MAY
JUN
2019

TODAY'S CPA

Texas Society of Certified Public Accountants

2018-2019 YEAR IN REVIEW

FOCUSING ON THE FUTURE

ETHICS AND THE BRAIN

EDUCATIONAL ASSISTANCE AND RELATED TAX CREDITS

U.S. OFFICE MARKET OVERVIEW

NEW GUIDANCE FOR COLLABORATIVE ARRANGEMENTS

TXCPA
Texas Society of Certified Public Accountants

MAY
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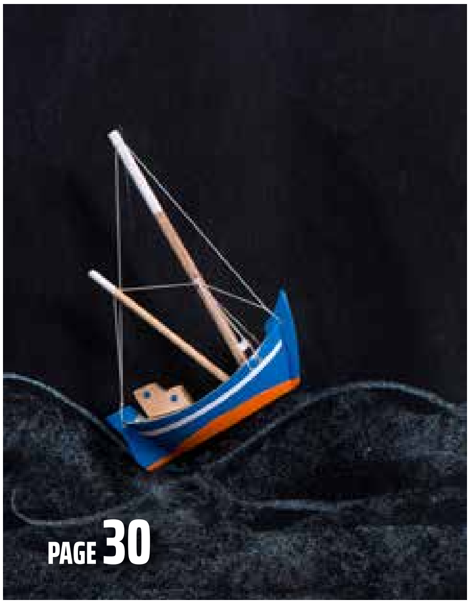

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WHAT DO YOU THINK!

I want to hear your feedback and questions during my chairmanship at TXCPA. Drop me a note at chairman@tscpa.net. I'd love to hear from you!

SHARING IN OUR SUCCESS

By TXCPA Chairman Stephen Parker, CPA-Houston

When we kicked off our year at the Annual Meeting of Members in San Antonio last June, I shared with you our five areas of focus for 2018-2019:

- Engage and Grow Our Community
- Fuel Our Chapters
- Reenergize Our Brand
- Advance the Future of Learning
- Successfully Navigate Sunset Review

I'm happy to report that, with your help and support, we made great strides in all of these areas. You'll read more about all that has been done for our members in this issue's cover story.

We increased the opportunities for engagement across the state with new programs and more use of technology to connect members.

We initiated insightful and productive conversations with our chapters' leadership about the ways we can work together to deliver value to members and improve the member experience.

We unveiled a new visual identity and have strengthened our branding and our member value proposition.

We launched a new online learning bundle that gives members the affordable, accessible and relevant CPE they desire.

And most importantly, we engaged in the Sunset Review process with the Texas State Board of Public Accountancy and provided leadership, support and input to represent your interests as Texas CPAs.

That was just the last 12 months, but we're not done. The momentum we have generated will continue to build into the next year, and the year after that one and so on. Together, we are making a difference in our profession, our association and our communities.

Thank you for the part you've played in delivering against our areas of focus. Every member matters and each of you have been critical to the progress we've made in 2018-2019. I look forward to where we're going next! ■

Stephen Parker, CPA, is a partner in PwC's Houston assurance practice. He can be contacted at stephen.g.parker@pwc.com.

ACCELERATED SHARE REPURCHASES PROVIDE FLEXIBILITY FOR BUYING BACK STOCK

By Don Carpenter, MSAcc/CPA

The corporate practice of repurchasing shares on the open market is nothing new. It has been used to return cash to shareholders for years. But with the recent windfalls from corporate tax reform, the magnitude of repurchases has skyrocketed, with 2018 repurchases exceeding $1 trillion, a considerable increase over the prior year.

Share repurchases allow companies to return extra cash to shareholders without setting expectations for future distributions that are implicit in increased dividend payouts. They also allow companies to selectively buy out large shareholders who may be at odds with management performance or strategy.

Share repurchases are beneficial for several reasons:

- Excess cash is a non-productive asset that reduces a company's return on assets and equity, both important measurements of management success; share repurchases reduce both assets and equity and improve these metrics;
- Share repurchases signal to the market that management and the board consider the stock to be undervalued and thus a good investment of the company's cash; but it may also indicate that relative to the company's valuation, there is a lack of attractive growth opportunities;
- Share repurchases shrink the outstanding capital stock of the company, improving earnings per share (EPS); companies in mature industries often see few alternatives for improving share price when earnings are relatively flat.

This final reason has drawn some criticism from Congress, which has requested that the Securities and Exchange Commission (SEC) consider new restrictions on repurchases, as executive bonuses and stock options are often contingent on EPS targets and market price. Congress is concerned that management may be using share repurchases to reach payout targets without a longer view of the impact of repurchases on the organization's financial well-being.

Regardless of the motivation for a repurchase, companies have traditionally been restricted regarding the timing of buying shares on the open market. Repurchases must operate within the trading windows and observe the same blackout periods that govern when corporate insiders may buy and sell shares.

These regulations generally allow for trading only for a short period after earnings are released to the investing public and before material additional information is available to insiders. Under these restrictions, a material share repurchase may take a considerable period of time to complete. Buying back large tranches of shares in a

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short trading window would artificially inflate demand and drive up the share price, reducing the number of shares the company could reacquire for a given investment.

Enter Accelerated Share Repurchases (ASRs). This "outsourced" repurchase program gives a company the opportunity to repurchase shares even during blackout periods and hype the EPS benefit of the repurchase when compared to traditional programs. To complete the repurchase, the company will rely on the services of one or more of its relationship banks. Although the structure of ASRs can vary, they typically include the following steps:

- Company A loans funds to the bank, which uses the funds to "borrow" shares of Company A from institutional investors (mutual funds, pension plans, etc.). The amount of this initial transaction is generally less than the total repurchase program announced by Company A.
- The bank returns the borrowed shares to Company A in consideration for the loan.
- The bank proceeds to opportunistically buy shares of Company A on the open market and uses the shares to "repay" the lenders of the borrowed shares in Step 1.
- At the conclusion of the program period (or earlier if the bank has completed all repurchases), Company A and the bank will settle any differences, with Company A either paying for additional shares or receiving a refund of proceeds for any repurchase shortfall.

The transaction is accounted for as a forward purchase contract. It offers several advantages over traditional repurchase structures. First, because the bank is not an "insider," it can continue to repurchase shares in a company during blackout periods, allowing for less volatility and the opportunity to exploit market dips. Just as importantly, the company can reduce its outstanding share count when shares are initially received from the bank. The tranche of shares that the bank borrows at the inception of the program would have had to be acquired over time by the company in a self-managed plan.

Since EPS is calculated on a weighted-average outstanding share count, the EPS benefit of the repurchase program is maximized by an ASR. It is this feature that makes an ASR particularly attractive, but is also the reason Congress is concerned. Because of the immediate EPS benefit, management can use ASRs to bump up share prices when stock options might otherwise expire or when bonus targets might not be met.

SINCE EPS IS CALCULATED ON A WEIGHTED-AVERAGE OUTSTANDING SHARE COUNT, THE EPS BENEFIT OF THE REPURCHASE PROGRAM IS MAXIMIZED BY AN ACCELERATED SHARE REPURCHASE.

The initial transaction is treated as a forward purchase, so the final settlement is usually structured to require an additional payment by the company and delivery of additional shares by the bank. Therefore, the initial loan may only include 75% - 80% of the total targeted repurchase. A refund of a portion of the initial funding, particularly if repeated on successive share repurchase programs, could call into question the integrity of the forward purchase.

It is unclear what action, if any, the SEC might take with regard to share repurchases, but until then, it appears that the appetite for these transactions is far from sated and we can expect to see companies continue to shrink their share base as the market demands ever-increasing EPS. ■

STUDENT AUXILIARY IS A STRONG CONNECTION TO FUTURE CPAs

By Rhonda Ledbetter, TXCPA Volunteer and Governance Specialist

The future is bright! Thanks to the powerful partnership between TXCPA and its chapters, there are strong connections between CPAs, accounting educators and the students who are the future of the profession. Those connections are nurtured through a variety of programs and projects, such as affiliated student groups. TXCPA Houston is celebrating the 30th anniversary of its Student Auxiliary, established in 1989.

TXCPA Houston Student Auxiliary provides activities and networking for college-level students in the Houston area who are interested in a career in accounting. Auxiliary meetings cover a variety of topics, including discussions on big data, soft skills, alternative career paths, cybersecurity, and careers in industry, audit and tax.
Student officers develop the topics and moderate the panel discussions. Following is a summary of the top events.

Career Speed Networking – Fast-paced discussions allow students to learn about a rich variety of career options. CPAs from industry and public practice move from table to table, spending approximately 10 minutes at each one. They talk briefly about their respective career paths and answer questions from students. Sometimes two professionals are paired – e.g., one from the energy industry and one from public with a practice focused on that business. Other pairings have covered health care, nonprofit, government and education.

Hot Topic – Professionals from a Houston office of a Big Four firm present a current topic, such as blockchain, big data, etc. The firm sponsors the food for the event and recruiters are on hand to meet with students one-on-one.

Panel Discussions – The groups are comprised of CPAs from different career stages and/or sizes of public

practice firms, and they talk about the wide range of areas in which they work. Popular topics include advisory, forensic/valuation, tax and audit.

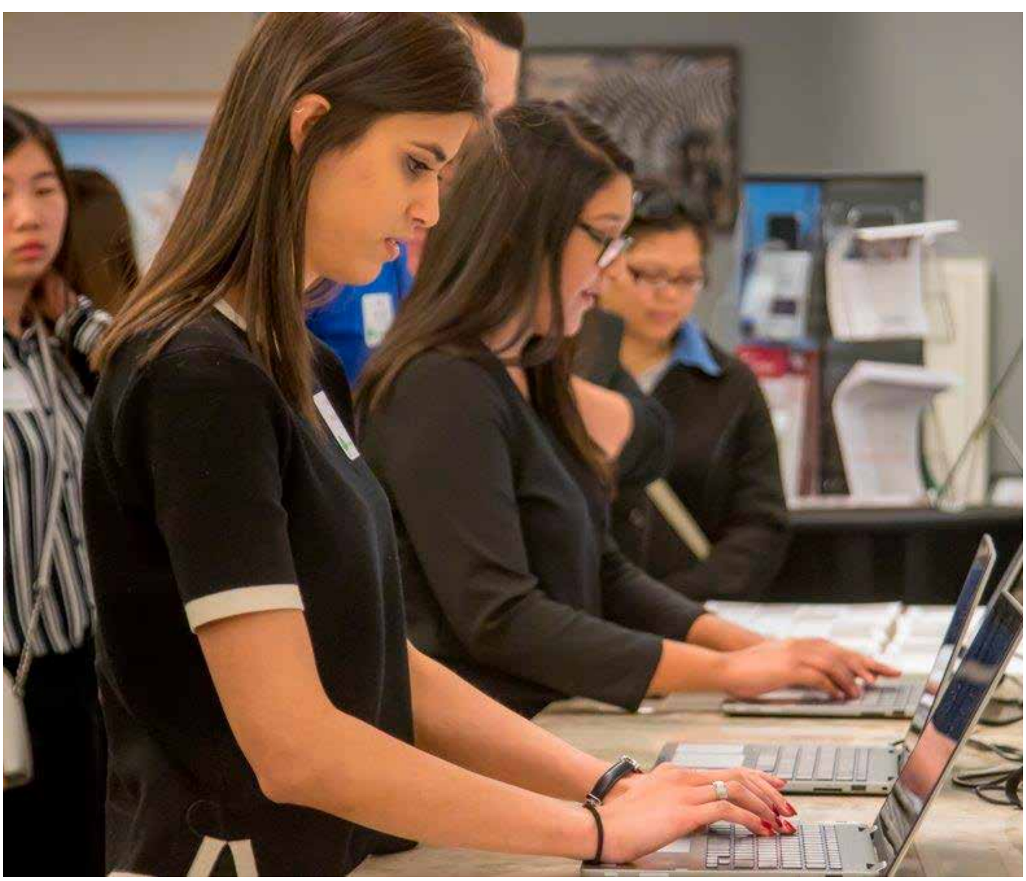
Excel Training – In this full-day interactive seminar, local CPAs teach Excel shortcuts and practices.

Letter of Intent Workshop – Students are led through the CPA Exam application process at a four-hour event held on a Saturday, enjoying pizza provided by Becker. The program is marketed to professors in a masters' or CAP program, as well as through the chapter's website and email communications.

IDEA Workshop – Audimation Services sends professionals to teach IDEA in a six-hour workshop for new users, where they are provided with electronic training materials.

Two exciting new projects are on track. The Auxiliary is the first accounting association to participate in the TrueUp National Bot Challenge. More than 40 students have signed up to create an accounting bot. The chapter helped recruit judges to review the entries and obtained corporate sponsorship to provide funding for cash prizes to local high scorers.

The other project is a recruiting fair that will be held in 2019-2020. Area firms will send recruiters to visit with students at booths, then utilize a speed networking format during dinner.



Students hungry for a place to form valuable friendships and let off steam from their intense studies enjoy Auxiliary social events. Fun food (underwritten by sponsors), games and team-building activities are on the menu to complete the well-rounded offerings.

Leadership skills are crucial to propelling a career. The Student Auxiliary provides great opportunities to develop these lifelong skills. Officers learn to perform tasks found in volunteer organizations, such as:

- Recruiting new members;
- Encouraging event attendees;
- Visiting accounting classes and campus clubs to share information about Student Auxiliary events and offerings;
- Serving as a facilitator for panel discussions;
- Contacting speakers and panelists;
- Developing questions for panelists to discuss; and
- Running the event, including greeting guests, ensuring that everyone checks in and gets a name tag, directing guests to the food and games, filling in when another officer can't attend and cleaning up.

