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TODAY'S CPA

Texas Society of Certified Public Accountants

A NEW FOCUS FOR INTERNAL FRAUD PREVENTION

NONPROFIT ORGANIZATION GOVERNANCE, FINANCIAL METRICS AND TECHNOLOGY

BOT TO THE FUTURE

MEDICARE AND THE FORGOTTEN CONTRIBUTIONS

AUDITORS' CAM DISCLOSURES, A MANAGEMENT PERSPECTIVE

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Texas Society of Certified Public Accountants

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THE CPA ADVANTAGE

By TXCPA Chairman Lei D. Testa, CPA-Fort Worth, CGMA

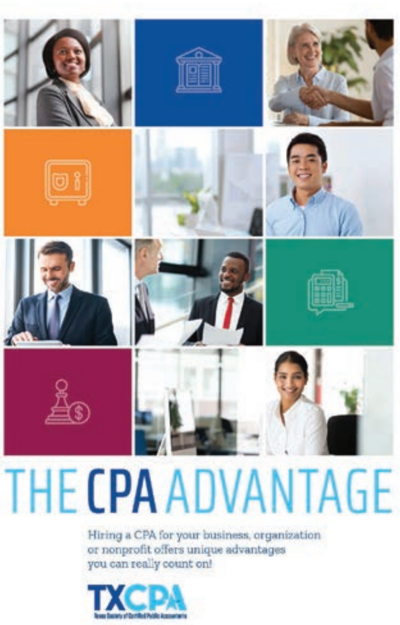
Share Your Thoughts

I'd love to hear your feedback and answer your questions. Drop me a note at chairman@tscpa.net.

Welcome to your March/April digital issue of *Today's CPA*. During this especially busy time of year, many people are thinking about our profession. And even though many of our members don't work in tax, we want to leverage the public's focus on CPAs to reinforce core messages about the value of working with CPAs, hiring CPAs and choosing the CPA profession.

Members look to TXCPA to promote the profession to the public and that's exactly what our new campaign, The CPA Advantage, is designed to do. We kicked off 2020 with brand new TXCPA ads running on Facebook, LinkedIn, Twitter, Spotify and in the digital versions of many local newspapers across the state. As of press time, our ads have had combined impressions of nearly 566,000 in just six weeks!

We also have a social media ad and a print ad available for your use! There's space available for co-branding the ads with your firm or company information. You can find everything you need in The CPA Advantage online toolkit for members. While you're there, check out the brochures, social media tips and PowerPoint presentations to help you promote your services. The TXCPA staff team is ready to provide you with personal assistance with co-branding and answer any questions you may have.



We know the many advantages we provide to our clients, companies and communities. I'm excited to continue to share that important message with the public while supporting and promoting our members and our profession!

ARE YOU MAXIMIZING THE POTENTIAL OF YOUR INTERNAL AUDIT TEAM?

By Don Carpenter, MSAcc/CPA

The internal audit function fulfills a unique mission within a business. Although internal auditors are generally employees of the organization, they are expected to bring an independent perspective to the evaluation of financial accuracy and internal controls.

This unique role is reflected in the dual reporting lines that many internal audit departments operate under. Generally, the department will report internally either directly or indirectly to the chief financial officer or general counsel.

In addition, the function may have a second reporting line directly to the Board of Directors, often via the audit committee. This second line serves to reinforce the independence of internal audit and allows the board to have direct visibility into company matters.

Traditionally, the resources of internal audit have been dedicated to supporting the board's fiduciary responsibility, particularly financial statement integrity and legal compliance. From this perspective, the staff's hours are typically focused within the following areas.

Policy and Procedure Compliance

Given the function's independence, it has been the responsibility of internal audit to conduct systematic, periodic reviews of compliance with the policies and procedures of the organization. After enactment of the Sarbanes-Oxley Act, the emphasis has been on compliance that is critical to financial statement accuracy. This can include verification of supporting transaction documentation and appropriate approvals, as well as review of non-routine accounting entries.

Fraud Investigation and Detection

Most organizations have established hotlines to allow employees and third parties to report suspected fraud or similar irregularities. These incidents are generally relayed to internal audit for investigation and verification. In addition, internal audit may proactively conduct reviews of sensitive areas to identify possible weaknesses, including segregation of duties, nepotism and appropriate access to the enterprises' reporting systems.

But with the accountability of organizations expanding to include such areas as environmental sustainability, cybersecurity, employee wellness and even philanthropy, a potential expansion of the role of internal audit should also be considered. As the mission of internal audit is redefined, it is necessary to consider existing talent and resources that have not been traditionally included in the function.

A more expansive role for internal audit could include the following areas.

Don Carpenter is clinical professor of accounting at Baylor University. Contact him at Don_Carpenter@baylor.edu.

WITH THE ACCOUNTABILITY OF ORGANIZATIONS EXPANDING, A POTENTIAL EXPANSION OF THE ROLE OF THE INTERNAL AUDIT FUNCTION SHOULD ALSO BE CONSIDERED.

Assurance

To control audit fees, internal audit can be utilized to reduce the staff hours of the company's assurance firm. Internal audit assistance is usually devoted to either internal control testing and/or substantive testing of a more routine, ministerial nature. There is no bright line test as to the extent of reliance on internal resources, but the assurance firm's direct participation must increase as risk and subjectivity increases.

A hidden benefit of assurance assistance is that the internal audit staff gains valuable knowledge of the business and the function's visibility within the organization is increased. Further, institutional knowledge of seasoned internal auditors is a resource for the assurance firm that may lack experience with the client.

Operational Efficiency

The responsibilities of internal audit may also be expanded to include initiatives that once were outsourced to consulting firms. Projects such as post-acquisition reviews, procurement contract compliance or logistics management do not directly affect financial integrity or legal compliance, but they are areas that have a direct impact on profitability.

A post-acquisition review might be conducted to determine whether:

- The synergies included in the acquisition economics materialized in the timeframe and to the extent planned, or
- Unexpected issues arose in subsequent periods that call into question the effectiveness of due diligence.

Procurement-related projects might include reviews to determine whether business personnel are sourcing inputs from approved vendors and if pricing is in line with negotiated terms. Such work could be expanded to determine whether sourced goods are fulfilling performance requirements or if alternative sources might provide better value.

As the role of internal audit expands into operational support, it will likely become necessary for existing talent to be supplemented with additional resources. For a business with considerable construction or manufacturing operations, adding personnel with engineering skills might be required, while logistical expertise such as routing or customs administration might be necessary if product flow is an integral part of the business model.

If this work is recurring, having permanent staff might be justified. Otherwise, supplementing an internal team with specialized outsourced skills may be more economically responsible.

Risk Management

Given the independence of the internal audit function, oversight of an organization's Enterprise Risk Management (ERM) program may also be included within its portfolio.

Cybersecurity exposures such as firewall testing or system access administration are important parts of any ERM program that can be managed internally with appropriate talent. Data back-up and disaster planning can be reviewed and documented by a qualified internal audit staff.

Finally, operational issues such as manufacturing or sourcing contingency plans or environmental risk management may become part of the internal audit review cycle.

Caution Needed

As an organization takes a fresh look at how internal audit might be utilized to help manage cost, maximize profitability and mitigate risk, two cautions should be noted.

First, to be effective, the function may require skillsets and resources beyond the traditional financial auditor, which may entail additional staff or consulting services.

Second, as the function becomes more operationally involved in the organization, care should be taken to ensure that independence is not compromised as individuals identify more directly with results and outcomes. More oversight of the area by upper management or the board may be required.

TAX SEASON RESOURCES FOR MEMBERS

Take advantage of TXCPA resources this tax season! The online, members-only TXCPA Exchange is a great place to ask questions, get advice, provide feedback and expand your professional network. Be sure to log in and join the Tax Issues community, where you can participate in the conversation and discuss your burning tax questions.

