

For Exams Scheduled After December 31, 2018



CPA EXAM REVIEW BUSINESS

ACADEMIC HELP

Click on Customer and Academic Support under CPA Resources at <http://www.becker.com/cpa-review.html>

CUSTOMER SERVICE AND TECHNICAL SUPPORT

Call 1-877-CPA-EXAM (outside the U.S. +1-630-472-2213)
or click Customer and Academic Support under CPA Resources at <http://www.becker.com/cpa-review.html>

This textbook contains information that was current at the time of printing. Your course software will be updated on a regular basis as the content that is tested on the CPA Exam evolves and as we improve our materials. Note the version reference below and click on Replacement Textbooks under CPA Resources at <http://www.becker.com/cpa-review.html> to learn if a newer version of this book is available to be ordered.

V 3.2



BUSINESS

Table of Contents

Program Attendance Record.....xi

Introduction..... Intro-1

BUSINESS 1: Corporate Governance and Financial Risk Management

1. Internal Control FrameworksB1-3

2. Enterprise Risk Management Frameworks B1-15

3. Sarbanes-Oxley Act of 2002 B1-29

4. Financial Risk Management: Part 1 B1-37

5. Financial Risk Management: Part 2 B1-49

BUSINESS 2: Financial Management

1. Capital Structure: Part 1.....B2-3

2. Capital Structure: Part 2..... B2-15

3. Working Capital Metrics..... B2-23

4. Working Capital Management: Part 1 B2-29

5. Working Capital Management: Part 2 B2-41

6. Financial Valuation Methods: Part 1..... B2-49

7. Financial Valuation Methods: Part 2..... B2-61

8. Financial Decision Models: Part 1 B2-67

9. Financial Decision Models: Part 2..... B2-81

BUSINESS 3: Operations Management: Cost Accounting and Performance Management

1. Cost Accounting: Part 1.....B3-3

2. Cost Accounting: Part 2..... B3-11

3. Cost Accounting: Part 3..... B3-25

4. Performance Management: Part 1 B3-37

5. Performance Management: Part 2..... B3-49

BUSINESS 4: Operations Management: Planning Techniques

1. Projection and Forecasting Techniques: Part 1B4-3

2. Projection and Forecasting Techniques: Part 2 B4-11

3. Ratio Analysis of Forecasts and Projections..... B4-25

4. Marginal Analysis..... B4-39

5. Budgeting: Part 1 B4-49

6. Budgeting: Part 2 B4-63

7. Variance Analysis B4-71

BUSINESS 5: *Economic Concepts and Analysis*

1. Economic and Business CyclesB5-3
2. Economic Measures and Indicators B5-15
3. The Economic Marketplace B5-31
4. The Impact of Market Influences: Part 1 B5-45
5. The Impact of Market Influences: Part 2..... B5-55
6. The Impact of Globalization B5-65
7. The Economic Effect of Significant Transactions B5-71

BUSINESS 6: *Process Management and Information Technology*

1. Process ManagementB6-3
2. IT Governance B6-15
3. The Role of IT in Business B6-23
4. Information Security and Availability B6-31
5. Processing Integrity B6-41
6. Systems Development and Maintenance..... B6-49

Class Question Explanations CQ-1
BlueprintBL-1
Glossary GL-1
Index.....Index-1

BEC

1

Corporate Governance and Financial Risk Management

Module

| | | |
|---|--|----|
| 1 | Internal Control Frameworks..... | 3 |
| 2 | Enterprise Risk Management Frameworks..... | 15 |
| 3 | Sarbanes-Oxley Act of 2002..... | 29 |
| 4 | Financial Risk Management: Part 1..... | 37 |
| 5 | Financial Risk Management: Part 2..... | 49 |

1 Introduction to COSO

The Committee of Sponsoring Organizations (COSO), an independent private sector initiative, was initially established in the mid-1980s to study the factors that lead to fraudulent financial reporting. The private "sponsoring organizations" include the five major financial professional associations in the United States: the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), the Financial Executives Institute (FEI), the Institute of Internal Auditors (IIA), and the Institute of Management Accountants (IMA).

In 1992, COSO issued *Internal Control—Integrated Framework* ("the framework") to assist organizations in developing comprehensive assessments of internal control effectiveness.

In 2013, the framework received an update to deal with changes in technology, business models, globalization, outsourcing, and regulatory environment. One significant enhancement to the 2013 update was the formalization of fundamental concepts that were part of the original 1992 framework. Specifically, these fundamental concepts have evolved into 17 principles that have been categorized within the five major internal control components. COSO's framework is widely regarded as an appropriate and comprehensive basis to document the assessment of internal controls over financial reporting.

