

Miles CPA Review: BEC - 2017 Updates

Summary of updates:

- **“New version” CPA exam structure (w.e.f. April 2017)**
- **BEC-1.1: Corporate Governance** - Additional content added as an Appendix
- **BEC-1.2: Internal Controls** - Additional content added as an Appendix
- **BEC-4.3: Project Management** - No longer tested on the CPA exams [to be deleted]

“New version” CPA exam structure (w.e.f. April 2017):

MCQ testlets

50% weightage

Recommended time:

- Testlet #1: 50 mins
- Testlet #2: 50 mins

TBS/WCT testlets

50% weightage

Recommended time:

- Testlet #3: 30 mins
- Testlet #4: 50 mins
- Testlet #5: 60 mins

| | MCQ testlets | | TBS/WCT testlets | | | |
|------------|-----------------------|-----------------------|----------------------|------------------|----------------------|----------------------|
| FAR | Testlet #1 33 MCQs | Testlet #2 33 MCQs | Testlet #3 2 TBSs | Break: 15 min | Testlet #4 3 TBSs | Testlet #5 3 TBSs |
| AUD | Testlet #1 36 MCQs | Testlet #2 36 MCQs | Testlet #3 2 TBSs | Break: 15 min | Testlet #4 3 TBSs | Testlet #5 3 TBSs |
| REG | Testlet #1 38 MCQs | Testlet #2 38 MCQs | Testlet #3 2 TBSs | Break: 15 min | Testlet #4 3 TBSs | Testlet #5 3 TBSs |
| BEC | Testlet #1 31 MCQs | Testlet #2 31 MCQs | Testlet #3 2 TBSs | Break: 15 min | Testlet #4 2 TBSs | Testlet #5 3 WCTs |

Old version vs. New version:

| | CPA exams (2011 – March 2017) | CPA exams w.e.f. April 2017 |
|---|--|--|
| Skill-level tested | <ul style="list-style-type: none"> • Remembering & Understanding • Application | <ul style="list-style-type: none"> • Remembering & Understanding • Application • Analysis • Evaluation (for AUD only) |
| Exam structure & scoring weights | FAR: 90 MCQs (60%), 7 TBSs (40%) AUD: 90 MCQs (60%), 7 TBSs (40%) REG: 72 MCQs (60%), 6 TBSs (40%) BEC: 72 MCQs (85%), 3 WCTs (15%) | FAR: 66 MCQs (50%), 8 TBSs (50%) AUD: 72 MCQs (50%), 8 TBSs (50%) REG: 76 MCQs (50%), 8 TBSs (50%) BEC: 62 MCQs (50%), 4 TBSs (35%), 3 WCTs (15%) |
| # of Testlets | 4 testlets: 3 MCQ testlets + 1 TBS/WCT testlet | 5 testlets: 2 MCQ testlets + 3 TBS/WCT testlets |
| Time Allotment | FAR: 4 hours AUD: 4 hours REG: 3 hours BEC: 3 hours | FAR: 4 hours AUD: 4 hours REG: 4 hours BEC: 4 hours |
| Break | Optional breaks (count against time) | 15-min Standard break (after Testlet #3) + Optional breaks (count against time) |

* MCQ - Multiple Choice Question | TBS - Task Based Simulation | WCT - Written Communication Task

BEC-1.1: Corporate Governance [Additional content as Appendix]

IV) Regulatory Pronouncements

IV A) Sarbanes Oxley Act, 2002

- SOX contains 11 titles that describe specific mandates and requirements; for the corporate governance provisions which are tested on the BEC exams, need to be familiar with Titles III, IV, VIII, IX and XI

| SOX - Title III | SOX - Title IV | SOX - Title VIII | SOX - Title IX | SOX - Title XI |
|---|---|--|--|--|
| Corporate Responsibility | Enhanced Financial disclosures | Corporate & Criminal Fraud Accountability Act | White-collar Crime Penalty Enhancement Act | Corporate Fraud & Accountability Act |
| <ul style="list-style-type: none"> • Independent audit Committee is mandatory • Management responsible for ICFR • Improper influence by Management • Insider trading | <ul style="list-style-type: none"> • No personal loan • Auditor assessment & reporting on I/C • Code of ethics • Financial expert • Real time disclosures | <ul style="list-style-type: none"> • Criminal penalties for altering documents • Debts incurred in violation of securities fraud laws = non-dischargeable • Whistle-blower protection • Criminal penalties for defrauding shareholders of public companies | <ul style="list-style-type: none"> • Corporate responsibility for financial reports • Attempts and conspiracies to commit criminal fraud offenses | <ul style="list-style-type: none"> • Criminal penalties for impeding any official proceeding • Increased SEC authority • Increased criminal penalties under 1934 Act • Retaliation against whistleblowers = federal crime |