Tax Issues Community >

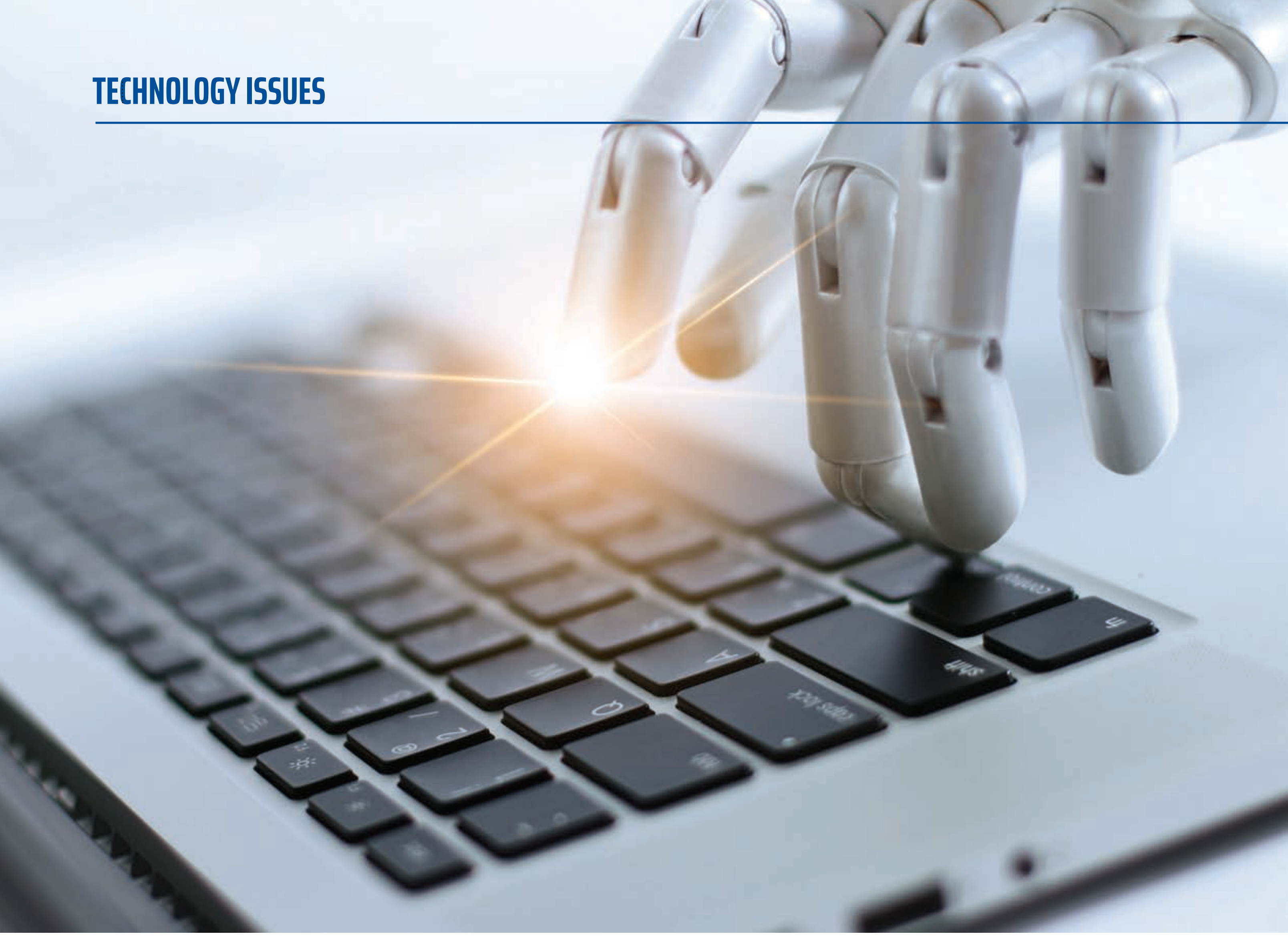
Timely updates on tax topics are also available on the Federal Tax Policy Blog. The blog provides important information and valuable commentary from the TXCPA Federal Tax Policy Committee.

Federal Tax Policy Blog >

Do you need to knock out a few CPE hours on your own time during tax season? Check out our vast selection of webcast and on-demand programs available to fit your schedule and your budget.

Online CPE Webcasts & On-Demand Programs >

TXCPA is your connection to top-notch education and up-to-date information this busy season and throughout the year.



BOT TO THE FUTURE

By Jack Cook

In computer lingo, a "bot" is the nomenclature for a robot program that looks for and reacts to certain parameters of people's questions. The Russians used bots to affect the 2016 U.S. election. They did this by posting and reposting incendiary political messages on Facebook.

Bots can also be used for tasks other than inflaming passions. Accounting firms can use them to boost their marketing presence and reach potential clients.

The two easiest and most useful bots to make/use are:

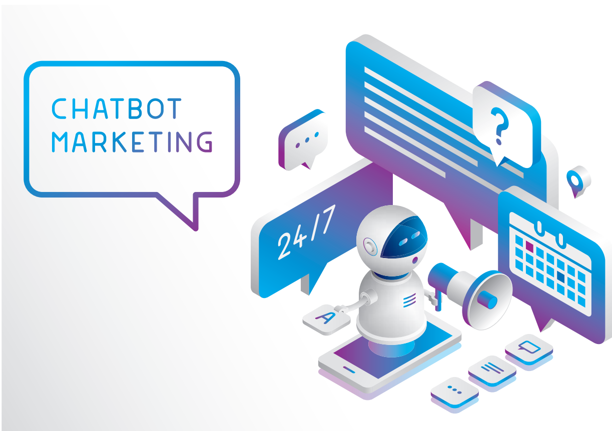
- An SMS textbot, and
- A Facebook chatbot.

SMS Text Bot

An SMS textbot is a bot that operates over text messaging. A textbot uses a dedicated subscription phone number with a set of keywords that it will respond to. For example, a client sends a text to the dedicated phone number of the textbot that asks, "Does your firm do tax returns?" The textbot will read the keywords "tax returns" and then respond with a preprogrammed message: "Yes, we do tax returns; what type, 1040s, 1120s, 1065s?"

The bot can ask questions to determine the type of return and based on the reply, can make queries appropriate for that type of filing. These types of bots are encountered when making airline reservations, calling your stockbroker and/or contacting just about any high-volume company.

Having never programmed a textbot before, it took the author about two hours to develop a simple "party" bot. Twilio and Diagflow were used. It cost less $1.00 per month for the subscription phone number.



Facebook Chatbot

A Facebook chatbot is essentially the same as an SMS textbot, but it operates on a Facebook page. For example, if someone comments on your firm's Facebook page and uses the keywords described above, it can similarly respond.

However, what makes the Facebook chatbot so powerful is that if someone "likes" your Facebook page, the bot can proactively reach out to that person. For example, the chatbot could reach out and ask the following:

"The deadline for filing 1099s is fast approaching. If you need more information or help, just type '1099' in reply and our algorithm can begin helping you with most of the information you need."

The easiest platform to use in programming these chatbots is Chatfuel. After you have programmed a chatbot using Chatfuel, it will prompt you to connect to Facebook. Once you have decided on the message and appropriate keywords, the actual programming process is quite simple. Remarkably, Chatfuel is free for the first 1,000 messages.

Using these types of bots can boost your social media profile, which in turn can boost your client base with very little expenditure.

Contact Jack Cook at jcook096@gmail.com.

TXCPA MIDYEAR BOARD OF DIRECTORS AND MEMBERS MEETING

By Rhonda Ledbetter, TXCPA Volunteer and Governance Specialist

At their first meeting of the new decade, TXCPA members and the Board of Directors were focused on the future. Houston was the setting for the January event.

Town Hall

TXCPA Chairman Lei Testa, CPA-Fort Worth, CGMA, provided an update on the five priorities for 2019-2020, communicated in her July/August 2019 Chairman's Message in *Today's CPA*.

1. Engaging the next generation of CPAs. Through our outreach on campuses and with our faculty ambassadors, TXCPA is aggressively growing the number of students who are involved. Engaging students and candidates in the Society and ensuring that they are aware of all the career paths available to them as a CPA will continue to be among our highest priorities.

2. Enhancing state and chapter collaboration. We're continuing to expand our chapter leader training opportunities. Chapter-specific dashboards and a chapter leader portal are making data more accessible than ever.

3. Extending our brand to promote the profession. As we learned in our research, TXCPA is intrinsically tied to the CPA brand in Texas and members feel strongly that promotion of the profession is part of our core mission. Through The CPA Advantage, we're releasing resources for members and chapters to use, and are launching more awareness campaigns using social media and some traditional media, as well.

4. Expanding digital learning opportunities. The initial feedback from members about the new online learning opportunities and the TXCPA Passport subscription service has been extremely positive. We'll continually add titles to the library, record live presentations and make sure content is accessible anywhere, on any device.

5. Educating stakeholders on the significance of professional licensing. Many states face significant battles with their legislatures regarding professional licensing and making sure anti-licensing advocates do not shift the conversation away from protecting the public. The Alliance for Responsible Professional Licensing is an organization that advocates for licensing practices within professions that deliver uniform qualifications, standards, safety and consistency, while also providing individuals with fair opportunities to pursue and maintain a career. TXCPA is keeping a close eye out for professional licensing issues that might arise and impact CPAs closer to home.

TXCPA's Five Priorities for 2019-2020

1. Engaging the next generation of CPAs
2. Enhancing state and chapter collaboration
3. Extending our brand to promote the profession
4. Expanding digital learning opportunities
5. Educating stakeholders on the significance of professional licensing

Volunteers from around the state joined Testa onstage to share their perspectives on the work being done around the five priorities and to answer questions. Those members were:

- Edie Cogdell, CPA-San Antonio, CGMA;
- Tram Le, CPA-Fort Worth;
- Josh LeBlanc, CPA-Southeast Texas;
- Stephen Parker, CPA-Houston; and
- Jerry Spence, CPA-Corpus Christi.

Other Business

A financial report was made by:

- Treasurer Billy Kelley, CPA-Permian Basin, CGMA;
- Treasurer-elect Edie Cogdell, CPA-San Antonio, CGMA; and
- CFO Steve Phillips, CPA-Fort Worth, CGMA.

The Annual Meeting of the Accounting Education Foundation was conducted by Art Agulnek, CPA-Dallas. Susan Adams, CPA-Fort Worth, was recognized as the newest Kenneth W. Hurst Fellow.