The Student Auxiliary Steering Committee, which includes former student officers and accounting professionals, assists the current leaders in planning monthly career panels and social events. Officers and steering committee members have a one-day retreat in June to work together in planning the new year's calendar of events.

The chapter has experienced an explosive 120% increase in student membership during the last year, from 221 to 487. A significant factor has been the chapter's outreach. With nine major universities in the area, plus satellite locations for two local community college systems, it is challenging to get information to all students and professors. To share the message, representatives attend as many campus career fairs as possible – hosting a table that provides accounting career information, upcoming event schedules and opportunities, and membership applications.

The Auxiliary is fortunate to have a great group of student officers who not only plan and facilitate the meetings, but also speak during accounting classes at their campus. In addition, there are very active TXCPA Faculty Ambassadors in the area who spread the word.

TXCPA's offer of complimentary membership to students at a school with a designated Faculty Ambassador has also been instrumental. The chapter works closely with TXCPA to encourage sign-ups at these events and at its Student Auxiliary programs.

Yes, the future of the accounting profession is bright indeed. Join in the excitement by being engaged in student outreach through your TXCPA chapter. ■

YOU'RE INVITED TO ATTEND

TXCPA'S 2019 ANNUAL MEETING OF MEMBERS AND BOARD OF DIRECTORS MEETING

Join us on June 21-22 for TXCPA's 2019 Annual Meeting of Members and Board of Directors Meeting!

You'll experience the best of New Orleans when you stay at the Sheraton New Orleans Hotel in the vibrant French Quarter.

The Annual Meeting is your ideal opportunity to connect with your professional community and hear about the latest accounting and business issues, earn CPE credit, network with colleagues and new contacts, discuss important topics with TXCPA leaders and have an impact on the future of the accounting profession.

FRIDAY & SATURDAY
JUNE 21-22, 2019
SHERATON NEW ORLEANS

SPEAKERS

Swati Garodia
Head of Products,
Tax & Accounting Firms,
Thomson Reuters

Barry Melancon
President & CEO,
American Institute
of CPAs and CEO,
Association of
International Certified
Professional Accountants

Scott Steinberg
TechSavvy Global

Anu Varadharajan
Lecturer,
Tulane University

THINGS TO DO IN NEW ORLEANS

A few suggestions of things to do during your stay include: **The French Quarter, Jackson Square, Bourbon Street, Eat a Beignet, Eat More Food!, Take a Tour, Enjoy the Nightlife.** No matter how many times you have been to New Orleans, there is always something unique and entertaining to do!

DETAILS

Sheraton New Orleans
500 Canal St
New Orleans, LA 70130

Rate: $189+
Check-in: 4 p.m.
Check-out: 11 a.m.
Hotel cutoff: June 4, 2019

TXCPA staff contact:
Holly McCauley
hmccauley@tscpa.net
972-687-8502 or
800-428-0272, ext. 202

MAKE YOUR RESERVATIONS TODAY!

Find meeting details and registration information at www.tscpa.org

ON A NATIONAL STAGE

TEXAN BILL REEB SET TO LEAD 431,000 MEMBER AMERICAN INSTITUTE OF CPAS

By Jodi Ann Ray, CAE, TXCPA President and CEO

There is much discussion now centered on the many changes impacting the accounting profession, the need to adapt to remain relevant, what's next and how the pace of change will never be slower than it is today. Determining how to approach this change and our dynamic environment is an opportunity that we have as leaders to shape the future of the profession. So what type of leader do you choose to help lead us through such change?


Bill Reeb, CPA-Austin, CITP, CGMA

This month, Texas' own **Bill Reeb, CPA-Austin, CITP, CGMA**, will step into the role of the 106th chairman of the American Institute of CPAs. Reeb is 63, currently hails from Austin and wears many hats as a CPA, consultant, educator and trainer, and serial entrepreneur. Reeb is the first Texan to serve in this role since B.Z. Lee from Houston served as AICPA chairman in 1983. Unfortunately, we lost Lee this year; however, his legacy of service will continue to make an impact for many years to come.

It's hard to think about many people not knowing Bill Reeb, but for those members who do not, we thought we would introduce him as he takes on this significant responsibility of representing the profession. There are a few things about Reeb that clearly stand out – his tremendous work ethic, the intensity in which he approaches his work, his instinct to be a problem solver and a unique sense of humor that you just can't miss.

These qualities and more make Reeb the right candidate at the right time to serve as chairman. As he steps into the role, he will take on a few firsts. Not only is he the first consultant to serve as chairman, he also comes from the smallest firm ever in the history of the profession to take on this role. The commitment of time and energy that someone makes to serve as chairman should not be underestimated.

Developing His Work Ethic

Reeb grew up in a military family and is the second of four children. His father was in the Air Force and like most military families, they moved every two to three years when Reeb was a young child. When he was in sixth grade, the family ended up settling back in his mom's hometown of Lockhart, Texas.

Reeb completed his undergraduate work at Southwest Texas State University (now Texas State University). He received his undergraduate degree in marketing with a minor in computer science. While in school, he took one class in accounting and that was enough for him to know that accounting was not for him.

As his sister has acknowledged, Reeb always wanted to make sure he was paying his own way. In high school through college, he had a band and played all the major places that were part of the Austin music scene. Although this was a passion and a source of income, it just wasn't going to pay all the bills.

He also worked full time while in college at Superior Dairies, driving milk to schools in the mornings and driving beer to bars in Central Texas for his uncle's beer distributor. His schedule finally caught up with him during his senior year while studying for finals. He drove his milk truck off the road into a culvert. As he was being rescued from a very significant accident, the DPS officer told him that no one had ever survived going into that culvert. As Reeb tells the story, "I got fired and fixed up all at the same time." His customers at the school cafeterias were so upset that he had gotten fired that he found himself back at work finishing his route for another month or so before he started his first full-time job at IBM. The president of Superior Dairies ended up driving him to his first day of work at IBM.

His Entrepreneurial Spirit

Reeb went to work at IBM and met his wife Michaelle on his first day. They were paired up as a sales team and in the three years that he stayed with IBM, they were one of the top sales teams in their region.

He left IBM to start a technology consulting business. They worked on major software projects for some of the largest companies in the country. It was there that Reeb realized that while his technical skills were valuable, his most important role was not about getting people to accept the technology, but navigating the political dance of getting different members of the team aligned as to where they were going.

Choosing the CPA Profession

It was while Reeb was completing these very complex and highly technical projects that were helping companies become more efficient that he knew he needed to become a CPA. He led a large software development project for Abbott Laboratories that allowed them to monitor, at all times, what products were on the various assembly lines, who was actually working on each line, their labor charges, as well as materials utilized. As the project progressed, the client's CPAs would come in to sign off on what was being done even though, at that time, they didn't know much about technology and software development. Reeb said: "It was clear to me. In order for me to continue doing what I wanted to do, I needed to have those three letters, CPA, behind my name to put my clients at ease."

While he continued the technology consulting practice, Reeb started to go to night school and got enough hours to sit for the CPA Exam. From there, he made a series of moves that helped build his experience and resume before he began focusing on consulting for small and family owned businesses. He received a number of inquiries from CPA firms, but at the time, he didn't necessarily want to become a CPA firm consultant. It was Michaelle and his martial arts background that helped him realize that you need to monitor and respond to change and take advantage of the opportunities that are presented to you. Now, 70% of his work is with CPA firms and CPA associations.

Serving in This Important Role

Although Reeb has served as a champion for the profession for many years, we wanted to know about his decision to take on the AICPA chairmanship role. He explained the process of the AICPA nominating committee, which is much like TXCPA's process – nominees must be cognizant of the current needs of the profession and ensure they're engaging and representing the perspectives of different stakeholders in the process.

He credits a series of fortunate events, including a call from TXCPA Past Chairman Allyson Baumeister, CPA-Fort Worth, CGMA, as to whether he would consider being nominated for chairman. As someone who teaches leadership, Reeb felt that the Board needed to see him as a leader or he didn't deserve to be considered. Without that call from Baumeister and the profession currently changing to embrace consulting, he likely would not be preparing to serve in this capacity. He sees what's happening in the profession now aligning with his passion, making this the right time for him to serve.

What's Next for the Profession

Reeb's perspective on the future is very clear. He said, "If we don't move to the advice side of what we do, we won't have a job that is as prestigious, trusted, respected and lucrative as the job we have now." He explained that our profession needs to stop paying lip service to being an advisor. He believes CPAs in public practice should be working closely with every compliance client, and CPAs in industry should be working closely with the rest of the management team to better understand where they want to go, what their goals are and what they want to achieve.

CPAs should also be working to help build the bridge from where clients and employers are, to where they want to go. There's a big difference between compliance and counsel. Only telling clients and employers where they are is not enough to help them survive and thrive. We have to be there in the trenches with them, helping them carve a path for their future. Compliance services are important. However, because our professionals commonly get consumed by them, whether they are in public practice or industry, getting the compliance done has become the "end game" for many. Compliance services are NOT the end game. They are an important first step. He's passionate as he talks about this subject and adds, "If we are not involved in our client's or our employer's strategy, we are in the wrong place."

CPAS NEED TO BE EVOLVING THEIR COMPETENCIES AND CAPABILITIES, SO THEY'RE READY TO TAKE ON ADDITIONAL HIGHER-VALUED ADVISORY AND MANAGEMENT WORK.

Members in public practice and in industry can do a quick test to see where they are operating. Think about your top 10 clients or your employer and what they plan to accomplish over the next 18 months. "If you cannot articulate their priorities, you are not acting as an advisor. And if the only items you can articulate are the financial priorities, then once again, you are not acting as an advisor." Reeb is not suggesting that you have to be able to do the work that each of the priorities requires, but you at least have to know what they are if you are going to be part of the team that gets them done. For most CPAs, this is the work they have been planning to get around to doing for years. Because the compliance side of the work seems to always consume all of the available time and resources, the advisory work often gets set aside to take on the next compliance deadline.

The biggest opportunity and the biggest challenge for the profession is one and the same. Technology is doing more of the compliance work and a lot of the work CPAs do with their clients or employers will be slowly, but surely taken over by automation. So, we need to make sure that as work is being done by bots (software robots) and artificial intelligence, that each of us is evolving our competencies and capabilities to be ready to leverage this gift of time by taking on additional higher-valued advisory and management work.

He concluded by saying: "We have to embrace the fact that change is a constant. We're not trying to be perfect, but trying to get better. We're here because our past leadership had the courage to position us to be here and we need to have the courage to ensure the successful future of our next generation of CPAs. We need to leave something even better than what was left for us." ■

About the Author:

Jodi Ann Ray, CAE, is TXCPA's president and CEO. Contact her at jray@tscpa.net.

Renew Your Membership

If you haven't already renewed your membership for the 2019-2020 year, now is the time! Dues renewal notices have been sent. There's even more added value this year with complimentary ethics CPE, deep discounts on TXCPA Passport CPE and exclusive access to new communities on TXCPA Exchange. And if you have more than one member in your firm, company or organization, you're eligible for TXCPA's Group Billing Program, which is designed to ensure your membership dues investment returns the highest value available.

For questions regarding member dues or the renewal process, please contact Member Services at 800-428-0272, option 1. Don't lose your connection to the leading advocate for Texas CPAs. **RENEW TODAY!**

TXCPA's New Complimentary Ethics Course

It's now easier than ever before to meet your four-hour ethics requirement for licensing. CPA members have access to a FREE, online, on-demand, TSBPA-approved ethics course as a benefit of membership.

The course is valid upon membership renewal (or join) date for the 2019-2020 fiscal year until May 31, 2020. Go to the Education section of our website at tscpa.org and click on Ethics CPE for Texas CPAs to learn more.

New for Members: TXCPA Passport

Looking for impressive savings on your CPE dollar? Subscribe to our NEW TXCPA Passport! For only $199, you'll receive one year of unlimited access to a catalog of on-demand CPE courses available to watch anytime.

The Passport gives you an immediate connection to a library of online programming covering a variety of topics in accounting, auditing, taxation, not-for-profit, fraud, management, leadership and more. More than 160 hours are available and more will be added in the coming months. Go to the Education section of our website at tscpa.org, click on Find CPE and then TXCPA Passport to start receiving your special savings designated exclusively for TXCPA members.

Join an Interest-Area Community on TXCPA Exchange

Members across Texas are connecting on TXCPA Exchange. In addition to our general All Member Forum, we now have THREE interest-area communities. You can join the Tax Issues, CPA Practice Management or Nonprofit Accounting communities to ask questions, offer feedback and network with fellow TXCPA members.

Log in today to join these new communities and maximize your use of TXCPA Exchange! Visit exchange.tscpa.org to take advantage of this valuable members-only benefit.

CGMA® Designation for Management Accounting Professionals

The Chartered Global Management Accountant (CGMA) designation from AICPA and the Chartered Institute of Management Accountants (CIMA) distinguishes professionals who have advanced proficiency in finance, operations, strategy and management. It is a respected complement to your CPA license.

With more than 150,000 designees, it is the most widely held management accounting designation in the world. It offers a number of benefits, including CGMA magazine and newsletter, educational opportunities, tools and reports, videos, podcasts, a community/global network and more.

For more information about the program, its benefits and how to become a CGMA designation holder, visit their website at cgma.org.

Submit an Article to *Today's CPA* Magazine

The editors of *Today's CPA* are seeking article submissions for the magazine. *Today's CPA* is a peer-reviewed publication with an Editorial Board consisting of highly respected CPA practitioners.

The publication features articles and columns that focus on issues, trends and developments affecting CPAs in all facets of business. If you would like to submit an article for consideration or to learn more, please contact Managing Editor DeLynn Deakins at ddeakins@tscpa.net or Technical Editor Brinn Serbanic at technicaleditor@tscpa.net.