➤ **SOX Title III - Corporate Responsibility**

- **Independent Audit committee** is responsible for appointment, compensation and oversight of any audit work performed by the audit firm
- Makes **officers responsible for maintaining effective ICFR** and requires principal executive and financial officers to disclose all significant I/C deficiencies to the company's auditors and audit committee. Requires quarterly certification of responsibility for and knowledge of any changes in ICFR
- **Improper Influence on Conduct of Audits** - Prohibits any officer or director of the issuer to fraudulently influence, coerce, manipulate, or mislead the auditor for the purpose of rendering such F/S materially misleading
- Requires executives of an issuer to forfeit any bonus or incentive-based pay or profits from the sale of stock, received in the 12 months prior to an earnings restatement
- SEC may bar any person who has violated federal securities laws from serving as an officer or director of an issuer
- Prohibits **insider trading** by officers and directors during blackout periods established between the ends of a quarter and the earnings report date

➤ **SOX Title IV - Enhanced financial disclosures**

- Prohibits personal loans to directors and executive officers
- Directors, officers, and 10%+ stockholders required to disclose stock transactions within 2 days
- **Auditors required to attest to management's assessment of effectiveness of I/C over financial reporting**
 - ✓ Management acknowledges responsibility for establishing and maintaining adequate I/C over financial reporting
 - ✓ Auditor examines design and operating effectiveness of I/C so as to provide an opinion on management's assertion of I/C
- Report whether **code of ethics** adopted for senior financial officers
- Must disclose whether at least 1 member of its audit committee is a '**financial expert**'
- **Real time issuer disclosures** - Must disclose material changes in the financial condition or operations on a rapid and current basis

➤ **SOX Title VIII: Corporate and Criminal Fraud Accountability Act**

- **Felony to knowingly alter, destroy or falsify documents/records with the intent to impede, obstruct or influence any existing/contemplated federal investigation**
 - ✓ Auditors are required to maintain work papers for 7 years
- Debts incurred in violation of securities fraud laws to be non-dischargeable in bankruptcy
- Statute of limitations on securities fraud claims is extended to 5 years from the fraud, or 2 years after the fraud was discovered
- Employees of issuers and CPA firms are extended **whistleblower protection** that would prohibit the employer from taking certain actions against employees who lawfully disclose private employer information to, among others, parties in a judicial proceeding involving a fraud claim.
 - ✓ Whistleblowers are also granted a remedy of special damages and attorney's fees
- **Criminal penalties for defrauding shareholders of public companies**

➤ **SOX Title IX: White Collar Crime Penalty Enhancement Act**

- **Corporate responsibility for financial reports** - Requires CEO & CFO to certify that financial statements filed with the SEC (10Q, 10K) comply with relevant securities laws and also fairly present, in all material respects, the financial condition & results of operations of the company
 - ✓ Criminal penalties apply for any wilful and knowing violations (upto \$5 MM in fines and/or 20 years imprisonment)
- Increases the criminal penalties associated with white-collar crimes and conspiracies to commit securities fraud, for committing mail & wire fraud, and for criminal violations of ERISA (Employee Retirement Income Security Act)

➤ **SOX Title XI: Corporate Fraud and Accountability Act**

- Identifies corporate fraud and records tampering as criminal offenses, and joins these offenses to specific penalties
- SEC may temporarily freeze large or unusual payments during the course of an investigation involving possible violations of the federal securities laws
- SEC may prohibit a person from serving as an officer or director of a public company if the person has committed a securities fraud
- Increased criminal penalties under Securities Exchange Act of 1934
- Complements Title VIII with respect to **whistleblower protection**; makes it a **criminal offense to retaliate against a whistleblower** providing truthful information relating to a federal crime to law enforcement officers.

