	7,000.00	1,130.72	5,869.28	265,503.25
26 2/1/2024	7,000.00	1,106.26	5,893.74	259,609.51
27 3/1/2024	7,000.00	1,081.71	5,918.29	253,691.22
28 4/1/2024	7,000.00	1,057.05	5,942.95	247,748.27
29 5/1/2024	7,000.00	1,032.28	5,967.72	241,780.55
30 6/1/2024	7,000.00	1,007.42	5,992.58	235,787.97
31 7/1/2024	7,000.00	982.45	6,017.55	229,770.42
32 8/1/2024	7,000.00	957.38	6,042.62	223,727.80
33 9/1/2024	7,000.00	932.20	6,067.80	217,660.00
34 10/1/2024	7,000.00	906.92	6,093.08	211,566.92
35 11/1/2024	7,000.00	881.53	6,118.47	205,448.45
36 12/1/2024	7,000.00	856.04	6,143.96	199,304.49
<b>2024 Totals</b>	<b>84,000.00</b>	<b>11,931.96</b>	<b>72,068.04</b>	
37 1/1/2025	8,500.00	830.44	7,669.56	191,634.93
38 2/1/2025	8,500.00	798.48	7,701.52	183,933.41
39 3/1/2025	8,500.00	766.39	7,733.61	176,199.80
40 4/1/2025	8,500.00	734.17	7,765.83	168,433.97
41 5/1/2025	8,500.00	701.81	7,798.19	160,635.78
42 6/1/2025	8,500.00	669.32	7,830.68	152,805.10
43 7/1/2025	8,500.00	636.69	7,863.31	144,941.79
44 8/1/2025	8,500.00	603.92	7,896.08	137,045.71
45 9/1/2025	8,500.00	571.02	7,928.98	129,116.73
46 10/1/2025	8,500.00	537.99	7,962.01	121,154.72
47 11/1/2025	8,500.00	504.81	7,995.19	113,159.53
48 12/1/2025	8,500.00	471.50	8,028.50	105,131.03
<b>2025 Totals</b>	<b>102,000.00</b>	<b>7,826.54</b>	<b>94,173.46</b>	
49 1/1/2026	9,000.00	438.05	8,561.95	96,569.08
50 2/1/2026	9,000.00	402.37	8,597.63	87,971.45
51 3/1/2026	9,000.00	366.55	8,633.45	79,338.00
52 4/1/2026	9,000.00	330.58	8,669.42	70,668.58
53 5/1/2026	9,000.00	294.45	8,705.55	61,963.03
54 6/1/2026	9,000.00	258.18	8,741.82	53,221.21
55 7/1/2026	9,000.00	221.76	8,778.24	44,442.97
56 8/1/2026	9,000.00	185.18	8,814.82	35,628.15
57 9/1/2026	9,000.00	148.45	8,851.55	26,776.60
58 10/1/2026	9,000.00	111.57	8,888.43	17,888.17
59 11/1/2026	9,000.00	74.53	8,925.47	8,962.70
60 12/1/2026	9,000.00	37.30	8,962.70	0.00
<b>2026 Totals</b>	<b>108,000.00</b>	<b>2,868.97</b>	<b>105,131.03</b>	
<b>Grand Totals</b>	<b>426,000.00</b>	<b>53,774.29</b>	<b>372,225.71</b>	
<b>Term</b>	<b>60</b>			
<b>Lease expense p/m</b>	<b>7,100.00</b>			

**PROBLEM 1**

**FUTURE AJES AND BALANCES BY MONTH**

**2022 entries and balances**

0.00 Def rent eliminated  
60.00 Term remaining at 1/1/22

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(7,100.00)	5,000.00	0.00	365,125.71	367,225.71
2/28/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,569.89)	3,469.89	0.00	359,555.82	363,755.82
3/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,584.35)	3,484.35	0.00	353,971.47	360,271.47
4/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,598.87)	3,498.87	0.00	348,372.60	356,772.60
5/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,613.45)	3,513.45	0.00	342,759.15	353,259.15
6/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,628.09)	3,528.09	0.00	337,131.06	349,731.06
7/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,642.79)	3,542.79	0.00	331,488.27	346,188.27
8/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,657.55)	3,557.55	0.00	325,830.72	342,630.72
9/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,672.37)	3,572.37	0.00	320,158.35	339,058.35
10/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,687.26)	3,587.26	0.00	314,471.09	335,471.09
11/30/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,702.20)	3,602.20	0.00	308,768.89	331,868.89
12/31/2022	7,100.00	0.00	7,100.00	(5,000.00)	(5,717.21)	3,617.21	0.00	303,051.68	328,251.68
	85,200.00	0.00	85,200.00	(60,000.00)	(69,174.03)	43,974.03	0.00		

**2023 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,732.28)	4,632.28	0.00	297,319.40	323,619.40
2/28/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,751.59)	4,651.59	0.00	291,567.81	318,967.81
3/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,770.97)	4,670.97	0.00	285,796.84	314,296.84
4/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,790.43)	4,690.43	0.00	280,006.41	309,606.41
5/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,809.97)	4,709.97	0.00	274,196.44	304,896.44
6/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,829.60)	4,729.60	0.00	268,366.84	300,166.84
7/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,849.30)	4,749.30	0.00	262,517.54	295,417.54
8/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,869.09)	4,769.09	0.00	256,648.45	290,648.45
9/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,888.96)	4,788.96	0.00	250,759.49	285,859.49
10/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,908.92)	4,808.92	0.00	244,850.57	281,050.57
11/30/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,928.96)	4,828.96	0.00	238,921.61	276,221.61
12/31/2023	7,100.00	0.00	7,100.00	(6,000.00)	(5,949.08)	4,849.08	0.00	232,972.53	271,372.53
	85,200.00	0.00	85,200.00	(72,000.00)	(70,079.15)	56,879.15	0.00		

**PROBLEM 1****FUTURE AJES AND BALANCES BY MONTH****2024 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(5,969.28)	5,869.28	0.00	227,003.25	265,503.25
2/29/2024	7,100.00	0.00	7,100.00	(7,000.00)	(5,993.74)	5,893.74	0.00	221,009.51	259,609.51
3/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,018.29)	5,918.29	0.00	214,991.22	253,691.22
4/30/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,042.95)	5,942.95	0.00	208,948.27	247,748.27
5/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,067.72)	5,967.72	0.00	202,880.55	241,780.55
6/30/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,092.58)	5,992.58	0.00	196,787.97	235,787.97
7/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,117.55)	6,017.55	0.00	190,670.42	229,770.42
8/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,142.62)	6,042.62	0.00	184,527.80	223,727.80
9/30/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,167.80)	6,067.80	0.00	178,360.00	217,660.00
10/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,193.08)	6,093.08	0.00	172,166.92	211,566.92
11/30/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,218.47)	6,118.47	0.00	165,948.45	205,448.45
12/31/2024	7,100.00	0.00	7,100.00	(7,000.00)	(6,243.96)	6,143.96	0.00	159,704.49	199,304.49
	85,200.00	0.00	85,200.00	(84,000.00)	(73,268.04)	72,068.04	0.00		

255,600.00 Expense 1/1/22 - 12/31/24

# **PROBLEM 1 CHANGE IN REASONABLE CERTAINTY AMORT TABLE**

Compound Period: Monthly

Nominal Annual Rate: 6.000%

## **CASH FLOW DATA**

Event	Date	Amount	Number	Period	End Date
1 Loan	12/31/2024	379,238.12	1		
2 Payment	1/1/2025	8,500.00	12	Monthly	12/1/2025
3 Payment	1/1/2026	9,000.00	12	Monthly	12/1/2026
4 Payment	1/1/2027	9,000.00	12	Monthly	12/1/2027
5 Payment	1/1/2028	9,000.00	12	Monthly	12/1/2028
	Term		48		

## **AMORTIZATION SCHEDULE - Normal Amortization**

	Date	Payment	Interest	Principal	Balance
Loan	12/31/2024				379,238.12
2024 Totals		0.00	0.00	0.00	
1	1/1/2025	8,500.00	62.34	8,437.66	370,800.46
2	2/1/2025	8,500.00	1,854.00	6,646.00	364,154.46
3	3/1/2025	8,500.00	1,820.77	6,679.23	357,475.23
4	4/1/2025	8,500.00	1,787.38	6,712.62	350,762.61
5	5/1/2025	8,500.00	1,753.81	6,746.19	344,016.42
6	6/1/2025	8,500.00	1,720.08	6,779.92	337,236.50
7	7/1/2025	8,500.00	1,686.18	6,813.82	330,422.68
8	8/1/2025	8,500.00	1,652.11	6,847.89	323,574.79
9	9/1/2025	8,500.00	1,617.87	6,882.13	316,692.66
10	10/1/2025	8,500.00	1,583.46	6,916.54	309,776.12
11	11/1/2025	8,500.00	1,548.88	6,951.12	302,825.00
12	12/1/2025	8,500.00	1,514.13	6,985.87	295,839.13
2025 Totals		102,000.00	18,601.01	83,398.99	
13	1/1/2026	9,000.00	1,479.20	7,520.80	288,318.33
14	2/1/2026	9,000.00	1,441.59	7,558.41	280,759.92
15	3/1/2026	9,000.00	1,403.80	7,596.20	273,163.72
16	4/1/2026	9,000.00	1,365.82	7,634.18	265,529.54

## **AJE at 12/31/24**

379,238.12	New LL at 12/31/24
199,304.49	Old LL at 12/31/24
<u>179,933.63</u>	Aje; DR ROU CR LL

## **Bal at 12/31/24**

339,638.12	ROU asset *
<u>379,238.12</u>	LL
<u>(39,600.00)</u>	"Deferred rent" amount to be amortized

## **\* Calc of 12/31/24 ROU asset**

159,704.49	Balance at 12/31/24 before recalc
<u>179,933.63</u>	AJE
<u>339,638.12</u>	ROU at 12/31/24

17	5/1/2026	9,000.00	1,327.65	7,672.35	257,857.19
18	6/1/2026	9,000.00	1,289.29	7,710.71	250,146.48
19	7/1/2026	9,000.00	1,250.73	7,749.27	242,397.21
20	8/1/2026	9,000.00	1,211.99	7,788.01	234,609.20
21	9/1/2026	9,000.00	1,173.05	7,826.95	226,782.25
22	10/1/2026	9,000.00	1,133.91	7,866.09	218,916.16
23	11/1/2026	9,000.00	1,094.58	7,905.42	211,010.74
24	12/1/2026	9,000.00	1,055.05	7,944.95	203,065.79
2026 Totals		108,000.00	15,226.66	92,773.34	
25	1/1/2027	9,000.00	1,015.33	7,984.67	195,081.12
26	2/1/2027	9,000.00	975.41	8,024.59	187,056.53
27	3/1/2027	9,000.00	935.28	8,064.72	178,991.81
28	4/1/2027	9,000.00	894.96	8,105.04	170,886.77
29	5/1/2027	9,000.00	854.43	8,145.57	162,741.20
30	6/1/2027	9,000.00	813.71	8,186.29	154,554.91
31	7/1/2027	9,000.00	772.77	8,227.23	146,327.68
32	8/1/2027	9,000.00	731.64	8,268.36	138,059.32
33	9/1/2027	9,000.00	690.30	8,309.70	129,749.62
34	10/1/2027	9,000.00	648.75	8,351.25	121,398.37
35	11/1/2027	9,000.00	606.99	8,393.01	113,005.36
36	12/1/2027	9,000.00	565.03	8,434.97	104,570.39
2027 Totals		108,000.00	9,504.60	98,495.40	
37	1/1/2028	9,000.00	522.85	8,477.15	96,093.24
38	2/1/2028	9,000.00	480.47	8,519.53	87,573.71
39	3/1/2028	9,000.00	437.87	8,562.13	79,011.58
40	4/1/2028	9,000.00	395.06	8,604.94	70,406.64
41	5/1/2028	9,000.00	352.03	8,647.97	61,758.67
42	6/1/2028	9,000.00	308.79	8,691.21	53,067.46
43	7/1/2028	9,000.00	265.34	8,734.66	44,332.80
44	8/1/2028	9,000.00	221.66	8,778.34	35,554.46
45	9/1/2028	9,000.00	177.77	8,822.23	26,732.23
46	10/1/2028	9,000.00	133.66	8,866.34	17,865.89
47	11/1/2028	9,000.00	89.33	8,910.67	8,955.22
48	12/1/2028	9,000.00	44.78	8,955.22	0.00
2028 Totals		108,000.00	3,429.61	104,570.39	
Grand Totals		426,000.00	46,761.88	379,238.12	
Term		48			
Lease expense p/m		8,875.00			

**PROBLEM 1****FUTURE AJES AND BALANCES BY MONTH AFTER OPTIONS TO EXTEND**

ROU Balance at 12/31/24                      339,638.12

**2025 entries and balances**

39,600.00 Difference b/t ROU Asset and LL at change date

48.00 Term remaining at 1/1/25

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(7,987.66)	8,437.66	0.00	331,650.46	370,800.46
2/28/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,196.00)	6,646.00	0.00	325,454.46	364,154.46
3/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,229.23)	6,679.23	0.00	319,225.23	357,475.23
4/30/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,262.62)	6,712.62	0.00	312,962.61	350,762.61
5/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,296.19)	6,746.19	0.00	306,666.42	344,016.42
6/30/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,329.92)	6,779.92	0.00	300,336.50	337,236.50
7/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,363.82)	6,813.82	0.00	293,972.68	330,422.68
8/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,397.89)	6,847.89	0.00	287,574.79	323,574.79
9/30/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,432.13)	6,882.13	0.00	281,142.66	316,692.66
10/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,466.54)	6,916.54	0.00	274,676.12	309,776.12
11/30/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,501.12)	6,951.12	0.00	268,175.00	302,825.00
12/31/2025	8,875.00	(825.00)	8,050.00	(8,500.00)	(6,535.87)	6,985.87	0.00	261,639.13	295,839.13
	106,500.00	(9,900.00)	96,600.00	(102,000.00)	(77,998.99)	83,398.99	0.00		

**2026 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,570.80)	7,520.80	0.00	255,068.33	288,318.33
2/28/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,608.41)	7,558.41	0.00	248,459.92	280,759.92
3/31/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,646.20)	7,596.20	0.00	241,813.72	273,163.72
4/30/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,684.18)	7,634.18	0.00	235,129.54	265,529.54
5/31/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,722.35)	7,672.35	0.00	228,407.19	257,857.19
6/30/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,760.71)	7,710.71	0.00	221,646.48	250,146.48
7/31/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,799.27)	7,749.27	0.00	214,847.21	242,397.21
8/31/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,838.01)	7,788.01	0.00	208,009.20	234,609.20
9/30/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,876.95)	7,826.95	0.00	201,132.25	226,782.25
10/31/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,916.09)	7,866.09	0.00	194,216.16	218,916.16
11/30/2026	8,875.00	(825.00)	8,050.00	(9,000.00)	(6,955.42)	7,905.42	0.00	187,260.74	211,010.74

**PROBLEM 1**

**FUTURE AJES AND BALANCES BY MONTH AFTER OPTIONS TO EXTEND**

**ROU Balance at 12/31/24                      339,638.12**

<b>12/31/2026</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(6,994.95)</b>	<b>7,944.95</b>	<b>0.00</b>	<b>180,265.79</b>	<b>203,065.79</b>
	<b>106,500.00</b>	<b>(9,900.00)</b>	<b>96,600.00</b>	<b>(108,000.00)</b>	<b>(81,373.34)</b>	<b>92,773.34</b>	<b>0.00</b>		

**2027 entries and balances**

	<b>Lease exp, gross</b>	<b>Def rent adj</b>	<b>Lease exp net</b>	<b>Cash</b>	<b>ROU</b>	<b>LL</b>	<b>Totals</b>	<b>EOP ROU</b>	<b>EOP LL</b>
<b>1/31/2027</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,034.67)</b>	<b>7,984.67</b>	<b>0.00</b>	<b>173,231.12</b>	<b>195,081.12</b>
<b>2/28/2027</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,074.59)</b>	<b>8,024.59</b>	<b>0.00</b>	<b>166,156.53</b>	<b>187,056.53</b>
<b>3/31/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,114.72)</b>	<b>8,064.72</b>	<b>0.00</b>	<b>159,041.81</b>	<b>178,991.81</b>
<b>4/30/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,155.04)</b>	<b>8,105.04</b>	<b>0.00</b>	<b>151,886.77</b>	<b>170,886.77</b>
<b>5/31/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,195.57)</b>	<b>8,145.57</b>	<b>0.00</b>	<b>144,691.20</b>	<b>162,741.20</b>
<b>6/30/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,236.29)</b>	<b>8,186.29</b>	<b>0.00</b>	<b>137,454.91</b>	<b>154,554.91</b>
<b>7/31/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,277.23)</b>	<b>8,227.23</b>	<b>0.00</b>	<b>130,177.68</b>	<b>146,327.68</b>
<b>8/31/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,318.36)</b>	<b>8,268.36</b>	<b>0.00</b>	<b>122,859.32</b>	<b>138,059.32</b>
<b>9/30/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,359.70)</b>	<b>8,309.70</b>	<b>0.00</b>	<b>115,499.62</b>	<b>129,749.62</b>
<b>10/31/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,401.25)</b>	<b>8,351.25</b>	<b>0.00</b>	<b>108,098.37</b>	<b>121,398.37</b>
<b>11/30/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,443.01)</b>	<b>8,393.01</b>	<b>0.00</b>	<b>100,655.36</b>	<b>113,005.36</b>
<b>12/31/2024</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,484.97)</b>	<b>8,434.97</b>	<b>0.00</b>	<b>93,170.39</b>	<b>104,570.39</b>
	<b>106,500.00</b>	<b>(9,900.00)</b>	<b>96,600.00</b>	<b>(108,000.00)</b>	<b>(87,095.40)</b>	<b>98,495.40</b>	<b>0.00</b>		

**2028 entries and balances**

	<b>Lease exp, gross</b>	<b>Def rent adj</b>	<b>Lease exp net</b>	<b>Cash</b>	<b>ROU</b>	<b>LL</b>	<b>Totals</b>	<b>EOP ROU</b>	<b>EOP LL</b>
<b>1/31/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,527.15)</b>	<b>8,477.15</b>	<b>0.00</b>	<b>85,643.24</b>	<b>96,093.24</b>
<b>2/29/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,569.53)</b>	<b>8,519.53</b>	<b>0.00</b>	<b>78,073.71</b>	<b>87,573.71</b>
<b>3/31/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,612.13)</b>	<b>8,562.13</b>	<b>0.00</b>	<b>70,461.58</b>	<b>79,011.58</b>
<b>4/30/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,654.94)</b>	<b>8,604.94</b>	<b>0.00</b>	<b>62,806.64</b>	<b>70,406.64</b>
<b>5/31/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,697.97)</b>	<b>8,647.97</b>	<b>0.00</b>	<b>55,108.67</b>	<b>61,758.67</b>
<b>6/30/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,741.21)</b>	<b>8,691.21</b>	<b>0.00</b>	<b>47,367.46</b>	<b>53,067.46</b>
<b>7/31/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,784.66)</b>	<b>8,734.66</b>	<b>0.00</b>	<b>39,582.80</b>	<b>44,332.80</b>
<b>8/31/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,828.34)</b>	<b>8,778.34</b>	<b>0.00</b>	<b>31,754.46</b>	<b>35,554.46</b>
<b>9/30/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,872.23)</b>	<b>8,822.23</b>	<b>0.00</b>	<b>23,882.23</b>	<b>26,732.23</b>
<b>10/31/2028</b>	<b>8,875.00</b>	<b>(825.00)</b>	<b>8,050.00</b>	<b>(9,000.00)</b>	<b>(7,916.34)</b>	<b>8,866.34</b>	<b>0.00</b>	<b>15,965.89</b>	<b>17,865.89</b>

**PROBLEM 1****FUTURE AJES AND BALANCES BY MONTH AFTER OPTIONS TO EXTEND**

ROU Balance at 12/31/24                      339,638.12

11/30/2028	8,875.00	(825.00)	8,050.00	(9,000.00)	(7,960.67)	8,910.67	0.00	8,005.22	8,955.22
12/31/2028	8,875.00	(825.00)	8,050.00	(9,000.00)	(8,005.22)	8,955.22	0.00	0.00	0.00
	106,500.00	(9,900.00)	96,600.00	(108,000.00)	(93,170.39)	104,570.39	0.00		

386,400.00 Expense 1/1/25 - 12/31/28

255,600.00 Expense 1/1/22 - 12/31/24

642,000.00 Total expense over lease term

642,000.00 Total expense expected

0.00 Difference

**EXPENSE REASONABLENESS CHECK**

	p/m rent	months	total expense
2022	5,000.00	12.00	60,000.00
2023	6,000.00	12.00	72,000.00
2024	7,000.00	12.00	84,000.00
2025	8,500.00	12.00	102,000.00
2026	9,000.00	12.00	108,000.00
2027	9,000.00	12.00	108,000.00
2028	9,000.00	12.00	<u>108,000.00</u>

Expected exp                      642,000.00



## **Problem 2**

### **Lessee cancels lease (no penalty)**

Company signs an office space lease which commences on January 1, 2024 for 48 months with the following payments for the next 48 months:

2024 Calendar year: \$3,000 per month

2025 Calendar year: \$4,000 per month

2026 Calendar year: \$5,000 per month

2027 Calendar year: \$5,500 per month

The discount rate at January 1, 2024 was 5.00%

At December 31, 2025, the company and landlord decide to mutually terminate the lease as of December 31, 2025 without penalty or any other form of payment by either party.

Set up the lease under ASC 842, run the entries up through December 31, 2025 and then record the entry to terminate the lease.

### **ASC sections on topic:**

#### **842-20-40-1**

A termination of a lease before the expiration of the lease term shall be accounted for by the lessee by removing the right-of-use asset and the lease liability, with profit or loss recognized for the difference.

PROBLEM 2 LEASE CANCELLATION

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Compound Period: Monthly

Nominal Annual Rate: 5.000%

CASH FLOW DATA

Event	Date	Amount	Number	Period	End Date
1 Loan	1/1/2024	188,450.24	1		
2 Payment	1/1/2024	3,000.00	12	Monthly	12/1/2024
3 Payment	1/1/2025	4,000.00	12	Monthly	12/1/2025
4 Payment	1/1/2026	5,000.00	12	Monthly	12/1/2026
5 Payment	1/1/2027	5,500.00	12	Monthly	12/1/2027

AMORTIZATION SCHEDULE - Normal Amortization

	Date	Payment	Interest	Principal	Balance
Loan	1/1/2024				188,450.24
1	1/1/2024	3,000.00	0.00	3,000.00	185,450.24
2	2/1/2024	3,000.00	772.71	2,227.29	183,222.95
3	3/1/2024	3,000.00	763.43	2,236.57	180,986.38
4	4/1/2024	3,000.00	754.11	2,245.89	178,740.49
5	5/1/2024	3,000.00	744.75	2,255.25	176,485.24
6	6/1/2024	3,000.00	735.36	2,264.64	174,220.60
7	7/1/2024	3,000.00	725.92	2,274.08	171,946.52
8	8/1/2024	3,000.00	716.44	2,283.56	169,662.96
9	9/1/2024	3,000.00	706.93	2,293.07	167,369.89
10	10/1/2024	3,000.00	697.37	2,302.63	165,067.26
11	11/1/2024	3,000.00	687.78	2,312.22	162,755.04
12	12/1/2024	3,000.00	678.15	2,321.85	160,433.19
2024 Totals		36,000.00	7,982.95	28,017.05	
13	1/1/2025	4,000.00	668.47	3,331.53	157,101.66

14	2/1/2025	4,000.00	654.59	3,345.41	153,756.25
15	3/1/2025	4,000.00	640.65	3,359.35	150,396.90
16	4/1/2025	4,000.00	626.65	3,373.35	147,023.55
17	5/1/2025	4,000.00	612.60	3,387.40	143,636.15
18	6/1/2025	4,000.00	598.48	3,401.52	140,234.63
19	7/1/2025	4,000.00	584.31	3,415.69	136,818.94
20	8/1/2025	4,000.00	570.08	3,429.92	133,389.02
21	9/1/2025	4,000.00	555.79	3,444.21	129,944.81
22	10/1/2025	4,000.00	541.44	3,458.56	126,486.25
23	11/1/2025	4,000.00	527.03	3,472.97	123,013.28
24	12/1/2025	4,000.00	512.56	3,487.44	119,525.84
2025 Totals		48,000.00	7,092.65	40,907.35	

25	1/1/2026	5,000.00	498.02	4,501.98	115,023.86
26	2/1/2026	5,000.00	479.27	4,520.73	110,503.13
27	3/1/2026	5,000.00	460.43	4,539.57	105,963.56
28	4/1/2026	5,000.00	441.51	4,558.49	101,405.07
29	5/1/2026	5,000.00	422.52	4,577.48	96,827.59
30	6/1/2026	5,000.00	403.45	4,596.55	92,231.04
31	7/1/2026	5,000.00	384.30	4,615.70	87,615.34
32	8/1/2026	5,000.00	365.06	4,634.94	82,980.40
33	9/1/2026	5,000.00	345.75	4,654.25	78,326.15
34	10/1/2026	5,000.00	326.36	4,673.64	73,652.51
35	11/1/2026	5,000.00	306.89	4,693.11	68,959.40
36	12/1/2026	5,000.00	287.33	4,712.67	64,246.73
2026 Totals		60,000.00	4,720.89	55,279.11	

37	1/1/2027	5,500.00	267.69	5,232.31	59,014.42
38	2/1/2027	5,500.00	245.89	5,254.11	53,760.31
39	3/1/2027	5,500.00	224.00	5,276.00	48,484.31
40	4/1/2027	5,500.00	202.02	5,297.98	43,186.33
41	5/1/2027	5,500.00	179.94	5,320.06	37,866.27
42	6/1/2027	5,500.00	157.78	5,342.22	32,524.05
43	7/1/2027	5,500.00	135.52	5,364.48	27,159.57
44	8/1/2027	5,500.00	113.16	5,386.84	21,772.73
45	9/1/2027	5,500.00	90.72	5,409.28	16,363.45

46	10/1/2027	5,500.00	68.18	5,431.82	10,931.63
47	11/1/2027	5,500.00	45.55	5,454.45	5,477.18
48	12/1/2027	5,500.00	22.82	5,477.18	0.00
2027 Totals		66,000.00	1,753.27	64,246.73	
Grand Totals		210,000.00	21,549.76	188,450.24	
Term		<u>48.00</u>			
Lease expense p/m		<u><u>4,375.00</u></u>			

**PROBLEM 2**  
**LEASE CANCELLATION**

ROU at 1/1/24      188,450.24  
LL at 1/1/24      188,450.24

**2024 entries and balances**

0.00 Deferred rent at 1/1/24  
48.00 Term remaining at 1/1/24

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(4,375.00)	3,000.00	0.00	184,075.24	185,450.24
2/29/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,602.29)	2,227.29	0.00	180,472.95	183,222.95
3/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,611.57)	2,236.57	0.00	176,861.38	180,986.38
4/30/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,620.89)	2,245.89	0.00	173,240.49	178,740.49
5/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,630.25)	2,255.25	0.00	169,610.24	176,485.24
6/30/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,639.64)	2,264.64	0.00	165,970.60	174,220.60
7/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,649.08)	2,274.08	0.00	162,321.52	171,946.52
8/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,658.56)	2,283.56	0.00	158,662.96	169,662.96
9/30/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,668.07)	2,293.07	0.00	154,994.89	167,369.89
10/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,677.63)	2,302.63	0.00	151,317.26	165,067.26
11/30/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,687.22)	2,312.22	0.00	147,630.04	162,755.04
12/31/2024	4,375.00	0.00	4,375.00	(3,000.00)	(3,696.85)	2,321.85	0.00	143,933.19	160,433.19
	52,500.00	0.00	52,500.00	(36,000.00)	(44,517.05)	28,017.05	0.00		

**2025 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,706.53)	3,331.53	0.00	140,226.66	157,101.66
2/28/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,720.41)	3,345.41	0.00	136,506.25	153,756.25
3/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,734.35)	3,359.35	0.00	132,771.90	150,396.90
4/30/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,748.35)	3,373.35	0.00	129,023.55	147,023.55
5/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,762.40)	3,387.40	0.00	125,261.15	143,636.15
6/30/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,776.52)	3,401.52	0.00	121,484.63	140,234.63
7/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,790.69)	3,415.69	0.00	117,693.94	136,818.94
8/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,804.92)	3,429.92	0.00	113,889.02	133,389.02
9/30/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,819.21)	3,444.21	0.00	110,069.81	129,944.81
10/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,833.56)	3,458.56	0.00	106,236.25	126,486.25
11/30/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,847.97)	3,472.97	0.00	102,388.28	123,013.28
12/31/2025	4,375.00	0.00	4,375.00	(4,000.00)	(3,862.44)	3,487.44	0.00	98,525.84	119,525.84
	52,500.00	0.00	52,500.00	(48,000.00)	(45,407.35)	40,907.35	0.00		

**2026 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,876.98)	4,501.98	0.00	94,648.86	115,023.86
2/28/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,895.73)	4,520.73	0.00	90,753.13	110,503.13
3/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,914.57)	4,539.57	0.00	86,838.56	105,963.56

**PROBLEM 2**  
**LEASE CANCELLATION**

		ROU at 1/1/24	188,450.24						
		LL at 1/1/24	188,450.24						
4/30/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,933.49)	4,558.49	0.00	82,905.07	101,405.07
5/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,952.48)	4,577.48	0.00	78,952.59	96,827.59
6/30/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,971.55)	4,596.55	0.00	74,981.04	92,231.04
7/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(3,990.70)	4,615.70	0.00	70,990.34	87,615.34
8/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(4,009.94)	4,634.94	0.00	66,980.40	82,980.40
9/30/2026	4,375.00	0.00	4,375.00	(5,000.00)	(4,029.25)	4,654.25	0.00	62,951.15	78,326.15
10/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(4,048.64)	4,673.64	0.00	58,902.51	73,652.51
11/30/2026	4,375.00	0.00	4,375.00	(5,000.00)	(4,068.11)	4,693.11	0.00	54,834.40	68,959.40
12/31/2026	4,375.00	0.00	4,375.00	(5,000.00)	(4,087.67)	4,712.67	0.00	50,746.73	64,246.73
	52,500.00	0.00	52,500.00	(60,000.00)	(47,779.11)	55,279.11	0.00		

**2027 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,107.31)	5,232.31	0.00	46,639.42	59,014.42
2/28/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,129.11)	5,254.11	0.00	42,510.31	53,760.31
3/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,151.00)	5,276.00	0.00	38,359.31	48,484.31
4/30/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,172.98)	5,297.98	0.00	34,186.33	43,186.33
5/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,195.06)	5,320.06	0.00	29,991.27	37,866.27
6/30/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,217.22)	5,342.22	0.00	25,774.05	32,524.05
7/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,239.48)	5,364.48	0.00	21,534.57	27,159.57
8/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,261.84)	5,386.84	0.00	17,272.73	21,772.73
9/30/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,284.28)	5,409.28	0.00	12,988.45	16,363.45
10/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,306.82)	5,431.82	0.00	8,681.63	10,931.63
11/30/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,329.45)	5,454.45	0.00	4,352.18	5,477.18
12/31/2027	4,375.00	0.00	4,375.00	(5,500.00)	(4,352.18)	5,477.18	0.00	(0.00)	(0.00)
	52,500.00	0.00	52,500.00	(66,000.00)	(50,746.73)	64,246.73	0.00		

**End of 2025 termination entry:**

Lease liability	119,525.84	
Right of use asset		98,525.84
Lease expense		21,000.00
	<u>119,525.84</u>	<u>119,525.84</u>

### **Problem 3**

#### **Lessee buys out lease**

Company signs a tractor lease which commences on January 1, 2024 for 48 months with the following payments:

2024 Calendar year:	\$1,500 per month
2025 Calendar year:	\$1,750 per month
2026 Calendar year:	\$2,000 per month
2027 Calendar year:	\$2,200 per month

There are also mileage charges of \$.40 per mile over 48,000 miles.

The discount rate at January 1, 2024 was 5.00%

At December 31, 2025, because the lessee knows they are going to get killed on mileage overages, they reach an agreement to buy the vehicle off the lease on December 31, 2025 for \$67,000.

Set up the lease under ASC 842, run the entries up through December 31, 2025 and then record the entry to buy the fine truck.

#### **ASC sections on topic:**

##### **842-20-40-2**

The termination of a lease that results from the purchase of an underlying asset by the lessee is not the type of termination of a lease contemplated by paragraph 842-20-40-1 but, rather, is an integral part of the purchase of the underlying asset. If the lessee purchases the underlying asset, any difference between the purchase price and the carrying amount of the lease liability immediately before the purchase shall be recorded by the lessee as an adjustment of the carrying amount of the asset.

PROBLEM 3 LESSEE BUYOUT OF LEASE

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Compound Period: Monthly

Nominal Annual Rate: 5.000%

CASH FLOW DATA

Event	Date	Amount	Number	Period	End Date
1 Loan	1/1/2024	80,572.91	1		
2 Payment	1/1/2024	1,500.00	12	Monthly	12/1/2024
3 Payment	1/1/2025	1,750.00	12	Monthly	12/1/2025
4 Payment	1/1/2026	2,000.00	12	Monthly	12/1/2026
5 Payment	1/1/2027	2,200.00	12	Monthly	12/1/2027

AMORTIZATION SCHEDULE - Normal Amortization

	Date	Payment	Interest	Principal	Balance
Loan	1/1/2024				80,572.91
1	1/1/2024	1,500.00	0.00	1,500.00	79,072.91
2	2/1/2024	1,500.00	329.47	1,170.53	77,902.38
3	3/1/2024	1,500.00	324.59	1,175.41	76,726.97
4	4/1/2024	1,500.00	319.70	1,180.30	75,546.67
5	5/1/2024	1,500.00	314.78	1,185.22	74,361.45
6	6/1/2024	1,500.00	309.84	1,190.16	73,171.29
7	7/1/2024	1,500.00	304.88	1,195.12	71,976.17
8	8/1/2024	1,500.00	299.90	1,200.10	70,776.07
9	9/1/2024	1,500.00	294.90	1,205.10	69,570.97
10	10/1/2024	1,500.00	289.88	1,210.12	68,360.85
11	11/1/2024	1,500.00	284.84	1,215.16	67,145.69
12	12/1/2024	1,500.00	279.77	1,220.23	65,925.46
2024 Totals		18,000.00	3,352.55	14,647.45	
13	1/1/2025	1,750.00	274.69	1,475.31	64,450.15



14	2/1/2025	1,750.00	268.54	1,481.46	62,968.69
15	3/1/2025	1,750.00	262.37	1,487.63	61,481.06
16	4/1/2025	1,750.00	256.17	1,493.83	59,987.23
17	5/1/2025	1,750.00	249.95	1,500.05	58,487.18
18	6/1/2025	1,750.00	243.70	1,506.30	56,980.88
19	7/1/2025	1,750.00	237.42	1,512.58	55,468.30
20	8/1/2025	1,750.00	231.12	1,518.88	53,949.42
21	9/1/2025	1,750.00	224.79	1,525.21	52,424.21
22	10/1/2025	1,750.00	218.43	1,531.57	50,892.64
23	11/1/2025	1,750.00	212.05	1,537.95	49,354.69
24	12/1/2025	1,750.00	205.64	1,544.36	47,810.33
2025 Totals		21,000.00	2,884.87	18,115.13	

25	1/1/2026	2,000.00	199.21	1,800.79	46,009.54
26	2/1/2026	2,000.00	191.71	1,808.29	44,201.25
27	3/1/2026	2,000.00	184.17	1,815.83	42,385.42
28	4/1/2026	2,000.00	176.61	1,823.39	40,562.03
29	5/1/2026	2,000.00	169.01	1,830.99	38,731.04
30	6/1/2026	2,000.00	161.38	1,838.62	36,892.42
31	7/1/2026	2,000.00	153.72	1,846.28	35,046.14
32	8/1/2026	2,000.00	146.03	1,853.97	33,192.17
33	9/1/2026	2,000.00	138.30	1,861.70	31,330.47
34	10/1/2026	2,000.00	130.54	1,869.46	29,461.01
35	11/1/2026	2,000.00	122.75	1,877.25	27,583.76
36	12/1/2026	2,000.00	114.93	1,885.07	25,698.69
2026 Totals		24,000.00	1,888.36	22,111.64	

37	1/1/2027	2,200.00	107.08	2,092.92	23,605.77
38	2/1/2027	2,200.00	98.36	2,101.64	21,504.13
39	3/1/2027	2,200.00	89.60	2,110.40	19,393.73
40	4/1/2027	2,200.00	80.81	2,119.19	17,274.54
41	5/1/2027	2,200.00	71.98	2,128.02	15,146.52
42	6/1/2027	2,200.00	63.11	2,136.89	13,009.63
43	7/1/2027	2,200.00	54.21	2,145.79	10,863.84
44	8/1/2027	2,200.00	45.27	2,154.73	8,709.11
45	9/1/2027	2,200.00	36.29	2,163.71	6,545.40

46	10/1/2027	2,200.00	27.27	2,172.73	4,372.67
47	11/1/2027	2,200.00	18.22	2,181.78	2,190.89
48	12/1/2027	2,200.00	9.11	2,190.89	0.00
2027 Totals		26,400.00	701.31	25,698.69	
Grand Totals		89,400.00	8,827.09	80,572.91	
Term		<u>48.00</u>			
Lease expense p/m		<u><u>1,862.50</u></u>			

**PROBLEM 3**  
**LEASE BUYOUT**

ROU at 1/1/24      80,572.91  
LL at 1/1/24      80,572.91

**2024 entries and balances**

0.00 Deferred rent at 1/1/24  
48.00 Term remaining at 1/1/24

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,862.50)	1,500.00	0.00	78,710.41	79,072.91
2/29/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,533.03)	1,170.53	0.00	77,177.38	77,902.38
3/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,537.91)	1,175.41	0.00	75,639.47	76,726.97
4/30/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,542.80)	1,180.30	0.00	74,096.67	75,546.67
5/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,547.72)	1,185.22	0.00	72,548.95	74,361.45
6/30/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,552.66)	1,190.16	0.00	70,996.29	73,171.29
7/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,557.62)	1,195.12	0.00	69,438.67	71,976.17
8/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,562.60)	1,200.10	0.00	67,876.07	70,776.07
9/30/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,567.60)	1,205.10	0.00	66,308.47	69,570.97
10/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,572.62)	1,210.12	0.00	64,735.85	68,360.85
11/30/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,577.66)	1,215.16	0.00	63,158.19	67,145.69
12/31/2024	1,862.50	0.00	1,862.50	(1,500.00)	(1,582.73)	1,220.23	0.00	61,575.46	65,925.46
	22,350.00	0.00	22,350.00	(18,000.00)	(18,997.45)	14,647.45	0.00		

**2025 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,587.81)	1,475.31	0.00	59,987.65	64,450.15
2/28/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,593.96)	1,481.46	0.00	58,393.69	62,968.69
3/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,600.13)	1,487.63	0.00	56,793.56	61,481.06
4/30/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,606.33)	1,493.83	0.00	55,187.23	59,987.23
5/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,612.55)	1,500.05	0.00	53,574.68	58,487.18
6/30/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,618.80)	1,506.30	0.00	51,955.88	56,980.88
7/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,625.08)	1,512.58	0.00	50,330.80	55,468.30
8/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,631.38)	1,518.88	0.00	48,699.42	53,949.42
9/30/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,637.71)	1,525.21	0.00	47,061.71	52,424.21
10/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,644.07)	1,531.57	0.00	45,417.64	50,892.64
11/30/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,650.45)	1,537.95	0.00	43,767.19	49,354.69
12/31/2025	1,862.50	0.00	1,862.50	(1,750.00)	(1,656.86)	1,544.36	0.00	42,110.33	47,810.33
	22,350.00	0.00	22,350.00	(21,000.00)	(19,465.13)	18,115.13	0.00		

**2026 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,663.29)	1,800.79	0.00	40,447.04	46,009.54
2/28/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,670.79)	1,808.29	0.00	38,776.25	44,201.25
3/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,678.33)	1,815.83	0.00	37,097.92	42,385.42

**PROBLEM 3**  
**LEASE BUYOUT**

		ROU at 1/1/24	80,572.91						
		LL at 1/1/24	80,572.91						
4/30/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,685.89)	1,823.39	0.00	35,412.03	40,562.03
5/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,693.49)	1,830.99	0.00	33,718.54	38,731.04
6/30/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,701.12)	1,838.62	0.00	32,017.42	36,892.42
7/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,708.78)	1,846.28	0.00	30,308.64	35,046.14
8/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,716.47)	1,853.97	0.00	28,592.17	33,192.17
9/30/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,724.20)	1,861.70	0.00	26,867.97	31,330.47
10/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,731.96)	1,869.46	0.00	25,136.01	29,461.01
11/30/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,739.75)	1,877.25	0.00	23,396.26	27,583.76
12/31/2026	1,862.50	0.00	1,862.50	(2,000.00)	(1,747.57)	1,885.07	0.00	21,648.69	25,698.69
	22,350.00	0.00	22,350.00	(24,000.00)	(20,461.64)	22,111.64	0.00		

**2027 entries and balances**

	Lease exp, gross	Def rent adj	Lease exp net	Cash	ROU	LL	Totals	EOP ROU	EOP LL
1/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,755.42)	2,092.92	0.00	19,893.27	23,605.77
2/28/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,764.14)	2,101.64	0.00	18,129.13	21,504.13
3/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,772.90)	2,110.40	0.00	16,356.23	19,393.73
4/30/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,781.69)	2,119.19	0.00	14,574.54	17,274.54
5/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,790.52)	2,128.02	0.00	12,784.02	15,146.52
6/30/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,799.39)	2,136.89	0.00	10,984.63	13,009.63
7/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,808.29)	2,145.79	0.00	9,176.34	10,863.84
8/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,817.23)	2,154.73	0.00	7,359.11	8,709.11
9/30/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,826.21)	2,163.71	0.00	5,532.90	6,545.40
10/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,835.23)	2,172.73	0.00	3,697.67	4,372.67
11/30/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,844.28)	2,181.78	0.00	1,853.39	2,190.89
12/31/2027	1,862.50	0.00	1,862.50	(2,200.00)	(1,853.39)	2,190.89	0.00	(0.00)	(0.00)
	22,350.00	0.00	22,350.00	(26,400.00)	(21,648.69)	25,698.69	0.00		

**End of 2025 buyout entry:**

Lease liability	47,810.33	
Right of use asset		42,110.33
Fixed asset	61,300.00	
Cash		67,000.00
	<u>109,110.33</u>	<u>109,110.33</u>



***Statement on  
Standards for Accounting  
and Review Services***

*April 2025*  
**27**

*Issued by the Accounting and Review Services Committee*

***Applicability of AR-C Section 70 to Financial  
Statements Prepared as Part of a Consulting Services  
Engagement***

*(Amends Statement on Standards for Accounting and Review Services [SSARS] No. 21, Statements on Standards for Accounting and Review Services: Clarification and Recodification, as amended, section 70, Preparation of Financial Statements [AICPA, Professional Standards, AR-C sec. 70])*

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## Accounting and Review Services Committee (2024–2025)

Michael A. Westervelt, *Chair*  
Jami Blake  
David Duckwitz  
Alison Houck

Douglas C. Koval  
Sarah McConnell  
Georgia Salinas

### AICPA Staff

Jennifer Burns <i>Chief Auditor</i> <i>Professional Standards and Services</i>	Michael P. Glynn <i>Associate Director</i> <i>Audit and Attest Standards — Public Accounting</i>
Kelly Hnatt <i>Hnatt Law Firm P.C.</i> <i>Outside Counsel to AICPA</i>	

**Note:** *Statements on Standards for Accounting and Review Services are issued by the Accounting and Review Services Committee (ARSC), the senior technical body of the AICPA designated to promulgate standards under the “General Standards Rule” (ET sec. 1.300.001)<sup>1</sup> and the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA Code of Professional Conduct with respect to unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market.*

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<sup>1</sup> All ET sections can be found in AICPA *Professional Standards*.

**Amendment to SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, as Amended, Section 70, *Preparation of Financial Statements* (AICPA, *Professional Standards*, AR-C sec. 70)**

1. This amendment is effective for the preparation of financial statements for periods ending on or after December 15, 2026. Early implementation is permitted.

(***Boldface italics*** denote new language. Deleted text is shown in ~~strikethrough~~.)

## **Introduction**

### **Scope of This Section**

- .01** This section applies when an accountant in public practice is engaged to prepare financial statements or prospective financial information ***and is not engaged to perform an audit, review, or compilation of those financial statements or a compilation or examination of that prospective financial information.*** (Ref: par. ~~.A1–.A2~~) This section may also be applied, adapted as appropriate in the circumstances, to the preparation of other historical financial information. (Ref: par. ~~.A3~~) This section ~~does not apply~~ ***is not required to be applied, but application is not precluded, in whole or in part,*** when an accountant prepares financial statements or prospective financial information (***Ref: par. .A1–.A4***)

- ~~• and is engaged to perform an audit, review, or compilation of those financial statements,~~
- a. as part of a consulting services engagement performed in accordance with CS section 100, Consulting Services: Definitions and Standards,\* in which the preparation of financial statements is not the primary objective of the engagement. (Ref: par. .A5)***
- b. as part of a personal financial plan performed in accordance with PFP section 100, Statement on Standards for Personal Financial Planning Services.†***
- c. as part of an engagement to estimate the value of a business, business ownership interest, security, or intangible asset in accordance with VS section 100, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset.‡***
- d. solely for submission to taxing authorities,***
- ~~• for inclusion in written personal financial plans prepared by the accountant,~~
- e. • in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or***
- ~~• in conjunction with business valuation services.<sup>[fn1]</sup>~~

<sup>[fn 1]</sup> [Footnote omitted for purposes of this proposed SSARS.]

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\* All CS sections can be found in AICPA *Professional Standards*.

† All PFP sections can be found in AICPA *Professional Standards*.

‡ All VS sections can be found in AICPA *Professional Standards*.



**.02** The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and ~~requires the accountant's to apply~~ professional judgment. (Ref: par. ~~A4~~**A5**)

[No amendment to paragraphs .03–.A3.]

## **Application and Other Explanatory Material**

### **Scope of This Section (Ref: par. .01–.02)**

...

*.A4 An accountant may voluntarily apply certain requirements of this section in instances in which this section would not otherwise apply. For example, if the accountant is not required to apply this section, to address the risk that users of the entity's financial statements may be misled by the practitioner's perceived association with the financial statements, the accountant may include the statement required by paragraph .14 of this section that "no assurance is provided" on the financial statements. The inclusion of such a statement does not result in the accountant being required to perform the engagement in accordance with this section and no other requirements would be required to be applied.*

*.A5 Consulting services differ fundamentally from the CPA's function of attesting to the assertions of other parties. In a consulting service, the practitioner develops the findings, conclusions, and recommendations presented. The nature and scope of work is determined solely by agreement between the practitioner and the client. Generally, the work is performed only for the use and benefit of the client.<sup>fn2</sup>*

<sup>fn2</sup> Paragraph .02 of CS section 100, Consulting Services: Definitions and Standards.

[No amendments to former paragraphs .A4–.A26, which are renumbered as paragraphs .A6–.A28. No further amendment to AR-C section 70.]

IN THE STATE COURT OF BIBB COUNTY  
STATE OF GEORGIA

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STATE COURT OF  
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DENSITY, INC.; DENSITY UTILITIES  
OF LOUISIANA, LLC; and DENSITY  
SERVICES, LLC,

Plaintiffs,

v.

C. LAMONT DAVIDSON, JR. a/k/a  
ROCKY DAVIDSON, individually, and  
DAVIDSON COLLINS, LLC,

Defendants.

PATTI M. GRAVES, CLERK  
*Patti M. Graves*

CIVIL ACTION

FILE NO. 82944

**CONSOLIDATED PRETRIAL ORDER**

The following constitutes the Parties' Pretrial Order in the above styled case:

- (1) The name, address and phone number of the attorneys who will conduct the trial are as follows:

Attorneys for Plaintiffs

David J. Hungeling  
Law Office of David J. Hungeling, P.C.  
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GA Bar No. 068798  
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Suite 650  
Atlanta, GA 30328-6175  
678-334-2771  
E-mail: bbost@gbklaw.com

- (2) The estimated time required for trial is:

5-7 days.

- (3) There are no motions or other matters pending for consideration by the Court, except the following:

- The Court granted summary judgment on Plaintiff's claim for costs and fees under O.C.G.A. § 13-6-11. Plaintiffs respectfully ask the Court to reconsider this ruling and note that under Georgia law, if Plaintiffs succeed on their claim for breach of fiduciary duty the jury would be permitted to award costs and fees under O.C.G.A. § 13-6-11, *See ADP-Financial Computer Svcs. v. First Nat'l Bank*, 703 F.2d 1261, 1267 (11<sup>th</sup> Cir. 1983); *Weprin v. Peterson*, 736 F. Supp. 1131, 1133 (N.D. Ga. 1988). **(Defendants' counsel reserves the right to challenge the timeliness, as well as the merits, of this request).**
- The Parties intend to file additional Motions in Limine prior to trial

- (4) The jury will be qualified as to relationship with the following:

- (i) Lamont Davidson, Jr. a/k/a Rocky Davidson;
- (ii) Davidson Collins, LLC n/k/a Qbix Accounting Solutions, LLC;
- (iii) Law Office of David J. Hungeling, P.C. d/b/a Hungeling Law;
- (iv) Adams Law Firm – Brian P. Adams
- (v) Density, Inc.;
- (vi) Density Utilities of Louisiana, LLC;
- (vii) Density Services, LLC;
- ~~(viii) All Witnesses in Case: (list to be provided before morning of trial);~~  
and
- (ix) CAMICO Mutual Insurance Co.

(5) Discovery:

(a) Except as noted below, all discovery has been completed. The Court will not consider any further motions to compel discovery except for good cause shown. The parties hereto, however, shall be permitted to take depositions of any person(s) for the preservation of evidence for use at trial. The following discovery matters remains outstanding: **None.**

(b) Unless otherwise noted, the names of the parties as shown in the caption to this order are correct and complete and there is no question by any party as to the misjoinder or non-joinder of any parties. **None.**

Defendants: Davidson Collins, LLC is now known as Qbix Accounting Solutions, LLC.

- (6) The following is **Plaintiffs'** brief and succinct outline of the case and contentions:

Plaintiffs filed this lawsuit alleging claims for Breach of Contract (Count I), Professional Negligence (Count II), Breach of Fiduciary Duty (Count III), and Attorney's Fees and Costs of Litigation (Count IV). Plaintiffs also seek punitive damages.

Defendant C. Lamont Davidson, Jr. a/k/a "Rocky" Davidson, is a Certified Public Accountant in Macon, Georgia. He is a principal and accountant at Davidson Collins, LLC, n/k/a Qbix Accounting Solutions, LLC. Plaintiffs operated forty-nine (49) waste water treatment systems in Louisiana with approximately 2,400 customers. Plaintiffs hired Defendants in May 2009. As a public utility company, Plaintiffs had to adhere to strict accounting and regulatory requirements. Plaintiffs also had to work closely with the Louisiana Public Service Commission ("LPSC" or the "Commission") for bond approvals and rate approvals. Davidson & Collins' engagement letter in 2010, stated that Rocky would provide "CFO services," which would include "regulatory compliance." Defendants' 2011 engagement letter described Mr. Davidson's role as "CFO/Controller/Accounting manager." Mr. Davidson noted in his deposition that Plaintiffs principal, Miller Heath, III, did not have a "strong understanding of accounting" and that Density was relying on Davidson & Collins to help make financial and accounting decisions.