The results of TXCPA's election were announced by Nominations Committee Chair Stephen Parker, CPA-Houston. Also, there was a vote to ratify the chairman-elect's appointees. Click here for a listing of the new TXCPA leaders for 2020-2021.

A report on the CPA-PAC was given by Committee Chair Jesse Dominguez, CPA-Austin, CGMA. Fundraising awards were presented to chapters. Please see Figure 1.

Figure 1:

CPA-PAC Awards for 2019

The following awards were presented to chapters for their work encouraging members to donate to the CPA-PAC.

Highest Percentage of Fundraising Goal
Large Chapter – Austin
Medium-sized Chapter – Corpus Christi
Small Chapter – Southeast Texas

Highest Percent Increase in Members Contributing
Medium-sized Chapter – El Paso
Small Chapter – Texarkana

TXCPA Strategic Planning

As discussed in a *Today's CPA* Spotlight on CPAs article highlighting Strategic Planning Committee Chair Ben Simiskey, CPA-Houston, TXCPA has begun the process of updating its three-year Strategic Plan. Eric Curtis, of Curtis Strategy, is facilitating the work of volunteer leaders and staff in examining the scope of where the Society should be rather than just developing a business plan.

There were roundtable discussions for members to discuss the value proposition at the state and chapter levels and share their recommendations for future direction. The updated plan will be shared as it evolves over the next several months.

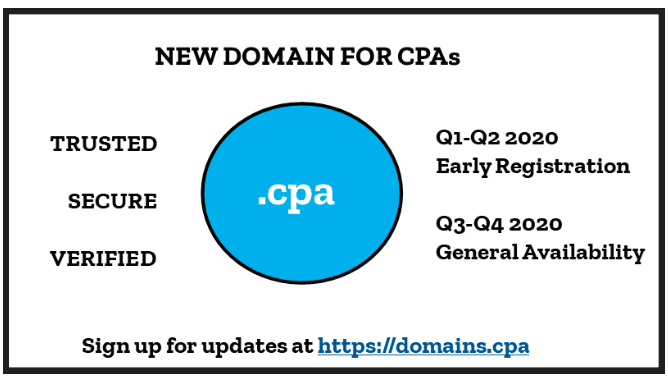
American Institute of CPAs

Texas' first chair of AICPA in many years is Bill Reeb, CPA-Austin, CGMA, CITP. He began his high-energy presentation by talking about the exponential pace of change, where today's most advanced artificial intelligence systems are much more powerful than those used in 2012. And yet, much of AI is still in its infancy. Technology is changing the landscape for accounting careers. He stressed that this is not about the current leaders of the profession; it's about the next generation.

The Dynamic Audit Solution is on track. Additional user acceptance testing will be continued in 2020, covering key workstreams such as expanded risk assessment, internal controls and work programs.

Blockchain is a focus and it will change the way that audits will be performed. The business value-add of blockchain is estimated to exceed $3.1 trillion by 2030. The profession needs to pay attention, which is why AICPA has working groups and a virtual currency task force to address important issues around it.

Entities are launching new top-level domain names as a way to increase trust and security in the marketplace. The all-new .cpa domain is being launched to serve the accounting profession. The new domain will be available for licensed CPA firms or individual CPAs. Early registration will be during the first half of 2020 and it will be widely available after that. CPAs and their firms are encouraged to register as soon as registration opens to ensure they are the first to register for their preferred domain name.



CPA Evolution

There's a need to evolve CPA licensure to adapt to technological innovation, new client and business demands, and changes to CPA core services. AICPA and the National Association of State Boards of Accountancy have been exploring if and how the CPA licensure model should change. The project has been named CPA Evolution.

Five guiding principles were provided for feedback in a variety of forums last year, including the TXCPA 2019 Annual Meeting of Members, as reported in the September/October issue of this magazine. The resulting list is:

- We must adapt quickly;
- Technological expertise is essential;
- Licensure requires rethinking;
- We must expand our view of the CPA candidate – all must demonstrate core competencies; and
- Change should be rapid yet deliberate.

The leaders of AICPA and NASBA have held several in-person meetings over the past few months to discuss the best way forward. At a recent meeting, a vote was taken of the attendees and a proposed new licensure model was chosen.

The recommended model starts with a strong core. After completing the core, each candidate would then choose a discipline in which to demonstrate deeper skills. The disciplines have not been finalized, but three identified to date are:

- Business reporting and analysis;
- Information systems and controls; and
- Tax compliance and planning.

Reeb led the meeting participants in exercises to gather input on the degree of education and testing that should be required of CPA candidates. You can learn more and see the proposed new CPA licensure model on the CPA Evolution website.

Upcoming Events

All members are warmly encouraged to be part of the 2020 Annual Meeting at the Worthington Hotel in Fort Worth, June 26-27. Book your room today!

Members will be a vital part of the Advocacy Day and Midyear Board of Directors and Members Meeting in Austin on Jan. 26-27, 2021.

Lifelong Learning

"CPAs are committed to lifelong learning. We will need to become adaptive learners, with frequent upgrades of skills and knowledge. We will need to learn, unlearn, relearn."

Bill Reeb, 2019-2020 AICPA Chairman

MARK YOUR CALENDAR:

TXCPA's 2020 Annual Meeting of Members and Board of Directors Meeting

June 26-27, 2020 at Worthington Renaissance Fort Worth Hotel, Fort Worth

Join us in Cowtown for learning, networking and fun!

Save Time and Maximize Value With TXCPA's Group Billing Program

If you have more than one TXCPA member who works in your organization, you're eligible for group billing benefits. Our convenient Group Billing Program allows renewal of all memberships within your organization at one time with a single dues invoice.

You'll also receive other great benefits, including one free membership for a non-CPA firm administrator or office manager, reduced pricing for the TXCPA Passport, a 20% discount on select in-house CPE seminars, a complimentary 30-day job posting in the TXCPA Career Center, and more. Participation in the specially designed program ensures that your membership dues investment returns the highest value available.

Learn more about the benefits of the Group Billing Program on our website. Contact Stephanie King at sking@tscpa.net or 800-428-0272, ext. 233 to enroll today!

Joe Guerra Receives 2020 B&I Award

Joe Guerra

TXCPA member Joe Guerra, CPA-San Antonio, CGMA, was recently recognized with the 2020 B&I award! The award honors CPAs who work in general industry, government or education, and have made significant contributions through their influence and impact on others in the accounting profession.

Guerra is CFO of La Familia Cortez, the owners and operators of the Mi Tierra restaurants in San Antonio. Since their founding, the restaurants have become some of the most iconic establishments in San Antonio.

Guerra has been a member of TXCPA San Antonio for many years. He encourages all accountants and accounting students to pursue the CPA license. His chapter involvement includes serving on the B&I Committee, the Board of Directors and more. He brings energy and enthusiasm to all that he does and challenges the leadership of TXCPA San Antonio to think outside the box with respect to how the chapter approaches people, how to better serve members and potential members, and what kinds of new, creative CPE offerings can be offered.

TXCPA congratulates Guerra on being named as the 2020 B&I award recipient!

Stay Connected to TXCPA – Update Your Information

Do you need to update your contact information, interest areas or other TXCPA preferences? Make sure you're getting the most from your membership and don't miss out on valuable resources by updating your information on our website. If you need assistance, please call member services at 800-428-0272 or 972-687-8500, option 1.

Click Here

TXCPA's Career Center – Connecting Employers and Qualified Candidates

Are you looking for an outstanding go-to place to find or post an employment position? Our online Career Center is for you! TXCPA makes this resource available to assist you in every phase of your career.

Job seekers can: View and apply for open positions, post their resumes, sign up for job alerts, get help with writing an effective resume, receive assistance from experienced career coaches, and more. TXCPA members can add a job seeker profile for free.

Employers can: Post their jobs online, manage applications, search resumes, set up an email resume alert, and more. TXCPA members receive exclusive savings on postings and can select options that provide enhanced visibility of their openings.

Check out the CAREER CENTER to learn more about the services available to find or post a job aimed specifically at accounting and finance professionals.

NONPROFIT ORGANIZATION GOVERNANCE, FINANCIAL METRICS AND TECHNOLOGY

By Dr. Kamala Raghavan

Board members of nonprofit organizations are often confused by the differing reports about the financials and operating metrics by the finance and fundraising areas. The chief financial officer (CFO) is guided by the compliance and reporting rules, while the development director is guided by annual fundraising goals.

The development director may announce that a major donor pledge has helped to exceed the organization's annual income goal, while the CFO refutes the claim and reports the organization's annual income shortfall due to the conditional nature of the gift. The directors with governance responsibilities are confused and wonder who is right – the CFO or the development director. Both of the officials are right, because each is presenting his/her individual report based on his/her own view.

Finance and development each bring a unique but different perspective to an organization's finances. For the finance team, Generally Accepted Accounting Principles (GAAP) rules established under Financial Accounting Standards Board (FASB) Statements No. 116 and No. 117 stipulate how gifts should be recorded and reported.

The development director's universe is about marketing and relationships with donors, their favorite programs or the general operating fund. Accounting and fundraising often use different databases and the reports leave the board members confused about the financial status of their organization.