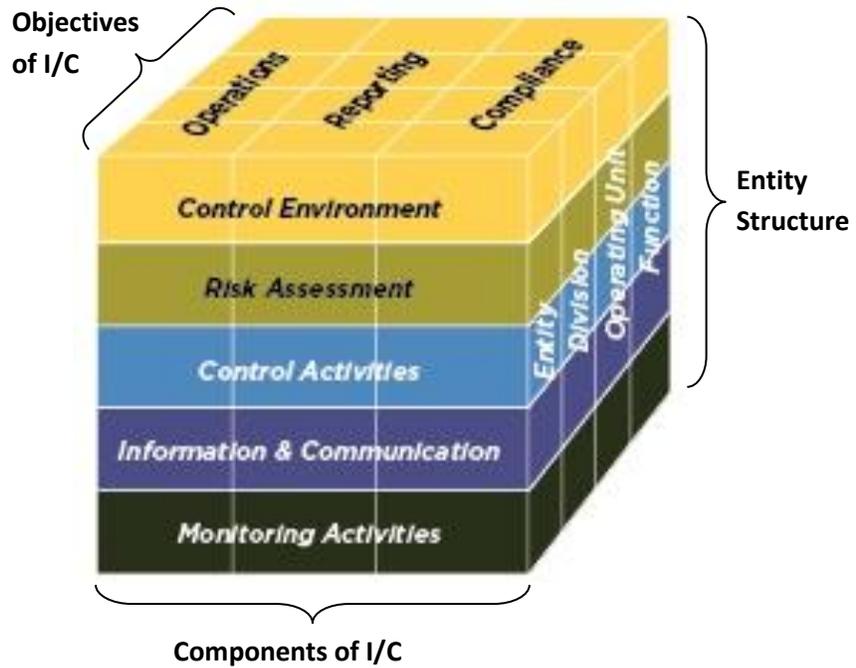
IV B) Dodd Frank Wall Street Reform and Consumer Protection Act, 2010

- The Dodd-Frank Act, 2010, contains numerous provisions for corporate governance, including executive compensation disclosure and related rules. Few provisions of Title IX of Dodd Frank Act (also known as **Investor Protections and Securities Reform Act**) below:
 - **Increasing Investor Protection**
 - ✓ Creates an Investor Advisory Committee (IAC), an Office of the Investor Advocate (OIA) and an ombudsman appointed by the Investor Advocate
 - ✓ Requires SEC to conduct studies on the financial literacy levels of retail investors, and the current rules and regulations concerning brokers, dealers and investment advisors
 - ✓ Requires Government Accountability Office (GAO) to conduct studies on conflicts of interest within investment firms and on the info presented to investors in mutual fund ads
 - **Accountability, Executive Compensation and Corporate Governance**
 - ✓ **Additional Disclosure Requirements** by publicly traded companies in any consent solicitation materials presented to shareholders at annual meetings or proxies
 - ⇒ Disclose the relationship between the total compensation paid and the company's financial performance
 - ⇒ Disclose
 - CEO's compensation,
 - Median compensation of the company's other employees, and
 - Ratio of the median compensation of the company's other employees to the CEO's compensation
 - ⇒ Disclose when any employees or board members are allowed to purchase financial instruments designed to hedge against any decrease in the company's stock value
 - ✓ **Clawbacks** - Requires public companies to adopt "clawback" policies that recover executive compensation made on the basis of erroneous/non-compliant financial statements
 - ⇒ In case of an issuer's accounting restatement due to the material non-compliance with any financial reporting requirement, the issuer will recover the excess incentive-based compensation (including stock options) paid during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement
 - ✓ **Prohibited Compensation Practices** - Prohibits regulators and financial institutions from allowing any incentive-based compensation arrangements that might cause the financial institution to suffer a material financial loss
 - ✓ **Increased Independence** - Forces securities exchanges to require that the compensation committees of publicly traded companies be independent of the company
 - ✓ **Shareholder Approval of Executive Compensation** - Shareholders must be given the power to vote on the amount and form of executive compensation & golden parachutes
 - ⇒ Shareholders may also vote to ban any Golden Parachute compensation

- **Improvements to the regulation of credit rating agencies**
 - ✓ Impose more stringent internal control requirements on credit rating agencies and create new rules dictating credit rating procedures and processes
 - ✓ Requires credit rating agencies to file additional disclosures that analyze the accuracy of prior credit ratings
- **Increasing regulatory enforcement & remedies** - SEC to compensate certain **whistleblowers** with % of collected monetary sanctions
 - ✓ “Whistleblower bounty program” allows persons who provide info which leads to a successful SEC enforcement to receive 10 to 30% of the monetary sanctions over \$1 MM

BEC-1.2: Internal Controls [Additional content as Appendix]

- **COSO I/C Cube** - depicts a direct relationship that exists between:
 - **Objectives** of the entity {FAR-REG-BEC}
 - **Components of I/C** {CRIME}
 - **Entity organizational structure** (operating units, legal entities, etc.)