As a public utility company, Density was required to comply with the accounting standards set by the National Association of Regulated Utilities Commissioners (NARUC). Mr. Davidson acknowledged that accountants are bound to understand their client's business and accounting rules used in the client's industry. Yet, Mr. Davidson states that he did "very little" to understand the NARUC guidelines. And Mr. Davidson's partner, Wendy Collins, spent less than an hour reviewing those guidelines. Mr. Davidson confessed: "I'm not sure we studied NARUC that much." When asked if he gained "an understanding of the key accounting principles under NARUC?" Mr. Davidson replied, "No." Mr. Davidson claims that he did not know who was supposed to prepare NARUC compliant financial statements. Although he tried to defend his work by claiming that he prepared financial statements in accordance with GAAP, he later admitted that GAAP requires the use of industry-specific accounting principles—*i.e.*, NARUC—in this case.

Defendants were first hired to "clean up" and properly account for Plaintiffs' prior financial transactions (*i.e.*, for years 2007-2008) and to ensure that Density's submissions to the Commission accurately stated the company's financial condition. Defendants, however, failed to prepare financial statements in accordance with NARUC as Mr. Davidson admitted in deposition.

This accounting work did not accurately reflect the transactions of the company or comply with NARUC, resulting in the misrepresentation of Plaintiff's assets and expenses. Plaintiffs hired an expert, Julianna Cave, to review and restate Plaintiff's financial records originally prepared by Defendants. While restating the records in accordance with NARUC, Ms. Cave found material differences from Mr. Davidson's work. Defendants under-reported Density's fixed assets by nearly a million dollars as of December 31, 2012. This error, combined with overstatement of Density's income and expenses, detrimentally impacted Density's ability to earn its authorized rate of return as set by the LPSC.

The LPSC approves rates sufficient to allow for Density to recover not less than the investment in the capital assets of the utility over the accounting life of the assets plus reasonable operating expenses plus a profit of about ten percent (10%) per year. As a regulated utility under Louisiana law, Density earned a rate based on the original cost book value—*i.e.*, Fixed Assets/Net Plant, which is the book value of acquisition costs plus capital expenditure ("CapEx") less depreciation. In this instance, the LPSC also approved a 'Formula Rate Plan,' that provided the additional benefit of insulating Density from inflationary operating costs. Density sought to fund CapEx, both future expenditures and reimbursements for past advances, through the issuance of a bond in the amount of \$4,470,000 with a twenty (20) year term ("Bond"). From its inception, Density intended to issue bonds to generate the capital necessary to operate. Defendants were aware that LPSC approval for the bond was mission critical to Density's business plan. An investment bank, Duncan-Williams, Inc., had already sold the Bond and the bond holders had deposited funds in an escrow account awaiting approval by the LPSC. The Bond's transaction costs were \$445,325. As a result, Density would have invested net Bond proceeds of \$4,024,675 in Fixed Assets/Net Plant at or about the date of the expected Bond closing in December 2011.

Defendants' negligence in preparing the Density accounting and financial statements caused these records to grossly understate Fixed Assets/Net Plant. For example Defendants' work showed Fixed Assets/Net Plant through 2010 as \$600,843 whereas the restated financials show Fixed Assets should have been not less than \$1,202,687, a difference of \$601,844. In considering Density's application for approval to issue the Bond the LPSC was specifically looking for investments in its plant. This half-million dollar difference on 2010 Fixed Assets/Net Plant was significant and had an impact on the LPSC decision-making process. LPSC's vote of non-opposition to the Bond on December 14, 2011 involved "several conditions" and arose out of its concerns over the unreported (and therefore unknown to its voting members) CapEx in Density's financials. Defendants negligently prepared these financials not in compliance with NARUC and not reflecting the actual Fixed Assets/Net Plant. Due to Defendants' errors, Density was unable to seek and obtain rate approvals from the LPSC that would allow Plaintiffs to profit or break-even.

The inability of the Company to adequately satisfy the LPSC's conditions caused the non-issuance of the Bond. Because the Commission would not approve the Bond and disbursement of proceeds as the Bond underwriters required, the Bond did not close and Density did not get the funding required to stay in business. The nature of the business, combined with components of the Clean Water virtually eliminate sources of debt for a Sewer Utility to nearly zero. Therefore, without the injection of bond proceeds to pay off start-up costs, fund future system improvements and operations, Density was forced to file for bankruptcy protection in March 2013.

Although Defendants claim no responsibility for causing (or even contributing to) Density's demise, Defendants admit they did not prepare Density's financials in accordance with NARUC and they admit making at least one material error in the financial statements. Shortly after being hired in May 2009, Defendants proposed that the prior transactions on Density's books be reversed and re-entered. Defendants reversed entries reflecting approximately \$626,000 in Density, Inc. funds spent for the benefit of Density Utilities. Most of this should have been re-entered to reflect CapEx and then included in the NARUC accounting, but Defendants did not re-enter entries and the LPSC did not know that these CapEx investments had been made. As a result, the PSC imposed conditions which caused the Bond to not issue as discussed above. Defendants admitted that the \$626,000 error was "material." The LPSC took note of the \$626,000 transaction and specifically asked for clarification about where this money was spent. Mr. Davidson prepared Density's response to the LPSC's question, but he failed to provide any meaningful insight. The LPSC continued to ask questions about the \$626,000 up until the Bond deal fell apart. Mr. Davidson admitted that removal of the \$626,000 from Density Utilities' books was an "error," and he reluctantly acknowledged that such omission fell below the standard of care.

The LPSC's criticism and rejection of the reimbursement requests arose out of at least two accounting errors by Defendants: (a) failure to show the full amount of the intercompany loans from Density Corp to Density Utilities, and (b) failure to show the loans were invested in Density Utilities for capital expenses instead of operating costs.

- (7) The following is **Defendants'** brief and succinct outline of the case and contentions:

The Defendants, Rocky Davidson and his accounting firm, deny that Plaintiffs have a valid claim against them, and deny any liability to Plaintiffs.

Contrary to the Plaintiffs' assertions, Rocky Davidson and his accounting firm performed work for Plaintiffs in accordance with professional standards. They performed literally thousands of accounting procedures over the more than three years that they did accounting work for Plaintiffs. Density Utilities and its related companies were well satisfied with the work performed



by Rocky Davidson and his accounting firm. Miller Heath III, a principal in The Density Companies did a testimonial video praising the Defendants' accounting work.

The rules relating to accounting set by the National Association of Regulated Utilities Commissioners ("NARUC") are primarily account designations known as a "Uniform System of Accounts." NARUC makes clear that accounting for utilities typically follows generally accepted accounting principles. Because the work performed by Mr. Davidson and his firm in preparing compiled financial statements for the Density Companies was in accordance with generally accepted accounting principles, NARUC was substantially complied with. The Public Service Commission in Louisiana (sometimes referred to as "LPSC") never complained about any financial data that was submitted to it by Density Utilities on the basis that it did not comply with NARUC.

In 2009, the management of Density Utilities, including Miller Heath III and his wife, Stephanie Heath, also an executive officer of the Plaintiff companies, determined that the accountants who were preparing the books and records for the Plaintiffs were doing an inadequate job. Terry Henderson, CPA, partner in the regional accounting firm, Mauldin & Jenkins, who did the Density Companies' tax returns and their audited and reviewed financial statements, recommended Rocky Davidson and Davidson Collins, LLC, for bookkeeping and other accounting work. Davidson Collins began work for the Density Companies on May 16, 2009. The books, records and financial statements were in bad shape, and Rocky Davidson and his colleague, Lesa Mazur, worked diligently to straighten out the books. In addition, Rocky Davidson looked back at the earlier accounting work and appropriately reclassified previously capitalized items as expenses.

Davidson Collins' staff and Rocky Davidson, individually, spent many hours during May through August 2009, and worked diligently to straighten out the Density Companies' books. Initially, Mr. Davidson went back through the Density Companies' 2007 and 2008 financial records and correctly reclassified items, including classifying previously capitalized start up items as expenses. In addition to straightening out the Density Companies' books, Rocky Davidson and his accounting firm set up utility billing on postcards, making Density's customer billing process more professional, efficient and timely. Rocky Davidson and his firm also helped the Density Companies set up document imaging for payables invoices and electronic payments through Bill.com.

Lesa Mazur, a staff accountant for Davidson Collins, worked for the Plaintiffs diligently, being in frequent contact with Density management and spending many hours on Density accounting matters every week during the years that she did accounting work for the Density Companies through January of 2013.

Rocky Davidson's accounting firm received frequent input concerning the monthly compiled financial statements from Miller Heath III, the President or CEO of the Density Companies.

The accounting work performed by Mr. Davidson and his firm was in accordance with generally accepted accounting principles and accurately reflected the transactions of the Density



companies. The restated Quickbooks financial statements prepared by an accountant on behalf of Plaintiffs are incorrect, contain multiple errors and could not be used as a complete set of books. The capitalization by Mr. Davidson and his accounting firm in the Defendants' financial statement was accurate; the restated books grossly overstate capitalized assets.

Fixed Assets/Net Plant were correctly stated in the original financial statements prepared by Rocky Davidson and his firm. There was not a \$600,000 understatement of the Fixed Assets / Net Plant through the end of 2010 in those financial statements. The Davidson Collins financial statements prepared by Davidson Collins contained the correct capitalization amounts. It is the Quickbooks as restated by Plaintiffs which overstate capital items, and these were done with a view to try to expose supposed errors in the original set of books. The restated books of Density Utilities are simply inaccurate and unreliable.

The Louisiana Public Service Commission, with input from its staff, made its rulings with respect to requests by Density Utilities based on the way Density Utilities was operated, presentations by Plaintiffs' executives, Miller Heath III and Density management, and presentations by regulatory attorneys on behalf of Density Utilities. Those rulings were not the result of accounting work performed by Mr. Davidson and his firm.

Among the thousands of accounting transactions procedures performed by Mr. Davidson and his firm, the only one where Defendants' performance could be questioned was early in the relationship. Rocky Davidson moved approximately \$626,000 of expenses from Density Utilities and Density Services, which were subsidiaries, to the parent corporation, Density, Inc. That sum should possibly have been reallocated among all three Density companies and \$140,000 was in fact allocated leaving approximately \$486,000 in the parent corporation.

Miller Heath III was the Density Companies' representative in contact with the Louisiana Public Service Commission. Mr. Heath would communicate the LPSC's positions on accounting issues to Lesa Mazur or Mr. Davidson. Mr. Heath was responsible as Density Utilities management for the financial information provided to the Louisiana Public Service Commission, including the Density Utilities Annual Reports for 2009, 2010 and 2013.

Rocky Davidson never communicated directly with the Louisiana Public Service Commission and was never told by Miller Heath III that the Louisiana Public Service Commission or its staff complained about the format of the compiled financial statements that Davidson Collins was preparing for Density Utilities, or the responses to data requests which Davidson Collins assisted Density Utilities with from time to time when Density Utilities would have to make a submission to the LPSC. Miller Heath III never told Rocky Davidson that the LPSC was complaining because the Density Utilities' financial statements did not use NARUC account designations.

Rocky Davidson was not in charge of preparing Density Utilities' responses to Louisiana Public Service Commission data requests. When requested, his firm did provide Miller Heath III and his staff with information to be utilized in Density Utilities' response.

Mr. Davidson worked closely with Mauldin & Jenkins partner, Terry Henderson CPA, during the initial period of the engagement with Density Companies and discussed with Mr. Henderson the capitalization of startup costs in 2009 and exchanged one or more E-mails on that subject. Terry Henderson and Mauldin & Jenkins audited the 2010 Financial Statement of Density Utilities of Louisiana, LLC and issued an unqualified audit opinion that the 2010 Financial Statement was materially correct. Mr. Henderson was also involved in making NARUC adjustments to the Density Utilities financial statements.

Rocky Davidson never held the office of CFO or Chief Financial Officer for any of the Density Companies, nor did he or his firm, Davidson Collins, perform all of the duties of a CFO or Chief Financial Officer.

Density's management felt that Density Utilities had a difficult time in its dealings with the Louisiana Public Service Commission. In 2011, Plaintiffs' Executive, Miller Heath III, characterized the Louisiana Public Service Commission's attitude towards Density Utilities as follows:

The LPSC felt that Density is looting the ratepayers;

The LPSC felt that other utilities are performing similar jobs for less than Density;

The LPSC felt that the principals of Density have no commitment to the utility;

The LPSC felt that Density is using the utility customers to subsidize the parent in the Services company;

The LPSC felt that Density is spending unwisely on overhead;

The LPSC felt that Density is intentionally delaying financing;

The LPSC felt that Density has done nothing since its rate was approved.

The LPSC's attitude as described above explains the LPSC's actions in making decisions on requests by Density Utilities concerning the 2011 bond issue and other matters. Significantly, none of these items relate to the financial statements prepared by Defendants or accounting services provided by Defendants.

Density Utilities' first proposed bond issue was approved, but did not go to market. A second bond issue approval was sought on an urgent basis from the LPSC beginning in November of 2011, for a bond issue of approximately \$4.4 million. The Commission and its Staff were leery of Density Utilities because of its past dealings with the LPSC, but the LPSC did review the bond issue and ultimately issued an Order approving a \$4.4 million bond issue after an Open Business and Executive Session on December 14, 2011.

The Commission's December 15, 2011 Order authorized issuance of the \$4.4 million bond issue, but consistent with earlier Orders of the Commission, required that some of the proceeds be

escrowed to be released only with the approval of the LPSC Staff. Density Utilities had sought the immediate payment of affiliated charges and reimbursement of certain past costs out of the proceeds of the 2011 bond issue. The Commissioners' public statements at the December 14, 2011 Open Session indicate that the LPSC did not want to be backed into a corner to have to decide reimbursements from the bond proceeds on an emergency basis and that the Commission was somewhat skeptical of Density Utilities based on its prior dealings with the Commission.

At the December 14, 2011 Open Session concerning the 2011 Bond Issue, the Commissioners on the Louisiana Public Service Commission voiced a number of negative comments about Density Utilities' track record in the State of Louisiana. The Commissioners noted that it had been a long haul over the past couple of years working with Density and the issues surrounding the sewer companies and systems under Density's control. One Commissioner stated:

"... I will be honest with you. I don't have a necessarily great reason to believe in Density. I just don't."

The LPSC Staff in its Report of February 13, 2012 noted that:

"Density Utilities' Response is rife with misleading statements, inconsistencies and sweeping generalizations regarding Staff's evaluation of Density's 2010 test year results. Misleading statements and inconsistencies have been prevalent throughout the Staff's and Commission's dealings with Density during the last three years."

The Louisiana Public Service Commission and its Staff made decisions concerning Density based on the way Density had conducted its business and interacted with the Commission and Staff over the three-year period preceding February 13, 2012. The decision with respect to the bond issue and other decision was not made based on accounting matters concerning Density, and the transcript of the December 14, 2011 Open Session contains no references to financial statements or accounting matters.

There is no mention in the LPSC's December 15, 2011 Order approving the bond issue, and no mention at the LPSC's December 14, 2011 Open Session, of any accounting irregularities in Defendants' accounting or of inappropriate presentation of information by Density Utilities' financial statements. At the time the Commission was considering the 2011 bond issue, the 2010 Mauldin & Jenkins audited financial statements of Density Utilities were filed with the Commission, along with the compiled financials for 2010.

Defendants complied with the standard of care in the work that they did for the Plaintiffs over a more than three-year period. During that time, Defendants performed thousands of accounting functions for the Plaintiffs, and the work was professionally performed. The approximately \$626,000 that was reclassified to the parent corporation, Density, Inc., did not have a harmful effect on any of the companies and, on a consolidated basis, presented an accurate financial picture of the companies.

The ruling of the Louisiana Public Service Commission on the 2011 bond issue and any other rulings by the Commission were based on Density's management's dealings with the

Commission and the substance of the operations of the Plaintiffs' wastewater utilities facilities, including actual expenditures on sewer plant improvements, not on line items of financial statements or any other accounting matters. Accordingly, none of the accounting work performed by Defendants caused any harm to the Plaintiffs by virtue of actions taken by the Louisiana Public Service Commission.

Density Corp. filed for Chapter 11 Reorganization in 2013, and Density Utilities in 2014. The assets of Density Utilities were ultimately sold in 2015 for \$1.2 million.

The specific enumerated damages of the Plaintiffs would not be recoverable from Defendants in any event. The attorney's fees for regulatory attorneys would have been incurred in any event, as Density sought to present its plans to the Public Service Commission. Bill Barta and other consultants were required by the Public Service Commission in connection with any substantial financial requests by Density or other utilities in Louisiana. Rocky Davidson's accounting work was professionally performed, and he should not disgorge any accounting fees. The bond issuance costs that were incurred had nothing to do with Davidson Collins' accounting work. Density Utilities' Quickbooks did not need to be restated because the Quickbooks prepared by Davidson Collins were correct.

Accordingly, the Defendants have no liability to Plaintiffs and are entitled to a verdict for the Defendants.

Even if there were some liability, which Defendants deny, Defendants' affirmative defenses would eliminate or reduce that liability.

Defendants contend that they are entitled to recover their costs of litigation including reasonable attorney's fees pursuant to O.C.G.A. § 9-15-14 because Plaintiffs' claims have been without substantial justification as Defendants' counsel notified Plaintiffs' counsel in Defendants' counsel's May 30, 2014 letter.

(8) The issues for determination by the jury are as follows:

(a) **Plaintiffs show the following:**

- (i) Whether each Defendant is liable to Plaintiffs for each of the causes of action set forth in Plaintiffs' Complaint;
- (ii) The validity of Defendants affirmative defenses;
- (iii) Whether Defendants' acts and omissions caused damages to Plaintiffs and the amounts of such damages;
- (iv) Whether Plaintiffs are entitled to an order disgorging Defendants of all fees and other benefits paid by Plaintiffs;

- (v) Whether Plaintiffs are entitled to recover expenses of litigation, and/or attorneys' fees; and
- (vi) The amount, if any, of such expenses of litigation, and/or attorneys' fees.

(b) **Defendants show the following:**

Defendants contend that the following are facts to be determined by the jury:

1. Did Defendants breach the standard of care in performing accounting work for the Plaintiffs?
2. Was any of Defendants' accounting work the cause in fact of damage to the Plaintiffs?
3. Was any of Defendants' accounting work performed by the Plaintiffs the proximate cause of damage to Plaintiffs?
4. Did the negligence of Plaintiffs equal or exceed any alleged negligence of Plaintiffs?
5. Did the Plaintiffs fail to mitigate their damages?
6. What percentage of fault is ascribed to the Plaintiffs by the jury?

(9) Specifications of negligence including applicable code sections are as follows:

**Plaintiffs:** Plaintiffs allege that Defendants were negligent in providing accounting and CFO services to Plaintiffs.

Relevant authorities upon which Plaintiffs rely are as follows:

**Plaintiffs' Substantive Claims**

- O.C.G.A. § 51-1-1 – Tort Defined;
- O.C.G.A. § 51-1-2 – Ordinary Diligence and Ordinary Negligence Defined;
- O.C.G.A. § 51-1-3 – Extraordinary Diligence and Slight Negligence Defined;
- O.C.G.A. § 51-1-4 – Slight Diligence and Gross Negligence Defined;
- O.C.G.A. § 51-1-6 – Recovery of Damages upon Breach of Legal Duty;
- O.C.G.A. § 51-1-7 – When Infraction of Public Duty Gives Cause of Action to Individual;



- O.C.G.A. § 51-1-8 – Right of Action Arising From Breach of Private Duty;
- O.C.G.A. § 51-1-19 – Negligence by Person Given Trust or Confidence for Consideration;
- O.C.G.A. § 51-2-1 – Basis for Imputation of Negligence; Fault of Parents or Custodians Not Imputable to Child;
- O.C.G.A. § 51-10-1 – Right of Action for Deprivation of Possession of Personalty;
- American Institute of Certified Public Accountants Rules: ET Secs. 53, 56, 201, 202, 501, AR Sec. 80, CS Sec. 100
- *Andrew Corp. v. Beverly Manufacturing Co.*, 415 F.Supp.2d 919 (N.D.Ill. 2006) (all claims)
- *Paul v. Smith, Gambrell & Russell*, 267 Ga. App. 107 (2004) (all claims)
- Restatement (Second) Torts § 552 (all claims)
- *Goldston v. Bank of Am. Corp.*, 259 Ga. App. 690 (2003) (all claims)
- *Hunter, Maclean, Exley & Dunn v. Frame*, 269 Ga. 844, 850 (Ga. 1998) (all claims)
- *Arnall, Golden & Gregory v. Health Serv. Centers*, 197 Ga. App. 791 (1990) (all claims)
- *Hunter, Maclean, Exley & Dunn v. St. Simons Waterfront, LLC*, 317 Ga. App. 1 (2012) (all claims)
- *Hewitt Assoc. v. Rollins*, 308 Ga. App. 848 (2011) (all claims)
- *Millsaps v. Kaufold*, 288 Ga. App. 44 (2007) (all claims)
- *Holmes v. Peebles*, 251 Ga. App. 417 (2001) (all claims)
- *Williamson v. Abellera*, 245 Ga. App. 312 (2000) (all claims)
- O.C.G.A. § 13-1-1 *et. seq.* (breach of contract)
- O.C.G.A. § 13-6-1 *et. seq.* (breach of contract)
- *Atlantic RIM Equities v. Slutzky, Wolfe & Bailey*, 2005 U.S. Dist. LEXIS 38262 (N.D. Ga.) (professional malpractice and breach of contract)
- *Newell Recycling of Atlanta v. Jordan Jones & Goulding*, 288 Ga. 236 (2010) (professional malpractice and breach of contract)
- *Inland Atl. Old Nat'l Phase I, LLC v. 6425 Old Nat'l, LLC*, 329 Ga. App. 671, 677 (2014) (breach of contract).
- *Maria v. Powell, Goldstein, Frazer & Murphy*, 612 F. Supp. 1507, 1511 (N.D. Ga. 1985) (professional malpractice)
- *Plumlee v. Davis*, 221 Ga. App. 848 (1996) (professional malpractice)
- *Allen v. Lefkoff, Duncan, Grimes & Dermer*, 265 Ga. 374 (1995) (professional malpractice)
- *Both v. Frantz*, 278 Ga. App. 556 (2006) (professional malpractice)
- *Young v. Williams*, 285 Ga. App. 208 (2007) (professional malpractice)
- *Butler v. Gary, Williams et al.*, 280 Ga. App. 207 (2006) (professional malpractice)
- *Nix v. Crews*, 200 Ga. App. 58 (1991) (professional malpractice)
- *Kirby v. Chester*, 174 Ga. App. 881 (1985) (professional malpractice)
- *Leibel v. Johnson*, 297 Ga. 180 (2012) (professional malpractice)

- *Botes v. Weintraub*, 463 Fed. App'x 879 (11th Cir. 2012) (professional malpractice)
- *Rogers v. Norvell*, 174 Ga. App. 453 (1985) (professional malpractice)
- *Oehlerich v. Llewellyn*, 285 Ga. App. 738 (2007) (professional malpractice)
- *Travelers Indemnity Co. v. Pullen & Co.*, 161 Ga. App. 784 (1982) (accounting malpractice).
- *Tante v. Herring*, 264 Ga. 694, (1994) (professional malpractice and breach of fiduciary duty)
- *Tunsil v. Jackson*, 248 Ga. App. 496 (2001) (professional malpractice and breach of fiduciary duty)
- *Stamps v. JFB Props., LLC*, 287 Ga. 124 (2010) (breach of fiduciary duty)
- *Cochran v. Murrah*, 235 Ga. 304 (1975) (breach of fiduciary duty)
- *Crosby v. Kendall*, 247 Ga. App. 843 (2001) (breach of fiduciary duty)

### Damages

- O.C.G.A. § 51-12-2 – General and Special Damages Distinguished; When Recovered;
- O.C.G.A. § 51-12-3 – Direct and Consequential Damages Distinguished;
- O.C.G.A. § 51-12-4 – Damages Given as Compensation for Injury; Measure of Damages Generally; Nominal Damages;
- O.C.G.A. § 51-12-5 – Additional Damages for Aggravating Circumstances;
- O.C.G.A. § 51-12-5.1 – Punitive Damages;
- O.C.G.A. § 51-12-6 – Damages for Injury to Peace, Happiness, or Feelings;
- O.C.G.A. §§ 13-6-1 *et seq.* & 51-12-1 *et seq.* – Recovery of Necessary Expenses;
- *Denim N. Am. Holdings v. Swift Textiles, LLC*, 2011 U.S. Dist. LEXIS 115498, (M.D. Ga. 2011)
- *Mitchell v. Backus Cadillac-Pontiac, Inc.*, 274 Ga. App. 330 (2005)
- *Rodrigue v. Mendenhall*, 145 Ga. App. 666 (1978)
- *Prudential Timber & Farm Co. v. Collins*, 144 Ga. App. 849, 852 (1978);
- *Lindgren v. Dowis*, 236 Ga. 278, 281-82 (1976)
- *Atlanta Oculoplastic Surgery, P.C. v. Nestlehutt*, 286 Ga. 731, 734 (2010);
- *Gravier v. Dreger & McClelland*, 280 Ga. App. 74, 78-9 (2006);
- *Dow Chem. Co. v. Ogletree*, 237 Ga. App. 27, 32 (1999);
- *Peters v. Hyatt Legal Svcs.*, 211 Ga. App. 587, 593 (1993);
- *Lucious v. Micro Gen. Corp.*, Civil Action File No. 1:03-CV-1270-TWT, 2004 U.S. Dist. LEXIS 14112, \*12-13 (NDGa. April 5, 2004);.
- *See ADP-Financial Computer Svcs. v. First Nat'l Bank*, 703 F.2d 1261, 1267 (11<sup>th</sup> Cir. 1983);
- *Weprin v. Peterson*, 736 F. Supp. 1131, 1133 (NDGa. 1988).

**Defendants show the following:**

Defendants contend that they met the standard of care and were not negligent in providing accounting services. Further, no alleged damages suffered by the Plaintiffs was caused or proximately caused by the Defendants.

- (10) If the case is based on a contract, either oral or written, the terms of the contract are as follows:

Plaintiffs entered into contracts for accounting and CFO services with the Defendants. Those engagement letters were identified as Exhibit 7 in depositions taken in this case.

**Defendants:** Defendants show that the three engagement letters speak for themselves, and that certain of the letters reference “on call” and “part time” CFO-type services.

- (11) The types of damages and the applicable measure of those damages are stated as follows:

**Plaintiffs:** Plaintiffs each seek award of compensatory and actual damages in the amount in which Plaintiffs’ have been damaged and disgorgement of monies and fees from Defendants as follows:

- fees paid to Defendants for the negligent services from May 2009 to January 2012 in the amount of \$262,808.45;
- fees in the amount of \$196,899.69 (through October 31, 2015) for Julianna Cave and a contract staff person (Veronica Parker) and fees of \$9,555.00, for Interlochen, incurred by Density for professional accounting services to restate the erroneous financials;
- \$128,000.00 paid to the law firm Adams & Reese to represent Density before the PSC regarding issues arising out of Defendants’ errors;
- \$120,000.00 in costs incurred for investment bank services on the unissued bond;
- \$86,000.00 paid to the law firm Phelps Dunbar also to represent Density before the PSC regarding issues arising out of Defendants’ errors;
- \$54,000 paid to Bill Barta for consultant fees arising out of the PSC’s order that Density hire Barta to address the issues arising out of Defendants’ errors;



- approximately \$40,000.00 for another PSC-required consultant (AUS) and two studies, an engineering study and a payroll study, also arising out of Defendants' errors;
- \$15,000.00 in travel costs associated with all of the above;
- Loss value of Plaintiffs' business resulting from Defendants' negligence and breach of fiduciary duty and failure of Bond deal to close including value of company and lost profits in an amount in excess of \$4.5 million;
- cost of litigation and reasonable attorney's fees to prosecute this case which amount continues to increase (Plaintiffs will provide a detailed summary of litigation costs and copy of their fee agreement before trial); and,
- prejudgment interest;

**Note:** The Court granted summary judgment on Plaintiff's claim for costs and fees under O.C.G.A. § 13-6-11. Plaintiffs respectfully ask the Court to reconsider this ruling and note that under Georgia law, if Plaintiffs succeed on their claim for breach of fiduciary duty the jury would be permitted to award costs and fees under O.C.G.A. § 13-6-11, *See ADP-Financial Computer Svcs. v. First Nat'l Bank*, 703 F.2d 1261, 1267 (11<sup>th</sup> Cir. 1983); *Weprin v. Peterson*, 736 F. Supp. 1131, 1133 (N.D. Ga. 1988).

**Defendants:** Defendants contend Plaintiffs suffered no damages resulting from accounting work performed by Defendants. Defendants' counsel also challenges Plaintiff's request that the Court reconsider its ruling regarding Plaintiffs' claim to costs and fees under O.C.G.A. § 13-6-11.

- (12) If the case involves divorce, each party shall present to the court at the pre-trial conference the affidavits required by Rule 24.2:

N/A

- (13) The following facts are stipulated:

None at this time.

- (14) The following is a list of all documentary and physical evidence that will be tendered at the trial by the Plaintiff or Defendants. All exhibits shall be marked by counsel prior to trial so as to not cause undue delay before the Court.

- (a) **Plaintiffs:** See Exhibit A

- (i) ~~All pleadings, discovery responses and other documents filed or served in this case;~~

- ~~(ii) All documents produced in this case by each party and by any non-parties;~~
- ~~(iii) All correspondence between Plaintiffs and Defendants;~~
- ~~(iv) All correspondence between Plaintiffs and any third parties relating to the facts material to this matter;~~
- ~~(v) All correspondence between or among Plaintiffs' counsel and Defendants' counsel in this action;~~
- (vi) All agreements between Plaintiffs and Defendants;
- (vii) Defendants' client files for Plaintiffs;
- (viii) Plaintiffs' restatement of financials;
- (ix) All Exhibits to the briefing on Defendants' Motion for Summary Judgment;
- (x) All exhibits to the depositions taken in this case;
- (xi) All documents identified by Defendants;
- (xii) All documents necessary for impeachment and rebuttal;
- (xiii) Demonstrative compilation exhibits;
- (xiv) Documentation relating to Plaintiffs' attorney's fees.

(b) **Defendants:**

- (i) All pleadings, discovery responses and other documents filed or served in this case;
- ~~(ii) All documents produced in this case by each party and by any non-parties;~~
- ~~(iii) All correspondence between Plaintiffs and Defendants;~~
- ~~(iv) All correspondence between Defendants and any third parties relating to the facts material to this matter;~~
- ~~(v) All correspondence between or among Plaintiffs' counsel and Defendants' counsel in this action;~~

- (vi) ~~All agreements between Plaintiffs and Defendants;~~
- (vii) Defendants' client files for Plaintiffs;
- (viii) Plaintiffs' restatement of financials;
- (ix) All Exhibits relating to the briefing on Defendants' and Plaintiffs' Motion for Summary Judgment;
- (x) All exhibits to the depositions taken in this case;
- (xi) All documents identified by Defendants or Plaintiffs;
- (xii) All documents necessary for impeachment and rebuttal;
- (xiii) Demonstrative compilation exhibits;
- (xiv) Documentation relating to Plaintiffs' attorney's fees;
- (xv) Plans of Reorganization in Chapter 11 Proceedings;
- (xvi) Contract for Sale of Density Utilities Assets;
- (xvii) Work papers and backup for original Quickbooks;
- (xviii) Work papers and backup for Restated Quickbooks;
- (xix) Miller Heath III Testimonial Video;
- (xx) Letter of Non-Opposition for Density Utilities of Louisiana to incurring indebtedness, 10/13/10, LPSC Docket S-31716;
- (xxi) Density Utilities of Louisiana, LLC, letter dated March 31, 2011 submitting financial statements to Louisiana Public Service Commission filed 4/4/11, LPSC Docket U-31893;
- (xxii) Louisiana Public Service Commission Order U-30864 or letter date: Effective: January 23, 2009; LPSC Docket U-30864;
- (xxiii) In re: Request for an increase in wastewater rate for entire service area. (Decided at the Commission's April 21, 2010 Business and Executive Session), 5/19/10, LPSC Docket U-30864-A;
- (xxiv) Order No. U-30864-A – Order with respect to request for an increase in wastewater rate for entire service area, decided 4-21-10, filed 5/19/10,

LPSC Docket U-30864;

(xxv) Order No. U-31893 – Order setting rate for Density Utilities, 7/18/12, LPSC Docket U-31893;

(xxvi) Joint Motion for Contested Stipulation Hearing and Statement of Public Interest with attachments, 12-7-09, LPSC Docket U-30864;

(xxvii) Density Utilities Annual Reports for 2009, 2010 and 2013 to Louisiana Public Service Commission in EisnerAmper Binder;

(xxviii) US Regulatory Accounting Systems in EisnerAmper Binder;

(xxix) Wyrick Gibbons Generally Accepted Accounting Principles for Regulated Utilities in EisnerAmper Binder;

(xxx) EisnerAmper Comparison of reviewed financial statements vs. compiled financial statements;

(xxxi) EisnerAmper Comparison of audited financial statement vs. audited financial statement;

(xxxii) EisnerAmper Pivot Table (2007 expenses) – Density Utilities Restated Property & Equipment / Land & Land Rights;

(xxxiii) EisnerAmper Pivot Table (2008 expenses) – Density Utilities Restated Property & Equipment / Land & Land Rights;

(xxxiv) EisnerAmper Pivot Table – Density Utilities – Structures and Improvements;

(xxxv) EisnerAmper Comparison of “due to” and “due from” Density Utilities for 2009, 2010 and 2011;

(xxxvi) EisnerAmper Revenue comparisons – Original to Restated – Density Utilities 2009 through 2011;

(xxxvii) Defendants’ counsel’s letter dated May 30, 2014 to Plaintiffs’ counsel regarding attorney’s fees and costs under O.C.G.A. § 9-15-14;

(xxxviii) Documents relating to Defendants’ attorney’s fees and costs.

15. Special authorities relied upon by Plaintiff relating to peculiar evidentiary or other legal questions are as follows:

Plaintiffs are aware of no peculiar evidentiary issues, at this time. Plaintiffs request the opportunity to brief any such issues should they arise during the course of the trial.

~~Plaintiffs reserve the right to submit special authorities with respect to all legal issues relevant to Plaintiffs' claims and the defenses asserted by the Defendants.—~~

16. Special authorities relied upon by Defendants relating to peculiar evidentiary or other legal questions are as follows:

Defendants are aware of no peculiar evidentiary issues at this time, Defendants request the opportunity to brief any such issues should they arise during the course of the trial.

~~Defendants reserve the right to submit special authorities with respect to all legal issues relevant to Plaintiffs' claims and the defenses asserted by the Defendants.~~

17. All requests to charge anticipated at the time of trial will be filed in accordance with Rule 10.3.
18. Testimony of the following person may be introduced by deposition:

**Plaintiffs:**

- C. Lamont Davidson
- ~~Leza Mazur~~
- Thomas Drew

Plaintiffs reserve the right to take testimony for the preservation and for use in evidence pursuant to the Georgia Civil Practice Act.

**Defendants:**

- Miller Heath III
- Stephanie Heath

Defendants reserve the right to take testimony for the preservation and for use in evidence pursuant to the Georgia Civil Practice Act.

19. The following is a list of witnesses that will or may be presented at trial:

(a) **Plaintiffs:**

(i) Witnesses who *will* be present at trial:

Miller Heath, III

(ii) Witnesses who *may* be present at trial:

1. Stephanie Heath;
2. Hal Novak;
3. Juliana Cave;
4. J.P. Gingras;
5. Virgil Adams;
6. Chris Edwards;
7. Terry Henderson;
8. Wendy Collins;
9. Amanda Wideman;
10. Charity White;
11. Brittany Heath;
12. Mallory Heath;
13. Natalie Canon;
14. Raisha Woell;
15. Raisha Fiveash;
16. Gary Shambaugh;
17. Sarah Collins;
18. Dollie Ramsey;
19. Vickie Spence;
20. Chris Poss;
21. William Barta;
22. Robert Rieger, Esq.;
23. Renee Crasto, Esq.;
24. John O. Shirley, Esq.;
25. Carman M. Lavergne, Esq.;
26. Wayne Breunig;
27. Dwight Clark;
28. Melanie Verzyvelt, Esq.;
29. Owen "Buddy" Stricker
30. Eve Kahao Gonzales;
31. Johnny Snellgrove
32. Robin Pendergrass;
33. Brian McManus;
34. Wesley J. Boyer, Esq.;
35. Brandi Smith;
36. Carl Perazzola;

37. James Smith;
38. Neil Hertenstein;
39. Clay Barrilleaux;
40. Linda Evans;
41. James M. Field;
42. Clude C. Holloway;
43. Foster L. Campbell;
44. Lambert C. Boissiere;
45. Eric F. Skrmetta;
46. Terri Lemoine;
47. Thomas Drew;
48. Jim Sherman;
49. Chris Clark;
50. All "will call" and "may call" witnesses listed by Defendants;
51. All witnesses necessary for rebuttal and impeachments;
52. All custodians of record necessary for authentication; and,
53. All Defendants.

~~Plaintiffs reserve the right to supplement this list prior to trial with adequate notice to all counsel.~~ Plaintiffs may rely upon representations by Defendants that they will have a witness present unless notice to the contrary is given in sufficient time prior to trial to allow the other party to subpoena the witness(s) or obtain his/her testimony by other means.

(b) **Defendants:**

- (i) Defendants *will* have present at trial:

Rocky Davidson

- (ii) Defendants *may* have present at trial:

Lesla Mazur

Wendy Collins

Stephanie Heath

Bill Barta

John Barrett

Ralph Smith

Terry Henderson

Dollie Ramsey

All "will call" and "may call" witnesses listed by Plaintiffs

All witnesses necessary for rebuttal and impeachment

All custodians of record necessary for authentication

All Plaintiffs

~~Defendants reserve the right to supplement this list prior to trial with adequate notice to all counsel.~~ Defendants may rely upon representations by Plaintiffs that they will have a witness present unless notice to the contrary is given in sufficient time prior to trial to allow the other party to subpoena the witness(s) or obtain his/her testimony by other means.

20. The form of all possible verdicts to be considered by the jury are as follows:

The parties shall prepare and submit a proposed Jury Verdict Form no later than the start of the first day of trial. If the parties cannot agree on a proposed verdict form, each party shall submit their proposed verdict form by such date.

21. Miscellaneous:

- (a) The possibility of settling the instant case is: Moderate.
- (b) The parties want the case to be reported.
- (c) The cost of such report will be paid by the parties equally.
- (d) Other matters: The parties will not be asking the jury to consider the fault of any non-parties or to have any non-parties on the verdict form.

**IT IS HEREBY ORDERED** that the foregoing, including the attachments thereto, constitutes the CONSOLIDATED PRETRIAL ORDER in the above case and supersedes the pleadings, which may not be further amended except by order of the Court to prevent manifest injustice.

This 6<sup>th</sup> day of September, 2017.

  
\_\_\_\_\_  
JEFF HANSON  
JUDGE, STATE COURT OF BIBB COUNTY



EXHIBIT A  
*Density v. Davidson*

**PLAINTIFFS' TRIAL EXHIBIT CHART**

<b><u>DESCRIPTION</u></b>	<b><u>DEPO EXHIBIT NO.</u></b>
Density Corp. Board Meeting 4/10/2008	2
Density Inc. Corporate Chart (Pre-Consolidation)	4
Density Inc. Corporate Chart (Post-Consolidation)	5
Davidson & Collins, LLC lists of services	7
Capitalized Expenses email 9/27/2010	10
Audit Reissue email 10/4/2010	12
Accounting Discussion email 10/28/2009	14
Density Utilities, LLC Financial Report 12/31/2009	15
Density Utilities, LLC Financial Report 12/31/2010	16
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## AR-C Section 70

### Preparation of Financial Statements

**Source:** SSARS No. 21; SSARS No. 23; SSARS No. 25; SSARS No. 26.

**Effective for the preparation of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.**

#### Introduction

##### Scope of This Section

**.01** This section applies when an accountant in public practice is engaged to prepare financial statements or prospective financial information. (Ref: par. .A1–.A2).

This section may also be applied, adapted as appropriate in the circumstances, to the preparation of other historical financial information. (Ref: par. .A3)

This section does not apply when an accountant prepares financial statements or prospective financial information

- and is engaged to perform an audit, review, or compilation of those financial statements,
- solely for submission to taxing authorities,
- for inclusion in written personal financial plans prepared by the accountant,
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or
- in conjunction with business valuation services. <sup>1</sup>

[As amended, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

**.02** The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. .A4)

##### The Preparation Engagement

**.03** An engagement to prepare financial statements is a nonattest service and does not require a determination about whether the accountant is independent of the entity. (Ref: par. .A5)

**.04** In addition, an engagement to prepare financial statements does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

**.05** This section is effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

## Objective

**.06** The objective of the accountant is to prepare financial statements pursuant to a specified financial reporting framework.

## Definitions

**.07** For purposes of Statements on Standards for Accounting and Review Services (SSARSs), the following terms have the meanings attributed as follows:

**Management.** The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

**Those charged with governance.** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

[As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

## Requirements

### General Principles for Performing Engagements to Prepare Financial Statements

**.08** In addition to complying with this section, an accountant is required to comply with section 60, *General Principles For Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

### Acceptance and Continuance of Client Relationships and Engagements to Prepare Financial Statements

**.09** If the accountant is not satisfied with any of the matters set out in paragraph .31 of section 60 as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

### Agreement on Engagement Terms

**.10** The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A7–.A11)

- a. The objective of the engagement
- b. The responsibilities of management set forth in paragraph .31*b* of section 60

- c. The agreement of management that each page of the financial statements will include a statement indicating that no assurance is provided on the financial statements or the accountant will be required to issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A13)
- d. The responsibilities of the accountant
- e. The limitations of the engagement to prepare financial statements
- f. Identification of the applicable financial reporting framework for the preparation of financial statements
- g. Whether the financial statements are to contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure) or omit substantially all disclosures required by the applicable financial reporting framework

[As amended, effective October 2016, by SSARS No. 23.]

**.11** The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A10)

#### **The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework**

**.12** The accountant should obtain an understanding of the financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A12)

#### **Preparing the Financial Statements**

**.13** The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.

**.14** The accountant should ensure that a statement is included on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements. If the accountant is unable to include a statement on each page of the financial statements, the accountant should do one of the following: (Ref: par. .A13)

- a. Issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A14)
- b. Perform a compilation engagement in accordance with section 80, *Compilation Engagements*.
- c. Withdraw from the engagement and inform management of the reasons for withdrawing. (Ref: par. .A15–.A16)

[As amended, effective October 2016, by SSARS No. 23. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

**.15** When preparing financial statements in accordance with a special purpose framework, the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. (Ref: par. .A17)

**.16** If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in financial statements and accepts responsibility for those judgments. (Ref: par. .A18 and .A24)

**.17** If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statements are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information. If management fails to provide such additional or corrected information, the accountant should disclose a material misstatement or misstatements in the financial statements in accordance with paragraph .18 or withdraw from the engagement and inform management of the reasons for withdrawing. (Ref: par. .A15–.A16) [As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

**.18** When, after discussions with management, the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement or misstatements in the financial statements. (Ref: par. .A19)

#### **Preparing Prospective Financial Information**

**.19** The summary of significant assumptions is essential to the user’s understanding of prospective financial information. Accordingly, the accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not prepare a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

#### **Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework**

**.20** When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission either in the financial statements or in an accompanying disclaimer. (Ref: par. .A20) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

**.21** The accountant should not prepare financial statements that omit substantially all disclosures required by the financial reporting framework if, in the accountant’s professional judgment, such financial statements would be misleading to users of the financial statements. (Ref: par. .A21–.A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

#### **Documentation in a Preparation Engagement**

**.22** The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following: (Ref: par. .A24)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11
- b. A copy of the financial statements that the accountant prepared

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**.23** If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

## **Application and Other Explanatory Material**

### **Scope of This Section (Ref: par. .01–.02)**

**.A1** If the accountant is engaged to prepare prospective financial information, references in this section to *financial statements* are to be taken as a reference to prospective financial information. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

**.A2** AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, “Preparation Guidelines;” chapter 7, “Reasonably Objective Basis;” chapter 8, “Presentation Guidelines;” and chapter 9, “Illustrative Prospective Financial Statements,” of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

**.A3** Other historical financial information to which this section may be applied includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Pro forma financial information

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

**.A4** The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

### **The Preparation Engagement (Ref: par. .03)**

**.A5** The "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295) addresses the accountant's considerations with respect to independence when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The accountant needs to be aware that the performance of the preparation services may impair independence unless the safeguards described in this subtopic are met. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

### **Definitions (Ref: par. .07)**



[.A6] [Paragraph deleted by the issuance of SSARS No. 25, February 2020.]

**Agreement on Engagement Terms (Ref: par. .10–.11)**

**.A7** Both management and the accountant have an interest in documenting the agreed-upon terms of the engagement to prepare financial statements before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or may expect the accountant to protect management against certain risks or to perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**.A8** When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**.A9** The understanding with management regarding the services to be performed for engagements to prepare financial statements is required by paragraph .10 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

**.A10** The roles of management and those charged with governance in agreeing upon the terms of the engagement to prepare financial statements for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance in accordance with paragraph .31*b* of section 60, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**.A11** An illustrative example of an engagement letter for an engagement to prepare financial statements is presented in the exhibit, "Illustrative Engagement Letter." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)**

**.A12** The requirement that the accountant obtain an understanding of the financial reporting framework adopted by management intended to be used in the preparation of the financial statements and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**Preparing the Financial Statements (Ref: par. .10, .14–.16, and .18)**

**.A13** The statement on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements. The statement is made at management's discretion, and the accountant's firm name is not required to be included. The accountant is concerned that the indication is not misleading. Examples of a statement on each page of the financial statements include the following:

- No assurance is provided on these financial statements.
- These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.

Other statements that convey that no assurance is provided on the financial statements would also be acceptable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

**.A14** An example of a disclaimer that the accountant may issue is as follows:

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by us and we do not express an opinion, a conclusion, nor provide any assurance on them.

*[Signature of the accountant's firm]*

*[City and state where the accountant practices]*

*[Date]*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. As amended, effective for the preparation of financial statements for periods beginning on or after December 15, 2025, by SSARS No. 26.]

**.A15** In circumstances addressed by the requirements of this section in which withdrawal from the engagement is necessary, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant's ethical obligations. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

**.A16** When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

**.A17** A description of the special purpose framework is usually placed next to or under the title of the financial statements (for example "statement of assets and liabilities—modified cash basis"). However, the description may be placed elsewhere in the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

**.A18** In the preparation of financial statements, the accountant may provide assistance to management with significant judgments (for example, the accountant may advise management on alternative accounting policies that are significant to the financial statements or help management with significant judgments regarding material accounting estimates). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

**.A19** The disclosure of the material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

#### **Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .20–.21)**

**.A20** The disclosure of the omission of substantially all disclosures required by the applicable financial reporting framework may be made on the face of the financial statements or in a selected note to the

financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

**.A21** The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by [*the applicable financial reporting framework*] Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

**.A22** Financial statements may be misleading, for example, if the applicable financial reporting framework includes the premise that the financial statements are prepared on the going concern basis and undisclosed uncertainties exist regarding the entity's ability to continue as a going concern. If the accountant becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity's ability to continue as a going concern in order to avoid the financial statements being misleading. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

**.A23** Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

#### **Documentation in a Preparation Engagement (Ref: par. .16 and .22)**

**.A24** Documentation may include documentation regarding significant consultations or significant professional judgments made throughout the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

### **Appendix — Preparation of Financial Statements Versus Assistance in Preparing Financial Statements (Ref: par. .A4)**

#### **.A25**

The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on the services the client requests the accountant to perform and requires the accountant to apply professional judgment. The following table provides examples of services that the accountant may be engaged to perform and whether section 70 would apply. The table is not intended to be all inclusive, and professional judgment would still need to be applied.

<b>Examples of Services for Which This Section Applies</b>	<b>Examples of Accountant Services for Which This Section Does Not Apply</b>
Preparation of financial statements prior to audit or review by another accountant	Preparation of financial statements when the accountant is engaged to perform an audit, review, or compilation of such financial statements
Preparation of financial statements for an entity to be presented alongside the entity's tax return	Preparation of financial statements with a tax return solely for submission to taxing authorities
Preparation of personal financial statements for presentation alongside a financial plan	Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
	Financial statements prepared in conjunction with litigation services that involve pending or potential

Examples of Services for Which This Section Applies	Examples of Accountant Services for Which This Section Does Not Apply
	legal or regulatory proceedings
	Financial statements prepared in conjunction with business valuation services
	Maintaining depreciation schedules
	Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
Preparation of single financial statements, such as a balance sheet or income statement or financial statements with substantially all disclosures omitted	Drafting financial statement notes
Using the information in a general ledger to prepare financial statements outside of an accounting software system	Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

## **Exhibit — Illustrative Engagement Letter (Ref: par. .A11)**

### **.A26**

The following is an example of an engagement letter for an engagement to prepare financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This engagement letter is intended as guidance that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the preparation of financial statements for a single reporting period. The accountant may seek legal advice about whether a proposed engagement letter is suitable.

To the appropriate representative of ABC Company: <sup>1</sup>

You <sup>2</sup> have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended and the related notes to the financial statements. <sup>3 4</sup> We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

### **Our Responsibilities**

The objective of our engagement is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion or provide any assurance on the financial statements.

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

## **Management Responsibilities**

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- f. To provide us with:
  - i. Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - ii. Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - iii. Unrestricted access to persons within ABC Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

*[If the accountant expects to issue a disclaimer, instead of the preceding paragraph, the following may be added:]*

*As part of our engagement, we will issue a disclaimer that will state that the financial statements were not subjected to an audit, review, or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.]*

## **Other Relevant Information**

Our fees for these services . . . .

*[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

*[Signature of accountant or accountant's firm]*

Acknowledged and agreed on behalf of ABC Company by:

*[Signed]*

*[Name and Title]*

*[Date]*

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

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Footnotes (AR-C Sec. 70 — Preparation of Financial Statements):

<sup>1</sup> [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

<sup>1</sup> The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A10.

<sup>2</sup> Throughout this engagement letter, references to *you*, *we*, *us*, *management*, and *accountant* would be used or amended as appropriate in the circumstances.

<sup>3</sup> If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

<sup>4</sup> The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.



Professional Ethics Division

# Nonattest services toolkit

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# Introduction

The provision of nonattest services to attest clients gives rise to threats to independence. The interpretations of the “[Nonattest Services](#)” subtopic (ET sec. 1.295)<sup>1</sup> of the “Independence Rule” (ET sec. 1.200.001) provide guidance on when nonattest services could or would impair independence. This nonauthoritative tool is designed to assist members in understanding the independence requirements related to providing nonattest services and with evaluating threats to independence when providing these services.

This toolkit does not provide authoritative guidance and should be used in conjunction with the applicable interpretations of the “Nonattest Services” subtopic. Specifically, this toolkit includes the following:

- Overview of independence considerations when providing nonattest services to an attest client
- Flowchart that illustrates the steps to evaluating independence when providing certain nonattest services
- A checklist to aid members with evaluating whether independence would be impaired under the interpretations of the “Nonattest Services” subtopic of the “Independence Rule”

The first instance of terms defined by the AICPA Code of Professional Conduct (code) are linked to the definition in the code.



The answers to frequently asked questions (FAQs) related to independence when providing nonattest services are available in [Q&A sections 200–280](#). The FAQs are not rules or interpretations of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance.

<sup>1</sup> ET sections referenced throughout this toolkit can be found in AICPA *Professional Standards*.

# Nonattest services

Nonattest services are services provided to a **client** that are not specifically related to the performance of an attest engagement. For example, nonattest services include activities such as financial statement preparation, cash to accrual conversions, reconciliations, and tax return preparation. If you perform nonattest services for an **attest client**, the “**Independence Rule**” and related interpretations (rules) impose limits on the nature and scope of the services you may provide. In other words, the extent to which you perform certain activities may be limited by the rules or you may be required to apply **safeguards** to not **impair** your independence when providing certain nonattest services.