2 COSO Internal Control Framework

The framework is used by company *management* and its board of directors to obtain an initial understanding of what constitutes an effective system of internal control and to provide insight as to when internal controls are being properly applied within the organization. The framework also provides confidence to external stakeholders that an organization has a system of internal control in place that is conducive to achieving its objectives.



Pass Key

An effective system of internal control requires more than adherence to policies and procedures by management, the board of directors, and the internal auditors. It requires the use of judgment in determining the sufficiency of controls, in applying the proper controls, and in assessing the effectiveness of the system of internal controls. The principles-based approach of the framework supports the emphasis on the importance of management judgment.

Material from *Internal Control—Integrated Framework*, © 2013 Committee of Sponsoring Organizations of the Treadway Commission (COSO). Used with permission.

2.1 Definition of Internal Control

Internal control is a process that is designed and implemented by an organization's management, board of directors, and other employees to provide reasonable assurance that the organization will achieve its operating, reporting, and compliance objectives.

2.2 Application to Management and Board

The framework assists an entity's management and board of directors in the following areas:

- Effectively applying internal control within the overall organization, on a divisional (operating) unit level or at a functional level.
- Determining the requirements of an effective system of internal control by ascertaining whether the components and principles exist and are functioning properly.
- Allowing judgment and flexibility in the design and implementation of the system of internal control within all operational and functional areas of the organization.
- Identifying and analyzing risks and then developing acceptable actions to mitigate or minimize these risks to an acceptable level.
- Eliminating redundant, ineffective, or inefficient controls.
- Extending internal control application beyond an organization's financial reporting.

2.3 Application to Stakeholders

The framework also provides value to external stakeholders and other parties that interact with the organization by providing:

- Greater understanding of what constitutes an effective system of internal controls.
- Greater confidence that management will be able to eliminate ineffective, redundant, or inefficient controls.
- Greater confidence that the board has effective oversight of the organization's internal controls.
- Improved confidence that the organization will achieve its stated objectives and will be capable of identifying, analyzing, and responding to risks affecting the organization.

2.4 COSO Cube

The 2013 framework continues to use a cube to depict the relationship between an entity's objectives, integrated internal control components, and organizational structure. The three categories of *objectives* (operations, reporting, and compliance) are shown as columns on the cube, and the five *internal control components* (control environment, risk assessment, control activities, information and communication, and monitoring activities) are depicted as rows. Additionally, the entity's *organizational structure* (entity level, division, operating unit, and function) is shown on the cube as a third dimension.



Internal Control—Integrated Framework, © 2013 Committee of Sponsoring Organizations of the Treadway Commission (COSO). Used with permission.

2.5 Framework Objectives

There are three *categories of objectives* within the framework.

1. Operations Objectives

Operations objectives relate to the effectiveness and efficiency of an entity's operations. This category includes financial and operational performance goals as well as ensuring that the assets of the organization are adequately safeguarded against potential losses.

2. Reporting Objectives

Reporting objectives pertain to the reliability, timeliness, and transparency of an entity's external and internal financial and nonfinancial reporting as established by regulators, accounting standard setters, or the firm's internal policies.

3. Compliance Objectives

Compliance objectives are established to ensure the entity is adhering to all applicable laws and regulations.

2.6 Components of Internal Control (CRIME)

The updated framework retained the original five integrated *components* of internal control, including the control environment, risk assessment, information and communication, monitoring activities, and (existing) control activities. These components and the 17 related fundamental principles are needed to achieve the three *objectives* of internal control.

Each of the 17 principles is intended to be suitable to all entities and is presumed to be relevant. However, management may determine that a principle is not relevant to a component.

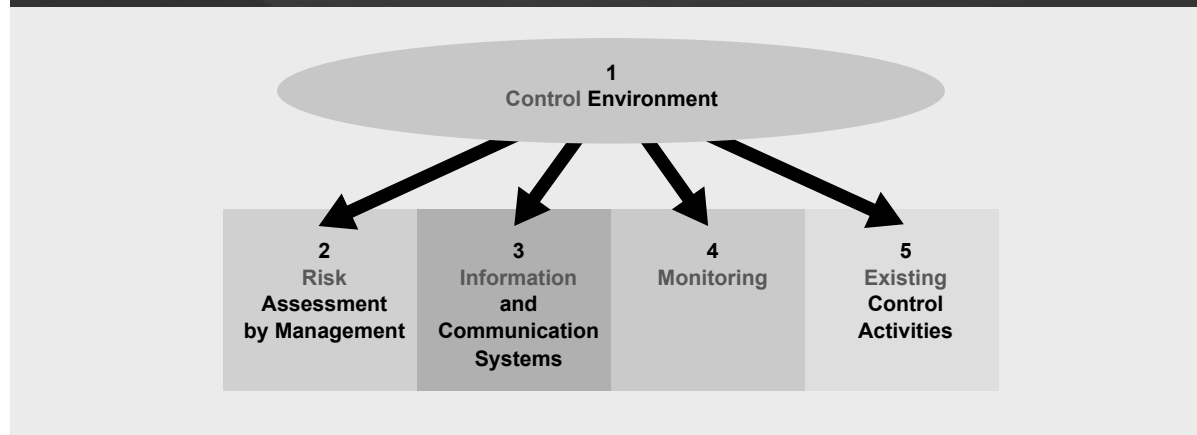
In addition, the framework introduces 81 points of focus. Some points of focus may not be suitable or relevant, and others may be identified. They are intended to facilitate designing, implementing, and conducting internal control by providing examples. They are not intended to be used as a checklist, and there is no requirement to separately assess whether points of focus are in place.