- Original framework was issued in 1992. In 2013, COSO added the **17 I/C Principles** because they are presumed essential in assessing that the **5 components** {CRIME} are present and functioning

| Components of I/C (5) | Control Environment | Risk Assessment | Information & Comm. Systems | Monitoring | Existing Control Activities |
|------------------------|--|--|---|--|---|
| Principles of I/C (17) | <ul style="list-style-type: none"> - Demonstrate commitment to integrity & ethical values - Board of Directors exercise oversight responsibility - Establish structure, authority & responsibility - Demonstrate commitment to competence - Enforce accountability | <ul style="list-style-type: none"> - Specify suitable objectives - Identify & analyze risk - Assess fraud risk - Identify & analyze significant change | <ul style="list-style-type: none"> - Use relevant information - Communicate internally - Communicate externally | <ul style="list-style-type: none"> - Conduct ongoing and/or separate evaluations - Evaluate & communicate deficiencies | <ul style="list-style-type: none"> - Select & develop control activities - Select & develop general controls over technology - Deploy through policies & procedures |

➤ Effective I/C

- An effective system of I/C
 - ✓ Provides **reasonable assurance** regarding achievement of an entity's objectives
 - ✓ Reduces, to an acceptable level, the risk of not achieving an entity objective and may relate to 1, 2, or all 3 categories of objectives {FAR-REG-BEC objectives}
 - ✓ Requires that:
 - ⇒ Each of the **5 components** and relevant principles is present and functioning
 - **"Present"** - components and relevant principles **exist in design & implementation of I/C**
 - **"Functioning"** - components and relevant principles **continue to exist in the operations and conduct of I/C**
 - ⇒ The 5 components operate together in an integrated manner
 - **"Operating together"** - all five components collectively reduce, to an acceptable level, the risk of not achieving an objective
 - Components should not be considered discretely; instead, they operate together as an integrated system. Components are interdependent with a multitude of interrelationships and linkages among them, particularly the manner in which principles interact within and across components
- When a major deficiency exists with respect to the presence and functioning of a component or relevant principle, or with respect to the components operating together in an integrated manner, the organization cannot conclude that it has met the requirements for an effective system of I/C
- When a system of I/C is determined to be effective, senior management and the board of directors have reasonable assurance, relative to the application within the entity structure, that the organization:
 - ✓ Prepares reports in conformity with applicable rules, regulations, and standards or with the entity's specified reporting objectives {FAR objective}
 - ✓ Complies with applicable laws, rules, regulations, and external standards {REG objective}
 - ✓ Achieves effective and efficient operations when external events are considered unlikely to have a significant impact on the achievement of objectives or where the organization can reasonably predict the nature and timing of external events and mitigate the impact to an acceptable level {BEC objective}
 - ⇒ Also, understands the extent to which operations are managed effectively and efficiently when external events may have a significant impact on the achievement of objectives or where the organization can reasonably predict the nature and timing of external events and mitigate the impact to an acceptable level
- I/C - Integrated Framework requires judgment in designing, implementing, and conducting I/C and assessing its effectiveness
 - ✓ The use of judgment, within the boundaries established by laws, rules, regulations, and standards, enhances management's ability to make better decisions about I/C, but cannot guarantee perfect outcomes [therefore, reasonable but not absolute assurance; refer Limitations of I/C]

- The 2013 framework also introduces 81 points of focus which typically are important characteristics of the 17 principles. Below is a recap of the 5 components with their 17 principles alongside the 81 points of focus:

[Note: From a CPA exam perspective, it may be useful to spend some time and read through these components, principles and points of focus]

| Control Environment | |
|--|--|
| Principles | Points of Focus |
| The organization demonstrates a commitment to integrity and ethical values | <ul style="list-style-type: none"> • Sets the tone at the top • Establishes standards of conduct • Evaluates adherence to standards of conduct • Addresses deviations in a timely manner |
| The board of directors demonstrates independence from management and exercises oversight of the development and performance of I/C | <ul style="list-style-type: none"> • Establishes oversight responsibilities • Applies relevant expertise • Operates independently • Provides oversight for the system of I/C` |
| Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives | <ul style="list-style-type: none"> • Considers all structures of the entity • Establishes reporting lines • Defines, assigns, and limits authorities and responsibilities |
| The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives | <ul style="list-style-type: none"> • Establishes policies and practices • Evaluates competence and addresses shortcomings • Attracts, develops and retain individuals • Plans and prepares for succession |
| The organization holds individuals accountable for their I/C responsibilities in the pursuit of objectives | <ul style="list-style-type: none"> • Enforces accountability through structures, authorities and responsibilities • Establishes performance measures, incentives and rewards • Evaluate performance measures, incentives and rewards for ongoing relevance • Considers excessive pressures • Evaluates performance and rewards or disciplines individuals |