## Conceptual framework for independence

If the nonattest service is not specifically addressed in the AICPA Code of Professional Conduct (code), you should first evaluate the service using the “**Conceptual Framework for Independence**” (ET sec. 1.210.010) (framework) to determine whether the service would impair independence even if the general requirements (which are discussed next) can be applied.

The framework cannot be used to overcome a prohibition or other requirement of the code. The framework incorporates a “threats and safeguards” approach, which is designed to assist members in analyzing relationships and circumstances that the code does not specifically address and in determining whether such relationships or circumstances may result in the violation of the rules.

For those unfamiliar with how to implement and use the framework, we developed the **Conceptual Framework Toolkit for Independence**. The toolkit includes, among other things, a worksheet to aid with applying the steps of the conceptual framework that could also be used to satisfy the documentation requirement found in paragraph .09 in the framework.

## General requirements

The “**General Requirements for Performing Nonattest Services**” interpretation (ET sec. 1.295.040) explains the required safeguards to be applied whenever **members** provide nonattest services to their attest clients. The general requirements are broken down into three main components.

The first general requirement explains that the attest client must agree to assume certain responsibilities related to the nonattest services engagement in order for independence to be maintained. Therefore, prior to agreeing to perform any nonattest services for the attest client, the *member* must obtain the attest client’s agreement that the attest client will do the following:

- a. Assume responsibilities as described in the “**Management Responsibilities**” interpretation (ET sec. 1.295.030) under the “Independence Rule.”

Examples of activities that would be considered management responsibilities can be found in ET section 1.295.030.

- b. Oversee the service by designating an individual, preferably within senior management, who possesses suitable skill, knowledge and experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them but is not required to possess the expertise to perform or re-perform the services.
- c. Evaluate the adequacy and results of the services performed.
- d. Accept responsibility for the results of the services.

The second general requirement explains that one of the key principles underlying the AICPA rules on nonattest services is that you may not assume management responsibilities or even appear to assume management responsibilities. Management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical and intangible resources.

Consider the scope and scale, frequency, and duration of services to determine if the services have become part of the client's internal control and you have assumed a management responsibility.

The third component is a requirement that members establish and document in writing their understanding with the attest client. The following needs to be documented:

- The objectives of the engagement
- The services to be performed
- The attest client's acceptance of its responsibilities
- The member's responsibilities
- Any limitation of the engagement

## Nonattest services that impair independence

The interpretations under the "Nonattest Services" subtopic include examples of nonattest services that impair independence even if the general requirements are met. For example, independence would be impaired if you were to perform an appraisal, a valuation, or an actuarial service for an attest client when (a) the services involve a significant degree of subjectivity and (b) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the attest client's **financial statements** (ET sec. 1.295.110) or if you were to provide expert witness services (ET sec. 1.295.140). As such, it is important to consult the "Nonattest Services" subtopic to ensure you are fully informed of all the various nonattest services that if performed would impair your independence.

More information related to some nonattest services addressed by the AICPA code may be found in the [\*Plain English Guide to Independence\*](#).

## Cumulative effect

At times, the general requirements may not by themselves reduce **threats** to an **acceptable level**. One such circumstance is when the attest client asks you to perform multiple nonattest services. Although individually the nonattest services may not impair independence, you should evaluate the threats in the aggregate to ensure that the safeguards provided for in the “General Requirements for Performing Nonattest Services” interpretation continue to adequately reduce threats to an acceptable level. If the general requirements safeguards do not reduce threats to an acceptable level, you should determine whether additional safeguards can be applied to reduce threats to an acceptable level or whether threats are so significant that you should not perform the additional nonattest service.

## Changes to engagement

Another issue that you may need to address is a change to your engagement that could require you to re-evaluate your independence. Changes in scope (scope creep), changes in client personnel, or changes to threats to independence are just some examples of events that could cause you to consider re-evaluating your independence. You should be alert to changes and re-evaluate your independence when appropriate throughout the **period of the professional engagement**.

# Exceptions

## Periods requiring independence

These nonattest services rules apply during the period of the professional engagement and during the period covered by the financial statements (to which the attest services relate).

A limited exception, however, exists in paragraph .03 of the “[Scope and Applicability of Nonattest Services](#)” interpretation (ET sec. 1.295.010). This exception explains that if you provide the entity with nonattest services that impair independence prior to the entity becoming an attest client, independence will not be considered impaired if the nonattest services related to periods prior to the period covered by the financial statements you are engaged to audit and those prior period financial statements were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm).

## Affiliate considerations

Although you are required by the “[Client Affiliates](#)” interpretation (ET sec. 1.224.010) to apply the “Independence Rule” and interpretations to [affiliates](#) of your [financial statement attest clients](#), there is some relief when it comes to nonattest services.

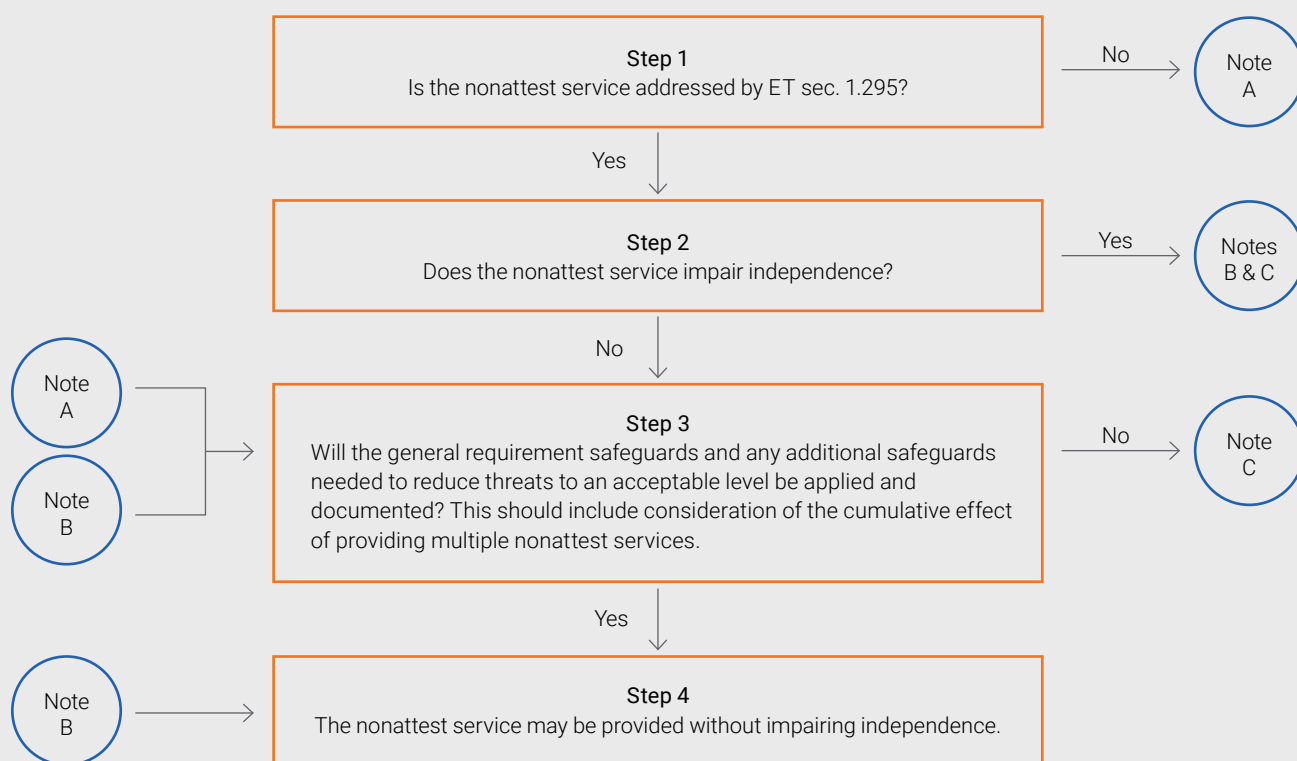
The first exception is that you may provide nonattest services that impair independence to certain affiliates if it is reasonable to conclude that the services do not create a self-review threat with respect to the financial statement attest client because the results of the nonattest services will not be subject to financial statement attest procedures.

The second exception relates to an acquisition or business combination that involves a financial statement attest client. Specifically, you could provide prohibited nonattest services to the acquirer of your financial statement attest client without impairing your independence provided (1) a financial statement attest client is acquired during the period of the professional engagement by either a non-client or a nonattest client (acquirer), (2) the attest engagement covers only periods prior to the acquisition, and (3) you or your firm will not continue to provide financial statement attest services to the acquirer.

# Independence evaluation and monitoring flowchart

The following flowchart illustrates the steps in deciding whether a nonattest service that is addressed in the code will impair your independence. This flowchart does not consider the possible need to re-evaluate the threats due to changes to the engagement such as changes to the scope, changes in client personnel or changes to threats

to independence. The flowchart also does not incorporate steps to evaluate threats in the aggregate when you are providing multiple nonattest services (that is, cumulative effect) or situations in which the nonattest service is not specifically addressed in the code.



**Note A:** If the nonattest service is not specifically addressed in the code, you should first evaluate the service using the “[Conceptual Framework for Independence](#)” (ET sec. 1.210.010). The [Conceptual Framework Toolkit for Independence](#) is available to assist you with this analysis. If after conducting your evaluation, you determine safeguards can be applied to eliminate or reduce threats to an acceptable level, then proceed to step 3.

**Note B:** This flowchart does not outline the various exceptions that could be considered at this point. If the affiliate exception outlined in paragraph .02b of the “[Client Affiliate](#)” interpretation (ET sec. 1.224.010) is applicable, then proceed to step 3. If the period of the professional engagement exception outlined in paragraph .03 of the

“[Scope and Applicability of Nonattest Services](#)” interpretation (ET sec. 1.295.010) is applicable, or if the acquisition or business combination exception outlined in paragraphs .05–.10 of the “[Client Affiliate](#)” interpretation is applicable, then proceed to step 4.

**Note C:** Independence will be impaired if the nonattest service was provided. In lieu of declining the nonattest service engagement, you may want to consider whether the scope of nonattest service engagement could be changed so that threats would be at an acceptable level, whether the application of additional safeguards would eliminate or reduce threats to an acceptable level, or whether you would prefer to resign from the attest engagement.

# Nonattest services checklist

1. What types of nonattest services will be performed for this attest client or for an [affiliate](#) of the financial statement attest client? (Check all that apply.)

- ☐ [Financial statement preparation](#) (1.295.010.06)
- ☐ [Cash to accrual conversions](#) (1.295.010.06)
- ☐ [Reconciliations](#) (1.295.010.06)
- ☐ [Advisory services](#) (1.295.105)
- ☐ [Appraisal, valuation, and actuarial services](#) (1.295.110)
- ☐ [Assisting attest clients with implementing accounting standards](#) (1.295.113)
- ☐ [Benefit plan administration](#) (1.295.115)
- ☐ [Bookkeeping, payroll, and other disbursements](#) (1.295.120)
- ☐ [Business risk consulting](#) (1.295.125)
- ☐ [Corporate finance consulting](#) (1.295.130)
- ☐ [Executive or employee recruiting](#) (1.295.135)
- ☐ [Forensic accounting](#) (1.295.140)
- ☐ [Hosting services](#) (1.295.143)
- ☐ [Information systems services](#) (1.295.145)
- ☐ [Internal audit](#) (1.295.150)
- ☐ [Investment advisory or management](#) (1.295.155)
- ☐ [Tax services](#) (1.295.160)
- ☐ Other:



# Nonattest services checklist (continued)

2. Will any of the nonattest service(s) involve leading or directing the entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources as described in the “[Management Responsibilities](#)” interpretation (ET sec. 1.295.030)? ☐ Yes ☐ No

Examples of such services include the following (check all that apply):

- ☐ Setting policy or strategic direction for the client
- ☐ Directing or accepting responsibility for actions of the client’s employees except to the extent permitted when using internal auditors to help with services performed under auditing or attestation standards
- ☐ Authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of a client or having the authority to do so
- ☐ Preparing source documents, in electronic or other form, that evidence the occurrence of a transaction
- ☐ Having custody of a client’s assets
- ☐ Deciding which recommendations of the member or other third parties to implement or prioritize
- ☐ Reporting to those charged with governance on behalf of management
- ☐ Serving as a client’s stock transfer or escrow agent, registrar, general counsel or equivalent
- ☐ Accepting responsibility for the management of a client’s project
- ☐ Accepting responsibility for the preparation and fair presentation of the client’s financial statements in accordance with the applicable financial reporting framework
- ☐ Accepting responsibility for designing, implementing, or maintaining internal control
- ☐ Performing ongoing evaluations of the client’s internal control as part of its monitoring activities
- ☐ Other:

3. If the proposed nonattest service is not specifically addressed in the code, was the “[Conceptual Framework for Independence](#)” (ET sec. 1.210.010) applied to evaluate whether the service would impair independence?

- ☐ Yes, I evaluated the service using the “Conceptual Framework for Independence” and my working paper reference is

- 
- ☐ This question is not applicable because the nonattest service is addressed in the code.

4. Will any of the nonattest service(s) impair independence under any of the interpretations discussed in questions 1 through 3?

- ☐ Yes, independence will be impaired.
- ☐ No, independence will not be impaired.

# Nonattest services checklist (continued)

5. If you answered “Yes” to question 4, will any of the nonattest service(s) that impair independence meet the exceptions provided for in either paragraph .02b or .06–.10 of the “Client Affiliates” interpretation (ET sec. 1.224.010) or in paragraph .03 of the “Scope and Applicability of Nonattest Services” interpretation (ET sec. 1.295.010)?
- ☐ Yes, the service will meet the exception under paragraph .02b of the “Client Affiliate” interpretation.
  - ☐ Yes, the service will meet the exceptions under paragraph .06–.10 of the “Client Affiliate” interpretation.
  - ☐ Yes, the service will meet the exception under paragraph .03 of the “Scope and Applicability of Nonattest Services” interpretation.
  - ☐ No, the service will not meet any of these exceptions.

If you answered “Yes,” proceed to question 6. If you answered “No,” independence is impaired and you can stop here.

6. Regarding the nonattest service(s) identified in question 1, has the attest client agreed to do the following before performing the nonattest service?

Agreement	Established before performing the nonattest service	If applicable, working paper reference
Assume all management responsibilities?	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____
Oversee the service by designating an individual who possesses suitable skill, knowledge, and/or experience (SKE)?	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____
Evaluate the adequacy and results of the services performed?	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____
Accept responsibility for the results of the services?	<input type="checkbox"/> Yes <input type="checkbox"/> No	_____

If you answered “No,” independence is impaired and you can stop here.

7. For each nonattest service type identified in question 1, identify the following (attach additional sheets, if necessary):

Specific nonattest service	Individual in firm responsible	Individual at client overseeing
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

# Nonattest services checklist (continued)

Describe SKE of client personnel identified

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8. Were the following established and documented before performing each of the nonattest service(s)?

Understanding	Established and documented prior		Working paper reference
Objectives of the engagement?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<hr/>
Services to be performed?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<hr/>
Client's acceptance of their responsibilities?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<hr/>
Firm responsibilities?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<hr/>
Any limitations of the engagement?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<hr/>

If you answered "No," because you did not establish the understanding before performing the nonattest service, you can stop here because independence is impaired. If you answered "No," because you failed to document the established understanding, you should do so now or risk being in violation of the "[Compliance With Standards Rule](#)" (ET sec. 1.310.001).

9. Were there any changes in the nonattest engagement that resulted in you reconsidering whether independence was affected?

- ☐ Yes, there was a change, but it did not affect independence.
- ☐ Yes, there was a change that affected independence, and I updated the checklist to reflect this change.
- ☐ No, there were no changes in the nonattest engagement.

The "[Cumulative Effect on Independence When Providing Multiple Nonattest Services](#)" interpretation (ET sec. 1.295.020) requires that before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services by the member or member's firm in the aggregate creates a significant threat to the member's independence that cannot be reduced to an acceptable level by the application of the safeguards in the "[General Requirements for Performing Nonattest Services](#)" interpretation (ET sec. 1.295.040). Accordingly, if multiple nonattest services were provided, answer questions 10–12.

## Nonattest services checklist (continued)

10. When the performance of additional nonattest services in the aggregate creates significant threats, describe the considerations evaluated that resulted in this conclusion as well as the safeguards applied to reduce the threats to an acceptable level.

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11. Did your evaluation in question 10 result in your concluding that the safeguards provided by the "[General Requirements for Performing Nonattest Services](#)" interpretation (ET sec. 1.295.040) did not reduce threats to an acceptable level? ☐ Yes ☐ No

12. If you concluded that additional safeguards were necessary (answered "Yes" to question 11), describe the additional safeguards applied to eliminate threats or reduce threats to an acceptable level.

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- a. The *attest client* or its management or directors have filed cross-claims to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations), and there is a significant risk that the cross-claim will result in a settlement or judgment in an amount that is material to the *covered member's firm* or the *attest client*.
- b. The *attest client's* underwriter and the *attest client* or its present management assert cross-claims against the *covered member*.

**.11** If only the underwriter or officers or directors of the *covered member's* other *attest clients* file cross-claims against the *covered member*, *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* unless other circumstances create *threats* to compliance with the “Independence Rule.”

### ***Other Third-Party Litigation***

**.12** A *lending institution* or other creditor, security holder, or insurance company that alleges reliance on the *attest client's financial statements* as a basis for having extended credit or insurance coverage to an *attest client* may commence third-party litigation against the *covered member* to recover their loss. An example is an insurance company commencing litigation either as a result of receiving an assignment of a claim or under subrogation rights against the *covered member* in the *attest client's* name to recover losses that the insurer reimbursed to the *attest client*. If the *attest client* is only the nominal plaintiff, *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* unless other circumstances exist, such as when the *covered member* alleges, as a defense, that present management engaged in fraud or deceit. The *attest client* is a nominal plaintiff when the insurance company or lender sues in the name of the *attest client* as a result of obtaining subrogation rights or an assignment from the *attest client* and the *attest client* does not have a beneficial interest in the claim.

**.13** If the real party in interest in the litigation (for example, the insurance company) is also the *covered member's attest client* (the plaintiff client), *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist if the litigation carries a significant risk of a settlement or judgment in an amount that would be material to the *covered member's firm* or the plaintiff client.

### ***Termination of Impairment***

**.14** *Threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] would be eliminated or reduced to an *acceptable level* when the parties reach a final resolution of the matter(s) at issue and the matter(s) no longer affects the relationship between the *covered member* and the *attest client*, as described in paragraph .01 of this interpretation. The *covered member* should determine whether the conditions of such resolution have effectively eliminated such *threats* or reduced them to an *acceptable level*. [Prior reference: paragraph .08 of ET section 101]

[See Revision History Table.]

## 1.295 Nonattest Services

### 1.295.010 Scope and Applicability of Nonattest Services

**.01** When a *member* performs nonattest services for an *attest client*, self-review, management participation, or advocacy *threats* to the *member's* compliance with the “Independence Rule” [1.200.001] may exist. When significant *independence threats* exist during the *period of the professional engagement* or the period covered by the *financial statements* (except as provided for in paragraph .03), *independence* will be *impaired* unless the *threats* are reduced to an *acceptable level* and any requirements included in the *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” have been met.

**.02** For purposes of the *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” [1.200.001], the term *member* includes the *member's firm*.

**.03** *Period of engagement*. A *member's independence* would not be *impaired* if the *member* performed nonattest services that would have otherwise *impaired independence* during the period covered by the *financial statements* if all of the following conditions exist:

- a. The nonattest services were provided prior to *period of the professional engagement*.
- b. The nonattest services related to periods prior to the period covered by the *financial statements*.
- c. The *financial statements* for the period to which the nonattest services relate were audited by another *firm* (or in the case of a review engagement, reviewed or audited by another *firm*).

**.04** *Activities related to attest services*. Performing attest services often involves communications between the *member* and *client* management regarding

- a. the *client's* selection and application of accounting standards or policies and *financial statement* disclosure requirements;
- b. the appropriateness of the *client's* methods used in determining accounting and financial reporting;
- c. adjusting journal entries that the *member* has prepared or proposed for *client* management consideration; and
- d. the form or content of the *financial statements*.

These communications are considered a normal part of the *attest engagement* and are not considered nonattest services subject to the “General Requirements for Performing Nonattest Services” [1.295.040] and “Documentation Requirements When Providing Nonattest Services” [1.295.050] interpretations.

**.05** However, the *member* should exercise judgment in determining whether his or her involvement has become so extensive that it would constitute performing a separate service

which would be subject to the “General Requirements for Performing Nonattest Services” interpretation [1.295.040].

**.06** For example, activities such as *financial statement* preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the *attest engagement* and, therefore, constitute a nonattest service. Such activities would not *impair independence* if the requirements of the *interpretations* of the “Nonattest Services” subtopic [1.295] are met.

**.07** *Engagements subject to independence rules of certain regulatory or standard-setting bodies.* Threats to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a member is not in compliance with the *independence* regulations of authoritative regulatory bodies that are more restrictive than the *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” (examples of such authoritative bodies are the SEC, the Government Accountability Office [GAO], the Department of Labor [DOL], the Public Company Accounting Oversight Board [PCAOB], and state boards of accountancy) when a member performs nonattest services for an *attest client* and is required to be independent of the *attest client* under the regulations of the applicable regulatory body. *Independence* would be *impaired* under these circumstances. [Prior reference: paragraph .05 of ET section 101]

**.08** Refer to the “Staff Augmentation Arrangements” interpretation [1.275.007] when the engagement involves lending *firm* personnel (augmented staff) to an *attest client* whereby the *attest client* is responsible for the direction and supervision of the activities performed by the augmented staff.

### ***Effective Date***

**.09** Paragraph .06 of this interpretation is effective for engagements covering periods beginning on or after December 15, 2014.

[See Revision History Table.]



A nonauthoritative question and answer regarding the period of the professional engagement is available. See Ethics Questions & Answers section 200.02, “Period of Impairment.”

## **1.295.020 Cumulative Effect on Independence When Providing Multiple Nonattest Services**

**.01** The *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” [1.200.001] include various examples of nonattest services that individually would not *impair independence* because the *safeguards* in the “General Requirements for Performing



Nonattest Services” interpretation [1.295.040] reduce the self-review and management participation *threats* to an *acceptable level*. However, performing multiple nonattest services can increase the significance of these *threats* as well as other *threats* to *independence*.

**.02** Before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services by the *member* or *member’s firm* in the aggregate creates a significant *threat* to the member’s *independence* that cannot be reduced to an *acceptable level* by the application of the *safeguards* in the “General Requirements for Performing Nonattest Services” interpretation [1.295.040].

**.03** In situations in which a member determines that *threats* are not at an *acceptable level*, *safeguards* in addition to those in the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] should be applied to eliminate the *threats* or reduce them to an *acceptable level*. If no *safeguards* exist that will eliminate or reduce the *threats* to an *acceptable level*, *independence* would be *impaired*.

**.04** For purposes of this interpretation, the member is not required to consider the possible *threats* to *independence* created due to the provision of nonattest services by other *network firms* within the *firm’s network*. [Prior reference: paragraph .05 of ET section 101]

### ***Effective Date***

**.05** This interpretation is effective for engagements covering periods beginning on or after December 15, 2014.

## **1.295.030 Management Responsibilities**

**.01** If a member were to assume a management responsibility for an *attest client*, the management participation *threat* would be so significant that no *safeguards* could reduce the *threat* to an *acceptable level* and *independence* would be *impaired*. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

**.02** Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered management responsibilities and, as such, *impair independence* if performed for an *attest client*, include

- a. setting policy or strategic direction for the *attest client*.
- b. directing or accepting responsibility for actions of the *attest client’s* employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- c. authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of an *attest client* or having the authority to do so.



- d. preparing *source documents*, in electronic or other form, that evidence the occurrence of a transaction.
- e. having custody of an *attest client's* assets.
- f. deciding which recommendations of the member or other third parties to implement or prioritize.
- g. reporting to *those charged with governance* on behalf of management.
- h. serving as an *attest client's* stock transfer or escrow agent, registrar, general counsel or equivalent.
- i. accepting responsibility for the management of an *attest client's* project.
- j. accepting responsibility for the preparation and fair presentation of the *attest client's financial statements* in accordance with the applicable financial reporting framework.
- k. accepting responsibility for designing, implementing, or maintaining internal control.
- l. performing ongoing evaluations of the *attest client's* internal control as part of its monitoring activities.

[Prior reference: paragraph .05 of ET section 101]



A nonauthoritative question and answer regarding management responsibilities and controllership services is available. See Ethics Questions & Answers section 200.03, "Controllership Services."

### 1.295.040 General Requirements for Performing Nonattest Services

**.01** When a member performs a nonattest service for an *attest client*, *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist. Unless an *interpretation* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" states otherwise, *threats* would be at an *acceptable level*, and *independence* would not be *impaired*, when all the following *safeguards* are met:

- a. The member determines that the *attest client* and its management agree to
  - i. assume all management responsibilities as described in the "Management Responsibilities" interpretation [1.295.030].
  - ii. oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the

services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

- iii. evaluate the adequacy and results of the services performed.
  - iv. accept responsibility for the results of the services.
- b. The member does not assume management responsibilities (See the “Management Responsibilities” interpretation [1.295.030] of the “Independence Rule”) when providing nonattest services and the member is satisfied that the *attest client* and its management will
- i. be able to meet all of the criteria delineated in item *a*;
  - ii. make an informed judgment on the results of the member’s nonattest services; and
  - iii. accept responsibility for making the significant judgments and decisions that are the proper responsibility of management.

If the *attest client* is unable or unwilling to assume these responsibilities (for example, the *attest client* cannot oversee the nonattest services provided or is unwilling to carry out such responsibilities due to lack of time or desire), the member’s performance of nonattest services would *impair independence*.

- c. Before performing nonattest services the member establishes and documents in writing his or her understanding with the *attest client* (board of directors, audit committee, or management, as appropriate in the circumstances) regarding
- i. objectives of the engagement,
  - ii. services to be performed,
  - iii. *attest client’s* acceptance of its responsibilities,
  - iv. member’s responsibilities, and
  - v. any limitations of the engagement.

**.02** The *safeguards* in paragraph .01 and the “Documentation Requirements When Providing Nonattest Services” interpretation [1.295.050] of the “Independence Rule” [1.200.001] do not apply to certain routine activities performed by the member, such as providing advice and responding to the *attest client’s* questions as part of the *attest client*-member relationship. However, in providing such services, the member must not assume management responsibilities, as described in the “Management Responsibilities” interpretation [1.295.030] of the “Independence Rule.” [Prior reference: paragraph .05 of ET section 101]

[See Revision History Table.]



A nonauthoritative question and answer regarding routine activities is available. See Ethics Questions & Answers (Q&A) section 200.01, “Routine Activities.”

Nonauthoritative questions and answers regarding suitable skill, knowledge, and experience are available. See Q&A sections 210.02–.10 of Q&A section 210, *Nonattest Services — General Requirements*.

### 1.295.050 Documentation Requirements When Providing Nonattest Services

**.01** Before performing nonattest services, the member should document in writing the member’s understanding established with the *attest client*, as described in paragraph .01c of the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001].

**.02** Failure to prepare the required documentation does not *impair independence* provided that the member did establish the understanding with the *attest client*. However, failure to prepare the required documentation would be considered a violation of the “Compliance With Standards Rule” [1.310.001].

**.03** The documentation requirement does not apply to nonattest services performed prior to the *period of the professional engagement* for an *attest client*. However, for nonattest services provided during the period covered by the *financial statements*, the member should document in writing that the requirements of the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] were met prior to the *period of the professional engagement*, including the requirement to establish an understanding with the *attest client*. [Prior reference: paragraph .05 of ET section 101]



Sample language for how to document your understanding with the attest client is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

### 1.295.105 Advisory Services

**.01** Self-review or management participation *threats* to compliance with the “Independence Rule” [1.200.001] may exist when a member performs advisory services for an *attest client*.

**.02** If the member’s services are only advisory in nature and the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. provide advice, research materials, and recommendations to assist management in performing its functions and making decisions.
- b. attend board meetings as a nonvoting advisor.
- c. interpret *financial statements*, forecasts, or other analyses.
- d. provide management with advice regarding its potential plans, strategies, or relationships.

**.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a member assumes any management responsibilities, as described in the “Management Responsibilities” interpretation [1.295.030]. Accordingly, *independence* is *impaired*. [Prior reference: paragraph .05 of ET section 101 and paragraphs .015–.016 of ET section 191]

### 1.295.110 *Appraisal, Valuation, and Actuarial Services*

**.01** Self-review or management participation *threats* to compliance with the “Independence Rule” [1.200.001] may exist when a member performs appraisal, valuation, or actuarial service for an *attest client*.

**.02** *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the member performs an appraisal, a valuation, or an actuarial service for an *attest client* when (a) the services involve a significant degree of subjectivity and (b) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the *attest client’s financial statements*. Accordingly, *independence* would be *impaired* under these circumstances..

**.03** When performing appraisal, valuation, and actuarial services for an *attest client* that are permitted under this interpretation, all requirements of the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001] should be met, including that all significant assumptions and matters of judgment are determined or approved by the *attest client*, and the *attest client* is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

#### ***Valuations Involving a Significant Degree of Subjectivity***

**.04** Examples of valuations that generally involve a significant degree of subjectivity include, ESOPs, business combinations, or appraisals of assets or liabilities. Accordingly, if these services produce results that are material to the *attest client’s financial statements*, *independence* would be *impaired*.

#### ***Actuarial Valuations of Pension or Postemployment Benefit Liabilities***

**.05** An actuarial valuation of an *attest client’s* pension or postemployment benefit liabilities generally does not involve a significant degree of subjectivity because reasonably consistent

results are produced when the same assumptions and information are used in performing the valuation. Therefore, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

### ***Appraisal, Valuations, and Actuarial Services for Nonfinancial Statement Purposes***

**.06** *Threats* would be at an *acceptable level* if a member provided appraisal, valuation, or actuarial services solely for nonfinancial statement purposes. Some examples are appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. Accordingly, *independence* would not be *impaired*. [Prior reference: paragraph .05 of ET section 101]



A nonauthoritative question and answer regarding appraisal, valuation, and actuarial services is available. See Ethics Questions & Answers section 220.01, “Appraisal, Valuation, and Actuarial Service.”

## **1.295.113 Assisting Attest Clients With Implementing Accounting Standards**

**.01** When a member assists an *attest client* with planning and executing the implementation of an accounting standard, self-review or management participation *threats* to compliance with the “Independence Rule” [1.200.001] may exist.

**.02** If a member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if, for example, a member does the following:

- a. Develops and provides training to *attest client* personnel on the effects of the accounting standard
- b. Researches, provides advice, makes recommendations, and assists management in identifying *financial statement* account balances, contracts, and transactions to be assessed under the accounting standard
- c. Provides advice and recommendations related to the application of the accounting standard, including
  - i. analyzing and advising management on the potential impact of the accounting standard on the entity’s accounting policies, procedures, and internal controls
  - ii. recommending possible revisions to existing policies, procedures, and internal controls

- iii. assisting the *attest client* with summarizing the *attest client's* analysis and policies related to the accounting positions under the accounting standard
- iv. preparing transition-related calculations to illustrate the impact of the application of the accounting standard for management's consideration and selection
- d. Provides observations and recommendations on management's existing overall project plan timeline or assists management in developing an overall project plan timeline to adopt the accounting standard
- e. Assists management in drafting implementation strategies or methods used to implement the accounting standard
- f. Assists the *attest client* in developing implementation templates or provides the *attest client* with firm-developed templates or tools, including those related to specific calculations under the accounting standard that meet the exception in paragraph .03a of the "Information Systems Services" interpretation [1.295.145] under the "Independence Rule," provided the attest client's management understands the nature of any underlying calculations and the impact the results will have on the financial statements
- g. Proposes standard journal entries or adjustments to existing journal entries necessary for adoption of the accounting standard, subject to *attest client* approval in accordance with paragraph .02e of the "Bookkeeping, Payroll, and Other Disbursements" interpretation [1.295.120]
- h. Provides recommendations related to existing or new information systems as a result of the accounting standard

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if, for example, a member does any of the following:

- a. Leads or supervises any *attest client* implementation team
- b. Makes decisions on which recommendations to prioritize or how to implement the accounting standard
- c. Sets any policy or procedures related to the accounting standard
- d. Accepts responsibility for designing new or redesigning existing internal controls over financial reporting
- e. Designs or develops new or redesigns existing financial information systems as described in the "Information System Services" interpretation [1.295.145] under the "Independence Rule"



## Effective Date

**.04** This interpretation is effective December 31, 2022. Early implementation is allowed.

[See Revision History Table.]



Nonauthoritative questions and answers regarding suitable skill, knowledge, and experience are available. See Ethics Questions & Answers (Q&A) sections 210.02–.10 of Q&A section 210, *Nonattest Services – General Requirements*.

A nonauthoritative practice aid related to the “Information Systems Services” interpretation [1.295.145] is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/isspracticeaid.pdf>.

## 1.295.115 Benefit Plan Administration

**.01** When a member provides benefit plan administration services to an *attest client*, self-review and management participation *threats* to the member’s compliance with the “Independence Rule” [1.200.001] may exist.

**.02** Notwithstanding the conclusions reached in paragraph .03 of this interpretation, a member should comply with the more restrictive *independence* provisions of the Employee Retirement Income Security Act (ERISA) of 1974 and DOL regulations when performing audits of employee benefit plans subject to those regulations.

**.03** If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, the member may

- a. communicate summary plan data to a plan trustee.
- b. advise management regarding the application and impact of provisions in a plan document.
- c. process certain transactions that have been initiated by plan participations or approved by the plan administrators using the member’s electronic media, such as an interactive voice response system or Internet connection or other media. Such transactions may include processing investment or benefit elections, changes in contributions to the plan, data entry, participant confirmations, and distributions and *loans*.
- d. prepare account valuations for plan participants using data collected through the member’s electronic or other media.

- e. prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other media.

**.04** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if, for example, a member

- a. makes policy decisions on behalf of management.
- b. interprets the provisions in a plan document for a plan participant on behalf of management without first obtaining management's concurrence.
- c. makes disbursements on behalf of the plan.
- d. has custody of the plan's assets.
- e. serves in a fiduciary capacity, as defined by ERISA. [Prior reference: paragraph .05 of ET section 101]

### 1.295.120 Bookkeeping, Payroll, and Other Disbursements

**.01** When a member provides bookkeeping, payroll, and other disbursement services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist.

**.02** If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. record transactions to an *attest client's* general ledger when management has determined or approved the account classifications for the transaction.
- b. post transactions coded by the *attest client* to the *attest client's* general ledger.
- c. prepare *financial statements* based on information in the *attest client's* trial balance.
- d. post *client*-approved journal or other entries to an *attest client's* trial balance.
- e. propose standard, adjusting, or correcting journal entries or other changes affecting the *financial statements* to the *attest client*. Prior to the member posting these journal entries or changes, the member should be satisfied that management has reviewed the entries and understands the nature of the proposed entries and the effect the entries will have on the *attest client's financial statements*.
- f. generate unsigned checks using *source documents* or other records provided and approved by the *attest client*.
- g. process an *attest client's* payroll using payroll time records that the *attest client* has provided and approved.
- h. transmit *client*-approved payroll or other disbursement information to a bank or similar entity subsequent to the *attest client's* review and authorization for the



member to make the transmission. Prior to such transmission, the *attest client* is responsible for making the arrangements with the bank or similar entity to limit the corresponding individual payments regarding the amount and payee. In addition, once transmitted, the *attest client* must authorize the bank or similar entity to process the payroll information.

- i. prepare a reconciliation (for example, bank and accounts receivable) that identifies reconciling items for the *client's* evaluation.

**.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. determines or changes journal entries, any account coding or classification of transactions, or any other accounting records without first obtaining the *attest client's* approval.
- b. authorizes or approves transactions.
- c. prepares *source documents*.
- d. makes changes to *source documents* without the *attest client's* approval.
- e. accepts responsibility to authorize payment of *attest client* funds, electronically or otherwise, except for electronic payroll tax payments when the member complies with the requirements of the “Tax Services” interpretation [1.295.160] of the “Independence Rule.”
- f. accepts responsibility to sign or cosign an *attest client's* checks, even if only in emergency situations.
- g. maintains an *attest client's* bank account or otherwise has custody of an *attest client's* funds or makes credit or banking decisions for the *attest client*.
- h. approves vendor invoices for payment. [Prior reference: paragraph .05 of ET section 101]

[See Revision History Table.]



Nonauthoritative questions and answers about bookkeeping services are available. See Ethics Questions & Answers section 230, *Nonattest Services — Bookkeeping, Payroll, and Other Disbursements*.

### 1.295.125 Business Risk Consulting

**.01** When a member provides business risk consulting services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist.

**.02** If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. assist management in its assessment of the *attest client's* business risk control processes.
- b. recommend improvements to an *attest client's* business risk control processes and assists in the implementation of these improvements.

**.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes or approves business risk decisions.
- b. presents business risk considerations to the board or others on behalf of management. [Prior reference: paragraph .05 of ET section 101]

### 1.295.130 Corporate Finance Consulting

**.01** When a member provides corporate finance consulting services to an *attest client*, self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist.

**.02** If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. assist management in developing its corporate strategies.
- b. assist management in identifying possible sources of capital that meet the *attest client's* specifications or criteria.
- c. introduce management to possible sources of capital that meet the *attest client's* specifications or criteria.
- d. assist management in analyzing the effects of proposed transactions with potential buyers, sellers, or capital sources.
- e. advise an *attest client* during its negotiations with potential buyers, sellers, or capital sources.
- f. assist the *attest client* in drafting its offering document or memorandum.

- g. participate with management in its transaction negotiations in an advisory capacity.
- h. be named as a financial adviser in an *attest client's* private placement memoranda or offering documents.

**.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest client* to the terms of a transaction.
- b. consummates a transaction on behalf of the *attest client*.
- c. acts as a promoter, an underwriter, a broker-dealer, or a guarantor of an *attest client's* securities or as a distributor of private placement memoranda or offering documents.
- d. maintains custody of an *attest client's* securities. [Prior reference: paragraph .05 of ET section 101]

### 1.295.135 Executive or Employee Recruiting

**.01** When a member provides executive or employee recruiting services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist.

**.02** If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. recommend a position description or candidate specifications.
- b. solicit and screen candidates based on criteria approved by the *attest client*, such as required education, skills, or experience.
- c. recommend qualified candidates to the *attest client* for their consideration based on criteria approved by the *attest client*.
- d. participate in employee hiring or compensation discussions in an advisory capacity.

**.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest client* to employee compensation or benefit arrangements.
- b. hires or terminates the *attest client's* employees. [Prior reference: paragraph .05 of ET section 101]

[See Revision History Table.]

## 1.295.140 Forensic Accounting

**.01 Forensic accounting services.** For purposes of this interpretation, forensic accounting services are nonattest services that involve the application of (a) special skills in accounting, auditing, finance, quantitative methods or certain areas of the law, and research and (b) investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings. Forensic accounting services consist of investigative services and litigation services.

**.02 Attest client.** For purposes of this interpretation, the term *attest client* refers to the *attest client* with respect to which the member is providing litigation services, not the law firm that engages the member on behalf of the law firm's client. If the law firm that engages the member on behalf of the member's *attest client* is also an *attest client* of the member, the member should consider the applicability of the "Cooperative Arrangements With Attest Clients" interpretation [1.265.010] of the "Independence Rule" [1.200.001].

**.03 Investigative services.** For purposes of this interpretation, investigative services include all forensic services that do not involve actual or threatened litigation, such as performing analyses or investigations that may require the same skills used in litigation services. When a member provides investigative services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. However, if the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* will be at an *acceptable level* and *independence* will not be *impaired*.

**.04 Litigation services.** For purposes of this interpretation, litigation services recognize the role of the member as an expert or a consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of expert witness services, litigation consulting services, or other litigation services:

- a. *Expert witness services.* For purposes of this interpretation, expert witness services are those litigation services in which a member is engaged to render an opinion before a trier of fact about the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events:
  - i. Expert witness services create the appearance that a member is advocating or promoting an *attest client's* position. Therefore, the advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, if a member is engaged conditionally or unconditionally to provide expert witness services or expert testimony for an *attest client*, *independence* would be *impaired*, except as discussed in the following item ii.
  - ii. *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and *independence* would not be *impaired*, if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more *attest clients* of the *firm*, provided that at the outset of the engagement

1. the member's *attest clients* constitute less than 20 percent of the members of the group, voting interests of the group, and the claim;
  2. no *attest client* within the group is designated as the lead plaintiff or defendant of the group; and
  3. no *attest client* has the sole decision-making power to select or approve the selection of the expert witness.
- iii. *Fact witness testimony.* Acting as a fact witness (also referred to as a “percipient witness” or “sensory witness”) would not be considered a nonattest service. Fact witness testimony is based on the member’s direct knowledge of the matters, facts, or events in dispute obtained through the member’s performance of prior *professional services* for the *attest client*. As a fact witness, the member’s role is to provide factual testimony to the trier of fact. While testifying as a fact witness, the trier of fact or counsel may question a member about the member’s opinions pertaining to matters within the member’s area of expertise. Answering such questions would not *impair* the member’s *independence*.
- iv. In determining whether the member’s services are considered expert witness services or fact witness testimony, members should refer to Rules 701–703 of Article VII, “Opinions and Expert Testimony,” of the *Federal Rules of Evidence* and also refer to other applicable laws, regulations, and rules.
- v. When providing expert witness services or fact witness testimony, members are required to comply with the “Integrity and Objectivity Rule” [1.100.001].
- b. *Litigation consulting services.* For purposes of this interpretation, litigation consulting services are those litigation services in which a member provides advice about the facts, issues, or strategy pertaining to a matter. The consultant does not testify as an expert witness before a trier of fact:
- i. When a member provides litigation consulting services, advocacy and management participation *threats* to the *covered member’s* compliance with the “Independence Rule” may exist. If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For purposes of complying with paragraph .01b of the “General Requirements for Performing Nonattest Services” interpretation of the “Independence Rule,” the *attest client* may designate its attorney to oversee the litigation consulting services.
  - ii. However, if the member providing litigation consulting services subsequently agrees to serve as an expert witness, *threats* to the member’s compliance with the “Independence Rule” would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.
- c. *Other litigation services.* The advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a

member serves as a trier of fact, a special master, a court-appointed expert, or an arbitrator (including serving on an arbitration panel) in a matter involving an *attest client*. These services create the appearance that the member is not independent; accordingly, *independence* would be *impaired*.

- d. However, if the member applies the “General Requirements for Performing Nonattest Services” interpretation of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member serves as a mediator or any similar role in a matter involving an *attest client*, provided that the member is not making any decisions on behalf of the parties but, rather, is acting as a facilitator by assisting the parties in reaching their own agreement. When providing such services, the member should consider the requirements of the “Conflicts of Interest” interpretation [1.110.010] of the “Integrity and Objectivity Rule.” [Prior reference: paragraph .05 of ET section 101]

**.05** See <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf> for information about transition provision for engagements commenced prior to February 28, 2007.

**.06** When providing any type of forensic accounting service, members are required to comply with the “Integrity and Objectivity Rule” [1.100.001].

[See Revision History Table.]

### 1.295.143 *Hosting Services*

**.01** For purpose of this interpretation, hosting services are nonattest services that involve a member accepting responsibility for the following:

- a. Acting as the sole host of a financial or non-financial information system of an *attest client*
- b. Taking custody of or storing an *attest client's* data or records whereby, that data or records are available only to the *attest client* from the member, such that the *attest client's* data or records are otherwise incomplete
- c. Providing electronic security or back-up services for an *attest client's* data or records

**.02** When a member provides hosting services, the member is maintaining the *attest client's* internal control over its data or records. Accordingly, the management participation *threat* to the member's compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*.

**.03** Examples of activities that are considered hosting services, and as such will *impair independence* if performed for an *attest client*, include accepting responsibility for the following:



- a. Housing the *attest client's* website or other non-financial information system
- b. Keeping the *attest client's* data or records on the *attest client's* behalf, for example, the *attest client's* general ledger information, supporting schedules (such as, depreciation or amortization schedules), lease agreements or other legal documents are stored on the member's *firm's* servers or servers licensed by the member's *firm* or the member is responsible for storing hard copy versions of the data or records
- c. Being the *attest client's* business continuity or disaster recovery provider

**.04** Examples of activities that are not considered to be hosting services, and as such will not *impair independence* provided members comply with the requirements of the other *interpretations* of the "Nonattest Services" subtopic include these:

- a. Retaining a copy of an *attest client's* data or records as documentation to support a service the member provided to the *attest client*. Some examples are as follows:
  - i. The payroll data that support a payroll tax return prepared by the member for the *attest client*
  - ii. A bank reconciliation that supports attest procedures performed by the member on the *attest client's* cash account
  - iii. The *attest client's* vendor data used to prepare an analysis of vendor activity
- b. Retaining, for a member's records, a copy of a work product prepared by the member (for example, a tax return).
- c. Using general ledger software to facilitate the delivery of bookkeeping services when either of the following occurs:
  - i. The member and the *attest client* maintain separate instances of the software on their respective servers, and the member provides updated financial information electronically to the *attest client*.
  - ii. The *attest client* enters into an agreement with a *third-party service provider* to maintain its software in a cloud-based solution and grants the member access to the software so that the member can perform the bookkeeping service for the *attest client*.
- d. Retaining data collected by the member related to a work product that the member prepared for an *attest client*. For example, the member conducts an employee survey and provides the *attest client* with a report. The member retains the survey data collected to support the work product.
- e. Electronically exchanging data, records, or the member's work product with an *attest client* or on behalf of an *attest client* at the *attest client's* request. For example, the member uses a portal as follows:
  - i. To exchange data and records with the *attest client* related to *professional services* provided by the member to the *attest client*

- ii. To deliver the member's work product to third parties at the *attest client's* request

To avoid providing hosting services, members should terminate the *attest client's* access to the data or records in the portal within a reasonable period of time after the conclusion of the engagement.

- f. Licensing software to an *attest client* that the *attest client* uses to input its data and receive an output that the *attest client* is responsible for maintaining, provided the software does not perform an activity that, if performed directly by the member, would *impair independence*.
- g. Having possession of a depreciation schedule prepared by the member, provided the depreciation schedule and calculation are given to the *attest client* so that *attest client's* books and records are complete.
- h. Retaining an *attest client's* original data or records to facilitate the performance of a nonattest service (for example, obtaining original records to prepare the attest client's tax return), provided that the data or records are returned to the *attest client* at the end of the engagement or, in a multi-year engagement, at least annually. This does not apply to ongoing hosting services as described in paragraph .01 of this interpretation.

### ***Effective Date***

**.05** This interpretation is effective July 1, 2019.

[See Revision History Table.]



Nonauthoritative questions and answers regarding hosting services are available. See Ethics Questions & Answers section 240, *Nonattest Services — Hosting Services*.

## **1.295.145 Information Systems Services**

### ***Introduction***

**.01** Self-review and management participation *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist when a member provides nonattest services related to an *attest client's* information systems.

**.02** This interpretation applies to all attest engagements, including those in which the subject matter of the engagement is not financial statements. In these cases, the member should define a financial information system as any information system that is subject to the member's attest procedures considering the relevant factors in paragraph .03a.



## Terminology

**.03** The following terms are defined solely for the purpose of applying this interpretation:

- a. A financial information system (FIS) is a system that aggregates source data underlying the *financial statements* or generates information that is significant to either the financial statements or financial processes as a whole. An FIS includes a tool that calculates results unless
  - i. the tool performs only discrete calculations;
  - ii. the *attest client* evaluates and accepts responsibility for the input and assumptions; and
  - iii. the *attest client* has sufficient information to understand the calculation and the results.
- b. Designing an information system means determining how a system or transaction will function, process data, and produce results (for example, reports, journal vouchers, and documents such as sales and purchase orders) to provide a blueprint or schematic for the development of software code (programs) and data structures.
- c. Developing an information system entails creating software code, for individual or multiple modules, and testing such code to confirm it is functioning as designed.
- d. Commercial off-the-shelf (COTS) refers to software developed, distributed, maintained, and supported by an entity or entities that are not the *member* or *member's firm* (a third-party vendor), sometimes referred to as an “off-the-shelf” package or solution. COTS solutions have generally referred to traditional on-premise software that runs on a customer’s own computers or on a third-party vendor’s “cloud” infrastructure. COTS solutions range from software packages that require only installation on a computer and are ready to run to large-scale, complex enterprise applications.

## Design, Development, or Implementation Services Not Related to an FIS

**.04** When performing design, development, or implementation services described in this interpretation for an *attest client* that are not related to an FIS, *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* provided all requirements of the “Nonattest Services” subtopic [1.295] of the “Independence Rule” are met, including that the *attest client* has not outsourced a function, process, or activity to the member, which would result in the member assuming a management responsibility.

## Design or Develop an FIS

**.05** When a member designs or develops an *attest client's* FIS, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards* and *independence* would be *impaired*.

**.06** To determine whether a nonattest service is related to an FIS, members should consider all relevant factors, such as whether the nonattest service will affect the following:

- a. System controls or system output that will be subject to attest procedures.
- b. A system that generates data that are used as input to the financial statements, including data or information that is either reflected in or used in determining amounts and disclosures included in the financial statements.
- c. A data-gathering system, such as an analytical or reporting tool, that is used in management's decision-making about matters that could significantly affect financial reporting.
- d. A system that is part of the *attest client's* internal controls over financial reporting, including information systems used to effect internal controls over financial reporting (for example, a system used to ensure that information produced for the financial statements is accurate). However, information systems used only in connection with controlling the efficiency and effectiveness of operations are considered unrelated to the financial statements and accounting records.

### ***Implement a COTS FIS Software Solution***

**.07** Implementation services involve activities related to an *attest client's* information systems after the design and development of the system. Implementation ceases when the system is available on a regular basis to the *attest client* for its intended use. For example, implementation services can include activities such as installing, configuring, interfacing, customizing, and data translation. Services that are performed post-implementation, such as the maintenance, support, and monitoring of the system, are not implementation services.

**.08** *Threats* created by certain COTS implementation services related to the *attest client's* FIS may be reduced to an *acceptable level* by the application of *safeguards*; however, in other situations, *threats* to compliance with the "Independence Rule" [1.200.001] would be significant and could not be reduced to an *acceptable level* by the application of *safeguards*. These situations are addressed in paragraphs .09–.20 of this interpretation.

### ***Install a COTS FIS Software Solution***

**.09** To install a COTS FIS software solution means the initial loading of software on the *client's* designated hosting site. Software configuration, interfacing, customizing and data translation activities may follow installation.

**.10** When a member installs a COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*, provided all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" are met.

### ***Configure a COTS FIS Software Solution***

**.11** To configure a COTS FIS software solution means inputting the *client-selected* features, functionality options, and settings within the third-party vendor's software,

which determines how the software will perform certain transactions and process data. Configuration options may also include selecting the predefined format of certain data attributes and the inclusion or exclusion of such attributes. However, if the member were to design or develop new software code or features to modify or alter the functionality of the COTS software solution in ways not predefined by the third-party vendor, this would be considered designing or developing activities, as described in items (b)–(c) of paragraph .03.

**.12** When a member configures a COTS FIS software solution based on *client*-selected features, functionality options, and settings within the third-party vendor's software, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* provided all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" are met.

### ***Customize a COTS FIS Software Solution***

**.13** To customize a COTS FIS software solution means to modify or enhance the features and functions in ways that go beyond the options provided by the third-party vendor when configuring the COTS software solution.

- a. Modification involves altering the COTS software solution code to change or add to the functionality provided by the third-party vendor.
- b. Enhancements involve developing new code, external to the COTS software solution, that works in concert with the COTS software solution to provide altered or additional functionality.

**.14** If a member customizes an *attest client's* COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards*; *independence* would be *impaired*.

