

# CHECKPOINT LEARNING

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## EXECUTIVE SUMMARY

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### PART 1. ACCOUNTING

#### Issues in Preparing a Statement of Cash Flows ..... 3

Chris Martin, CPA, provides an in-depth exploration of the preparation, presentation, and analysis of the Statement of Cash Flows, focusing on its critical role in financial reporting. Through practical guidance, case studies, and illustrative examples, the session will equip participants with the knowledge and tools needed to classify transactions, prepare statements using both the direct and indirect methods, and effectively interpret cash flow data for strategic decision-making. Designed for financial professionals, the material in this session helps to ensure mastery of ASC 230 requirements in addition to enhancing confidence as we apply these principles in real-world scenarios. *[Running time: 1:26:17]*

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

- Explain why the statement of cash flows is so important.
- Properly classify various cash flow transactions.
- Prepare a statement of cash flows using the indirect method.
- Consider different ways to analyze the cash flow statement.

### PART 2. AUDITING

#### Best Practices for Effective & Efficient Auditing: Designing Audit Procedures, Part One ..... 25

Susan Longo, CPA, begins this two-part discussion in which we will explore the risk assessment process in auditing, focusing on identifying, assessing, and responding to risks in accordance with the updated standards, emphasizing compliance with SAS 145 and related standards. Through detailed explanations, case studies, and examples, this material emphasizes the critical importance of understanding a client's business model, documenting risks at the assertion level, and designing targeted audit strategies and procedures. Our aim is to enhance auditors' ability to address financial reporting errors, omissions, and fraud, ensuring thorough and effective audit engagements that align with professional standards and user expectations. This segment will resume next month when we will present part two. *[Running time: 53:17]*

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

- Identify and assess risk of misstatement at the relevant assertion level.
- Identify significant risks.
- Link the risk assessment to the preparation of a detailed audit plan.
- Document identified risks, significant risks, and the risk assessment.

## ABOUT THE SPEAKERS

**Chris Martin, CPA**, is a self-employed CPA who offers financial management, accounting, and education practitioner/consultant services to clients throughout the US and internationally in Bermuda and India. He has 30+ years in the accounting and accounting education professions, having worked with Checkpoint Learning since 2003. His public accounting career included such positions as senior manager at Andersen and as CFO for an SEC-registered communications company based in Atlanta.

**Susan Longo, CPA**, provides financial reporting services to industry and CPA practices throughout the United States and Canada. Having been recognized as an “Outstanding Instructor” by the AICPA and numerous state CPA societies, she has authored, edited, and instructed courses in accounting, auditing, nonprofits, and governmental entities for leading providers in the continuing professional education field. In addition, she has served as director of development for the AICPA and as accounting department/MBA chair for two universities. Her practice expertise is in compliance auditing for nonprofit organizations, governmental entities, employee benefit plans, HUD, financial institutions, broker-dealers, CIRAs, and contractors. After graduating from the University of Michigan, she joined a national accounting firm, where she received extensive auditing experience with governmental agencies, Fortune 500 companies, and in business consulting.

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Title of Course (Enter full title)	
Date of Class (MM/DD/YYYY)	
Time (Enter time of class)	
Location (Enter location of class)	
Learning Objectives (Refer to executive summary)	
Program Description (Refer to executive summary)	
Instructional delivery method	Group Live
Recommended CPE credit	3.0 Credits
Recommended field of study(ies) (Refer to executive summary)	
Program Level	Update
Prerequisites (Circle One)	<ul style="list-style-type: none"> <li>• Basic Accounting and Auditing professional experience</li> <li>• Basic Tax professional experience</li> <li>• Basic Governmental professional experience</li> </ul>
Advance preparation	None required
Course registration and, where applicable, attendance requirements <sup>(1)</sup>	

(1) Insert instructions for your students to register for the class and any other attendance requirements (e.g., bring your laptop, be prepared to work in groups, you will be required to sign in and sign out of the session, etc.)

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—From a Declaration of Principles jointly adopted by a *Committee of the American Bar Association* and *Committee of Publishers and Association*

### PART 1. ACCOUNTING

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#### Issues in Preparing a Statement of Cash Flows

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Welcome, everyone, to our first session on the A and A portion of this month's program. In this session, we'll provide an in-depth exploration of the preparation, presentation, and analysis of the Statement of Cash Flows, focusing on its critical role in financial reporting. Through practical guidance, case studies, and illustrative examples, the session will equip participants with the knowledge and tools needed to classify transactions, prepare statements using both the direct and indirect methods, and effectively interpret cash flow data for strategic decision-making. Designed for financial professionals, the material in this session helps to ensure mastery of ASC 230 requirements in addition to enhancing confidence as we apply these principles in real-world scenarios.

Now let's join Chris Martin, CPA, who will lead us as we delve into issues in preparing a statement of cash flows.

#### Mr. Martin

Hi, I'm Chris, welcome to today's presentation. I hope today's presentation is going to be very helpful for you as we go over how to actually complete the cash flow statement. We're going to be covering everything from analyzing your clients' transactions and those debits and credits in the cash account, ultimately how we produce the cash flow statement and how the cash flow statement can be used by investors, by lenders and other users of the financial statements to help analyze a company's performance as they convert all of those different transactions into the real stuff that really matters, the cash that comes in and the cash that goes out. You can see my bio there on the screen. I have had many years of public accounting experience and many years of experience in the private world as well, and I've been teaching cash flow statements for about 20 years. So I've got some really helpful hints for you today that I'm going to be sharing, and I hope that you find them as helpful as other participants have in this particular on-demand presentation. I look forward to sharing all of these various ideas with you.

Let's take a look at our learning objectives for today, and you can see those coming up on your screen now. So upon completion of this on-demand webinar, you should be better able to, first of all, just explain why the cash flow statement is so important. We're going to learn that the standard-setting bodies actually tell us that this cash flow statement should be one of the most important financial statements that any investor or lender or other users of financial statements are actually going to utilize in their analysis of how a company actually operates. We're then going to take a look at all the various transactions that your client gets involved in from a GAAP perspective and we're going to talk about how we then classify those transactions into the various categories. We'll find that those are going to be operating, financing, and investing categories in order to create this cash flow statement. We're then going to have a little bit of an opportunity to go through a quiz and we'll classify a lot of different transactions into those various categories to give you an opportunity to practice doing that. We'll then have a case study where we are going to put the presentation here on pause and allow you to actually create an indirect method cash flow statement. And if you so choose a direct method cash flow statement as well. We'll have answer keys for you that will then allow you to check your work, and this is an invaluable tool that you can then turn around and use in your engagement teams or maybe even with your clients in order to help increase those particular skills and the comprehension of this cash flow statement. We're also then going to consider the different ways to analyze the cash flow statement. So we'll pretend like we are an investor or a lender or another user of the financial statements and go through some of the key performance indicators that oftentimes are used in analyzing this statement.

So first of all, when is the statement of cash flows actually required by the standards? I'm going to be sharing with you in a slide in just a few minutes the FASB standard, which is going to be Number 450, which requires the cash flow statement anytime the company is a profit-oriented business or a nonprofit organization. So all of those different entities are required to produce the cash flow statement when they are producing a set of financial statements. Also,

anytime the financial statements are prepared in accordance with generally accepted accounting principles and both the balance sheet and an income statement are presented. You see the note at the bottom on your screen there. All companies that meet the above criteria (except certain employee benefit plans and investment companies) are required to present the statement regardless of their legal form. So whether they are a nonprofit organization or a for-profit business entity, they are presenting their financial statements in accordance with GAAP and they're also showing a balance sheet and an income statement. If any of those are not met, then a cash flow statement would not normally be required.

So when is a cash flow statement not required? Take a look at your screen. A cash flow statement is not going to be required whenever the financial statements are prepared in accordance with a special purpose framework. So for example, if you have a client that is on one of these special purpose frameworks, like the cash method of accounting, or the tax basis of accounting or the regulatory basis of accounting, then a cash flow statement would not be required. Think, for example, the cash flow statement, you know how it works is going to be basically a conversion of the accrual method to the cash basis of accounting. So if your client is already on the cash basis, the statement of cash receipts and cash disbursements takes the place of a cash flow statement in that particular financial reporting framework. We also see there in bullet point #2 a cash flow statement is typically not going to be required when the statements are the financial statements of individuals. And a lot of times, at least in my experience, if I were preparing a set of financial statements for an individual, most likely they are on the cash basis of accounting anyway. So bullet point #1 negates the need for that cash flow statement in those particular situations.

So what is the purpose of the cash flow statement? Well, we see here that the cash flow statement is a statement that shows the changes in a company's cash and their cash equivalents during an accounting period by simply listing the cash receipts and the cash disbursements that are generated by the company's activities during a period. So to make it a little bit easier, if you were to take the T-account for cash, obviously there's going to be debits and there are going to be credits within that particular T-account throughout the year. We're simply taking all of those debits and all those different credits and we're categorizing them into the various categories and then combining them all into a singular statement that shows all of those inflows and outflows of cash. Now notice also that we talked about cash and cash equivalents. So we're going to be defining in footnote #1, which oftentimes is the summary of significant accounting policies that the company has elected, we're going to be defining for the users of these financial statements what the client actually means when they say cash and cash equivalents. And I'll have a slide for those for you in just a moment that shows you those various definitions and typically what gets included within that cash account on the balance sheet.

As I mentioned just a few minutes ago, ASC 230 is the actual FASB statement that deals with the statement of cash flow. So I wanted to share my screen with you right quickly and show you in Checkpoint where you can find this particular statement in case you have any particular questions or you would like additional illustrations, examples, or if you have questions and need to do a little bit more research on the various transactions that your client happens to have.

So I'm going to share my screen with you. What you should be seeing right now is my home screen to Checkpoint. Now Checkpoint happens to be the research tool that I personally subscribe to. So you might use something like Accounting Research Manager or another tool. Regardless of the tool that you use, you should have access to the FASB standards within that particular tool. Otherwise, you can order all of these different materials from various sources and make sure that your firm's library has these resources available to you and your engagement teams.

If you take a look at the upper right-hand side of my screen there, under the FASB codification, as I open that, we're going to go into the codification itself. And then within the codification, notice that we have general principles, we have presentation, assets, liabilities, equity, revenues, expenses, etc. Well, since we're talking about the statement of cash flows, that's going to be in the presentation section, along with the balance sheet, income statement, all of the other financial statements as well. So notice right here under Section 230 is the Statement of Cash Flows. So everything you could ever want to know about how to create a statement of cash flows, how to answer any particular questions, and again, they provide a lot of different examples and various illustrations for you there as well. You'll

also notice that they've got some presentation matters. So we're going to be talking about some supplementary disclosures that are going to be included that are required by this particular standard. And so we'll show you various ways that you can disclose those supplemental items as well. Also, any footnote disclosures are also going to be included there. Notice that there's implementation guidance and illustrations. So a very helpful standard. It's written very well. It's easy to understand and it's easy to apply.

Now, in addition to this particular FASB standard, if you happen to also be a subscriber to Checkpoint, or if you happen to be a PPC user and you have access to the PPC resources, notice that PPC in this Accounting Services section, right in the center of the screen, they have PPC's guide to preparing financial statements. This is a publication that I use all the time anytime I'm working with clients, or I happen to be teaching classes on the various financial statements that are out there, and PPC has done a tremendous job of creating a great publication that makes all of the preparation of these various financial statements really easy to understand and actually easy to perform. Notice that there is a separate chapter, Chapter 6 here, on the statement of cash flows. So I really encourage you to check this particular publication out, especially if you and your firm have access to it already. OK, so let's jump back into the presentation and continue on.

OK, so we just saw where to find the FASB standard ASC 230. We see here on the screen that the FASB tells us that this information that's contained within the statement of cash flows should help investors, creditors, and others be able to assess the client's entity or the entity's ability to generate positive future cash flows, to be able to assess their ability to meet their obligations, to pay dividends, and it highlights the needs for any external financing. It also helps us assess the reasons and understand the differences between the net income that's reported on the income statement and what has come in as far as cash receipts and cash disbursements. Again, it really is that transformation of those GAAP income statement items into the cash flows, the ins and outs of cash. It also then shows the effects of an entity's financial position of both its cash and its noncash investing and financing transactions during the period. You remember just a moment ago, I mentioned the fact that we are going to have several supplemental disclosures and we're going to have to disclose any noncash transactions that impact the investing and financing activities. And I'll be showing you how to do that here in just a few minutes as well. We'll make that very easy for you to understand with several different examples and illustrations. And it will also be part of the case study that we'll be doing here in just a few minutes.

Now, as I mentioned a few minutes ago as well, anytime we talk about cash from a cash flow statement perspective, we truly are talking about the cash and the cash equivalents. This is how they're defined in the FASB standards. Cash equivalents are considered the short-term highly liquid investments that meet the following criteria. First of all, they're readily convertible into known amounts of cash. So essentially, they are cash. So we lump them into that balance sheet account called cash and cash equivalents. It might be other investments that are so near their maturity that they present an insignificant risk of change in value because of the changes in interest rates. So if I had to cash it in today, if I had a CD or some other type of short-term investment that I could cash in today, it's going to be pretty much valued at what it is today. And so that's that readily known amounts of cash that I can utilize in my operations if needed. We see there in the third dashed bullet point, generally these are investments that have original maturities of three months or less, and those are the ones that actually qualify. Remember, the definition is typically going to be presented in the significant accounting policies footnote, which oftentimes shows up as footnote #1.

So let's talk about the elements in the style of the cash flow statement itself. As I mentioned earlier, we're going to be taking these debits and credits into the cash account, and we're going to be simply classifying them into one of three different categories. Now you see those categories in the last bullet point there on your screen. The typical order of presentation is going to be the operating activities, the investing activities, the financing activities, and if our clients have these noncash transactions, then we're going to have the noncash disclosures that can be shown on the face of the cash flow statement at the bottom as supplemental information or they can simply be included in a footnote disclosure as well. It's going to be your choice and basically it's going to be the choice of your clients as to how they would like this particular statement to be presented. In the second bullet point, we show the net change in cash during the period. So we're going to show that there's a reconciliation between beginning cash, the cash that's actually generated during the period and the ending cash that ties back to the balance sheet. We have that supplemental

disclosure of those noncash activities. Again, the recommended title is going to be Statement of Cash Flows as opposed to the Cash Flow Statement. There is an official title. We would like for you to use the Statement of Cash Flows itself, even though a lot of times in our conversations we might call this by various other names.

So this is what the typical cash flow statement presentation would look like. We have our client's name, the Statement of Cash Flows. Remember that is the recommended title and we're going to have the time period covered. Similar to the income statement, the cash flow statement is over a period as opposed to a point in time as is the balance sheet. You'll notice also then we're going to show the cash flows from operating activities. We're then going to have a detailed presentation and then that's going to sum into the net cash flows from operating activities. That's going to either be a plus or a minus depending on whether we have cash provided by or cash used by those types of activities. That's going to be followed by the cash flows from the investing activities. Again, a detailed presentation of all the different transactions from the investing category netting down to the net cash flows from those types of activities. Similarly, then the cash flows from the financing activities. And then ultimately, we're going to come down to the net increase in cash and cash equivalents throughout all of those different categories, simply summing those and netting them together. Then we add the cash and the cash equivalents at the beginning of the year and then that reconciles down to the cash and the cash equivalents at the end of the year. And of course, that should then tie back to the cash that's presented on the face of the balance sheet. Notice that this particular presentation shows that supplemental schedule of noncash investing and financing activities at the bottom of this particular statement of cash flows. And again, that can be presented in a footnote disclosure as opposed to on the face of the statement itself. It's going to be again, your choice, your client's choice from that standpoint.