So, what's the answer? This article outlines the following basic steps to strengthen the governance process at nonprofit organizations:

- Education;
- Collaboration;
- Technology, including business process transformation;
- Sustainability; and
- Governance.

Nonprofit organizations are facing a new era where funders/donors see themselves as investors looking for proof of an organization's effectiveness before they contribute. The organizations are dealing with a new definition of effectiveness going beyond the traditional measure of the percentage of administrative and fundraising overhead to revenues.

By integrating systems to present a holistic picture and using innovative technologies, a nonprofit organization's leaders can provide donors the true costs of achieving their mission so that they can make better decisions for resourcing their programs.

Education

The first step is education. Board members may be reluctant to go through extensive training in accounting and finance, but they must realize that they have a fiduciary responsibility to the organization.

Resources such as Board source, Nonprofits Assistance Fund and Nonprofit Finance Fund can help. Even a basic glossary of common terms can be helpful for both fundraisers and finance to understand how the various terms used about dollars raised can have different meanings to the audiences.

Collaboration

Another critical step towards mutual understanding is collaboration. When three blind men discuss what each of them felt by touching the elephant, they can put together a full picture of the elephant.

By collaborating ahead of time on how temporarily restricted contributions such as pledges and grants will be reported under accounting rules along with explanations on the differences, the board and executive leadership will be able to get a clear picture of the organization's financial health.

Technology

Utilizing technology can help bridge the gap in communication and information reporting if business processes are carefully orchestrated using an integrated Enterprise Resource Platform (ERP) allowing the organization to automate many back-office functions and integrate fundraising software and accounting. Basic technology can accomplish three major tasks – data mapping and business process design, appropriate technology, and vision.

With data mapping and business process design, all involved parties need to agree on the data and operational level, synchronizing coding structures, and mapping multiple criteria to transactions. The chosen technology must be able to accommodate additional data and business processes, along with good change management strategies.

Vision must emanate from the nonprofit organization's boards and executive leadership, and must consist of transparency, impact and stewardship of resources. The vision is based on the answer to these basic questions:

- What is the most meaningful aspect of the work that we do?
- How can stewardship and progress toward the goals be tracked and communicated?

Results can be accomplished only by synchronized functionality between fundraising and finance teams, and by using technology to communicate a holistic picture of the organization.

Disruptive Technologies. The next step in technology development would be to review and identify the available disruptive technologies, such as predictive analytics, blockchain and artificial intelligence, while being cognizant of the need for robust cybersecurity practices to improve the organization's effectiveness in the donors' view.

The following disruptive technologies are rapidly changing the processes in the corporate sector of the economy, and donors and other stakeholders will also expect their adoption by the nonprofit sector.

Blockchain is a database that holds data and programs in heavily encrypted "blocks" of individual transactions as a result of executable files. The programs and codes can only be added and cannot be edited or deleted, with each block linked to the previous one, making a "blockchain." It uses a digital ledger to share and track information related to contracts and transactions, and the records are permanent, verifiable and secure.

In summary, blockchain is a distributed database consisting of blocks of items that are timestamped, verifiable, permanent, and hashed and linked to other blocks. Blockchain is gaining adoption by governments and nonprofit organizations around the world.

Figure 1: What is Blockchain?

Blockchain is a data structure that uses a distributed system of databases (ledgers). Every user is a "node" and has a copy of the ledger.

Nodes are connected by networks. All ledger records are visible to everyone, verified and cannot be changed once the transaction is done.

Please also see Figure 2.

Source: *pWC Governance in the age of Blockchain, 2018*

Predictive analytics bring together statistical analysis, data modeling and machine learning to observe trends and project into the future to help with judgements on likely outcomes. With predictive analytics, managers can adjust their resource capacity levels and types to future demands. They can transform "raw" transactional data into information to test hypotheses, analyze trends and make better decisions. Forward thinking nonprofits can use it to predict human resource levels, pricing, forecasting etc.

Figure 2: How Blockchain Works

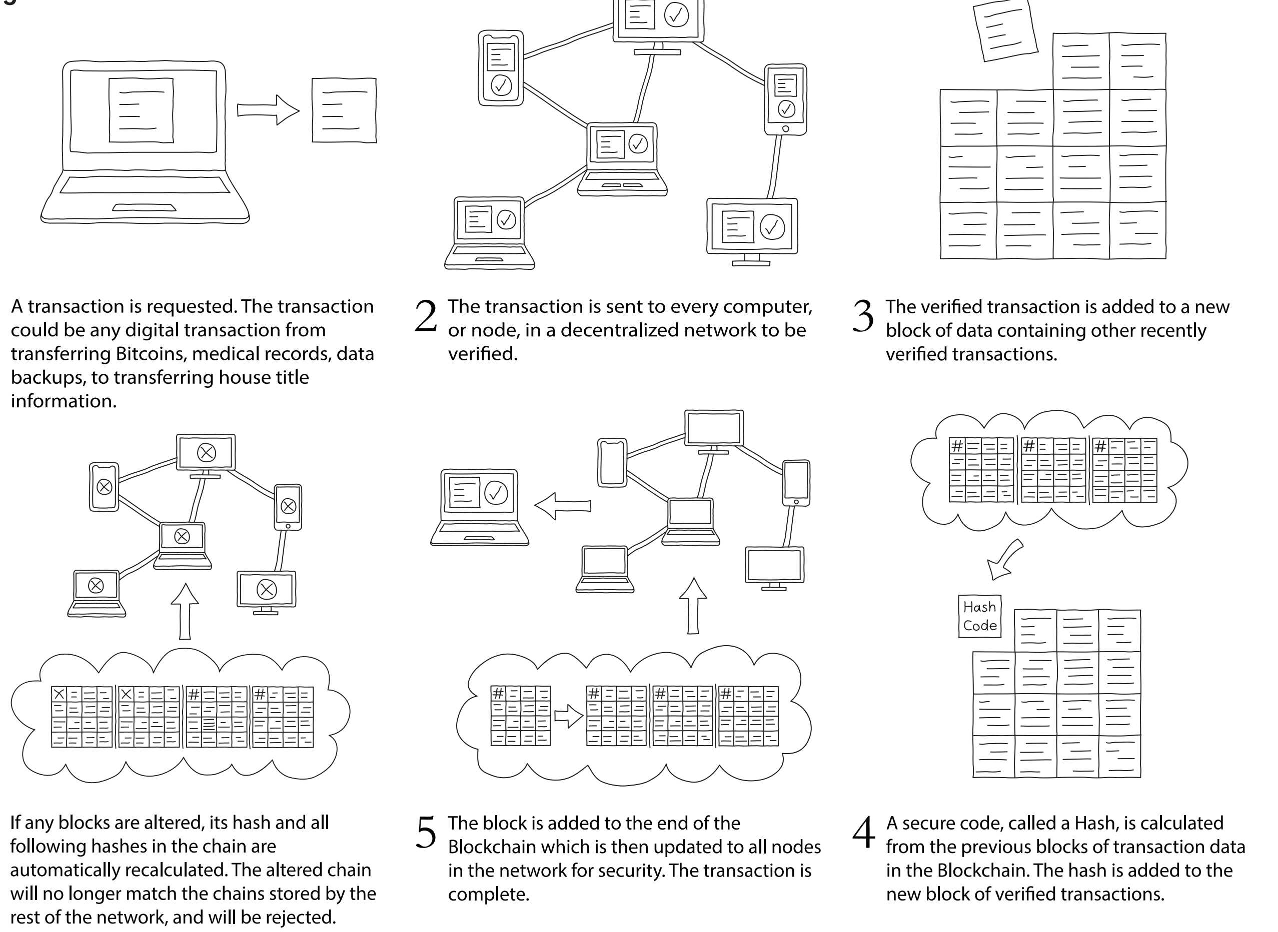


Figure 3: BudgIT and cMAPIT

BudgIT, a Nigerian startup and winner of Open Data Institute's Social Impact Award, is promoting citizens' understanding of government spending and budgets by providing the data in its portal. The increased transparency enables the fight against corruption in areas such as procurement, property ownership, etc.

cMAPIT, another Nigerian startup and winner of the Open Data Business Award, provides tools for citizens to track public policy and governance. It uses geospatial* data and drone technology to monitor public works projects, and it supports health and agriculture sectors. (*Geospatial data is data with an identifying geographic or locational component, such as latitude and longitude of a public building. It originates from the GPS data.)

While pursuing the digital transformation, managers need to pay attention to implementing safeguards to protect the vast data stored in their systems from fraud and malicious interference. Some basic steps before getting started in data analytics are:

- Understand the data, identify anomalies and risk factors in the data, and identify new sources of data;
- Recognize the relational and non-relational data;
- Use multiple, synergistic tools, such as multivariate and inferential statistics, visualization tools, optimization, machine learning, and predictive analytics tools.
- Use standard vendor-developed risk dashboards and filters to maximize efficiency, and use the regulatory and risk mapping view to map data and processes.
- Based on the analysis, communicate the decisions and actions to add value to the citizenry.

Cybersecurity and Risk Management. Nonprofit organizations have been historically behind their corporate peers in reviewing and strengthening their cybersecurity and risk management practices. With the

rapid acceleration of innovative technologies, they will have to step up their risk management framework.