### ***Interface a COTS FIS Software Solution***

**.15** Providing interface services for a COTS FIS software solution means connecting two or more systems by designing and developing software code that passes data from one system to another. Interfaces may flow in one direction or be bidirectional. Interfaces may involve the performance of an end-to-end transaction or they may pass data from one system to another.

**.16** If a member provides interface services for a COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards*; *independence* would be *impaired* except as provided for in paragraph .17.

**.17** If a member uses a third-party vendor's application, such as an application programming interface (API), to interface legacy or COTS FIS software solutions, *threats* to *independence* would be at an *acceptable level*, provided the member will not be designing or developing code for the application to work and all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" [1.200.001] are met.

### ***Data Translation Services Related to a COTS FIS Software Solution***

**.18** Performing data translation services for a COTS FIS software solution involves designing and developing the rules or logic necessary to convert legacy system data to a format compatible with that of the new system.

**.19** If a member performs data translation services for a COTS FIS software solution, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards* and *independence* would be *impaired* except as provided for in paragraph .20.

**.20** If a member uses a third-party vendor’s application, such as an API, to perform data translation services for a COTS FIS software solution, *threats* to *independence* would be at an *acceptable level*, provided the member will not be designing or developing code for the application to work and all requirements of the “Nonattest Services” subtopic [1.295] of the “Independence Rule” [1.200.001] are met.

### ***System and Network Maintenance, Support, and Monitoring***

**.21** Maintenance, support, and monitoring services are activities that are provided after a financial or nonfinancial system or network is implemented. If post-implementation services involve the *attest client* outsourcing an ongoing function, process, or activity to the member that would result in the member assuming a management responsibility, compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards* and *independence* would be *impaired*. Examples of services that involve an ongoing function, process, or activity that would result in the member assuming a management responsibility include services in which the member directly or indirectly does any of the following:

- a. Operates the *attest client’s* network, such as managing the *attest client’s* systems or software applications
- b. Supervises *client* personnel involved in the operation of the *attest client’s* information systems
- c. Has responsibility for monitoring or maintaining the *attest client’s* network performance
- d. Operates or manages the *attest client’s* information technology help desk
- e. Has responsibility to perform ongoing network maintenance, such as updating virus protection solutions, applying routine updates and patches, or configuring user settings
- f. Has responsibility for maintaining the security of the *attest client’s* networks and systems

**.22** *Independence* will not be *impaired* provided all requirements of the “Nonattest Services” subtopic [1.295] of the “Independence Rule” [1.200.001] are met and the maintenance, support, or monitoring services are individually separate, distinct, and not ongoing

engagements in which the *attest client* has outsourced no function, process, or activity to the member that would result in the member assuming a management responsibility. Examples of services that would not impair independence may include any of the following services:

- a. Analyzing a network and providing observations or recommendations
- b. Applying virus protection solutions or updates that the member did not design or develop
- c. Applying certain updates and patches that the member did not design or develop
- d. Providing advice, training, or instruction on a software solution
- e. Assessing the design or operating effectiveness of an *attest client's* security over information technology systems
- f. Assessing the *attest client's* information technology security policies or practices



A nonauthoritative practice aid is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/isspracticeaid.pdf>.

Nonauthoritative questions and answers regarding information systems design, implementation, and integration services are available. See Ethics Questions & Answers section 250, *Nonattest Services — Information Systems Services*.

### 1.295.150 Internal Audit

**.01** For purposes of this interpretation, internal audit services involve assisting the *attest client* in the performance of its internal audit activities, sometimes referred to as “internal audit outsourcing.” When a member provides internal audit services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist.

**.02** The *attest client's* management is responsible for directing the internal audit function, including the management thereof. Such responsibilities include, but are not limited to, designing, implementing and maintaining internal control. *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*, cannot be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if the *attest client* outsources the internal audit function to the member, whereby the member, in effect, manages the *attest client's* internal audit activities.

**.03** However, except for the outsourcing services discussed in paragraph .02, *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if the member assists the *attest client* in performing



financial and operational internal audit activities, provided that, in addition to the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” the member is satisfied that management

- a. designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for the internal audit function.
- b. determines the scope, risk, and frequency of internal audit activities, including those the member will perform in providing the services.
- c. evaluates the findings and results arising from the internal audit activities, including those the member will perform in providing the services.
- d. evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

**.04** For example, if the member applies the *safeguards* in paragraph .03, the member may assess whether performance is in compliance with management’s policies and procedures, identify opportunities for improvement, and recommend improvement or further action for management consideration and decision making.

**.05** The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. The member should also be satisfied that *those charged with governance* are informed about the member’s and management’s respective roles and responsibilities in connection with the engagement. Such information should provide *those charged with governance* a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

**.06** *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, in addition to those activities listed in the “Management Responsibilities” interpretation [1.295.030] of the “Independence Rule,” a member

- a. performs ongoing evaluations (see paragraph .10 that follows) or control activities (for example, reviewing *loan* originations as part of the *attest client’s* approval process or reviewing customer credit information as part of the customer’s sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed or accounted for, or both, and performs routine activities in connection with the *attest client’s* operating or production processes that are equivalent to those of an ongoing compliance or quality control function.
- b. performs separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the *attest client’s* business process.

- c. has *attest client* management rely on the member's work as the primary basis for the *attest client's* assertions on the design or operating effectiveness of internal controls.
- d. determines which, if any, recommendations for improving the internal control system should be implemented.
- e. reports to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function.
- f. approves or is responsible for the overall internal audit work plan, including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures.
- g. is connected with the *attest client* as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the *attest client's* directories or other *attest client* publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the *attest client's* internal audit function, or using the *attest client's* letterhead or internal correspondence forms in communications).

**.07 Monitoring activities.** Designing, implementing, or maintaining the *attest client's* monitoring activities are management responsibilities. Accordingly, *independence* would be *impaired* if a member accepts responsibility for performing such activities. Monitoring activities are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to the *attest client's* business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the components of internal control in the ordinary course of managing the business. A member who performs such activities for an *attest client* would be considered to be accepting responsibility for maintaining the *attest client's* internal control. Accordingly, the management participation *threat* created by a member performing ongoing evaluations is so significant that no *safeguards* could reduce the *threat* to an *acceptable level*, and thus *independence* would be *impaired*.

**.08** Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the *attest client's* business process, separate evaluations generally do not create a significant management participation *threat* to *independence*.

**.09** Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Internal Control—Integrated Framework*, for additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

**.10** Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation *threat* to *independence*, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall *financial statements* of the *attest client*, as well as the frequency of the internal audit services. If the *threat* to *independence* is considered significant, the member should apply *safeguards* to eliminate or reduce the *threat* to an *acceptable level*. If no *safeguards* could reduce the *threat* to an *acceptable level*, then *independence* would be *impaired*.

**.11** *Attest-related services*. Services considered extensions of the member's audit scope applied in the audit of the *attest client's financial statements*, such as confirming accounts receivable and analyzing fluctuations in account balances, are not considered internal audit services and would not be subject to this interpretation even if the extent of such testing exceeds that required by generally accepted auditing standards (GAAS). In addition, engagements performed under the attestation standards would not be considered internal audit services and, therefore, would not *impair independence*.

**.12** When a member performs internal audit services that would not *impair independence* under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, *independence* would not be considered *impaired*, provided the member is satisfied that *attest client* management does not rely on the member's work as the primary basis for its assertion. [Prior reference: paragraph .05 of ET section 101]

[See Revision History Table.]

### 1.295.155 *Investment Advisory or Management*

**.01** When a member provides investment advisory or management services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. recommend the *attest client's* allocation of funds among various investments or asset classes based upon the *attest client's* desired rate of return, risk tolerance, or other parameters.
- b. perform recordkeeping and reporting of the *attest client's* portfolio balances, including providing the *attest client* with a comparative analysis of the *attest client's* investments to third-party benchmarks.
- c. evaluate the manner in which an *attest client's* portfolio is being managed by investment account managers, including assessing whether the managers are
  - i. following the guidelines of the *attest client's* investment policy statement.



- ii. meeting the *attest client's* investment objectives.
- iii. conforming to the *attest client's* stated investment parameters or risk tolerance.
- d. transmit an *attest client's* investment selection, with the *attest client's* consent, to the *attest client's* broker-dealer or equivalent, provided that the *attest client* has authorized the broker-dealer or equivalent to execute the transaction.

**.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes investment decisions on behalf of management or otherwise has discretionary authority over an *attest client's* investments.
- b. executes a transaction to buy or sell an *attest client's* investments.
- c. has custody of an *attest client's* assets, such as taking temporary possession of securities purchased by an *attest client*. [Prior reference: paragraph .05 of ET section 101]

### 1.295.160 Tax Services

**.01** For purposes of this interpretation, tax services include preparation of a tax return, transmittal of a tax return, and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, having a power of attorney limited strictly to tax matters; and authorized representation of *attest clients* in administrative proceedings before a taxing authority.

**.02** For purposes of this interpretation, a tax return includes all tax filings, including informational tax forms (such as estimated tax vouchers), extension forms, and Forms 990, 5500, 1099, and W-2, filed with a taxing authority or other regulatory agency.

**.03** *Preparation and transmittal.* When a member prepares a tax return and transmits the tax return and related tax payment to a taxing authority in paper or electronic form, self-review and management participation *threats* to the member's compliance with the “Independence Rule” [1.200.001] may exist. If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member does not have custody or control over the *attest client's* funds or assets and the individual designated by the *attest client* to oversee the tax services

- a. reviews and approves the tax return and related tax payment.
- b. if required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

The following are not considered having custody or control over an *attest client's* funds: making electronic tax payments authorized by an *attest client* pursuant to a taxing authority's prescribed criteria (as discussed in paragraph .04), affixing the *attest client's* depository account information on a tax return, or remitting an *attest client's* check made payable to the taxing authority.

**.04** If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member signs and files a tax return on behalf of management, provided that the member has the legal authority to do so and

- a. the taxing authority has prescribed procedures in place for an *attest client* to permit a member to sign and file a tax return on behalf of the *attest client* (for example, Forms 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in Form 8879, or
- b. an individual in management who is authorized to sign and file the *attest client's* tax return provides the member with a signed statement that clearly identifies the return being filed and represents that such individual
  - i. is authorized to sign and file the tax return.
  - ii. has reviewed the tax return, including accompanying schedules and statements, and it is true, correct, and complete to the best of the individual's knowledge and belief.
  - iii. authorizes the *member* or another named individual in the *member's firm* to sign and file the tax return on the *attest client* behalf.

**.05** *Authorized representation in administrative proceedings.* If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a member acts as the *attest client's* authorized representative in administrative proceedings before a taxing authority, provided that the member obtains the *attest client's* agreement prior to committing the *attest client* to a specific resolution with the taxing authority. [Prior reference: paragraph .05 of ET section 101]

**.06** *Power of attorney.* When a member has an *attest client's* power of attorney, the self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist. If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member's use of the power of attorney is limited strictly to tax matters and the member does not bind the *attest client* to any agreement with a taxing authority or other regulatory agency. [No prior reference: new content]

**.07** *Representation in court.* *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through

the application of *safeguards*, and *independence* would be *impaired* if a member represents an *attest client* in court to resolve a tax dispute. For purposes of this interpretation, court encompasses a tax, district, or federal court of claims and the equivalent state, local, or foreign forums. [Prior reference: paragraph .05 of ET section 101]

**.08** For information about transition provision for engagements commenced prior to February 28, 2007, see <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf>.

### ***Effective Date***

**.09** Paragraph .06 of this interpretation is effective December 15, 2014.



A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available. See “Background and Basis for Conclusions: Revisions to Interpretations and Rulings Under Rule 101 — Independence” in *Basis for Conclusions Documents*.

In addition, nonauthoritative questions and answers regarding performance tax services are available. See Ethics Questions & Answers section 280, *Nonattest Services — Tax Services*.

## **1.297 Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements**

### **1.297.010 Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements**

**.01** The “Independence Rule” [1.200.001] and its *interpretations* apply to all *attest engagements*. However, when performing engagements to issue reports in accordance with Statements on Standards for Attestation Engagements (SSAEs), when *independence* is required or when the *member’s* compilation report does not disclose a lack of *independence*, the *covered member* needs to be independent with respect to the responsible party(ies), as defined in the SSAEs.

**.02** If the individual or entity that engages the *covered member* (engaging entity) is not the responsible party, the *covered member* need not be independent of that engaging entity. However, because *threats* to the *member’s* compliance with the “Integrity and Objectivity Rule” [1.100.001] and the “Conflicts of Interest” interpretation [1.110.010] may still exist with respect to the engaging entity, *members* should comply with this rule and interpretation.

## **Examples of Matters in Peer Reviews Engagements with Year-Ends between 3/01/2023 and 6/30/2024<sup>1</sup>**

The AICPA is using data collected during peer reviews to learn about trouble spots and is developing resources within the AICPA that will allow firms to have a more focused remedy for their findings. Our ultimate goal is to assist firms with the hurdles they've faced in the past, provide them with tools to drive up their quality and overall "up the game on quality" in the profession.

See below for examples of matters related to the following areas:

### **Professional Standards**

[Clarified Auditing Standards](#)

[Accounting and Review Services](#)

[Attestation Standards](#)

[Code of Professional Conduct](#)

[Statements on Quality Control](#)

[FASB Accounting Standards Codification](#)

### **Practice Areas**

[Governmental, Single Audit, and HUD](#)

[ERISA](#)

[Service Organization Control Reports](#)

[Banking, including FDICIA](#)

[PCAOB](#)

[Not for profit](#)

### **Professional Standards**

#### *Clarified Auditing Standards*

- Failure to appropriately document planning procedures, including:
  - Risk assessment (and linkage of risks to procedures performed)
  - Planning analytics
  - Understanding of IT environment
  - Internal control testing
  - Consideration of going concern
- Failure to properly support and document the assessed level of risk in accordance with professional standards including:
  - Setting control risk at less than high without testing the effectiveness of controls

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<sup>1</sup> Due to the timing of when peer reviews are performed, there is a lag between the year-end of the engagement and when a matter is included in this report. Peer reviews are due six months after a firm's peer review year end. A firm's peer review would cover engagements with year ends during the peer review year (report dates for projections and AUPs). As an example, if a firm's peer review year is January 1, 2023, to December 31, 2023, its peer review is not due until June 30, 2024. Therefore, a January 31, 2023, year-end audit would not be included in the MFC data until approximately June 30, 2024. However, a December 31, 2023, year-end audit in the same scenario would be included in the MFC data around June 30, 2024 as well. Refer to <https://www.aicpa-cima.com/resources/article/peer-review-summary> for more information about peer review.

We prepare our analysis on MFCs for engagements with year ends (report dates for projections and AUPs) from the most recently accepted peer reviews, generally within the last 15 months. By using a 15-month period, we can ensure we are providing information based on the most recent engagements, including a calendar year end.

- Performing risk assessment at the audit level rather than at the relevant assertion level
- Failure to properly identify and/or document the relevant risks and controls associated with the role of IT
- Failure to document linkage between risk assessment procedures and actual substantive procedures performed
- Failure to document fraud risk assessment procedures regarding inquiries with those in charge of governance and response to management override of controls
- Failure to document sources of information from which conclusions were drawn about design and implementation of controls
- Failure to properly document understanding of key internal controls and related walkthroughs
- Failure to appropriately identify or address management override and improper revenue recognition as significant risks due to fraud
- Failure to document fraud considerations related to major program compliance
- Failure to properly document consideration of all non-attest services performed
- Failure to obtain appropriate management representation letters. Matters included failure to:
  - Update the letter to include all representations required by the applicable professional standards
  - Date the letter appropriately
  - Include appropriate financial statement periods
  - Include required representations
  - Include appropriate wording concerning consultation with an attorney
- Failure to communicate and/or document required communications with those charged with governance
- Failure to properly adopt new standards regarding revenue recognition
- Failure to include audit documentation that contains sufficient competent evidence to support the firm's opinion on the financial statements
- Failure to adhere to established quality control policies and procedures including:
  - Incorrect or insufficient use of third-party practice aids
  - Usage of outdated quality control materials
  - Insufficient review of audit documentation
  - Compliance with policies related to continuing professional education (CPE) to provide reasonable assurance that personnel will have the knowledge and resources necessary to perform engagements in accordance with professional standards
- Failure to include all elements in the engagement letter as required by current professional standards. Matters included failure to:
  - Include required reference regarding engagements performed in accordance with Uniform Guidance and Government Auditing Standards
  - Include identification of significant risks during planning
- Failure to document required communication with the predecessor auditor
- Failure to document testing of subsequent events through the date of the auditor's report
- Failure to identify significant threats to independence and apply adequate safeguards to eliminate threat or reduce it to an acceptable level
- Failure to adequately document internal controls over preparation of the SEFA or testing of those controls

- Failure to provide sufficient audit documentation such that an experienced auditor having no previous connection to the audit would be able to understand the extent and results of procedures performed
- Failure to perform analytical review procedures in accordance with professional standards including developing expectations when performing the analytical procedures

### *Accounting and Review Services*

#### *Compilations*

- Failure to prepare reports in accordance with professional standards. The following matters were noted:
  - Not updated for SSARS pronouncements
  - No explanation of the degree of responsibility the accountant is taking with respect to supplementary information
  - Failure to date the report appropriately
  - Failure to mention that substantially all disclosures are omitted
  - Failure to report on all periods presented in the financial statements
  - Failure to include a separate paragraph indicating that the financial statements were prepared in accordance with a special purpose framework and that framework differs from generally accepted accounting principles
- Failure to include all elements in the engagement letter (e.g., objectives of the engagements) required by SSARSs. Other miscellaneous matters were noted relative to the engagement letter including:
  - Failure to note the lack of independence or the letter referred to GAAP on an engagement performed in accordance with a special purpose framework
  - Failure to identify non-attest services provided
  - Failure to obtain required signatures

#### *Reviews*

- Failure to obtain appropriate management representation letters. Matters included failure to:
  - Include all representations required by the applicable professional standards
  - Date the letter appropriately
  - Include appropriate financial statement periods
- Failure to update reports in conformity with the applicable professional standards including:
  - Inappropriate titles or lack of a title
  - No headings on the report
  - Failure to include an explanation of the degree of responsibility being taken with respect to supplementary information in a separate paragraph
  - Failure to include required statements regarding independence and other ethical responsibilities in accordance with current standards
  - Failure to include statement regarding supplementary information
- Failure to include all the required elements within the engagement letter
- Failure to cover all of the periods or the correct periods presented in the financial statements in the accountant's report
- Failure to disclose the fact that substantially all disclosures have been omitted on the face of the financial statements or in the selected notes
- Failure to include a statement that indicates that at a minimum, no assurance is provided on the financial statements

- Failure to disclose departures from the financial reporting framework including the omission of the statement of cash flows
- Failure to document materiality in accordance with current professional standards

### *Attestation Standards*

(Note: Most MFCs in this area are related to AUPs or SOC. SOC related MFCs are included in the practice area section below.)

- Failure to include required language in the AUP report in accordance with current professional standards including:
  - A statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures
  - All elements required by attestation standards in the engagement letter
  - Failure to include the word “independent” in the title
  - Date the letter in accordance with professional standards
- Failure to obtain a management representation letter
- Failure to provide appropriate documentation concerning agreed upon procedures
- Failure to obtain an engagement letter
- Failure to appropriately identify the specified parties, responsible party or subject matter in the engagement letter

### *Code of Professional Conduct*

- Failure to establish and document in writing the understanding with the client with regard to non-attest services provided
- Failure to address management’s responsibilities to oversee and evaluate the results of the services performed
- Failure to identify significant threats to independence that require the application of safeguards, along with the applicable safeguards applied to overcome the threats

### *Statements on Quality Control*

- Leadership Responsibilities for Quality within the Firm
  - Failure to update the quality control document regarding EQCR and monitoring
  - Failure to devote sufficient resources for the support of its quality control policies and procedures
  - Failure to ensure that firm personnel complete the appropriate amount of CPE in areas of practice and in accordance with the requirements of professional standards
- Engagement Performance
  - Failure to properly complete or utilize purchased practice aids to assist in performing and documenting engagements
  - Failure to perform EQCR on engagements that meet the firm’s criteria

### *FASB Accounting Standards Codification*

- Failure to disclose the date through which subsequent events were evaluated
- Failure to adopt the latest professional standards with respect to revenue recognition
- Failure to correctly classify long term debt on the cash flow statements
- Failure to include a statement of cash flows
- Failure to correctly segregate liabilities into current and noncurrent classifications
- Failure to include required disclosures concerning:



- Opening balances of receivables and accounts payable
- Methods and assumptions used to determine fair value
- Investment securities including investment cost, fair value and unrealized appreciation/depreciation of investments
- Composition of current and deferred income taxes
- Inventory at the lower of cost or net realizable value
- Timing of satisfaction of performance obligations
- Policies related to goodwill
- Long term debt for the next five years
- Qualitative and quantitative management of liquid resources
- Revenue recognition for ASC 606
- Allocation of functional expenses
- Risks and uncertainties
- PPP and/or SBA loans
- Pledged assets
- Operating lease obligations
- Failure to perform sufficient procedures or sufficiently document the procedures to obtain assurance of the fair value measurements
- Failure to properly implement new leasing standards
- Failure to properly classify unrealized gains or losses on investments
- Failure to appropriately implement provisions of ASU No. 2016-14 including:
  - Failure to include required qualitative disclosures in financial statements
  - Failure to appropriately classify net assets as with and without donor restrictions
- Failure to document consideration of revenue recognition under ASC 606
- Failure to properly classify current liabilities in the firm compiled classified balance sheets
- Failure to include appropriate disclosures in footnotes related to plan amendments adopted during the year, fair value measurements parties in interest, or plan administration costs absorbed by the plan sponsor

### Practice Areas

Issues noted above related to professional standards and FASB Accounting Standards Codification were prevalent in each of these practice areas. Matters included in this section are those trends identified for each specific practice area.

### *Governmental, Single Audit, and HUD Reporting*

- Failure to include all of the required elements of professional standards in the Independent Auditor's Report including the following omissions: reference to the engagement being performed in accordance with *Government Auditing Standards*, addressing supplemental information and required supplemental information, reference to prior year financial statements when comparative years are presented
- Failure to include all of the required elements of professional standards in the Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters including omitted "Independent" from report title, omitted or incorrect reference to material weaknesses or significant deficiencies included in the Schedule of Findings and Questioned Costs, indication that there were no significant deficiencies identified
- Failure to report findings in the appropriate form in the Schedule of Findings and Questioned Costs



- Inadequate documentation related to the agreed upon procedures engagement that accompanies a public housing authority or multifamily single audit

#### Disclosure and Presentation

- Failure to present the financial statements in accordance with professional standards including presentation of funds, missing significant policy footnotes, missing or insufficient disclosures, post-retirement benefits, debt, investments, subsequent events
- Failure to include disclosures required by FASB ASC 606

#### Documentation and Performance

- Failure to properly document independence considerations required by Yellow Book including the evaluation of management's skill, knowledge, or experience to effectively oversee non audit services performed by the auditor, evaluation of self-review threat, and safeguards applied to address a significant threat to independence
- Failure to meet the Yellow Book CPE requirements including 80 hours of A&A and 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the auditee operates
- Failure to properly document consideration of the impact of new GASB lease standards
- Inadequate documentation related to evaluation of actuary qualifications
- Failure to document communications with the predecessor auditor
- Failure to properly document linkage between assessed risk to the procedures performed
- Failure to comply with the procedures outlined in the HUD audit guide. Matters included:
  - Failure to identify testing of direct and material compliance requirements
  - Failure to select a sample size that was equal or greater to the minimum suggested in the HUD audit guide
- SINGLE AUDIT: Failure to identify and test sufficient and appropriate major programs, failure to cluster, failure to properly perform Type A and Type B program risk assessments, failure to group programs with the same Assistance Listing number, and incorrect determination of the auditee as low-risk resulting in insufficient coverage
- SINGLE AUDIT: Failure to properly conclude and document either that an applicable compliance requirement does not apply to the particular auditee or that noncompliance with the requirements could not have a direct and material effect on a major program
- SINGLE AUDIT: Failure to document an understanding of internal control over compliance of federal awards sufficient to plan the audit to support low assessed level of control risk for major programs, including consideration of risk of material noncompliance (materiality) related to each applicable compliance requirement and major program
- SINGLE AUDIT: Failure to document the adequacy of the planned sample size for test of controls over compliance to achieve a low level of control risk
- SINGLE AUDIT: Failure to document the testing of controls and compliance for the relevant assertions related to each applicable compliance requirement with a direct and material effect for the major program
- SINGLE AUDIT: Lack of documentation of risk of material noncompliance for the major program's compliance requirements occurring due to fraud
- SINGLE AUDIT: Lack of documentation related to the SEFA:
  - Internal controls over the preparation of the SEFA
  - Procedures to determine whether the SEFA is fairly presented in all material respects
  - Reconciliation of the SEFA to amounts in the financial statements
  - Appropriate identification of relevant clusters

- SINGLE AUDIT: Lack of documentation of consideration of subsequent events related to the major program and its compliance requirements

### *ERISA*

- Incomplete or unclear audit documentation in the following areas:
  - Risk assessment
  - Internal controls or walkthrough of those controls
  - Sampling
  - Reliance on and evaluation of SOC1 report
  - Management's assessment of whether the entity issuing certification is a qualified institution under DOL rules and regulations
  - Management's determination that an audit qualified for a 103(a)(3)(c) audit
  - Identification of all parties in interest
- Failure to implement requirements for ERISA Section 103(a)(3)(C) audits including:
  - Failure to include the required representations in the management representation letter
  - Failure to include all required elements in the engagement letter
  - Failure to correctly cover comparative years in the auditor's report

### *Service Organization Control (SOC) Reports*

Failure to include required elements in the report such as:

- Complementary user entity controls
- Carve outs
- Identification of the criteria against which the subject matter was measured or evaluated
- Inclusion of all controls in control activity section
- Statement concerning independence as required under SSAE 21
- Failure to have sufficient working paper support for information included in the report, such as lack of or poor documentation of:
  - Procedures to assess the nature, timing, and extent of the procedures (specifically sampling methodology)
  - Procedures to test carve outs
  - Procedures to assess the suitability criteria to evaluate whether management's description of the service organization's system is fairly presented
  - Procedures to assess the completeness and accuracy of population files

### *Banking, including FDICIA*

- Failure to include all elements required by professional standards in the accountant's report on internal controls including walkthroughs of the controls
- Failure to comply with the independence rules applicable to these engagements
- Failure to properly disclose:
  - Loan servicing fees including the amount of contractual fees and assumptions used to estimate the fair value of the fees
  - The allowance for loan losses and impaired loans
- Failure to properly disclose the methodology used to determine sample size or the adequacy of the method used
- Failure to obtain a representation letter

## PCAOB

- Failure to include required references to PCAOB standards

## Not for profit

- Failure to obtain the necessary knowledge of current standards and obtain the proper training for NFP engagements
- Failure to appropriately document assessment of the SKE of staff designated to oversee non-attest services
- Failure to include all representations required by the applicable professional standards in the management representation letter including:
  - The required elements regarding oversight and responsibility for multiple non-attest services performed
  - Modifications to indicate the client had not utilized legal counsel regarding litigation, claims or assessment
- Failure to document walk through procedures performed
- Failure to document application of safeguards to eliminate threats or reduce them to an acceptable level
- Failure to include all required elements within the engagement letter including the identification of the applicable financial reporting framework for the preparation of the financial statement
- Failure to include all periods covered by the financial statement in the firm representation letter
- Failure to include required disclosures regarding:
  - Risks and uncertainties
  - Leases
  - Liquidity
- Failure to include the required footnote for liquidity and availability in financial statements
- Failure to clearly, sufficiently and adequately document the assessed level of risk at the relevant assertion level in accordance with professional standards including:
  - Setting control risk at less than high without testing the effectiveness of controls
- Failure to modify language in the accountants report as required by current applicable professional standards to reflect that some of the prior year comparative information was summarized and therefore not the minimum required by GAAP
- Failure to properly present net assets, functional expenses and/or liquidity in financial statements
- Failure to implement current professional standards regarding qualitative information that is useful in assessing liquidity and qualitative information that communicates how the entity manages its liquid resources available to meet cash needs within one year of the date of the statement of financial position
- Failure to include all required elements in the auditor's report including the statement that the supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements and a statement that the supplementary information is the responsibility of management and was derived from, and related directly to, the underlying accounting and other records used to prepare the financial statements.
- Failure to document threats to independence
- Failure to include appropriate documentation and/or disclosures related to the implementation of ASC 606 including:
  - Revenue recognition
  - Opening balance of contract assets and liabilities

- Failure to appropriately classify assets in accordance with ASU 2016-14
- Failure to include required language under SAS 134



# At a glance

From the Audit & Attest Standards Team

## Revisions to Requirements Related to the Auditor's Inquiries of a Predecessor Auditor Regarding Fraud and Noncompliance with Laws and Regulations (NOCLAR)

### What happened?

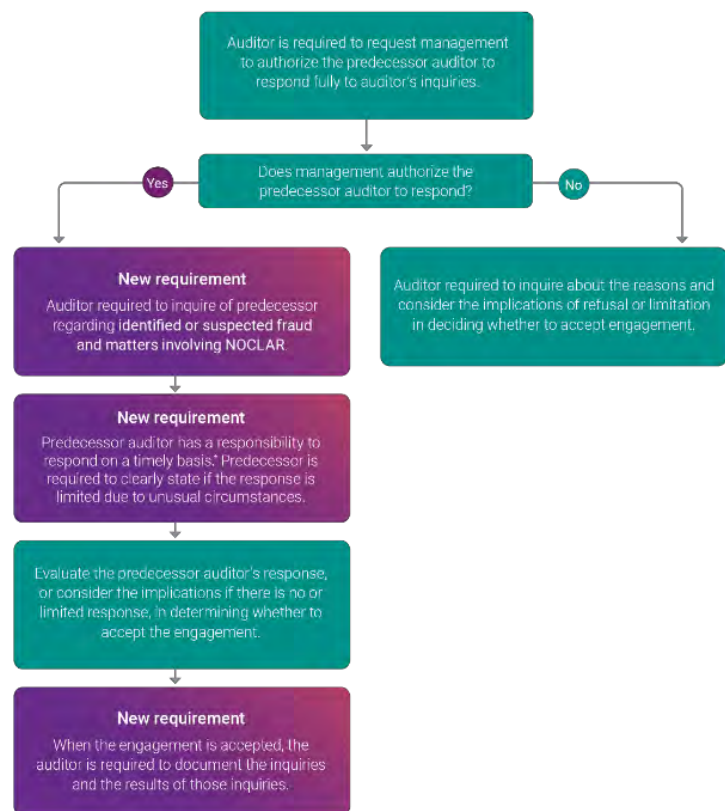
In June 2022, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 147, *Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations*. SAS No. 147 amends SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as amended, section 210, *Terms of Engagement*.

SAS No. 147 clarifies requirements and guidance related to the auditor's inquiries of a predecessor auditor about matters that will assist the auditor in determining whether to accept the engagement. In doing so, SAS No. 147 narrowly revises auditing standards generally accepted in the United States of America (GAAS) to require an auditor, once management authorizes the predecessor auditor to respond to inquiries from the auditor, to inquire of the predecessor auditor regarding identified or suspected fraud and matters involving NOCLAR. In addition, SAS No. 147 clarifies that once an engagement is accepted, the auditor should document the inquiries of the predecessor auditor and the results of those inquiries.

SAS No. 147 does not revise the audit requirement that the auditor request management to authorize the predecessor auditor to respond fully to the auditor's inquiries regarding matters that will assist the auditor in determining whether to accept the engagement.

The flowchart on the opposite side of the page illustrates the narrow revisions to GAAS. The additional procedures introduced by SAS No. 147 are in purple.

### Before engagement acceptance



\* Prior to the issuance of SAS No. 147, this was stated as application guidance based on the AICPA Code of Professional Conduct statement that members have a responsibility to cooperate with each other.

### Next steps?

SAS No. 147 is effective for audits of financial statements for periods beginning on or after June 30, 2023.

SAS No. 147 is available for auditors to read and consider in order to adequately prepare for implementation, and can be viewed on the AICPA's website under [recently issued ASB standards – not yet effective](#).

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## Amendment to AU-C Section 935, *Compliance Audits*

### What happened?

On August 4, 2022, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 148, Amendment to AU-C Section 935.

### What has changed?

SAS No. 148 amends AU-C section 935, *Compliance Audits*, to address conforming changes and update the appendix “AU-C Sections That Are Not Applicable to Compliance Audits” (the appendix) to reflect the issuance of the following SASs:

- SAS No. 142, *Audit Evidence* (AU-C section 500)
- SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C section 315)

No amendment is necessary to AU-C section 935 to reflect the issuance of the following SASs:

- SAS No. 143, *Auditing Accounting Estimates and Related Disclosures* (AU-C section 540)
- SAS No. 144, *Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources*

### Revisions arising from SAS No. 142

SAS No. 142 superseded SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, section 500, *Audit Evidence* (AU-C section 500A), and amended various AU-C sections, including AU-C section 501, *Audit Evidence – Specific Considerations for Selected Items*. The amendments in SAS No. 142 moved what had been paragraph .08 of AU-C section 500A, relating to using the work of a management’s specialist, to become paragraph .27 of AU-C section 501, without any substantive changes to that paragraph. This paragraph was applicable to compliance audits when it was in AU-C section 500A, and that applicability didn’t change when it was relocated. Accordingly, the appendix in AU-C section 935 is revised to reflect the continued applicability of this paragraph in a compliance audit.

### Revisions arising from SAS No. 145

- Updated appendix to include
  - paragraphs comparable to those in AU-C section 315A that are not applicable to a compliance audit.

- paragraphs that address significant risks and classes of transactions, account balances, and disclosures that are not significant but are material, as these concepts are not applicable to compliance audits.

- Added a requirement to AU-C section 935 to address the auditor’s responsibility in adapting and applying requirements relating to the control activities component in a compliance audit.
- For ease of use and clarity, added, adapted as necessary, requirements related to identifying and assessing risks of material noncompliance and, consequently, included the SAS No. 145 paragraphs containing those requirements in the appendix as paragraphs that are not applicable when applying AU-C section 315 to a compliance audit. Application material was added to AU-C section 935 that references the 22 relevant application material paragraphs for paragraphs 35 and 37–38 in SAS No. 145.
- Added a requirement relating to documentation of identified and assessed risks of material noncompliance, and consequently included the comparable paragraph from SAS No. 145 in the appendix as a paragraph that is not applicable in a compliance audit.
- Certain other editorial revisions were made for clarity or consistency with other AU-C sections.

### Next steps?

The effective date of the amendment to the appendix with regard to AU-C section 501 is aligned with the effective date of SAS No. 142 because, as explained previously, this amendment arises from SAS No. 142. This amendment is not intended to change current practice, as only the placement of the underlying requirement within generally accepted auditing standards (GAAS) changed. All other amendments in this SAS arise from SAS No. 145, and accordingly, their effective date is aligned with the effective date of SAS No. 145.

Early implementation of SAS No. 148 is permitted. The ASB recommends that any firm that performs compliance audits implement SAS No. 148 concurrently with its implementation of SAS No. 145. SAS No. 148 is available for auditors to read and consider in order to adequately prepare for implementation and can be viewed on the AICPA’s website under recently issued standards.



# At a glance

From the Audit & Attest Standards Team

## New Statement on Auditing Standards for Group Audits

### What happened?

In March 2023, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 149, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*. SAS No. 149 supersedes section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, of SAS No. 122, as amended, and makes conforming amendments to various other SASs.

The ASB also issued Statement on Quality Management Standards (SQMS) No. 3, *Amendments to QM Sections 10, A Firm's System of Quality Management, and 20, Engagement Quality Reviews*. The amendments to QM sections 10 and 20 conform certain terms to language used in SAS No. 149 and provide guidance on differentiating between a resource and an information source.

### What has changed?

The most *significant change* introduced by SAS No. 149 is that it provides a risk-based approach to planning and performing a group audit. Former AU-C section 600 required the group engagement team to identify significant components at which to perform audit work; whereas SAS No. 149 directs the group auditor to use professional judgment in determining the components at which to perform procedures, based on assessed risks. SAS No. 149 also better aligns the standard with other recently issued SASs and clarifies the interaction between the SAS and other AU-C sections.

### New terms and definitions

SAS No. 149 introduces the term *referred-to auditor* and defines it as an auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements. The definition also indicates that a referred-to auditor is not a component auditor and, accordingly, is not a part of the engagement team for a group audit. In former AU-C section 600, an auditor for whom the group auditor assumes responsibility and an auditor to whom the group auditor makes reference are both termed *component auditors*.

SAS No. 149 also revises the definition of the term *component auditor* to indicate that a component auditor is part of the engagement team. The ASB made this change to reflect SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C section 220), which revises the definition of the term *engagement team* to include component auditors. This change is intended to improve audit quality by making the group engagement partner responsible for the direction and supervision of component auditors and review of their work. In addition, the definition of component auditor has been revised so that it excludes referred-to auditors.

Consistent with former AU-C section 600, investments accounted for using the equity method of accounting are considered components and therefore are included in the scope of SAS No. 149. The SAS identifies procedures the group auditor is required to perform to determine whether to use the audited financial statements of the equity method investment, including the accompanying audit report, as audit evidence; matters that may cause the group auditor to conclude that additional audit procedures are necessary; and additional procedures the group auditor may perform to obtain sufficient appropriate audit evidence.

### Next steps?

SAS No. 149 is effective for audits of group financial statements for periods ending on or after December 15, 2026.

SQMS No. 3 is effective concurrently with the effective dates provided in QM sections 10 and 20.

SAS No. 149 and SQMS No. 3 are available for auditors to read and consider in order to adequately prepare for implementation, and can be viewed on the AICPA's website under [recently issued ASB standards – not yet effective](#).



# Establishing and Maintaining a **System of Quality Management** for a CPA Firm's Accounting and Auditing Practice

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**Chapter 1:** Overview of Statement  
on Quality Management Standards No. 1

For Small- and  
Medium-Sized Firms



## Quality Management Implementation Task Force

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## Notice to readers

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This practice aid does not address the quality control requirements of the Sarbanes-Oxley Act of 2002 (SOX), nor does it address the quality control requirements of PCAOB standards that auditors of issuers must follow. Auditors of issuers should follow these other standards and make changes to their firm's quality control systems as necessary.

Additional information about the PCAOB and SOX can be obtained at the PCAOB website at [pcaobus.org](http://pcaobus.org).

# How to use this practice aid

This AICPA Audit and Accounting Practice Aid, *Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice*, is intended to help practitioners design, implement, and operate a system of quality management for their firm's accounting and auditing practice, as required by Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*, issued by the AICPA.

SQMS No. 1 requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management. In applying a risk-based approach, the firm is required to take into account the nature and circumstances of both the firm and the engagements performed by the firm. This practice aid explains how to apply a risk-based approach and includes a library of potential risks and suggested responses.

Use this practice aid, and the Example Risk Assessment template, to help you apply the risk-based approach, identify the quality risks to your practice, and implement policies and procedures as necessary for the facts and circumstances of your practice.

Many of the policies and procedures may need to be modified to be applicable to your firm. Some may not be applicable at all. You may need to add policies and procedures that are already part of your system. Some of the policies and procedures are required by SQMS No. 1; these are noted in chapters 3 and 4.

Be aware that if you do not customize the risks and responses to the nature of your practice

- you won't be in compliance with the standards.
- you won't be doing what is most efficient and effective for your practice.

If all you do is

- copy the quality risks from this practice aid, it is likely that your quality risks will be incomplete, or that you will include quality risks that do not apply to your firm. Do not copy the quality risks from this practice aid without thoughtful consideration of any modifications needed for your firm's nature and circumstances.
- copy and paste the policies and procedures in this practice aid, you will be committing to responses that may not apply to your firm. And, because you included them in your documentation of your system of quality management, your peer reviewer will expect you to apply those policies and procedures.

In addition, a firm's risk assessment should be iterative and updated when changes in the nature and circumstances of the firm or its engagements occur. An incomplete or out-of-date risk assessment can have a significant effect on the system of quality management.

This practice aid is intended for firms with two or more personnel. If your firm has only one assurance partner, or only one partner with expertise in a specialized area, you may find the AICPA Audit and Accounting Practice Aid *Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice* for sole practitioners, also helpful.

# Chapter 1 – Overview of statements on quality management standards

Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*, (QM section 10),<sup>1</sup> was issued by the Auditing Standards Board of the AICPA in June 2022 and is effective for a firm's accounting and auditing practice as of December 15, 2025. This standard supersedes Statement on Quality Control Standards No. 8, *A Firm's System of Quality Control*.<sup>2</sup>

The biggest change reflected in the new QM standard is the introduction of a risk-based approach in designing, implementing, and operating a system of quality management (SOQM), which helps firms identify and address risks specific to their practice and creates a more scalable approach to quality for all firms. The risk-based approach comprises (a) establishing quality objectives (the desired outcomes relating to the components of the SOQM to be achieved by the firm); (b) identifying and assessing quality risks (a risk that has a reasonable possibility of occurring and, individually or in combination with other risks, adversely affecting the achievement of one or more quality objectives); and (c) designing and implementing responses (policies or procedures designed and implemented by the firm to address one or more quality risks).

The standard's approach emphasizes the responsibility of firm leadership for proactively managing quality and provides flexibility to deal with differences in the size of firms and the nature of the services they provide. The essence of this approach is to focus firms' attention on risks that may have an impact on engagement quality. The approach requires a firm to customize the design, implementation, and operation of its SOQM based on the nature and circumstances of the firm and the engagements it performs. The standard also has an increased emphasis on a continual flow of remediation and improvement.

An SOQM addresses the following eight components, which are highly integrated and do not act in a linear manner:

1. The firm's risk assessment process
2. Governance and leadership
3. Relevant ethical requirements
4. Acceptance and continuance of client relationships and specific engagements
5. Engagement performance
6. Resources
7. Information and communication
8. The monitoring and remediation process

The objective of the firm is to design, implement, and operate an SOQM for its accounting and auditing practice that provides the firm with reasonable assurance that

- 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
- engagement reports issued by the firm are appropriate in the circumstances.

In this context, reasonable assurance is not intended to be obtained through independent assurance that the system is effective (for example, by having a peer review every year); instead, it is obtained through the operation of the system as a whole.

<sup>1</sup> The QM sections can be found in AICPA *Professional Standards*.

<sup>2</sup> The Statements on Quality Control Standards are codified in the QC sections in AICPA *Professional Standards*.



# The firm's risk assessment process

The purpose of the risk assessment process element of an SOQM is to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks. The risk assessment process section of SQMS No. 1 focuses firms' attention on risks that may have an impact on engagement quality.

The risk assessment is a three-step process:

1. **Establish quality objectives.** The standard requires the firm to establish specific quality objectives for each component except risk assessment and monitoring and remediation. The firm is required to establish additional quality objectives when necessary to achieve the objective of the SOQM. However, the firm may not find it necessary to establish additional quality objectives.
2. **Identify and assess risks to the achievement of the quality objectives** (referred to in the standard as quality risks). Identifying and assessing quality risks involves
  - a. understanding the factors (that is, the conditions, events, circumstances, actions, or inactions) that may adversely affect the achievement of the quality objectives and

- b. taking into account how and the degree to which the factors may adversely affect the achievement of the quality objectives. (The assessment of identified quality risks does not require formal ratings or scores.)

A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. Not all risks meet the definition of a quality risk.

3. **Design and implement responses to address the quality risks.** The nature, timing, and extent of the firm's responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks. Certain responses are specified in the standard; however, the specific responses required by the standard will not be sufficient for the firm to address all its quality risks.

Firms are also required to identify information indicating the need for additions or modifications to quality objectives, quality risks, or responses.

## Governance and leadership

The purpose of the governance and leadership element of an SOQM is to promote an internal culture based on the recognition that quality is essential in performing engagements. The governance and leadership section of SQMS No. 1 addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations. The standard also addresses the importance of quality in the firm's strategic decisions and actions — including financial and operational priorities — as well as firm leadership's ability to influence decisions about the firm's resources.

The firm is required to assign ultimate responsibility and accountability for the SOQM to the firm's CEO, managing partner (or equivalent), or if appropriate, managing board of partners (or equivalent).

In addition, the firm is required to assign the following to designated individuals:

- Operational responsibility for the SOQM
- Operational responsibility for specific aspects of the SOQM, including compliance with independence requirements and the monitoring and remediation process

SQMS No. 1 emphasizes the firm's commitment to quality through a culture that reflects the firm's role in serving the public interest through consistent quality engagements. Leadership demonstrating a commitment to quality through its actions and behaviors reinforces the responsibility that all personnel hold for quality relating to the performance of engagements and activities within the SOQM.

## Relevant ethical requirements

The purpose of the relevant ethical requirements element of an SOQM is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when performing professional responsibilities. The relevant ethical requirements component of SQMS No. 1 addresses responsibilities regarding ethical requirements for the firm and its personnel as well as others in the firm's network. The following quality objectives should be established relating to the firm and its personnel:

- Understand the relevant ethical requirements to which the firm and the firm's engagements are subject.
- Fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject.

The firm should also ascertain that others (including the network, network firms, individuals in the network or network firms, or service providers) who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject

- understand the relevant ethical requirements that apply to them, and
- fulfill their responsibilities in relation to the relevant ethical requirements that apply to them

Examples of relationships between the relevant ethical requirements component and other components include the following:

- The information and communication component may address the communication of various matters related to relevant ethical requirements, including
  - the firm communicating the independence requirements to all personnel and others subject to independence requirements.
  - personnel and engagement teams communicating relevant information to the firm without fear of reprisals, such as situations that may create threats to independence or breaches of relevant ethical requirements.
- As part of the resources component, the firm may
  - assign individuals to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.
  - use IT applications to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

The relevant ethical requirements that apply to others depend on the provisions of the relevant ethical requirements and how the firm uses others in its SOQM or in performing engagements. Examples follow:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms.
- The principle of confidentiality may apply to the firm's network, other network firms, or service providers when they have access to client information obtained by the firm.

# Acceptance and continuance of client relationships and specific engagements

The purpose of the acceptance and continuance of client relationships and specific engagements component of an SOQM is to provide reasonable assurance that the firm makes appropriate judgments about whether to accept or continue a client relationship and whether to perform a specific engagement. A firm's acceptance and continuance policies represent a key element in quality management, while also mitigating litigation and business risk. This component of SQMS No. 1 also addresses quality objectives for firms around client acceptance and continuance decisions. These objectives include judgments by the firm to accept or continue a client relationship or specific engagement based on

- information obtained about the nature and circumstances of the engagement.

- information obtained about the integrity and ethical values of the client, including the identity and business reputation of the client's principal owners, key management, and those charged with its governance.
- the firm's ability to perform the engagement in accordance with professional standards, and applicable legal and regulatory requirements

SQMS No. 1 also emphasizes that the financial and operational priorities of the firm should not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

## Engagement performance

The purpose of the engagement performance element of an SOQM is to provide the firm with reasonable assurance that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and that the firm issues reports that are appropriate in the circumstances. The engagement performance section of SQMS No. 1 provides quality objectives that firms should establish to obtain reasonable assurance that high-quality performance is being attained in the firm's engagements. Establishing and maintaining quality objectives such as the following help the firm in obtaining reasonable assurance relating to the engagement performance element of an SOQM:

- Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.
- The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources

assigned or made available to the engagement teams; the work performed by less experienced engagement team members is directed, supervised, and reviewed by suitably experienced engagement team members.

- Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, maintain professional skepticism.
- Consultation on difficult or contentious matters is undertaken, and the conclusions agreed to are implemented.
- Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's SOQM, are brought to the attention of the firm and resolved.
- Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, and professional standards.

# Resources

The purpose of the resources element of an SOQM is to provide the firm with reasonable assurance that it is appropriately obtaining, developing, using, maintaining, allocating, and assigning resources in a timely manner to enable the design, implementation, and operation of the SOQM. SQMS No. 1 addresses all resources that the firm needs both to operate the system and to perform engagements. These resources cover the following:

- **Technological resources.** For example, audit tools or IT applications used by the firm for independence monitoring.
- **Intellectual resources.** For example, the firm's methodology, guidance, templates, or tools.
- **Human resources.** This may include people outside the firm used in engagements, including component auditors or engagement quality reviewers who are external to the firm.

The standard focuses on what resources are needed, how they are used and maintained, and whether they are appropriate. The principles-based nature of the requirements relating to resources takes into account the variety of resources used and their source. The resources section of SQMS No. 1 also covers the use of resources from service providers and how to determine that those resources are appropriate for the intended use by the firm. A resource from a service provider could be a methodology, an IT application, or people used in an engagement. Services that come from a firm's network, if the firm belongs to a network, are not considered as coming from a service provider.

# Information and communication

The purpose of the information and communication element of an SOQM is to address the importance of communicating information obtained, generated, or used both within the firm and to external parties on a timely basis to enable the design, implementation, and operation of the SOQM.

This component of SQMS No. 1 underscores the importance of a continuous flow of information and communication by linking the exchange of information to the firm's culture so that it is driven from top leadership throughout the firm. The standard requires that the firm establish an information system with processes to identify, capture, process, and maintain information, acknowledging that less complex firms with fewer personnel and direct involvement of leadership may

accomplish the objective with less rigorous or detailed policies and procedures.

This component of SQMS No. 1 also encourages firms to be transparent to external parties about their SOQM in a relevant, innovative, and proactive manner. This component requires that firms establish policies and procedures that address when communications with external parties are appropriate. To promote continual innovation in this area, the standard provides flexibility regarding the specific information communicated, the form of that communication, and the nature, timing, and extent of communication.



## Monitoring and remediation

The purpose of the monitoring and remediation process element of an SOQM is to provide the firm with relevant, reliable, and timely information about the design, implementation, and operation of the SOQM so the firm may take appropriate action to remediate identified deficiencies on a timely basis. SQMS No. 1 focuses on monitoring activities that address the entire SOQM. The standard emphasizes performing tailored monitoring activities sufficient to provide a basis for the firm to evaluate the SOQM.

The requirements also emphasize factors that firms should consider in designing monitoring activities, rather than prescribing such activities. The nature, timing, and extent of monitoring activities will be driven by many firm-specific factors including the following:

- How the underlying system is designed
- The nature and circumstances of the firm and engagements it performs
- The extent of changes to the system
- The results of previous monitoring activities or external inspections

This component includes a requirement to inspect completed engagements and for engagement partners to be inspected on a cyclical basis. The firm determines its inspection criteria, including how often to select completed engagements, which completed engagements to select, which engagement partners to select, and how frequently to select an engagement partner. In doing so, the firm takes into account factors such as other types of monitoring the firm does, areas of risk, and how the system is designed.

The standard includes requirements for evaluating findings, identifying deficiencies, and evaluating the severity and persuasiveness of the deficiencies. These include a requirement to investigate the root cause of identified deficiencies. The requirement is intended to be flexible to encourage firms to scale the nature, timing, and extent of the procedures to investigate the root cause of the deficiencies so that they are appropriate and tailored to the circumstances. The evaluation of the severity and pervasiveness of deficiencies is also used by leadership in evaluating the system and concluding whether it achieved its objectives.



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# Establishing and Maintaining a **System of Quality Management** for a CPA Firm's Accounting and Auditing Practice

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**Chapter 2:** Overview of Risk Assessment Requirements

For Small- and  
Medium-Sized Firms

## Quality Management Implementation Task Force

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# Chapter 2 – Overview of risk assessment requirements

The starting point for the system of quality management (SOQM) is the design and implementation of a risk assessment process to

- establish quality objectives;
- identify and assess quality risks; and
- design and implement responses to address the quality risks.

**This chapter describes the requirements for the firm to perform a risk assessment** (see paragraphs .24–.28 and .A40–.A55 of Statement on Quality Management Standards [SQMS] No. 1, *A Firm's System of Quality Control* [QM section 10]<sup>1</sup>) and includes practical guidance for performing the risk assessment.