Now, one of the most challenging parts that a lot of accountants have whenever they're creating the statement of cash flows is properly classifying the various transactions. So I'm going to go over the different types of transactions that we have. We'll go through some definitions, and then again, in a few minutes you're going to have a quiz that's going to allow you to go through a number of transactions and take a hand and try to classify them properly. Then we'll go over all of those together. Before we get there, though, let's talk about how we go about thinking about these cash flows and how you would ultimately properly classify them into the appropriate categories. The first one I want to talk about is going to be the operating cash flows. Now you see here in these bullet points, these are all the activities related to the production and the delivery of goods and services. So this is kind of the normal daily operations that your client goes through. They're operating types of activities that are there. Now you see in bullet point #2, generally this is going to be the cash effects of any transactions that enter into the computation of net income. Now I think back to my early years in public accounting and I started at Arthur Andersen way back a number of years ago. I won't even say how many, but I remember as an inexperienced staff person, oftentimes we would get assigned to do the statement of cash flows. And oftentimes we thought it was very challenging. And I was kind of afraid of it because I remember back in my college days, I didn't really understand the statement of cash flows. I thought it was kind of difficult. I didn't really understand how the transactions came about, how we included them as positives or minuses, etc. So I had a really good senior that I worked with that sat down and said, OK, I'm going to teach you how to do the statement of cash flows. It can be really easy, right? Because everything is challenging or difficult until you know how to do it. And so she gave me a lot of helpful hints that actually I use up to this day. I'm going to be sharing those with you today. The first one is going to be the fact that if the transaction itself hits this income statement, it is always going to be in the operating section. Now, Chris, what do you mean by hits the income statement? Well, I'm a very visual person, and so I like to envision the actual journal entry that's used to record a particular transaction. So I'm going to encourage you to do this as well, right? Think about what the journal entry is that resulted in that debit or that credit to cash. If that journal entry hits one of the income statement accounts, it's going to go into the operating section. And in my many years of public accounting, and private accounting as well, I have never found an exception to this rule. So you'll be able to use this particular test when we get to our quiz here in just a few minutes: if it hits the income statement, it's going to go into the operating section. Now notice also that this operating section also is what we call the catch-all category. So it includes all cash flows that for whatever reason we're not able to classify as either investing or financing. And we're going to make this very easy for you to make sure that we can easily get those into these various categories. And then anything that you're struggling with, we simply put it into the operating category.

Here's a real quick quiz for you in a practical application. Typically, if a cash transaction hits this income statement, it will be categorized as an operating cash flow. Is that true or is that false? Now obviously I made this very clear for you just a moment ago. If it hits the income statement, it will definitely be categorized as an operating cash flow. So we're going to answer true to this true/false practical application question.

Now what about the investing activities? So I want you to think about investing in general. If I were to ask you, if I were your, you know, your spouse or your child or maybe your mom or dad or maybe one of your friends or maybe a colleague or maybe one of your clients, and I said, you know, define for me in layman's terms what investing activities are, you'd probably say, hey, you know what I'm investing in stocks or bonds, right? I'm buying something, you know, from a company, some common stock or preferred stock. And those are all investing types of activities. But you can also invest in yourself, right? I can buy myself a new car. I can invest in a college education. You're investing today by sitting here and going through this training program here today. You're investing in your success as a CPA, or as an accountant from that standpoint, to increase your competency in the creation of various financial statements. So you can invest in yourself as well. So all of these types of activities where a company might invest in themselves or invest in the typical types of investments that are out there classify as investing transactions. So notice here on the screen, it's going to be making or collecting loans, or acquiring and disposing of debt or equity securities of other entities, property, plant, and equipment, or any other type of productive asset. So it encompasses all of the different definitions that we talked about just a moment ago. Now another helpful hint that this one senior taught me is going to be illustrated here. Notice in these bullet points it says making or collecting loans, acquiring and disposing of debt or equity securities, acquiring or disposing of property, plant, and equipment, acquiring or disposing of other types of productive assets. And so one of the things that this particular senior taught me was that the baby always keeps its name. And I know that that sounds like a really weird hint, but when you have a child or let's say you get a new puppy—and I've actually got 4 pups of my own, Rocky, Presley, Guffey, and Bruno—when they're born or when you adopt them, you typically give them a name and they keep that name throughout their entire life cycle. The same is going to be true for these cash flow transactions. What was the categorization at the initiation of that transaction? So if I bought a new delivery van for my company, that is an investing transaction. So anything else that's going to happen to that delivery van is also going to be an investing transactions. When I go to sell it, it's also then going to be an investing transaction. The baby keeps its name. What was it at the initiation point of that original transaction? And it's going to keep that categorization, that name, throughout its life cycle. This is another helpful hint that you're going to see is going to be helpful to you when you do your cash flow categorization quiz here coming up in just a couple of minutes.

All right, the next one here. Before we get there, let's summarize what we just talked about. So these cash provided or used by investing activities, OK. These are determined again from changes in long-term assets other than from depreciation, depletion, or amortization. And it includes things like we just described, right: cash that was spent to acquire property, plant, and equipment, proceeds that were received from the sale of that property, plant, and equipment, cash spent to acquire those investments, the proceeds then that were received from the sale of those investments, and it could be the receipts from loans to another entity. So similar to investing in stocks or bonds, if I were to loan money to you, from my perspective, my loaning the money to you is an investing activity. We're going to find in just a moment when we talk about the financing activities, on your cash flow statement, that's going to be a financing activity when you've borrowed money. So I'm the lender. It's going to be an investing activity for me. It's going to be a financing activity for you. So when you pay that principal back, it's going to be a financing activity for you, but it's going to be an investing activity for me. Notice the next one. The interest and dividends received from investments are not classified as investing activities. Let's think about that for just a moment. So I received interest income. I received dividend income. What's the journal entry? The keyword there was income. It's hitting the income statement. So any interest and dividends, whether that's an expense or whether that's income, is going to be classified as what? An operating activity. Again, this is going to show up on your quiz here in just a moment. The proceeds from sales are included in the cash from investing activities and any associated gain or loss on the sale is excluded from the cash from operating activities. We're going to see this exact scenario when we do our case study here towards the end of the presentation. So coming up very shortly. Let me walk you through this one very quickly. If we notice up there in the second bullet point, we said that this includes any proceeds that were received from the sale of property, plant, and equipment. Well, oftentimes when you have the sale of an asset, you're going to wind up having a gain or



a loss on that particular sale. We're going to think through the journal entry. If we have cash being received, the cash debit is going to be on the cash flow statement, but we're going to have part of that journal entry that hits the income statement. That's going to be that gain or loss on that particular sale. That portion hits the income statement. So it's going to go to the operating section. It's always going to be that way. And you're going to see that in several different illustrations coming up in just a few minutes.

OK, practical application, let's answer these two questions then. Proceeds from interest income on investing activities is classified as investing activities: true or false? So we just discussed the proceeds from interest income hits the income statement. So this is going to be false. That is not classified as an investing activity. It's going to be classified as what? An operating activity. What about dividends received from investments being classified as an investing activity? Is that true or false? So I've received dividends. That's going to be dividend income, right? Because I'm going to debit cash, credit dividends received or dividend income or whatever your client happens to call that—that hits the income statement. So these dividends are going to be operating activities. So this is going to be a false statement. Now, oftentimes I get a question from participants that says, hey, Chris, what about whenever I pay those dividends? Where's that going to go? Well, we're going to see this particular situation in just a moment. When you pay dividends, it's going to be a financing activity. And oftentimes I'll get the question that says, hey, but doesn't that hit the income statement? And I'm like, well, no, let's think about the journal entry. When you declare and pay dividends, there is no such thing as a dividend expense. It simply is a reduction from equity. So it's going to be classified as a financing activity. Not to give the answers away on your quiz, but you will see this one on your quiz coming up here in just a moment as well.

So our third category is going to be financing activities. Now we've mentioned financing activities just a moment ago when I was giving several different examples from an investing standpoint. It would be the opposite side of investing. So for example, if I loan you money, it's investing for me, but if you borrow that money, it's financing for you. So let's take a look at the definition that you see here on the slide. So my client or my company obtains resources from owners. So maybe we're selling common stock in our company or preferred stock, any kind of an equity type of transaction, or maybe investors actually supply our company with that contributed capital. It also includes providing those same owners with a return of or on their investment. So I'm paying them dividends, for example, as we just talked about on that previous slide. Again here is obtaining resources from creditors. So I go out and I borrow money; that is going to be a financing activity. And then remember the baby keeps its name. So when I repay that principal that I borrowed, it's also going to be a financing activity. Remember a lot of times though, those repayments include interest portions. So the interest portion is going to hit the interest expense. That goes to operating, but the principal part stays where it belongs in the financing section.

So as you see here, it's determined from any changes in long-term debt. So we borrowed or we've paid down our long-term debt, and from changes in that contributed capital, whether we've sold stock or whether we purchased maybe some treasury stock or we've received other contributed capital from investors. It includes things like receipts from borrowing money, and then the cash paid to reduce any long-term debt principal, receipts from issuing stock, payments made for dividends, cash paid to purchase treasury stock, and receipts from reissuing that treasury stock. So any of those equity types of transactions typically fall into the financing activities section.

OK, here's your practical application question. Since amounts borrowed and/or repaid is classified as financing activities, the related interest is also classified as financing. A lot of accountants get tripped up here, but remember that interest portion hits the income statement, it always goes to the operating section. So the answer here would be false.

Now a little bit earlier I mentioned outside of the operating and investing and financing activities, our clients may be involved in what we refer to as noncash transactions. We see here that noncash transactions are defined as any investing or financing activities that affect the balance sheet accounts, but they don't involve the receipt or the payment of cash. So let's say that I am the owner of a particular company and I decide that I want to buy a new delivery van for my organization. So I go to the delivery van store, to the auto dealership, and I negotiate the purchase of this delivery van. And let's say it's a \$50,000 purchase. And so I go, hey, you know what, I would like to finance this with your organization. So they go through some financing activities and they say, OK, we can definitely loan you the money. Are you going to have any kind of cash down payment? Let's say that I decide, hey, yeah, I'm going

to pay \$10,000 in cash and I'd like to finance the rest of this particular purchase. When I get back to my place of business, I'm going to enter this particular transaction into my general ledger, right? So I'm going to have to debit delivery van for the \$50,000. I'm going to have to credit cash for the \$10,000 down payment. There's my cash flow, it's a credit to cash. And I'm going to have a long-term debt of \$40,000 for this borrowing of the other portion to pay for that particular delivery van. So do I have a cash flow? The answer is yes. There's \$10,000 outflow. What was the purpose of it? It was to buy a delivery van. We've already determined now that's going to be an investing activity. But now I have this \$40,000 amount to make up for the rest of that particular purchase; that is going to be the noncash portion. So we're going to have to disclose that, again, as supplemental information, at the bottom of the cash flow statement or in a footnote disclosure. We see there in bullet point #2 it must be presented or disclosed outside the actual body of the statement. It can be shown at the bottom or in a footnote, but it's not part of the cash flow statement itself.

Now here's some general rules to help you kind of understand and remember these various categorizations. So typically, if you have a change in current assets and current liabilities, these are going to result in an operating activity. If you have a change of the long-term assets, typically that's going to be an investing activity, right? Those production, those purchases of plant, property, and equipment, for example. If we have changes in the long-term liabilities, so debt, or in stockholders' equity, like common stock, then it's typically going to fall into the financing activities category. Easy enough, right? Hopefully all of those different helpful hints and the various things that we've talked about in this particular table help you understand how to classify all of these different transactions.

So now we're going to give you an opportunity to actually practice this. So we're going to have you pause this recording and complete the cash flow quiz that's been included with your on-demand webinar materials. Typically this takes about 10 minutes. You're going to find that there are 23 different transactions that your client has gotten involved with, and I'm going to really encourage you to take 10 minutes, or whatever amount of time it takes you, to properly classify those. After you have finished your quiz, unpause the video and then we're going to go over all of the different answers together. If you can do these 23 transactions, there's almost no other cash flow that's out there that you would not be able to do. So I want you to have some real success in classifying these various items. So again, take some time, put some thought into them and try to classify them. Let me show you what those materials are going to look like so that you'll know what the quiz is going to consist of.

So I'm going to share my screen with you. So again, in the materials that were supplied for your on-demand presentation here today, you will see this cash flow quiz where we have these various transactions from our client and you're going to be classifying those as operating, investing, financing, or noncash, and some of them might have more than one component. There's going to be 23 different transactions, and when we come back, we'll go over all of these together to see how well you've done and hopefully you'll have a lot of success. And again, this is going to increase your confidence level in being able to go through those debits and credits and cash with your client to properly classify those in your cash flow statement. [Refer to the supplement titled "Cash Flow Quiz" which may be accessed from Course References within the toolbox on the menu bar. Additionally, this supplement is linked at the bottom of this page.]

Welcome back to the presentation. Let's see how well you've done. Let's go over the answers to the quiz. So again, I'm going to share my screen with you. Let's go back into that quiz that I shared right before you got started and let's go over these together.

#1 We have proceeds from the disposition of property, plant, and equipment or other productive assets. So I'm selling some property, plant, and equipment. Remember the baby keeps its name. What was this transaction classified as when we purchased this plant, property, and equipment? Well, we know when we purchase plant, property, and equipment, or other productive assets, we know that's an investing activity. So it stays an investing activity when we sell it. So, investing.

#2 The proceeds from the sale of debt or equity securities of other entities and from returns of investment in those instruments. So again, we're selling some debt or equity securities. What was this transaction when we purchased those debt or equity securities? Those were investing activities when we purchased them. So they're also investing activities when we sell those particular items.

#3 Proceeds from issuing equity securities such as common stock. So I've sold some common stock in my company, and I've gotten cash for that. Well, we know that when we sell our common stock, it is a financing activity. I'm obtaining resources from investors. It's an equity transaction. It falls into the financing category.

#4 I convert debt to equity. So I owe you \$10,000, and rather than paying you the \$10,000, I give you \$10,000 worth of the common stock of my company. So I've converted this debt to equity. Think about the journal entry that's involved here. There's no debit or credit to cash. So we know that this is going to be a noncash transaction.

#5 Repayments of amounts that we've borrowed, including short-term, long-term debt, seller finance debt, capitalized lease obligations, whatever it is, I'm repaying amounts that I've borrowed. What did I classify this as when I borrowed this money? Well, when I borrow money, remember it's financing. So when I repay it, it's also then going to be financing.

#6 Collection of principle on loans to other entities. So I've loaned you money. For me that was an investing activity because I loaned you money. It was financing for you, but it was investing for me. So when I collect that principle, it remains an investing activity.

#7 Payment of dividends or other distributions to owners, including payments to reacquire treasury stock. Remember, there is no dividends expense, so it doesn't hit the income statement, which is the mistake that a lot of people make. But this is going to be the payment of dividends, which comes out of equity. So it's going to be classified as a financing transaction.

#8 The purchase of a productive asset by making a down payment and financing the balance with the vendor. This was the situation that we talked about right before you started your quiz. I bought that delivery van by making a \$10,000 payment and then financing the balance of that. So, we know that we do have a cash flow there. And because I'm purchasing a productive asset, we know that this cash flow is going to be classified as investing. But the other portion, the financing the balance with the vendor, is going to be classified as a noncash disclosure. Now oftentimes I'll get questions on this particular scenario. So let me give you just a little bit of a nuanced transaction here. Let's say that I want to purchase a new delivery van and rather than go down to the dealership and have them finance it for me, I go to my local lending institution and I'm like, hey, I want to buy a delivery van and it's valued at \$50,000. And they go, hey, Chris, you know your credit's good enough. We're going to loan you \$50,000 to go buy this delivery van. So they loaned me \$50,000. Now I go back to my place of business and I have this loan. Debit cash, credit long-term debt for \$50,000. That is going to be a financing transaction. I've just borrowed \$50,000. There's a cash flow, a debit to cash. Now I go down to the local dealership and I'm like, hey, I want to buy this \$50,000 delivery van and I write them this check for \$50,000. So I'm going to debit delivery van, credit cash for \$50,000. So now I have another cash outflow that's going to be an investing activity. So in that particular situation, because I structured this transaction in that particular way, I have a cash inflow and I have a cash outflow. There's no noncash portion of this particular transaction. So it really depends on how you or how your client happens to have structured the transaction. And that's going to help you, again as you think through those journal entries, how you would properly classify those particular transactions in the cash flow statement.

#9 Acquiring assets by issuing related debt. So that's the opposite of the situation that we just talked about. Rather than making a down payment, I'm going to buy that delivery van with 100% financing. This is going to be debit delivery van, credit long-term debt. This is a noncash disclosure. There's no debit or credit to cash, which is going to be the requirement in order for something to hit the cash flow statement.

#10 Cash receipts from a lawsuit settlement or a refund from a supplier. This would be some kind of item that hits the income statement, like I have a fine or a penalty or some kind of a lawsuit settlement. So debit some kind of an expense, credit cash, hits the income statement. This is going to be an operating activity.

#11 Acquiring a business using cash. A business is an asset, so that's going to be an investing activity.

#12 Acquisition of the materials for the manufacture of goods for resale, buying our raw materials or our inventory, including things like paying the principal payments on accounts payable or any other short or long-term obligations

payable to suppliers. Paying my utilities expenses, whatever it happens to be, these are in the ordinary course of business for a company to be able to operate. These are going to be classified as operating activities.

#13 Entering into a financing or an operating type of lease. Well this would be a financed lease. This is a way of financing that particular purchase. Just like borrowing the money, this is going to be a financing activity.

#14 Payments to employees for compensation. Payroll expense, payments to other vendors, or for other goods or services, utilities expenses, etcetera. These are all going to hit the income statement. These are going to be operating activities.