Accountants Confidential Assistance Network Resources

Five Pitfalls of Unhealthy Living

The TXCPA Peer Assistance Foundation makes a positive impact on the CPA profession in Texas through administration of the Accountants Confidential Assistance Network (ACAN). This year, we're celebrating 25 years of ACAN and the work they do to help CPAs, exam candidates and accounting students learn how to merge healthier living with a demanding accounting career.

Managing your health is a significant, proactive activity. There are obvious and not-so-obvious professional impacts of not investing in your health and well-being. When you don't make time for healthy habits, you may begin to recognize these five pitfalls:
Reduced stamina – by eating a balanced diet and exercising regularly, you'll likely have more energy;
More frequent illnesses – studies show that eating right, exercising, managing stress and getting enough sleep all boost your immune system and help fight disease;
Increased negative self-talk and less joy – when you exercise, your body releases endorphins that elevate your mood and give you a sense of well-being;
Premature aging – countless studies show that a lack of physical and mental activity produces weakness and contributes to the aging process, while people have stayed "young" by exercising into their 80s and beyond;
Discouraging your future leaders – young people in the United States place a high premium on work/life integration, and in the accounting profession, future leaders look to their established leaders and ask themselves whether they want to follow in their footsteps.

What kind of role model are you and what do your health habits say to others about your ability to prioritize? If there are areas you can and should improve on, start making healthier decisions today.

Source: *Journal of Accountancy*
Author: Jennifer Wilson of ConvergenceCoaching LLC

2019 SUMMER AND FALL
TXCPA CONFERENCES

Mark your calendar now for TXCPA's popular, live learning opportunities being held this spring and summer. Come for the sessions, benefit from the networking and leave with knowledge to advance your career.

Texas School District Accounting & Auditing Conference
San Antonio, June 3-4

CPE by the Sea Conference
Galveston, June 12-14

Advanced Health Care Conference Plus Pre-Conference Workshop
San Antonio, July 21-23

Texas State Taxation Conference
Houston, August 5

Forensic, Litigation and Valuation Services Conference
San Antonio, August 8-9

Advanced Estate Planning Conference Plus Pre-Conference Workshop
San Antonio, August 14-16

Financial Institutions Conference
Dallas, September 16 - 17

Governmental Accounting & Single Audits Conference Plus Optional Bonus Session
Austin, September 29 - October 1

Accounting Education Conference
Austin, October 4 - 5

To learn more and register, go to **tscpa.org**.

TXCPA'S 2018-2019 YEAR IN REVIEW

FOCUSING ON THE FUTURE

By DeLynn Deakins, *Today's CPA* Managing Editor

What an exciting year it has been for TXCPA, your professional home! TXCPA remained highly successful as the largest, most influential association of accounting and finance professionals in Texas.

Under the direction of our 2018-2019 Chairman Stephen Parker, CPA-Houston, we continued our work supporting the dynamic three-year strategic plan TXCPA 2020. There are three pillars of success that form the foundation of TXCPA 2020: Community and Connection, Professional Excellence and Advocacy.

At the Annual Meeting of Members in San Antonio last June, we outlined five areas of focus: Engage and Grow Our Community, Fuel Our Chapters, Reenergize Our Brand, Advance the Future of Learning, and Successfully Navigate Sunset Review. Closing out the year, here are some highlights of our key successes in those areas.

COMMUNITY AND CONNECTION

Engage and Grow our Community

TXCPA's overall membership is holding steady, while our student membership grew 50% in 2018-2019! One of our top priorities remains growing our community and engaging young people who are considering a career in accounting and becoming a CPA.

Tracking and measuring member data is an essential part of engaging and growing our community. We completed a membership value study in early 2019, which provided important insights on what our members value most, how they perceive the value of TXCPA membership, and how they would like to consume products and services from our association. Based on the

We relaunched our career center! The career center is the ideal place for members to search for a new job or post an opening and hire just the right candidate. Go to https://careers.tscpa.org/ to learn more and get started.

feedback, our leadership recommended holding CPA dues at the same rate. The chapters agreed, so there will be no dues increase for CPA members in the 2019-2020 year as we continue to remain focused on adding value for our members.

We also completed a member satisfaction survey in November of 2018. This survey followed up on the satisfaction survey done in 2017. In the latest survey, members expressed that they look to TXCPA to provide:

- Accessible, relevant and affordable CPE content;
- Timely and up-to-date professional information;
- Networking opportunities; and
- Advocacy for the CPA license.

The challenges they cited encountering are:

- Keeping up with change; and
- Finding qualified new staff/talent.

The survey revealed a statistically significant increase in the overall member satisfaction score for the Society from the previous survey. We would like to thank all the members who took the time to provide their input. TXCPA is using the actionable data received as we develop programs and initiatives to best meet the needs of members.

Member Satisfaction Increase - 2017 to 2018

2017 Overall Member Satisfaction Score

2018 Overall Member Satisfaction Score

Overall TXCPA member satisfaction increased from a score of 7.91 in 2017 to a score of 8.20 in 2018.

We launched three NEW communities on TXCPA Exchange: Practice Management, Tax Issues and Nonprofit Accounting. These new communities offer opportunities for members to discuss specific topics with their peers.

REENERGIZE OUR BRAND

At Advocacy Day and the Midyear Board of Directors and Members Meeting in January, we unveiled our new visual identity and refreshed brand. The most noticeable change was a shift from TSCPA to TXCPA, which gives us the opportunity to distinctly show who we connect, protect and advance – Texas CPAs. Now, we can more clearly distinguish our Texas pride and identify ourselves as separate from the Texas State Board of Public Accountancy (TSBPA) and other state CPA societies.

Our new visual identity lays a foundation on which we can focus our messaging and resources to be aligned with our brand promise to promote and protect the profession, and connect and promote members. As a relevant and magnetic organization for future generations of Texas CPAs, TXCPA can continue to grow and stay strong.

Go to tscpa.org to see the look and feel of the newly redesigned TXCPA website.

FUEL OUR CHAPTERS

The TXCPA chapters are where members have an opportunity to connect and serve on a regular basis. To that end, a new task force was formed in June to collaborate and recommend ways TXCPA and our chapter network can work together to best serve the needs of current and future members. As a result of the task force recommendations, we're increasing the visibility of shared resources that are available to the chapters,

BRAND IMPLEMENTATION TASK FORCE

TXCPA thanks the members of the Brand Implementation Task Force, which includes:

Brandon Booker, Fort Worth

Sheila Enriquez, Houston

Kate Rhoden, Austin

Bill Schneider, Dallas

Jeannette Smith, Rio Grande Valley

Priscilla Soto, San Antonio

AJ Taylor, Brazos Valley

Stephen Parker, TXCPA Chairman

Jodi Ann Ray, TXCPA President and CEO

Staff Liaison: **Melinda Bentley, Director, Marketing and Communications**

BRAND PLATFORM

Mission: The Texas Society of CPAs exists to support its members in their professional endeavors and to promote the value and high standards of Texas CPAs.

Vision: Empower members to lead and succeed.

Our purpose: To connect, protect and advance CPAs in Texas.

Brand promise: We promote and protect the profession, and connect and promote individual members.

Positioning: The largest, most influential association of accounting and finance professionals in Texas, dedicated to supporting one another, and promoting and protecting the value of the CPA designation.

Tagline: Connecting. Protecting. Advancing.

Brand personality: Trustworthy, Leader, Knowledgeable, Collaborative, Friendly

expanding and enhancing chapter leader training, and making reports, chapter metrics and other resources more readily available.

To be as efficient with our resources as possible, we're investing in strong technology that can be used across the chapter network to save resources and provide members with a consistent member experience.

PROFESSIONAL EXCELLENCE

Advance the Future of Learning

Delivering superior CPE is a top priority for the Society. With TXCPA's extensive lineup of high-quality live and web-based courses, you can choose when, where and how to take your CPE as you need it.

TXCPA past chairman Kathy Kapka, CPA-East Texas, created a brand new FREE on-demand ethics course for CPA members who renew their membership for 2019-2020. The program can be accessed between the time your membership is renewed and May 31, 2020. For those members who prefer to take a live ethics course, some of our chapters offer opportunities to take it in person.

We've invested in a new learning management platform to ensure quick and nimble delivery of programs to

CHAPTER TASK FORCE

TXCPA thanks the members of the Chapter Task Force, which includes:

Jesse Dominguez, Austin

Travis Garmon, San Angelo

Arturo Machado, San Antonio

Jennifer Perales, Corpus Christi

Tim Pike, Dallas

Jennifer Poff, TXCPA Houston Executive Director

Susan Roberts, Fort Worth

Ben Simiskey, Houston

Stephen Parker, TXCPA Chairman

Jodi Ann Ray, TXCPA President and CEO

Staff Liaison: **Bryan Garza**, Director, Membership and Community

GROW YOUR BUSINESS AS A PEER REVIEWER

Are you looking to help grow your business and build your reputation as a firm that's committed to providing high-quality services? Become a peer reviewer! As a peer reviewer, you can leverage your accounting and auditing practice expertise. It also creates additional opportunities to network with your peers.

To learn more about the requirements, visit AICPA.org/beareviewer. Call TXCPA at 800-428-0272 to find out how you can become a peer reviewer in Texas.

members. New content has been developed for our TXCPA Passport package that is now available for members on demand.

You also receive a minimum of six hours of free CPE on professional issues each year. These updates are available in convenient two-hour broadcasts three times per year.

Administering the Peer Review Program

Peer Review continues to go through a tremendous amount of change. As we administer the program, our focus is to use resources as effectively as possible and make the program both educational and supportive. Our thanks goes to the TXCPA Peer Review Committee and staff members who are navigating the changes to make this possible.

In January, we began conducting technical peer reviews for our colleagues at the Louisiana Society of CPAs.

ADVOCACY

TXCPA Advocacy Day and Sunset Legislation

In late January, TXCPA hosted its Advocacy Day for the CPA profession. Hundreds of TXCPA members from around the state convened in Austin to learn how to be effective advocates for the profession and meet with their legislators to discuss issues of concern. It takes a number of members who commit their time during tax season to ensure we are protecting our members and the accounting profession and we are grateful for your commitment.

At press time, the Texas legislative session was in its final weeks. The number one priority for TXCPA and the profession in the session was to assure passage of the Sunset legislation that will continue the Texas State Board of Public Accountancy (TSBPA) and the Texas Public Accountancy Act (TPAA).

The Sunset legislation (HB 1520 and SB 613) was introduced in the later part of February. The bill sponsors were Rep. Senfronia Thompson (D-Houston) and Senator Kirk Watson (D-Austin). In addition to pushing for its passage, TXCPA worked to have the bill amended to include provisions related to CPA firm mobility.

TXCPA reviews all draft legislation to determine its potential impact on the profession and our members. During the current session, over 9,500 bills and resolutions have been introduced and we are actively monitoring 145 proposed bills.

Professional Standards and Federal Tax Policy Committees

An important piece of our advocacy platform is the work of the Professional Standards Committee and Federal Tax Policy Committee. These committees issue responses to exposure drafts from standards-setting bodies that have an impact on the practice of accountancy. Their important work ensures that TXCPA has a consistent presence before regulators each year. You can view all of

TXCPA'S CPA-POLITICAL ACTION COMMITTEE

TXCPA PAC

Your contribution to the CPA-Political Action Committee (CPA-PAC) is the fastest, simplest and most efficient way to get involved in the political process and its positive effects on our profession. Of all the funds contributed to the CPA-PAC, 75% is used to provide bipartisan support to state lawmakers in your community through your local chapter, while the remaining 25% is used to provide bipartisan support to candidates in campaigns for statewide office. Members of the TXCPA PAC Committee work closely with local chapters and their public affairs committees to determine the policymakers who should receive contributions.

To learn more about the CPA-PAC and make a contribution, please visit the Advocacy section of TXCPA's website at tscpa.org.

TXCPA's responses on our website at tscpa.org.

TXCPA is All About You

We would like to thank you for your TXCPA membership and support! TXCPA's success in 2018-2019 is the direct result of the guidance from our outstanding leadership and countless volunteer hours from our members. If you have not served in a volunteer role and are interested in participating, please contact your chapter or visit the "Get Involved" section under the Membership tab of our website at tscpa.org.

Be sure to read your upcoming July/August issue of *Today's CPA* magazine. We'll be introducing TXCPA's incoming chairman Lei D. Testa, CPA-Fort Worth.

We hope to see you at the 2019 Annual Meeting of Members and Board of Directors Meeting on June 21-22 in New Orleans. We have a full agenda of dynamic speakers and leaders who'll be discussing professional and business issues, and TXCPA's plans to connect, protect and advance CPAs in Texas. ■

ETHICS AND THE BRAIN

By Richard Pitre, Ph.D., CPA

Ethics reflect a moral choice as to how we behave, the process of critically analyzing the impact of values related to everyday life. Every decision is a choice, with choice being the ability to contemplate our decisions.

The frontal lobe of the brain is where ethical values reside and function, and it is where the process of reflective thought takes place. Understanding how ethics work within the brain is an effective and efficient way of using the brain to know how values are shaped. It is an internal sense of understanding an individual's traits, feelings and behaviors. The process is the frontal lobe concept.

This article provides key insights from a study that analyzed the impact of the brain on organized thoughts and its ability to control behavior that prevents or at least minimizes the occurrence of accounting scandals. The question that arises: Is training in organized ethics at all levels of the organization the answer?

As depicted by the illustration in Figure 1, there is a relationship between the brain and ethical values.[2] The mind, the frontal lobe, is the faculty of human reasoning and thoughts.

The frontal lobe links and integrates all components of behavior at the highest level. This involves the ability to project future consequences resulting from current actions, the choice between good and bad actions – known as conscience. It involves the override and suppression of socially unacceptable responses, and the determination of similarities and differences between things or events.[3] This all occurs in the cerebrum or cortex, which is associated with higher brain function.