## Establish quality objectives

The firm should establish for each of the following components quality objectives required by the standard:

- Governance and leadership
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Engagement performance
- Resources
- Information and communication

These specific quality objectives are discussed later in this practice aid.

The firm might find it helpful to break the quality objectives into sub-objectives, although that is not required.

Firms should establish policies or procedures to identify information indicating that additional quality objectives are needed due to the firm's circumstances. However, the quality objectives are sufficiently comprehensive that it is unlikely the firm would find it necessary to establish additional quality objectives.

<sup>1</sup> All QM sections can be found in AICPA *Professional Standards*.



## Identify quality risks

There may be many risks that could adversely affect the achievement of the quality objectives. However, it is not reasonable or practicable for the firm to identify and assess every possible risk and to design and implement responses for every risk. Accordingly, the standard requires the firm to identify *quality* risks.

A risk qualifies as a quality risk when it meets both of the following criteria:

**1** The risk has a reasonable possibility of occurring.

**2** The risk has a reasonable possibility of, individually or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

The firm exercises professional judgment in determining whether a risk meets the threshold set out in the definition of quality risks.



**NOTE:** The threshold for identifying quality risks is at the level of the quality objectives. If a firm has sub-objectives, there may be circumstances in which a risk has a reasonable possibility of adversely **affecting the achievement of the sub-objective**, but does not have a reasonable possibility of adversely **affecting the achievement of a quality objective**; in this case, the risk would not be considered a quality risk.



# How the firm identifies and assesses quality risks

The process the firm is required to follow in identifying and assessing quality risks is as follows:

## Step 1: Identify the risks.

Understand the various conditions, events, circumstances, actions, or inactions related to the firm and its engagements that could adversely affect the achievement of the quality objectives. The risks include anything that could prevent the firm from achieving the quality objectives. For example, not taking any positive action to achieve the quality objective would prevent the firm from achieving the quality objective.

## Step 2: Assess the risks.

In assessing the risks, the firm takes into account the following:

- How and the degree to which the conditions, events, circumstances, actions, or inactions may affect the achievement of the quality objectives.
- The likelihood of the risk occurring. This is necessary to determine whether the risk meets the threshold of a quality risk.

Another way of expressing this is in terms of likelihood and magnitude. How likely is the risk to occur? How bad would it be if it did? The identification and assessment of the quality risks may be undertaken simultaneously. A firm may choose to identify and assess quality risks as two discrete steps, but this is not required.



# The conditions, events, circumstances, actions, or inactions that could adversely affect the achievement of the quality objectives

QM section 10 includes specific conditions, events, circumstances, actions, or inactions related to the nature and circumstances of the firm and its engagements that the firm is required to

- understand and
- take into account, thinking about how they may adversely affect the achievement of the quality objectives.

The next step is for the firm to identify any quality risks.

The following table lists these specific conditions, events, circumstances, actions, or inactions.

The conditions, events, circumstances, actions, or inactions that the firm is required to understand	
The complexity and operating characteristics of the firm	Matters such as the size of the firm; the geographical dispersion of the firm; how the firm is structured; the extent to which the firm concentrates or centralizes its processes or activities (for example, use of service delivery centers); and the characteristics and availability of the firm’s resources.
The strategic and operational decisions and actions, business processes, and business model of the firm	Matters such as decisions about financial and operational priorities, including the firm’s strategic goals; how financial resources are managed; growth of the firm’s market share; industry specialization; and new industries or service offerings.
The characteristics and management style of leadership	Matters such as the composition and tenure of firm leadership; how authority is distributed among leadership; how leadership motivates and encourages personnel; and the culture created by firm leadership.
The resources of the firm, including the resources provided by service providers	Matters such as the general background of the firm’s personnel and overall staff profile and structure; the use of technology and how that technology is obtained, developed, and maintained; and the availability and allocation of financial resources.  With respect to service providers, matters such as the nature of the resources provided by service providers; how and the extent to which they will be used by the firm; and the general characteristics of the service providers used by the firm.
Law, regulation, professional standards, and the environment in which the firm operates	Matters such as regulations directly relevant to the firm and professional standards, other standards, or regulations affecting engagements performed by the firm (for example, general purpose frameworks for financial reporting commonly used in the jurisdiction).

## The conditions, events, circumstances, actions, or inactions that the firm is required to understand

<b>The nature and extent of the network requirements and network services</b>	Matters such as the nature of the network; how the network is organized; and the quality of network requirements or network services provided.
<b>The types of engagements performed by the firm and the reports to be issued</b>	<p>Matters such as which engagements the firm performs, including</p> <ul style="list-style-type: none"><li>• audits or reviews of financial statements, and whether the firm performs engagements to report on summary financial statements or reviews of interim financial statements</li><li>• other assurance or related services engagements and the types of subject matter for which such engagements are undertaken (for example, sustainability reports, controls at service organizations)</li></ul> <p>The firm may also understand and consider how the reports the firm issues may be used.</p>
<b>The types of entities for which engagements are undertaken</b>	Matters such as the industries in which the firm's clients operate and the nature of their business; the size and complexity of the firm's clients; the nature of the firm's clients' shareholding (for example, owner-managed); and the size or nature of the firm's clients' stakeholders.

It is essential to note that this list of conditions, events, circumstances, actions, or inactions is not exhaustive. There may be other conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of a quality objective, which the firm would need to understand and further consider to determine whether a quality risk exists.

Furthermore, not all the conditions, events, circumstances, actions, or inactions are relevant to every quality objective.

The following table includes examples of conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, and the quality risks that may arise.

Condition, event, circumstance, action, or inaction that may adversely affect the achievement of a quality objective	Quality risks that may arise
<b>The complexity and operating characteristics of the firm.</b> The firm is a large firm with multiple offices. Each office has a leader in charge of engagement quality and administrative and operational matters.	In the context of governance and leadership, quality risks relating to how a consistent culture is maintained throughout the firm because of the dispersion of the firm and the leadership responsibilities
<b>The strategic and operational decisions and actions, business processes, and business model of the firm.</b> The firm has a strategic goal to grow its tax practice and offer more extensive tax planning advice and support.	In the context of relevant ethical requirements, a quality risk that the firm breaches independence requirements regarding nonaudit services
<b>The characteristics and management style of leadership.</b> Given that the firm is small, leadership is concentrated to a single individual who has daily interactions with personnel.	In the context of engagement performance, a quality risk that personnel do not bring differences of opinion that involve leadership to the attention of the firm
<b>The resources of the firm, including the resources provided by service providers.</b> The firm has a service delivery center located in another jurisdiction that performs certain aspects of the firm's audit engagements.	In the context of engagement performance, a quality risk that engagement personnel are not appropriately directed and supervised and that their work is not appropriately reviewed
<b>Law, regulation, professional standards, and the environment in which the firm operates.</b> Due to the global pandemic, engagement teams work remotely.	In the context of information and communication, a quality risk that information is not communicated appropriately to engagement teams working remotely, such that engagement teams are unable to understand and carry out their responsibilities in performing the engagement
<b>Law, regulation, professional standards, and the environment in which the firm operates.</b> New regulations are introduced mandating audit firm rotation every 10 years, resulting in the firm losing many of its engagements in quick succession and many personnel becoming underutilized.	In the context of acceptance and continuance, a quality risk that the firm inappropriately accepts a client relationship or specific engagement, given that the firm has excess staff capacity

Condition, event, circumstance, action, or inaction that may adversely affect the achievement of a quality objective	Quality risks that may arise
<p><b>The nature and extent of the network requirements and network services.</b> The network requires all firms in the network to use the network-developed IT software for independence. Personnel are required to record their financial interests in the software, and all services to clients are logged in the software. The software tracks information to automatically alert the firm if there is an independence breach.</p>	<p>In the context of relevant ethical requirements, a quality risk that the network does not appropriately take into account requirements regarding independence in developing the software and that the firm is not alerted when there is an independence breach</p>
<p><b>The types of engagements performed by the firm and the reports to be issued.</b> The firm performs assurance engagements for greenhouse gas statements.</p>	<p>In the context of resources, a quality risk that the firm does not have appropriate intellectual resources to support these engagements and that engagement teams use intellectual resources that do not take into account laws and regulations related to emissions</p>
<p><b>The types of entities for which engagements are undertaken.</b> The firm performs compilations of financial statements for entities that operate in an industry in which recent revisions to the accounting standards have given rise to complex financial statement disclosures. Typically, the compilation engagements performed by the firm are not complex.</p>	<p>In the context of engagement performance, a quality risk that the engagement teams performing the compilations do not undertake appropriate consultation, given that they have not previously needed to consult on complex financial statement disclosures</p>
<p><b>The types of entities for which engagements are undertaken.</b> The firm performs audits of entities involved in an industry with specialized accounting.</p>	<p>In the context of resources, a quality risk that personnel lack the appropriate knowledge or experience of relevant accounting standards applicable to that industry</p>



The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction that may give rise to a quality risk. The documentation of the quality risks may include the reasons for the assessment given to the quality risks (that is, the considered occurrence and effect on the achievement of the quality objectives).

In some circumstances, it may be appropriate for the firm to document its process and analysis for establishing quality objectives, identifying and assessing quality risks, and designing responses to such risks, to provide a history of the basis for decisions made by the firm about its SOQM.

Further considerations on documentation are included in the documentation section.



# Practical tips on designing and performing the risk assessment process

Your firm may find the following tips helpful in organizing the process.

☐ **Determine who within the firm will take ownership and lead the implementation process.**

- Note that SQMS No. 1 requires that the firm assign ultimate responsibility and authority for the SOQM to the firm's managing partner, and assign, to appropriate individuals within the firm, (i) operational responsibility for the SOQM, and (ii) operational responsibility for specific aspects of the SOQM. Note that, depending on firm size, these may all be the same person.

☐ **Determine the resources — human, intellectual, and technical — needed for successful implementation.**

Tip: your staff may view working on this project as an opportunity.

☐ **Develop a timeline for performing the risk assessment and designing and implementing responses, that ends with full compliance with SQMS No. 1 by Dec. 15, 2025.**

☐ **Talk with your peer reviewer about your implementation plan. Note that your peer reviewer, to maintain independence, cannot be part of your SOQM — just like you can't be part of your client's system of internal control over financial reporting — but can advise you.**

☐ **Plan a risk assessment brainstorming session (or more than one) to do the following:**

- Determine the order in which the components will be assessed. It could be all at once, one at a time, or in groupings (such as acceptance/resources, followed by performance/information, followed by governance and ethical components).

- Determine the participants for the components. Depending on the component and the size of your firm, you might find it necessary to involve the firm's other departments (such as IT, HR, and risk advisory).

- Develop a template that includes the quality objectives for that component, along with space to document brainstorming risks identified, risk significance, and planned responses. Or use whiteboards or sticky notes, and take pictures of them at the end of the session.

☐ **Hold a risk assessment session and during the meeting:**

- Set a time limit on brainstorming and stick to it.
  - Do not get stuck on one area.
  - Remember the goal at this stage is to identify and assess the risks, not to develop responses.
  - Keep front of mind that risk assessment is iterative, and the firm may find more ideas as implementation develops.
- Brainstorm risk identification.
  - Think about what in your practice could go wrong from a quality perspective.
  - Think about what you have to do (or are currently doing) in your practice to make sure things go right.
  - Consider any information the firm may have related to current quality risks (for example, information provided to insurance carriers).
- Go over the identified risks and assess them for likelihood and magnitude. Decide which risks are quality risks. It may take a few iterations to determine the appropriate level for quality risks, to avoid being too granular or too high level. (This step may call for a separate session.)

- Do just enough to know that the risk will warrant a response and move on.
  - You do not have to document every risk that is considered.
  - You may wish to track borderline risks that don't quite rise to quality risks for reassessment in the future.
  - Tip: moving into a new industry or area of practice is always a quality risk.
- Don't worry about perfection in documentation — just get it in your file.
- Don't worry about matching risks to objectives.
- Don't spend time trying to perfect the likelihood, magnitude, or reasons for the risk.
- The number of risks a firm should identify is a matter of professional judgment and depends on the nature and circumstances of the firm. But consider:
  - If you have many risks that are covered by the same responses (for example, policies and procedures), that's a sign you're too granular, and you may wish to group the risks.
  - If you have haven't identified risks associated with all responses (for example, policies and procedures), that may be a sign that you haven't identified enough quality risks.

□ **Perform a gap analysis. Based on the quality risks identified, map current controls — or “responses to quality risks,” as SQMS No. 1 calls them.**

- Identify quality risks without appropriate responses as well as any current responses that do not map to a quality risk.
- Take note of the specified responses within SQMS No. 1 that the firm is required to design and implement.
  - Design and implement new responses for risks that are not addressed. Consider discontinuing current responses that do not map to a quality risk.
  - Document the risk assessment process. This documentation does not need to be very detailed; it should describe the process (that is, what you did to identify and assess quality risks) without including every risk identified.



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# Establishing and Maintaining a **System of Quality Management** for a CPA Firm's Accounting and Auditing Practice

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**Chapter 3:** Library of Quality Objectives,  
Potential Risks, and Potential Responses

For Small- and  
Medium-Sized Firms

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This AICPA Audit and Accounting Practice Aid replaces *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which was issued in 2015. Although this practice aid has been reviewed by the AICPA Audit and Attest Standards staff, it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA and has no official or authoritative status.

This practice aid does not address the quality control requirements of the Sarbanes-Oxley Act of 2002 (SOX), nor does it address the quality control requirements of PCAOB standards that must be followed by auditors of issuers. Auditors of issuers should follow these other standards and make changes to their firm's quality control systems as necessary.

Additional information about the PCAOB and SOX can be obtained at the PCAOB website at [www.pcaobus.org](http://www.pcaobus.org).



# How to Use this Practice Aid

This AICPA Audit and Accounting Practice Aid, *Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice*, is intended to help sole practitioners design, implement, and operate a system of quality management for their firm's accounting and auditing practice, as required by Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*, issued by the AICPA.

SQMS No. 1 requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management. In applying a risk-based approach, the firm is required to take into account the nature and circumstances of both the firm and the engagements performed by the firm. This practice aid explains how to apply a risk-based approach and includes a library of potential risks and suggested responses.

Use this practice aid, and the Example Risk Assessment template, to help you apply the risk-based approach, identify the quality risks to your practice, and implement policies and procedures as necessary for the facts and circumstances of your practice.

Many of the policies and procedures may need to be modified to be applicable to your firm. Some may not be applicable at all. You may need to add policies and procedures that are already part of your system. Some of the policies and procedures are required by SQMS No. 1; these are noted in chapters 3 and 4.

Be aware that if you do not customize the risks and responses to the nature of your practice

- you won't be in compliance with the standards.
- you won't be doing what is most efficient and effective for your practice.

If all you do is

- copy the quality risks from this practice aid, it is likely that your quality risks will be incomplete, or that you will include quality risks that do not apply to your firm. Do not copy the quality risks from this practice aid without thoughtful consideration of any modifications needed for your firm's nature and circumstances.
- copy and paste the policies and procedures in this practice aid, you will be committing to responses that may not apply to your firm. And, because you included them in your documentation of your system of quality management, your peer reviewer will expect you to apply those policies and procedures.

In addition, a firm's risk assessment should be iterative and updated when changes in the nature and circumstances of the firm or its engagements occur. An incomplete or out-of-date risk assessment can have a significant effect on the system of quality management.

This practice aid is intended for firms with two or more personnel. If your firm has only one assurance partner, or only one partner with expertise in a specialized area, you may find the AICPA Audit and Accounting Practice Aid *Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice* for sole practitioners, also helpful.

# Chapter 3 — Library of Quality Objectives, Potential Risks, and Potential Responses

## Instructions for Using this Library

This chapter addresses the components that are subject to the risk assessment process, which are all components, except for the risk assessment process, which is addressed in chapter 2, “Overview of Risk Assessment Requirements”, and monitoring, which is addressed in chapter 4, “Monitoring and Remediation Process”.

This chapter is organized by component. For each component in this chapter, there are four tables:

- **Table 1:** Required Quality Objectives
- **Table 2:** Required Quality Objectives and Potential Quality Risks
- **Table 3:** Required and Suggested Quality Responses
- **Table 4:** Example of Evaluated Quality Risks and Linked Responses

### Table 1: Required Quality Objectives

This table contains the quality objectives (QO) that the firm is required to establish for the component.

### Table 2: Required Quality Objectives and Potential Quality Risks

This table contains the quality objectives that the firm is required to establish for the component. Following each objective is a repository of potential quality risks (QRI). (Note: You may believe that a risk fits better under a different quality objective. If so, feel free to move it; what is important is that all quality risks are identified.)

### Quality Risks

A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. A quality risk is a risk that has a reasonable possibility of occurring, and individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives. Not all risks meet the definition of a *quality risk*.

The quality risks library is intended to be a repository of potential risks; it is not all-inclusive, nor are all quality risks in the library necessarily applicable to your firm. In identifying and assessing quality risks, focus on understanding conditions, events, circumstances, actions, or inactions that relate to the nature and circumstances of your firm and its engagements. The scalability of the Statements on Quality Management Standards (SQMSs) lies in your ability to identify the risks and responses that are appropriate for the nature and circumstances of your practice. The quality risks in the library should be tailored to suit your firm. You may decide to evaluate risks at a very high level, for example, stating risks as the reverse of the quality objectives, in which case, all the risks would be quality risks. You may decide to evaluate risks at a somewhat more granular level or at a very granular level, or a combination of these approaches.

To determine if a risk is a quality risk for your firm

- determine the likelihood of the risk occurring, and
- determine the impact that the risk could have, whether individually or in combination with other risks, to the firm achieving one or more quality objectives.



**Note:** Formal ratings or scores are not required by QM section 10, *A Firm's System of Quality Management*. However, this practice aid provides drop-down menus to assess the risks as low, medium, or high. Risks that have a low likelihood of occurring and a low impact are not considered quality risks for purposes of this practice aid.

**WARNING:** The risk is evaluated before the effect of controls (that is, quality responses, which are policies, and procedures). You may think that a quality risk doesn't exist because your firm already has effective controls to mitigate it. Evaluate risks as if you were starting to build a system of quality management (SOQM) from the ground up. (On the Responses tab, you can consider your existing policies and procedures).

### Table 3: Required and Suggested Quality Responses

Responses (QRe) are policies or procedures designed and implemented by firms to address one or more quality risks. Policies are identified with bold text.

QM section 10 has a limited number of required specified responses, which are identified in this practice aid. The firm is expected to design and implement its own additional responses that are responsive to its identified quality risks. In addition to the required specific responses, this table contains potential additional responses that should be linked to your firm's risks and tailored to suit the nature and circumstances of your firm.

Although responses are categorized by component, responses may be related in several ways. A response may address multiple quality risks across various components. For example, the responses designed and implemented by the firm to address complaints and allegations may address quality risks related to the quality objectives in (i) resources (for example, personnel's commitment to quality), (ii) relevant ethical requirements, and (iii) governance and leadership.

A response may support another response in another component. This is particularly the case for responses related to resources and information and communication because these elements are often needed to support the operation of other responses. See the exhibit, "Relevant Responses From Other Components," at the end of this chapter.

### Table 4: Example of Evaluated Quality Risks and Linked Responses

This table provides examples of evaluated quality risks and linked responses to the quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste the examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The examples included illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

**Note:** QM section 10 requires the firm to assign ultimate responsibility and accountability for the firm's SOQM to the firm's CEO, the firm's managing partner (or equivalent), or, if appropriate, the firm's managing board of partners (or equivalent). For purposes of this practice aid, this position is referred to as the *firm's managing partner*.

## Governance and Leadership

**Table 1: Required Quality Objectives— Governance and Leadership**

QO #	Ref:	Quality Objectives (QO)
GOV QO-1	QM sec. 10, par. .29a	<p>The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following:</p> <ul style="list-style-type: none"> <li>• The firm's role in serving the public interest by consistently performing quality engagements</li> <li>• The importance of professional ethics, values, and attitudes</li> <li>• The responsibility of all personnel for quality relating to the performance of engagements or activities within the SOQM and their expected behavior</li> <li>• The importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities</li> </ul>
GOV QO-2	QM sec. 10, par. .29b	Leadership is responsible and accountable for quality.
GOV QO-3	QM sec. 10, par. .29c	Leadership demonstrates a commitment to quality through its actions and behaviors.
GOV QO-4	QM sec. 10, par. .29d	The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm's SOQM.
GOV QO-5	QM sec. 10, par. .29e	Resource needs, including financial resources, are planned for, and resources are obtained, allocated, or assigned in a manner that is consistent with the firm's commitment to quality.

**Table 2: Required Quality Objectives and Potential Quality Risks — Governance and Leadership**

QO#	QRI #	Quality Risk (QR)	Likelihood	Impact	Quality Risk
GOV QO-1	QM sec. 10, par. .29a	<p>The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following:</p> <ul style="list-style-type: none"> <li>i. The firm’s role in serving the public interest by consistently performing quality engagements</li> <li>ii. The importance of professional ethics, values, and attitudes</li> <li>iii. The responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management and their expected behavior</li> <li>iv. The importance of quality in the firm’s strategic decisions and actions, including the firm’s financial and operational priorities</li> </ul>			

**Public Interest Role and Culture of Quality**

GOV QO-1	GOV QRI-1	The firm does not demonstrate a commitment to quality through the culture that exists throughout the firm.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-2	The firm does not acknowledge its role in serving the public interest and does not strive to perform quality engagements.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-3	The firm does not recognize or reinforce the importance of professional ethics, values, and attitudes.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-4	The firm does not recognize or reinforce the responsibility of all personnel for quality relating to the performance of engagements or activities within the SOQM and their expected behavior.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-5	The firm does not recognize or reinforce the importance of quality in the firm’s strategic decisions and actions, including the firm’s financial and operational priorities.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-6	The firm’s culture and communication does not include a focus on the public interest or the importance of professional ethics, values, and attitudes in the performance of accounting and auditing services.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-7	The firm fails to establish or communicate consequences for unsatisfactory quality performance to personnel.	Choose an item.	Choose an item.	Choose an item.



QO#	QRI #	Quality Risk (QR)	Likelihood	Impact	Quality Risk
GOV QO-1	QM sec. 10, par. .29a	<p>The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following:</p> <ul style="list-style-type: none"> <li>i. The firm's role in serving the public interest by consistently performing quality engagements</li> <li>ii. The importance of professional ethics, values, and attitudes</li> <li>iii. The responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management and their expected behavior</li> <li>iv. The importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities</li> </ul>			
Financial and Strategic Priorities					
GOV QO-1	GOV QRI-8	As the firm opens new offices or undergoes mergers or acquisitions, consistent culture is not permeated throughout the firm.	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-9	The firm does not prioritize quality in merger decisions. (For example, does the target firm meet our quality expectations and is it assessed for quality during due diligence?)	Choose an item.	Choose an item.	Choose an item.
GOV QO-1	GOV QRI-10	The firm accepts engagements in conjunction with a practice acquisition or strategic hire that otherwise would not meet the firm's engagement acceptance or continuance criteria.	Choose an item.	Choose an item.	Choose an item.
GOV QO-2	QM sec. 10, par. .29b	Leadership is responsible and accountable for quality.			
GOV QO-2	GOV QRI-11	Leadership is not responsible or accountable for quality.	Choose an item.	Choose an item.	Choose an item.
GOV QO-2	GOV QRI-12	Leadership is not evaluated and held accountable for demonstrating a culture that has quality at its core.	Choose an item.	Choose an item.	Choose an item.
GOV QO-2	GOV QRI-13	The performance evaluations required by Statement on Quality Management Standards (SQMS) No. 1, <i>A Firm's System of Quality Management</i> (paragraph 57), of the firm's managing partner and the quality management (QM) partner are not conducted effectively or not acted upon appropriately.	Choose an item.	Choose an item.	Choose an item.
GOV QO-2	GOV QRI-14	Leadership and employees in firm leadership positions do not have sufficient and appropriate understanding of quality management standards or the firm's SOQM to fulfill their leadership responsibilities.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk (QR)	Likelihood	Impact	Quality Risk
GOV QO-2	QM sec. 10, par. .29b	Leadership is responsible and accountable for quality.			
GOV QO-2	GOV QRI-15	Leadership responsibilities and accountability for quality are not clearly defined and assigned.	Choose an item.	Choose an item.	Choose an item.
GOV QO-2	GOV QRI-16	The firm does not hold employees in leadership positions accountable for behaviors in which quality was not demonstrated.	Choose an item.	Choose an item.	Choose an item.
GOV QO-2	GOV QRI-17	The tone, messaging, and communication that exists at the firm's [national, regional, or office] leadership levels is not embraced or communicated throughout the firm.	Choose an item.	Choose an item.	Choose an item.
GOV QO-3	QM sec. 10, par. .29c	Leadership demonstrates a commitment to quality through its actions and behaviors.			
GOV QO-3	GOV QRI-18	Leadership does not demonstrate a commitment to quality through its actions and behaviors (for example, establishing the tone at the top through their actions and behaviors and clear, consistent, and frequent actions and communications at all levels within the firm).	Choose an item.	Choose an item.	Choose an item.
GOV QO-3	GOV QRI-19	Professionals in leadership positions who work on accounting and auditing engagements do not demonstrate a commitment to quality while working on such engagements.	Choose an item.	Choose an item.	Choose an item.
GOV QO-3	GOV QRI-20	The actions and decisions of partners and employees in leadership positions do not demonstrate a commitment to quality (for example, resource allocation, acceptance, continuation, compensation, and advancement decisions).	Choose an item.	Choose an item.	Choose an item.
GOV QO-3	GOV QRI-21	Unethical behavior is unchallenged or noncompliance with the SOQM is not addressed, including swift disciplinary action by leadership when warranted.	Choose an item.	Choose an item.	Choose an item.
GOV QO-3	GOV QRI-22	Leadership "tone at the top" is ineffective at building a commitment to quality for all employees.	Choose an item.	Choose an item.	Choose an item.
GOV QO-3	GOV QRI-23	Professionals in leadership positions prioritize economic gain over quality through their actions and behaviors.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk (QR)	Likelihood	Impact	Quality Risk
GOV QO-3	QM sec. 10, par. .29c	Leadership demonstrates a commitment to quality through its actions and behaviors.			
GOV QO-3	GOV QRI-24	Leadership lacks the resources to enforce the principles of SQMS No. 1.	Choose an item.	Choose an item.	Choose an item.
GOV QO-4	QM sec. 10, par. .29d	The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm’s system of quality management.			
Organizational Structure					
GOV QO-4	GOV QRI-25	The organizational structure and assignment of roles, responsibilities, and authority is not appropriate and does not enable the design, implementation, and operation of the firm’s SOQM.	Choose an item.	Choose an item.	Choose an item.
GOV QO-4	GOV QRI-26	The firm may be growing through acquisition at a pace faster than its current SOQM and organizational structure can support.	Choose an item.	Choose an item.	Choose an item.
GOV QO-4	GOV QRI-27	Regarding the use of service delivery centers, the organizational structure and assignment of roles, responsibilities, and authority is not appropriate for, or is not effective at, achieving the objectives of the SOQM.	Choose an item.	Choose an item.	Choose an item.
Roles, Responsibility, and Authority					
GOV QO-4	GOV QRI-28	The managing partner lacks assurance experience.	Choose an item.	Choose an item.	Choose an item.
GOV QO-4	GOV QRI-29	Persons assigned roles relevant to the SOQM lack the skills, knowledge, and experience to undertake those roles.	Choose an item.	Choose an item.	Choose an item.
GOV QO-4	GOV QRI-30	Persons assigned roles relevant to the SOQM lack the authority to be able to successfully implement policies and procedures.	Choose an item.	Choose an item.	Choose an item.
GOV QO-4	GOV QRI-31	The firm does not adequately communicate the firm’s expectations regarding firm culture and expected behaviors of its professionals.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk (QR)	Likelihood	Impact	Quality Risk
GOV QO-4	QM sec. 10, par. .29d	The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm's system of quality management.			
GOV QO-4	GOV QRI-32	The firm does not have a process that continually monitors compliance with relevant ethical requirements (that is, code of professional conduct, state licensing, and other regulatory bodies).	Choose an item.	Choose an item.	Choose an item.
GOV QO-5	QM sec. 10, par. .29e	Resource needs, including financial resources, are planned for, and resources are obtained, allocated, or assigned in a manner that is consistent with the firm's commitment to quality.			
GOV QO-5	GL QRI-33	Resource needs, including financial resources, are not obtained by, allocated, or assigned to the appropriate parties in a manner that facilitates the firm's commitment to quality.	Choose an item.	Choose an item.	Choose an item.
GOV QO-5	GL QRI-34	The firm's resource planning does not effectively determine the resources currently required.	Choose an item.	Choose an item.	Choose an item.
GOV QO-5	GL QRI-35	The firm's resource planning does not effectively forecast the firm's future resource needs.	Choose an item.	Choose an item.	Choose an item.
GOV QO-5	GL QRI-36	The firm's resource planning does not effectively establish processes to deal with unanticipated resource needs when they arise.	Choose an item.	Choose an item.	Choose an item.
GOV QO-5	GL QRI-37	The managing partner or QM partner are unwilling or unable to appropriately influence how those resources are allocated or assigned, including the timing of when they are used.	Choose an item.	Choose an item.	Choose an item.
GOV QO-5	GL QRI-38	Insufficient resources are allocated to developing an effective SOQM.	Choose an item.	Choose an item.	Choose an item.

**Table 3: Required and Suggested Quality Responses — Governance and Leadership**

QRe#	Quality Response (QRe)	Note, Tip, or Warning
<b>Governance and Leadership</b>		
<b>GOV QRe-1</b>	<b>Policy: The firm assigns ultimate responsibility and accountability for the SOQM to the firm’s CEO or the firm’s managing partner (or equivalent) or, if appropriate, the firm’s managing board of partners (or equivalent).</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .21a]
<b>GOV QRe-1.01</b>	The managing partner [Name] accepts ultimate responsibility for the firm’s SOQM and for setting a tone that emphasizes the importance of quality and of following the firm’s SOQM.	<b>NOTE:</b> The managing partner has the ultimate responsibility and that responsibility remains even if a different person is the QM partner. The person in charge of the audit and accounting practice, if different, is also responsible for setting the proper tone at the top.
<b>GOV QRe-1.02</b>	The managing partner acknowledges this responsibility, and the importance of quality, through [a written] communication to firm personnel at least once a year.	
<b>GOV QRe-2</b>	<b>Policy: The firm assigns operational responsibility for the SOQM to individuals with the appropriate influence and authority within the firm.</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .21b]
<b>GOV QRe-2.01</b>	[Name of partner or director] is designated as the QM partner and has overall responsibility for developing and implementing appropriate policies and procedures for the firm’s quality management system.	<p><b>NOTE:</b> As your firm grows or develops specializations, the firm may need to designate additional partners with QM responsibility.</p> <p><b>TIP:</b> Names can be maintained in a separate chart for ease of updating.</p>
<b>GOV QRe-3</b>	<p><b>Policy: The firm assigns operational responsibility for specific aspects of the SOQM to individuals with the appropriate influence and authority within the firm, including</b></p> <ul style="list-style-type: none"> <li>• <b>compliance with independence requirements, and</b></li> <li>• <b>the monitoring and remediation process.</b></li> </ul>	<p><b>NOTE:</b> The number of individuals assigned operational responsibility for various aspects of the firm’s SOQM depends on the size and structure of the firm.</p> <p><b>NOTE:</b> This is a required response. [QM sec. 10, par. .21c]</p>
<b>GOV QRe-4</b>	<b>Policy: The firm documents its QM policies and procedures and communicates them to the firm’s personnel.</b>	
<b>GOV QRe-4.01</b>	The QM partner is responsible for documenting the firm’s QM policies and procedures and keeping that documentation up to date (reviewing at least annually).	

QRe#	Quality Response (QRe)	Note, Tip, or Warning
<b>Governance and Leadership</b>		
<b>GOV QRe-4.02</b>	New hires are required to acknowledge receipt of the firm's QM document in writing, and that they have been informed that failure to adhere to the firm's policies and procedures or failure to demonstrate commitment to ethical principles may result in disciplinary action.	
<b>GOV QRe-4.03</b>	At least annually, firm personnel receive training on the firm's QM policies and procedures and acknowledge receipt of the QM document. This training is provided through <i>[select as appropriate: an informal discussion; an in-house training session; or in-house training sessions with a web-based or video-based discussion of QM to ensure all personnel hear the message the same way]</i> .	
<b>GOV QRe-4.04</b>	Firm training on the firm's QM policies and procedures includes the following: <ul style="list-style-type: none"> <li>• A review of changes during the year</li> <li>• A "refresh" of the understanding of experienced employees and partners</li> <li>• A discussion of the "why" behind policies and procedures. Those responsible for QM matters are always prepared to demonstrate, explain, or make the case for why a requirement is in place (that is, what benefit it serves).</li> <li>• "Tests" on the QM document to determine which part of the policy is misunderstood or not well known</li> </ul>	
<b>GOV QRe-5</b>	<b>Policy: The firm's policy is to promote an internal culture that recognizes that quality is essential in performing engagements.</b>	
<b>GOV QRe-5.01</b>	The firm promotes an internal culture that recognizes quality is essential through <i>[describe the firm's specific actions, for example, a mission statement that includes the firm's core values and the importance of quality; frequent messages to personnel about the importance of quality and that it is not sacrificed for the need to achieve profitability; the status of the QM partner within the firm (that is, the QM function is not relegated to an administrative role); the QM partner reports directly to the managing partner; and considering quality in performance appraisals and compensation]</i> .	<p><b>TIP:</b> Culture is evidenced anecdotally. The most meaningful document that conveys a firm's culture is not its mission statement but, rather, its budget. How the firm allocates its resources, including financial and human, is critical to achieving quality in performing engagements.</p> <p><b>TIP:</b> Messages can be as informal as emails or "reminders" at staff meetings.</p> <p><b>TIP:</b> Establishing a code of conduct (and periodically revisiting that code for ongoing relevance) is one way to promote an internal culture that recognizes quality. How a firm follows and enforces the code of conduct (for example, actions taken when the code is not followed) also provides evidence of culture. In addition, evaluating trends in the volume or nature of unethical behavior that is reported and taking steps to improve is another way of reinforcing a culture of quality within a firm.</p>

QRe#	Quality Response (QRe)	Note, Tip, or Warning
<b>Governance and Leadership</b>		
<b>GOV QRe-6</b>	<b>Policy: The firm does not allow financial and operational priorities to override the quality of the work performed and assigns management responsibilities accordingly.</b>	
<b>GOV QRe-6.01</b>	The managing partner and each engagement partner evaluate client relationships and specific engagements so that financial and operational priorities do not override the objectives of the SOQM.	<b>NOTE:</b> Tight deadlines, scope creep, and incentive-based compensation are examples of matters that may result in overrides to the objectives of the SOQM.
<b>GOV QRe-6.02</b>	The firm emphasizes to all personnel that fee considerations and scope of services should not infringe upon quality work.	<b>NOTE:</b> What happens in your firm if the engagement team goes significantly over budget for the engagement? Is there explicit or implicit pressure on personnel to skip planned procedures due to time constraints?
<b>GOV QRe-6.03</b>	The firm considers the costs associated with a strong SOQM, such as the costs of maintaining necessary competency, practice aids and professional subscriptions, hiring consultants and EQ reviewers, and so on, as an investment and factors them in when determining rates and fees.	
<b>GOV QRe-6.04</b>	The firm's strategic decision-making process is aligned with the firm's quality objectives and approved by leadership with the ultimate responsibility for the firm's SOQM.	<b>NOTE:</b> A firm's business strategy may include matters such as the firm's decisions about financial and operational matters, the firm's financial goals, how financial resources are managed, growth of the firm's market share, industry specialization, or new service offerings.
<b>GOV QRe-7</b>	<b>Policy: Personnel with sufficient and appropriate experience, authority, and ability are assigned responsibility for developing, implementing, and operating the firm's SOQM.</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .20]
<b>GOV QRe-7.01</b>	<p>The firm's QM partner has the following characteristics:</p> <ul style="list-style-type: none"> <li>• Sufficient and appropriate experience and competency to serve in that capacity</li> <li>• Up to date with industry-specific continuing professional education in any high-risk areas the QM partner reviews</li> <li>• Has no history of significant performance issues identified through regulator inspections, internal monitoring, or peer review</li> </ul>	<b>NOTE:</b> "Up to date" means within the past 24 months or sooner if there have been new professional standards or changes in regulations.

QRe#	Quality Response (QRe)	Note, Tip, or Warning
<b>Governance and Leadership</b>		
<b>GOV QRe-8</b>	<b>Policy: The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality management policies and procedures.</b>	
<b>GOV QRe-8.01</b>	The firm provides the designated QM partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's QM policies and procedures.	<b>NOTE:</b> Is this time budgeted?
<b>GOV QRe-8.02</b>	The quality management partner has the ability to influence the nature and extent of resources that the firm obtains, develops, uses, and maintains.	
<b>GOV QRe-8.03</b>	The quality management partner has the authority to determine how resources are allocated or assigned, including the timing of when they are used.	
<b>GOV QRe-8.04</b>	The firm annually performs resource planning that includes <ul style="list-style-type: none"> <li>• determining the resources currently required,</li> <li>• forecasting the firm's future resource needs, and</li> <li>• establishing processes to deal with unanticipated resource needs when they arise.</li> </ul>	
<b>GOV QRe-8.05</b>	The firm evaluates the effectiveness of the resources obtained, allocated, and assigned to ensure they support the firm's commitment to quality.	
<b>GOV QRe-8.06</b>	The firm obtains feedback from personnel, such as the method for personnel to propose new or revised policies and procedures.	<b>TIP:</b> This can be as informal as sending a request to all firm personnel when updating the firm's policies and procedure asking for input or as formal as using an independent third-party provider to facilitate the communication by personnel, anonymously if desired.
<b>GOV QRe-9</b>	<b>Policy: Performance evaluation, compensation, and advancement (including incentive systems) with regard to firm partners and personnel demonstrate the firm's overarching commitment to the objectives of the SOQM.</b>	
<b>GOV QRe-9.01</b>	Performance evaluation and advancement systems are designed and implemented so that partners and staff involved in the accounting and auditing practice are rewarded for the quality of their work and their compliance with professional standards.	<b>WARNING:</b> You may talk the talk, but if compensation is primarily based on concepts like realization and coming in under budget, you aren't walking the walk.



QRe#	Quality Response (QRe)	Note, Tip, or Warning
<b>Governance and Leadership</b>		
<b>GOV QRe-9.02</b>	<p>The firm's compensation system provides incentives to accounting and auditing partners and senior-level employees to perform high-quality accounting and auditing work. The compensation system does the following:</p> <ul style="list-style-type: none"> <li>• Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed</li> <li>• Rewards partners and personnel for timely (a) identification of significant and emerging accounting and auditing issues and (b) consultation with firm experts</li> </ul>	<p><b>NOTE:</b> Quality is both expected and rewarded.</p> <p><b>TIP:</b> Defining how quality will be measured and incorporating quality-related measures in personnel evaluations, with associated effects on compensation and promotion, demonstrates the firm's commitment to quality.</p>
<b>GOV QRe-9.03</b>	Leadership includes quality initiatives as a goal to be measured each year.	
<b>GOV QRe-9.04</b>	Performance evaluation and advancement systems are designed and implemented so that partners and staff are rewarded for their professional values and attitudes.	<p><b>NOTE:</b> Professional values and attitudes may include the following:</p> <ul style="list-style-type: none"> <li>• Professional manner; for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability</li> <li>• A commitment to teamwork</li> <li>• Maintaining an open mind to new ideas or different perspectives in the professional environment</li> <li>• Pursuit of excellence</li> <li>• A commitment to continual improvement (for example, setting expectations beyond the minimum requirements and placing a focus on continual learning)</li> <li>• Social responsibility</li> </ul>

**Table 4: Example of Evaluated Quality Risks and Linked Responses — Governance and Leadership**

The following table provides examples of evaluated quality risks and linked responses to each quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste these examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The following examples illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

Governance and Leadership							
<b>GOV QO-1</b>		<p>The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following:</p> <ul style="list-style-type: none"> <li>i. The firm's role in serving the public interest by consistently performing quality engagements</li> <li>ii. The importance of professional ethics, values, and attitudes</li> <li>iii. The responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management and their expected behavior</li> <li>iv. The importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities</li> </ul>					
QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
<b>GOV QO-1</b>	<b>GOV QRi-3</b>	The firm does not recognize or reinforce the importance of professional ethics, values, and attitudes.	Low	High	Yes	The firm promotes an internal culture that recognizes quality is essential through a mission statement that includes the firm's core values and the importance of quality; frequent messages to personnel about the importance of quality and that it is not sacrificed to the need to achieve profitability; the status of the QM partner within the firm (that is, the QM function is not relegated to an administrative role); the QM partner reports directly to the managing partner; and considering quality in performance appraisals and compensation.	GOV QRe-5.01

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
<b>GOV QO-1</b>	<b>GOV QRi-5</b>	The firm does not recognize or reinforce the importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities.	Medium	High	Yes	The firm's strategic decision-making process is aligned with the firm's quality objectives and approved by leadership with the ultimate responsibility for the firm's SOQM.	GOV QRe-6.04
<b>GOV QO-2</b>	Leadership is responsible and accountable for quality.						
<b>QO GOV-2</b>	<b>GOV QRi-11</b>	Leadership is not responsible or accountable for quality.	Low	High	Yes	The managing partner [Name] accepts ultimate responsibility for the firm's SOQM and for setting a tone that emphasizes the importance of quality and of following the firm's SOQM.	GOV QRe-1.01
<b>GOV QO-4</b>	The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm's system of quality management.						
<b>QO GOV-4</b>	<b>GOV QRi-32</b>	The firm does not have a process that continually monitors compliance with relevant ethical requirements (that is, code of professional conduct, state licensing, and other regulatory bodies).	High	Medium	Yes	The firm assigns operational responsibility for specific aspects of the SOQM to individuals with the appropriate influence and authority within the firm, including <ul style="list-style-type: none"> <li>compliance with independence requirements, and the monitoring and remediation process.</li> </ul>	GOV QRe-3

# Relevant Ethical Requirements

**Table 1: Required Quality Objectives – Relevant Ethical Requirements**

QO#	Ref:	Quality Objectives
RER QO-1	QM sec. 10, par. .30a	<p>The firm and its personnel</p> <ul style="list-style-type: none"><li>i. understand the relevant ethical requirements to which the firm and the firm's engagements are subject.</li><li>ii. fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject.</li></ul>
RER QO-2	QM sec. 10, par. .30b	<p>Others, including the network, network firms, individuals in the network or network firms, or service providers, who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject</p> <ul style="list-style-type: none"><li>i. understand the relevant ethical requirements that apply to them, and</li><li>ii. fulfill their responsibilities in relation to the relevant ethical requirements that apply to them.</li></ul>

**Table 2: Required Quality Objectives and Potential Quality Risks – Relevant Ethical Requirements**

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
RER QO-1	QM sec 10, par. .30a	The firm and its personnel i. understand the relevant ethical requirements to which the firm and the firm’s engagements are subject, and ii. fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm’s engagements are subject.			
RER QO-1	RER QRI-1	The firm and its personnel do not understand the relevant ethical requirements to which the firm and the firm’s engagements are subject.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-2	The firm and its personnel fail to fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm’s engagements are subject.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-3	The firm does not receive, investigate, or resolve complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements, or noncompliance with the firm’s policies or procedures established in accordance with the firm’s SOQM.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-4	Consultation and evaluation of identified independence matters results in an incorrect conclusion.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-5	Personnel and engagement teams are hesitant to communicate relevant information to the firm or those charged with overseeing relevant ethical requirements due to fear of reprisals.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-6	The firm and its personnel do not identify, communicate, evaluate, or report ethical breaches.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-7	Independence and objectivity are impaired due to a familiarity threat.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-8	Independence may be influenced by gifts from management or the client.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-9	Unpaid fees for professional services previously rendered to an attest client may create self-interest, or undue influence, or advocacy threats to compliance with the “Independence Rule” (ET sec. 1.200.001) of the AICPA Code of Professional Conduct.	Choose an item.	Choose an item.	Choose an item.
RER QO-1	RER QRI-10	The firm and its personnel do not timely identify, evaluate, or address noncompliance or threats to compliance with regulatory requirements.	Choose an item.	Choose an item.	Choose an item.

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
<b>RER QO-2</b>	<b>QM sec. 10, par. 30b</b>	Others, including the network, network firms, individuals in the network or network firms, or service providers, who are subject to the relevant ethical requirements to which the firm and the firm's engagements i. understand the relevant ethical requirements that apply to them, and i. fulfill their responsibilities in relation to the relevant ethical requirements that apply to them.			
<b>RER QO-2</b>	<b>RER QRi-11</b>	Others who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject do not understand the relevant ethical requirements that apply to them.	Choose an item.	Choose an item.	Choose an item.
<b>RER QO-2</b>	<b>RER QRi-12</b>	Others who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject do not fulfill their responsibilities in relation to the relevant ethical requirements that apply to them.	Choose an item.	Choose an item.	Choose an item.
<b>RER QO-2</b>	<b>RER QRi-13</b>	Network office does not understand the relevant ethical requirements that apply to the network or fulfill its responsibilities in relation to them.	Choose an item.	Choose an item.	Choose an item.
<b>RER QO-2</b>	<b>RER QRi-14</b>	Network firms used for component audits or other services do not understand the relevant ethical requirements that apply to them or fulfill their responsibilities in relation to them.	Choose an item.	Choose an item.	Choose an item.
<b>RER QO-2</b>	<b>RER QRi-15</b>	Non-network component auditors do not understand the relevant ethical requirements that apply to them or fulfill their responsibilities in relation to them.	Choose an item.	Choose an item.	Choose an item.

**Table 3: Required and Suggested Quality Responses — Relevant Ethical Requirements**

QRe#	Quality Response	Note, Tip, or Warning
<b>Relevant Ethical Requirements</b>		
<b>RER QRe-1</b>	<b>Policy: The firm and its personnel comply with relevant ethical requirements.</b>	<b>TIP:</b> Relevant ethical requirements are those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office (GAO), and any other applicable regulators.
<b>RER QRe-1.01</b>	A person with appropriate authority [Name] is responsible for staying informed on relevant ethical requirements; providing guidance; answering questions; monitoring compliance; and resolving matters with respect to independence, integrity, and objectivity.	<p><b>TIP:</b> The AICPA’s Ethics Hotline can be reached at 877.777.7077 or <a href="mailto:ethics@aicpa.org">ethics@aicpa.org</a>. The AICPA Ethics Tools and Aids, including the Plain English Guide to Independence, can be found at <a href="https://pub.aicpa.org/codeofconduct/Ethics.aspx">https://pub.aicpa.org/codeofconduct/Ethics.aspx</a>.</p> <p><b>NOTE: This is a required response. [QM sec. 10, par. .35a(i)]</b></p>
<b>RER QRe-1.02</b>	Access to current guidance materials regarding the applicable independence, integrity, and objectivity requirements is available to all personnel through [identify how, for example, through subscription service or via the AICPA’s website].	
<b>RER QRe-1.03</b>	Documentation of the resolution of ethical matters is required when consultation, including of professional literature or the AICPA Ethics Hotline, has occurred.	
<b>RER QRe-1.04</b>	The firm meets all the requirements of the “Nonattest Services” interpretation ( <a href="#">ET sec. 1.295</a> ), and the requirements of other regulators, as applicable, when providing nonattest services (such as bookkeeping, financial statement preparation, and tax services) to clients for whom the firm also performs an audit, review, compilation, or attestation engagement.	<b>WARNING:</b> Peer reviewers will ask for documentation of compliance, including documentation that the client has suitable skills, knowledge, and experience to accept responsibility.
<b>RER QRe-1.05</b>	The firm has established and follows a process for identifying all services performed for each client and evaluating, at the attest engagement level, whether nonattest services are provided that might impair independence. [Describe the process.]	<b>WARNING:</b> As a firm gets larger, it may be more difficult for the firm to track what services are being performed for every client in order to determine that independence is not being impaired.

QRe#	Quality Response	Note, Tip, or Warning
Relevant Ethical Requirements		
<b>RER QRe-1.06</b>	The firm maintains a current list of <ul style="list-style-type: none"> <li>• all entities with which firm personnel are prohibited from having a financial or business relationship and</li> <li>• all activities the firm is prohibited from performing, as defined in the firm's independence policies.</li> </ul>	<b>NOTE:</b> Examples of prohibited activities include providing certain valuation and IT services to an audit client. See the rules of specific standard setters to determine the extent and relevance of any prohibition.
<b>RER QRe-2</b>	<b>Policy: The firm communicates its independence requirements to firm personnel and, when applicable, others subject to them.</b>	<b>NOTE:</b> Per-diem personnel are firm personnel.
<b>RER QRe-2.01</b>	The firm provides its personnel with a list of all entities with which firm personnel are prohibited from having a business relationship and informs them on a timely basis about any changes in the firm's clients to which independence policies apply.	<b>WARNING:</b> Your firm's system may need to take the existence of related entities into account.
<b>RER QRe-2.02</b>	The firm reminds personnel of independence considerations for regulated industries.	<b>WARNING:</b> Regulators often have more restrictive independence requirements. For example, many regulators prohibit the CPA's involvement in the preparation of financial statements and define "preparation" very broadly. Know your industry and its regulatory requirements.
<b>RER QRe-2.03</b>	The firm provides reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity, as necessary and at least annually.	
<b>RER QRe-2.04</b>	The firm informs its personnel of the types of financial or other relationships that may impair independence and that may be prohibited.	
<b>RER QRe-2.05</b>	The firm requires all professional personnel to take independence and ethics training [ <i>specify period, such as annually</i> ]. Such training covers the firm's independence and ethics policies and the independence and ethics requirements of all applicable regulators.	<b>WARNING:</b> The state-specific ethics course required by many states for licensure may not be sufficient for the needs of your practice, and your firm may have to supplement that.
<b>RER QRe-2.06</b>	The firm has clear and concise written independence guidance covering relationships and activities that impair independence, including investments, loans, brokerage accounts, business relationships, employment relationships, and fee arrangements.	



QRe#	Quality Response	Note, Tip, or Warning
Relevant Ethical Requirements		
RER QRe-3	<b>Policy:</b> The firm evaluates threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time. The firm takes appropriate action to eliminate or reduce these threats to an acceptable level by applying safeguards.	
RER QRe-3.01	Approval of the assignment of engagement personnel by another partner or manager is required for each audit or attestation examination.	
RER QRe-3.02	New personnel assigned to the engagement are encouraged to bring a fresh perspective.	<b>WARNING:</b> This procedure is effective only when you have the appropriate attitude.
RER QRe-3.03	A partner who is not otherwise associated with the engagement reviews the engagement.	
RER QRe-3.04	The firm (the managing partner, QM partner, and others, as appropriate) considers the significance of each client to the firm. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of the partner's service to the client, (c) the manner in which the partner is compensated, and (d) the effect that losing the client would have on the partner and the firm.	
RER QRe-3.05	When a relationship or circumstance that may create threats to compliance with the rules is identified, the firm performs procedures to evaluate threats and apply safeguards (using the Conceptual Framework Toolkit for Members in Public Practice).	<b>TIP:</b> The Conceptual Framework Toolkit for Members in Public Practice is available at no charge at <a href="https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/conceptual-framework-toolkit-for-members-in-public-practice-final.pdf">https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/conceptual-framework-toolkit-for-members-in-public-practice-final.pdf</a> .
RER QRe-3.06	The engagement partner [ <i>considers or provides the firm with</i> ] relevant information about client engagements, including the scope of services and any changes, such as new engagements or changes in the level of service, to enable [ <i>the engagement partner or the firm</i> ] to evaluate the overall impact, if any, on independence requirements.	