#15 The purchase of debt or equity securities of other entities. I just bought some common stock in NVIDIA, for example. That's going to be an investing activity. The typical things that you think of when you're investing in something.

#16 A loan made to another entity. So, again, I loan you money. We've already talked about this one. This is going to be an investing activity for me, a financing activity for you as the borrower.

#17 Proceeds from issuing bonds, mortgages, and notes or any other short-term or long-term borrowings. I'm borrowing money. We know that's going to be a financing activity.

#18 The interest payments to creditors and lenders. Hits the income statement, operating.

#19 The acquisition of property, plant, and equipment or other productive assets for cash payments made at or near the time of purchase. We saw a little bit earlier, we sold that plant, property, and equipment. Here we're purchasing it. We already know that this is going to be an investing activity.

#20 Taxes and other government payments for fees, fines, duties, or penalties. What's the journal entry? Hits the income statement, right? Operating activities.

#21 Proceeds from the sale of loans made by the company. This one's a little tricky. This is going to be one of those situations where "the baby keeps its name" is going to come in really handy. I have made a loan to you. I've loaned you \$10,000. And so rather than you paying me back, I've actually sold this loan to someone else and they basically purchased that loan from me. That loan was an investing activity when I made the loan to you. And remember, that baby keeps its name. So when I sell this loan to another entity, it's still going to be an investing activity. OK? Easy enough, right?

#22 The sale of a business unit, a subsidiary, or division for cash. When I set this up, when I purchased it, or when I acquired it, it was investing. So this is still going to be an investing activity when I sell this business unit, the subsidiary, or this division.

#23 The last one here, a refund to a customer, a charitable contribution, again, or a lawsuit settlement. This is going to hit the income statement. So this is going to be an operating activity.

Now as you go through your materials, you're going to notice that we have provided the answer key for all of these various questions. I hope you did really well. If you didn't, then go back and take a look at the slides that we've covered so far and think about the reasons that you might have misclassified one of these particular transactions. Again, I think if you can get all 23 of these correct, there's not too many cash flow statements or any transactions that are out there that your client's going to get involved with that you're not going to be able to properly classify. So success here should really boost your confidence in your ability to create these cash flow statements in a real-life type of a scenario. So check those answer keys out. Also, if you happen to be maybe a senior or a manager, maybe even a partner, this would be a really good way to repolish your skills in creating a cash flow statement, maybe even to train your staff in their ability to do the cash flow statement. And if you're like me, often times I would put on my PBC

request list as an auditor to my client to being able to prepare the cash flow statement for me, this might be a really good teaching tool for your clients to actually understand the cash flow statement a little bit better, and maybe even they start to prepare that for you, then you can just review and maybe reperform some of their work as part of your audit, your review, your compilation. Maybe you're a controller or a CFO and this is going to help hone your skills and your ability to create a cash flow statement before your auditors actually show up.

[For the answer key to the Cash Flow Quiz, refer to the supplement titled "Cash Flow Quiz Answer Key" which may be accessed from Course References within the toolbox on the menu bar. Additionally, this supplement is linked at the bottom of this page.]

Let's jump back into the presentation then and talk about how we go about creating the cash flow statement itself.

So now that we're good at classifying these various transactions, let's talk about how we pull it all together into the format of the statement of cash flows. Now you see here on the screen, there are actually two methods to present the statement. At least the cash flows from operations section. We have the indirect method and we have the direct method. You'll notice from this particular pie chart that the indirect method is the most common method for preparing and for presenting the statement of cash flows. There are some other organizations that actually require, there's actually some regulatory requirements that require, the direct method in certain situations. And just so you know, the actual standard-setting bodies prefer the direct method, OK, over the indirect method. So, Chris, why do most companies present the indirect method? Well, we're going to answer that question as we go into the tools that you need and the illustrations of both methods here in just a moment. We'll see that the direct method is the indirect method plus an additional disclosure that's going to be included in that. And because it includes this additional disclosure, most companies opt for just simply using the indirect method. And I'll show you those examples here in just a moment.

Now, whenever you're using the direct method, OK, remember the FASB ASC 230 that I showed you just a little bit earlier, it has certain required disclosures that have to be included. So take a look at these green inflows. We're required to show on the face of this statement in the operating section, a direct flow, right, a direct disclosure, OK, of how these inflows actually happened. So we have to show the cash collected from customers. We have to show the interest and dividends that we received, and we have to show any other operating cash receipts if there happened to be any. If you look at the graphic on the right-hand side of your screen, notice that this company is using the direct method of presentation and in their operating activities section, they have cash collected from customers of \$20,000. They paid some rent for \$2,000. They paid cash to their employees for \$3,000, and they paid cash for utilities of \$2,000. So their entire cash flow from operating activities was \$13,000. Now in just a moment we'll be contrasting this operating section with the indirect method. And in that indirect method, we're not showing these direct presentations of where the cash came from or where the cash went. We're basically showing it as a reconciliation of net income to the cash flows from operating activities. Notice that at the bottom of this presentation graphic that reconciliation is shown at the bottom. Notice that they say here's net income of \$7,000, plus depreciation expense less, right, any gain on the sale of stock, and they go through these various transactions in order to back into the cash flow from operating activities of \$13,000. Notice that the totals are equal. One just happens to be a direct presentation. The other happens to be the indirect presentation. So the outflows on the left-hand side, these are going to be cash paid to employees and other suppliers for goods or services, any interest that was paid, income taxes paid, and any other operating cash payments if any. Also required is this reconciliation of the net income to the cash provided or used by the operating activities. This is the primary reason that most companies will opt to use the indirect method because in that indirect method we're just simply replacing this operating activity section with this required reconciliation that's shown at the bottom of this direct method presentation. And again, you and your clients get to discuss, you get to use whichever method you prefer. You're correct with whichever method you choose, unless there's some requirement from an investor, maybe from a lender, maybe from a regulatory requirement, that requires you to use the direct method presentation. I know, for example, certain governmental agencies, if you happen to be preparing a set of financial statements for certain governmental agencies, they require the direct method presentation. Outside of that, you get to choose.

Now in the indirect method we see here that the cash from operating activities simply is derived indirectly from the net income via certain adjustments that we make to convert that net income from the accrual basis to the cash basis. This is where a lot of accountants really get confused and they think that this is going to be very challenging. So we're going to go through a few examples to help you understand why this happens to be the case and how you can go through your clients' transactions and think these through so that you understand the reasonings behind it so that you can always get these correct. This then is the effect of all the different noncash items such as depreciation, depletion, amortization, gains or losses. We remove those from net income because they're not cash. So for example, if I back up one slide and we take a look at this reconciliation at the bottom, we start out with net income of \$7,000. We add back depreciation expense. Chris, why do I add back depreciation expense? Well, net income is lower because we incurred depreciation expense, but we didn't write a check out for depreciation expense. It just happens to be an accrual basis accounting deduction, right, that reduces net income. Because there was no cash outflow for depreciation expense, we add it back to help us then back indirectly into the cash flow portion of what we got from the operating activities. Now we'll be going through several different examples here in just a moment.

Here's what the indirect method presentation then is going to look like. So again, compare and contrast it with the direct method presentation. The only section that's going to be different is this operating activities section. The investing and financing sections are completely identical. This is the only section that's different. Now we're going to be making certain adjustments to that net income. As you see here, plus depreciation expense, less the gain on sale of stock, less the increase in accounts receivable, less the increase in inventory, plus an increase in accounts payable, plus an increase in interest payable, etcetera. Now your clients may have other items than the ones that are shown here in this particular illustration. So let's go through a couple of summarizations to help you understand the reasonings behind these pluses and minuses.

So we're going to make these adjustments to net income. Now we see here current assets that are associated with operations. If the balance increases during the period, it's going to be shown as a minus. If the balance decreases during the period, it's going to be shown as a plus. If we're dealing with current liabilities that are associated with operations, things like accrued operating expenses, for example, those accrued utilities expense, accrued interest expenses, all of those things that we talked about a little bit earlier. If the balance increases during the period, it's shown as a positive. If the balance decreases during the period, it's shown as a minus. The gains classified as investing or financing. So for example, we had a gain on the extinguishment of debt. It's going to be shown as a minus and a loss is going to be shown as a plus. I'm going to go through some transactions with you here in just a moment to actually explain the reasonings behind these. Otherwise if you're pretty good at this, you can just memorize this particular table and you will always get them right as well. Another similar table follows this one.

If a current asset increases, it's shown as a minus. If a current asset decreases, it's shown as a plus. If a current liability increases, it's a plus. If a current liability decreases, it's a minus. I believe this particular table comes from one of the CPA review courses, like as a real easy way to help you understand whether you're dealing with a plus or a minus. Now you may be like me. I'm like, you know what? I just don't want to take this for granted and memorize the table. I want to understand the reasonings behind this. So I've created a few different transactions for you in Excel that I want to go over that basically explains why these are pluses and why these are minuses. So bear with me. I'm going to share my screen with you again and we'll go over these various transactions together.

So I've got various transactions here on this Excel spreadsheet. Let's talk about the journal entries that are used to record these transactions. Our clients or our company has incurred depreciation expense. What's the journal entry? Well, obviously it's going to be debit depreciation expense, credit accumulated depreciation. Do you see a debit or credit to cash there? The answer is no. So there's no cash flow associated with it. But because net income is lower, we have to add it back in order to reconcile from net income to the cash flows from the operating activities.

Now we have a gain or loss on the sale of an asset. Typically if you think about a gain, a gain is going to be included in the cash proceeds from that particular sale, right? So if I sold a particular asset for \$50,000 and there was a gain associated with it, that gain is included in that \$50,000 proceeds, right? Now we talked about a little bit earlier, if I'm selling an asset, that cash flow has to be investing, right? But the gain hits the income statement, right? So that gain

portion has to be one of the reconciling items in the operating section. So that kind of tool that we learned a little bit earlier about if it hits the income statement always holds true here. So we see here on our spreadsheet, the gain is included in the cash proceeds from the sale and is properly recorded in the investing section. However, because we had a gain, net income is higher. So it has to be subtracted from the net income in order to reconcile to the cash flows from the operating activities. Now a loss would be the exact opposite treatment. So in that particular situation where we had a loss, right, we're going to add that back because the net income is lower because of that particular sale. But the sale itself is accounted for elsewhere.

What about a change in accounts receivable? Let's think about how accounts receivable actually come about. Typically accounts receivable result because we've sold a product or we've sold a service, right? So we sold a good or service. Typically when we do that under accrual accounting, we're going to debit accounts receivable, we're going to credit revenue. There's no cash flow associated with that, right? But in this particular situation, net income is higher. So we would need to subtract it from net income. But when I collect that accounts receivable, right, we're going to have a cash flow. Notice what's highlighted in yellow. We're debiting cash and we're crediting the accounts receivable. So there's a cash inflow for that particular transaction. So we would add that back to net income. Now when you net these transactions together, you have a result of either a net increase or a net decrease. So you just simply report it as such. Did you have an add-back or did you have a subtraction? That's how you deal with these increases and decreases in accounts receivable.

Inventory is just a little bit trickier because it includes a couple of other transactions in there. So let's think about how an inventory item comes about. Typically, our clients are going to purchase inventory from one of their suppliers. So notice, we're buying inventory. What's the journal entry? Typically, we're going to debit inventory, right? And we're going to credit accounts payable. There's no cash flow associated with that, right? There's no debit or credit to cash. But then when I sell that inventory, as we saw just above, I'm going to debit the accounts receivable, credit revenue. So see the discussion for the changes in accounts receivable just above. But we also have an additional transaction. I have to debit the cost of sales because I've got to take the inventory off the books. So I'm going to be crediting my inventory. There's no cash flow, but because we had this debit to cost of sales, net income is lower for that decrease in inventory. So I would need to add that back. So the net of those above entries will result in either an increase or a decrease in inventory. So you simply report it as such. A net increase, you subtract from net income; a net decrease, you would add that back to net income because of that inclusion of the cost of sales portion.

What about the change in accounts payable? To record an accounts payable, typically we're going to incur an expense, right? So debit expense, credit accounts payable, again no cash flow, but because net income is lowered, we would need to add that back. But when I pay those accounts payable, I'm going to debit the accounts payable, credit cash. There is a cash outflow there. So we're subtracting that as an operating cash outflow. So the net of those above entries then result in a net increase or a net decrease in accounts payable. So you just simply again report it as such. A net increase is an add-back to net income. A net decrease results in a subtraction from net income. Changes in interest payable, any of those other kind of payables, would be the same as for the A/P shown just above. I hope these journal entries kind of help you connect with the actual rationale behind the tables and those helpful hints that we just saw that was made part of your slides. Let's go back and take a look at those one more time.

So again, if I go back one slide, these were those adjustments to net income to show those pluses and minuses. Hopefully you understand those a little bit better. And now we see that we had that summary table that shows if we had an increase or a decrease in the current asset or current liability, how you would ultimately treat those in the operating activities section of your cash flow statement. If you're using the indirect method or if you're using the direct method, remember in that reconciliation, that's also required as a separate presentation item in that style of presentation.

That leads us to our cash flow case study. So I'm going to give you the opportunity to pause the video here and to actually go complete the cash flow case study that's included with your on-demand webinar materials. Now this typically takes maybe 15 to 20 minutes, and we're going to really encourage you to use what you've learned thus far to actually create the cash flow statement. Now you've got a couple of templates that are going to be made available

to you. So you can create the [direct] method or you can use the indirect direct method. Whichever style you prefer, we've got answer keys for both of those. So I'm going to discourage you from looking ahead at your answer key so that you can really have a success in creating this statement of cash flows. Now let's go take a look at our materials together. And I want to go through a few journal entries with you that's going to help you be more successful in going through this particular case study.

[For materials to work through the case study, refer to the supplement titled "Case Study" which may be accessed from Course References within the toolbox on the menu bar. Additionally, this supplement is linked at the bottom of this page.]

So what you see on your screen now are going to be the case study materials again that are included with your presentation materials. We see here we have a client named Longhorn Associates and they've requested our assistance in preparing a statement of cash flows. During the current year our client entered into the following transactions. We're going to take a look at these together in just a moment. We're going to go through the actual journal entries so that we can figure out how we go about classifying these transactions together. So our client declared and they paid \$5,000 worth of dividends. They also purchased equipment for \$75,000 by paying \$25,000 down and financing the balance with a 5-year note payable to the seller. They also sold a \$50,000 asset, which had accumulated depreciation of \$15,000, for \$45,000. So again, one of the helpful hints that I shared with you a little bit earlier is to think through the journal entries that created these various transactions. So let's do those together.

So in Tab 1 of our spreadsheet here, you'll see that I have summarized those three transactions that Longhorn has entered into during the year. Again, they declared and paid \$5,000 worth of dividends. So let's take a look at transaction #1 together. How would we put that in the general ledger?

So transaction #1, when we declared dividends, we simply entered this transaction. We're going to debit equity, right, for \$5,000 and we're going to credit dividends payable. Note, there is no cash flow associated with the declaration of dividends. So if that's all that our clients did was to declare those dividends, it's not going to show up on the cash flow statement from that standpoint, right? But we learned that they also paid those dividends during the period. So when you pay the dividends, you're going to debit that dividend payable for \$5,000, you're going to credit cash for \$5,000. That is going to be a cash flow, right? There's a credit to the cash account. Where's that going to go? Well we learned earlier, that's going to be a financing transaction for \$5,000. So this is going to show up in the financing section of your statement of cash flows.

Transaction #2, they purchased equipment using cash and some debt. So let's take a look at that journal entry together. So I'm debiting the equipment for \$75,000, I'm crediting debt for \$50,000, and we're crediting cash for \$25,000. We saw a similar transaction a little bit earlier. So do we have a cash flow? We do. We have a cash flow here for \$25,000. Where's that going to show up on my cash flow statement? Well, I'm purchasing some equipment, so we know that that's an investing activity. So \$25,000 is going to go in the investing section of my cash flow statement. But what about this \$50,000 debt that's there? Well, that's that change in a long-term asset and a long-term debt. That's going to be one of those noncash disclosures. So we're going to put that as supplemental information at the bottom of our cash flow statement or in a footnote disclosure. Again, remember your choice on how you go about doing that.