New technologies bring their own risk issues, and organizations need to enhance their governance and validation processes to address the new technological risks without choking the benefits.

Sustainability

In their seminal article, "Nonprofit Starvation Cycle," Ann Goggins Gregory and Dan Howard explain that the popular trend of restricting funding to specific programs without accounting for infrastructure expenses leads to an unintended consequence, a "nonprofit starvation cycle." This is where charities cease to function because of their inability to pay for overhead costs, such as administrative employees, computers and electric bills. The article encourages nonprofits to recalibrate funder expectations by providing accurate financial reports and other supporting information to reflect the true costs of operations to break this unhealthy cycle.

Most nonprofit organizations try to consider sustainability, but do not consider the need for surpluses. Key performance metrics that include cash flow and balance sheet reporting are critical in order to identify overall financial health of the organization. However, many organizations fail to consider the impact of a structural deficit (the gap between funds raised for a program or project, and costs to perform the tasks involved in implementation and maintenance) that can lead to collapse of long-term sustainability.

Governance

Managers and board members need to work together to identify financial, program and operational goals. Operations and finance teams will work from these goals to identify data elements, data entry, data storage and security.

Relevant reports and dashboards need to be created from the integrated enterprise resource systems. Performance metrics must efficiently ensure organizational health, program success and mission impact. Robust financial systems that consider and allocate direct and indirect costs across programs help executives make data-driven decisions about strategy, focus and program investments.

Nonprofit organizations should use both financial and non-financial metrics similar to the balanced scorecard approach used by corporations. Financial, non-financial, talent, innovation and operations metrics must work cohesively to improve efficiency and effectiveness. Following are some of the financial and non-financial metrics that are commonly used.

Financial metrics:

- Financial segment reports (operations, capital expenditures, special projects, etc.);
- Staff roles and responsibilities;
- Revenue (sources) and expense (uses) drivers using Charity Navigator recommended scorecards and other metrics;
- Commonly used nonprofit organization financial ratios;
- Liquidity (can it pay current debts) = current assets (cash + A/R + inventory) / current liabilities;
- Going concern (can it survive) = revenues / expenses;
- Capital structure (reliance on debt) = (debt / total assets) and (debt / net assets);
- Program effectiveness (expenses to accomplish its goals) = program expenses / total expenses;
- Efficiency (expenses' trend to achieve output) = program expenses / number of clients served;
- Leverage and debt coverage (debt service expense coverage relative to income = (revenue + support + gains + interest + depreciation) / annual debt expense;
- fund raising efficiency = public support / fundraising expenses;
- Investment performance (rate of total return on investments) = (interest and dividends - gains/losses) / (average FV of investments)*; and
- Average FV of investments = (beginning of year FV + end of year FV) / 2.

Innovation and operations metrics:

- Customer satisfaction and/or complaints;
- Customer response times;
- Training for employees;
- Improvement in system efficiencies;
- Compliance reports and stewardship reports based on donor intent and transparency; and
- Outcomes measurement.

Talent/HR metrics:

Measurement of human resources falls into three broad areas – functional, operational and strategic measures.

Functional measures include employment efficiency, and effectiveness measures such as turnover, cost per hire and grievance numbers have traditionally been used. Sick leave (a useful proxy for staff dissatisfaction), outstanding annual leave (contingent liability), costs of employee disability insurance, expenditure on training and improvements in performance, staff turnover and recruitment costs are other commonly tracked and reported measures.

Operational measures to track productivity and profitability (revenue per employee, operating costs per work team) link talent management to organizational performance. Organizational effectiveness measures, combined with talent management, can include customer service measures like type of customer contact (in person/telephone/email) and call efficiency (abandoned service calls).

Possible metrics for return on investment (ROI) measures include:

- Success in the recruiting process;
- The impact of an employment procedure;
- Changes in an employee benefits package; and
- The outcome of a diversity initiative, employee development program, suggestion program, etc.

Human resources functional areas are viewed as profit efficiency centers by allowing them to use "make or buy "analysis (buy services at best price from internal or external sources), making it important to have the program ROI measured and results disseminated to stakeholders.

Strategic measures are future oriented based on current skill base, culture, environment, technology and demographics. They match the current skill base against future needs by identifying and measuring intellectual capital to create the "knowledge management database" and align the human resources function with the organization's strategic planning process. The above measures need to be based on the budgets and ongoing plans, and implemented with identifiable accountability measures.

STRATEGIC MEASURES ARE FUTURE ORIENTED BASED ON CURRENT SKILL BASE, CULTURE, ENVIRONMENT, TECHNOLOGY AND DEMOGRAPHICS.

Nonprofit Ratings and Reporting Guidelines

The watchdog agency Charity Navigator was founded in 2001 to evaluate nonprofit effectiveness similar to Consumer Reports. It has since become the largest and widely used evaluator of charities in the United States. Its professional analysts have developed a metrics-based rating system to evaluate nonprofit organization performance based on their review of tens of thousands of nonprofit organizations.

Charity Navigator's rating system examines two broad areas of performance:

- Financial Health and Accountability; and
- Transparency.

Charity Navigator's ratings demonstrate to donors how efficiently a nonprofit organization will use their contribution, how well funded its programs and services are, and its commitment to governance, best practices and transparency. Any nonprofit that receives a four-star rating from the agency is viewed as one with superior fiscal responsibility, signaling to potential donors its excellence in both information transparency and financial best practices. In the world of nonprofit fundraising, a four-star Charity Navigator rating is the most valuable and objective measure.

The Urban Institute and the Center for What Works have collaborated and developed a framework of common outcome indicators for the nonprofit sector, as well as a sample outcome monitoring chart and indicators for 14 program areas (www.Urban.org/nonprofits/index.cfm). Examples of program areas include adult education, family literacy, affordable housing, emergency shelter, performing arts, youth mentoring and others.

FASB Concepts Statement No. 4 also states that nonprofit organizations should provide information about service accomplishments as part of financial reporting. Service efforts and accomplishments can fall into four categories:

- Quantity of effort spent on the program (inputs);
- Level of services provided (outputs);
- Effect the service has on the program's objectives (outcomes); and
- Comparison of level of inputs with outputs or outcomes (efficiency).

Currently, most nonprofit organizations are accustomed to reporting inputs in financial terms, but output measures are expressed in non-financial terms, such as a homeless shelter reporting on the number of people housed, instead of a specific program. Outcome measures should express how well the program accomplished its goal, in view of external factors that could have had an impact on it.

Efficiency measures need to be well defined and developed, and provide information on how an organization achieves its program goals.

Staying Ahead of the Curve

Nonprofit organizations are entering new, exciting and scary times due to the paradigm shift caused by technology and donor expectations. To survive,

NONPROFIT ORGANIZATIONS NEED TO BE AWARE AND WILLING TO CHANGE AS NEEDED, AND THEY SHOULD TAILOR THE PROGRAM MONITORING CHART AND OUTCOME INDICATORS BASED ON THEIR OWN MISSION.

they need to be prepared to stay ahead of the curve by building donor affiliations and loyalty.

Regardless of the performance metrics and presentation formats used, they will change as the processes mature. For example, completion of a project or meeting an expected outcome by the due date could be a good indicator in the early stages, but this evolves into other indicators like percent completion or average days completed ahead of the due date over the duration of the project.

Nonprofit organizations need to be aware and willing to change as needed, and they should tailor the program monitoring chart and outcome indicators based on their own mission. By measuring and drawing correlations between their programs and the outcomes, nonprofits will provide assurance to donors that their contributions are being used for the stated purposes both effectively and efficiently.

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FEATURE

MEDICARE FOR ALL AND THE FORGOTTEN CONTRIBUTIONS

By Arthur Young, Ph.D., CPA, and Dennis Jones, Ed.D.

As the country moves toward the 2020 presidential election, "Medicare for All" has become a hot political topic. If this becomes the law of the land, one group that may have a grievance is made up of the workers who contributed to Medicare for many years. Under Medicare for All, these workers will receive the same health care benefits as someone who has never paid into the system.

The purpose of this article is to compute a dollar value for their "contributions" and subsequent investment returns (i.e., assuming they had been able to invest these "contributions" in the stock market).

The Medicare tax was first collected in 1966. At that time, the tax rate was 0.35% of an employee's earnings, for both the employee and the employer, for a combined amount of 0.70% (Social Security Administration, 2013). There was a ceiling on the amount of wages that were subject to the Medicare tax and this ceiling also applied to wages subject to the Social Security program.

The Medicare tax rate gradually rose to 1.45% of the earnings of the employee, for a 2.90% combined amount by 1986. In 1994, the ceiling on wages that were subject to the Medicare tax was removed and at that time, all wages became subject to the Medicare tax. See Table 1 for a summary of the Medicare tax rates and tax base (1973-2017).

The starting point for computing the terminal value of these Medicare contributions is to determine how much the employee had withheld from wages for Medicare and then add that to the employer's matching contribution. This computation assumes the employer's contribution would be instead given directly to the employee as a salary and, therefore, subject to the income tax. For purposes of this simulation, a 30% marginal tax rate is used. (See Footnote 1.) The employee contribution plus the "net of tax" employer contribution is added to the employee's fictional "Medicare Investment Fund" (MIF) at the end of each year.