Ethical Values

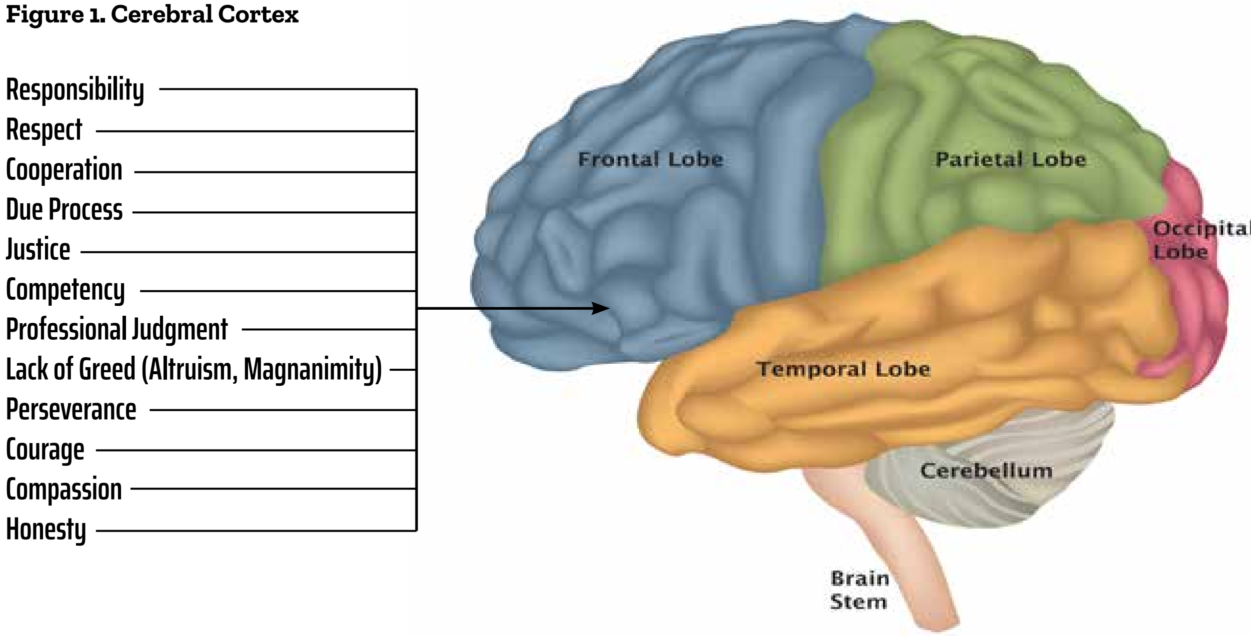
For the study, the author chose 12 ethical values as depicted in Figure 1. These ethical values have been developed over the past 20 years in teaching ethics to practicing CPAs and accounting students as a requirement for the CPA Exam. They reside in the frontal lobe of the cerebral cortex.

The main value question is, "Am I an Honest Person?" To be honest is to refrain from falsehood, embezzlement, cheating or other

WHAT IS ACCOUNTING FRAUD?

"Accounting scandals are political or business scandals that arise with the disclosure of financial misdeeds by trusted executives of corporations or governments. Such misdeeds typically involve complex methods for misusing or misdirecting funds, overstating revenues, understating expenses, overstating the value of corporate assets or underreporting the existence of liabilities, sometimes with the cooperation of officials in other corporations or affiliates. In public companies, this type of 'creative accounting' can amount to fraud and investigations are typically launched by government oversight agencies, such as the Securities and Exchange Commission (SEC) in the United States."[1]

Figure 1. Cerebral Cortex



deceitful activities. When we are honest, we build strength of character that allows us to be of great service to ourselves and to humanity. Truth as an obstacle triggers a values check. It is essential to understand that we cannot control the truth with a lie, but we can limit the damages of a lie with the truth.

To evaluate your degree of honesty, it is necessary to understand your sensitivity to the other values as they relate to honesty and ethical values. The sensitivity to these values is the foundation of an ethical way of life. An honest individual continually engages the cerebral cortex by asking the following questions:

- Am I **Responsible** – Do I make a choice even when I am not sure of what the right choice is and then stand by it despite criticism from others?
- Am I **Respectful** – Do I embrace differences, uniqueness and fundamentally accept the existence of others?
- Am I **Cooperative** – As part of the group, do I sync my individual contributions and work towards a common goal?
- Do I Practice **Due Process** – Do I accept the fundamental right of expression within the constraints of organizational objectives?
- Do I Practice **Justice** – Do I embrace the concept of workplace reward and punishment?
- Am I **Competent** – Do I possess the key skills to perform the identified task and can I deal with change in an intellectual manner?
- Do I Have **Professional Judgment** – Do I have an attitude of skepticism with a mind that questions and critically assesses the evidence? Do I have a sufficient amount of interaction between education and experience?
- Do I Lack **Greed** – Do I have an excessive or rapacious desire? Do I believe in equal work for equal pay, that what I receive should equal what I give, that my debits should always equal my credits?
- Can I **Persevere** – Do I have the mental strength to survive, with a commitment of challenging work through patience and endurance?
- Am I **Courageous** – Do I have core strength that comes from the heart, a firmness of mind and will in the face of opposition?
- Am I **Compassionate** – Do I have the right response to suffering, the right interaction with my fellow human beings?

Ethical Training

Once the above questions are answered, we should engage in a continual process of asking and answering the questions on a frequent basis, such that they become the default process of unconscious action. The research shows that the frontal lobe is associated with reasoning, planning, parts of speech, movement, emotions and problem solving.

A small region of the brain, the prefrontal cortex where most of an individual's thoughts and planning take place, is responsible for the moment-by-moment control of habits that are switched on at any given time.[4] This is the area of the brain where the default process occurs. Therefore, the more you do something over and over, the easier it is for your brain to create a pattern and automate that response for next time. That is the role of the brain in creating the default process of unconscious action.

Organizationally, this process is accomplished through ethics training. Ethical training is the application of moral principles, standards of behavior, codes of conduct and ethical principles to organizational business transactions and should occur on a frequent basis. The more this application occurs, the greater the probability the default process will be retained in memory. This is needed to improve ethical outcomes. Can it be taught? The culture of an organization is the reflection of its ethical values and it is believed that education has a considerable influence.

Over 2500 years ago, this issue was debated by Socrates and his fellow Athenians. Their conclusion was that ethics consist of knowing what we ought to do and such knowledge can be taught.[5]

Additionally, the late Harvard psychologist, Lawrence Kohlberg, found that a person's ability to deal with moral issues develops in stages, that a person's ability to deal with moral issues is not formed all at once. Just as there are stages of growth in physical development, the ability to think morally also develops in stages.[6]

Levels of Moral Development

The earliest level of moral development is that of the child, which Kohlberg called the preconventional level. The person at the preconventional level defines right and wrong in terms of what authority figures say is right or wrong, or in terms of what results in rewards and punishments.

The second level of moral development is the level most adolescents reach. Kohlberg called this the conventional level. The adolescent at the conventional level has internalized the norms of those groups among whom he/she lives.

The third level is reached when a person continues to develop morally. At that point, they reach what Kohlberg labeled the postconventional level. The person at the postconventional level stops defining right and wrong in terms of group loyalties or norms. Instead, the adult at this level develops moral principles that define right and wrong from a universal point of view.

Many factors can stimulate a person's growth through the three levels of moral development. Kohlberg found that one of the most crucial factors is education. He discovered that when his subjects took courses in ethics and these courses challenged them to look at issues from a universal point of view, they tended to move upward through the levels.

Medical and Scientific Support

In addition to the philosophical theory that ethics can be taught, there is the medical/scientific support for this theory, as well: Neuroplasticity. In layman terms, neuroplasticity is the brain's ability to change over time. According to Pascale Michelon, Ph.D.: "For a long time, it was believed that as we aged, the connections in the brain became fixed and then simply faded. Research has shown that in fact the brain never stops changing through learning. Plasticity is the capacity of the brain to change with learning. Changes associated with learning occur mostly at the level of connections between neurons: New connections form and the internal structure of the existing synapses change."

Michelon says that when you become an expert in a specific domain, the areas in your brain that deal with this type of skill will grow. For instance, London taxi drivers have a larger hippocampus (in the posterior region) than London bus drivers. Why is that? It is because this region of the hippocampus is specialized in acquiring and using complex spatial information to navigate efficiently. Taxi drivers have to navigate around London, whereas bus drivers follow a limited set of routes.[7]

The Organizational Impact

An ethical mind improves leadership by creating servant leaders. Servant leadership as used in this research is defined as leadership that seeks to serve, not to be served, and it focuses primarily on the growth and well-being of people and the communities to which they belong. The servant leader shares power, puts the needs of others first and helps people develop and perform to the extent of their abilities.[8]

An ethical mind fosters creative thinking that is important in an organization. The process of creative thinking is often overlooked in the most critical levels of the organization – upper management. This usually occurs because leaders are generally consumed with the day-to-day pursuit of shareholder wealth instead of the process of making ethical choices to achieve wealth maximization. Therefore, precious little time is spent creatively thinking about organizational values.[9]

Frontal lobe reasoning, planning and problem solving improve organizational culture. This culture plays a significant role in the way organizations operate in a global economy. When ethical values become the default process of unconscious action, decisions are not only based on rules and the consequences of misapplication of rules, but on an organizational culture where the question of right vs. wrong does not even arise. It is about living your values even when it's extremely difficult, about using your values and purpose as a filter for decisions and daily actions.[10]

Frontal lobe reasoning helps eliminate threats to ethical compliance. According to AICPA, CPAs often face risks of encountering relationships or circumstances that could compromise compliance with rules. These risks are divided into six categories.[11]

- Self-review threat. The threat that a member will not appropriately evaluate prior services.
- Advocacy threat. The threat that a member will promote a client's or employer's position to the point that his/her objectivity is compromised.
- Adverse interest threat. The threat that a member will not be objective, because his/her interests are in opposition to those of a client or employer.
- Familiarity threat. The threat that because of a long or close relationship with a client or employer, a member will become too sympathetic to their interests or too accepting of their work.
- Undue influence threat. The threat that a member will subordinate his/her judgment to that of an individual associated with a client, employer or other relevant third party, because of the individual's (1) reputation or expertise, (2) aggressive or dominant personality, or (3) attempts to coerce or exercise excessive influence over the member.
- Self-interest threat. The threat that a member will act in a manner that is adverse to the interests of his/her firm.

Leadership Responsibilities

It is necessary that organizational leaders maintain their ethical focus, starting at the board level. Board members need to be abreast of ongoing research, such as the relationship between the brain and ethical values. Awareness of current research like this and others will help the board and other top management personnel to understand that the brain has the ability to shut off damaging habits and that ethics training can turn unhealthy habits into healthy ones.

Therefore, the board needs to:

- Perform a moral compass analysis prior to accepting board service,
- Be committed to rigorous ethical training,
- Be committed to a broad set of ethical values for the organization, with a commitment to upholding those values at all levels of the organization,
- Understand how ethical values connect them to the broader society.

Leaders need to have a macro vision of organizational operations. This view will keep them focus on the role of ethical values on organizational

Figure 2. Ethics as the Organizational Protector

process, being change agents, and on overall organizational development and growth as configured in Figure 2.

Leaders of organizations, including board members, CPA firm partners, CEOs, and CFOs, should be required to take an ethics class on a regular basis. Ethics training will help them become more people oriented by understanding that there is a universal people connection derived from ethical training.

Ethical values help to connect us as a humanity. The values discussed in this article are common to all successful civilizations. They do not uphold the individual's right at all costs nor do they impose moral solutions in an authoritarian way. They are based on the belief that strong rights presume strong responsibilities. They transcend differences in culture, ethnicity, religion, and socio-economic status. They help us to know what we really believe and why we believe what we believe.

The study of ethics should inspire, educate and empower people to know that it is very difficult to:

- Be honest, responsible, respectful and cooperative,
- Practice justice and due process,
- Be competent,
- Have professional judgment,
- Lack greed,
- Persevere,
- Be courageous and compassionate,

and be unethical. This values connection is part of the default action stimulated by the brain. The default process has its genesis of ethical brain stimulation long before you become a leader. Your thinking, controlled by your brain, ultimately impacts how you lead, and the benefits of ethical training are a great reinforcement of brain thoughts and behavior.