Transaction #3, then we sold a \$50,000 asset with accumulated depreciation of \$15,000 for proceeds of \$45,000. This one's a little tricky, so let's think it through together. So transaction #3, we sold a \$50,000 asset with accumulated depreciation of \$15,000 for \$45,000. So I'm going to debit my proceeds, right? So a debit to cash for \$45,000. There's my cash flow. Where's that going to go, right? I'm selling an asset. What was it when I bought the asset? It was investing. So we're going to have a \$45,000 investing flow, cash flow, right, for these proceeds. We're going to have to get the accumulated depreciation [off] the books. So we have to debit it for \$15,000. We've got to write off the asset. So credit our property for \$50,000, and we're left with that gain on sale for \$10,000, right. We saw this one in our quiz just a little bit earlier where we had these gains on sales, right? And we also just went through the transactions that I explained why you would increase or decrease in that reconciliation for a gain or loss on sale. Here we have a gain. Remember, because we had this gain, my net income is higher by \$10,000 but the proceeds are in the investing



section where they belong. So we know that we have to then what? Decrease my net income for this \$10,000. So it hits the income statement. So it's going to go in that operating section in my indirect presentation or in that reconciliation if I happen to be using the direct method.

So you've got your three transactions laid out for you. So I'm going to allow you a few minutes to actually pause your video and go and complete your case study. Before we get there, let me show you the other resources that you have available to assist you in this project. So in your case study materials, notice right below those three transactions, you've got Longhorn's balance sheets so that you can do your changes in accounts receivable and inventory, etcetera, like we looked at just a few minutes ago. Beneath your balance sheet, you have your income statement, and here are your instructions. Prepare a statement of cash flows using the indirect method. Prepare all the required disclosures. Note that all interest and taxes were paid on or before December the 31st this year and in the prior year. If you'll recall in the slides that we looked at just a little bit earlier, we had the requirement from the accounting standard that says that we have to always show the cash paid for interest and the cash paid for taxes. So we didn't really go into a lot of details with this, but those particular items show up in the direct method. But because we're including this in the indirect method, we're going to show the cash paid for taxes and the cash paid for interest as a supplemental disclosure as well, just like noncash disclosures, at the bottom of the cash flow statement or in a footnote disclosure. You'll note here because they paid all of those various items you can pull those directly from the income statement because all of it was paid during the year. It wasn't accrued, if you will.

Now if you would like to prepare this using the direct method, you need to understand a few relationships. So in Part 2, assuming the following relationships, prepare the cash flows from operating activities section using the direct method, knowing that [accounts receivable relate to sales, prepaid expenses relate to expenses for salaries, accrued salaries relate to, I'm sorry, I misstate because the way that this is laid out,] accounts receivable relate to sales, prepaid expenses relate to other expenses, just note that there's a little bit of an overflow there, the accrued salaries relate to salaries expense, and the inventory and accounts payable relate to the cost of goods sold, similar to what we saw just a few minutes ago when we were going through those journal entries together.

Now what you have is resources to help you. You have an indirect method template here. This is the way that I do it. I like a blank sheet of paper where I can just go through the traditional preparation of that. I know that many firms actually use an Excel template, etcetera. So you do have an Excel template spreadsheet that's laid out here for you that you can utilize that shows all the different changes in your balance sheet items. And you just simply take these changes in accounts receivable, inventory, etcetera, and you drop those in into the appropriate place and then slide those numbers to the left to build that cash flow statement right here in column #2. Any time that you use a template like this, and if you have your own, you're more than welcome to fill in those particular numbers into your firm's chosen method of template that you might have prepared. This particular one has a proof where everything will zero out at the bottom to make sure that you've accounted for all the different changes. Notice also that they've included a section here for the noncash items. We have answer keys for both different templates. There's also a template here just above this one for the direct method. So again, choose the method that you would like to present, pause the video, take maybe 20 minutes or so to prepare a statement of cash flows, and we'll go back over the answers as soon as you return.

[For the answer key to the Case Study, refer to the supplement titled "Case Study Answer Key" which may be accessed from Course References within the toolbox on the menu bar. Additionally, this supplement is linked at the bottom of this page.]

OK, welcome back. I hope that that was an enjoyable cash flow statement preparation exercise for you. And let's go over the answers and see how well you did. Hopefully, you were able to balance back out to the balance sheet. The good thing about the cash flow statement is you always have a lot of really good check figures, right? So that you can make sure that you've accounted for everything that happens to be there. So let's take a look at the answer key. Remember, the answer keys are included in your materials. So I'm going to pull those up for you here on the screen and we'll go over this indirect method answer key together. So first of all, notice that we're starting out with net income and remember the cash flows from operating activities in the indirect method simply is that reconciliation

between net income and those cash flow activities from the operating activities of your client. So we start with net income. It comes directly from the income statement of \$34,320 and then we're going to have all of those different adjustments to reconcile net income to the net cash provided by operating activities. So you notice from the income statement, we had depreciation expense of \$20,000. We've already talked about the reasonings that we would add that back. This \$34,000 is lower because we had depreciation expense, so we need to add that back. We had an increase in receivables of \$13,000. So again, we subtract that. We had a decrease in inventories, that's going to be a \$1,000 add-back, a decrease in those prepaid expenses of \$2,000, a decrease in the accounts payable so we're going to subtract that out for 4,000, we're going to have an increase in those accrued expenses, that's going to be an add-back of \$2,000, and there's that gain on sale of the plant asset that we had. Then remember those proceeds are included down here in this \$45,000 amount. But we have to include that portion in the operating section reconciliation because this net income is higher because of the gain. But the proceeds that that gain is included in is properly included in the investing section in this \$45,000 amount. So we're simply just excluding it here to arrive at these net cash provided by operating activities of \$32,320.

Then we have our cash flows from the investing activities. These came directly from those journal entries that I just went over with you, right? So we had that sale of plant assets of \$45,000 and we had that purchase of equipment. Remember it was that down payment of \$25,000. So we had a net cash provided by those investing activities of \$20,000.

Then we had a singular financing activity, right. We had the payment of those cash dividends of \$5,000. When we sum all of that down, we get this net increase in cash for the period of \$47,320. We add that to the cash that existed at the beginning of the year of \$13,000, comes directly from your balance sheet, and that results in the cash at the end of the year of \$60,320. And again, there's your check figure that goes back to the balance sheet itself.

Here's our supplemental disclosure of the cash flow information. Remember, we are required by ASC 230 to include the cash that was paid for interest and the cash paid for taxes. So here's that supplemental disclosure here shown at the bottom of this cash flow statement of \$10,000 and \$17,680. Again, those came directly from your income statement because we were told in the instructions and the client paid all of that during the year. And here's that supplemental disclosure of the noncash investing and financing activity. During the current year, Longhorn Associates issued long-term debt instruments of \$50,000 in exchange for equipment. Easy enough. Again, I hope you had a lot of success in creating this particular indirect method presentation.

Hopefully you had an opportunity to try the direct method, and if you didn't have the opportunity yet, I encourage you to do that after today's presentation. Here's what the direct method would look like. Remember I had some slides that showed you what is required from a direct method presentation, so you can refer back to those particular slides. We have that cash received from customers. And luckily, we have all the different computations here for you to show you how they arrived at the \$247,000. So cash received from customers, we had cash paid to suppliers, we had cash paid for salaries, cash paid for interest, cash paid for taxes, cash paid for other expenses. Again, summing down to that same total of the \$32,320. All of these numbers will be readily apparent from the balance sheet and from the income statement. So you'll be able to actually trace all of those various computational items back to understand how this accountant arrived at these various numbers. Remember though, if you had the direct method as your method of presentation, you are required to show this reconciliation portion, which is going to be exactly as it is shown here in this indirect method presentation.

Now that we know how to classify these various cash transactions and then how to pull all of those various cash inflows and outflows together into the statement of cash flows, and we know that we can present that either with an indirect presentation or a direct presentation with all the required supplemental disclosures of either the interest and the taxes that were paid for cash and those noncash disclosures for those changes in investing and financing activities that did not involve the inflow or outflow of cash, let's think about how a user of the financial statements might utilize this cash flow information in making their investment types of decisions. There's a lot of different ratios and a lot of different key performance indicators that users of financial statements can utilize as part of the cash flows themselves. And we've got just a couple of them included here for you in your materials. And I'm going to show you a couple of

other resources that you might utilize and analyze the cash flows from your client. So the first one we want to look at here is going to be the free cash flow. We see here it represents the cash that a company is able to generate after they've laid out the money that's required to maintain or expand its asset base. Now anytime that you're using any of these, just some things to be aware of. You can make this particular amount look better by holding off on paying your bills and collecting faster on your receivables, holding off on buying inventory, etcetera. So a company is actually able to manipulate this free cash flow number. So just be aware of that if you happen to be an investor or a lender, from that standpoint. The quality of income ratio—now this ratio needs to be looked at over a period of time for a company. Whenever they're comparing to other companies, you also need to keep in mind that you need to stay within that particular industry. So for example, if you tried to compare this ratio for a restaurant company, and if you've ever worked in a restaurant company or had a client that was associated with the restaurant business, typically that's a very cash-generating business, right? It's a cash business. If you're trying to compare a cash business like a restaurant company to a company that has a longer operating cycle, let's say for example a large manufacturer where it's going to take maybe one to two years from the acquisition of inventory to the final sale of that product, it just won't be comparable. So you need to stay within the industry. We see here that quality of income ratio measures the portion of income that was generated in cash. All other things equal then, a quality of income ratio near 1.0 would indicate a high likelihood that revenues are realized in cash and that expenses are associated with the cash flows themselves. Now others, like the operating cash flows divided by net income, is how you would create this quality of income ratio. And again, there's lots of others that you might want to consider.

So one of the resources that I use very, very often, I'm going to share this with you on the screen, is called investopedia.com. Now, I'm sure that many of you are very, very familiar with investopedia.com. If you're not, I'm going to really encourage you to check this particular website out. I think it's incredibly helpful in helping you understand how to compute various ratios, how to interpret them, how to compare them, how to analyze the cash flow statement, and basically how to analyze just about any financial statement that happens to be out there. When I went to investopedia.com, I just simply entered cash flow metrics into the search bar there. And it says, hey, what's the formula for calculating free cash flow? How do you evaluate a statement of cash flow? How do cash flow and free cash flow differ? Price to free cash flow, the definition, the uses in the calculation. How to calculate taxes and operating cash flow, etcetera. Right? Cash flow on steroids. Why companies might cheat, so maybe even some fraud risk factors and how they might manipulate their cash flow information to make the company look better or worse depending on what their reasoning might be for, again, trying to make the company look better or worse. Maybe, for example, they want to look not as profitable or not as cash flow intensive to a potential acquirer, for example, or they want to make their cash flow look better in order to obtain favorable financing from a particular vendor. So again, a lot of really great metrics that you can learn from investopedia.com, and obviously you can go and use ChatGPT or some of the other AI tools and ask it how to actually analyze the cash flow statement. You're going to get some really amazing results from those particular resources as well. So again, I encourage you to check out investopedia.com or any of those AI tools that are available to us all.

As we jump back into the presentation then, just keep in mind that GAAP specifically does not allow the computation of cash flow per share. I've never seen this done. But if your client wanted to show cash flow per share, just inform them that is not allowed, primarily because the standard-setting bodies believe that it would be too confused with earnings per share, which is oftentimes considered a more relevant computation. As I mentioned again just a moment ago when we were looking at those key performance indicators, any time that you want to analyze a company utilizing cash flows, you should always look at more than one particular year because the choice to pay bills earlier or later or maybe focusing on collecting money from customers, those can significantly swing cash from operations. You're going to be looking more at the trends versus one year's worth of activity. Looking at capital expenditures, for example, allows you to focus on whether they're growing the business or maybe not putting any money into the business that may later on have some negative ramifications. Financing activities helps us understand their approach to financing the business, as you know, for example, are they borrowing money or are they utilizing the equity that would be available to them? So again, using that cash flow information is very, very useful to investors, to lenders, and other users of the financial statements. Learn to be a better cash flow analyst by again looking at some of those items that we just saw in investopedia.com.

That brings us back to our learning objectives. Hopefully now you should at least be better able to explain why the cash flow statement is so important. You now know how to properly classify those various cash flow statements and those transactions. I've given you several different helpful hints. Remember, the baby keeps its name and the fact that if it hits the income statement, it's always going to show up in the operating section. I still use those to this day. We can now prepare a statement of cash flows using the indirect method, and I want to add to that using the direct method as well. And we've considered different ways that we might analyze the cash flow statement. And we know various resources that we have to use as tools to help us get better at analyzing this very important financial statement that our clients produce.

I'm going to invite you to please join me on LinkedIn. You see my LinkedIn profile link here on your screen. I promise that I will accept your invitation to connect. It's a great place for us to network and it's an excellent place for you to ask me any particular questions related to cash flow statements or any other topic that I teach here through Checkpoint Learning. So please join me there on LinkedIn.

Given all of that, I just want to say thank you so much for joining me here today. I hope you learned a lot and I hope that you will share this information with your colleagues, your staff, maybe the partners and managers you work with, maybe even your clients to help them get better at cash flow statements.

## **SUPPLEMENTAL MATERIALS**

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### **Issues in Preparing a Statement of Cash Flows**

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by Chris Martin, CPA

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There are no supplemental materials for this segment. Go to the next page for discussion questions.

## GROUP STUDY MATERIALS

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### A. Discussion Questions

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1. Why is the Statement of Cash Flows considered one of the most critical financial statements for investors and creditors?
2. Why is the “baby keeps its name” rule a helpful guide when categorizing cash flow transactions? Provide an example.
3. What is the primary difference between the direct method and the indirect method for presenting operating activities? Why do most companies prefer the indirect method?
4. How are noncash investing and financing activities disclosed in the Statement of Cash Flows, and why are they important?
5. How do changes in working capital accounts (e.g., accounts receivable, inventory, and accounts payable) impact the cash flows under the indirect method?
6. What are some key metrics derived from the Statement of Cash Flows, and how can they help analyze a company’s performance?

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**B. Suggested Answers to Discussion Questions**

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1. The Statement of Cash Flows helps investors and creditors evaluate:

- The company's ability to generate positive future cash flows.
- Its ability to meet financial obligations and pay dividends.
- The differences between net income and actual cash movements.
- The need for external financing and understanding noncash transactions.

**Key Considerations:** While accrual-based accounting provides a comprehensive view of a company's profitability, it does not always reflect the actual movement of cash, which is vital for assessing liquidity and solvency. Accruals such as accounts receivable, prepaid expenses, or deferred revenues can artificially inflate net income without corresponding cash inflows, potentially masking financial stress. For instance, a company may report strong net income while struggling to collect cash from customers, jeopardizing its ability to pay creditors or fund operations. By focusing on the Statement of Cash Flows, investors and creditors can evaluate whether a company's reported earnings are supported by actual cash generation and whether it has sufficient cash reserves to meet current and future obligations. This transparency is crucial for understanding the company's operational health, assessing its reliance on external financing, and identifying any patterns of unsustainable cash flow management.

2. The rule means that the initial classification of a transaction (operating, investing, or financing) remains the same throughout its lifecycle.

**Example:** Purchasing equipment (investing activity) keeps its classification as investing when it's sold later.

**Key Considerations:** The "baby keeps its name" rule simplifies the classification process by providing a consistent framework for categorizing cash flow transactions throughout their lifecycle. This consistency ensures that related cash flows, such as the purchase and subsequent sale of an asset, are appropriately recorded within the same activity category. For example, equipment purchased as an investing activity remains part of the investing category when it is later sold, even though the gain or loss on the sale may affect net income in the operating section. By adhering to this rule, accountants avoid confusion and reduce the risk of misclassification, which could distort the presentation of cash flows and mislead users of the financial statements. Additionally, this principle aligns with the concept of comparability in financial reporting, as it allows stakeholders to track and analyze cash flow trends over time without inconsistencies arising from changes in categorization. This clarity is critical for users who rely on the Statement of Cash Flows to make informed decisions about the company's operations, investments, and financing strategies.

3. The direct method shows cash receipts and cash disbursements directly from operations. The indirect method starts with net income and adjusts for noncash items and changes in working capital.

The indirect method is preferred because (1) it's simpler and more cost-effective to prepare because it reconciles directly with the income statement, and (2) it avoids additional disclosures required by the direct method.

**Key Considerations:** While the Financial Accounting Standards Board (FASB) prefers the direct method for presenting operating activities because it provides a clearer, more detailed view of cash inflows and outflows, the indirect method remains far more common due to its practical advantages. The indirect method starts with net income, which is already calculated as part of the financial statements, and makes adjustments for noncash items, such as depreciation and changes in working capital. This approach streamlines the preparation process by leveraging existing data rather than requiring a detailed breakdown of every cash transaction, which can be time-consuming and costly for companies with high transaction volumes. Additionally, the direct method mandates an additional reconciliation to net income, further increasing the effort required for compliance. For these reasons,

most companies opt for the indirect method to save time and reduce costs, while still meeting reporting requirements. This preference reflects a balance between user needs and practical limitations in financial reporting, allowing companies to efficiently present cash flow information without incurring unnecessary burdens.