As these re-characterized payments were originally intended to help workers with health care during

Table 1: Medicare Tax Rates 1973-2017

Tax Rate as a Percent of Taxable Earnings
Rate for Employees and Employers, Each

Years	Medicare Tax Rate	Maximum Taxable Base
1973-1990	0.90%-1.45%	Same as Social Security (=51,300 in 1990)
1991-1993	1.45%	125,000 (1991), 130,200 (1992), 135,000 (1993)
1994	1.45%**	All Earnings are Subject to the Medicare Tax

** Beginning in 2013, an additional Medicare tax of 0.9% was assessed on earned income exceeding $200,000 for individuals and $250,000 for married couples filing jointly.

Source: Social Security Administration (2013, 2019)

their retirement years, it seems appropriate that such payments should be invested in long-term securities. One such appropriate investment might be stocks of companies that are included in the Dow Jones Industrial Average (DJIA). This is an index of 30 large companies that are widely owned.

The SPDR Dow Jones Industrial Average ETF Trust (stock symbol: DIA) started operations in January 1998 and is the easiest way to invest in the stocks that make up this index. Before then, it would have been possible to invest in the individual stock of the 30 components.

Information related to the annual return of the stocks and their dividend yield are available in the DIA prospectus. (See Table 2.) The current estimate from the prospectus is that the ordinary operating expenses of the DIA will equal 0.17% of the net assets each year.

The simulations are based on two hypothetical workers. (See Table 3.) The first earns an annual wage equal to the National Average Wage Index (AWI) Series Amount as the earnings of an employee (Social Security Administration, 2018) and (b) the second is a case study for a more typical worker. They work from 1973-2017 and then liquidate their MIFs at the end of 2017. The case study worker makes very little in wages immediately after high school, but eventually settles into a well-paying profession in her middle age years.

Tables 4 and 5 summarize the computations. The MIF has a zero balance until the end of the first year. At that time, the amount that would have been withheld from the employee's paycheck for Medicare plus the employer's net matching amount is added to get a year-end balance.

In year 2, the computation is more complex. The beginning of year MIF balance is the starting point. To this (a) the stock market return is added or subtracted, (b) the amount of dividends is added and (c) an amount is deducted as a percentage of the beginning of the year balance for fees, taxes and commissions. The amount deducted in this computation is 1%. (See Footnote 2 for a more detailed explanation.) Taxes based on a dividend yield of 3% and a tax rate of 15% would equal 0.45%, and other fees, commissions and state income taxes, if applicable, would make up the remaining 0.55% in the computation. Finally, (d) the current year's "contributions" are added to determine the end-of-year balance. This computation is repeated in years 3 and beyond. All dividends are reinvested in this computation.

At the end of 2017, the investment fund is sold and an after-tax value is computed. The 15% capital gains tax rate is assumed. The after-tax value is the amount of wealth increase that the hypothetical worker contributing to Medicare would now have, if the "contributions" made into the Medicare system were instead invested in the DJIA.

The Case of the Worker Making an Amount Equal to the AWI Series Amount

A worker (i.e., Mark) who worked from 1973 to 2017 is examined. (See Footnote 3 as to why these years were picked.) He had Medicare tax withheld from his salary each year. In addition, in this simulation he received payments from the employer equal to the employer's matching Medicare contribution.

Table 4 summarizes the year-by-year computations through the 2017 calendar year, at which time the MIF had a net asset value of $272,385 (see Table 4) and a tax basis of $91,132 ($62,047 + 29,085). In this simulation, at the end of 2017, the MIF is liquidated and the capital gains tax is subtracted, leaving a net liquidation value for the MIF of $245,197.

Case Study: The Case of a Typical Worker (1973-2017)

In this case study, the employment history of a typical worker (i.e., Barbara) is examined. She went to work for a few years immediately after high school and then attended college (1976-1979). She had inconsistent earnings until 2003, making under $10,000 in 1994, 1995 and 2001. Then in 2003, she became established in a well-paying profession. This earnings pattern is probably more typical than the first hypothetical worker, who enters the workforce right after high school and immediately makes an amount equal to the AWI Series Amount for the year.

The computation results in an almost identical final liquidation value of the MIF. The MIF grew to a value of $245,682 by the end of 2017. (See Table 5.) The final liquidation value after deducting a capital gains tax on the fund's liquidation is $222,552. (See Footnote 4 for calculation.) Once again, like Mark, the opportunity cost for Barbara was very significant.

Similar computations can be made for various other cases. Table 6 (located at https://faculty.tarleton.edu/djones/documents/table6.xlsx) includes a Microsoft Excel worksheet that will compute the December 31, 2017 value for any employee amount plus "net" employer contributions. The assumptions used for this worksheet are once again a rate of return and rate of dividends equal to that of the DJIA and fund expenses equal to 1% of the beginning of year net assets.

Table 2: Stock Market Returns and Dividend Yields (1973-2017)

YEAR	DIA YE INDEX	YE DIV YIELD	STOCK MRK INCREASE
1973	850.86	4.15%	-16.60%
1974	616.24	6.12%	-27.57%
1975	852.41	4.39%	38.32%
1976	1,004.65	4.12%	17.86%
1977	831.17	5.52%	-17.27%
1978	805.01	6.03%	-3.15%
1979	838.74	6.08%	4.19%
1980	963.99	5.64%	14.93%
1981	875.00	6.43%	-9.23%
1982	1,046.54	5.17%	19.60%
1983	1,258.64	4.48%	20.27%
1984	1,211.57	5.00%	-3.74%
1985	1,546.67	4.01%	27.66%
1986	1,895.95	3.54%	22.58%
1987	1,938.83	3.67%	2.26%
1988	2,168.57	3.67%	11.85%
1989	2,753.20	3.74%	26.96%
1990	2,633.66	3.94%	-4.34%
1991	3,168.83	3.00%	20.32%
1992	3,301.11	3.05%	4.17%
1993	3,754.09	2.65%	13.72%
1994	3,834.44	2.76%	2.14%
1995	5,117.12	2.28%	33.45%
1996	6,448.27	2.03%	26.01%
1997	7,908.25	1.72%	22.64%
1998	9,181.43	1.65%	16.10%
1999	11,497.12	1.47%	25.22%
2000	10,786.85	1.60%	-6.18%
2001	10,021.50	1.81%	-7.10%
2002	8,341.63	2.27%	-16.76%
2003	10,453.92	2.00%	25.32%
2004	10,783.01	2.22%	3.15%
2005	10,717.50	2.30%	-0.61%
2006	12,463.15	2.24%	16.29%
2007	13,264.82	2.35%	6.43%
2008	8,776.39	3.61%	-33.84%
2009	10,428.05	2.63%	18.82%
2010	11,577.51	2.54%	11.02%
2011	12,217.56	2.71%	5.53%
2012	13,104.14	2.72%	7.26%
2013	16,576.66	2.23%	26.50%
2014	17,823.07	2.18%	7.52%
2015	17,425.03	2.50%	-2.23%
2016	19,762.60	2.42%	13.42%
2017	24,719.22	2.10%	25.08%

Source: State Street Global Advisors (2019)

Table 3: Wages Used in Simulations

YEAR	NATIONAL AVERAGE WAGE INDEX (AWI) SERIES AMOUNT	CASE STUDY WAGE
1973	7,580	1,938
1974	8,031	4,435
1975	8,631	4,222
1976	9,226	1,586
1977	9,779	0
1978	10,556	250
1979	11,479	0
1980	12,513	15,625
1981	13,773	16,891
1982	14,531	19,851
1983	15,239	15,428
1984	16,135	12,934
1985	16,823	11,080
1986	17,322	16,526
1987	18,427	19,874
1988	19,334	31,157
1989	20,100	30,772
1990	21,028	29,450
1991	21,812	35,283
1992	22,935	25,808
1993	23,133	13,999
1994	23,754	7,148
1995	24,706	3,133
1996	25,914	13,791
1997	27,426	24,460
1998	28,861	21,785
1999	30,470	28,136
2000	32,155	25,560
2001	32,922	0
2002	33,252	31,500
2003	34,065	64,392
2004	35,649	63,684
2005	36,953	65,626
2006	38,651	56,867
2007	40,405	69,211
2008	41,335	71,346
2009	40,712	73,981
2010	41,674	82,936
2011	42,980	70,509
2012	44,322	91,350
2013	44,888	93,356
2014	46,482	88,551
2015	48,099	89,976
2016	48,642	92,798
2017	50,322	98,092

Source: Social Security Administration (2018)

A Catalyst for Discussions

As this article has demonstrated, many workers have sacrificed a great deal to participate in the Medicare system. Arguably, in some cases, their sacrifices have been significant.

Congress will need to examine a number of factors before determining what is best for the country's Medicare program. They will certainly need to conduct some type of cost-benefit analysis when exploring possible changes.

The ideas expressed in this article may serve as a catalyst for discussions related to the "cost" side of the analysis and a reminder of the past contributions made into the system.