Pass Key

The COSO framework does not prescribe which controls an entity should implement for effective internal control. Instead, an organization's selection of controls requires management's judgment based on factors unique to the entity.

Illustration 1 Components of Internal Control (CRIME)



Pass Key

Remember that it would be a **CRIME** if you forgot the five components of internal control:

- Control** Environment
- Risk** Assessment
- Information** and Communication
- Monitoring**
- (Existing)** Control Activities

2.6.1 Control Environment

The control environment includes the processes, structures, and standards that provide the foundation for an entity to establish a system of internal control. The importance of internal control and expected standards of conduct is established through a "tone at the top" approach taken by the senior management and board of directors of an entity. The five principles related to the control environment are:

- 1. Commitment to Ethics and Integrity:** There is a commitment to ethical values and overall integrity throughout the organization. Points of focus include setting the tone at the top, establishing standards of conduct, evaluating adherence to standards of conduct, and addressing deviations in a timely manner.
- 2. Board Independence and Oversight:** The board is independent from management and oversees the development and performance of internal control. Points of focus include establishing oversight responsibilities and providing oversight for the system of internal control.
- 3. Organizational Structure:** Management establishes an organizational structure. Points of focus include establishing reporting lines, as well as defining, assigning, and limiting authorities and responsibilities that are appropriate to the organization's objectives.

4. **Commitment to Competence:** There is a commitment to hire, develop, and retain competent employees. Other points of focus include evaluating competence and addressing shortcomings in addition to succession planning.
5. **Accountability:** Individuals are held accountable for their internal control responsibilities. Points of focus include establishing performance measures, incentives, and rewards, and evaluating those for ongoing relevance while considering excessive pressures.

2.6.2 Risk Assessment

Risk assessment is an entity's identification and analysis of risks to the achievement of its objectives. The four principles related to risk assessment are:

1. **Specify Objectives:** The organization creates objectives that allow for identification and assessment of the risks related to those objectives. Points of focus include identifying objectives that reflect management's choices while complying with applicable accounting standards, laws, and regulations.
2. **Identify and Analyze Risks:** The organization identifies risks across the entity and analyzes risks in order to determine how the risks should be managed. Points of focus include analyzing internal and external factors, involving appropriate levels of management and determining how to respond to risks.
3. **Consider Potential for Fraud:** The organization considers the potential for fraud in assessing risks. Points of focus include assessing incentives and pressures, opportunities and attitudes, and rationalizations.
4. **Identify and Assess Changes:** The organization identifies and assesses changes that could significantly affect the system of internal control. Points of focus include assessing changes in the external environment, business model, and leadership.

2.6.3 Information and Communication

Information and communication systems support the identification, capture, and exchange of information in a timely and useful manner. The three principles related to information and communications are:

1. **Obtain and Use Information:** The organization obtains or generates and uses relevant, high-quality information to support the functioning of internal control. Points of focus include management identifying and defining information requirements within the internal control component level.
2. **Internally Communicate Information:** The organization internally communicates information necessary to support the functioning of internal controls, including relevant objectives and responsibilities. Points of focus include the flow of information up, down, and across the organization using a variety of methods and channels.
3. **Communicate With External Parties:** The organization communicates with external parties regarding matters that affect the functioning of internal control. Points of focus include management having open, two-way external communication channels using a variety of methods and channels.

2.6.4 Monitoring Activities

Monitoring is the process of assessing the quality of internal control performance over time by assessing the design and operation of controls on a timely basis and taking the necessary corrective actions. The two principles related to monitoring activities are:

1. **Ongoing and/or Separate Evaluations:** The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning. One point of focus is to consider establishing baseline understandings.