4. Noncash transactions (e.g., acquiring equipment via a loan) are disclosed as supplemental information at the bottom of the statement or in a footnote. The importance is that this ensures full transparency regarding significant financing or investing activities that do not involve cash.

**Key Considerations:** Noncash investing and financing activities are critical to providing a complete picture of a company's financial transactions, even when cash is not directly involved. While these activities do not appear in the main body of the Statement of Cash Flows, disclosing them as supplemental information—either at the bottom of the statement or in a footnote—ensures transparency and helps users understand the company's financing decisions and noncash obligations. For example, if a company acquires equipment by issuing debt or stock, this transaction significantly impacts the company's future cash flows and financial commitments, even though no cash changed hands at the time. By including these disclosures, users such as investors and creditors gain insight into the company's reliance on alternative financing methods, its strategic decisions regarding asset acquisition, and its overall financial health. These disclosures also enable more accurate assessments of leverage, liquidity, and the company's ability to meet long-term obligations, ensuring stakeholders have a clear and comprehensive understanding of the business's cash flow dynamics.

5. Changes in working capital accounts (e.g., accounts receivable, inventory, and accounts payable) impact the cash flows under the indirect method as follows:
  - Increase in current assets: Subtracted from net income (e.g., rising A/R means cash not yet collected).
  - Decrease in current assets: Added to net income.
  - Increase in current liabilities: Added to net income (e.g., unpaid expenses mean cash was retained).
  - Decrease in current liabilities: Subtracted from net income.

**Key Considerations:** Changes in working capital accounts—such as accounts receivable, inventory, and accounts payable—are critical to reconciling net income to operating cash flows under the indirect method, as they reflect the timing differences between accrual-based accounting and actual cash movements. For instance, an **increase in accounts receivable** indicates that revenue was recognized but not yet collected in cash, which reduces cash flow and must therefore be subtracted from net income. Conversely, a **decrease in inventory** suggests that previously purchased inventory has been sold without additional cash outflows, leading to an add-back to net income. On the liability side, an **increase in accounts payable** implies that expenses were incurred but not yet paid, which preserves cash and is thus added back to net income. In contrast, a **decrease in accounts payable** means cash was used to settle liabilities, requiring a subtraction from net income. By analyzing these relationships with journal entries, such as debiting accounts receivable and crediting revenue, or debiting cash and crediting accounts payable, accountants can clearly see the impact of these changes on cash flow. Understanding these adjustments is essential for accurately reflecting how operating activities affect a company's liquidity and ensuring transparency in financial reporting.

6. Some key metrics derived from the Statement of Cash Flows, including how they can help analyze a company's performance include:
  - Free Cash Flow: Cash from operations – Capital expenditures. This metric measures the ability to generate cash after maintaining/expanding operations.
  - Quality of Income Ratio: Operating cash flow ÷ Net income. This metric assesses how much of the income is backed by actual cash flow.



Key Considerations: Metrics derived from the Statement of Cash Flows, such as **Free Cash Flow** and the **Quality of Income Ratio**, provide critical insights into a company's financial performance and operational efficiency. Investors, creditors, and other stakeholders rely on these metrics to evaluate a company's ability to generate cash, fund capital expenditures, and meet financial obligations. For example, **Free Cash Flow** highlights the cash available after covering essential investments in property, plant, and equipment, making it a key indicator of financial flexibility and sustainability. A consistently positive Free Cash Flow signals strong performance, while a negative trend may suggest cash flow problems or heavy reliance on debt and external financing. Similarly, the **Quality of Income Ratio** measures the proportion of net income supported by actual cash inflows, with a ratio close to 1.0 indicating that earnings are backed by robust cash generation. However, users must remain cautious of potential manipulations—companies may artificially inflate cash flow metrics by delaying payments to suppliers, accelerating customer collections, or underinvesting in capital expenditures. Analyzing these trends over multiple periods and in the context of the company's industry is crucial for forming accurate assessments and identifying red flags that could signal liquidity or operational issues.

## PART 2. AUDITING

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### Best Practices for Effective & Efficient Auditing: Designing Audit Procedures, Part One

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Welcome to the second and final program section on the A and A portion of this month's program. In this session, we'll begin our discussion on best practices for effective and efficient auditing.

In this two-part session, we will explore the risk assessment process in auditing, focusing on identifying, assessing, and responding to risks in accordance with the updated standards, emphasizing compliance with SAS 145 and related standards. Through detailed explanations, case studies, and examples, this material emphasizes the critical importance of understanding a client's business model, documenting risks at the assertion level, and designing targeted audit strategies and procedures. Our aim is to enhance auditors' ability to address financial reporting errors, omissions, and fraud, ensuring thorough and effective audit engagements that align with professional standards and user expectations.

Now let's join Susan Longo, CPA, who will lead us as we delve into part one of our discussion on best practices for effective and efficient auditing, designing audit procedures. Be sure to tune in next month as we present part two.

#### Ms. Longo

Hello, I'm Susan Longo. In this course, we're going to tackle the risk assessment process in our auditing standards, our ability to identify risk, to assess risk, and to respond to that risk. We're going to do so by looking at a detailed analysis of what could go wrong at the front end of the process and linkages that take us from that initial understanding of the client, clear to the audit program, which is the design of our audit procedures.

So as that sort of opening graphic to remind you that of the three steps: the identifying risk occurs when we complete the environmental analysis, the understanding of the client, what they do, how they do it, they're in in today's language for the new standard SAS 145. It is an understanding of the business model and please note that practice aids have changed in order to address all the aspects of the business model. Once we understand that, part of that will be understanding what could go wrong in terms of financial reporting, whether it's error, omission, or fraud. So it will be an identification of risk and an understanding of whether those risks are significant and whether they attach to something such as fraud. And the response to the risk is of course the procedures that will be designed, but they have to be specific at the assertion level with respect to the risk. So we're going to show you two things: a practice aid to illustrate that and document that linkage and then a series of case studies to help you practice the process.

So just to make sure we understand that this will be a process because it applies to everything in that environmental analysis, it will apply to our internal control evaluation as well as our account balance evaluation. So the important thing to recognize is that risk assessment is not something done at the trial balance level where we look at audit areas as such and confine ourselves to cash, receivables, inventory, property, etcetera. But it's also an understanding that the same risk assessment applies to internal controls. And where we in one case say it's what could go wrong, the language is a little different under internal controls. It's what kind of control failure could occur. But essentially, it means the same thing. And we do need to know that there are differences in terms of the assertions depending upon whether we are looking at internal controls or our account balances.

When the risk assessment standards came out a long time ago, included in that was a discussion of what is risk, and it started out with an understanding of what is a significant audit area. And that definition has morphed over the years, but essentially a significant audit area is a significant transaction class that is a driver of that business model. Anything related to revenue would be a significant audit area. A material account balance, something that requires significant disclosures, something that contains a fraud risk or a significant risk is considered a significant audit area. Please understand that this definition only makes materiality one aspect of defining a significant audit area. So what we often find is that auditors will kind of shortcut this process and say, well, anything over X percentage or X dollars is

what I consider to be significant. But we can clearly identify areas where on that balance sheet, so to speak, the number might not be material, but is there in fact a significant, is it considered, a significant audit area? The case would be yes. An example would be in a not-for-profit organization, a deferred revenue may vary from one year to another and in one year it may not be material, but is it significant and does it require an understanding of the risks related to it? The answer is absolutely yes, and you would never ignore it. Can you look at it on the flip side? And that's equally as important. That is that auditors who focus on high dollars and define high dollars as significant are in fact over auditing when we have something like an intangible that's not being amortized or goodwill that's not being amortized and there are large dollars attached to it. But having determined what that is and the fact is that that account is going to remain the same does not turn it into a significant audit area year after year after year. So we need to make sure that we're looking at all four factors before we define something as a significant audit area.

So again, significance is both quantitative and qualitative. Quantitative in terms of materiality and the volume of the transactions. Qualitative is the risk assessment, the relationship of the current year to prior years and succeeding periods. And I think that again is something that auditors forget. Risk assessment is not done by siloing the current reporting period. We know that the flow occurs from one year to another. So if we just take inventory as an example, it was generated in prior periods and it may be sold in the next. If we take grants, we may have had the grant that was awarded in a prior period, expended in this period, will continue to be expended in the next. So the characteristics as it flows from period to period are some of the qualitative characteristics. It is important that you understand that risk assessment clearly when we read our audit report is a user-focused definition. So you need to be able to identify who those users are and recognize what their risk tolerance is all about. And I don't think a lot of auditors spend time considering that. So there are some major changes in the last series of auditing standards that emphasize this user approach and this user documentation of that user risk analysis. And so if that is not part of your risk assessment at the present time, you probably need to revise what you're doing in risk assessment.

So if we're going to build an audit strategy, then we're going to have to ask some questions about risk and begin to be able to understand the various aspects of risk. So first of all, can we define what type of risk it is? Is it error, omission, or fraud? Is it related to dollars or to disclosure? And we need to recognize the standards are very sensitive to disclosure. So for instance, our auditing standard on estimates now places responsibility for the auditor not only to understand the reasonableness of the number but also the narrative that's sitting in the footnotes and the type of risk related to, for instance, going concern. There may be no dollars attached to that, but the auditing standard is saying that if the appropriate disclosures are not there, then we have a report modification, we have a qualified or adverse opinion. It's not that we would have some sort of a disclosure in the financial statements. That's what's missing. And so the emphasis on disclosure is a lot more than just kind of a consideration that I can tick and tie a disclosure to what else is in the financial statements. So it does require a risk analysis of our footnotes. Is the risk pervasive? Does it attach to a particular account balance, revenue, or is it attaching to a lot of components? So when we look at, for instance, the fact that we have a change in the controller or CFO, that's a pervasive risk. That individual has reporting responsibilities of everything. And an understanding of what could go wrong when that change in personnel occurs is very different than saying, well, you know, in prior years a proportionate amount of revenue was from grants and now what's happened is we've lost all those grants so we have moved to a donor-based nonprofit. And those kinds of things are particular to revenue flow and not necessarily to anything else other than that revenue cycle. What are the risks of error? And I always like to say and omissions. But some people feel that errors, when you define errors, that also means omissions. I just like to be a little bit more specific. So what's the past history? Are there accounts that by their nature would be susceptible to error or by virtue of the business model would be susceptible to error? Is that definition colored by our knowledge of control weaknesses and do we have any indications in the current period that we might have to revisit our thoughts about risk? So a couple of things. What we're really talking about here is risk. Risk is not anything related to our accounting services. We are in the audit engagement. We are not in the fix the QuickBooks engagement. So when we talk about risks, we're not talking about, well, the bookkeeper can't do the following. We're talking about at the point we have in fact a corrective set of books, which is one of the issues when we do risk assessment as it rears its ugly head when we do analytic procedures. You can't start out doing analytics, you can't start out with your risk assessment, until the books have been adjusted. And that's why the accounting services gets done first, not as you work your way from account balance to account balance. That is one of the reasons why certain accountants are neither efficient nor effective at the process, because they try to do both at the same time and can't.

So when we're talking about risk assessment, it is literally a what could go wrong analysis. Important that when we define what could go wrong, we do so with the right vocabulary, that we are in fact looking at a very detailed analysis. Probably the best way of illustrating it is, when we look at as part of this what could go wrong, the risk assessment we do for fraud and the fraud risk. There are some standard assumed risks of fraud, revenue, management oversight, that sort of thing. And they're sort of pre-printed on the practice aid and that tends to be pretty much as far as anybody goes. And then they just say, well, you know, we kind of watch for it as we're performing the engagement. When in fact the standards say that you need to do as much detailed risk assessment in the fraud area as you do anywhere else. To do that, you actually need to know the various fraud schemes and scams that can occur in each of the significant audit areas. And from there you look at how those schemes and scams would be structured, how they would be perpetrated, and the effect on the financial statements, specific account balances, assertions, and understanding of the direction of it. And when we look at fraud risk assessment, we just don't see that. And if you don't know how fraud could actually occur, it's very hard to go to the next step, which is what's the probability? And then the next step is, well, what's the detailed audit procedure to determine? Does internal control prevent and detect? Now I'm not testing internal control. Then what's the substantive audit procedure that proves it did not happen? So you have to understand, in the fraud world, that's your choice. Internal controls, prevents and detects. I'll test the controls. I don't test controls. Then you have to do the detailed testing. But if you don't know how the fraud could be perpetrated, it's hard to design the audit procedure. The same thing happens with any other element of risk assessment. You have to be able to define what could go wrong. Going back to my example, if we have a pervasive risk, like a major change at the top, the controller or the CFO, what could go wrong is important because what happens if you understand that is, you recognize that you are not auditing one fiscal period. You now have in front of you three segments to that fiscal period. You have the period when the old CFO was there but getting ready to leave and what happened during that period? Why did they want to or were they forced out in terms of their leaving? What did they, you know, what did they have in their bottom drawer or unanswered emails, etcetera? Then there's a break and what could have happened during that break in terms of what fell through the cracks. And then we've got the new CFO, what do they know about the business? What did they bring from their other employment that they're now embedding in the system? You have three separate [parts]. The same thing was true if we just, you know, go back a couple of years when we had COVID-19 and the shutdown that occurred. You could not audit that year as an entire year because everything that you would say would be well it's COVID, it's COVID, it's COVID. It didn't make any sense. What you had to do was take the first quarter, then you had the intermediate period when there was a total lockdown and then you started to have the recovery and you had three separate periods with three separate risk assessments. So whether it is time-related or whether it is business cycle, that is we have a revenue being generated at one point during the year and all the expenditures for the remainder part of the year, those sorts of things affect our definition of what could go on. But when we define it, we have to be able to say where it can actually happen. Where can the error, omission, or fraud be embedded in the financial statements or in the disclosures? And because the standard now requires us to do this at the assertion level, you have to be able to do it at the assertion level. For some time there were a group of auditors that said, I can do this at the financial statement level, and I just need to know what RMM is, and I'm going to say the risk of material misstatement is this, and I don't need inherent risk and control risk and I don't need to do it at the assertion level. And now you're being told under SAS 145, no, you must do a separate inherent risk and a separate control risk assessment and it must be done at the assertion level. Now, if you don't understand direction, then what's going to happen is you're going to do both sides of it. A prime example is cut-off testing, five days before and five days after. Whoa, wait a minute. One means existence and the other means completeness. They're not both. It's not in both directions. Now, don't tell me again that Karen the bookkeeper doesn't know how to do this. I told you already we're going to fix the books. So the issue is, what is the predisposition to move things from a succeeding period into the current period, or to move things from the current period into the succeeding period. One is existence and the other is completeness. Understanding that, by the way, totally changes how you test for and do a search for unrecorded liabilities. You really have to understand how you're going to determine what could go wrong.

So the analysis for what could go wrong is let's look at that understanding of the client, the business model, and create a list of risk factors. Now notice what that word is. I'm going to go from facts to factors. These are the events and circumstances, the structure of the business that can give rise to risk. They are not risk. Just because you have debt, just because that debt has a debt covenant, is not a what could go wrong analysis. Those are facts. The fact is that I've got debt. It's recorded, doesn't make it risky. The fact that I've got a debt covenant, that's a fact, but that doesn't make

it risk. The risk is, well, if we're not going to meet the debt covenant, what might we do to manipulate the financial statements? That's what you have to be able to express. So when you do that, what you're going to find is some of the analysis that you've got right now is simply a reiteration of facts. That is, you filled out one part of the practice aid with all of the description of the business. And when the question said, what's your risk, you repeated that, and all you've got is facts rather than an understanding of how the financial statements might be misstated, what could go wrong? Once you have articulated that, we will then define what could go wrong in terms of an audit area, an assertion, a direction, and a magnitude. And so when you document the risk assessment for each risk, that's what needs to be documented: the audit area, the assertion, the direction, and the magnitude. Now magnitude doesn't necessarily mean the larger total assets, total revenue, sliding scale. What it means is an understanding of a range, because if we look at different circumstances, we're going to find that in some cases that the magnitude of risk that we would allow to be present is very large. In other cases it might even actually be zero. So as an example, we have a HUD apartment complex, 175 units. We have an approved rent schedule. We have a tenant list. We provide the tenants with some other ancillary services and of course as we all know in the HUD arena, those tenants have the opportunity if they can requalify to extend their leases another year. If the circumstances are that the complex had 100% occupancy last year and they had 100% occupancy in the current period and there was no change in the rent to any tenant, when we start to think about magnitude, the answer is: if the rent schedule is not exactly the same from one year to the next, we have zero tolerance for any difference, because it shouldn't be exactly the same. And in other cases where we have massive amounts of property, plant, and equipment, we're going to be at the opposite extreme. And we're going to say to auditors, whoa, wait a minute, they have a budgeting process, they have a capital budget, all expenditures that are capitalized are pre-approved by... So why am I testing every single fixed asset addition when if I go through my what could go wrong there's nothing there? So an analytic should be able to get you where you want to be rather than all the detailed testing. Now again, we are in the audit world. If you tell me I need to do that because I need the information for the tax return, that's fine, except don't bill it to the audit, bill it to the tax return please.