Effective ethical training is achieved through the actual application or use of ethical successes, failures, ideas, beliefs and methods, as opposed to theories and philosophical discussions lacking in sincerity and meaningful content. Ultimately, choices have consequences and proper training enhances the positive and minimizes the negative. ■

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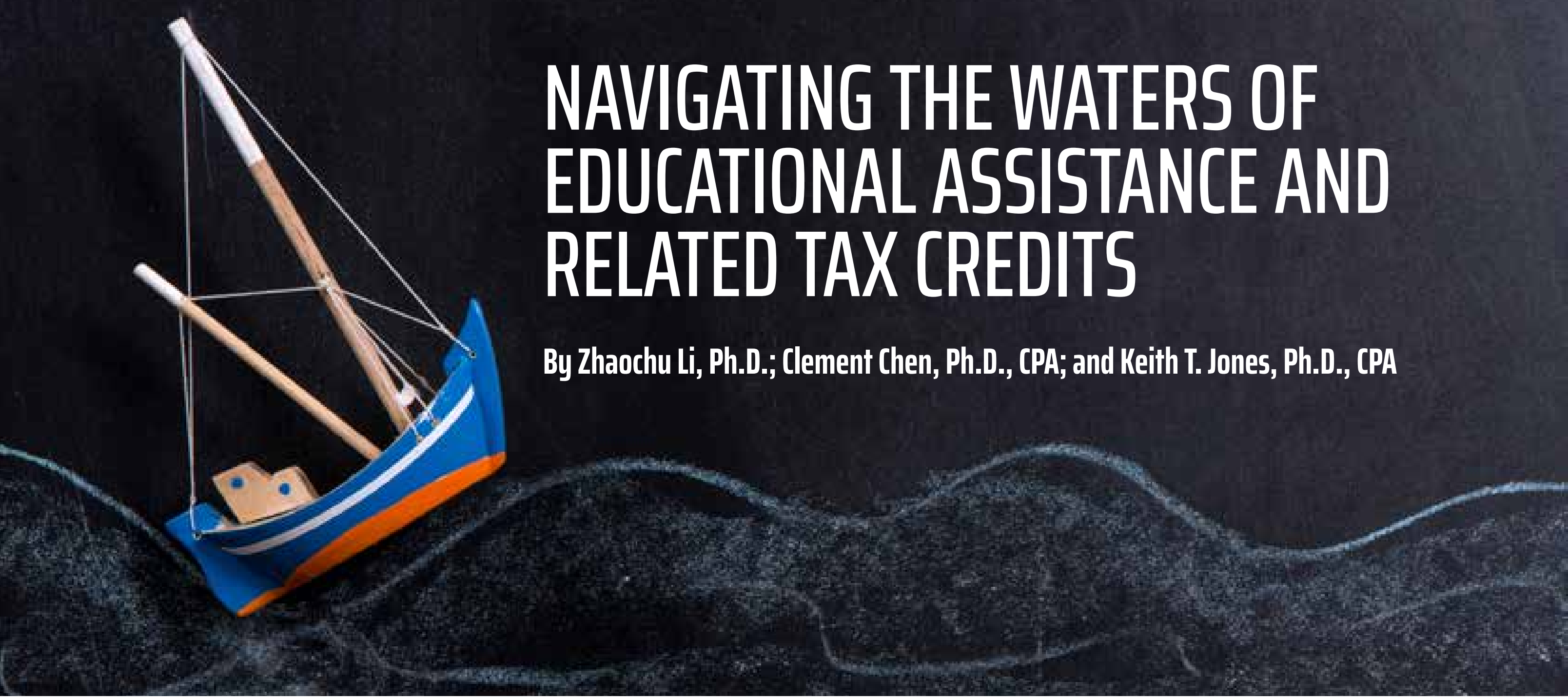

NAVIGATING THE WATERS OF EDUCATIONAL ASSISTANCE AND RELATED TAX CREDITS

By Zhaochu Li, Ph.D.; Clement Chen, Ph.D., CPA; and Keith T. Jones, Ph.D., CPA

Taxpayers often receive educational assistance to finance their postsecondary studies. Examples of educational assistance include scholarships, grants and fellowships. Educational assistance is tax-exempt if used to pay for expenses, such as tuition and required fees.

At the same time, taxpayers are eligible to take education credits that reduce their overall tax liability. Two available education credits are the American opportunity credit (AOC) and the lifetime learning credit (LLC). Although it seems counter-intuitive to include tax-exempt educational assistance in income, doing so can potentially increase a taxpayer's eligible education credit and reduce a taxpayer's overall tax liability.

This article provides a detailed explanation as to whether and how much educational assistance a taxpayer should include in taxable income to have the lowest tax liability. Unfortunately, most taxpayers are not aware of this strategy and tax-filing software generally does not provide the proper guidance. Therefore, CPAs and tax advisers may be able to help their clients save significant taxes using the strategy from this article.

Pitfalls When Claiming Both Tax-Exempt Educational Assistance and Education Credits

When a taxpayer excludes educational assistance from income, the Internal Revenue Service (IRS) assumes that the taxpayer uses the assistance to pay for qualified education expenses. The definition of qualified education

CPAs and tax advisers may be able to help their clients save significantly by using this tax-saving strategy.

expenses differs among types of educational assistance and tax credits, but always includes tuition and required fees.

For example, scholarships are the most common type of educational assistance and qualified education expenses for scholarships include tuition, required fees and course-related expenses, such as books, supplies and equipment. For the AOC, qualified education expenses are the same as for scholarships; however, for the LLC, course-related expenses must be paid directly to a taxpayer's educational institution to be considered as qualified education expenses.

Issues can arise when a taxpayer receives educational assistance and claims an education credit at the same time. If a taxpayer chooses to exclude all or part of the educational assistance from taxable income, he/she must use adjusted qualified education expense (AQEE) to calculate education tax credits. The IRS defines AQEE as qualified education expenses less any tax-exempt educational assistance (IRS 2017).

As a result, the available tax credit may be smaller, due to the reduced AQEE. However, if a taxpayer includes some

educational assistance in income, he/she could have a larger AQEE and may be eligible for a larger tax credit.

Scholarship Example. Brian is a sophomore in college and pays tuition of $4,000, which is his only education expense. Brian's college awards him a scholarship of $3,000 and credits it directly to his school account. If Brian chooses to exclude the entire scholarship from his income, his tax-exempt educational assistance is $3,000. His AQEE for the AOC is thus $1,000 (4,000 – 3,000), allowing him to claim $1,000 of the credit. However, if Brian chooses to exclude only $2,000 of the scholarship from his income, his tax-exempt educational assistance is $2,000.

His AQEE for the AOC becomes $2,000 (4,000 – 2,000) and he could claim $2,000 of the credit. The reason that Brian may want to include more scholarship in his income is explained below.

EXHIBIT 1: FIGURING SCHOLARSHIP INCLUSIONS FOR THE AMERICAN OPPORTUNITY CREDIT BASED ON MARGINAL TAX RATE (MTR) AND ADJUSTED QUALIFIED EDUCATION EXPENSE (AQEE)

Step 1. Exclude the entire scholarship and find a taxpayer's taxable income. Use the taxable income to determine the MTR.

Step 2. Subtract the entire scholarship from the sum of tuition and required fees and course-related expenses to determine the AQEE.

Step 3. If AQEE ≥ $4,000, do not include any scholarship in income. The taxpayer can already claim the maximum credit of $2,500.

If $2,000 ≤ AQEE < $4,000, do not include any scholarship in income yet and go to Step 4.

If AQEE < $2,000, include as much scholarship as possible in income until AQEE increases to $2,000, then go to Step 4.

Step 4. Use the taxpayer's MTR from Step 1.

If MTR ≥ 25%, do not include any more scholarship in income. Calculate the credit using the sum of AQEE from Step 2 and any scholarship inclusion from Step 3.

If MTR < 25%, include as much scholarship as possible in income until either AQEE increases to $4,000 or MTR increases to 25%. Calculate the credit using the sum of AQEE from Step 2 and all scholarship inclusions from Step 3 and 4 (if any).

Why Include Tax-Exempt Educational Assistance in Income?

There are two simultaneous effects when including any educational assistance in taxable income. On the one hand, the inclusion results in an additional tax liability, which is the product of the included educational assistance and the taxpayer's marginal tax rate (MTR). On the other hand, the inclusion means that a taxpayer could potentially have a higher AQEE for education credits and thus claim a larger AOC or LLC.

Whether the increase in tax liability is more than the increase in an education credit depends on a taxpayer's MTR and AQEE and whether the taxpayer claims the AOC or the LLC. The following sections in this article explain whether to include scholarships in income to minimize taxes and how much to include. The same analysis applies to other types of educational assistance.

The American Opportunity Credit and Scholarship Inclusions

The AOC allows a maximum credit of $2,500 per student per year. The credit equals the first $2,000 of AQEE plus 25% of the next $2,000. AQEE over $4,000 does not generate additional credit. Exhibit 1 provides a step-by-step guide for including scholarships in income when claiming the AOC.

Table 1 includes examples for Exhibit 1. It compares four cases with different scholarship inclusions and tax savings. All cases assume that college student John pays $5,000 for tuition and required fees and receives a scholarship of $4,000. His MTR is 12% before including any scholarship in his income. If John excludes the entire scholarship from income, his AQEE for the AOC is $1,000 (5,000 – 4,000), based on which John can claim $1,000 of the AOC. Table 1 ignores other factors that could affect

TABLE 1:
SCHOLARSHIP INCLUSIONS AND THE AMERICAN OPPORTUNITY CREDIT BASED ON MTR = 12%

	Case 1	Case 2	Case 3	Case 4
Education expenses; scholarships	Tuition/fees: $5,000 Scholarship: $4,000			
Scholarship inclusion	$1,000	$2,000	$3,000	$4,000
Tax-exempt scholarship	3,000 (4,000 – 1,000)	2,000 (4,000 – 2,000)	1,000 (4,000 – 3,000)	0 (4,000 – 4,000)
Additional taxable income	1,000	2,000	3,000	4,000
Additional tax liability	120 (1,000 x 12%)	240 (2,000 x 12%)	360 (3,000 x 12%)	480 (4,000 x 12%)
AQEE before scholarship inclusion	1,000 (5,000 – 4,000)	1,000 (5,000 – 4,000)	1,000 (5,000 – 4,000)	1,000 (5,000 – 4,000)
AQEE after scholarship inclusion	2,000 (5,000 – 3,000)	3,000 (5,000 – 2,000)	4,000 (5,000 – 1,000)	5,000 (5,000 – 0)
Tax credit before scholarship inclusion	1,000	1,000	1,000	1,000
Tax credit after scholarship inclusion	2,000	2,250 (2,000 + ((1,000 x 25%))	2,500 (2,000 + ((2,000 x 25%))	2,500 (2,000 + ((2,000 x 25%))
Additional tax credit after scholarship inclusion	1,000 (2,000 – 1,000)	1,250 (2,250 – 1,000)	1,500 (2,500 – 1,000)	1,500 (2,500 – 1,000)
Tax Savings (additional credit – additional liability)	$880 (1,000 – 120)	$1,010 (1,250 – 240)	$1,140 (1,500 – 360)	$1,020 (1,500 – 480)

the decision for scholarship inclusion and assumes that John has sufficient tax liability to absorb the credit.

In Case 1, John includes $1,000 of the scholarship in his income and his AQEE increases to $2,000. His tax liability and tax credit increase by $120 and $1,000, respectively, resulting in a tax savings of $880. In Cases 2 and 3, John includes $2,000 and $3,000 of his scholarship in income and his tax savings become $1,010 and $1,140 respectively. The first three cases show that John's tax savings increase as he includes more scholarship in income.

However, in Case 3, John's AQEE after scholarship inclusion reaches $4,000, which is the maximum amount of expense a taxpayer can use to claim the AOC. According to Exhibit 1, John should stop including any more scholarship in his income, because doing so will increase his tax liability, but not his tax credit. As shown in Case 4, if John includes $1,000 more scholarship income than in Case 3, he will pay $120 more tax.

The Lifetime Learning Credit and Scholarship Inclusions

The LLC equals 20% of the first $10,000 of AQEE, for a maximum of $2,000 per year in an undergraduate or graduate program. In contrast to the AOC, the LLC is not limited to the first four years of postsecondary education. Qualified education expenses for the LLC include tuition and required fees, but do not include course-related expenses, such as books and supplies, unless they are paid directly to a taxpayer's educational institution. Exhibit 2 provides a step-by-step guide for including scholarships in taxable income when claiming the LLC.

Table 2 includes examples for Exhibit 2 by comparing four cases with different scholarship inclusions and tax savings. All cases assume that college student Kim pays $11,000 for tuition and fees and receives a scholarship of $4,000. Her MTR is 12% before any scholarship inclusion.

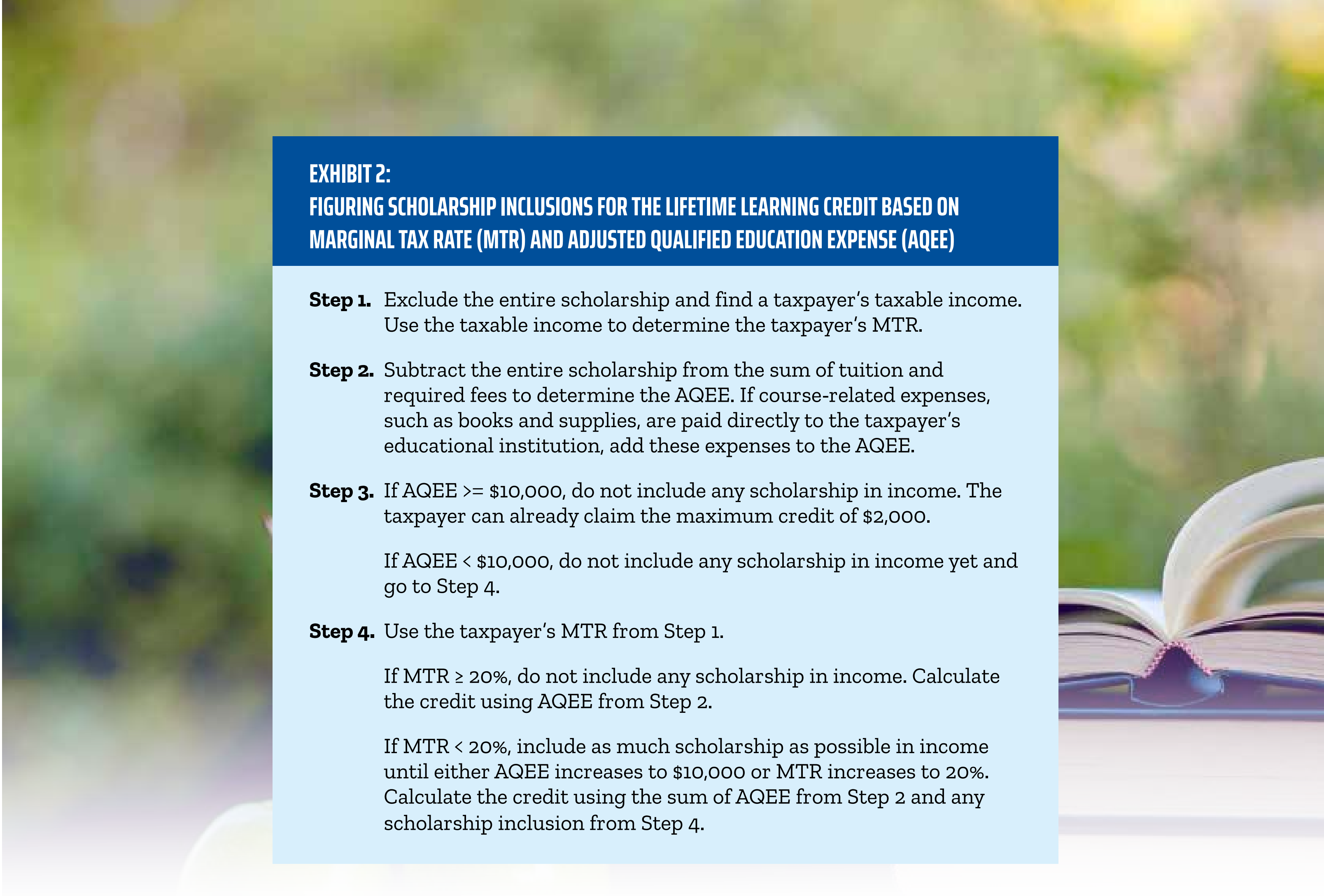

EXHIBIT 2:
FIGURING SCHOLARSHIP INCLUSIONS FOR THE LIFETIME LEARNING CREDIT BASED ON MARGINAL TAX RATE (MTR) AND ADJUSTED QUALIFIED EDUCATION EXPENSE (AQEE)

Step 1. Exclude the entire scholarship and find a taxpayer's taxable income. Use the taxable income to determine the taxpayer's MTR.