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FOOTNOTES

[1]A 30% marginal tax rate is applied to reduce the amount of the employer Medicare contribution that is instead paid to the employee in this simulation. This would be taxed as salary and would, therefore, be subject to the income tax. The federal income tax rate for single taxpayers that had taxable income from $37,950 to $91,900 was 25% in 2017 (Pomerleau, 2016). The National AWI Series wage was $50,322 in that year (Social Security Administration, 2018).

Similarly, if the amount of the wages included in the National AWI Series computations for prior years was equal to the taxpayer's taxable income, the marginal tax rates for those years would also be close to 25%. For example, in 1980, taxable income of $12,513 would place a single taxpayer in the 24% tax bracket. In 1990, taxable income of $21,028 would place a single taxpayer in the 28% tax bracket. In 2000, taxable income of $32,155 would place a single taxpayer in the 28% tax bracket. Finally, in 2010, taxable income of $41,674 would place a single taxpayer in the 25% tax bracket (Tax Foundation. 2013).

Most wages are earned in states with a state income tax that is often close to a 5% marginal tax rate. Therefore, a marginal tax rate of 30% was used as a combination of a federal tax rate of 25% plus a state income tax rate of 5%.

[2]The year-end dividend yield for the DJIA ranged from 3% to 6.43% for the years 1973 to 1992 (State Street Global Advisors, 2019). Since then, except for 2008, it has ranged from 1.47% to 2.76%. The income tax rate on dividends has often been a flat 15% over the past 45 years. Using a 3% dividend yield would result in a federal tax rate equal to 0.45% of the end-of-year net assets. State income taxes would slightly increase this amount.

Table 4: Growth of Medicare Investment Fund … National AWI Series Case

YEAR	BEG OF YEAR BALANCE	STOCK MRK INCREASE	BOY OF YR PLUS STK RET	DIVIDENDS	CONTRIB FOR YEAR	MM FEE AND TAX 1.00%	END OF YR BALANCE
1973	0	0	0	0	129	0	129
1974	129	(36)	93	6	123	1	221
1975	221	85	305	13	132	2	448
1976	448	80	529	22	141	4	687
1977	687	(119)	568	31	150	7	742
1978	742	(23)	719	43	179	7	934
1979	934	39	974	59	205	9	1,228
1980	1,228	183	1,412	80	223	12	1,703
1981	1,703	(157)	1,545	99	304	17	1,932
1982	1,932	379	2,311	119	321	19	2,732
1983	2,732	554	3,286	147	337	27	3,743
1984	3,743	(140)	3,603	180	357	37	4,102
1985	4,102	1,135	5,236	210	386	41	5,791
1986	5,791	1,308	7,099	251	427	58	7,720
1987	7,720	175	7,894	290	454	77	8,561
1988	8,561	1,014	9,576	351	477	86	10,318
1989	10,318	2,782	13,100	490	495	103	13,982
1990	13,982	(607)	13,375	527	518	140	14,280
1991	14,280	2,902	17,182	515	538	143	18,092
1992	18,092	755	18,847	575	565	181	19,807
1993	19,807	2,718	22,525	597	570	198	23,494
1994	23,494	503	23,997	662	586	235	25,009
1995	25,009	8,366	33,376	761	609	250	34,495
1996	34,495	8,974	43,469	882	639	345	44,645
1997	44,645	10,108	54,753	942	676	446	55,925
1998	55,925	9,004	64,928	1,071	711	559	66,152
1999	66,152	16,684	82,836	1,218	751	662	84,144
2000	84,144	(5,198)	78,945	1,263	793	841	80,160
2001	80,160	(5,687)	74,472	1,348	812	802	75,830
2002	75,830	(12,711)	63,119	1,433	820	758	64,613
2003	64,613	16,361	80,974	1,619	840	646	82,788
2004	82,788	2,606	85,394	1,896	879	828	87,340
2005	87,340	(531)	86,810	1,997	911	873	88,844
2006	88,844	14,471	103,315	2,314	953	888	105,693
2007	105,693	6,799	112,492	2,644	996	1,057	115,074
2008	115,074	(38,938)	76,136	2,749	1,019	1,151	78,753
2009	78,753	14,821	93,574	2,461	1,004	788	96,251
2010	96,251	10,610	106,861	2,714	1,027	963	109,640
2011	109,640	6,061	115,701	3,135	1,059	1,096	118,799
2012	118,799	8,621	127,420	3,466	1,093	1,188	130,791
2013	130,791	34,659	165,449	3,690	1,106	1,308	168,937
2014	168,937	12,703	181,640	3,960	1,146	1,689	185,056
2015	185,056	(4,133)	180,923	4,523	1,186	1,851	184,781
2016	184,781	24,788	209,570	5,072	1,199	1,848	213,993
2017	213,993	53,671	267,664	5,621	1,240	2,140	272,385
			Selected Totals	**62,047**	**29,085**		

There would also be additional management fees, commissions and other expenses. For example, the annual estimated expenses of the DIA ETF is equal to 0.17% of average net assets. Commissions on trading the DIA ETF would also be an expense and some brokerage accounts charge annual maintenance fees.

The 1% expense ratio may be a little bit too high, but in this study, it was decided to use this conservative estimate. To slightly mitigate the high expense ratio, it was decided to apply this to the beginning of the year net assets.

[3]A work/education period of 45 years is reasonable for a typical worker. At the time this simulation was started, the most recent year of the wage from the National AWI Series was for the year 2017. Therefore, this year was selected as the last year and then the previous 44 years were also included.

[4]Tax Basis = $51,573 + 39,906 = $91,479
Capital Gain = $245,682 – 91,479 = $154,203
Capital Gains Tax = $154,203 x 15% = $23,130
MIF Liquidated Value = $245,682 – 23,130 = $222,552

Table 5: Growth of Medicare Investment Fund … Case Study

YEAR	BEG OF YEAR BALANCE	STOCK MRK INCREASE	BOY OF YR PLUS STK RET	DIVIDENDS	CONTRIB FOR YEAR	MM FEE AND TAX 1.00%	END OF YR BALANCE
1973	0	0	0	0	33	0	33
1974	33	(9)	24	1	68	0	93
1975	93	36	128	6	65	1	198
1976	198	35	233	10	24	2	265
1977	265	(46)	219	12	0	3	229
1978	229	(7)	221	13	4	2	237
1979	237	10	247	15	0	2	259
1980	259	39	298	17	279	3	591
1981	591	(55)	537	35	373	6	938
1982	938	184	1,122	58	439	9	1,610
1983	1,610	326	1,936	87	341	16	2,348
1984	2,348	(88)	2,260	113	286	23	2,635
1985	2,635	729	3,364	135	254	26	3,727
1986	3,727	842	4,569	162	407	37	5,100
1987	5,100	115	5,216	191	490	51	5,846
1988	5,846	693	6,539	240	768	58	7,488
1989	7,488	2,019	9,507	356	759	75	10,546
1990	10,546	(458)	10,088	397	726	105	11,106
1991	11,106	2,257	13,363	401	870	111	14,523
1992	14,523	606	15,129	461	636	145	16,081
1993	16,081	2,207	18,288	485	345	161	18,957
1994	18,957	406	19,363	534	176	190	19,884
1995	19,884	6,651	26,535	605	77	199	27,019
1996	27,019	7,029	34,047	691	340	270	34,808
1997	34,808	7,881	42,689	734	603	348	43,678
1998	43,678	7,032	50,710	837	537	437	51,647
1999	51,647	13,026	64,673	951	694	516	65,801
2000	65,801	(4,065)	61,736	988	630	658	62,696
2001	62,696	(4,448)	58,247	1,054	0	627	58,675
2002	58,675	(9,835)	48,839	1,109	776	587	50,138
2003	50,138	12,696	62,833	1,257	1,587	501	65,176
2004	65,176	2,052	67,228	1,492	1,570	652	69,638
2005	69,638	(423)	69,215	1,592	1,618	696	71,728
2006	71,728	11,683	83,411	1,868	1,402	717	85,964
2007	85,964	5,530	91,494	2,150	1,706	860	94,490
2008	94,490	(31,973)	62,518	2,257	1,759	945	65,588
2009	65,588	12,343	77,932	2,050	1,824	656	81,149
2010	81,149	8,945	90,094	2,288	2,044	811	93,615
2011	93,615	5,175	98,790	2,677	1,738	936	102,270
2012	102,270	7,421	109,691	2,984	2,252	1,023	113,903
2013	113,903	30,184	144,087	3,213	2,301	1,139	148,463
2014	148,463	11,163	159,626	3,480	2,183	1,485	163,804
2015	163,804	(3,658)	160,145	4,004	2,218	1,638	164,729
2016	164,729	22,098	186,827	4,521	2,287	1,647	191,989
2017	191,989	48,152	240,141	5,043	2,418	1,920	245,682
			Selected Totals	**51,573**	**39,906**		

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FEATURE

WILL I GET CAUGHT?

SPEAKING TO THE MIND OF THE PERPETRATOR: A NEW FOCUS FOR INTERNAL FRAUD PREVENTION

By Steve Dawson, CPA, CFE

"If I thought they were looking, I never would have done it." In my 35 years of conducting internal fraud investigations, this is one of the most common statements I hear from guilty parties after we obtain a confession.