All right. So again, we need to be at the assertion level. We call the inherent risk evaluation a what could go wrong analysis and an internal control evaluation to be a risk of control failure. So it's just a little different terminology, but it is in fact the same type of analysis.

So here's a case to give you an example of what we might consider. We have an auditor; the entity engages in bill and hold. When what could go wrong is being analyzed, year-end inventory balances could be greater than the inventory that the entity actually holds because you failed to exclude inventory held for others. So that is an existence and a rights and obligations risk that could result in an overstatement of the inventory. Now, when you document risk assessment, that's how specific you need to be. You have to identify the type of transaction. You have to identify the account balance. You have to identify the what could go wrong, attach an assertion to it and a direction. Here's the second one. We have significant customer accounts receivable that are over 90 days and no allowance for doubtful accounts accrued at the year-end. That would be, by the way, a GAAP violation in today's world. When the auditor considers what could go wrong, the period and accounts receivable balance could include amounts that won't be collected. So there's valuation allowance, or a valuation assertion, and an overstatement. Now, in this particular case, not only do you have an audit problem with respect to the assertion of valuation, but in this particular case you also have a GAAP problem by virtue of the fact it is not possible under the credit loss standard to have no allowance for doubtful accounts. So you got a double problem in this particular case.

So if I may, here's some examples of what often shows up in workpaper documentation and an understanding of how you need to revise it. So one might say, well, there's poor internal controls over inventory. What does that mean? I don't know what controls. I don't know what you mean by the word poor. But if you tell me that there could be an overstatement because of theft and we have an existence problem, I'm now ready to understand my next step which is developing the strategy. Reading the first one, I cannot tell you what I'm going to do. I can't even tell you whether I'm going to do walkthroughs or test the controls or strictly substantive tests. And if I'm doing either one of those things, I could not design an audit procedure based upon that articulated risk. So the idea of a well-articulated risk is that you need to be able to come up with an audit strategy and an audit plan. And if you cannot by reading what you wrote, then you did not write that well. The audit strategy and the audit plan. The audit strategy is the overall of how

we're going to attack this thing, and the plan is the specific audit program. If you cannot create a knowledge of exactly what procedure you're going to perform as a result of your articulated risk, you have not written the risk with enough detail. So significant related party sales still open. Well, the answer is there's an overstatement of revenue due to sham transactions with related party with an occurrence. No recording of year-end payables, an understatement of accrued liabilities due to the failure to make year-end accruals. It's a completeness problem. So all of these on the left column are general statements. The inventory costing system is complex. OK. I can't debate that one way or the other, but I certainly don't know what that means in terms of my next steps in the audit. But telling me that they have an improper application of an aspect of that cost accounting system, now I know how to test. So again, when you have to document risks, and all the practice aides ask for that, you have to be able to identify the what could go wrong, and when doing that, attach to that description an audit area, and an assertion, and a direction, and the magnitude. And without that, we are not able to go forward. And without that, linkage falls apart. And simply stated, linkage is: I'm going to go from risk to procedures, and I'm going to go from procedures back to risk. So I'm going to say: I'm going to look at your understanding of the entity and the identified risk. I'm going to go to your risk assessment. I'm going to go to your audit strategy. I'm going to go to your audit plan, your audit program, and your audit procedures on the workpaper. So I can look at a risk and see why you performed a particular audit procedure. Also going to go in the opposite direction. I'm going to look at a workpaper. I'm going to see a test on that workpaper. I'm going to go back and find it in the audit program, the audit plan, strategy, risk assessment, and identified risk. And if I can't, I do not have linkage. And not having linkage is sort of the major threat you have to getting through quality review and certainly getting through peer review. It's all about linkage.

All right. So remember that when we look at risk assessment, we are looking at the overall pervasive risks, which are significant risks, and the assertion-level risks. And we have to make sure when we do that, that we remember that we have identified risks which can be related to fraud, significant risks, and where substandard procedures alone would not be sufficient. And that is a series of things that the standard setters have defined. Things where you are in an IT system and the IT system controls it and those sorts of things.

All right, so if we're going to document our audit strategy, then we have to start with what's happening in the engagement, the beginnings of it. That overall strategy is understanding that that leads us right into what is our reporting structure. The overall strategy is going to help us craft that auditor's report. And one of the things that I try to emphasize is that when you start this process of understanding the entity and you're documenting everything, by the time you get done with that, you should know everything in the reporting package. There should be absolutely no surprises beyond that point. And if you properly documented it, you would find that things, the linkage would be so obvious, but you would also find that some of the disconnects which lead to deficiencies in reporting would never be there. So for instance, there's always a question about related parties and related party transactions. And there's a little, you know, we provide some information, probably not as much as you should on that form, but that's another story for another day. But that particular footnote, that particular question, leads directly to a footnote. So to evaluate whether or not you have information on that practice aid, understanding the entity, that meets your requirements, you got to be able to read it and say, can I write the footnote by what I wrote? And nine chances out of 10, the answer's going to be no. Well, I just roll over the footnote from last year that, you know, that's fine, but that doesn't answer the documentation requirements. So as you go through that gathering of information upfront, you should literally manually go, all right, that question is related to that footnote, that question is related to that footnote. And that winds up in the report, and all of a sudden that reporting package it at the end is connected to what you had at the very beginning. So what are we going to start with? What are the reporting requirements? Is it strictly a GAAP set of financial statements or is it a tax set of financial statements, tax basis or GAAP basis, or is there anything unique that's going to be added? Is it consolidated or consolidating? Is it one year or multiple years? All of those reporting requirements. Do we understand that it is a single-year presentation or it's a two-year presentation comparative, but last year was done by somebody else. Are there others involved in the audit? And that answers the question and goes directly to the report by saying and we're going to make reference to. So all of what we gain initially is directed toward understanding what it is that we have for an objective.

The reporting, make sure we understand our deliverables and critical dates. And if you don't understand those dates, we again don't tend to understand the proper way to put together the budget. Budgets tend to be a function of, well, I

can't do any more than X because the fee is Y. And that doesn't tend to be the appropriate way to budget. And you have to be able to create the time frames to work backwards from what's the drop-dead date to give it to the client. We need to be able to focus the audit team, and the best way to do that is to actually understand what happened to the client from the prior year. Now I will say that for some auditors this is a relatively easy thing to do. Between the partners and the managers they talk to the client all year long. For others, this is once-a-year, and an uncomfortable position at the beginning of the year, when, the beginning of the audit year, when you walk in and you really don't know what's happened. If you know that the client does internal reporting monthly or quarterly, whatever it turns out to be to focus the team, you really need interim reports. Now interim reports from the client provide two things. One: an immediate analysis of what actually happened. It's tough to remember nine months ago in any kind of great detail, not hard if you're doing a one or two or three months. And then the other is that if you get these interim reports and you spend the 10 to 15 minutes developing the questions, calling the client, asking and documenting the answers to those questions, you have now done preliminary analytics. And so preliminary analytics is at the end of the year is not something else that you do. You do need to understand these things before you can create the right expertise on the audit team. And there are times when you definitely need more experience in certain areas of the audit.

So if we have an understanding of the basic characteristics of what's happening for the year, we now have a strategy to respond. So what we're doing is we're responding to changes. That's our main focus: to respond to changes. So this results in when you ask a question, do you have to have a follow-up or two or three? Do you actually ask that question several times in different modes to see whether you get a consistent answer? Please remember assignment of personnel now is a partner-level responsibility, not an HR function or a scheduling manager function. It is a partner-level responsibility. It is the partner that assigns the staff in terms of understanding the levels, not necessarily the amount of staff time there, the partner's time on the job. All of that is a partner-level responsibility, and it is the mix of the team that responds. So if in fact we have a need for someone that has expertise in specialized GAAP area, then we need to make sure that either that they're a member of the team or that we have access to an internal expert. With respect to this, it doesn't matter which standard-setting body has done a survey. We will tell you that partner-level involvement and involvement of the quality control or EQCR partner in planning is absolutely critical. You don't want these individuals coming in at the end saying: oh, you should have. Well, you should have is rework, and that's very expensive and very frustrating for the client. So partner-level involvement, engagement partner, signing partner, second partner, concurring partner, EQCR partner, the whole cast of characters depending upon the firm, is critical. We need to recognize that we are creatures of habit. We are linear thinkers as accountants and the client can pretty much design the audit for us if you've been there over and over and over again. And so what we have to be able to do is be a little bit unpredictable. Now what generally happens when somebody says be a little bit unpredictable, that means somebody is going to vary the amount of testing and that is not what that means. It does mean look at audit areas with different types of procedures to vary which of the audit areas have a particular concentration in any one year. It is not, it is not being the same audit, not having the same audit approach from year to year. And please remember that a change in accounting principle will always need an overall strategy. Now we've had the FASB address revenues and leases and financial instruments and derivatives and those kind of complex areas. Right now they've been fairly quiet in some of the things that they've been doing, more clarification than anything else. But anytime we have a change in accounting principle, that is an overall risk.

So we need to remind everybody that we will be required to test journal entries, and that requires two things. One, we need to test the internal controls over the journal entries, and we need to test the journal entries, and the journal entries are throughout the year. Now let me remind you that that standard does not say I don't have to do this for recurring journal entries. There's absolutely nothing in the standard that says I don't have to do this for recurring journal entries. If they are recurring, I might not have to test every one of them, but I do not have the option to write a memo that says all the journal entries are recurring journal entries and therefore we don't have to do any journal entry testing. That does not work. Please remember you must test both the internal controls over those journal entries as well as the journal entries themselves. You're required to evaluate significant accounting estimates, and we have a new audit standard that talks about that, which designs things quite differently than what we've had before. First thing is you're going to evaluate the significant accounting estimates to the report date. And I think auditors up to this point said, OK, so it's a significant audit area. I'm going to do my audit program in that area. Somebody's going to review it, stick it in the binder. We're ready to go. And the answer is all significant accounting estimates now go through a

detailed subsequent events review up to the report date. The next thing that is clearly important about significant audit estimates is that we are required as auditors to develop an independent estimate. Now what we did and do forever when we perform analytic procedures is to develop an expectation. We don't prove out an analytic. We have an expectation of what we should see, perform the analytic. We have a threshold for variance. If that analytic doesn't fall within that acceptable range, then we have to investigate. That structure has now been placed on accounting estimates. You cannot evaluate the client's estimate if you don't have your own opinion of what that estimate ought to be. So you're required, it's not an option, you're required as an auditor to develop and document an independent accounting estimate: fair value, inventory valuation, pension liability, deferred compensation, accrual, you name it, including revenue. There are lots of ways you're allowed to do that. You are allowed to take the client's model and come up with your own assumptions and data. You can develop your own model. You can use a proprietary model like Excel or IDEA. Lots of different ways. Auditing standards does not care what you use, just cares that you have your independent estimate before you evaluate the clients. We have to evaluate the business rationale for unusual transactions. Why did this happen? What were the circumstances that drove this to occur? And the answers to some of those things is what is going to help us design our further audit procedures.

[Please join us next month for the continuation and conclusion of this discussion.]



## SUPPLEMENTAL MATERIALS

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### **Best Practices for Effective & Efficient Auditing: Designing Audit Procedures, Part One**

By Susan Longo, CPA

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There are no supplemental materials for this segment. Go to the next page for discussion questions.

## GROUP STUDY MATERIALS

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### **A. Discussion Questions**

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1. What is the importance of understanding a client's business model in the risk assessment process, and how does SAS 145 emphasize this?
2. Why is it essential to identify risks at the assertion level, and what happens if risks are defined too broadly?
3. Why must auditors develop independent estimates for significant accounting estimates, and how does this enhance audit quality?

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## B. Suggested Answers to Discussion Questions

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1. Understanding a client's business model is critical because it provides context for identifying risks related to errors, omissions, or fraud in financial reporting. SAS 145 emphasizes that auditors must perform a thorough risk assessment based on an understanding of the entity's business, operations, and environment. This knowledge allows auditors to identify significant audit areas and tailor procedures to address risks at the assertion level.

Key Considerations: Understanding a client's business model is essential for auditors because it reveals how the company generates revenue, incurs costs, and manages risks, enabling auditors to identify areas prone to errors, omissions, or fraud. A thorough grasp of the business model helps auditors go beyond basic materiality thresholds to consider both **quantitative** and **qualitative** factors, such as significant transaction classes, industry-specific risks, or emerging trends. For instance, deferred revenue in a not-for-profit organization may not appear material but could pose substantial risks due to its unique accounting treatment and flow across reporting periods. SAS 145 highlights that risks must be assessed with an emphasis on "**what could go wrong**" at the assertion level, requiring auditors to analyze the potential for misstatements in specific financial statement areas. By connecting the business model to financial processes, auditors can anticipate risks associated with changes, such as new business lines, evolving markets, or shifts in accounting practices. This approach ensures that audit procedures are tailored, effective, and aligned with the entity's operational and reporting realities, leading to a more robust and efficient audit.

2. Identifying risks at the assertion level is essential because it ensures audit procedures are specific and targeted. If risks are defined too broadly—such as stating “poor internal controls over inventory”—the auditor cannot determine what specific audit steps to take, such as testing existence, completeness, or valuation of inventory.

Key Considerations: Identifying risks at the assertion level is critical because it allows auditors to develop targeted procedures that directly address the specific risks of misstatement in financial reporting. Assertions—such as **existence, completeness, valuation, rights and obligations**, and **presentation and disclosure**—serve as the foundation for linking risks to audit tests. Defining risks too broadly, such as simply stating “poor internal controls over inventory,” leaves the auditor without a clear direction on which assertion is affected and what steps to take. Broad definitions may result in either **over-auditing**, where unnecessary procedures are performed, or **gaps in testing**, where critical risks are overlooked. By articulating “what could go wrong” at a granular level and linking it to a transaction, account balance, and assertion, auditors can determine the magnitude and direction of the risk, such as an inventory overstatement due to errors in costing methods. This specificity ensures that the audit plan and strategy are **efficient, focused**, and directly responsive to identified risks, resulting in stronger audit quality and better resource allocation.

3. Auditors are required to develop independent estimates to ensure they can evaluate the reasonableness of management's estimates objectively. This is critical for areas like fair value measurements, inventory valuation, or pension liabilities, where subjectivity and judgment are significant.

Key Considerations: Developing independent estimates is a cornerstone of audit quality because it ensures auditors approach management's estimates with an objective and critical mindset. Management's estimates, particularly for complex areas like **fair value measurements, loan loss reserves**, or **pension liabilities**, often rely on significant **judgment** and **assumptions** that may be biased, flawed, or inadequately supported. By creating their own independent estimates, auditors establish a **benchmark** to evaluate the reasonableness of management's figures, reducing the risk of overreliance on client-prepared data. This independent approach also strengthens the auditor's professional skepticism, as it highlights discrepancies between management's methods and alternative approaches, requiring further investigation. Auditors can leverage a variety of tools, such as statistical models, proprietary software like **Excel** or **IDEA**, or external economic data, to construct well-documented and defensible estimates. For example, when evaluating a client's loan loss reserve, the auditor

might independently analyze economic conditions, historical loan performance, and default rates to validate or challenge the client's assumptions. This process enhances audit quality by ensuring that financial statement estimates are reasonable, unbiased, and aligned with applicable standards, fostering greater confidence in the audit opinion.

## GLOSSARY

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**Accrual Basis**—Accrual basis is an accounting concept wherein transactions and events are recognized for financial purposes when they legally occur, regardless of exchange of cash.

**Analytical Procedures**—Evaluations of financial information made by a study of plausible relationships among financial and nonfinancial data which involves comparing recorded amounts to expectations developed by the auditor.

**Audit Procedures**—An audit procedure is specific and specialized steps or actions auditors take to meet audit objectives. It may vary for different audit engagements, depending on the complexity of the accounting system, the type of entity, and other factors unique to the engagement. Audit procedures are to be tailored to the engagement, as compared to audit standards, which do not change. Audit procedures are used for test of controls and substantive testing. The seven basic audit procedures are recalculation, observation and examination, confirmation, inquiry and written representations, scanning, analytical procedures, and examination of documents in two directions, vouching from the accounting records back to the original source documents and tracing from the source documents forward through the accounting process to the final recording of the transaction.