Step 2. Subtract the entire scholarship from the sum of tuition and required fees to determine the AQEE. If course-related expenses, such as books and supplies, are paid directly to the taxpayer's educational institution, add these expenses to the AQEE.

Step 3. If AQEE >= $10,000, do not include any scholarship in income. The taxpayer can already claim the maximum credit of $2,000.

If AQEE < $10,000, do not include any scholarship in income yet and go to Step 4.

Step 4. Use the taxpayer's MTR from Step 1.

If MTR ≥ 20%, do not include any scholarship in income. Calculate the credit using AQEE from Step 2.

If MTR < 20%, include as much scholarship as possible in income until either AQEE increases to $10,000 or MTR increases to 20%. Calculate the credit using the sum of AQEE from Step 2 and any scholarship inclusion from Step 4.

If Kim excludes the entire scholarship from taxable income, her AQEE for the LLC is $7,000 (11,000 – 4,000), based on which Kim can claim $1,400 (7,000 × 20%) of the LLC. Table 2 ignores other factors that could affect the decision for scholarship inclusion and assumes that Kim has sufficient tax liability to claim all of the LLC.

In Case 1, she includes $1,000 of the scholarship in her income and her AQEE becomes $8,000. Kim's tax liability and tax credit increase by $120 and $200 respectively, resulting in a net tax savings of $80. In Cases 2 and 3, Kim includes $2,000 and $3,000 of the scholarship in her income and her net tax savings become $160 and $240, respectively.

The first three cases show that Kim's net tax savings increases as she includes more scholarship in income. However, in Case 3, Kim's AQEE after scholarship inclusion reaches $10,000, which is the maximum amount of expenses a taxpayer can use to claim the LLC. Based on Exhibit 2, Kim should stop including any more scholarship in her income because doing so will increase her tax liability, but not her tax credit. As shown in Case 4, if Kim includes $1,000 more scholarship income than in Case 3, she will pay $120 more tax.

Include any educational assistance in income to minimize taxes. Therefore, it is important that CPAs and tax professionals inform their clients about implementing this tax-saving strategy.

Potential Tax Savings

Taxpayers generally prefer to exclude tax-exempt educational assistance from their income. However, including some tax-exempt educational assistance in income could potentially increase a taxpayer's education credit and reduce his/her overall tax.

Unfortunately, tax preparation software generally only asks users if they have any out-of-pocket education expense, but does not tell users whether they should include any educational assistance in income to minimize taxes. Therefore, it is important that CPAs and tax professionals inform their clients about implementing this tax-saving strategy.

First, tax advisers should alert their clients about potential pitfalls when claiming tax-exempt educational

TABLE 2:
SCHOLARSHIP INCLUSIONS AND THE LIFETIME LEARNING CREDIT BASED ON MTR = 12%

	Case 1	Case 2	Case 3	Case 4
Education expenses; scholarships	Tuition/fees: $11,000 Scholarship: $4,000			
Scholarship inclusion	$1,000	$2,000	$3,000	$4,000
Tax-exempt scholarship	3,000 (4,000 – 1,000)	2,000 (4,000 – 2,000)	1,000 (4,000 – 3,000)	0 (4,000 – 4,000)
Additional taxable income	1,000	2,000	3,000	4,000
Additional tax liability	120 (1,000 x 12%)	240 (2,000 x 12%)	360 (3,000 x 12%)	480 (4,000 x 12%)
AQEE before scholarship inclusion	7,000 (11,000 – 4,000)	7,000 (11,000 – 4,000)	7,000 (11,000 – 4,000)	7,000 (11,000 – 4,000)
AQEE after scholarship inclusion	8,000 (11,000 – 3,000)	9,000 (11,000 – 2,000)	10,000 (11,000 – 1,000)	11,000 (11,000 – 0)
Tax credit before scholarship inclusion	1,400 (7,000 x 20%)	1,400 (7,000 x 20%)	1,400 (7,000 x 20%)	1,400 (7,000 x 20%)
Tax credit after scholarship inclusion	1,600 (8,000 x 20%)	1,800 (9,000 x 20%)	2,000 (10,000 x 20%)	2,000 (10,000 x 20%)
Additional tax credit after scholarship inclusion	200 (1,600 – 1,400)	400 (1,800 – 1,400)	600 (2,000 – 1,400)	600 (2,000 – 1,400)
Tax Savings (additional credit – additional liability)	$80 (200 – 120)	$160 (400 – 240)	$240 (600 – 360)	$120 (600 – 480)

assistance and education credits at the same time. In addition, tax advisers should explain to their clients why including tax-exempt educational assistance in taxable income could reduce overall tax liability in some cases. Doing so will potentially add value to the services offered.

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U.S. OFFICE MARKET OVERVIEW: WHERE ARE WE AND WHERE ARE WE HEADED

By Mike Ebbitt

Developing and executing a strategic plan to help manage real estate and occupancy costs is an important consideration for businesses and firms. CPAs can assist their clients and employers in this decision by developing a budget and financial projections. A well thought out plan will have long-term financial implications and will impact the ability to attract and retain talent moving forward.

By sharing some examples of how other organizations are successfully using their space, this article offers valuable insights to develop your own occupancy strategies.

The U.S. office market is poised for moderate growth in 2019. Office-using employment is expected to grow by 1.5 percent or by more than 300,000 jobs – a modest deceleration from 2018, primarily due to a very tight labor market. Sunbelt and tech markets are expected to register the largest percentage gains in employment, led by San Francisco, Orlando, Houston, Austin and Tampa, each at 2.7 percent or more. San Francisco, Dallas/Ft. Worth, Houston, New York and Chicago are projected to add the largest number of jobs in 2019 – between 15,000 and 25,000 each.

Office-using employment growth, although at a slower rate due to labor market constraints, will drive further office market expansion in 2019. New office product will help meet strong tenant demand for modern, efficient, highly amenitized space to attract and retain employees in an increasingly competitive labor market. Occupiers will continue to seek flexible space offerings and lease structures that keep them adaptable to changes in the economy and their organizational needs.

Successful Strategies

With shorter business cycles and technological advancements and markets becoming more unpredictable than ever, occupiers will continue the shift to more flexible real estate strategies. Work environments and lease structures must be adaptable to support highly dynamic organizational objectives. Following are some growing trends.

1. The historically low levels of unemployment create some challenges for companies. Tenants are reevaluating their real estate as a result. The most successful companies are using their office space as an asset to attract top talent rather than merely an expense.

2. Another trend is the drive toward efficiency. For a growing number of office tenants signing new leases, workplace strategies are being used to optimize space needs. Nationally, the average range is 150-225 rentable square feet (RSF) per person.

3. Additionally, there has been a shift in the location of private offices. Companies are moving away from offices located at the exterior in lieu of designating their offices in the interior of the space. The main benefit is the addition of more natural light.

Tip: The first step toward effective space management is to gather and analyze demand forecast data at the business-unit level. Ideally, this should include the current state of seat occupancy and vacancy, as well as business unit growth projections.

4. Planning ahead. Use of forecast data is essential for making proactive real estate decisions. Effectively planning for future requirements necessitates more than that. It also requires buy-in and coordination between a company's leadership, HR, finance and real estate teams with the goal of minimizing the gap between space supply and demand to directly support business success. Working across business units in this way, executives can factor in long-term organizational needs, goals and planned projects to create fact-based strategies for future real estate needs.

Key takeaway: When done correctly, rather than merely reacting, an organization can proactively respond to changing business needs and priorities. The most common cost savings opportunities include reducing seat vacancy, trimming square footage, increasing space efficiency and tightening seat density.

Renew or Relocate Guide

Markets fluctuate, employees multiply and new technologies emerge. One thing is certain: you need to make room for the future even if you can't predict it. Whether that means a moderate renovation or full relocation, the following tips will help you start the discussion.

Size Matters. The size of your company will determine both the time the move will take and the type of lease terms you're likely to receive.

Whether it takes 12 weeks or 12 months, your move can be split into three phases: planning, selection and buildout.

Phase 1: Plan Your Strategy. Your move strategy is about more than picking a new building. A real estate decision can affect every facet of your business: productivity, revenue, well being, sustainability and future success. Questions to consider include:

- What are your company's broader business objectives?
- Which real estate decision will support those goals?
- How fast is your growth rate? Do you need flexible terms?
- What is your exit plan when the lease ends?
- Who is your workforce and what is their work style?

Understanding and acknowledging where your business is today – in terms of the demographics of its employees, their needs and wants, its operational processes, and leadership style – is the baseline for understanding what kind of space will best serve your business.

Identify inefficiencies in your current workspace, decide how the new space should function, present the plan to stakeholders and consider these questions:

- How can operations improve?
- What style of building suits you?
- Enclosed office or small cube?
- How many square feet per employee?

To gain feedback, use an executive questionnaire. Get insight from leadership on the scope of the project and the function of the space. Questions may include:

- Rate the quality of your existing floorplan. How do you define quality?
- What do you want to prioritize most? Customer image? Cost? Recruiting new talent?
- How important are informal meeting areas?

Time is your biggest asset. Procrastinating in Phase 1 is perhaps the biggest mistake you can make when considering a move.

Tip: It's never too early to start thinking about your occupancy plans. Kick off initial discussions no fewer than six to nine months before your lease expires.

Are renewals involved? Renewals without negotiations are dangerous. Why? Your landlord hopes he/she will not have to recapitalize your premises for another tenant. Revise your approach even if you plan to renew your lease. It is not a renewal, but rather "Building Option One" to compare with all the other buildings you will evaluate. In essence, your building provides you with two opportunities: the one your renewal option declares and the one you successfully negotiate using the open market as your backdrop of comparable spaces.

The fact is, you are considering leasing space in your landlord's building again, not simply renewing. As a result, all business points should be on the table for discussion.

Tip: Gain negotiating leverage by touring the market and understanding your options. Your landlord will work hard not to lose you.

Phase 2: Selection. Negotiate your lease. It is crucial that you understand all of the costs and risks associated with each property along with the terms to which you're agreeing. Insist on future protection clause in case your needs change. Perform proper physical due diligence so you're not surprised by building issues later.

Dangers to avoid in phase 2 include not thoroughly inspecting a building. Many tenants overlook one of the biggest liabilities in a new lease: the base building systems and condition of the premises; i.e., the physical condition and safety of the building. Poor infrastructure is an obvious red flag, but building enhancements can be just as concerning. When a landlord makes a significant improvement to the building (such as adding a new roof or replacing the HVAC), those associated costs are often billed back to tenants over the duration of the lease.

Tip: A proper inspection and lease protection can prevent a large liability from a capital improvement project.

Phase 3: Build Out. Begin coordinating your move during construction, up to 24 weeks before your move-in date. The steps include: select architect, design, city review, preconstruction and construction, furniture selection, information services and audio visual, security, signage, move-in.

Your plan should include:

- Initial planning: define roles, resources, budget, timing, change messaging and vendors;
- Communicate: prepare employee welcome materials and move instructions;
- Transfer: finalize security, mail and technology moves;
- Organize: label day 1 tasks, directions, workstations, keys and layout;
- Confirm: check inventory, end of lease terms, final invoices and do a walk-through of your old space.

Trend to Watch in 2019 – 'Open Office' Concept

More and more companies are closing the door on the popular "open office" design trend. A recent study shows that the open office may do more harm than good. Here are some thoughts based on science. The *Journal of Environmental Psychology* jumped into the fray and came out with a huge study (40k+ workers and over 300 companies). What did they find?

- Closed offices outperformed open offices for productivity;
- Proxemics issues (how people feel when close) create uncomfortable workers (and therefore less productivity);
- Noise and visual disruption (or as Geoffrey James says "visual and noise pollution") creates distraction and focus issues.

If your firm or company wants to give its employees space to collaborate and socialize without falling victim to these issues, new and emerging design trends may have the answer. Some offices incorporate the best of both worlds with flexible design plans.