QRe#	Quality Response	Note, Tip, or Warning
Relevant Ethical Requirements		
RER QRe-3.07	The firm requires personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken.	
RER QRe-3.08	The firm compiles and communicates relevant information to appropriate personnel so that the firm and its personnel can readily determine whether they satisfy independence requirements; the firm can maintain and update information relating to independence; and the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.	
RER QRe-3.09	The firm requires personnel to consult with individuals outside the firm on independence, integrity, or objectivity concerns that research has not clearly resolved.	<b>WARNING:</b> Make sure personnel, including engagement partners, are encouraged to consult; if they ask only when they are sure there is a problem, problems may get overlooked. Not wanting to know the answer to an independence question is a good indication that consultation is needed. The AICPA's Ethics Hotline can be reached at 877.777.7077 or <a href="mailto:ethics@aicpa.org">ethics@aicpa.org</a> ; the GAO's Yellow Book Technical Assistance can be reached at 202.512.9535 or <a href="mailto:yellowbook@gao.gov">yellowbook@gao.gov</a> .
RER QRe-4	<b>Policy: Firm personnel are required to notify the firm of breaches of the relevant ethical requirements, including independence requirements, and the firm takes appropriate actions to resolve such situations.</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35a(ii)]
RER QRe-4.01	All professional personnel are required to notify [ <i>specify who in the firm, for example, the managing partner of the office</i> ] of any potential activities involving themselves, their spouses, or their dependents that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship.	
RER QRe-4.02	The firm has a process that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy.	<b>NOTE:</b> This process can be as informal as a suggestion box or as formal as a whistleblower program.
RER QRe-4.03	The firm's policy and procedures manual sets forth the consequences for professional personnel who violate the firm's independence policies and procedures, including engaging in activities with entities with which firm personnel are prohibited from having a business relationship.	

QRe#	Quality Response	Note, Tip, or Warning
Relevant Ethical Requirements		
RER QRe-4.04	The firm determines the need for safeguards for engagements when the familiarity threat exists on an audit, review, or attestation engagement.	<b>TIP:</b> A familiarity threat may exist when, for example, the same engagement partner or senior manager has performed the engagement for the entity for an extended period of time, such as five years or more. The safeguard may be having an engagement quality control review or inspection performed periodically by someone not otherwise involved with the engagement.
RER QRe-4.05	The firm promptly communicates identified breaches of these policies and procedures, and the required corrective actions, to (a) the engagement partner who, with the firm, needs to address the breach, and (b) other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action.	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35a(ii)]
RER QRe-4.06	The engagement partner and other relevant personnel confirm to the firm that the required corrective actions have been taken.	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35a(ii)]
RER QRe-4.07	Appropriate personnel <i>[identify]</i> are responsible for periodically <i>[identify time period]</i> reviewing unpaid fees from clients to ascertain whether any outstanding amounts may impair the firm's independence and following up with the engagement partner.	See paragraphs .01–.02 of the "Unpaid Fees" interpretation (ET section 1.230.010).
RER QRe-5	<b>Policy: The firm does not accept, or withdraws from, the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.</b>	<b>WARNING:</b> Threats to independence may arise during the engagement (for example, when the firm is asked to perform nonattest services during the course of an attest engagement or the assessment of the client's knowledge, skills, and experience changes). Evaluate threats and apply safeguards BEFORE performing the procedures.
RER QRe-5.01	The firm consults internally, and with legal counsel and other parties if necessary, when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied.	<b>NOTE:</b> The client's needs may be met with a different service that doesn't require independence.
RER QRe-5.02	The firm withdraws from the engagement when withdrawal is possible under applicable law or regulation, or does not accept the engagement, when effective safeguards to reduce threats to independence to an acceptable level cannot be applied.	

QRe#	Quality Response	Note, Tip, or Warning
Relevant Ethical Requirements		
RER QRe-6	<b>Policy: The firm obtains written confirmation, upon hire and at least annually, of compliance with its policies and procedures regarding independence from all personnel required to be independent by relevant requirements.</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35b]
RER QRe-6.01	Personnel, including per-diem personnel, provide written representations, upon hire and on an annual basis, stating that they have read the firm's independence, integrity, and objectivity policies; understand the applicability of those policies to their activities; and have complied with the requirements of those policies since their last representation. Personnel are required to review the most current list of all entities with which firm personnel are prohibited from having a business relationship prior to providing the written representation.	
RER QRe-6.02	[Specify name or position, for example, the firm's QM partner] is responsible for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions.	<b>NOTE:</b> Par. .21c(i) requires the firm to assign operational responsibility for compliance with independence requirements to individuals with the appropriate influence and authority within the firm, typically partners.
RER QRe-6.03	On each engagement, the engagement partner signs a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.	<b>NOTE:</b> This procedure necessitates that each engagement include a program step requiring sign-off for compliance with independence regulations, whether in the acceptance/continuance form or other phase of the engagement.
RER QRe-7	<b>Policy: When another firm, or firm personnel in associated member firms, perform part of the engagement, the firm confirms the independence of the other firm and adherence to other relevant ethical requirements.</b>	
RER QRe-7.01	Written confirmations are obtained regarding the other firm's independence with respect to audit engagements and either written or oral confirmations are obtained for review or attestation engagements. Oral confirmations are documented.	
RER QRe-7.02	The firm's policies and procedures manual or practice aids describe the form and content of independence representations, and the frequency with which they are to be obtained.	

QRe#	Quality Response	Note, Tip, or Warning
Relevant Ethical Requirements		
RER QRe-7.03	As a member of a network, the firm <ul style="list-style-type: none"> <li>• meets all the relevant ethical requirements, and</li> <li>• monitors its independence with respect to financial statement audits, reviews, and other attest engagements performed by other members of the network.</li> </ul>	
RER QRe-8	<b>Policy: The firm rotates personnel for audit or attest engagements for which regulatory or other authorities require such rotation after a specified period.</b>	
RER QRe-8.01	The QM partner monitors regulatory requirements for financial institutions and other regulated entities and notifies partners of the need for rotation.	<b>TIP:</b> You may decide that for certain industries, rotation of partners, although not required by regulators, is appropriate for your SOQM.
RER QRe-9	<b>Policy: The firm has procedures for receiving complaints about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm's policies and procedures, investigates the complaints, and resolves them.</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35c]
RER QRe-9.01	The firm informs its personnel of the process established for complaints and concerns to be raised without fear of reprisal.	
RER QRe-9.02	A survey is circulated to clients annually to inquire about services rendered and to collect other feedback.	<b>TIP:</b> Consider debriefing with the client to receive feedback on the services provided.
RER QRe-9.03	Complaints and allegations received are referred to a partner not involved with the engagement to which the complaint relates for investigation or to an external party based on the seriousness and extent of the allegation.	
RER QRe-9.04	The firm has procedures for tracking complaints received and for tracking progress made for their investigation and timely resolution.	
RER QRe-9.05	Resolutions to complaints are documented and communicated to all relevant parties.	

**Table 4: Example of Evaluated Quality Risks and Linked Responses – Relevant Ethical Requirements**

The following table provides examples of evaluated quality risks and linked responses to each quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste these examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The following examples illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

Relevant Ethical Requirements							
<b>RER QO-1</b>		The firm and its personnel i. understand the relevant ethical requirements to which the firm and the firm's engagements are subject, and ii. fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject.					
QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
<b>RER QO-1</b>	<b>RER QRi-3</b>	The firm does not receive, investigate, or resolve complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements, or noncompliance with the firm's policies or procedures established in accordance with the firm's SOQM.	Low	High	Yes	The firm has procedures for receiving complaints about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm's policies and procedures, investigates the complaints, and resolves them.	RER QRe-9
<b>RER QO-1</b>	<b>RER QRi-3</b>	The firm does not receive, investigate, or resolve complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements, or noncompliance with the firm's policies or procedures	Medium	High	Yes	Complaints and allegations received are referred to a partner not involved with the engagement to which the complaint relates for investigation or to an external party based on the seriousness and extent of the allegation.	RER QRe-9.03
<b>RER QO-1</b>	<b>RER QRi-5</b>	Personnel and engagement teams are hesitant to communicate relevant information to the firm or those charged with overseeing relevant ethical requirements due to fear of reprisals.	Low	High	Yes	The firm has a process that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy.	RER QRe-4.02

# Acceptance and Continuance of Client Relationships and Specific Engagements

**Table 1: Required Quality Objectives — Acceptance and Continuance of Client Relationships and Specific Engagements**

QO #	Ref:	Quality Objectives
EAC QO-1	QM sec. 10, par. .31a(i)	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management and, when appropriate, those charged with governance) that is sufficient to support such judgments.
EAC QO-2	QM sec. 10, par. .31a(ii)	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.
EAC QO-3	QM sec. 10, par. .31b	The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

**Table 2: Required Quality Objectives and Potential Quality Risks — Acceptance and Continuance of Client Relationships and Specific Engagements**

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
<b>EAC QO-1</b>	<b>QM sec. 10, par. 31a(i)</b>	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management and, when appropriate, those charged with governance) that is sufficient to support such judgments.			
<b>EAC QO-1</b>	<b>EAC QRi-1</b>	The firm does not obtain information about the nature and circumstances of the engagement and the client (including management and, when appropriate, those charged with governance) that is sufficient to support judgments about client acceptance or continuance.	Choose an item.	Choose an item.	Choose an item.
<b>Engagement Nature</b>					
<b>EAC QO-1</b>	<b>EAC QRi-2</b>	The firm does not understand the industry of the entity for which the engagement is being undertaken, as well as the relevant regulatory factors.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-3</b>	The firm does not understand the nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model and how it is financed. (Information gathering efforts do not address all relevant information or subsidiaries or affiliates).	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-4</b>	The firm fails to obtain or understand the nature and circumstances of the engagement.	Choose an item.	Choose an item.	Choose an item.
<b>Integrity</b>					
<b>EAC QO-1</b>	<b>EAC QRi-5</b>	The firm does not adequately evaluate the integrity and ethical values of the appropriate owners, key management, related parties, and those charged with governance.	Choose an item.	Choose an item.	Choose an item.
<b>Inaccurate or Incomplete Information</b>					
<b>EAC QO-1</b>	<b>EAC QRi-6</b>	The firm does not properly evaluate or consider information that was obtained from the acceptance or continuance process.	Choose an item.	Choose an item.	Choose an item.



QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
<b>EAC QO-1</b>	<b>QM sec. 10, par. 31a(i)</b>	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management and, when appropriate, those charged with governance) that is sufficient to support such judgments.			
<b>EAC QO-1</b>	<b>EAC QRi-7</b>	Information obtained during the acceptance or continuance process of a client relationship or specific engagement is not sufficient, is not derived from credible sources, or does not support the firm's judgment about the integrity and ethical values of the client.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-8</b>	The firm starts work on a client engagement before acceptance or continuance is approved.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-9</b>	The firm starts work on a client engagement before the client has agreed to the terms of the engagement.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-10</b>	The firm does not consider information obtained subsequent to the approved acceptance of the client or engagement.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-11</b>	The firm accepts or continues an engagement when the terms of the engagements are not clear or properly agreed upon, which may lead to liability or damage to the firm's reputation.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-12</b>	The firm does not identify threats, such as nonattest services, to independence or other ethical requirements.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-13</b>	The firm's investigation research tool does not provide accurate results or is limited in its ability. For example, the tool searches only within the United States.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-14</b>	The firm does not apply all client acceptance procedures to all clients from an office acquisition or merger.	Choose an item.	Choose an item.	Choose an item.
<b>EAC QO-1</b>	<b>EAC QRi-15</b>	The firm or engagement team does not take appropriate action when they become aware of information that may have caused the firm to decline the client relationship or specific engagement had the firm known that information prior to accepting or continuing such relationship.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EAC QO-1	QM sec. 10, par. 31a(i)	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management and, when appropriate, those charged with governance) that is sufficient to support such judgments.			
Improper Review					
EAC QO-1	EAC QRI-16	The firm does not assign acceptance or continuance approval responsibilities to an individual who has the knowledge and expertise to adequately evaluate them (balancing risk vs. economic benefit).	Choose an item.	Choose an item.	Choose an item.
EAC QO-1	EAC QRI-17	The engagement partner does not (a) follow the firm’s policies or procedures for the acceptance or continuance of a client relationship or specific engagement or (b) take responsibility for the appropriateness of the conclusions reached in the acceptance or continuance of a client relationship or specific engagement, which includes appropriately considering whether significant matters that have arisen during the previous engagement have implications for continuing the engagement or relationship.	Choose an item.	Choose an item.	Choose an item.
Individual Compensation and Goals					
EAC QO-1	EAC QRI-18	The individual who is responsible for approving acceptance or continuance evaluation is not compensated and evaluated in a manner that holds them accountable for the results of poor acceptance or continuance decisions.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	QM sec. 10, par. 31a(ii)	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on the firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.			
Operational Constraints					
EAC QO-2	EAC QRI-19	The firm accepts or continues an engagement with unreasonable final issuance expectations or insufficient staffing to complete the engagement.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-20	The firm agrees to work not included in the original scope without following the firm’s procedures for changes in work scope.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EAC QO-2	QM sec. 10, par. 31a(ii)	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.			
EAC QO-2	EAC QRI-21	The firm inappropriately accepts a client relationship or specific engagement because the firm has excess staff capacity.	Choose an item.	Choose an item.	Choose an item.
Ability to Perform – Competency and Capacity					
EAC QO-2	EAC QRI-22	The firm accepts or continues a client relationship or specific engagement when the firm does not have the ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-23	The firm does not understand the nature of the underlying subject matter and the applicable criteria by which it must be evaluated.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-24	The firm does not identify or understand professional standards or applicable legal and regulatory requirements that include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-25	The firm does not evaluate the availability of appropriate resources that would be needed to perform the engagement. This would include consideration of core engagement team resources, engagement quality (EQ) review assignment, need for specialists, or other experts or IT system requirements.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-26	Training on, and communication of, the firm's acceptance or continuance policies and procedures and any changes to them for all partners and professional staff are not adequate or timely.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-27	The firm inappropriately accepts a client relationship or specific engagement when the firm does not have sufficient staffing capacity, and the firm cannot create the required capacity through talent acquisition or other means.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRI-28	The firm inappropriately accepts a client relationship or specific engagement when the firm does not have personnel with adequate competency or technical training to perform and supervise the engagement.	Choose an item.	Choose an item.	Choose an item.

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
EAC QO-2	QM sec. 10, par. .31a(i)	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.			

#### Ability to Perform – Competency and Capacity

EAC QO-2	EAC QRi-29	The firm's acceptance of a client results in the violation of an ethical or legal requirement (such as independence or conflict of interest).	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-30	The firm does not evaluate whether the firm and the engagement team are able to fulfill their responsibilities in relation to the relevant ethical requirements.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-31	The firm fails to timely evaluate or revise acceptance or continuance policies and procedures for client relationships or specific engagements that pose threats to compliance with rules and regulations arising from (a) changes in independence rules or interpretations, and (b) new laws or regulations affecting such client relationships or specific engagements.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-32	Firm partner accepts or continues an engagement that does not meet the firm's engagement acceptance or continuation criteria or is otherwise prohibited by the firm.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-33	The firm does not recognize when the firm is obligated by law or regulation to accept or continue a client relationship or specific engagement, nor understand the appropriate procedures to follow in such circumstances.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-34	The engagement partner accepts or continues an engagement without appropriately identifying and evaluating the effect of nonattest services on firm independence.	Choose an item.	Choose an item.	Choose an item.

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
EAC QO-3	QM sec. 10, par. .31b	The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.			
Firm Compensation and Goals					
EAC QO-3	EAC QRi-35	The financial and operational priorities of the firm lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-36	The proposed fee is materially inadequate for the time and resources required to perform a quality and profitable engagement.	Choose an item.	Choose an item.	Choose an item.
EAC QO-2	EAC QRi-37	The firm inappropriately accepts a client or engagement because large fees, financial benefit, or opportunity for the firm outweigh concerns over risks relating to, for example, resources, competencies, management integrity, or other issues.	Choose an item.	Choose an item.	Choose an item.

**Table 3: Required and Suggested Quality Responses – Acceptance and Continuance of Client Relationships and Specific Engagements**

QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
		<p><b>WARNING:</b> A firm’s client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Consider both the client’s integrity and reputation and your firm’s expertise and ability to meet the client’s needs. Both of these factors can affect the firm’s reputation and involvement in litigation.</p>
EAC QRe-1	<p><b>Policy:</b> The firm considers the risk associated with providing professional services in particular circumstances, including evaluating factors that have a bearing on management’s integrity. The firm only accepts or continues engagements and client relationships when it concludes that the risk is at an acceptable level.</p>	<p><b>NOTE:</b> The risk is that (a) the firm and its personnel will fail to comply with professional standards and applicable legal and regulatory requirements, or (b) reports issued by the firm will not be appropriate in the circumstances.</p>
EAC QRe-1.01	<p>The firm informs personnel of the firm’s policies and procedures for accepting and continuing clients, through discussion or distribution of the firm’s policies and procedures manual, and informing professional personnel that they are expected to be familiar with the firm’s policies and procedures for the acceptance and continuance of clients, including who in the firm is authorized to accept engagements on behalf of the firm. Such policies and procedures state that the firm’s clients should not present undue risks to the firm, including damage to the firm’s reputation.</p>	
EAC QRe-1.02	<p>The firm communicates with the predecessor auditor as required, and considers communicating with the predecessor accountant when recommended, by professional standards. This communication includes inquiries regarding the nature of any disagreements and whether there is evidence of “opinion shopping.” If the client does not give permission to contact the predecessor, the firm considers the reasons why and implications for acceptance.</p>	<p><b>NOTE:</b> Communicating with the predecessor auditor is required by generally accepted auditing standards. Other professional standards may require or recommend communicating with the predecessor accountant. Best practice is to communicate even if not required.</p>

QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
<b>EAC QRe-1.03</b>	<p>The firm obtains and evaluates relevant information before accepting or continuing any client, such as</p>	<p><b>NOTE:</b> This information directly relates to the risk that the firm will fail to perform and report in conformity with applicable professional standards. For smaller clients, this assessment may be quite simple. The results of this assessment are used in determining whether to accept the engagement, and if so, how the engagement is conducted.</p>
	<ul style="list-style-type: none"> <li>• the nature and purpose of the services to be provided and management's understanding thereof.</li> <li>• the identity of the client's principal owners, key management, related parties, and those charged with its governance.</li> <li>• the nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, income tax returns, and credit reports.</li> <li>• information obtained from inquiries of third parties about the client, its principal owners, key management, and those charged with governance that may have a bearing on evaluating the client. Examples of such third parties are bankers, factors, legal counsel, credit services, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge.</li> <li>• information, from discussions with the client and inquiries of others, concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards, compliance with laws and regulations, and internal control over financial reporting</li> <li>• emerging risks (for example, cryptocurrency, regulatory changes, or geopolitical events).</li> </ul>	<p><b>TIP:</b> Review the state regulatory website for state-specific regulations that apply to your client— this could also affect supplemental information in your engagement letter.</p>
<b>EAC QRe-1.04</b>	<p>The firm conducts a background check of the business, its officers, and the persons in question by using resources available on the internet and evaluates the information obtained regarding management's integrity. An investigative firm is used when the firm is unable to obtain sufficient information about the prospective client after completing the preceding steps, or when the firm becomes aware that there is an indication that management or someone affiliated with the prospective client may be less than reputable.</p>	

QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
EAC QRe-1.05	The firm evaluates the risk of providing services to significant clients or to other clients for which the firm's objectivity may be, or appear to be, impaired. The firm takes appropriate safeguards if necessary or if safeguards cannot reduce the threat to objectivity and independence to an acceptably low level, the firm does not accept the engagement.	
EAC QRe-1.05	The firm considers the timing of the acceptance of the engagement and whether that affects the firm's ability to perform all procedures necessary for the engagement (for example, inventory observation, both beginning and ending.)	
EAC QRe-2	<b>Policy: The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.</b>	<b>WARNING:</b> This policy and its related procedures are KEY to managing the risk that the firm will fail to perform and report in conformity with applicable professional standards.
EAC QRe-2.01	If the engagement is for a level of service that the firm is not currently providing (for example, reviews or audits), the firm considers the implications for obtaining the necessary competency and the implications for peer review.	
EAC QRe-2.02	<p>The firm defines <i>high-risk engagements</i> based on the characteristics of the firm. The firm considers the following criteria in determining whether the engagement is high risk <i>[list criteria, such as the following]</i>:</p> <ul style="list-style-type: none"> <li>• Whether the client is in a specialized industry — that is, an industry for which there is an AICPA Audit and Accounting Guide, or the engagement is subject to governmental auditing standards — and the extent of the firm's experience in this area.</li> </ul>	<p><b>NOTE:</b> High-risk engagements, by their nature, require more resources.</p> <p><b>WARNING:</b> "You don't know what you don't know" when performing an engagement in a specialized industry for which your firm does not have expertise. Specialized industries require an ongoing investment in training to obtain and maintain the necessary competence.</p>



QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
		<b>List of AICPA Audit and Accounting Guides for specific industries:</b> <ul style="list-style-type: none"><li>• Airlines</li><li>• Construction Contractors</li><li>• Employee Benefit Plans</li><li>• Investment Companies</li><li>• Life and Health Insurance Entities</li><li>• Not-for-Profit Entities</li><li>• Property and Liability Insurance Entities</li><li>• State and Local Governments</li><li>• Brokers and Dealers in Securities</li><li>• Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies</li><li>• Entities With Oil and Gas Producing Activities</li><li>• Gaming</li><li>• Health Care Entities</li><li>• <i>Government Auditing Standards</i> and Single Audits</li></ul>
	<ul style="list-style-type: none"><li>• New industry for the firm.</li></ul>	<b>WARNING:</b> Accepting an engagement in a new industry requires the firm to learn that industry. Hiring experienced staff, more consultation, performing an EQ review – these may all be necessary and come at a cost.
	<ul style="list-style-type: none"><li>• New or specialized accounting pronouncements apply to the client.</li><li>• New professional standards apply to the firm relating to the engagements.</li></ul>	
	<ul style="list-style-type: none"><li>• Engagements that require an inordinate amount of time to complete relative to the available resources of the firm.</li></ul>	<b>NOTE:</b> Engagements like this can affect the firm’s other engagements.
	<ul style="list-style-type: none"><li>• The existence of conditions such as aggressive earnings management, unreliable processes for developing accounting estimates or questionable estimates by management, and questions regarding the entity’s ability to continue as a going concern.</li><li>• Emerging risks in existing clients (for example, cryptocurrency, regulatory changes, or geopolitical events).</li><li>• The entity is in development stage.</li></ul>	

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QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
<b>EAC QRe-2.03</b>	The firm accepts engagements that meet the firm's criteria as high risk only when the firm has, or is willing to make, the investment to acquire the necessary competency. The firm acknowledges that accepting a high-risk engagement entails assigning more experienced staff, may necessitate the use of external resources, and requires that an EQ review be performed.	<b>WARNING:</b> An otherwise low-risk client might have transactions that are so risky that the firm may decide to not accept the engagement or apply safeguards addressed only at that risk.
<b>EAC QRe-2.04</b>	The firm evaluates whether it (or its practice office) has, or can reasonably expect to obtain, the competency and capability necessary to perform the engagement, including relevant regulatory or reporting requirements.	<b>WARNING:</b> The firm is required to have obtained the necessary knowledge and expertise before the report is issued to have reasonable assurance that the firm met professional standards and that the report is appropriate. Best practice is to have that knowledge and expertise when planning the engagement, so you don't have to go back at the end and identify what you didn't know at the beginning.
<b>EAC QRe-2.05</b>	<p>The firm determines the following before accepting an engagement:</p> <ul style="list-style-type: none"> <li>• Sufficient personnel with the necessary capabilities and competence are available. This includes determining that personnel have sufficient knowledge and experience for specialized industries and the firm has sufficient technical resources available to engagement personnel, including audit and accounting guides, and, when necessary, has arranged for personnel to receive appropriate continuing professional education and training.</li> <li>• Whether specialists will be needed, and if so, will be available (for example, through the resources of another practice office or alternative source).</li> </ul>	<p><b>NOTE:</b> The QM standards require that the EQ review be performed at appropriate points during the engagement. Identifying the person who will perform the EQ review as soon as the need for an EQ review has been identified, even if it is prior to acceptance of the engagement, and agreeing on engagement terms, best allows for this. Delaying after the need is identified creates concern that an EQ reviewer will not be available and creates time pressure to identify an EQ reviewer by the appropriate point in the engagement (when the cost may be higher).</p>
	<ul style="list-style-type: none"> <li>• That individuals meeting the criteria and eligibility requirements to perform an EQ review are available when needed, for example, for engagements that meet the firm's definition of <i>high risk</i>.</li> </ul>	
	<ul style="list-style-type: none"> <li>• The firm is able to complete the engagement within the reporting deadline.</li> </ul>	

QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
<b>EAC QRe-2.06</b>	The firm obtains relevant information to determine whether the relationship should be continued, and the firm evaluates the client continuance decision at least annually <i>[insert timing, for example, a preliminary decision at the end of the current-year engagement for (every client/high-risk clients) as part of finalizing the current-year engagement, and a final evaluation before the engagement letter is sent for the next engagement]</i> .	<b>TIP:</b> The benefit to considering whether to continue the engagement and client relationship at the end of the current engagement is that the memory is fresh in terms of client integrity and issues encountered, and there may be less financial pressure at this time.
<b>EAC QRe-2.07</b>	<p>The following are conditions that the firm considers in evaluating whether to continue an engagement or client relationship <i>[describe conditions, such as the following]</i>:</p> <ul style="list-style-type: none"> <li>• The existence of conditions such as <ul style="list-style-type: none"> <li>– aggressive earnings management,</li> <li>– unreliable processes for developing accounting estimates or questionable estimates by management, or</li> <li>– questions regarding the entity's ability to continue as a going concern.</li> </ul> </li> <li>• The entity is in the development stage.</li> <li>• The client is delinquent in paying fees. (This may also affect the firm's independence.)</li> <li>• The firm is unable to meet the client's deadlines.</li> <li>• The services required have grown beyond the firm's ability to deliver (scope creep).</li> <li>• The firm is no longer willing to make the investment required to maintain competency.</li> <li>• The firm is unable to obtain the necessary resources to carry out the engagement, such as a person to perform an EQ review or replace the loss of key personnel.</li> <li>• Internal or external inspections have indicated deficiencies in the execution of the engagement (or similar engagements) and the firm is unable to mitigate the deficiencies.</li> <li>• Partner rotation is required by law or regulation for the engagement under consideration.</li> <li>• The client has ignored prior recommendations, such as those that address deficiencies in internal control.</li> </ul>	<b>WARNING:</b> Do not put your clients on "auto-renew." Continuance of clients is an active decision and should be considered carefully without simply "defaulting" to the previous year's determination.

QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
<b>EAC QRe-2.08</b>	<p>When triggering events occur, the firm reevaluates the decision to accept or continue an engagement or client relationship.</p> <p>The following are examples of such triggering events:</p> <ul style="list-style-type: none"> <li>• Significant changes in the client, such as a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or its financial stability.</li> </ul> <hr/> <ul style="list-style-type: none"> <li>• Changes in the nature or scope of the engagement, such as <ul style="list-style-type: none"> <li>– requests for additional services,</li> <li>– a request to step down from an audit to a review engagement, or</li> <li>– an initial public offering.</li> </ul> </li> </ul> <hr/> <ul style="list-style-type: none"> <li>• The decision to discontinue services to clients in a particular industry.</li> </ul>	<p><b>NOTE:</b> The procedure is not to decline the engagement when a request for a change is made but to evaluate the client's reasons for the request and then determine whether to accept or decline.</p>
<b>EAC QRe-2.09</b>	<p>When making the decision, the firm evaluates the information obtained regarding acceptance or continuance of the client or engagement by doing the following:</p> <hr/> <ul style="list-style-type: none"> <li>• The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm, <i>[using the AICPA Private Companies Practice Section (PCPS) Client Acceptance Evaluation Tool or Client Continuance Evaluation Tool.]</i></li> </ul> <hr/> <ul style="list-style-type: none"> <li>• The engagement partner makes a recommendation about whether to accept or continue the engagement, or the client relationship, and submits the recommendation with supporting documentation to the managing partner (of the practice office or of the firm) for approval.</li> </ul> <p>The engagement partner's recommendation is reviewed and approved by <i>[specify, for example, the QM partner or the managing partner, or in certain defined circumstances, such as high-risk engagements, both.]</i></p> <p>If the recommendation to accept a client or continue a client relationship is not approved, the managing partner and the other partners discuss the reasons why.</p>	<p><b>NOTE:</b> Acceptance and continuance decisions are iterative and are made before each engagement is accepted and as necessary when circumstances change.</p> <hr/> <p><b>NOTE:</b> The AICPA PCPS Client Acceptance Evaluation Tool and Client Continuance Evaluation Tool are free tools available at <a href="https://www.aicpa-cima.com/resources/landing/trusted-client-adviser-toolbox">https://www.aicpa-cima.com/resources/landing/trusted-client-adviser-toolbox</a>.</p>

QRe#	Quality Response	Note, Tip, or Warning
Acceptance and Continuance of Client Relationships and Specific Engagements		
EAC QRe-2.10	The engagement partner documents evidence of consideration and approval of engagement acceptance (or continuance) in the planning section of the engagement documentation.	
EAC QRe-3	<b>Policy: The firm has established policies and procedures for circumstances in which information becomes known subsequent to accepting or continuing a client relationship or specific engagement that might have affected the firm's decision to accept or continue a client relationship or specific engagement.</b>	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35d(i)]
EAC QRe-3.01	<p>When the firm becomes aware of information that would have caused the firm to decline the engagement if the information had been available earlier, the firm considers the following:</p> <ul style="list-style-type: none"> <li>• Undertaking consultation within the firm or legal counsel</li> <li>• The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to continue the engagement or report to regulatory authorities</li> <li>• Discussing with the appropriate level of client's management and those charged with governance</li> </ul>	
	<ul style="list-style-type: none"> <li>• Whether to withdraw from the engagement or from the client relationship</li> </ul>	<b>NOTE:</b> See procedures for withdrawal later in this document.
EAC QRe-4	<b>Policy: The firm obtains an understanding with the client regarding the services to be performed.</b>	<b>TIP:</b> Having an "evergreen" engagement letter, or an engagement letter that covers more than one year, exposes the firm to a variety of risks. If circumstances necessitate the use of a multi-year engagement letter, even when not required by the standards, best practice is to send a written letter annually confirming the existing terms and explaining any changes.
EAC QRe-4.01	The firm prepares a written engagement letter for each engagement, documenting the understanding with the client regarding the nature, scope, and limitations of the services to be performed.	
EAC QRe-4.02	The firm obtains the client's signature on that letter before significant resources are committed to the engagement.	
EAC QRe-4.03	If the nature or scope of the engagement changes, the firm documents the change in an addendum to the engagement letter that is sent to the client.	

QRe#	Quality Response	Note, Tip, or Warning
<b>Acceptance and Continuance of Client Relationships and Specific Engagements</b>		
<b>EAC QRe-5</b>	<b>Policy: The firm has established procedures on withdrawal from an engagement or from both the engagement and the client relationship, as follows:</b>	
<b>EAC QRe-5.01</b>	The firm considers whether there is a professional, regulatory, or legal requirement for the firm to remain in place.	<b>NOTE:</b> This is a required response. [QM sec. 10, par. .35d(ii)]
<b>EAC QRe-5.02</b>	<p>When the firm is unable to withdraw from an engagement and the firm is aware of information that would have caused the firm to decline or discontinue the engagement, the firm does the following:</p> <ul style="list-style-type: none"> <li>• Considers the effect of the information on the performance of the engagement</li> <li>• Communicates the information to the engagement partner and requests the engagement partner to increase the extent and frequency of supervision and review</li> <li>• Assigns more experienced personnel to the engagement</li> <li>• Determines that an EQ review should be performed</li> </ul>	
<b>EAC QRe-5.03</b>	The firm considers whether there is a professional, regulatory, or legal requirement for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal.	
<b>EAC QRe-5.04</b>	The firm discusses with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship if the firm determines that it is appropriate to withdraw.	
<b>EAC QRe-5.05</b>	The firm considers the implications for previous engagements with this client, including the need to withdraw previously issued reports.	
<b>EAC QRe-6</b>	<b>Policy: The firm documents how issues relating to acceptance or continuance of client relationships were resolved.</b>	
<b>EAC QRe-6.01</b>	The firm documents, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.	

**Table 4: Example of Evaluated Risks and Linked Responses – Acceptance and Continuance of Client Relationships and Specific Engagements**

The following table provides examples of evaluated quality risks and linked responses to each quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste these examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The following examples illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

Acceptance and Continuance of Client Relationships and Specific Engagements							
QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
EAC QO-1		Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) that is sufficient to support such judgments.					
EAC QO-1	EAC QRI-2	The firm does not understand the entity's industry for which the engagement is being undertaken, as well as the relevant regulatory factors.	Low	High	Yes	The firm accepts engagements that meet the firm's criteria as high risk only when the firm has, or is willing to make, the investment to acquire the necessary competency. The firm acknowledges that accepting a high-risk engagement entails assigning more experienced staff, may necessitate the use of external resources, and requires that an EQ review be performed.	EAC QRe-2.03

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
EAC QO-1	EAC QRi-15	The firm or engagement team does not take appropriate action when they become aware of information that may have caused the firm to decline the client relationship or specific engagement had the firm known that information prior to accepting or continuing such relationship.	Low	High	Yes	The firm has established policies and procedures for circumstances in which information becomes known subsequent to accepting or continuing a client relationship or specific engagement that might have affected the firm's decision to accept or continue a client relationship or specific engagement.	EAC QRe-3
EAC QO-2	EAC QRi-34	The engagement partner accepts or continues an engagement without appropriately identifying and evaluating the effect of nonattest services on firm independence.	Medium	Medium	Yes	The firm considers the risk associated with providing professional services in particular circumstances, including evaluating factors that have a bearing on management's integrity. The firm only accepts or continues engagements and client relationships when it concludes that the risk is at an acceptable level.	EAC QRe-1
EAC QO-2	Firm judgments about whether to accept or continue a client relationship or specific engagement are appropriate based on the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.						
EAC QO-2	EAC QRi-22	The firm accepts or continues a client relationship or specific engagement when the firm does not have the ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements.	Medium	High	Yes	The firm evaluates whether the firm (or practice office) has, or can reasonably expect to obtain, the competency and capability necessary to perform the engagement, including relevant regulatory or reporting requirements.	EAC QRi-22



# Engagement Performance

**Table 1: Required Quality Objectives – Engagement Performance**

QO #	Ref:	Quality Objectives
EP QO-1	QM sec. 10, par. .32a	Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.
EP QO-2	QM sec. 10, par. .32b	The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members.
EP QO-3	QM sec. 10, par. .32c	Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, maintain professional skepticism.
EP QO-4	QM sec. 10, par. .32d	Consultation on difficult or contentious matters is undertaken and the conclusions agreed are implemented.
EP QO-5	QM sec. 10, par. .32e	Differences of opinion within the engagement team, or between the engagement team and the EQ reviewer or individuals performing activities within the firm's SOQM, are brought to the attention of the firm and resolved.
EP QO-6	QM sec. 10, par. .32f	Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or professional standards.

**Table 2: Required Quality Objectives and Potential Quality Risks – Engagement Performance**

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
<b>EP QO-1</b>	<b>QM sec. 10, par. .32a</b>	Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.			
<b>EP QO-1</b>	<b>EP QRi-1</b>	Engagement teams do not understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-2</b>	The engagement team does not follow the firm’s policies and procedures to ensure quality engagements are performed consistently and in conformity with professional standards.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-3</b>	The engagement team does not review quality management materials (for example, an audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like) to determine that they are suitable and reliable for use on the specified engagement.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-4</b>	The engagement team does not tailor quality management materials to each engagement or does not use the templates and practice aids that are appropriate for the engagement.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-5</b>	The engagement team fails to identify industry- or regulatory-specific requirements that may not be addressed in third-party practice aids (for example, state regulatory requirements).	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-6</b>	The engagement partner does not determine that engagement teams understand firm policies or know where to find them.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-7</b>	The engagement partner is not sufficiently and appropriately involved throughout all phases of the engagement, including planning, staff assignments, timing of the engagement, and preliminary audit strategy.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-8</b>	The engagement partner does not take responsibility for determining that staff members assigned to the engagement understand the relevant ethical requirements, including independence.	Choose an item.	Choose an item.	Choose an item.
<b>EP QO-1</b>	<b>EP QRi-9</b>	Engagement team members do not sufficiently understand their responsibilities in connection with engagements, in accordance with professional standards, and how they should fulfill those responsibilities.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-1	QM sec. 10, par. .32a	Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.			
EP QO-1	EP QRI-10	The engagement team is not assigned based on competence and capabilities.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-11	Changes to the client's background information, including those obtained during client acceptance and continuance procedures, are not considered during planning procedures.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-12	Engagement quality reviewers are not sufficiently involved throughout the engagement.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-13	The need for a specialist or consultant is not identified during the planning phase.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-14	Engagement teams do not sufficiently document planning procedures.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-15	The roles and responsibilities of each individual on the engagement are not thoroughly and clearly communicated prior to commencing the engagement.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-16	The resource needs and nature of the engagement are not appropriately considered, both during the planning stage and when circumstances change during the performance of the engagement, leaving the engagements understaffed.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-17	Engagement team members, including engagement partners, do not have the appropriate experience, including industry considerations.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-18	Engagement teams are not aware of economic conditions that may affect their clients.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-19	The engagement partner does not actively participate in fraud brainstorming sessions.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-20	The budgets created for individual engagements are inappropriate based on the nature of the work to be performed.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-1	QM sec. 10, par. .32a	Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.			
EP QO-1	EP QRI-21	The staffing on each engagement is not commensurate with the budgeted hours.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-22	The engagement partner does not take ultimate responsibility for the engagement.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-23	New hires, merged practices, or engagement team members from other practice offices may have different understandings of the firm's policies and procedures, necessitating more thorough review and supervision by the engagement partner.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-24	The engagement partner does not appropriately manage deadlines or workload concentrations.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-25	Changes to strategy, planning materiality, or plan are not documented or approved by the engagement partner.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-26	The engagement partner fails to react to engagement scope expansion after the engagement letter was signed and staffing has been assigned.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-27	Engagement team members do not identify matters for consultation.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-28	The work done by a firm service delivery center, another network firm, or a component auditor, is not adequately directed, supervised, or reviewed.	Choose an item.	Choose an item.	Choose an item.
EP QO-1	EP QRI-29	The documentation is not adequately reviewed to ensure the documentation provides a clear understanding of the work performed, the evidence obtained and its source, and the conclusions reached before the report is issued.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-2	QM sec. 10, par. .32b	The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members.			
EP QO-2	EP QRI-30	The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is not appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams, and the work performed by less experienced engagement team members is not directed, supervised, and reviewed by more experienced engagement team members.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-31	Team members, including component auditors and remote workers, are not adequately directed and supervised throughout the engagement.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-32	All required checklists and work programs have not been completed, or the objectives of the work programs have not been achieved.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-33	The work performed does not support the conclusions reached or is not properly documented.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-34	Lack of interaction and communication with the client or between engagement team members adversely affects engagement quality.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-35	Reports are issued before the work is complete and properly reviewed (that is, engagement quality [EQ] reviewer reviewed the file after report issuance; legal confirmations are received after the report is issued).	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-36	The firm does not have appropriate policies for identifying engagements that should have a pre-issuance review by a person that is not a member of the engagement team.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-37	The firm uses personnel from a service delivery center to perform procedures on audit engagements that do not have a sufficient understanding of the applicable professional standards and the firm's policies and procedures.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-38	The EQ review policy is poorly communicated to EQ reviewers.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-39	The EQ review policy is inappropriate for the firm's practice.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-2	QM sec. 10, par. .32b	The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members.			
EP QO-2	EP QRI-40	The EQ review policy is not consistently applied.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-41	Identification of risky clients during the acceptance and continuance process does not result in the assignment of an EQ reviewer to the engagement.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-42	The engagement team does not follow the established criteria for EQ reviews, including the selection of the EQ reviewer.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-43	The engagement partner does not take responsibility for the EQ review.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-44	The EQ review fails to identify significant issues resulting in quality being compromised.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-45	The engagement team does not have access to a qualified independent reviewer to perform EQ reviews.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-46	The engagement team does not follow the policies and procedures addressing the performance and documentation requirements of the EQ review.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-47	The engagement partner does not understand the responsibilities related to the EQ review.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-48	EQ reviewers are not provided sufficient time to complete the EQ review.	Choose an item.	Choose an item.	Choose an item.
EP QO-2	EP QRI-49	An engagement report is issued despite unresolved questions by the EQ reviewer related to engagement team judgments and conclusions.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-3	QM sec. 10, par. .32c	Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, maintain professional skepticism.			
EP QO-3	EP QRI-50	Engagement teams do not exercise appropriate professional judgment and, when applicable to the type of engagement, do not maintain professional skepticism.	Choose an item.	Choose an item.	Choose an item.
EP QO-3	EP QRI-51	Overly heavy workloads or impending deadlines result in work being rushed, skepticism being set aside, and poor judgment being used.	Choose an item.	Choose an item.	Choose an item.
EP QO-3	EP QRI-52	Engagement teams are not trained on how to exercise professional judgment and professional skepticism on engagements.	Choose an item.	Choose an item.	Choose an item.
EP QO-3	EP QRI-53	Familiarity with the client and other unconscious auditor biases impede the engagement team's ability to exercise appropriate professional skepticism.	Choose an item.	Choose an item.	Choose an item.
EP QO-3	EP QRI-54	The engagement team forms incorrect or inappropriate conclusions based on client pressure or influence.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	QM sec. 10, par. .32d	Consultation on difficult or contentious matters is undertaken and the conclusions agreed are implemented.			
EP QO-4	EP QRI-55	Consultation on difficult or contentious matters is not undertaken, or if it is, the conclusions agreed are not implemented.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-56	The engagement team does not follow policies and procedures addressing when consultations should take place, how they are performed and documented, and conclusions implemented.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-57	Leadership does not provide an environment that reinforces the importance and benefit of consultation and encourages engagement teams to consult.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-58	Engagement teams do not undertake consultations on difficult or contentious matters because they do not recognize which matters (for example, areas involving high subjectivity or difficult-to-interpret accounting guidance) require consultation.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-59	Engagement partners do not take responsibility for the engagement team identifying matters for consultation and undertaking consultation.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-60	Engagement teams do not undertake consultations on difficult or contentious matters because they do not know what or with whom to consult.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-4	QM sec. 10, par. .32d	Consultation on difficult or contentious matters is undertaken and the conclusions agreed are implemented.			
EP QO-4	EP QRI-61	Engagement teams do not undertake consultations on difficult or contentious matters because they are concerned with adverse consequences on performance evaluations.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-62	Engagement teams do not appropriately evaluate new accounting standards.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-63	Incomplete facts are presented for consultation on difficult or contentious matters causing incorrect conclusions.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-64	Consultation conclusions are not implemented.	Choose an item.	Choose an item.	Choose an item.
EP QO-4	EP QRI-65	The results of consultations are unclear or inappropriate.	Choose an item.	Choose an item.	Choose an item.
EP QO-5	QM sec. 10, par. 32e	Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, are brought to the attention of the firm and resolved.			
EP QO-5	EP QRI-66	Differences of opinion by engagement team members reporting directly to the engagement partner are not adequately considered by the engagement partner.	Choose an item.	Choose an item.	Choose an item.
EP QO-5	EP QRI-67	Differences of opinion within the engagement team, or between the engagement team and the EQ reviewer or individuals performing activities within the firm's SOQMS, are not brought to the attention of the firm or if they are, they are not resolved.	Choose an item.	Choose an item.	Choose an item.
EP QO-5	EP QRI-68	Engagement team members do not follow or are not aware of the process to follow when a difference of opinion occurs.	Choose an item.	Choose an item.	Choose an item.
EP QO-5	EP QRI-69	Senior members of the engagement team, as well as the EQ reviewer and other members of the firm's quality management system, do not create an environment that encourages open discussion of competing viewpoints.	Choose an item.	Choose an item.	Choose an item.
EP QO-5	EP QRI-70	Resolution of differences of opinion are not properly evaluated and documented.	Choose an item.	Choose an item.	Choose an item.



QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-5	QM sec. 10, par. 32e	Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, are brought to the attention of the firm and resolved.			
EP QO-5	EP QRi-71	An engagement report is issued despite a difference of opinion being unresolved.	Choose an item.	Choose an item.	Choose an item.
EP QO-5	EP QRi-72	Significant engagement issues identified during EQ review or report review are not addressed before the report is issued.	Choose an item.	Choose an item.	Choose an item.
EP QO-6	QM sec. 10, par. 32f	Engagement documentation is assembled on a timely basis after the date of the engagement report, and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or professional standards.			
EP QO-6	EP QRi-73	Engagement documentation is not assembled on a timely basis after the date of the engagement report or is not appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, or professional standards.	Choose an item.	Choose an item.	Choose an item.
EP QO-6	EP QRi-74	Engagement documentation is not assembled timely, either because firm policy is not clear and appropriate or because firm policy is not followed.	Choose an item.	Choose an item.	Choose an item.
EP QO-6	EP QRi-75	Engagement documentation is added or modified after the document completion date and such modifications are not authorized or documented.	Choose an item.	Choose an item.	Choose an item.
EP QO-6	EP QRi-76	Engagement documentation is not appropriately maintained and retained, either because firm policy is not clear and appropriate or because firm policy is not followed.	Choose an item.	Choose an item.	Choose an item.
EP QO-6	EP QRi-77	The engagement team does not appropriately perform the firm's document retention procedures; therefore, documentation is not appropriately maintained and retained.	Choose an item.	Choose an item.	Choose an item.

**Table 3: Required and Suggested Quality Responses – Engagement Performance**

QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-1	<b>Policy: The firm uses quality management materials (for example, an audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like) to assist with engagement performance.</b>	
EP QRe-1.01	<p>The engagement partner establishes procedures to ensure that regardless of whether the firm develops its own quality management materials or obtains it from a third-party provider</p> <ul style="list-style-type: none"> <li>• the material is reliable and suitable for the engagement.</li> <li>• the quality management materials are up to date.</li> <li>• modifications to the package and to individual forms are appropriate.</li> <li>• the forms being used are appropriate for the engagement.</li> </ul>	
	<ul style="list-style-type: none"> <li>• industry or regulatory requirements are identified (for example, requirements specific to your client's state).</li> </ul>	<b>TIP:</b> Review your client's state regulatory website where you can find the requirements and example reports.
EP QRe-2	<b>Policy: Planning for engagements meets professional, regulatory, and the firm's requirements.</b>	
EP QRe-2.01	The firm provides personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations.	
EP QRe-2.02	The firm trains personnel on the use of the firm's practice aids (audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like).	

QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

### EP QRe-2.03

Planning considerations may vary depending on the size and complexity of the engagement. The firm follows the following procedures for planning engagements:

- When the firm accepts an audit, review, or attestation examination in an industry in which the firm's personnel do not have recent experience, the firm requires all senior members of the engagement team to take industry-specific continuing professional education before planning procedures are performed.

- The engagement partner accepts responsibility for planning the engagement.

- Appropriate personnel are assigned responsibilities during the planning phase.
- The engagement partner, or personnel designated by the engagement partner, develops or updates background information on the client and the engagement.

- Planning includes determination of whether the engagement meets the firm's criteria for performing an EQ review. If so, the person performing the EQ review reviews the planning timely.

- If a specialist or consultant is used to provide the engagement team with the necessary competence, that person reviews the planning timely.

**REMEMBER:** Planning comes FIRST!

**TIP:** How recent depends upon changes in the industry and related accounting; not more than five years is a useful guideline, but it could be less, especially in regulated industries. Also, make sure that the engagement team is using the most recent AICPA Audit and Accounting Guide for that industry, when applicable.

**WARNING:** The higher the risk that the firm will fail to perform and report in conformity with applicable professional standards in an engagement, the more important it is that the engagement partner be more deeply involved in planning.

**WARNING:** QM section 20, *Engagement Quality Review*, requires that the EQ review take place at appropriate times during the engagement.

QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-2.04	<p>The engagement team prepares planning documentation that includes the following:</p> <ul style="list-style-type: none"> <li>• Proposed work programs tailored to the specific engagement</li> <li>• Staffing requirements</li> <li>• Whether there is a need for specialized knowledge and how that will be obtained (for example, from other practice offices or through consultation)</li> <li>• Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement</li> <li>• Consideration of risks, including fraud considerations, affecting the client and the engagement and how they may affect the procedures to be performed</li> <li>• A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality management policies and procedures.</li> <li>• Approval of planning and of the proposed work program by the engagement partner before work to obtain engagement evidence begins</li> </ul>	<p><b>NOTE:</b> Although planning is an iterative process, having the engagement partner approve planning before fieldwork begins results in a more effective, efficient, and higher quality engagement.</p>
EP QRe-3	<p><b>Policy: The engagement is performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.</b></p>	
EP QRe-3.01	<p>Each engagement is assigned an engagement partner, who accepts ultimate responsibility for the engagement.</p>	
EP QRe-3.02	<p>A written work program is used in each engagement.</p>	

QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

EP QRe-3.03	<p>Each engagement is required to be supervised by suitably experienced engagement team members. Engagement supervision includes the following: Briefing the engagement team on the objectives of their work</p> <ul style="list-style-type: none"> <li>• Tracking the progress of the engagement</li> <li>• Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement</li> <li>• Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately</li> <li>• Identifying matters for consultation or consideration by more experienced engagement team members during the engagement</li> </ul>
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EP QRe-3.04	Engagement personnel prepare working papers that adhere to the firm's guidelines, applicable regulatory requirements, and professional standards for the form and content of documentation of the work performed and conclusions reached.
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**NOTE:** If you haven't documented what you have done, it's as if you didn't do it. Remember, the standard requires documentation for "an experienced reviewer with no connection to the engagement" — someone with no access to anything except what is in the working papers. Therefore, the working papers need sufficient detail for the reviewer to understand exactly what was done.

EP QRe-3.05	Engagement documentation makes clear when and by whom engagement documentation was prepared and reviewed.
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EP QRe-4	<b>Policy: Qualified engagement team members review work performed by other team members on a timely basis.</b>
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EP QRe-4.01	The firm's methodology prescribes who on the engagement team reviews the work of other members of the engagement team.
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**NOTE:** This can include the extent of the engagement partner's review.

EP QRe-4.02	For each engagement, there is evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.
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QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-4.03	The firm prescribes the extent of review of the nature, timing, and extent of procedures performed to have reasonable assurance that they are consistent with the approach described in the planning documentation. Exceptions are investigated and resolved.	<b>WARNING:</b> The financial statements can be materially correct, the report can be appropriate in the circumstances, and yet, the engagement may not be in compliance with professional standards because, for example, the engagement team did not obtain sufficient appropriate engagement evidence or the documentation does not reflect all the procedures performed and evidence obtained.
EP QRe-4.04	<p>Engagement documentation is reviewed to determine whether the following have occurred:</p> <ul style="list-style-type: none"> <li>• The work has been performed in accordance with professional standards and applicable legal and regulatory requirements.</li> <li>• Significant findings and issues have been raised for further consideration.</li> <li>• Appropriate consultations have taken place and the resulting conclusions have been documented and implemented.</li> <li>• The nature, timing, and extent of the work performed is appropriate and without need for revision.</li> <li>• The work performed supports the conclusions reached and is appropriately documented.</li> <li>• The evidence obtained is sufficient and appropriate to support the report.</li> <li>• The objectives of the engagement procedures have been achieved.</li> </ul>	<b>WARNING:</b> The review of engagement documentation to determine that the work has been performed in accordance with professional standards is not the same as the review to determine that the report issued by the firm is appropriate in the circumstances. Reviewing engagement documentation entails reviewing the working papers for documentation of sufficient appropriate engagement evidence.
EP QRe-5	<b>Policy: Engagements as specified in the firm's methodology are reviewed by a person who is not a member of the engagement team before the reports or other communications are issued.</b>	<b>NOTE:</b> Pre-issuance reviews by a person who is not a member of the engagement team may be less extensive than an EQ review.

QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

EP QRe-5.01	<p>The firm's methodology specifies which engagements require pre-issuance review by a person who is not a member of the engagement team and prescribes the extent of the pre-issuance review of the report and other communication, financial statements, and selected documentation of the work performed, and conclusions reached. This includes</p> <ul style="list-style-type: none"> <li>• assigning a reviewer with the appropriate qualifications, and</li> <li>• prescribing the documentation that the reviewer must review for each level of service and permitting the reviewer to select additional documentation to review.</li> </ul>	<p><b>TIP:</b> A pre-issuance review by a person who is not a member of the engagement team, although only required by the standard for engagements meeting the firm's criteria for an EQ review, provides a fresh look and is very helpful. The firm can prescribe procedures for different levels of services that are less extensive than those required for EQ review.</p>
EP QRe-6	<p><b>Policy: Firm leaders set a tone that addresses the importance and understanding of exercising professional judgment and professional skepticism.</b></p>	
EP QRe-6.01	<p>The engagement partner takes responsibility for ensuring engagement team members understand the importance and practice professional judgment and professional skepticism.</p>	
EP QRe-6.02	<p>When performing engagements, the engagement team practices professional skepticism in discussions and when reviewing client materials.</p>	
EP QRe-7	<p><b>Policy: The firm establishes, documents, and follows procedures when the firm uses external personnel, such as from other firms, for audit or accounting engagements.</b></p>	
EP QRe-7.01	<p>Those procedures address the following:</p> <ul style="list-style-type: none"> <li>• The form in which instructions are given to external personnel</li> <li>• The extent to which their work is reviewed</li> </ul>	<p><b>TIP:</b> For example, when external personnel are used to observe inventory, when using independent contractors as part of the engagement team, or when assuming responsibility for the work of component auditors</p>

QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-8	<b>Policy:</b> The firm has criteria for determining whether an EQ review should be performed, evaluates all engagements against the criteria, performs an EQ review for all engagements that meet the criteria, and completes the review before the report is released.	<p><b>NOTE:</b> This is a required response. [QM sec. 10, par. .35f and QM sec. 20 par. .24b]</p> <p><b>TIP:</b> If your acceptance and continuance policies and procedures limit engagement risk, the need for an EQ review may be diminished.</p> <p><b>WARNING:</b> Criteria that are not responsive to the structure and nature of the firm's practice are not appropriate.</p>
EP QRe-8.01	The firm's criteria for requiring that an EQ review be performed are based on the firm's assessment of which engagements would most benefit from an independent review, taking into account the structure and nature of the firm's practice.	<p><b>WARNING:</b> When setting criteria for an EQ review, it is critical that the firm carefully consider which engagements have the highest risk of NOT being performed in accordance with the standards or that the report will NOT be appropriate in the circumstances. Consider the engagements that the firm performs in setting the criteria and not only engagements that are clearly outside the firm's expertise. Recognize that risk factors to the firm change over time and the firm's criteria for an EQ review may need to change accordingly.</p>



QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
Ep QRe-8.02	<p>The firm's criteria include the following: <i>[specify criteria, which could include the following]</i>:</p> <ul style="list-style-type: none"> <li>• The identification of unusual circumstances or risks in an engagement or class of engagements as pre-determined by the firm, for example <ul style="list-style-type: none"> <li>– audits in which a going concern issue was identified but the report was not modified,</li> <li>– a compilation with disclosures when the firm has only been doing compilations without disclosures, or</li> <li>– a review (or other engagement) for an entity with issues that the firm rarely encounters (for example, joint ventures)</li> </ul> </li> <li>• An EQ review is required by law or regulation.</li> <li>• An engagement for which the undue influence threat may exist (for example, an engagement that represents over 10% of the firm's audit and accounting practice)</li> <li>• A <i>high-risk engagement</i>, as defined by the firm, using the same criteria used for acceptance and continuance</li> <li>• An engagement in an industry in which the firm's practice is limited, and the firm's personnel have little or no experience</li> <li>• An engagement for which the familiarity threat may exist</li> <li>• An engagement for an entity operating in a highly specialized or regulated industry, including financial institutions, employee benefit plans, and audits in accordance with government auditing standards</li> </ul>	<p><b>WARNING:</b> Appropriate criteria for most firms will consist of a mix of the following and not rely on just one criterion.</p> <p><b>WARNING:</b> The engagement partner or quality management partner can always request an EQ review, but having your firm's only criterion for performing an EQ review be "the engagement partner or the quality management partner have identified unusual circumstances or risks in an engagement" is not appropriate. This criterion is too subjective to be responsive to the structure and nature of the firm's practice. Likewise, the client's revenue volume or total assets as the sole criterion is not appropriate because these are not, in and of themselves, indicators of the risk of the engagement.</p> <p><b>NOTE:</b> The criterion that an EQ review is required by law or regulation is a required response. [QM sec. 10, par. .35f(i)]</p>
EP QRe-8.03	The firm evaluates all engagements against the criteria and performs an EQ review for all engagements that meet the criteria.	
EP QRe-9	<b>Policy: EQ reviewers meet the firm's criteria for eligibility.</b>	<b>TIP:</b> The AICPA's list of peer reviewers and your state society are resources for finding an EQ reviewer.
EP QRe-9.01	Selection of the EQ reviewer is not made by the engagement partner.	

QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

EP QRe-9.02	<p>The EQ reviewer meets the following criteria:</p> <ul style="list-style-type: none"> <li>• Has sufficient technical expertise and experience.</li> <li>• Carries out responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the EQ reviewer. If the reviewer's objectivity becomes impaired, the reviewer must be replaced.</li> <li>• Does not make decisions for the engagement team or participate in the performance of the engagement, except to serve as a consultant to the engagement partner at any stage during the engagement, with the understanding that the EQ reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.</li> <li>• Does not assume any of the responsibilities of the engagement partner or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans, or affiliated or related entities.</li> <li>• Meets the independence requirements relating to the engagements reviewed, even though the EQ reviewer is not a member of the engagement team.</li> </ul>
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EP QRe-9.03	When the firm does not have suitably qualified personnel to perform the EQ review, the firm engages a suitably qualified external person to perform the engagement quality review.
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EP QRe-10	<b>Policy: The firm establishes procedures addressing the nature, timing, extent, and documentation of the EQ review.</b>
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EP QRe-10.01	<p>Regarding the EQ review, the engagement partner understands and performs the following:</p> <ul style="list-style-type: none"> <li>• The engagement partner remains responsible for the engagement and its performance, and the EQ reviewer does not make decisions for the engagement team.</li> <li>• The engagement partner may consult the EQ reviewer at any stage during the engagement, with the understanding that the EQ reviewer's objectivity may be impaired if the nature and extent of consultations becomes significant.</li> </ul>
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QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
<b>EP</b> <b>QRe-10.02</b>	<p>For engagements for which the firm’s EQ review criteria stipulate that an EQ review is required, the engagement partner</p> <ul style="list-style-type: none"> <li>• determines that an EQ reviewer has been appointed,</li> <li>• discusses with the EQ reviewer the significant findings or issues that arose during the engagement, if any, and</li> <li>• does not release the report until the completion of the EQ review.</li> </ul>	<p><b>TIP:</b> The EQ review is completed when the EQ reviewer decides it is completed.</p>
<b>EP</b> <b>QRe-10.03</b>	<p>Timing of the EQ review: Performing an EQ review is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the EQ review does not need to be completed before the date of the auditor’s report. When the EQ review results in additional audit procedures being performed, the date of the auditor’s report is changed to the date by which sufficient appropriate audit evidence has been obtained.</p>	<p><b>WARNING:</b> Although permitted by the standard, completing the EQ review after dating the report is far from optimal, and the time between dating the report and then completing the EQ review is expected to be minimal.</p>

QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

### EP QRe-10.04

The firm's procedures require that for audit and examination engagements, the EQ reviewer does the following, at appropriate points during the engagement:

- Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation
- Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions, and account balances
- Confirm with the engagement partner that there are no significant unresolved issues
- Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached
- Review documentation of the resolution of significant accounting, auditing, or financial reporting issues, including documentation of consultation with firm personnel or external sources
- Review the summary of uncorrected misstatements related to known and likely misstatements
- Review additional engagement documentation to the extent considered necessary
- Read the financial statements and the report and consider whether the report is appropriate
- Complete the review before the release of the report
- Determine whether the issues raised in the review require additional procedures that necessitate changing the auditor's report date

**NOTE:** QM section 20, *Engagement Quality Reviews*, addresses the appointment and eligibility of the EQ reviewer and the EQ reviewer's responsibilities relating to the performance and documentation of an EQ review. QM section 20 requires that the EQ review be conducted at appropriate points during the engagement, which has the advantage of reducing the time pressure for resolving issues that the EQ reviewer identifies.

### EP QRe-10.04

Before reports are released, matters that would cause the reviewer to question the engagement team's judgments and conclusions are resolved and the resolution is documented.

QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

EP QRe-10.05	<p>The EQ review is documented. Documentation includes the following:</p> <ul style="list-style-type: none"> <li>• The procedures required by the firm's policies on EQ review have been performed.</li> <li>• The EQ review has been completed before the report is released.</li> <li>• An assertion that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate.</li> </ul>
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EP QRe-11	<p><b>Policy: The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented.</b></p>
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EP QRe-11.01	The firm informs personnel of its consultation policies and procedures.
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EP QRe-11.02	<p>The firm identifies circumstances, including specialized situations, in which firm personnel are expected to consult. Those circumstances include the following [<i>specify the criteria, such as the following</i>]:</p> <ul style="list-style-type: none"> <li>• Application of newly issued technical pronouncements</li> <li>• Industries with special accounting, auditing, or reporting requirements</li> <li>• Emerging practice problems</li> <li>• Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made</li> <li>• Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the time a report was issued</li> <li>• Identification of suspected fraud or illegal acts</li> <li>• Filing requirements of regulatory agencies</li> </ul>
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EP QRe-11.03	The firm requires sufficiently experienced engagement team members to identify matters for consultation or consideration during the engagement.
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QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

**EP**  
**QRe-11.04**

The firm has established criteria that require consultation with outside parties, such as other firms, the AICPA Technical Hotline (877.242.7212), the AICPA Audit Quality Center, the AICPA Center for Plain English Accounting, other professional and regulatory bodies, and commercial organizations that provide relevant quality management services. Before using such services, the firm evaluates whether the external provider is qualified for that purpose.

**EP**  
**QRe-11.05**

The firm designates individuals within and outside the firm as consultants in certain areas. Such individuals have appropriate knowledge, authority, and experience. A list is maintained of the individuals within and outside the firm that the firm has designated as consultants, along with the areas where they are responsible for consulting.

**EP**  
**QRe-11.06**

The firm requires the engagement partner to determine the need to consult. That determination is based on the following:

- The materiality of the matter
- The experience of senior engagement personnel in a particular industry or functional area
- Whether the financial reporting framework or professional standards applicable to the engagement are as follows:
  - Based on authoritative pronouncements that are subject to varying interpretations
  - Based on varied interpretations of prevailing practice
  - Under active consideration by an authoritative body

**WARNING:** Don't hesitate to consult; those who only ask when they are unable to draw their own conclusion may not know whether they have come to the correct conclusion.

QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-11.07	<p>The firm maintains and provides its personnel with access to adequate and current reference materials, including materials relevant to its clients. Those materials include the most current versions of the following:</p> <ul style="list-style-type: none"> <li>• AICPA <i>Professional Standards</i></li> <li>• AICPA Audit and Accounting Guides relevant to all industries in which the firm practices</li> <li>• FASB pronouncements</li> <li>• Any other pronouncements relevant to the firm's practice (for example, SEC pronouncements, GASB pronouncements, <i>Government Auditing Standards</i> [Yellow Book], and other government audit guides relevant to the firm's practice)</li> </ul>	<p><b>TIP:</b> The U.S. Government Accountability Office's Yellow Book Technical Assistance can be reached at 202.512.9535 or <a href="mailto:yellowbook@gao.gov">yellowbook@gao.gov</a>.</p>
EP QRe-11.08	Those consulted are provided with all relevant facts that will enable them to provide informed advice.	
EP QRe-11.09	The firm resolves differences of opinion between engagement personnel and specialists before report issuance.	
EP QRe-11.10	<p>The firm requires documentation of consultations. That required documentation includes the following:</p> <ul style="list-style-type: none"> <li>• All relevant facts and circumstances</li> <li>• References to professional literature used in the determination</li> <li>• Conclusions reached and how they were implemented</li> <li>• Signatures of engagement partner and consultant</li> <li>• Reference to the engagement working papers</li> </ul>	
EP QRe-12	<b>Policy: The firm addresses and resolves differences of opinion within the engagement team; with those consulted; and, when applicable, between the engagement partner and the EQ reviewer.</b>	
EP QRe-12.01	The firm follows procedures for consultation in resolving differences within an engagement team. If further action is necessary, the engagement partner, the quality management partner, and the firm's leadership, if necessary, resolve the differences.	

QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-12.02	The conclusion reached to resolve the matter of disagreement and how that conclusion was implemented are documented.	
EP QRe-12.03	The firm not release the report until any differences of opinion are resolved.	
EP QRe-12.04	Any party to the consultation or difference of opinion, or both, who disagrees with the conclusion may document the disagreement with, and disassociate themselves from, the resolution of the matter.	<b>NOTE:</b> Resolution does not require consensus. Although consensus is optimal, ultimately, the managing partner is responsible for determining the resolution.
EP QRe-13	<b>Policy: Engagement teams complete the assembly of final engagement files on a timely basis.</b>	<b>TIP:</b> Assembling the final files sooner rather than later is best practice.
EP QRe-13.01	Final engagement files are assembled by the earlier of time limits required by professional standards and applicable regulatory requirements, if any, or 60 days from the report release date.	<b>TIP:</b> Because deadlines have power, it is helpful for the firm to specify a time limit for all engagements in the absence of time limits required by professional standards or regulatory requirements.
EP QRe-14	<b>Policy: The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.</b>	
EP QRe-14.01	The firm implements adequate and appropriate controls over the confidentiality, custody, integrity, accessibility, and retrievability of the firm's engagement documentation.	<b>NOTE:</b> The firm may be subject to law or regulation around confidentiality, such as the General Data Protection Act or California Consumer Act.



QRe#	Quality Response	Note, Tip, or Warning
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## Engagement Performance

### EP QRe-14.02

Adequate and appropriate controls over confidentiality, custody, integrity, accessibility, and retrievability of engagement documentation include the following:

- Requiring that engagement documentation clearly indicates when and by whom it was prepared and reviewed.
- Procedures to protect the integrity of the information at all stages of the engagement, including preventing unauthorized changes to the engagement documentation. For electronic engagement documentation, this includes
  - using passwords or data encryption, or both, to restrict access to authorized users, and
  - using appropriate back-up routines at appropriate stages during the engagement.
- Procedures for tracking the distribution of engagement documentation materials to personnel at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement.
- Procedures to allow access to hard copy engagement documentation for authorized users, including the engagement team and other authorized users, such as inspectors, and restrict access by others.
- Maintaining engagement documentation in one location to enhance retrievability (this applies to both hard copy and electronic documentation, although back-up files would be maintained elsewhere).
- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
  - Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations
  - Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary

**NOTE:** Based on the size of the firm and the formality of your documentation, you may decide this level of detail is not necessary in your quality management materials.

QRe#	Quality Response	Note, Tip, or Warning
Engagement Performance		
EP QRe-15	<b>Policy:</b> The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.	
EP QRe-15.01	The quality management partner maintains a list specifying the period of time sufficient to meet the needs of the firm, the requirements of the state board of accountancy, and applicable professional standards for each level of engagement service.	<b>TIP:</b> Your firm's professional liability insurance carrier can be a resource in determining appropriate time limits.
EP QRe-15.02	Engagement documentation is retained for the specified period of time.	

**Table 4: Example of Evaluated Quality Risks and Linked Responses – Engagement Performance**

The following table provides examples of evaluated quality risks and linked responses to each quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste these examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The following examples illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

Engagement Performance							
<b>EP QO-1</b>		Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.					
QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
EP QO-1	EP QRi-4	The engagement team does not tailor quality management materials to each engagement or does not use the templates and practice aids that are appropriate for the engagement.	Low	High	Yes	The engagement partner establishes procedures to ensure that regardless of whether the firm develops its own quality management materials or obtains it from a third-party provider <ul style="list-style-type: none"> <li>• the material is reliable and suitable for the engagement.</li> <li>• the quality management materials are up to date.</li> <li>• modifications to the package and to individual forms are appropriate.</li> <li>• the forms being used are appropriate for the engagement.</li> <li>• industry or regulatory requirements are identified (for example, requirements specific to your client's state).</li> </ul>	EP QRe-1.01

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
EP QO-2	The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members.						
EP QO-2	EP QRi-31	Team members, including component auditors and remote workers, are not adequately directed and supervised throughout the engagement.	Low	High	Yes	For each engagement, there is evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.	EP QRe-4.02
EP QO-4	Consultation on difficult or contentious matters is undertaken and the conclusions agreed are implemented.						
EP QO-4	EP QRi-58	Engagement teams do not undertake consultations on difficult or contentious matters because they do not recognize which matters (for example, areas involving high subjectivity or difficult-to-interpret accounting guidance) require consultation.	High	Medium	Yes	<p>The firm identifies circumstances, including specialized situations, when firm personnel are expected to consult. Those circumstances include the following <i>[specify the criteria, such as the following]</i>:</p> <ul style="list-style-type: none"> <li>• Application of newly issued technical pronouncements</li> <li>• Industries with special accounting, auditing, or reporting requirements</li> <li>• Emerging practice problems</li> <li>• Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made</li> <li>• Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the time a report was issued</li> <li>• Identification of suspected fraud or illegal acts</li> <li>• Filing requirements of regulatory agencies</li> </ul>	EP QRe-11.02

# Resources

**Table 1: Required Quality Objectives – Resources**

QO #	Ref:	Quality Objectives
RES QO-1	QM sec. 10, par. .33a	Personnel are hired, developed, and retained and have the competence and capabilities to <ul style="list-style-type: none"> <li>i. consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or</li> <li>ii. perform activities or carry out responsibilities in relation to the operation of the firm’s systems of quality management.</li> </ul>
RES QO-2	QM sec. 10, par. .33b	Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives.
RES QO-3	QM sec. 10, par. .33c	Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of the firm’s SOQM or performance of engagements.
RES QO-4	QM sec. 10, par. .33d	Engagement team members are assigned to each engagement, including an engagement partner, who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements.
RES QO-5	QM sec. 10, par. .33e	Individuals who have appropriate competence and capabilities, including sufficient time, are assigned to perform activities within the SOQM.
RES QO-6	QM sec. 10, par. .33f	Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm’s SOQM and the performance of engagements.
RES QO-7	QM sec. 10, par. .33g	Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm’s SOQM and the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable.
RES QO-8	QM sec. 10, par. .33h	Human, technological, or intellectual resources from service providers are appropriate for use in the firm’s SOQM and in the performance of engagements, taking into account preceding quality objectives RES QO-4 through RES QO-7.

**Table 2: Required Quality Objectives and Potential Quality Risks – Resources**

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-1	QM sec. 10, par. .33a	Personnel are hired, developed, and retained and have the competence and capabilities to <ul style="list-style-type: none"> <li>i. consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or</li> <li>ii. perform activities or carry out responsibilities in relation to the operation of the firm’s system of quality management.</li> </ul>			
Human Resources					
RES QO-1	RES QRi-1	Personnel, including partners, do not have, or cannot gain, the competence and capabilities to consistently perform quality engagements, which includes not only technical competence but professional ethics, values, and attitudes.	Choose an item.	Choose an item.	Choose an item.
RES QO-1	RES QRi-2	Personnel, including partners, do not have the competence and capabilities to perform activities or carry out responsibilities in relation to the operation of the firm’s SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-1	RES QRi-3	The firm does not have sufficient personnel or personnel with the appropriate competence and capabilities to perform the engagements it has accepted.	Choose an item.	Choose an item.	Choose an item.
RES QO-1	RES QRi-4	The firm does not adequately develop personnel that are hired and retained.	Choose an item.	Choose an item.	Choose an item.
RES QO-1	RES QRi-5	The firm does not have sufficient resources to recruit quality candidates.	Choose an item.	Choose an item.	Choose an item.
RES QO-1	RES QRi-6	The firm experiences high turnover.	Choose an item.	Choose an item.	Choose an item.
RES QO-1	RES QRi-7	Personnel, including partners, do not consistently perform quality engagements.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-2	QM sec. 10, par. .33b	Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives.			
Human Resources					
RES QO-2	RES QRI-8	Personnel do not demonstrate a commitment to quality through their actions and behaviors; do not develop or do not maintain the appropriate competence to perform their roles; and are not held accountable or recognized through timely evaluations, compensation, promotion, and other incentives.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-9	The capabilities and competencies possessed by personnel, including partners, do not support the firm’s quality objectives.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-10	Personnel, including partners, do not demonstrate a commitment to quality.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-11	Personnel, including partners, are not aware of their developmental needs to enable them to meet the firm’s quality objectives.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-12	The firm does not provide opportunities for personnel to participate in professional development activities that enable them to accomplish their assigned responsibilities.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-13	Learning and development programs are not delivered in a frequency, length, or format that ensures participant engagement and advancement of learning objectives.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-14	The firm does not encourage professional development (for example, passing the CPA exam).	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-15	Newly hired per-diem personnel are not aware of firm policies and procedures.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-16	Personnel, including partners, are not aware of their responsibilities and professional development opportunities.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-17	Training programs are insufficiently focused on meeting the development needs of personnel, including competence in technical and specialized (“soft”) skills.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-2	QM sec. 10, par. .33b	Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives.			
Human Resources					
RES QO-2	RES QRI-18	The partner in charge of an engagement in a specialized industry does not have sufficient current knowledge to perform quality engagements in that specialized industry.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-19	Personnel do not have the appropriate continuing professional education (CPE) required by law, regulation, or professional standards (which require competency) for the work they perform (for example, <i>Government Auditing Standards</i> requirements, AICPA Employee Benefit Plan Audit Quality Center requirements, and so on).	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-20	Personnel, including partners, are not aware of changes in applicable professional standards, regulations, or firm policy.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-21	Personnel, including partners, selected for advancement do not have the qualifications to fulfill the responsibilities they will be called on to assume.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-22	Leadership does not designate a person responsible for identifying and communicating the qualifications necessary to accomplish professional responsibilities at each professional level within the firm.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-23	Personnel, including partners, are not properly incentivized to maintain a high degree of quality in their engagements or in the performance of the SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-24	The firm’s compensation, recognition, and promotion mechanisms are ineffective in recognizing and rewarding competency (and, by association, quality), at any level.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-25	The firm does not have established criteria for advancement to the next level of responsibility.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRI-26	The firm does not hold personnel accountable for actions or behaviors that negatively affect quality, such as failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role, or implement the firm’s responses as designed.	Choose an item.	Choose an item.	Choose an item.



QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
EP QO-2	QM sec. 10, par. .33b	Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives.			

### Human Resources

RES QO-2	RES QRi-27	Quality objectives and per-diem personnel's commitment to quality are not a component of advancement and compensation determinations.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRi-28	Evaluations are not undertaken at appropriate intervals and do not include competency areas and other performance measures.	Choose an item.	Choose an item.	Choose an item.
RES QO-2	RES QRi-29	Positive actions or behaviors demonstrated by per-diem personnel are not adequately or consistently recognized (such as through compensation, promotion, other incentives, or, as appropriate, simple or informal incentives that are not based on monetary rewards).	Choose an item.	Choose an item.	Choose an item.
RES QO-3	QM sec. 10, par. .33c	Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of the firm's system of quality management or performance of engagements.			

### Human Resources

RES QO-3	RES QRi-30	Individuals are not obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of the firm's SOQM or performance of engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-3	RES QRi-31	The firm relies on an external workforce, network firm, or component auditor that does not perform the engagement or a portion of the engagement in accordance with applicable standards.	Choose an item.	Choose an item.	Choose an item.
RES QO-3	RES QRi-32	Alternate work forces, network resources, component auditors, and other third-party resources, are not properly evaluated for competence and capabilities or trained in the performance of engagements, prior to utilization.	Choose an item.	Choose an item.	Choose an item.
RES QO-3	RES QRi-33	The firm lacks an appropriate network or third-party providers to enable the operation of the firm's SOQM or performance of engagements.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-3	QM sec. 10, par. .33c	Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of the firm's system of quality management or performance of engagements.			

### Human Resources

RES QO-3	RES QRI-34	The firm lacks internal expertise to perform adequate monitoring of the firm's SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-3	RES QRI-35	The firm is not able to timely identify the need for network or third-party providers to enable the operation of the firm's SOQM or performance of engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-3	RES QRI-36	The firm is not able to timely evaluate the appropriateness of network or third-party providers to enable the operation of the firm's SOQM or performance of engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	QM sec. 10, par. .33d	Engagement team members, including an engagement partner, who have appropriate competence and capabilities to consistently perform quality engagements, including being given sufficient time, are assigned to each engagement.			

### Human Resources

RES QO-4	RES QRI-37	Engagement team members, including an engagement partner, are assigned to engagements when they do not have appropriate competence and capabilities to consistently perform quality engagements, including being given sufficient time.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	RES QRI-38	Engagement teams are not afforded sufficient time or there are insufficient staffing levels to consistently perform quality audit engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	RES QRI-39	Leadership is not aware of which partner is responsible for certain engagements, which causes a high-risk industry engagement to be inadequately performed.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	RES QRI-40	The engagement partner does not fulfill all required responsibilities.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	RES QRI-41	Engagement team members, including the engagement partner, suffer "impairment" due to physical or mental considerations (fatigue, burnout, distractions, not taking paid time off, unreasonable workload compression, insufficient succession planning, and so on) such that they are unable to effectively perform relevant responsibilities.	Choose an item.	Choose an item.	Choose an item.

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-4	QM sec. 10, par. .33d	Engagement team members, including an engagement partner, who have appropriate competence and capabilities to consistently perform quality engagements, including being given sufficient time, are assigned to each engagement.			
Human Resources					
RES QO-4	RES QRi-42	The engagement partner perpetuates errors on engagements that cause nonconformity with the applicable professional standards.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	RES QRi-43	Engagement team members, including the engagement partner, do not collectively have appropriate competence and capabilities in the circumstances of the particular engagement.	Choose an item.	Choose an item.	Choose an item.
RES QO-4	RES QRi-44	Engagement team members are not properly supervised, including in a remote working environment.	Choose an item.	Choose an item.	Choose an item.
RES QO-5	QM sec. 10, par. .33e	Individuals who have appropriate competence and capabilities, including sufficient time, to perform such activities are assigned to perform activities within the system of quality management.			
Human Resources					
RES QO-5	RES QRi-45	Individuals who do not have appropriate competence and capabilities, including sufficient time, are assigned to perform activities within the SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-5	RES QRi-46	Insufficient resources are allocated to developing and maintaining an effective SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-5	RES QRi-47	Individuals assigned roles relevant to the SOQM lack the competence and capabilities to undertake those roles.	Choose an item.	Choose an item.	Choose an item.
RES QO-5	RES QRi-48	Personnel performing quality management operational and monitoring functions do not have sufficient time dedicated to QM activities.	Choose an item.	Choose an item.	Choose an item.
RES QO-5	RES QRi-49	Personnel performing quality management functions are not adequately trained to perform QM activities.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-6	QM sec. 10, par. .33f	Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the performance of engagements.			
Technological Resources					
RES QO-6	RES QRI-50	Technological resources to enable the operation of the firm's SOQM and the performance of engagements that are obtained or developed are not appropriate, are not implemented, are not maintained, are not used, or are used inappropriately.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-51	The firm fails to invest in and use technological resources that have the ability to enhance quality as well as other benefits such as efficiency.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-52	Inadequate consideration is given to the features, security, controls, and so on when obtaining or developing technological resources that are used in the SOQM, including engagement performance.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-53	Appropriate levels of security and controls are not maintained over IT applications (for example, access to technology tools is granted to unauthorized professionals or is untimely revoked due to reassignments, role changes, terminations, and other unforeseen circumstances).	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-54	Personnel are not properly trained to use the firm's technological resources (for example, computer-assisted auditing tool) resulting in overreliance or improper evaluation of results.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-55	Personnel do not have the appropriate competence and capabilities to use technological resources effectively.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-56	Software applications used in assurance, including the firm's engagement performance methodology, are not performing as designed (including version enhancements).	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-57	Firm and client data is susceptible to cyber breaches, loss, or theft of IT equipment.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRI-58	IT failure prevents access to engagement files.	Choose an item.	Choose an item.	Choose an item.

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-6	QM sec. 10, par. .33f	Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the performance of engagements.			
Technological Resources					
RES QO-6	RES QRi-59	Personnel, including partners, use their personal devices for client work, which presents risks to the control and security of data.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-60	There are disparate, unintegrated systems that do not carry data properly from one to the other or use inconsistent data. Note: This may occur as the result of a merger or acquisition.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-61	Appropriate technological resources are not obtained or are inappropriately developed, are not maintained or lack the necessary IT infrastructure and IT processes for the resource to function effectively, or are not used appropriately.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-62	Technological resources are altered inappropriately.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-63	Technological resources become obsolete.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-64	The firm does not develop, implement, or maintain the necessary technological resources to meet its quality objectives and enable personnel to carry out quality engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-65	In obtaining, developing, implementing, and maintaining an IT application, the firm does not appropriately assess or respond to findings related to the use of the application.	Choose an item.	Choose an item.	Choose an item.
RES QO-6	RES QRi-66	Personnel are not given timely access to the necessary technological resources to complete their assigned responsibilities.	Choose an item.	Choose an item.	Choose an item.

QO#	QRi #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-7	QM sec. 10, par. .33g	Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm’s system of quality management and the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable.			
Intellectual Resources					
RES QO-7	RES QRi-67	Intellectual resources to enable the operation of the firm’s SOQM and the consistent performance of quality engagements are obtained or developed inappropriately, are not implemented, are not maintained, are not used, or are used inappropriately, and such intellectual resources are not consistent with professional standards and applicable legal and regulatory requirements.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-68	The firm relies on third-party practice aids without appropriately customizing them for the nature and circumstances of its practice.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-69	The firm does not receive updated quality management materials on a regular basis.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-70	The firm subscribes only to general quality management materials that are not industry specific.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-71	The intellectual information, including data obtained from third parties or developed by the firm, is not appropriately vetted, is incorrect, or is not updated timely.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-72	The firm does not develop, maintain, and implement the necessary intellectual resources — such as software licenses, research tools, and professional literature — to meet its quality objectives and enable personnel to carry out quality engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-73	Internally developed spreadsheets for firm personnel, including partners, to use contain errors or employ inappropriate methodologies.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-74	Appropriate templates are not used properly in the performance of engagements.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRi-75	The firm does not have properly designed, implemented, or effective policies or procedures regarding use of the firm’s intellectual resources.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-7	QM sec. 10, par. .33g	Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm’s system of quality management and the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable.			
Intellectual Resources					
RES QO-7	RES QRI-76	Information used to monitor the SOQM is not complete, accurate, or updated with respect to engagement data (engagement listings, classification of engagements, personnel hours, personnel experience, and so on).	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRI-77	The firm does not timely identify and train personnel on changes in applicable professional standards and legal and regulatory requirements.	Choose an item.	Choose an item.	Choose an item.
RES QO-7	RES QRI-78	Following a merger or acquisition, intellectual resources are not integrated or consistent across the firm.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	QM sec. 10, par. .33h	Human, technological, or intellectual resources from service providers are appropriate for use in the firm’s system of quality management and in performing engagements, taking into account preceding quality objectives RES QO-4 through RES QO-7.			
Service Providers					
RES QO-8	RES QRI-79	Human, technological, or intellectual resources from service providers are not appropriate for use in the firm’s SOQM and in the performance of engagements, taking into account the quality objectives in paragraph 33d, e, f, and g of QM section 10, <i>A Firm’s System of Quality Management</i> .	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-80	Service provider updates are incorrect, do not reflect changes in professional standards and applicable legal and regulatory requirements, are not timely, or are not accepted by the firm.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-81	Third-party audit team members used on audit engagements are unfamiliar with the firm’s policies and procedures.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-82	The firm fails to timely and effectively determine whether a resource from a service provider is appropriate for use in the firm’s SOQM or in the performance of engagements, nor does the firm take the actions necessary for use to be appropriate (for example, by tailoring the resource for the firm’s nature and circumstances).	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
RES QO-8	QM sec. 10, par. .33h	Human, technological, or intellectual resources from service providers are appropriate for use in the firm’s system of quality management and in performing engagements, taking into account preceding quality objectives RES QO-4 through RES QO-7.			
Service Providers					
RES QO-8	RES QRI-83	The firm fails to timely and effectively consider (i) the nature of the service provider’s resources, (ii) how and the extent to which the firm will use them, and (iii) the general characteristics of the service providers used (for example, the varying types of other professional services firms that are used).	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-84	The firm is not adequately monitoring service providers used in the firm’s SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-85	Client data confidentiality is violated as a result of a data breach when using vendor cloud platforms or other external service providers.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-86	The firm does not timely and effectively communicate information to the service provider or to personnel, including partners necessary for the resource to function effectively.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-87	The firm does not maintain the appropriate policies, procedures, and open channels of communication regarding when and to what extent service providers are or can be used in the firm’s SOQM.	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-88	The firm is unable to obtain sufficient service providers or obtain them timely (for example, EQ reviewers).	Choose an item.	Choose an item.	Choose an item.
RES QO-8	RES QRI-89	The firm over-relies on or does not properly evaluate the work of service providers.	Choose an item.	Choose an item.	Choose an item.



**Table 3: Required and Suggested Quality Responses – Resources**

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>Human Resources</b>		
<b>RES QRe-1</b>	<b>Policy: The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances.</b>	<b>NOTE:</b> Depending on the firm’s engagements, “sufficient personnel” may consist of only you.
<b>RES QRe-2</b>	<b>Policy: The firm hires only personnel that have the characteristics to enable them to perform competently.</b>	
<b>RES QRe-2.01</b>	An individual in the firm [ <i>name or title</i> ] is responsible for the firm’s hiring and human resources management, including evaluation of personnel needs; establishment of hiring objectives based on factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement; and providing final approval.	<b>NOTE:</b> Depending on the size and structure of the firm, some of these procedures may be delegated (for example, to the practice office level).
<b>RES QRe-2.02</b>	The firm has a process to identify personnel needs at all levels for use in hiring.	
<b>RES QRe-2.03</b>	The firm has hiring criteria that address the following: <ul style="list-style-type: none"> <li>• The attributes, achievements, and experiences desired in entry-level and experienced personnel to enable them to perform competently within the firm</li> <li>• How the firm evaluates personal characteristics such as integrity, competence, and motivation of new hires</li> <li>• Any additional information the firm requires for experienced hires, such as background checks and inquiries about any outstanding regulatory actions</li> </ul>	
<b>RES QRe-2.04</b>	The firm identifies sources of employment candidates or external human resources, such as universities, executive recruiters, or networks.	

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>RES QRe-2.05</b>	The firm has criteria for determining which individuals will be involved in the interviewing and hiring process.	
<b>RES QRe-2.06</b>	Individuals who will be interviewing candidates or otherwise participating in the hiring process are trained in interviewing techniques.	<b>NOTE:</b> This training may be very informal but is necessary, if only to be sure they don't ask anything illegal.
<b>RES QRe-2.07</b>	The firm evaluates the results of the hiring process for each candidate, including approval by the managing partner, or a person designated by the managing partner, of all hiring decisions, in accordance with applicable legal and regulatory requirements.	
<b>RES QRe-3</b>	<b>Policy: Individuals obtained from external resources meet the firm's criteria for eligibility.</b>	
<b>RES QRe-4</b>	<b>Policy: The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner.</b>	
<b>RES QRe-4.01</b>	The firm specifies the knowledge, skills, and abilities (competencies) that the engagement partner for each of the firm's accounting, auditing, or attestation engagements (the partner or other person who is responsible for supervising those types of engagements and signing or authorizing someone to sign the accountant's report on such engagements) should possess to fulfill the engagement partner's responsibilities.	

QRe#	Quality Response	Note, Tip, or Warning
Resources		
RES QRe-4.02	<p>Such competencies for the practitioner-in-charge include the following:</p> <ul style="list-style-type: none"> <li>• An understanding of the role of the firm's system of quality control control and the AICPA Code of Professional Conduct</li> <li>• An understanding of the performance, supervision, and reporting aspects of the engagement</li> <li>• An understanding of the applicable accounting, auditing, or attestation professional standards, including those standards directly related to the industry in which a client operates</li> <li>• An understanding of the industry in which a client operates, including the industry's organization and operating characteristics, to identify the areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates</li> <li>• Skills that indicate sound professional judgment, including the ability to exercise professional skepticism</li> <li>• An understanding of how organizations are dependent on or enabled by information technologies and the manner in which information systems are used to record and maintain financial information</li> </ul>	
RES QRe-5	<b>Policy: The firm determines the capabilities and competencies possessed by personnel.</b>	
RES QRe-5.01	The firm evaluates personal characteristics such as integrity, competence, and motivation of personnel on an ongoing basis.	<b>NOTE:</b> The criteria used in evaluating these personal characteristics for new hires can be adapted for this procedure.
RES QRe-5.02	The firm periodically evaluates all personnel, including owners, who sign reports on behalf of the firm to assess whether they possess the knowledge, skills, and abilities (competencies) necessary to enable them to be qualified to perform the firm's accounting, auditing, or attestation engagements (for example, by means of coaching, peer evaluation, or self-appraisal).	

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>RES QRe-6</b>	<b>Policy: The firm assigns responsibility for each engagement to an engagement partner. The identity and role of the engagement partner are communicated to management and those charged with governance; the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and the responsibilities of the engagement partner are clearly defined and communicated to that individual.</b>	
<b>RES QRe-6.01</b>	Responsibility for each engagement is assigned to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role.	<b>WARNING:</b> Audits often have quality issues when engagement partners take assignments that are outside their normal scope of duties (for example, a tax partner performs an ERISA audit).
<b>RES QRe-6.02</b>	The identity and role of the engagement partner are communicated to management and those charged with governance at the beginning of the engagement.	
<b>RES QRe-6.03</b>	The responsibilities of an engagement partner are clearly defined by the firm and are communicated to the engagement partner.	
<b>RES QRe-6.04</b>	The partner responsible for partner assignments monitors the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities.	
<b>RES QRe-6.05</b>	When an engagement is found to be materially non-conforming after report issuance (for example, through firm monitoring, peer review, or regulatory inspection), the firm (a) requires the engagement partner to take appropriate training and monitors that person's performance (for example, through EQ review) until the firm is satisfied that remediation has occurred, (b) limits or prohibits the engagement partner's assignments on future engagements in that industry or area, or (c) dismisses the engagement partner from the firm.	
<b>RES QRe-7</b>	<b>Policy: The firm assigns appropriate personnel with the necessary competence and capabilities to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enables the firm to issue reports that are appropriate in the circumstances.</b>	

QRe#	Quality Response	Note, Tip, or Warning
Resources		
RES QRe-7.01	<p>The firm assigns personnel (including partners) to engagements based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed. In doing so</p>	<p><b>WARNING:</b> Do not confuse availability with appropriateness. Availability is necessary but it is not, in and of itself, sufficient.</p>
	<ul style="list-style-type: none"> <li>• the firm designates a responsible party or parties for the assignment of personnel to engagements, including partner and manager assignments.</li> <li>• the firm considers each of the following factors to determine how personnel are assigned to engagements: engagement size and complexity; specialized experience or expertise required; personnel availability and involvement of supervisory personnel; timing of work to be performed; continuity and rotation of personnel; opportunities for on-the-job training; previous knowledge; skills and abilities gained through other experience; and situations in which independence or objectivity concerns exist.</li> </ul>	
RES QRe-7.02	<p>The firm assures that individuals are maintaining the appropriate licenses to perform their assigned engagements, including for states other than where the individual primarily practices public accounting.</p>	<p><b>TIP:</b> The website CPAMobility.org may be helpful in determining the necessary individual licenses.</p>
RES QRe-7.03	<p>The firm maintains the appropriate firm licenses or permits, including for states other than where its main office is domiciled.</p>	<p><b>TIP:</b> The website CPAMobility.org may be helpful in determining the necessary firm licenses or permits.</p>
RES QRe-7.04	<p>When the firm accepts an audit in an industry in which the firm's personnel do not have recent experience, the firm consults appropriate resources (for example, literature, the AICPA Technical Hotline, or a suitably qualified external person) to determine the extent of changes relevant to the engagement. When determined to be necessary, the firm engages a suitably qualified external person to assist with the performance of an audit as a member of the engagement team.</p>	<p><b>TIP:</b> How recent depends on changes in the industry and related accounting; not more than five years is a useful guideline, but it could be less, especially in regulated industries.</p>
RES QRe-7.05	<p>In all states where the firm practices, the firm (a) is licensed under the same names under which it practices; (b) must obtain licenses or permits that are effective before any reports are issued in the state; (c) considers variations in licensing bodies' rules and regulations and how they affect the firm's need to be licensed in that state; and (d) addresses any restrictions on practice imposed by the licensing bodies.</p>	

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>RES QRe-8</b>	<b>Policy: Personnel, including partners, participate in general and industry-specific CPE and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other regulators.</b>	<b>TIP:</b> A mix of CPE delivery methods (that is, self-study, webcasts, live presentations) enhances the learning experience.
<b>RES QRe-8.01</b>	The firm has an individual or individuals responsible for the firm's CPE and professional development activities, including maintaining CPE records and course materials for personnel.	
<b>RES QRe-8.02</b>	The firm encourages personnel to pass the Uniform CPA Examination and covers the cost, including paid time off to take the exam.	
<b>RES QRe-8.03</b>	The firm has an orientation and training policy for new hires.	
<b>RES QRe-8.04</b>	The firm informs personnel of their responsibilities and professional development opportunities.	<b>TIP:</b> Establishing developmental opportunities for personnel that reinforce quality can reinforce the firm's commitment to quality.
<b>RES QRe-8.05</b>	The firm provides CPE to personnel in subjects that are relevant to their responsibilities, either through in-house programs or externally developed courses.	
<b>RES QRe-8.06</b>	<i>[If the firm practices in a specialized industry]</i> a partner is designated with firm-wide responsibility for the quality of the firm's practice in [name the specialized industry]. That partner is required to take annual CPE in the specialized industry.	
<b>RES QRe-8.07</b>	All personnel must comply with the professional education requirements of the boards of accountancy in states where they are licensed, and as applicable, the AICPA, the state CPA society, and <i>Government Auditing Standards</i> .	

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>RES QRe-8.08</b>	<p>The firm establishes CPE requirements for professional personnel. Under these requirements</p> <ul style="list-style-type: none"> <li>• all professional personnel must participate in CPE and professional development activities, which support their performance in their assigned engagements and are appropriate when considering their role in the firm.</li> <li>• if an individual signs opinions on, performs engagement quality control reviews for, or manages engagements in, a specialized industry or area, the individual must have a minimum of eight hours of CPE specific to the industry or area every three years (or within the firm's or individual's CPE period covering a three-year period).</li> </ul>	<p><b>WARNING:</b> The requirements for CPE are intended to address competency, not just maintaining a CPA license. Accordingly, all professional personnel, not just those with a CPA license, must take CPE. Taking more CPE than required by state law or regulation may be needed to obtain the necessary competency.</p>
<b>RES QRe-8.09</b>	<p>All personnel must take ethics CPE periodically [<i>specify the period, for example, the minimum required by state law or regulation</i>].</p>	<p><b>NOTE:</b> This applies to non-licensed professional personnel, as well.</p>
<b>RES QRe-8.10</b>	<p>The firm reimburses personnel who are CPAs for membership in a state society and the AICPA, including AICPA section memberships as relevant.</p>	<p><b>TIP:</b> This best practice provides personnel with a wealth of resources, such as access to the AICPA Technical Hotline and Ethics Hotline, professional journals, audit tools, and more.</p>
<b>RES QRe-8.11</b>	<p>The firm informs personnel of changes in accounting and auditing standards, independence, integrity, and objectivity requirements and the firm's technical policies and procedures with respect to them (for example, by distributing technical pronouncements and conducting training courses on recent changes and areas noted by the firm as needing improvement).</p>	
<b>RES QRe-8.12</b>	<p>The firm encourages personnel to participate in professional development activities, such as taking graduate-level courses, becoming members of professional organizations, serving on professional committees, speaking to professional groups, and writing for professional publications.</p>	

QRe#	Quality Response	Note, Tip, or Warning
Resources		
RES QRe-9	<b>Policy: Personnel selected for advancement have the qualifications to fulfill the responsibilities they will be called on to assume.</b>	<b>NOTE:</b> In the smallest firms, procedures to address this policy may be developed on an “as needed” basis.
RES QRe-9.01	<p>The firm has a director of human resources to identify and communicate, for example, through the firm’s policies and procedures manual, the qualifications necessary to accomplish responsibilities at each professional level in the firm. This includes the following:</p> <ul style="list-style-type: none"> <li>• Establishing criteria for evaluating personnel at each professional level and for advancement to the next level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.</li> <li>• Informing firm personnel about the criteria for advancement to the next higher level of responsibility.</li> </ul>	<b>NOTE:</b> In smaller firms, a partner or other person may function in this role without the title.
	<ul style="list-style-type: none"> <li>• Informing personnel that failure to adhere to the firm’s policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.</li> </ul>	
RES QRe-9.02	The [director of human resources/specify designated person or persons] is responsible for making advancement and termination decisions, including identifying responsibilities and criteria for evaluation at each level and deciding who will prepare evaluations.	
RES QRe-9.03	The firm designates who is responsible for periodically evaluating the performance of personnel at each level and advising them of their progress in the firm.	
RES QRe-9.04	Periodically [specify the period, for example, at least annually or at the conclusion of engagements that last at least three weeks], the firm reviews with personnel their performance evaluations, including an assessment of their knowledge, skills, and abilities (competencies) and progress with the firm. The discussion addresses performance, future objectives of the firm and the individual, feedback on the operation of the firm’s responses and SOQM, assignment preferences, and career opportunities.	<b>TIP:</b> Timely feedback and effective performance reviews give due recognition and reward to the development and maintenance of competence.



QRe#	Quality Response	Note, Tip, or Warning
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## Resources

### RES QRe-9.05

The firm establishes compensation and advancement criteria for partners and other high-level staff, which address the following:

- Feedback based on monitoring results, peer reviews, and regulatory inspections
- Appropriate identification of significant and emerging accounting and auditing issues
- Appropriate consultation with firm experts when challenging issues arise

**TIP:** Technical knowledge, adherence to firm policies and procedures, staff development, client management, and practice development are all important considerations in determining partner and senior-level compensation.

## Technological Resources

### RES QRe-10

**Policy: The firm develops or obtains the technology to enable the firm's SOQM, and maintains it, including an annual evaluation to ensure that it is appropriate.**

### RES QRe-10.01

Before obtaining technological resources, the firm conducts research into its usability in the engagements it performs.

### RES QRe-10.02

After implementing new technological resources, the firm monitors and evaluates its effectiveness in increasing quality in the firm's engagements. This assessment considers the following:

- The data inputs are complete and appropriate.
- Data confidentiality is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.
- The outputs of the IT application achieve the purpose for which they will be used.
- The general IT controls necessary to support the IT application's continued operation as designed are appropriate.
- The need for specialized skills to use the IT application effectively, including the training of individuals who will use the IT application.
- The need to develop procedures that set out how the IT application operates.

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>RES QRe-10.03</b>	For technologies that do not enhance quality, the firm looks for new technologies that would have a greater impact on the quality of engagements.	
<b>RES QRe-10.04</b>	The firm documents evaluations, monitoring, and decisions about technologies to be used in the SOQM.	
<b>RES QRe-11</b>	<b>Policy: The firm prohibits the use of IT applications or features of IT applications until such time that it has been determined that they operate appropriately, achieve the purpose for which they are intended, and have been approved for use.</b>	
<b>RES QRe-11.01</b>	The firm uses passwords to restrict access to electronic engagement documentation and timely update authorization when employment status has changed.	
<b>RES QRe-11.02</b>	The firm specifies the qualifications or experience that individuals need to use the resource, including the need for an expert or training for personnel. For example, the firm may specify the qualifications or expertise needed to use an IT application that analyzes data, given that specialized skills may be needed to interpret the results.	
<b>RES QRe-11.03</b>	The firm trains all personnel to use applicable technical resources effectively.	
<b>RES QRe-11.04</b>	The firm stores, safeguards, and maintains electronic and paper-based information.	
<b>RES QRe-11.05</b>	The firm performs regular back-up routines for electronic documentation stored on servers, laptops, and smart phones.	
<b>RES QRe-11.06</b>	The firm prohibits the use of personal devices unless protective software from the firm is installed and maintained on the device with password protection.	

QRe#	Quality Response	Note, Tip, or Warning
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## Resources

**RES QRe-11.07** The firm assigns responsibility to a qualified individual in the firm for managing the technical resource applications and any program changes to those resources.

**RES QRe-11.08** The firm requires the use of certain IT applications in performing engagements or relating to other aspects of the engagement.

**RES QRe-11.09** The firm specifies the responsibilities of the engagement partner regarding the use of technological resources.

## Intellectual Resources

**RES QRe-12** **Policy: The firm uses quality management materials (for example, an audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like) to assist with the operation of the firm's SOQM and the consistent performance of quality engagements.**

**RES QRe-12.01** The firm QM partner establishes procedures to ensure that, regardless of whether the firm develops its own quality management materials or obtains it from a third-party provider

- the material is reliable and suitable for the practice.
- the quality management materials are up to date.
- modifications to the package and to individual forms are appropriate.
- the forms being used are appropriate for the engagement.

**RES QRe-12.02** The firm evaluates the use of intellectual resources to ensure that they remain appropriate for the operation of quality engagements.

**RES QRe-12.03** The firm determines that intellectual resources considered for use by the firm follow professional standards as well as legal and regulatory requirements that apply to the engagements that the firm performs.

QRe#	Quality Response	Note, Tip, or Warning
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## Resources

RES QRe-12.04	Before obtaining or developing intellectual resources, the firm considers the impact on the firm's SOQM and on the engagements that it performs.
RES QRe-12.05	The firm documents its considerations regarding intellectual resources.
RES QRe-12.06	The firm assigns responsibility to a qualified individual in the firm for managing the intellectual resources and any changes to those resources.
RES QRe-12.07	The firm requires the use of certain intellectual resources in performing engagements or relating to other aspects of the engagement.
RES QRe-12.08	The firm specifies the responsibilities of the engagement partner regarding the use of intellectual resources.
RES QRe-12.09	The firm describes how intellectual resources are to be used, including how the intellectual resource should be applied, and the availability of training and support.

## Service Providers

RES QRe-13	<b>Policy: The firm devotes sufficient time and resources to timely obtain resources from service providers when internal resources are not sufficient to meet the quality objectives.</b>
RES QRe-13.01	The firm evaluates the use of resources received from service providers to meet its quality objectives and its appropriateness for its SOQM.
RES QRe-13.02	Before using a resource (whether human, technical, or intellectual) from a service provider, the firm establishes an understanding of the nature of the resources provided, how and the extent to which they will be used by the firm, and the general characteristics of the service provider, including their experience and reputation.