**Audit Strategy**—Audit strategy is the auditor's operational approach to achieving the objectives of the audit. It is a high-level description of the audit scope. It includes matters such as identifying material locations and account balances, identifying audit areas with a higher risk of material misstatement, the overall responses to those higher risks, and the planned audit approach by area (for example, substantive procedures or a combined approach of substantive procedures and tests of controls).

**Cash Basis**—Cash basis is a method of accounting in which no transactions are entered for income until cash is constructively received, and no entries are made for expenses until cash is actually paid. There are no receivables, payables or depreciation under the cash basis of accounting.

**Cash Equivalents**—Cash equivalents are negotiable, highly liquid items that are the equivalent of cash in value and availability (e.g., checks, bank drafts, cashier's checks, certified checks, and money orders) and, in a broader sense, any short-term, highly liquid investment, such as commercial paper, Treasury notes, and marketable equity securities. Cash equivalents are classified as current assets.

**Control Risk**—The risk that a misstatement due to error or fraud that could occur in an assertion and that could be material, individually or in combination with other misstatements, will not be prevented or detected on a timely basis by the company's internal control.

**Current Assets**—Current Assets are those so categorized in the current assets section of the balance sheet. They typically consist of such assets as cash, marketable securities, accounts receivables, inventory and prepaid expenses. They can be thought of as assets that will typically turnover in one business cycle.

**Current Liabilities**—Liabilities that will be due within a short time (usually one year or less) and that are to be paid out of current assets.

**Direct Method**—The direct method shows as its main components operating cash receipts and payments, such as cash received from customers and cash paid to suppliers and employees, the sum of which is net cash flow from operating activities.

**Environmental Analysis**—Analysis that focuses on factors outside the organization that may create opportunities for or threats against it.

**Financing Activities**—Financing assets and liabilities that in management's view are part of the financing of the entity's business and other activities such as activities involving bank loans, leases, and issuance of bonds.

**Fraud Risk Assessment**—An assessment of the potential for fraud to affect an organization's ability to maintain operations and reputation identifies and addresses an organization's vulnerability to both internal and external fraud.

**Free Cash Flow (FCF)**—The amount of cash flow that is free for common shareholders after accounting for fixed commitments such as capital.

**Indirect Method**—The indirect method begins with net income and adjusts it for revenue and expense items that were not the result of operating cash transactions in the current period, to reconcile net income to net cash flow from operating activities.

**Inherent Risk**—The risk posed by an error or omission in a financial statement due to a factor other than a failure of internal control.

**Investing Activities**—Activities that management views as unrelated to the central purpose for which the entity is in business including investing to generate dividends, interest or capital gain but not for the primary revenue and expense-generating activities.

**Materiality**—A concept that recognizes that some matters, either individually or in the aggregate, are important for fair presentation of a subject matter or an assertion about a subject matter, while other matters are not important. A synonym for significant and applies primarily to audits and attestation engagements with a financial component.

**Operating Activities**—Activities that management views related to the central purpose for which the entity is in business.

**Risk Assessment**—The auditor's assessment of the risks of material misstatement, whether due to error or fraud, at the financial statement and relevant assertion levels, which aids in designing further audit procedures. The term also applies to the auditee's assessment of the risk of error or fraud related to the auditee's system of internal control.

**Statement of Cash Flows**—A financial statement that reflects the inflow of revenue vs. the outflow of expenses resulting from operating, investing and financing activities during a specific time period.

**Subsequent Events**—Events or transactions that affect the financial statements and that occur subsequent to the date of the financial statements, but before the statements are issued.

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

1. What is the purpose of the cash flow statement as outlined in the course?
  - A. To identify discrepancies in audit procedures.
  - B. To present a company's net income for a year.
  - C. To reconcile taxable income to cash earnings.
  - D. To summarize changes in cash during a period.
2. Which method for presenting a cash flow statement is preferred by FASB but less commonly used in practice?
  - A. Direct Method
  - B. Indirect Method
  - C. Reconciliatory Method
  - D. Simplified Flow Method
3. What type of activity is cash received from the sale of property, plant, and equipment?
  - A. Financing Activity
  - B. Investing Activity
  - C. Operating Activity
  - D. Supplemental Disclosure
4. When is a cash flow statement required by FASB standards?
  - A. When a company does not report net income.
  - B. When a company is publicly traded.
  - C. When a company prepares financial statements under GAAP.
  - D. When a company uses cash-basis accounting.
5. How are interest payments classified in the cash flow statement?
  - A. Financing Activity
  - B. Investing Activity
  - C. Operating Activity
  - D. Supplemental Disclosure

*Continued on next page*

6. What is the "indirect method" of preparing a cash flow statement?
  - A. A direct reporting of all cash receipts and disbursements.
  - B. A method required for nonprofit organizations.
  - C. A method that reconciles net income to cash flows.
  - D. A simplified version of the cash flow statement.
7. What is the primary purpose of the supplemental disclosures in the cash flow statement?
  - A. To calculate depreciation and amortization.
  - B. To detail changes in current assets.
  - C. To explain discrepancies in net income.
  - D. To report significant non-cash activities.
8. Which of the following is classified as an operating activity in the cash flow statement?
  - A. Collection of accounts receivable.
  - B. Payment of dividends.
  - C. Proceeds from issuing bonds.
  - D. Purchase of equipment.
9. What type of transaction is the issuance of stock?
  - A. Financing Activity
  - B. Investing Activity
  - C. Operating Activity
  - D. Supplemental Disclosure
10. What is the classification for cash paid to purchase inventory?
  - A. Financing Activity
  - B. Investing Activity
  - C. Operating Activity
  - D. Supplemental Disclosure

*Continued on next page*



11. What is the primary focus when responding to identified risks in an audit?
  - A. General observations of the client's business practices.
  - B. Designing procedures specific to the assertion level.
  - C. Creating audit plans without linkage to risk factors.
  - D. Adjusting risk assessments based solely on materiality.
12. What is a key requirement when addressing risks at the assertion level in audits?
  - A. Focusing on pervasive risks only.
  - B. Prioritizing high-dollar amounts above all other factors.
  - C. Separate assessments for inherent risk and control risk.
  - D. Using analytics as the sole method of risk assessment.
13. What should auditors consider when defining "what could go wrong" in financial statements?
  - A. A focus on the largest account balances.
  - B. A general summary of the entity's operational challenges.
  - C. Reliance on historical patterns of client errors.
  - D. Specific errors, omissions, or fraud that could impact assertions.
14. How does an auditor's understanding of a client's business model enhance the risk assessment process?
  - A. It eliminates the need for additional fraud risk assessments.
  - B. It facilitates the identification of risks specific to financial misstatements.
  - C. It helps identify unrelated operational risks.
  - D. It provides a checklist of risks across all business types.
15. Why must auditors perform inherent risk assessments separately from control risk assessments?
  - A. To align with updated auditing standards that require assertion-level focus.
  - B. To allow for higher flexibility in designing audit programs.
  - C. To eliminate the need for detailed control evaluations.
  - D. To simplify the evaluation of significant and fraud risks.

## Subscriber Survey

### Evaluation Form

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

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

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Accounting Session	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Auditing Session	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Small Business Session	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

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

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

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

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

	Overall	Knowledge of Topic	Presentation Skills
Accounting Speaker	_____	_____	_____
Auditing Speaker	_____	_____	_____
Small Business Speaker	_____	_____	_____

Are you using **CPE Network® A&A Report** for: CPE Credit ☐ Information ☐ Both ☐

Were the stated learning objectives met? Yes ☐ No ☐ \_\_\_\_\_

If applicable, were prerequisite requirements appropriate? Yes ☐ No ☐ \_\_\_\_\_

Were program materials accurate? Yes ☐ No ☐ \_\_\_\_\_

Were program materials relevant and contribute to the achievement of the learning objectives? Yes ☐ No ☐ \_\_\_\_\_

Were the time allocations for the program appropriate? Yes ☐ No ☐ \_\_\_\_\_

Were the supplemental reading materials satisfactory? Yes ☐ No ☐ \_\_\_\_\_

Were the discussion questions and answers satisfactory? Yes ☐ No ☐ \_\_\_\_\_

Specific Comments:

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Name/Company \_\_\_\_\_

Address \_\_\_\_\_

City/State/Zip \_\_\_\_\_

Email \_\_\_\_\_

**Once Again, Thank You...**

**Your Input Can Have a Direct Influence on Future Issues!**

# CPE Network<sup>®</sup>

## CPE Group Attendance Sheet

Firm/Company Name: \_\_\_\_\_

Account #: \_\_\_\_\_

Location: \_\_\_\_\_

Program Title: \_\_\_\_\_ Date: \_\_\_\_\_

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

I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network<sup>®</sup> newsletter, and earned the number of hours shown.

Instructor Name: \_\_\_\_\_ Date: \_\_\_\_\_

E-mail address: \_\_\_\_\_

License State and Number: \_\_\_\_\_

# CPE Network<sup>®</sup>

## CPE Group Attendance Sheet

Firm/Company Name: \_\_\_\_\_  
Account #: \_\_\_\_\_  
Location: \_\_\_\_\_  
Program Title: \_\_\_\_\_ Date: \_\_\_\_\_

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

I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network<sup>®</sup> newsletter, and earned the number of hours shown.

Instructor Name: \_\_\_\_\_ Date: \_\_\_\_\_  
E-mail address: \_\_\_\_\_  
License State and Number: \_\_\_\_\_

# CPE Network/Webinar Delivery Tracking Report

<b>Course Title</b>	
<b>Course Date:</b>	
<b>Start Time:</b>	
<b>End Time:</b>	
<b>Moderator Name, Credentials, and Signature Attestation of Attendance:</b>	
<b>Delivery Method:</b>	Group Internet Based
<b>Total CPE Credit:</b>	3.0
<b>Instructions:</b>	During the webinar, the moderator must verify student presence a minimum of <u>3 times per CPE hour</u> . This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
<b>Brief Description of Method of Polling</b>	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

[illegible]

# CHECKPOINT LEARNING NETWORK

# CPE NETWORK<sup>®</sup>

# USER GUIDE

REVISED December 31, 2023

## Welcome to CPE Network!

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

This User Guide has the following sections:

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

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

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

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

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

### **Copyrighted Materials**

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



# “Group Live” Format

## CPE Credit

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

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

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

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

## Advertising / Promotional Page

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

## Monitoring Attendance

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

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

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

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

## **Elements of Engagement**

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

## **Make-Up Sessions**

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

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

## **Awarding CPE Certificates**

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

## Subscriber Survey Evaluation Forms

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

## Retention of Records

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

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

## Finding the Transcript

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

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

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

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

### Requesting Participant CPE Certificates

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

Email: [CPLgrading@cerifi.com](mailto:CPLgrading@cerifi.com)

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

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

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

## “Group Internet Based” Format

### CPE Credit

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

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

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

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

### **Advertising / Promotional Page**

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

### **Monitoring Attendance in a Webinar**

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

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

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

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and asks that participants confirm their attendance by using the “raise hands”

feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone's hands and continues the training.

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

#### **Additional Notes on Monitoring Mechanisms:**

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

#### **Real Time Moderator During Program Presentation**

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

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance

monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

### **Make-Up Sessions**

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

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

### **Awarding CPE Certificates**

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

### **Subscriber Survey Evaluation Forms**

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

### **Retention of Records**

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

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

### **Finding the Transcript**

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

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

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

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



## Requesting Participant CPE Certificates

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

Email: [CPLgrading@CeriFi.com](mailto:CPLgrading@CeriFi.com)

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

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

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

# “Self-Study” Format

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

## Self-Study—Email

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

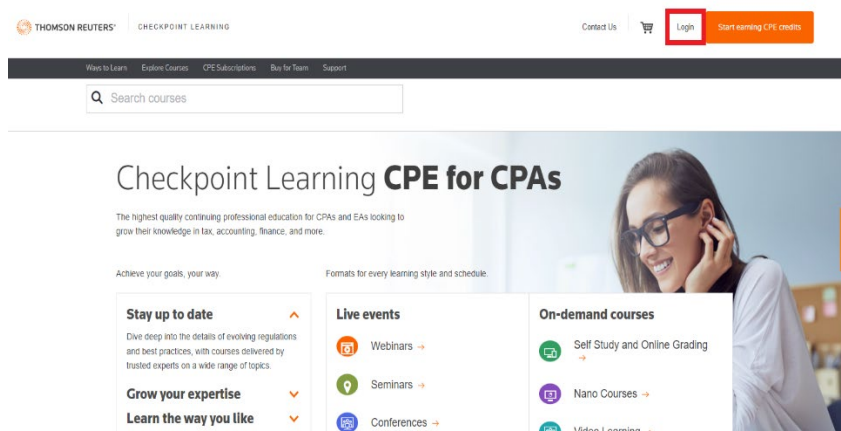
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.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

**CPLgrading@cerifi.com**

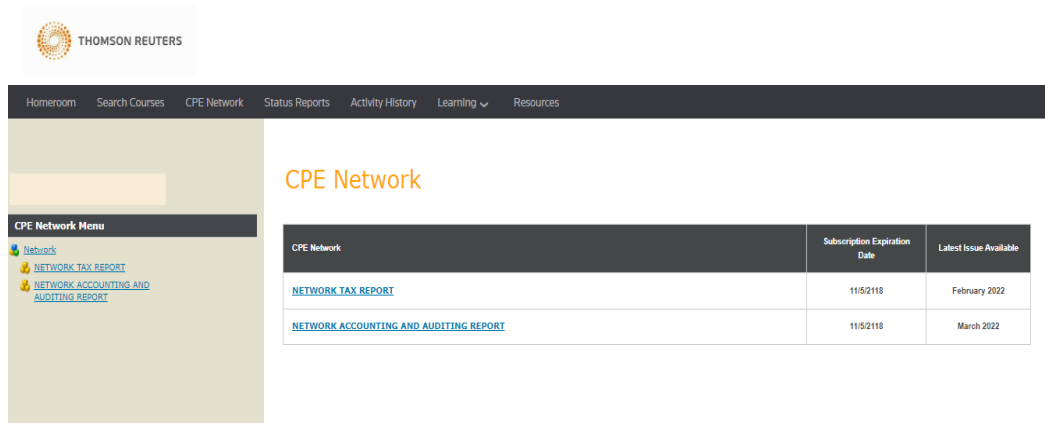
## Self-Study—Online

Follow these simple steps to use the online program:

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

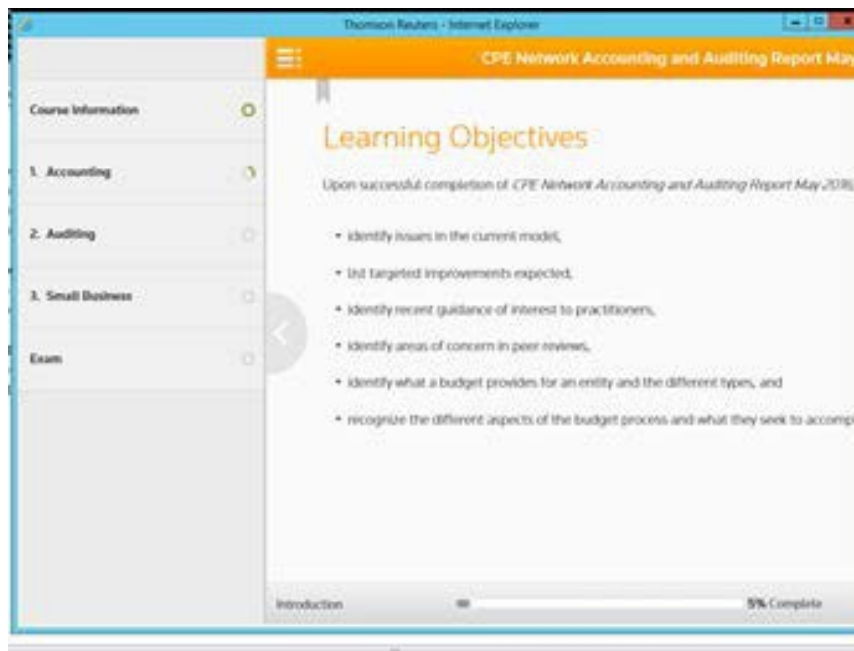


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



CPE Network	Subscription Expiration Date	Latest Issue Available
<a href="#">NETWORK TAX REPORT</a>	11/5/2118	February 2022
<a href="#">NETWORK ACCOUNTING AND AUDITING REPORT</a>	11/5/2118	March 2022