Flexible plans offer private spaces for those who need a little solitude to get the job done – individual offices or small conference areas for groups to gather away from the crowd, but their main work areas still reflect an open design. People can sit among their peers in an open space for a few hours before moving to a private office to make phone calls or zone in on the details of a creative project.

Final Thoughts

The integration of these strategies, location factors and space considerations requires comprehensive due diligence and a measured approach.

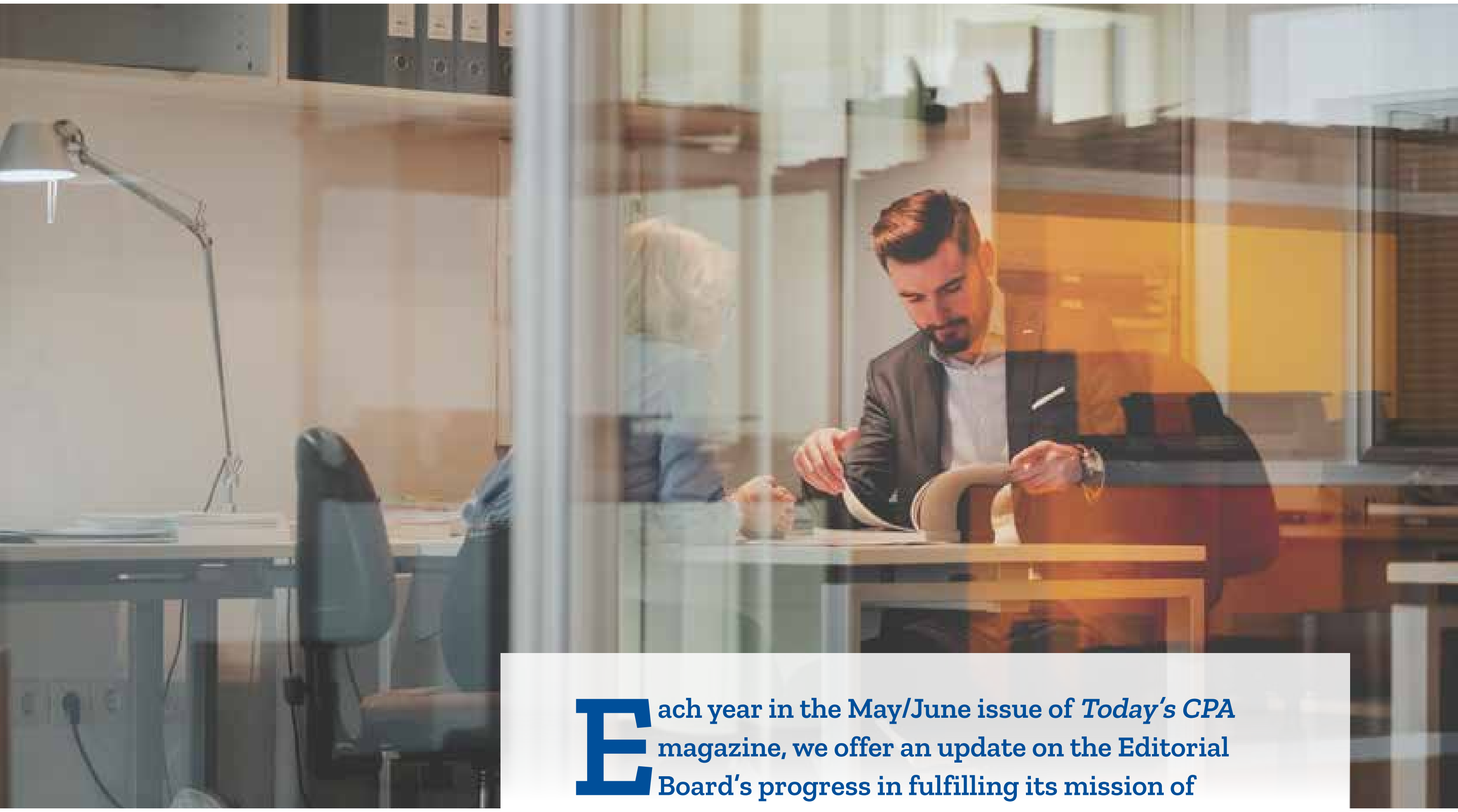
The information provided in this article should help serve as a reference. While it can't replace the personalized insight gained from working one-on-one with a tenant advisor, it can offer a starting point for the considerations and steps that should be taken to ensure your facility is an asset, not just office space. ■

About the Author:

As director of the office tenant representation team based in DFW, Mike Ebbitt oversees the building and growth of the specialty group. His team assists tenants with occupancy needs in office properties throughout DFW and across the nation. Whether the assignment is a relocation, expansion, consolidation, sublease, acquisition or disposition, Lee provides end-to-end occupier representation services. Ebbitt may be contacted at mebbitt@lee-associates.com or 972-934-4004.

AN UPDATE ON *TODAY'S CPA*

By *Today's CPA* Technical Editor Brinn Serbanic and *Today's CPA* Managing Editor DeLynn Deakins



Each year in the May/June issue of *Today's CPA* magazine, we offer an update on the Editorial Board's progress in fulfilling its mission of supplying relevant, informative and thought-provoking material for our readership.

The March/April and September/October issues are digital-only issues of *Today's CPA* magazine.

Looking back at the 2018-2019 year, the concepts of change and innovation shaped our profession. A number of news articles in the media dubbed 2018 "The Year of the Accountant" and more specifically, the tax accountant. The most far-reaching tax code reform in decades – the Tax Cuts and Jobs Act (TCJA) – dominated continuing professional education, professional publications and mainstream media. The TCJA affected every facet of taxation – international, estate and gift, small and large businesses, individuals, and nonprofit organizations.

The TCJA turned traditional planning strategies on their head in many cases, and sent tax accountants scrambling to understand and plan for these new regulations, with initially very little guidance available. Virtually each month over the past 18 months, a new pearl of guidance was issued from the IRS and Treasury. Much of 2018's planning and restructuring was put to the test and came to fruition during the spring's furious and fast-paced compliance season.

In other tax news, *South Dakota v. Wayfair* was a landmark case in the determination of sales tax nexus, overturning the former physical presence standard established almost 30 years ago in *Quill Corp v. North Dakota.* As a cascade of other states jumped on the bandwagon to institute and enforce similar statutes, many questions still remain to be answered: what's the impact for income tax, how is "substantial nexus" defined, etc.?

Last year also saw the implementation of Financial Accounting Standards Board (FASB) ASU 2016-14, the most significant update to nonprofit financial reporting since the 1990s, as well as the implementation of the new revenue recognition standards, first effective for public companies, but now rolling out to private companies by the end of this year.

Coming soon for the banking industry is the effective date of the much talked about FASB CECL standards that will fundamentally change how financial institutions account for expected credit losses.

Overview

Today's CPA is a bi-monthly, peer-reviewed magazine published for the members of TXCPA. Articles submitted for consideration in *Today's CPA* are reviewed and selected by members of TXCPA's Editorial Board. The Editorial Board represents a cross-section of the overall membership of TXCPA, including representatives from industry, public practice and academia. The board is also charged with brainstorming potential topics to be covered in the magazine and soliciting submissions from a diverse author pool.

In each issue, we attempt to balance the magazine's content to cover the various interest areas of TXCPA's membership, although certain issues during the year are devoted to a specific theme. Articles in the publication may include case studies, technical analysis and informed commentary on the topic.

Each issue of the magazine includes an article that offers continuing professional education (CPE) credit. The CPE article is peer-reviewed, and the quiz is pre-tested by reviewers prior to publication.

Figure 1 is a comparative summary of our activities for the past three calendar years. Submissions remained steady in 2018, although a larger number of the accepted articles were solicited by invitation. The key to maintaining high-quality material in our journal is increasing the number of submissions. We are continuing our efforts to solicit more submissions from both practitioners and academics.

Acknowledgements

We would like to thank the members of the Editorial Board for their time and considerable effort in volunteering to review articles for publication, pre-test CPE quizzes, and participate in meetings and on conference calls. The names of the members are listed in the magazine's masthead each issue. We also thank the accounting and financial professionals who author articles for *Today's CPA*.

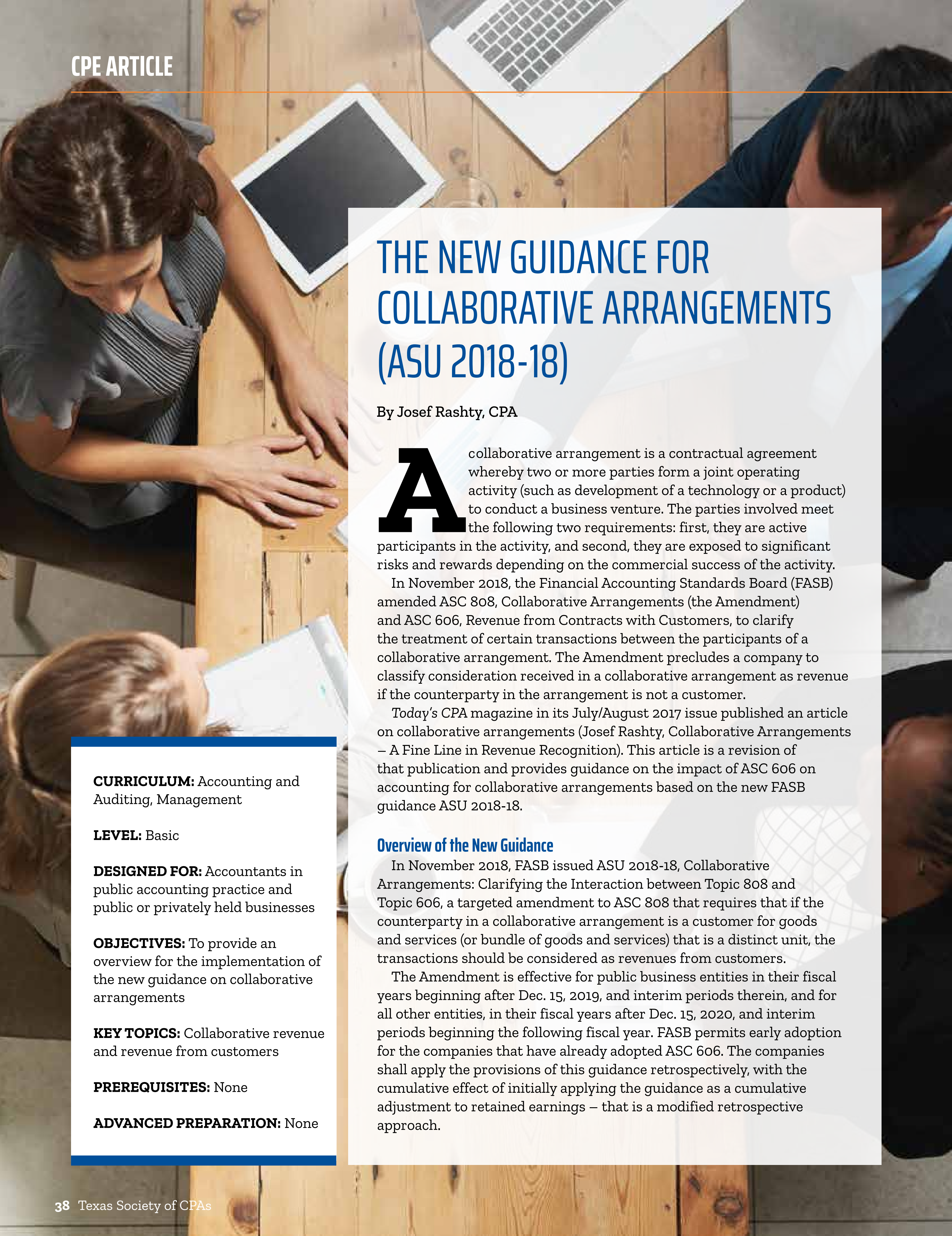
If you or someone in your organization would like to write an article for *Today's CPA* or have an idea you feel can be developed into an article, we encourage you to contact us. The Editorial Board maintains a list of topics desired for publication and we would be willing to work with you to find a match to your particular area of expertise.

It is only by receiving a large number of relevant submissions from a broad cross-section of our readership that we can continue to deliver high-quality content for TXCPA members. If you would like to receive our editorial guidelines, please contact DeLynn Deakins at ddeakins@tscpa.net or visit the TXCPA website at tscpa.org.

There is certainly no shortage of relevant and compelling content for *Today's CPA* to cover and we invite you to join us each issue in exploring the important topics that shape and impact our profession. ■

FIGURE 1. SUMMARY OF 2016 - 2018 ACTIVITY

ARTICLES	2018	2017	2016
Received	35	36	45
Accepted	24 (69%)	25 (69%)	29 (64%)
Rejected	9 (26%)	10 (28%)	15 (33%)
In Review	2	1	1
Invited Articles	5	2	2



THE NEW GUIDANCE FOR COLLABORATIVE ARRANGEMENTS (ASU 2018-18)

By Josef Rashty, CPA

A collaborative arrangement is a contractual agreement whereby two or more parties form a joint operating activity (such as development of a technology or a product) to conduct a business venture. The parties involved meet the following two requirements: first, they are active participants in the activity, and second, they are exposed to significant risks and rewards depending on the commercial success of the activity.

In November 2018, the Financial Accounting Standards Board (FASB) amended ASC 808, Collaborative Arrangements (the Amendment) and ASC 606, Revenue from Contracts with Customers, to clarify the treatment of certain transactions between the participants of a collaborative arrangement. The Amendment precludes a company to classify consideration received in a collaborative arrangement as revenue if the counterparty in the arrangement is not a customer.