| Risk Assessment | |
|--|--|
| Principles | Points of Focus |
| The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives | <ul style="list-style-type: none"> • Operations Objectives <ul style="list-style-type: none"> ✓ Reflects management’s choices ✓ Considers tolerances for a risk ✓ Includes operations and financial performance goals ✓ Forms a basis for committing of resources • External Financial Reporting Objectives <ul style="list-style-type: none"> ✓ Complies with applicable accounting standards ✓ Considers materiality ✓ Reflects entity activities • External Non-Financial Reporting Objectives <ul style="list-style-type: none"> ✓ Complies with externally established standards and frameworks ✓ Considers the required level of precision ✓ Reflects entity activities • Internal Reporting Objectives <ul style="list-style-type: none"> ✓ Reflects management’s choices ✓ Considers the required level of precision ✓ Reflects entity activities • Compliance Objectives <ul style="list-style-type: none"> ✓ Reflects external laws and regulations ✓ Considers tolerances for risk |
| The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed | <ul style="list-style-type: none"> • Includes entity, subsidiary, division, operating unit, and functional levels • Analyzes internal and external factors • Involves appropriate levels of management • Estimates significance of risks identified • Determines how to respond to risks |
| The organization considers the potential for fraud in assessing risks to the achievement of objectives | <ul style="list-style-type: none"> • Considers various types of fraud • Assesses incentives and pressures • Assesses opportunities • Assesses attitudes and rationalizations |
| The organization identifies and assesses changes that could significantly impact the system of I/C | <ul style="list-style-type: none"> • Assesses changes in the external environment • Assesses changes in the business model • Assesses changes in leadership |

| Information and Communication | |
|--|--|
| Principles | Points of Focus |
| The organization obtains or generates and uses relevant, quality information to support the functioning of other components of I/C | <ul style="list-style-type: none"> • Identifies information requirements • Captures internal and external sources of data • Processes relevant data into information • Maintains quality throughout processing • Considers costs and benefits |
| The organization internally communicates information, including objectives and responsibilities for I/C, necessary to support the functioning of other components of I/C | <ul style="list-style-type: none"> • Communicates I/C information • Communicates with the board of directors • Provides separate communication lines • Selects relevant method of communication |
| The organization communicates with external parties regarding matters affecting the functioning of other components of I/C | <ul style="list-style-type: none"> • Communicates to external parties • Enables inbound communications • Communicates with the board of directors • Provides separate communication lines • Selects relevant method of communication |

| Monitoring Activities | |
|---|---|
| Principles | Points of Focus |
| The organization selects, develops, and performs ongoing and /or separate evaluations to ascertain whether the components of I/C are present and functioning | <ul style="list-style-type: none"> • Considers a mix of ongoing and separate evaluations • Considers rate of change • Establishes baseline understanding • Uses knowledgeable personnel • Integrates with business processes • Adjusts scope and frequency • Objectively evaluates |
| The organization evaluates and communicates I/C deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate | <ul style="list-style-type: none"> • Assesses results • Communicates deficiencies to parties responsible for corrective action and to senior management and the board of directors • Monitors corrective |

| Existing Control Activities | |
|---|---|
| Principles | Points of Focus |
| The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels | <ul style="list-style-type: none"> • Integrates with risk assessment • Considers entity-specific factors • Determines relevant business processes • Evaluates a mix of control activity types • Considers at what level activities are applied • Addresses segregation of duties |
| The organization selects and develops general control activities over technology to support the achievement of objectives | <ul style="list-style-type: none"> • Determines dependency between the use of technology in business processes and technology general controls • Establishes relevant technology infrastructure control activities • Establishes relevant security management process control activities • Establishes relevant technology acquisition, development, and maintenance process control activities |
| The organization deploys control activities through policies that establish what is expected and procedures that put policies into action | <ul style="list-style-type: none"> • Establishes policies and procedures to support deployment of management's directives • Establishes responsibility and accountability for executing policies and procedures • Performs in a timely manner • Takes corrective action • Performs using competent personnel • Reassesses policies and procedures |