QRe#	Quality Response	Note, Tip, or Warning
<b>Resources</b>		
<b>RES QRe-13.03</b>	Once a service provider's resource is used, the firm monitors and evaluates its effectiveness in increasing quality in the firm's engagements or SOQM, as applicable.	
<b>RES QRe-13.04</b>	For resources that are not appropriate, the firm works with service providers to remediate the resources or looks to other means for these resources.	
<b>RES QRe-13.05</b>	The firm establishes an understanding with the service provider regarding the frequency and accuracy of updates to the resources they are providing, when applicable.	
<b>RES QRe-13.06</b>	The firm considers the results of attestation engagements performed by independent third parties on the resource (for example, assurance engagements on quality control materials or reports on service organization controls).	<b>TIP:</b> In determining whether a resource is appropriate, the firm may consider the results of an examination engagement performed on that resource and whether the criteria used to evaluate the resource in that examination are suitable. Paragraph .27 of AT-C section 105, <i>Concepts Common to All Attestation Engagements</i> , <sup>1</sup> requires suitable criteria for reasonably consistent measurement or evaluation of the resource within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Criteria promulgated by a body designated by the Council of the AICPA under the AICPA Code of Professional Conduct are, by definition, considered to be suitable (see paragraphs .A44–.A46 of AT-C section 105. This includes criteria developed by the AICPA.
<b>RES QRe-13.07</b>	The firm establishes an understanding with the service provider regarding the information needed from the firm for the resource to operate effectively. Firm leadership will be assigned to monitor the firm's compliance.	
<b>RES QRe-13.08</b>	The firm documents the use of resources from service providers and from the network and the evaluation of the resources provided.	

**Table 4: Example of Evaluated Quality Risks and Linked Responses – Resources**

The following table provides examples of evaluated quality risks and linked responses to each quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste these examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The following examples illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

Resources							
<b>RES QO-1</b>		Personnel are hired, developed, and retained and have the competence and capabilities to <ul style="list-style-type: none"> <li>i. consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or</li> <li>ii. perform activities or carry out responsibilities in relation to the operation of the firm's system of quality management.</li> </ul>					
QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
<b>RES QO-1</b>	<b>RES QRI-2</b>	Personnel, including partners, do not have the competence and capabilities to perform activities or carry out responsibilities in relation to the operation of the firm's SOQM.	Low	High	Yes	The firm has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements and enable the firm to issue reports that are appropriate in the circumstances.	RES QRe-1
<b>RES QO-2</b>		Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives.					
<b>RES QO-2</b>	<b>RES QRI-10</b>	Personnel, including partners, do not demonstrate a commitment to quality.	Low	High	Yes	The firm evaluates personal characteristics such as integrity, competence, and motivation of personnel on an ongoing basis.	RES QRe-5.01

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
RES QO-6	Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the performance of engagements.						
RES QO-6	RES QRe-56	Software applications used in assurance, including the firm's engagement performance methodology, are not performing as designed (including version enhancements).	Medium	High	Yes	<p>After implementing new technological resources, the firm monitors and evaluates its effectiveness in increasing quality in the firm's engagements. This assessment considers the following:</p> <ul style="list-style-type: none"> <li>• The data inputs are complete and appropriate.</li> <li>• Data confidentiality is preserved.</li> <li>• The IT application operates as designed and achieves the purpose for which it is intended.</li> <li>• The outputs of the IT application achieve the purpose for which it will be used.</li> <li>• The general IT controls necessary to support the IT application's continued operation as designed are appropriate.</li> <li>• The need for specialized skills to use the IT application effectively, including the training of individuals who will use the IT application, is met.</li> <li>• The need to develop procedures that set out how the IT application operates is met.</li> </ul>	RES QRe-10.02

# Information and Communication

**Table 1: Required Quality Objectives – Information and Communication**

QO #	Ref:	Quality Objectives
I&C QO-1	QM sec. 10, par. .34a	The information system identifies, captures, processes, and maintains relevant and reliable information that supports the SOQM, whether from internal or external sources.
I&C QO-2	QM sec. 10, par. .34b	The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another.
I&C QO-3	QM sec. 10, par. .34c	Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following: <ul style="list-style-type: none"> <li>i. Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the SOQM or engagements.</li> <li>ii. Personnel and engagement teams communicate information to the firm when performing activities within the SOQM or engagements.</li> </ul>
I&C QO-4	QM sec. 10, par. .34d	Relevant and reliable information is communicated to external parties, including the following: <ul style="list-style-type: none"> <li>i. Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them.</li> <li>ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the SOQM.</li> </ul>



**Table 2: Required Quality Objectives and Potential Quality Risks – Information and Communication**

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
<b>I&amp;C QO-1</b>	<b>QM sec. 10, par. .34a</b>	The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources.			
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-1</b>	The information system does not identify, capture, process, or maintain relevant and reliable information that supports the SOQM, whether from internal or external sources.	Choose an item.	Choose an item.	Choose an item.
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-2</b>	Electronic and paper-based information is not appropriately stored and maintained.	Choose an item.	Choose an item.	Choose an item.
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-3</b>	The integrity of the SOQM may be compromised, including data loss due to system failure or theft, either physical or cyber; unauthorized changes; and version control.	Choose an item.	Choose an item.	Choose an item.
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-4</b>	Information that the firm identifies, captures, processes, and maintains is not complete, accurate, timely, or valid to enable the proper functioning of the firm's SOQM and to support decisions regarding the SOQM.	Choose an item.	Choose an item.	Choose an item.
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-5</b>	Procedures to identify, capture, process, maintain, and communicate information are not established or clearly defined.	Choose an item.	Choose an item.	Choose an item.
<b>Monitoring</b>					
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-6</b>	Information from the resolution of complaints and allegations received is not communicated and used to improve the firm's SOQM.	Choose an item.	Choose an item.	Choose an item.
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-7</b>	Remediation efforts to resolve deficiencies in information and communication remain unresolved or improvements are delayed or not completed.	Choose an item.	Choose an item.	Choose an item.
<b>Change Management</b>					
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-8</b>	The firm does not have effective tools for communicating information and changes regarding the SOQM (for example, policies, procedures, and changes to the SOQM) to those who need to be informed.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-1	QM sec. 10, par. .34a	The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources.			
Change Management					
I&C QO-1	I&C QRI-9	The firm does not communicate changes to the SOQM to personnel and engagement teams to the extent that the changes are relevant to their responsibilities.	Choose an item.	Choose an item.	Choose an item.
I&C QO-1	I&C QRI-10	The firm does not have effective tools for communicating changes in accounting standards, professional standards, law, or regulation.	Choose an item.	Choose an item.	Choose an item.
Laws and Regulations					
I&C QO-1	I&C QRI-11	The firm fails to identify a requirement to communicate with an external party.	Choose an item.	Choose an item.	Choose an item.
I&C QO-1	I&C QRI-12	The information needed to verify compliance with the firm's SOQM (for example, licensure status, independence compliance, continuing professional education [CPE], and so on) is not adequately maintained or checked for completeness.	Choose an item.	Choose an item.	Choose an item.
I&C QO-1	I&C QRI-13	The information provided by personnel regarding compliance with the firm's SOQM (for example, licensure status, independence compliance, CPE, and so on) is not checked for accuracy.	Choose an item.	Choose an item.	Choose an item.
I&C QO-1	I&C QRI-14	The firm's SOQM fails to develop and evolve in line with changes in the regulatory framework, changes in the nature and circumstances of the firm, best practices, and so on (for example, the firm relies on manual processes, which become too difficult to maintain as the size of the firm grows).	Choose an item.	Choose an item.	Choose an item.
Other					
I&C QO-1	I&C QRI-15	A failure to exchange information between the firm and the engagement team, or among engagement team members, results in quality issues.	Choose an item.	Choose an item.	Choose an item.
I&C QO-1	I&C QRI-16	A failure to exchange information results in lost opportunities to improve the firm's quality management system.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-2	QM sec. 10, par. .34b	The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another.			
I&C QO-2	I&C QRI-17	The culture of the firm does not recognize nor reinforce the responsibility of personnel to exchange information with the firm and with one another.	Choose an item.	Choose an item.	Choose an item.
Tone at the Top					
I&C QO-2	I&C QRI-18	The actions, informal communications, and responses of individuals of various leadership positions (including engagement team leadership) imply that certain aspects of the firm's SOQM are not important or necessary.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-19	The firm's culture does not recognize and reinforce the responsibility of personnel to exchange information within the firm and one another.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-20	The QM partner fails to communicate to relevant personnel and engagement teams changes in the independence and other SOQM requirements and the firm's policies or procedures to address such changes.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-21	Engagement personnel are affected by email fatigue.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-22	The firm fails to establish a culture of collaboration among teams and across the firm.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-23	Lack of a proper chain of command results in inconsistent messaging of firm policies and methodology.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-24	A culture of working within silos conflicts with the responsibility of personnel to collaborate and exchange information within and across practice groups, resulting in audit quality issues.	Choose an item.	Choose an item.	Choose an item.
Engagement Team and Personnel Responsibility					
I&C QO-2	I&C QRI-25	The firm inadequately communicates quality issues.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-26	Personnel are not informed of where improvements can be made to the quality of the work they perform.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-2	QM sec. 10, par. .34b	The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another.			
I&C QO-2	I&C QRI-27	The firm fails to communicate the responsibility for implementing the firm's policies and procedures to personnel.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-28	Engagement teams fail to communicate information to the EQ reviewer or individuals providing consultation.	Choose an item.	Choose an item.	Choose an item.
I&C QO-2	I&C QRI-29	Group engagement teams fail to communicate matters to component auditors in accordance with the firm's policies or procedures, including matters related to quality management at the engagement level.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	QM sec. 10, par. .34c	Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following: i. Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the system of quality management or engagements. ii. Personnel and engagement teams communicate information to the firm when performing activities within the system of quality management or engagements.			
I&C QO-3	I&C QRI-30	Unreliable information is exchanged throughout the firm and with engagement teams.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-31	Relevant and reliable information is not exchanged throughout the firm and with engagement teams. The nature, timing, and extent of the information is not sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the SOQM or engagements.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-32	Personnel and engagement teams do not communicate information to the firm when performing activities within the SOQM or engagements.	Choose an item.	Choose an item.	Choose an item.
Ultimate Responsible Party					
I&C QO-3	I&C QRI-33	Individuals tasked with the operational and monitoring functions over the firm's SOQM are not given clear instructions regarding their roles and responsibilities.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-34	Those charged with operational and monitoring functions over the firm's SOQM do not have a direct line of communication to the managing partner.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-3	QM sec. 10, par. .34c	<p>Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following:</p> <ul style="list-style-type: none"> <li>i. Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the system of quality management or engagements.</li> <li>ii. Personnel and engagement teams communicate information to the firm when performing activities within the system of quality management or engagements.</li> </ul>			
Firm Communication					
I&C QO-3	I&C QRI-35	External conditions force engagement teams to work remotely (for example, a global pandemic) and the practical difficulties involved presents a risk that information is not communicated to engagement teams to enable them to understand and carry out their responsibilities in performing the engagement.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-36	Leadership lacks a policy to communicate important matters to the firm and criteria for identifying such matters.	Choose an item.	Choose an item.	Choose an item.
Engagement Team and Personnel Responsibility					
I&C QO-3	I&C QRI-37	The engagement team does not communicate concerns with how the firm is responding to identified quality management risks. (for example, concerns about the firm's processes for assigning personnel to engagements). <i>[Note that the information provided through these communications may indicate a deficiency of the firm's SOQM.]</i>	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-38	Relevant and reliable information is not sufficiently communicated to personnel and engagement teams to enable them to understand and execute their responsibilities within the SOQM.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-39	Findings from an EQ review, peer review, or other quality reviews or assessments are not communicated to the engagement teams.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-40	The engagement partner and partner(s) providing other services to the client do not communicate relevant information to each other for independence purposes.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-41	Engagement team members are not adequately informed of their roles and responsibilities at the engagement level.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-3	QM sec. 10, par. .34c	Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following: <ul style="list-style-type: none"> <li>i. Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the system of quality management or engagements.</li> <li>ii. Personnel and engagement teams communicate information to the firm when performing activities within the system of quality management or engagements.</li> </ul>			
I&C QO-3	I&C QRI-42	Personnel and engagement teams fail to communicate relevant or reliable information to the firm when performing activities within the SOQM or engagements.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-43	Firm professionals do not receive timely feedback on performance.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-44	Firm professionals fail to communicate information obtained during client acceptance and continuance that is relevant to engagement teams planning and performing engagements.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-45	The firm fails to communicate or make readily available firm policies to personnel.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-46	The firm's policies and procedures are not updated consistently and timely.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-47	Firm forms and templates are inappropriately modified or completed incorrectly by engagement teams.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-48	Firm policies, procedures, and methodologies are not clearly documented, organized in a logical format, or easily accessible, so they are difficult for engagement teams to locate, follow, and comply with.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-49	Changes to the firm's policies, procedures, or methodology are not communicated to personnel.	Choose an item.	Choose an item.	Choose an item.
I&C QO-3	I&C QRI-50	Learning and development programs are not delivered in a frequency, length, and format that ensures participant engagement.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-4	QM sec. 10, par. .34d	Relevant and reliable information is communicated to external parties, including the following: i. Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them. ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the system of quality management.			
I&C QO-4	I&C QRI-51	Relevant and reliable information is not communicated to external parties. Irrelevant or unreliable information is communicated to external parties.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-52	Information is not communicated by the firm to or within the firm's network or to service providers, if any, preventing the network or service providers from fulfilling their responsibilities relating to the network requirements or network services or resources provided by them.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-53	Information is not communicated externally when required by law, regulation, or professional standards, or to support external parties' understanding of the SOQM.	Choose an item.	Choose an item.	Choose an item.
Incoming and Outgoing Communication					
I&C QO-4	I&C QRI-54	The firm does not obtain relevant and reliable information from service providers that is necessary to establish and maintain the design, implementation, and operation of the firm's SOQM.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-55	The firm fails to communicate information to its network that can result in quality issues either at the firm or elsewhere in the network.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-56	The firm fails to communicate relevant and reliable information to service providers.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-57	Improper information may be disseminated to external parties.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-58	Leadership lacks a policy regarding proper communications with external parties.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-59	Engagement quality issues are not communicated to firm clients timely or at all.	Choose an item.	Choose an item.	Choose an item.

QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-4	QM sec. 10, par. .34d	Relevant and reliable information is communicated to external parties, including the following: i. Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them. ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the system of quality management.			

### Laws and Regulations

I&C QO-4	I&C QRI-60	The firm is unaware of its communication responsibilities under professional standards or legal and regulatory requirements, or both.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-61	Information is not communicated externally when required by law, regulation, or professional standards, or to support external parties' understanding of the SOQM.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-62	Law, regulation, or relevant ethical requirements include provisions addressing the duty of confidentiality, and the firm does not prevent violations from happening; detect violations that have occurred; or take corrective measures when aware of violations.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-63	Law or regulation requires the firm to publish a transparency report and specifies the nature of the information that is required to be included in the transparency report, and the firm fails to do so.	Choose an item.	Choose an item.	Choose an item.

### Independence and the SOQM

I&C QO-4	I&C QRI-64	The firm does not obtain information from the network or other network firms about clients of other network firms when there are independence requirements that affect the firm.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-65	The firm does not obtain an understanding of the SOQM in place at network firms or service providers.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-66	Deficiencies in the SOQM of network firms or service providers that are identified by the firm are not brought to the attention of the counterparty in a prompt manner.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-67	The firm does not communicate its findings from monitoring its quality management system to its network.	Choose an item.	Choose an item.	Choose an item.



QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk
I&C QO-4	QM sec. 10, par. .34d	<p>Relevant and reliable information is communicated to external parties, including the following:</p> <ul style="list-style-type: none"> <li>i. Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them.</li> <li>ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the system of quality management.</li> </ul>			
Independence and the SOQM					
I&C QO-4	I&C QRI-68	The firm obtains information from the network or other network firms about clients of other network firms when there are independence requirements that affect the firm, and the firm fails to act timely or appropriately.	Choose an item.	Choose an item.	Choose an item.
I&C QO-4	I&C QRI-69	The firm fails to communicate information to its network that can result in quality issues, independence violations, or other matters at the firm or within the network.	Choose an item.	Choose an item.	Choose an item.

**Table 3: Required and Suggested Quality Responses — Information and Communication**

QRe#	Quality Response	Note, Tip, or Warning
<b>Information and Communication</b>		
<b>I&amp;C QRe-1</b>	<p><b>Policy: The firm communicates information about our SOQM as prescribed by its policies and procedures with the following external parties if requested:</b></p> <ul style="list-style-type: none"> <li>• <b>Management or those charged with governance of a potential new client</b></li> <li>• <b>External oversight authorities</b></li> <li>• <b>Group auditors</b></li> <li>• <b>Other users of our firm engagement reports</b></li> </ul>	<p><b>NOTE:</b> Establishing policies or procedures that address when it is appropriate to communicate with external parties about the firm's SOQM is a required response. [QM sec. 10, par. .35e(i)]</p>
<b>I&amp;C QRe-1.01</b>	The firm communicates information to service providers, or network firms, necessary for them to fulfill their responsibilities.	
<b>I&amp;C QRe-1.02</b>	The firm communicates information externally when required by law, regulation, or professional standards (for example, if the firm becomes aware of noncompliance with laws and regulations by a client, and relevant ethical requirements require the firm to report the noncompliance to an appropriate external authority).	<p><b>TIP:</b> Know your client base; securities law or regulation requires the firm to communicate certain matters to those charged with governance.</p>
<b>I&amp;C QRe-1.03</b>	The QM partner is responsible for identifying external parties with whom the firm is required to communicate, and the information required to be communicated.	<p><b>NOTE:</b> Confidentiality law or regulation prohibits disclosure of certain information — stay alert.</p>
<b>I&amp;C QRe-2</b>	<p><b>Policy: The firm shares information about the firm's SOQM externally only after the QM partner has reviewed for accuracy and relevance, and has confirmed that sharing does not breach confidentiality requirements.</b></p>	<p><b>NOTE:</b> This is a required response. [QM sec. 10, par. .35e(ii)]</p>
<b>I&amp;C QRe-2.01</b>	When communicating with external parties, I provide the results of monitoring activities and external inspections and how the firm has remediated identified deficiencies, if applicable.	<p><b>NOTE:</b> Paragraphs .A137–.A138 of QM section 10 address other factors to consider when developing your communication policy.</p>

QRe#	Quality Response	Note, Tip, or Warning
<b>Information and Communication</b>		
<b>I&amp;C QRe-2.02</b>	The QM partner periodically reviews the information provided through the firm's website for accuracy, completeness, and balance.	<p><b>NOTE:</b> Forms of external communication include</p> <ul style="list-style-type: none"> <li>• a web page,</li> <li>• social media or webcasts,</li> <li>• discussions between the engagement team and those charged with governance, and</li> <li>• a transparency or audit quality report.</li> </ul> <p><b>NOTE:</b> A transparency report may be required by law or regulation and specifies the nature of the information required to be included.</p>
<b>I&amp;C QRe-3</b>	<b>Policy: The QM partner reports directly to the managing partner.</b>	<p><b>NOTE:</b> Individuals assigned operational responsibility for the SOQM, compliance with independence requirements, and the monitoring and remediation process are required to have a direct line of communication to the individual assigned ultimate responsibility and accountability for the SOQM. [QM sec. 10, par. .23]</p>
<b>I&amp;C QRe-3.01</b>	Those charged with operational and monitoring functions over the firm's SOQM have a direct line of communication to the managing partner.	
<b>I&amp;C QRe-4</b>	<b>Policy: The firm has established communication channels to facilitate communication across the firm (for example, weekly leadership meetings).</b>	
<b>I&amp;C QRe-4.01</b>	The firm publishes a quarterly newsletter that discusses internal and external developments. The newsletter is distributed through various channels to avoid being lost in email.	
<b>I&amp;C QRe-4.02</b>	Engagement teams communicate information about the operation of firm's responses (for example, concerns about the firm's process for assigning personnel to engagements).	
<b>I&amp;C QRe-4.03</b>	When leadership becomes aware of information that affects specific engagement teams, they alert the engagement partner to communicate the information to the rest of the engagement team.	

QRe#	Quality Response	Note, Tip, or Warning
Information and Communication		
<b>I&amp;C QRe-4.04</b>	Although there may be formal channels of communication, leadership promotes a culture in which collaboration and open communication are encouraged.	<b>TIP:</b> Such a culture may include a mentoring program and is evidenced when staff are comfortable speaking with firm leadership.
<b>I&amp;C QRe-4.05</b>	The firm holds annual firm-wide or practice-office-wide brainstorming sessions.	

**Table 4: Example of Evaluated Quality Risks and Linked Responses — Information and Communication**

The following table provides examples of evaluated quality risks and linked responses to each quality risk. Please note that this is for illustrative purposes only. Your firm may identify other risks, may evaluate the likelihood and impact of those risks differently, and may choose other responses. The examples are not complete; if all you do is copy and paste these examples, your SOQM will not provide reasonable assurance of achieving its objectives.

The following examples illustrate the documentation of establishing quality objectives, evaluating quality risks, and designing the firm's responses to those quality risks. This is not a complete picture of an established SOQM. The implementation, evaluation, and monitoring of the system will need to be documented and established, as well.

Information and Communication							
<b>I&amp;C QO-1</b>		The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources.					
QO#	QRI #	Quality Risk	Likelihood	Impact	Quality Risk	Quality Response	QRe#
<b>I&amp;C QO-1</b>	<b>I&amp;C QRI-11</b>	The firm fails to identify a requirement to communicate with an external party.	Low	High	Yes	The firm communicates information externally when required by law, regulation, or professional standards. For example, if the firm becomes aware of noncompliance with laws and regulations by a client, and relevant ethical requirements require the firm to report the noncompliance to an appropriate external authority.	I&C QRe-1.02
<b>I&amp;C QO-4</b>		Relevant and reliable information is communicated to external parties, including the following: i. Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them. ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the system of quality management.					
<b>I&amp;C QO-4</b>	<b>I&amp;C QRI-53</b>	Information is not communicated externally when required by law, regulation, or professional standards, or to support external parties' understanding of the SOQM.	Medium	High	Yes	The firm communicates information about our SOQM as prescribed by our policies and procedures with the following external parties if requested: • Management or those charged with governance of a potential new client • External oversight authorities • Group auditors or other users of the firm's engagement reports	I&C QRe-1

## Exhibit: Relevant Responses From Other Components

The following is a list of information and communication quality risks that can be addressed by quality responses (firm policies) from other components.

Quality risk #	Quality risk	Quality response	QRe#
<b>Governance and Leadership</b>			
<b>I&amp;C QRI-45</b>	The firm fails to communicate or make readily available firm policies to personnel.	The firm documents its QM policies and procedures and communicates them to the firm's personnel.	GOV QRe-4
<b>I&amp;C QRI-23</b>	Lack of a proper chain of command results in inconsistent messaging of firm policies and methodology.	The firm devotes sufficient and appropriate resources for the development, communication, and support of its QM policies and procedures.	GOV QRe-8
<b>I&amp;C QRI-43</b>	Firm professionals do not receive timely feedback on performance.	Performance evaluation, compensation, and advancement (including incentive systems) with regard to firm partners and personnel demonstrate the firm's overarching commitment to the objectives of the SOQM	GOV QRe-9
<b>Relevant Ethical Requirements</b>			
<b>I&amp;C QRI-20</b>	The QM partner fails to communicate to relevant personnel and engagement teams changes in the independence and other SOQM requirements and the firm's policies or procedures to address such changes.	The firm communicates its independence requirements to firm personnel and, when applicable, others subject to them.	RER QRe-2
<b>I&amp;C QRI-12</b>	The information needed to verify compliance with the firm's SOQM (for example, licensure status, independence compliance, CPE, and so on) is not adequately maintained or checked for completeness.	The firm obtains written confirmation, upon hire and at least annually, of compliance with its policies and procedures regarding independence from all personnel required to be independent by relevant requirements.	RER QRe-6
<b>Engagement Acceptance and Continuance</b>			
<b>I&amp;C QRI-44</b>	Firm professionals fail to communicate information obtained during client acceptance and continuance that is relevant to engagement teams planning and performing engagements.	The firm has established policies and procedures when information that becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm's decision to accept or continue a client relationship or specific engagement.	EAC QRe-3

Quality risk #	Quality risk	Quality response	QRe#
<b>Engagement Performance</b>			
<b>I&amp;C QRI-48</b>	Firm policies, procedures and methodologies are not clearly documented, organized in a logical format, or easily accessible so they are difficult for engagement teams to locate, follow, and comply with.	The firm uses quality management materials (for example, an audit and accounting manual, standardized forms, checklists, templates, practice aids, tools, questionnaires, and the like) to assist with engagement performance.	EP QRe-1 and RES QRe-12
<b>I&amp;C QRI-51</b>	Relevant and reliable information is not communicated to external parties.	The firm establishes, documents, and follows procedures when the firm uses external personnel, such as from other firms, for audit or accounting engagements.	EP QRe-7
<b>I&amp;C QRI-28</b>	Engagement teams fail to communicate information to the engagement quality reviewer or individuals providing consultation.	The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented.	EP QRe-11
<b>Resources</b>			
<b>I&amp;C QRI-40</b>	The engagement partner and partner(s) providing other services to the client do not communicate relevant information to each other for independence purposes.	The firm assigns responsibility for each engagement to an engagement partner. The identity and role of the engagement partner are communicated to management and those charged with governance; the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and the responsibilities of the engagement partner are clearly defined and communicated to that individual.	RES QRe-6
<b>I&amp;C QRI-56</b>	The firm fails to communicate relevant and reliable information to service providers.	The firm develops or obtains the technology to enable the firm's SOQM, and maintains it, including an annual evaluation to ensure that it is appropriate.	RES QRe-10



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# Establishing and Maintaining a **System of Quality Management** for a CPA Firm's Accounting and Auditing Practice

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## **Chapter 4:** Monitoring and Remediation Process

For Small- and  
Medium-Sized Firms

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## Notice to readers

This AICPA Audit and Accounting Practice Aid replaces *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which was issued in 2015. Although this practice aid has been reviewed by the AICPA Audit and Attest Standards staff, it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA and has no official or authoritative status.

This practice aid does not address the quality control requirements of the Sarbanes-Oxley Act of 2002 (SOX), nor does it address the quality control requirements of PCAOB standards that must be followed by auditors of issuers. Auditors of issuers should follow these other standards and make changes to their firm's quality control systems as necessary.

Additional information about the PCAOB and SOX can be obtained at the PCAOB website at [www.pcaobus.org](http://www.pcaobus.org).



# How to Use this Practice Aid

This AICPA Audit and Accounting Practice Aid, *Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice*, is intended to help sole practitioners design, implement, and operate a system of quality management for their firm's accounting and auditing practice, as required by Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*, issued by the AICPA.

SQMS No. 1 requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management. In applying a risk-based approach, the firm is required to take into account the nature and circumstances of both the firm and the engagements performed by the firm. This practice aid explains how to apply a risk-based approach and includes a library of potential risks and suggested responses.

Use this practice aid, and the Example Risk Assessment template, to help you apply the risk-based approach, identify the quality risks to your practice, and implement policies and procedures as necessary for the facts and circumstances of your practice.

Many of the policies and procedures may need to be modified to be applicable to your firm. Some may not be applicable at all. You may need to add policies and procedures that are already part of your system. Some of the policies and procedures are required by SQMS No. 1; these are noted in chapters 3 and 4.

Be aware that if you do not customize the risks and responses to the nature of your practice

- you won't be in compliance with the standards.
- you won't be doing what is most efficient and effective for your practice.

If all you do is

- copy the quality risks from this practice aid, it is likely that your quality risks will be incomplete, or that you will include quality risks that do not apply to your firm. Do not copy the quality risks from this practice aid without thoughtful consideration of any modifications needed for your firm's nature and circumstances.
- copy and paste the policies and procedures in this practice aid, you will be committing to responses that may not apply to your firm. And, because you included them in your documentation of your system of quality management, your peer reviewer will expect you to apply those policies and procedures.

In addition, a firm's risk assessment should be iterative and updated when changes in the nature and circumstances of the firm or its engagements occur. An incomplete or out-of-date risk assessment can have a significant effect on the system of quality management.

This practice aid is intended for firms with two or more personnel. If your firm has only one assurance partner, or only one partner with expertise in a specialized area, you may find the AICPA Audit and Accounting Practice Aid *Establishing and Maintaining a System of Quality Management for a CPA Firm's Accounting and Auditing Practice* for sole practitioners, also helpful.

# Chapter 4 — Monitoring and Remediation Process

The monitoring and remediation process involves an ongoing consideration and evaluation of the appropriateness of the design, implementation, and the effectiveness of the operation of a firm's system of quality management (SOQM) and a firm's compliance with its quality management policies and procedures.

A monitoring and remediation process

- provides relevant, reliable, and timely information about the design, implementation, and operation of the SOQM, and
- enables the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

The information provided also enables the firm — specifically, the managing partner — to evaluate whether the SOQM provides reasonable assurance that

- the firm adheres to professional standards and regulatory and legal requirements, and
- reports that are issued by the firm are appropriate in the circumstances.

The purpose of the monitoring and remediation process is to provide feedback on how the SOQM is working, determine whether changes are needed and, if so, implement the necessary changes. Monitoring activities include inspections of engagement documentation, reports and financial statements, and inspections of other components covered by the firm's SOQM. Reviews of engagement documentation, reports and financial statements can occur

- before the report is issued (engagement quality [EQ] review or other pre-issuance review) or
- after the report is issued (post-issuance review).

EQ review and other pre-issuance reviews are not, in and of themselves, suitable inspection procedures for monitoring. However, to the extent that information obtained from a pre-issuance review is evaluated in terms of what happens on other engagements and addressed systemically — that is monitoring.

Post-issuance reviews can occur on an engagement-by-engagement basis or at set times during the year.

The difference between engagement performance quality management (QM) procedures and monitoring QM procedures is that monitoring activities are designed to determine the root cause of the problem and then fix the problem systemically. Engagement performance QM procedures fix the problem at the engagement level but does not look for the root cause, nor are engagement performance QM procedures designed to fix the problem systemically.

**TIP:** Monitoring and remediation is a continuous process. If you are in the frame of mind to always be looking for errors and root causes, that's monitoring. Send an email to the firm when you see something — that's monitoring, communicating, and documenting. Save the email in a "monitoring" folder and you've documented as you go along so you can "get credit" for what you already do.



**NOTE:** Inspection of engagement documentation, reports and financial statements is only one type of monitoring activity. Don't forget other aspects, such as resources (human, intellectual, and technological), continuing professional education (CPE), licenses, and the requirements of audit quality centers of which your firm is a member.

The rest of this chapter presents suggested policies and procedures for the monitoring and remediation process. These suggested policies and procedures may not be all inclusive; you need to tailor this information based on your firm. The firm does not have to apply the risk assessment process to monitoring and remediation. However, in evaluating and concluding on the SOQM, the firm does need to consider whether the monitoring and remediation process achieves the objectives of

- providing relevant, reliable, and timely information about the design, implementation, and operation of the SOQM, and
- enabling the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

Policy or procedure	Note, Tip, or Warning
<p><b>Policy: The firm has a monitoring and remediation process designed to provide relevant, reliable, and timely information about the design, implementation, and operation of the SOQM and enable the firm to take appropriate actions to respond to identified deficiencies, so deficiencies are remediated on a timely basis. (QM sec. 10, par. .36)</b></p>	
<p><b>Policy: I accept operational responsibility for the firm’s monitoring and remediation process. (QM sec. 10, par. .21c(ii))</b></p> <p>The firm (for example, the managing partner) determines that the QM partner and all others responsible for conducting monitoring and remediation procedures (QM sec. 10, par. .22)</p> <ul style="list-style-type: none"> <li>• have appropriate experience, knowledge, influence, and authority within the firm and sufficient time to fulfill their assigned responsibility,</li> <li>• understand their assigned roles and that they are accountable for fulfilling them,</li> <li>• have a direct line of communication to the managing partner,</li> <li>• have no history of limitations or restrictions on their ability to practice public accounting, and</li> <li>• have not acted as engagement partner on one or more materially non-conforming engagements that were uncovered through peer review, monitoring, or regulatory inspection.</li> </ul>	<p><b>NOTE:</b> Statement on Quality Management Standards (SQMS) No. 1 requires individuals with operational responsibilities for the SOQM (for example, the QM partner) to possess the first three bullet points, but firms may consider additional qualities when assigning roles and responsibilities.</p>
<p>The QM partner is responsible for determining that the firm’s QM policies and procedures and its methodologies remain relevant and adequate. Factors that may be considered include the following:</p> <ul style="list-style-type: none"> <li>• External factors <ul style="list-style-type: none"> <li>– Changes in professional standards or other regulatory requirements applicable to the firm’s practice</li> <li>– Changes in applicable AICPA membership requirements</li> </ul> </li> <li>• Internal indicators <ul style="list-style-type: none"> <li>– Mergers and divestitures of portions of the practice</li> <li>– Results of previous monitoring activities</li> <li>– Results of inspections and peer reviews</li> <li>– Review of litigation and regulatory enforcement actions against the firm and its personnel</li> <li>– Changes in firm operations and services</li> </ul> </li> </ul>	<p><b>NOTE:</b> Examples of changes in professional standards that may result in a need to revise QM policies and procedures are changes to the AICPA Code of Professional Conduct.</p>

Policy or procedure	Note, Tip, or Warning
<p>At least annually, the QM partner performs, or selects an individual or team to perform, monitoring activities, including inspections, on the firm's SOQM. The QM partner uses criteria established by the firm to determine that individuals responsible for performing monitoring activities have (See paragraph .40 of QM section 10)</p> <ul style="list-style-type: none"> <li>• the competence and capabilities, including sufficient time, to perform the monitoring activities effectively.; and</li> <li>• objectivity, based on the premise that objectivity is enhanced when engagement team members or the EQ reviewer of an engagement are not involved in performing monitoring activities related to that engagement.</li> </ul>	
<p><b>Policy: The firm designs and performs monitoring activities that are sufficiently comprehensive to provide a basis for the identification of deficiencies. (QM sec. 10, par. .37)</b></p>	
<p>The firm determines the nature, timing, and extent of the monitoring activities considering the following: (QM sec. 10, par. .38)</p> <ul style="list-style-type: none"> <li>• The reasons for the assessments given to the quality risks</li> <li>• The design of the responses</li> <li>• The design of the firm's risk assessment process and monitoring and remediation process</li> <li>• Changes in the SOQM</li> <li>• The results of the firm's evaluations of each engagement</li> <li>• The results of previous monitoring activities</li> <li>• Other relevant information, including the results of both internal and external inspections</li> </ul>	<p><b>TIP:</b> Many firms perform their annual inspection at the same time of the year as their peer review is performed. Peer review is not a substitute for all monitoring activities. However, a firm may leverage inspections performed by peer review for some or all engagements for the period covered by the peer review. Firms will need to work with their peer reviewers to align the timing of the results of peer review inspections with the timing of the firm's evaluation of their SOQM.</p>
<p>In accordance with the membership requirements of the AICPA Governmental Audit Quality Center and the AICPA Employee Benefit Plan Audit Quality Center, the engagement letter covering the firm's peer review will require that the governmental audits and Employee Retirement Income Security Act (ERISA) employee benefit plan audits selected for review during the firm's peer review are reviewed by someone who is employed by a member firm of the respective center. Also, information relative to the firm's most recently accepted peer review is available to the public in accordance with the membership requirements of the respective centers.</p>	

Policy or procedure	Note, Tip, or Warning
<p>The QM partner (and the team or designated individual) plans the annual monitoring activities to be performed. Monitoring activities include review of engagements and engagement partners that represent a reasonable cross-section of the firm's accounting and auditing practice using the following criteria <i>[specify criteria, which could include, but are not limited to, the following]</i>:</p> <ul style="list-style-type: none"> <li>• Engagements required to be selected during peer review (under Government Auditing Standards, ERISA, FDIC Improvement Act financial institutions, and examinations of service organizations [SOC 1® and SOC 2® engagements])</li> <li>• Specialized industries with emphasis given to high-risk engagements</li> <li>• Initial engagements</li> <li>• The tenure and experience of engagement partners</li> <li>• The types of engagements performed by the firm, and the extent of the firm's experience in performing the type of engagement</li> <li>• The types of entities for which engagements are undertaken <ul style="list-style-type: none"> <li>– Entities operating in emerging industries</li> <li>– Entities operating in industries associated with a high level of complexity or judgment</li> <li>– Entities operating in an industry new to the firm</li> </ul> </li> <li>• An appropriate cross-section of the firm's auditing and accounting partners, taking into account partners who have had negative results in the prior inspections or peer reviews and partners who have specialties other than accounting and auditing, but still service accounting and auditing clients</li> <li>• The results of the firm's evaluations of each engagement partner's commitment to quality</li> <li>• Complaints or allegations about an engagement partner</li> <li>• Engagements from a merged-in practice</li> <li>• SEC registrants and other engagements performed in accordance with PCAOB standards</li> <li>• Engagements with areas that have been identified as findings in other reviews (that is, PCAOB, peer review, or prior internal inspection)</li> </ul>	<p><b>NOTE:</b> It is a requirement that the inspection of at least one completed engagement for each engagement partner is performed on a cyclical basis determined by the firm. (For examples of how to apply a cyclical basis for inspection, see paragraph .A165 of QM section 10)</p> <p><b>TIP:</b> The most effective monitoring focuses on areas of high risk (the risk that the firm isn't meeting professional standards or its own QM policies and procedures).</p> <p><b>WARNING:</b> Identifying a cross- section of the firm's practice requires properly identifying all the types of engagements the firm performs. Accordingly, the firm needs sufficient detail to track its engagement population, for example, a time and billing system that separately identifies an employee benefit plan audit performed in conjunction with the employer audit. This also has implications for document retention and peer review.</p> <p><b>WARNING:</b> Remember — you don't know what you don't know. If you are new to an industry, or if very few people in the firm have experience in an industry or technical area, hiring an external inspector to perform all or some inspection procedures may be beneficial.</p>
<p>The selected engagements are reviewed for compliance with the firm's policies and procedures.</p>	
<p>When deficiencies are identified in engagements, the QM partner considers the need to expand the selection of engagements to assist in the evaluation of the severity and pervasiveness of identified deficiencies. In addition to engagement inspection and reviews, the firm's monitoring activities include performing appropriate tests of compliance with the firm's policies and procedures on a sample basis. The monitoring activities include the following:</p> <ul style="list-style-type: none"> <li>• Assessing the appropriateness, reliability and suitability of the firm's guidance materials and practice aids, such as audit programs, forms and checklists, and determining whether they reflect recent professional pronouncements. This assessment includes soliciting comments from professional personnel as to the effectiveness of practice aids and tools.</li> </ul>	
<ul style="list-style-type: none"> <li>• Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.</li> </ul>	<p><b>TIP:</b> For small firms, this can be done by providing information at staff meetings.</p>



Policy or procedure	Note, Tip, or Warning
<ul style="list-style-type: none"> <li>• Interviewing personnel at all professional management and staff levels to obtain information about operating procedures and assess their understanding of the firm's QM policies and procedures and implementation thereof.</li> <li>• Reviewing correspondence regarding the resolution of independence and client acceptance matters within the practice office.</li> <li>• Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.</li> </ul>	
<ul style="list-style-type: none"> <li>• Reviewing summaries of CPE records for a sample of personnel to track compliance with the requirements of the AICPA and other regulatory bodies (such as the Government Accountability Office [GAO] and the Office of Management and Budget [OMB]), as well as the firm's CPE requirements.</li> </ul>	<p><b>NOTE:</b> This procedure encompasses reviewing both individual personnel's compliance and the firm's tracking of that compliance.</p>
<ul style="list-style-type: none"> <li>• Reviewing other administrative and personnel records pertaining to the QM objectives, such as               <ul style="list-style-type: none"> <li>– personnel evaluations, including documentation of hiring and advancement decisions, and</li> <li>– participants' evaluations of practice office training programs. Reviewing — or designating a management-level individual to be responsible for reviewing — professional development activities to determine whether they are appropriate, effective, and meet the needs of the firm.</li> </ul> </li> <li>• Soliciting information from the firm's personnel, either during staff meetings or through interviews of selected professional personnel, regarding the effectiveness of training programs, including in-house training programs.</li> <li>• Periodically reviewing the process for personnel evaluation and counseling to ascertain the following:               <ul style="list-style-type: none"> <li>– Whether procedures for evaluation and documentation are being followed on a timely basis</li> </ul> </li> </ul>	
<ul style="list-style-type: none"> <li>– That personnel decisions are consistent with evaluations</li> <li>– Whether personnel who have been promoted have achieved the applicable requirements for advancement</li> </ul>	<p><b>NOTE:</b> As the firm's personnel increase in number, the need for more formal procedures also increases.</p>
<ul style="list-style-type: none"> <li>• Determining that recognition is given to outstanding performance</li> </ul>	
<ul style="list-style-type: none"> <li>• Considering whether the firm's professional development programs should be revised, based on the results of the firm's inspection or peer review, and recommending revisions.</li> </ul>	<p><b>NOTE:</b> Professional development activities include the plan for both the firm and each individual to gain the skills, competencies, and knowledge necessary for the firm's practice.</p>
<ul style="list-style-type: none"> <li>• Inspecting documentation and contracts with the firm's service providers to evaluate if the firm complied with relevant policies and procedures.</li> <li>• Checking and evaluating IT applications to evaluate if they are operating as intended and are fit for purpose.</li> </ul>	

Policy or procedure	Note, Tip, or Warning
<p><b>Policy: The firm evaluates findings to determine whether deficiencies exist, including within the monitoring and remediation process. (QM sec. 10, par. .41)</b></p>	<p><b>NOTE:</b> When discussing the severity of issues with controls, the AICPA auditing, attestation, and accounting and review services standards use the terms <i>deficiency</i>, <i>significant deficiency</i>, and <i>material weakness</i>, whereas the peer review standards use the terms <i>finding</i>, <i>deficiency</i>, and <i>significant deficiency</i>. The use of the terms deficiency and significant deficiency in QM section 10 and this practice aid is consistent with the use in the AICPA auditing, attestation, and accounting and review services standards, adapted as necessary in the circumstances</p> <p><b>TIP:</b> See this helpful <a href="#">Q&amp;A Issues in Peer Review and Firm Systems of Quality Management</a> for additional discussion.</p>
<p>The firm evaluates the severity and pervasiveness of identified deficiencies by (QM sec. 10, par. .42)</p> <ul style="list-style-type: none"> <li>• investigating root causes of the identified deficiencies.</li> <li>• evaluating the effect of the identified deficiencies, individually and in aggregate, on the SOQM.</li> </ul>	<p><b>TIP:</b> Using a root cause analysis to evaluate deficiencies is a new requirement and will require your firm to take time to develop procedures to understand the underlying factors creating a deficiency (root cause). The nature and severity of an identified deficiency will influence the rigor of the procedures used to understand why the deficiency happened or how the situation that created the deficiency developed. The firm may also consider why deficiencies did not arise in other circumstances with similar characteristics. (See paragraphs .A181–.A185 of QM section 10)</p>
<p>For each engagement reviewed, the monitoring team (or individual) is responsible for</p> <ul style="list-style-type: none"> <li>• identifying and summarizing the deficiencies noted, and</li> <li>• discussing the results of the inspection or review with the engagement partners and other appropriate personnel responsible for each of the engagements selected for review and determining whether any remedial action needs to be taken or improvements made with respect to those specific engagements.</li> </ul>	
<p>The firm designs and implements remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. (QM sec. 10, par. .43)</p>	
<p>The QM partner evaluates whether the remedial actions</p> <ul style="list-style-type: none"> <li>• are appropriately designed to address the identified deficiencies and their related root causes and determines that they have been implemented.</li> <li>• implemented to address previously identified deficiencies are effective. (QM section 10, par. .44)</li> </ul>	

Policy or procedure	Note, Tip, or Warning
<p>If this evaluation indicates that the remedial actions are not appropriately designed and implemented or are not effective, the QM partner takes action to determine that the remedial actions are modified so they are effective. (QM sec. 10, par. .45)</p>	
<p>Recommendations for appropriate remedial actions include one or more of the following:</p> <ul style="list-style-type: none"> <li>• Taking appropriate corrective action in relation to an individual engagement or member of personnel</li> <li>• The communication of the findings to those responsible for training and professional development</li> <li>• Changes to the QM policies and procedures</li> <li>• Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.</li> </ul>	<p><b>NOTE:</b> Deficiencies may indicate a lack of due care or a lack of competency in various areas, and remedial actions should be responsive.</p>
<p>When the results of monitoring activities (through firm monitoring, peer review or regulatory inspection) indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm (QM sec. 10, par. .46.)</p> <ul style="list-style-type: none"> <li>• determines what further action is appropriate to comply with relevant professional standards and applicable legal and regulatory requirements;</li> <li>• considers whether to obtain legal advice; and</li> <li>• takes and documents the appropriate action.</li> </ul>	<p><b>NOTE:</b> In such circumstances for audit engagements, <i>AU-C section 560, Subsequent Events and Subsequently Discovered Facts</i>, and <i>AU-C section 585, Consideration of Omitted Procedures After the Report Release Date</i>,<sup>1</sup> are applicable.</p>
<p>The QM partner communicates on a timely basis [<i>identify period, at least annually</i>] to the managing partner (a) a description of the monitoring activities performed; (b) the identified deficiencies, including their severity and pervasiveness; and (c) the remedial actions to address the identified deficiencies. (QM sec. 10, par. .47)</p>	
<p>The firm communicates on a timely basis [<i>identify period, at least annually</i>] to engagement teams and other individuals assigned activities within the SOQM to enable them to take prompt and appropriate action in accordance with their responsibility for (a) the monitoring activities performed; (b) the identified deficiencies, including their severity and pervasiveness; and (c) the remedial actions to address the identified deficiencies. (QM sec. 10, par. .48)</p>	
<p>The partners review the recommended remedial actions and reach final conclusions regarding the actions to be taken.</p> <p>[<i>In firms with multiple practice groups:</i>] The practice group responds regarding the specific remedial actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.</p>	
<p>The QM partner is responsible for documenting the implementation of specific remedial actions or steps based upon the results of the monitoring and remediation process.</p>	

<sup>1</sup> All AT-C sections can be found in AICPA *Professional Standards*.

Policy or procedure	Note, Tip, or Warning
<p>The managing partner evaluates and concludes one of the following on the effectiveness of the SOQM at least annually. (QM sec. 10, par. .55)</p> <ol style="list-style-type: none"> <li>The SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved.</li> <li>Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the SOQM, the SOQM provides the firm with reasonable assurance that the objectives of the SOQM are being achieved.</li> <li>The SOQM does not provide the firm with reasonable assurance that the objectives of the SOQM are being achieved.</li> </ol>	
<p>If the managing partner concludes there are identified deficiencies or that the SOQM does not provide the firm with reasonable assurance that the objectives of the SOQM are achieved, the firm (QM sec. 10, par. .56)</p> <ul style="list-style-type: none"> <li>takes prompt and appropriate action.</li> <li>communicates to <ul style="list-style-type: none"> <li>engagement teams and other appropriate individuals to the extent that it is relevant to their responsibilities, and</li> <li>external parties in accordance with the firm's policies and procedures.</li> </ul> </li> </ul>	
<p>Periodically [<i>specify the period—for example, at least annually or at the conclusion of engagements that last at least three weeks</i>], the firm reviews performance evaluations with the managing partner and QM partner, which take into account the evaluation of the SOQM. (QM sec. 10, par. .57 )</p>	
<p>The QM partner may identify the need to do the following:</p> <ul style="list-style-type: none"> <li>Revise policies and procedures related to the other components of the SOQM because they are ineffective or inappropriately designed</li> <li>Improve compliance with firm policies and procedures related to the other components of the SOQM</li> </ul>	
<p>The firm communicates in training programs, meetings, and firm policy correspondence the need for changes and improved compliance with the SOQM.</p>	
<p><b>Policy: The firm prepares documentation of its SOQM that is sufficient to achieve the following: (QM section 10, par. .58)</b></p> <ul style="list-style-type: none"> <li>Support a consistent understanding of the SOQM by personnel, including an understanding of their roles and responsibilities regarding the SOQM and performing engagements.</li> <li>Support the consistent implementation and operation of the responses.</li> <li>Provide evidence of the design, implementation, and operation of the responses to support the managing partner's evaluation of the SOQM.</li> </ul>	

Policy or procedure	Note, Tip, or Warning
<p>The firm's documentation of its SOQM includes the following: (QM sec. 10, par. .59)</p> <ul style="list-style-type: none"> <li>• Identification of the managing partner and QM partner</li> <li>• The firm's quality objectives and quality risks</li> <li>• A description of the responses and how the firm's responses address the quality risks</li> <li>• Regarding the monitoring and remediation process <ul style="list-style-type: none"> <li>– evidence of the monitoring activities performed</li> <li>– the evaluation of findings, and identified deficiencies and their related root causes</li> <li>– remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions, and</li> <li>– communications about monitoring and remediation</li> </ul> </li> <li>• The conclusions reached based on the evaluation of the SOQM and the basis for that conclusion.</li> </ul>	<p><b>TIP:</b> The results of the monitoring process and related remediation efforts may include revisions and updates to the quality objectives, quality risks, and quality responses. Monitoring acts as a feedback to the SOQM so the SOQM can be enhanced and tailored based on the firm's evolving risks and changing circumstances.</p>
<p>The firm documents its monitoring and remediation process of the QM system. Documentation is provided through the firm's summary monitoring report, electronic databases, manual notes, checklists, and forms.</p>	
<p>Documentation addresses the following:</p> <ul style="list-style-type: none"> <li>• Evidence of the monitoring activities performed, including a description of the monitoring activities performed to review and test compliance with firm quality management policies and procedures relating to all of the components of quality management, such as <ul style="list-style-type: none"> <li>– review of the firm's professional library and practice aids to determine that they are appropriate and up to date, and</li> <li>– interviews of a sample of personnel regarding the effectiveness of the firm's professional development programs</li> </ul> </li> <li>• The evaluation of findings, and identified deficiencies and their related root causes</li> <li>• Recommended remedial actions that are designed to prevent the recurrence of the deficiency to address identified deficiencies and the evaluation of the design and implementation of such remedial actions</li> <li>• Communications about monitoring and remediation</li> <li>• The conclusions reached based on the evaluation of the system and the basis for that conclusion</li> </ul>	
<p><b>Policy: The firm retains documentation that provides evidence of the design, implementation, and operation of the SOQM for an appropriate period of time. (QM sec. 10, par. .61)</b></p>	
<p>The firm retains monitoring and remediation documentation for a time sufficient to allow those monitoring the QM system, including peer reviewers, to evaluate the firm's compliance with its system. Outside of other legal or regulatory requirements, the firm generally retains such documentation until the next peer review report has been completed.</p>	

Policy or procedure	Note, Tip, or Warning
<p><i>[In firms that are members of a network:]</i></p> <p>If the firm is a member of a network in which the network performs monitoring activities relating to the firm's SOQM, the firm (QM sec. 10, par. .51)</p> <ul style="list-style-type: none"> <li>• determines the effect of the monitoring activities performed by the network on the nature, timing, and extent of the firm's monitoring activities,</li> <li>• determines the firm's responsibilities in relation to the monitoring activities, and</li> <li>• obtains the results of the monitoring activities from the network in a timely manner.</li> </ul>	
<p>If the firm is a member of a network that undertakes monitoring activities across network firms, the firm</p> <ul style="list-style-type: none"> <li>• understands the overall scope of the monitoring activities and understands how the network will communicate the results of its monitoring activities</li> <li>• at least annually, obtain results of the monitoring activities across network firms, and <ul style="list-style-type: none"> <li>– communicates the information to engagement teams and other individual assigned activities within the SOQM, and</li> <li>– considers the effect of the information on the firm's SOQM. (QM sec. 10, par. .52)</li> </ul> </li> </ul>	
<p>If the firm is a member of a network firm and the firm identifies a deficiency in the network requirements, the firm (QM sec. 10, par. .53)</p> <ul style="list-style-type: none"> <li>• communicates to the network relevant information about the identified deficiency, and</li> <li>• designs and implement appropriate remedial actions.</li> </ul>	