Today's CPA magazine in its July/August 2017 issue published an article on collaborative arrangements (Josef Rashty, Collaborative Arrangements – A Fine Line in Revenue Recognition). This article is a revision of that publication and provides guidance on the impact of ASC 606 on accounting for collaborative arrangements based on the new FASB guidance ASU 2018-18.

Overview of the New Guidance

In November 2018, FASB issued ASU 2018-18, Collaborative Arrangements: Clarifying the Interaction between Topic 808 and Topic 606, a targeted amendment to ASC 808 that requires that if the counterparty in a collaborative arrangement is a customer for goods and services (or bundle of goods and services) that is a distinct unit, the transactions should be considered as revenues from customers.

The Amendment is effective for public business entities in their fiscal years beginning after Dec. 15, 2019, and interim periods therein, and for all other entities, in their fiscal years after Dec. 15, 2020, and interim periods beginning the following fiscal year. FASB permits early adoption for the companies that have already adopted ASC 606. The companies shall apply the provisions of this guidance retrospectively, with the cumulative effect of initially applying the guidance as a cumulative adjustment to retained earnings – that is a modified retrospective approach.

CURRICULUM: Accounting and Auditing, Management

LEVEL: Basic

DESIGNED FOR: Accountants in public accounting practice and public or privately held businesses

OBJECTIVES: To provide an overview for the implementation of the new guidance on collaborative arrangements

KEY TOPICS: Collaborative revenue and revenue from customers

PREREQUISITES: None

ADVANCED PREPARATION: None

Collaborative Arrangements

The purpose of a collaborative arrangement is to provide partners with a share of profits and losses in joint operating activities. In collaborative arrangements, partners usually share responsibilities, but one partner may have the sole responsibility for certain activities, while others share the remaining responsibilities.

Counterparties in a collaborative arrangement often conduct their activities without the creation of a separate legal entity. As a result, collaborative arrangements usually provide a certain level of flexibility and less structure in their operations.

Collaborative arrangements are typically within the scope of Topic 808; however, the new guidance requires that if the counterparty is a customer for goods and services (or bundle of goods and services) that is a distinct unit, the transaction is revenue from customers according to Topic 606 paragraphs 606-10-15-4 and 606-10-25-19 through 25-22 (ASC 808-10-05-15-5B). If so, the company applies the guidance of ASC 606 for recognition, measurement, presentation and disclosure requirements.

Revenue from Customers

When FASB issued ASC 606, it received inquiries regarding its applicability to collaborative arrangements. FASB determined that companies should apply the guidance in ASC 606 for revenue recognition if a customer and distinct goods and services exist within a collaborative arrangement (ASC 808-10-15-4).

Customer

A customer is a party that has contracted to obtain goods or services that are output of another entity's ordinary activities in exchange for consideration. FASB has stated that a counterparty to the contract would not be a customer if, for example, the counterparty has contracted with an entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities (ASC 606-10-5-3).

Distinct Goods and Services

A good or service that a company has promised to a customer is distinct if both of the following criteria are met: First, the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct). Second, the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract) (ASC 606-10-25-19).

A customer can benefit from a good or service if the good or service could be used, consumed, sold for an amount that is greater than its scrap value, or otherwise held in a way that generates economic benefits. For some goods or services, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources (ASC 606-10-25-20).

Nevertheless, the practical application of being distinct could be challenging for some companies involved in collaborative arrangements and may require exercise of significant judgment. The following summarizes the process:

- The company determines that the units of account within a collaborative arrangement exist;
- Furthermore, it assesses whether the good or service is capable of being distinct and separately identifiable from other promises in the contract;
- Finally, it assesses that all or part of the unit account is a transaction with a customer.

Generally, a good or service is not distinct if it is combined with other goods and services in the contract. If so, the company needs to find a bundle of goods and services that is distinct.

Principal vs. Agent Considerations

In collaborative arrangements involved in earning processes, companies often need to assess which party is the principal or agent. ASC 808 relies on the guidance of ASC 606 to determine the counterparties as principal or agent. ASC 606 has revised the guidance for recognition of revenues for principals (who recognize revenues on a gross basis) versus agents (who recognize revenues on a net basis). *Today's CPA* in its January/February 2017 issue published an article on gross vs. net revenue recognition (Josef Rashty, Amendment to Gross versus Net Revenue Recognition). Nevertheless, regardless of the method of accounting (i.e., gross versus net), the amount of net profit remains the same under the two different methods – only the top-line inflows change pursuant to the accounting method.

ASC 606 states that the party that exercises control records its revenues on a gross basis, whereas the other party recognizes it on a net basis. The revenue recognition model has changed from a risks and rewards model under ASC 605 to a model based on control under ASC 606 (ASC 606-10-55-37). ASC 606-10-55-39 identifies the following indicators that enable a company to exercise control over the specified goods or services before its transfers them to customers:

- Fulfillment responsibility – the company is the primary responsible for fulfilling the promise to provide the specified goods or services to customers;
- Inventory risk – the company has inventory risk before the specified goods and services are transferred to customers;

- Price determination – the company has discretion in establishing prices for specified goods and services.

Application of ASC 606 in Collaborative Arrangements

Facts and Circumstances

Biotech entered into a collaborative arrangement with Pharmco to jointly develop a drug for cancer treatment. They equally participated in costs for development of the drug. Biotech and Pharmco jointly obtained a patent for the drug pursuant to its successful development and FDA approval. Subsequently, in an arm's length transaction, Biotech assumed responsibility for the manufacturing of the product and Pharmco for its marketing and sales.

Biotech at this stage sells its drug exclusively to Pharmco; however, if Pharmco is no longer willing to purchase this drug, it can sell it to other parties under separate arrangements. Thus, Biotech and Pharmco are not dependent parties and no longer share the risks and rewards in their collaborative arrangement.

The additional information is as follows:

- Biotech sells 10 units to Pharmco and Pharmco sells those units to its customers.
- The cost of goods sold (COGS) for Biotech is approximately $90 per unit for a total of $900.
- Biotech sells the drug exclusively to Pharmco for $120 per unit for a total of $1,200.
- Pharmco sells the drug to consumers for $160 per unit for a total of $1,600 and its additional cost of goods sold is approximately $10 per unit for a total of $100. Thus, its total cost of goods sold (including its purchases from Biotech for $1,200) amounts to $1,300.

Analysis of the Arrangement

It appears that in this arrangement, Pharmco is a party that has contracted to obtain products that are the output of Biotech ordinary activities in exchange for consideration. Thus, we can conclude that Pharmco is potentially a customer in this arrangement based on ASC 606. Furthermore, at this stage that the drug has been patented and approved for sale and marketing, they no longer share in any risk and reward arrangement. They both incur expenses and have revenues of their own and are independent of each other.

Moreover, we can conclude that the product is distinct. Pharmco can benefit from the product by selling it to its customers who are willing to pay for it for the treatment of their illness. Biotech's promise to transfer the product to Pharmco (its customer) has been separately identified in its contract.

Finally, the facts and circumstances do not reflect a principal and agent relationship between Biotech and Pharmco in this transaction. Therefore, we can conclude that the transaction is within the scope of ASC 606 since Pharmco is a customer and the unit of account is distinct within the collaborative arrangement.

Journal Entries

Biotech has sold Pharmco (its customer) its products in an arm's length transaction and Pharmco, in turn, has sold these units to its customers. The journal entries for this transaction are as follow:

Biotech

Cash	$1,200	
Revenue from Pharmco		$1,200
COGS	$900	
Cash		$900

Pharmco

Cash	$1,600	
Revenue from customers		$1,600
COGS to Biotech	$1,200	
Other COGS	$100	
Cash		$1,300

Application of ASC 808 in Collaborative Arrangements

Facts and Circumstances

Pharmco and Biotech agree to equally participate in the results of research and development activities for a drug candidate and its commercialization activities pursuant to a joint development and marketing agreement (a 50 percent, 50 percent arrangement). Pharmco remains responsible for the commercialization activities of the drug and Biotech for its manufacturing.

FASB requires that participants in a collaborative arrangement shall report costs incurred and revenue generated from transactions with third parties (that is, parties that do not participate in the arrangement) in their respective financial statements (ASC 808-10-65-1).

In this example, Biotech has concluded that based on an evaluation of the facts and circumstances, it is the principal on the sales to third parties and will present 100 percent of the sales revenue, cost of goods sold and marketing expenses in its income statement. Furthermore, Pharmco has concluded that other authoritative accounting literature does not apply to these payments, either directly or by analogy.

The additional information is as follows:

- Pharmco, acting merely as an agent, sells 10 units to customers on behalf of Biotech.
- Pharmco sells the drug to consumers on behalf of Biotech for $160 per unit for a total of $1,600.
- Biotech's cost of goods sold is $90 per unit for a total of $900.

- Biotech reimburses Pharmco $40 per unit sold for a total of $400 for its share in collaborative arrangement net profit.
- Pharmco's collaborative arrangements expenses are approximately $10 per unit for a total of $100. Pharmco reflects these expenses as collaborative arrangement expenses in its books.

Analysis of the Arrangement

Since Biotech has concluded that it is the principal, it reflects 100 percent of the sales, cost of sales and marketing expenses in its income statement. It also transfers a portion of that net profit to Pharmco as collaborative revenue. Pharmco incurs $100 as collaborative expenses and reflects them in its books accordingly.

Journal Entries

The journal entries for this transaction are as follow:

Biotech		
Cash	$1,600	
Revenue from customers		$1,600
COGS	$900	
Cash		$900
COGS - collaborative expenses	$400	
Pharmco I/C		$400
Pharmco		
Biotech I/C	$400	
Collaborative revenue		$400
Collaborative arrangement expenses	$100	
Cash		$100

Comparative Analysis of Sales to Customers vs. Collaborative Revenue

Table 1 summarizes the journal entries for Biotech and Pharmco in the above two examples.

Disclosure Requirements for Collaborative Arrangements

Companies that enter into collaborative arrangements should provide the following disclosures in their financial statements:

- Nature and purpose of the arrangement and the rights and obligations of the parties involved;
- Accounting policy and method that the parties have followed pursuant to the provisions of ASC 808 and ASC 606, and identification of principal vs. agent if applicable;
- The income statement classification reflecting collaborative revenues vs. revenues from customers and the associated cost of goods sold charges and collaborative arrangement expenses.

Final Remarks

The revenue recognition guidance excludes from its scope contracts with collaborators; however, a contract with a collaborator can be within the scope of ASC 606 if certain conditions are met (existence of a customer and distinct goods and services).

The counterparty can be a collaborator (within the scope of ASC 808) for certain parts of the contract and a consumer (within the scope of ASC 606) for other parts of an arrangement. Companies exercise significant judgment to determine if certain transactions are within the scope of ASC 808 or ASC 606.

ASU 2018-18 does not provide specific guidance for transactions that fall within the scope of ASC 606; thus, most likely, diversity will continue to prevail on how companies account for such transactions.

TABLE 1

	Collaboration Revenue	Revenue from Customers	COGS	Net Profit
Biotech				
Sale to Pharmco	–	$1,200	$900	$300
Sale to customers	–	$1,600	$1,300*	$300
Pharmco				
Sale to customers	–	$1,600	$1,300	$300
Agent fee	$400	–	$100**	$300

* Includes $400 collaborative arrangement expenses.

** Pharmco's collaborative arrangement expenses.

This table reflects that the top-line inflows change pursuant to the accounting method that companies have followed; however, the net profit bottom line remains the same regardless of the accounting method.

The author believes that the new guidance has clarified, but not significantly, the accounting issues regarding the classification of collaborative arrangements under ASC 808 and ASC 606. Furthermore, ASC 808 relies on ASC 606 for the definition of principal vs. agent, and it raises the question whether ASC 808 (as a standalone standard) is meaningful or is it feasible to collapse it into ASC 606 for revenue recognition purposes. ■

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CPE ARTICLE: THE NEW GUIDANCE FOR COLLABORATIVE ARRANGEMENTS (ASU 2018-18)

By Josef Rashty, CPA

Today's CPA offers the self-study exam for readers to earn one hour of continuing professional education credit. The questions are based on technical information from the preceding article. If you score 70 or better, you will receive a certificate verifying you have earned one hour of CPE credit – granted as of the date the test arrived in the TXCPA office – in accordance with the rules of the Texas State Board of Public Accountancy (TSBPA). If you score below 70, you will receive a letter with your grade.

1. A collaborating arrangement by definition is:
A. a joint venture
B. a consolidated entity
C. a joint operating activity
D. none of the above

2. FASB issued its amendment on collaborative arrangements in:
A. June 2017
B. August 2017
C. November 2018
D. December 2019

3. Collaborative arrangements are usually within the scope of:
A. ASC 606
B. ASC 808
C. Neither a nor b
D. non-GAAP reporting

4. _________ is the FASB standard that defines a customer.
A. ASC 606
B. ASC 808
C. Neither a nor b
D. Non-GAAP reporting

5. A collaborative arrangement can become within the scope of ASC 606 if the following condition(s) exist:
A. a customer
B. a distinct good or service
C. Neither a nor b
D. Both a and b

6. __________ defines a principal in a collaborative arrangement.
A. ASC 808
B. ASC 606
C. Both a and b
D. Neither a nor b

7. ASC 606 states that the party that exercises control in a collaborative arrangement is often:
A. the principal
B. the agent
C. the customer
D. the government

8. Regardless of the accounting method that companies use in their collaborative arrangements:
A. the top line revenue arrangement remains the same
B. net profit changes
C. either a or b
D. net profit remains the same

9. A counterparty in collaborative arrangements:
A. is always a customer
B. is never a customer
C. can be a customer for part of an arrangement
D. none of the above

10. The author commented that the new FASB guidance has _________ clarified accounting for collaborative arrangements.
A. extensively
B. substantially
C. significantly
D. not significantly

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