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



**Learning Objectives**

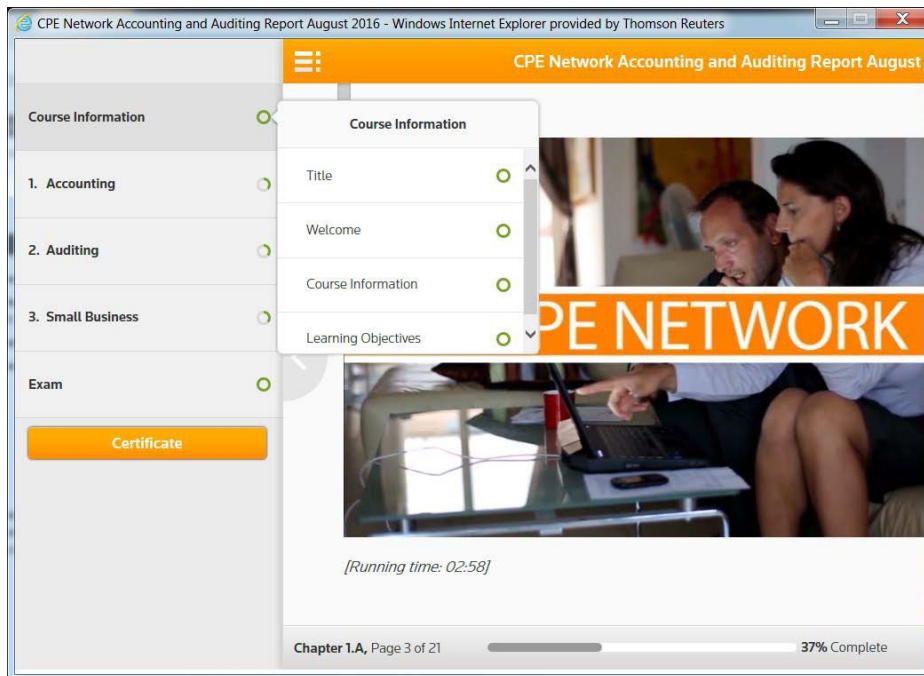
Upon successful completion of *CPE Network Accounting and Auditing Report May 2018*, 1

- identify issues in the current model,
- list targeted improvements expected,
- identify recent guidance of interest to practitioners,
- identify areas of concern in peer reviews,
- identify what a budget provides for an entity and the different types, and
- recognize the different aspects of the budget process and what they seek to accomplish

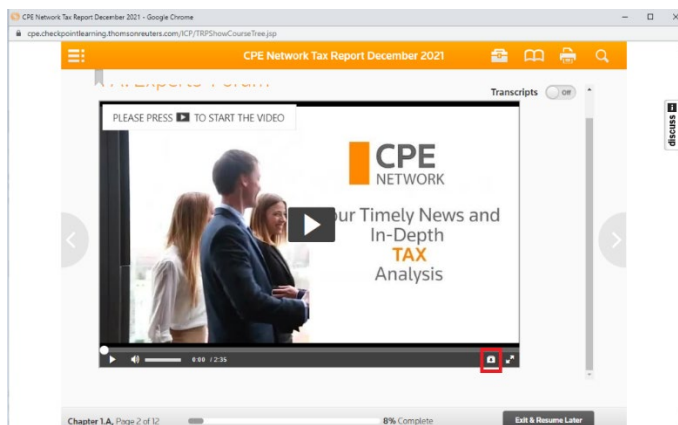
Introduction 0% Complete

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

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



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



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

Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2016

Transcripts ☒

## Chapter 1 Liabilities and Equity: Another Look at the Model

Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

For more on the targeted improvements in this area, let's join Paul Munter, professor in practice for the University of Colorado at Boulder, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today, we want to talk a little bit

Please note that the transcript [Liabilities and Equity Transcripts](#) can also be found as a link and in the Tools section.

Chapter 1A, Page 4 of 21 8% Complete [Exit & Resume Later](#)

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

D:\xml\production\working\U6015494\N... Network Accounting and Auditing Report May 2016

Transcripts ☒

## Chapter 1 Liabilities and Equity: Another Look at the Model

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Chapter 1A, Page 4 of 21 8% Complete [Exit & Resume Later](#)

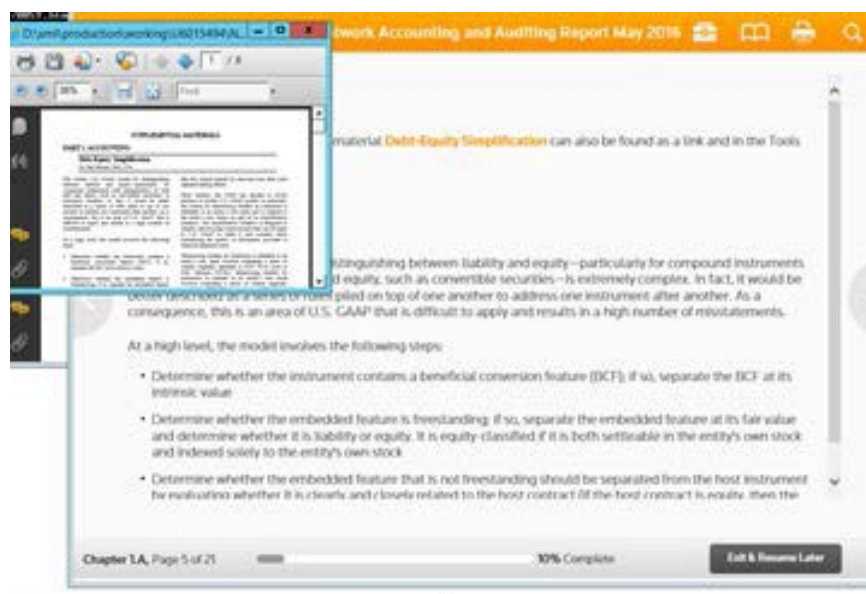
**STUDENT ANALYSIS AND COMMENTARY**

**CHAPTER 1: ACCOUNTING**

**Liabilities and Equity: Another Look at the Model**

The video discusses the targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement. The video discusses the targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

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



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

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

The screenshot displays a web-based interface for a CPE (Continuing Professional Education) report. The header bar is orange and contains the text "CPE Network Accounting and Auditing Report July 2016" along with icons for a menu, a printer, a book, a document, and a search function. Below the header, the main content area is titled "Suggested Answers to Discussion Problems". It contains three numbered items:

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

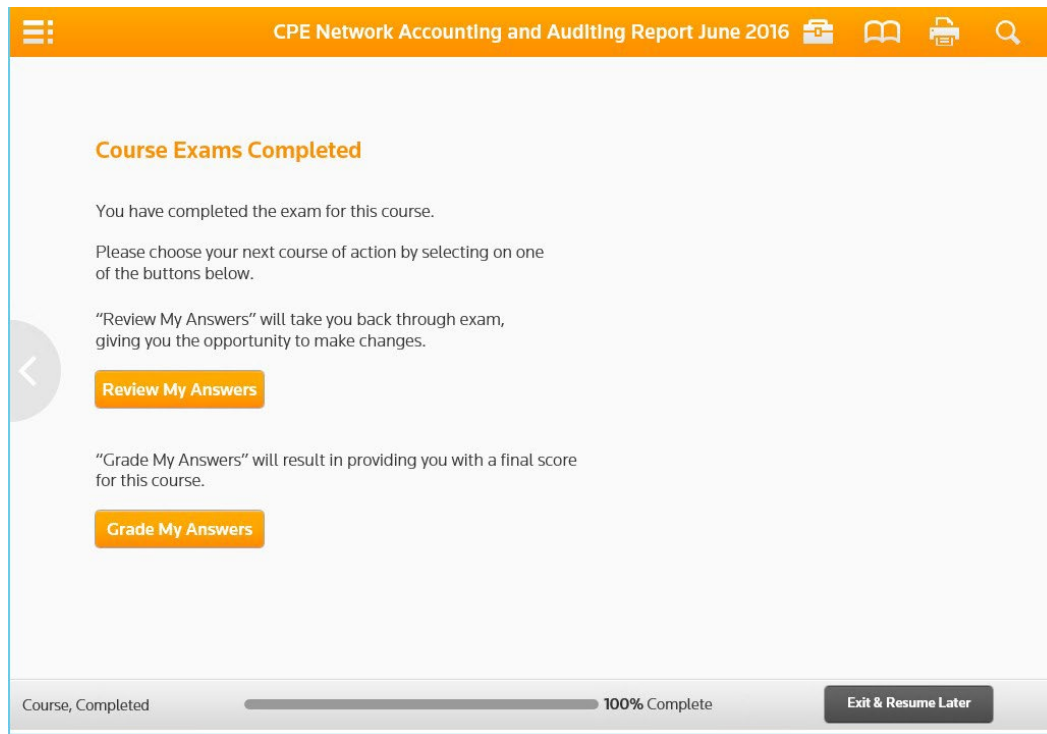
An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions should be made at acquisition and, preferably, formally documented. It is not appropriate to use "hindsight" to classify securities transactions, perhaps by considering changes in value after acquisition.
2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price. "Short-term," in this context, is intended to be measured in hours and days, rather than in months or years, according to ASC 320. However, an entity is not precluded from classifying as trading a security it plans to hold for a longer period, as long as that designation occurs at acquisition.
3. Impairment is recognized in earnings when a decline in value has occurred that is deemed to be other than temporary, and the current fair value becomes the new cost basis for the security. An investment is considered to be impaired if the fair value of the investment is less than its cost basis. Cost includes adjustments made for

At the bottom of the page, there is a footer bar. On the left, it says "Chapter 3.A, Page 20 of 20". In the center, there is a progress bar that is filled to the right, with the text "100% Complete" next to it. On the right side of the footer bar, there is a button labeled "Exit & Resume Later".



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

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



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

### Additional Features Search

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

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

### Print

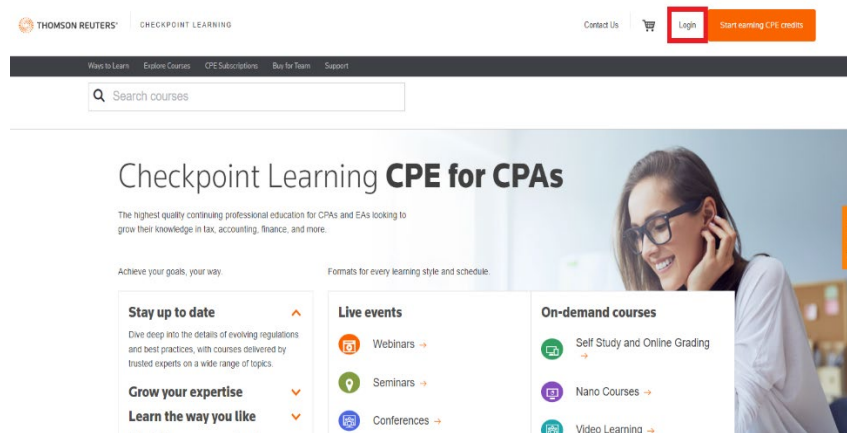
To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.



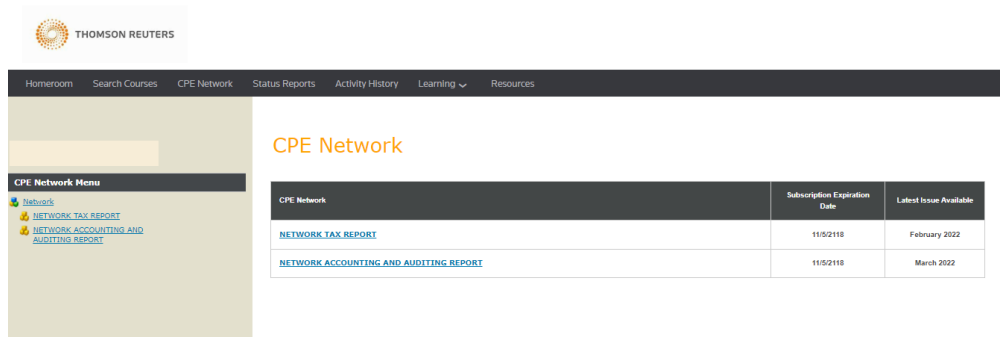
# Transitioning From DVDs

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

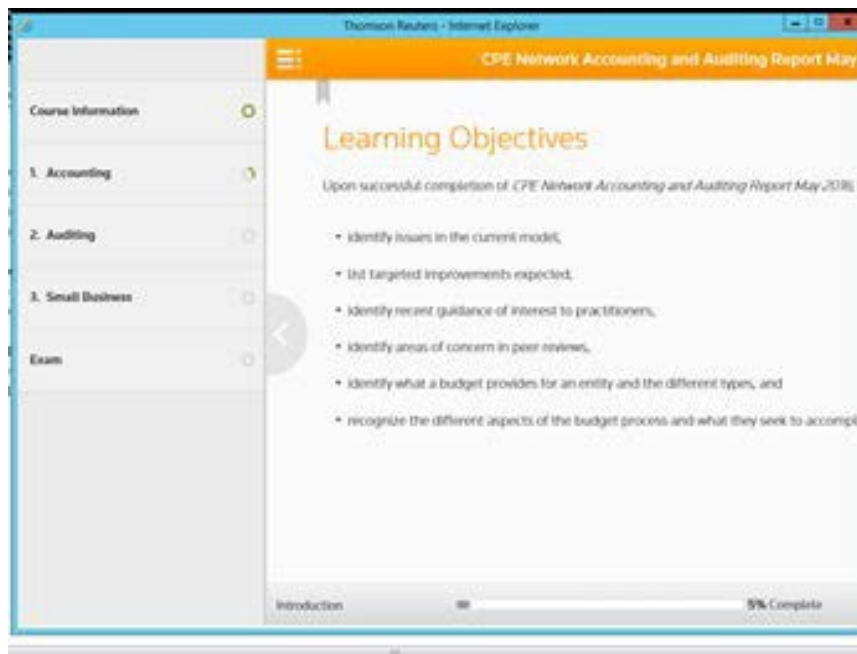
- Go to [www.checkpointlearning.thomsonreuters.com](http://www.checkpointlearning.thomsonreuters.com) .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



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

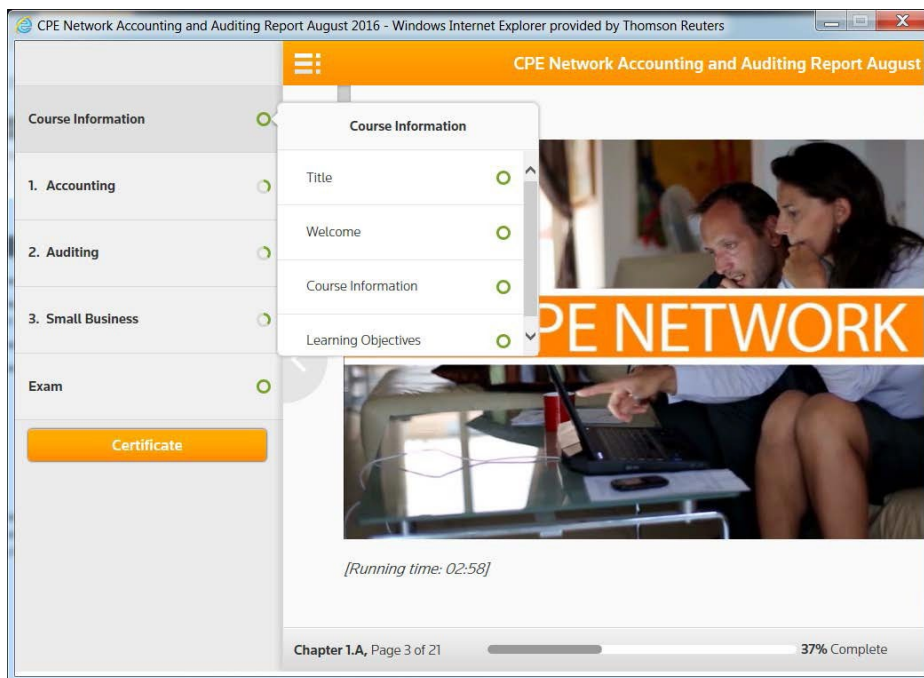


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Video segments may be downloaded from the CPL player by clicking on the download button noted above. You may need to use the scroll bar to the right of the video to see the download button. **Tip: You may need to use the scroll bar to the right of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

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

# What Does It Mean to Be a CPE Sponsor?

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

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

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

## CPE Sponsor Requirements

### Determining CPE Credit Increments

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

## **Program Presentation**

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

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

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

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

## **Monitor Attendance**

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

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

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

### **Elements of Engagement**

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

### **Awarding CPE Certificates**

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

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

### **Seminar Quality Evaluations for Firm Sponsor**

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

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

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

### **Retention of Records**

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

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

# Appendix: Forms

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

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



# Getting Help

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

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