Performing investigations day in and day out, my desire is to learn from each of these confession-seeking interviews. I want to understand what could be done to prevent fraud from happening in the first place. Could the company design better controls? Dual authorizations? Signature thresholds? Segregation of duties? I get plenty of ideas from these investigation post-mortems.

Creative new schemes inspire creative new tactics to discourage fraud. Yet even with newer and more specific control activities, I never seem to complete an investigation before five more are waiting around the corner. I constantly ask myself: "What am I missing? What more can I do to help organizations prevent internal fraud?" I have to conclude that all of these controls just don't seem to be working.

Back to this revelation from guilty parties, "I never would have done it IF..." The possible answer appears and the light comes on for the first time. A stronger strategy is right in front of me and really always has been. "I never would have done it if I THOUGHT they were looking." Not "if I KNEW" but rather "if I THOUGHT."

Thinking an organization is watching is what the Association of Certified Fraud Examiners refers to as the "perception of detection." The ACFE states that this perception of detection is the number one internal control that can be implemented to prevent internal fraud. Regardless of the size or complexity of a business, this preemptive environment of discovery is one of the most successful ways to deter internal fraud.

It's clear that we need this new focus, this new approach to internal fraud prevention. We must address the mind of the potential perpetrator, his/her thought process and how to increase this perception of detection.

The Potential Perpetrator's Thought Process

Stage 1: Need/Greed – Due to financial pressures, individuals encounter financial needs that must be addressed. If a critical need is not present, often greed is the motivator. Regardless of need or greed, once the idea to commit a fraud is born, the potential perpetrator moves into Stage 2.

Stage 2: Will I Get Caught? – Potential perpetrators weigh the chances of getting away with the scheme. If they believe that they can follow through with their plan undetected, they approach Stage 3.

Stage 3: The Wall of Internal Controls – Historically, this is where we invest our time in fraud prevention. We focus on building a wall of control activities, adding this control and that control, until we believe we have a barrier so tall no one can scale its height. Often, we build controls from previous experience with fraud or examples we've seen elsewhere. The controls are built after the crime has already occurred. The trouble is the next potential perpetrator simply evaluates this wall of internal controls, sees where people are watching for fraud (or even recognizes that no one is truly looking at compliance with the controls), walks calmly around the wall, circumventing its effectiveness, and we have a new fraud to investigate.

Figure 1: Stages of a Perpetrator's Thought Process

The three stages of a potential perpetrator's thought process include:

- **Stage 1:** Need/Greed
- **Stage 2:** Will I Get Caught?
- **Stage 3:** Circumventing the Wall of Internal Controls

While control activities are important, what if we shifted our focus from building Stage 3 barriers where people are already creating ways to commit fraud and already planning how to get around the wall of internal controls? Instead, we speak directly to the mind of the potential perpetrator. We interrupt their thought process in Stage 2 where they are considering their potential to be discovered. We seek to effectively stop the development of the scheme itself by answering the question "Will I get caught?" with a resounding YES.

The Perception of Detection

What can we implement that stops a potential perpetrator in Stage 2? We use simple processes and procedures, typically less expensive to implement than full control activities. These processes increase the perception of detection, not the probability of detection or the possibility of detection, but the perception of detection. We address the statement, "If I thought they were looking …"

In my investigation practice, I drive the highways of this country often. On one highway in particular, I drive through a small town that always has a sheriff's patrol car parked in the bar ditch parallel to the highway. As I approach the area, seeing the patrol car, I do what every other driver does; I make sure I drive the speed limit, obeying the law. As I pass, I glance into the windows of the patrol car and notice that no one is actually in the car. In effect, this car can do nothing to catch and penalize me for speeding through town. But did I speed through town? No, and neither does anyone else. No one wants to chance getting a ticket.

The presence of the car increased my perception of detection; I changed my behavior realizing I could get caught speeding. Even residents of this town familiar with the empty car know there is a chance someone could be there next time. It's just not worth getting the ticket.

How can we apply this type of technique to internal fraud prevention? Let me insert myself into the shoes of a perpetrator. I am an employee performing a shell company fraud. I commit the crime by creating fictitious invoices for my employer; my employer pays the shell company that I own. No one knows I own this shell company. It just looks like a normal supplier.

One day, my supervisor comes to my office with a Conflict of Interest Form. She explains this is a new form that all employees are now required to complete on an annual basis as part of our new periodic master vendor file review. I am asked to disclose any companies that we do business with where I may have a conflict of interest, such as ownership, personal relationships, family relationships, etc. Am I going to disclose my shell company on this form? Of course not. It's a fraud. My employer will not actually gain any useful information and it seems as though this whole new vendor review process is worthless in detecting my scheme.

But what is achieved is heightening the perception of detection. I am now feeling very uneasy understanding that my employer is looking more closely at vendors. I know I must complete this form annually and it's a part of a larger compliance process reviewing the master vendor list. I am now worried about other checks they are performing on vendors. What else are they asking and looking for?

Now, because of this new form, my perception of detection has increased exponentially. This one piece of paper, this empty patrol car, has created fear, regret and anxiety in my fraudster's conscience. If I had this information before I created the shell company, if I thought they were looking, I never would have done it.

This simple form is an example of a process focused solely on increasing the perception of detection, speaking to the mind of the potential perpetrator during the Stage 2 evolution of the fraud thought process. This form and other processes like it cost pennies to produce.

Companies should perform periodic risk assessments to determine those areas most vulnerable to fraud.

Increasing Awareness

So how do you begin? As part of this new focus of prevention, I believe you can significantly raise the perception of detection in your workplace by implementing or strengthening processes in the following areas:

- Education,
- Targeted control processes,
- Effective fraud reporting,
- Modeling of ethical leadership, and
- Other physical controls.

Education

Educating the workforce increases fraud awareness. This does not have to be overly time-consuming. Most organizations already conduct periodic company-wide staff meetings covering many different operational areas. Consider adding 15 minutes to each meeting and address issues such as the definition of internal fraud or the costs of fraud.

Defining fraud (schemes, theft against the organization by its own officers, directors and employees, attacks from within, betrayals of trust, etc.) helps identify issues the company is already protecting against. Talking about the costs – fewer pay increases, increased layoffs, decreases in employee benefits, low employee morale, legal fees and investigation costs – requires all employees to consider specific consequences and encourages them to want to deter fraud, as well.

These meetings could review the existing policy or how to report suspicious activity. The point isn't to create experts in prevention. However, every time fraud is mentioned or discussed as a subject in a staff meeting, the workforce understands that the company is proactive in preventing it. They hear that the topic is important enough to discuss with everyone.

Targeted Control Processes

All companies should perform periodic risk assessments to determine the most vulnerable areas. I recommend seeking the input of various employees, regardless of rank or tenure. If an employee provides input into the risk assessment process and the design of internal controls to address those risks, I believe that he/she will be less likely to steal from that process.

Those organizations that have an internal audit function should communicate the content of the audit workplan to the workforce periodically. This makes employees aware of the areas that may be looked at for fraud.

Organizations should revisit older control processes that have been abandoned over time. Some of these age-old processes are honestly some of the most effective controls I have seen, such as:

- Mandatory consecutive vacation days,
- Rewards for whistleblowers,
- Surprise audits (such as cash counts),
- Job rotation/cross-training.

While these controls can be considered typical of the Stage 3 Wall, their power in this new focus is about communication. Communicating that controls exist makes a potential perpetrator think twice if he/she understands a vacation, surprise audit or job rotation could reveal his/her fraud.

Effective Fraud Reporting

Every organization should have a fraud policy/reporting policy as part of a strong anti-fraud program. The policy should include enough information defining fraud and explain typical warning signs. It should put the potential reporters at ease, letting them know they don't have to be experts and that they have certain whistleblower protections. The workforce needs a mechanism to report their suspicions. Most reporting mechanisms are structured anonymously and can be either internally or externally administered.

Most importantly, the existence of a reporting mechanism should be continually communicated to the workforce. Communication raises awareness, which raises the perception of detection.

Modeling of Ethical Leadership

Roman Emperor Marcus Aurelius once said, "A man should be upright, not kept upright." It's a beautiful thought. Unfortunately, assuming every person lives up to this ideal is not practical.

In his book *Why People Obey the Law*, Tom R. Tyler points out that historically, a workforce will adopt the same ethical mindset as its leaders. He outlines the Principle of Legitimacy, which states that individuals will obey the law based on their perception of, or belief in, their leaders.

A workforce will adopt the same ethical mindset as its leaders.

Accordingly, company policies should reflect standards expected of all individuals and should be modeled first by company leadership. Organizations should develop foundational policies that include the following:

- **Code of Ethics** – The content should address various areas, such as the use of common sense in making ethical decisions, competition, conflicts of interest, gifts from outside the company, outside employment and the proper treatment of confidential information.
- **Fraud Policy and Reporting/Whistleblower Protection** – A fraud policy is an absolute necessity. Its content outlines the measures that will be taken in the event of a suspected fraud. The policy itself provides information that educates the workforce, thus raising the level of awareness. The provisions that address reporting and whistleblower protections provide a framework for how to handle suspicions correctly, thus protecting the workforce, as well as the company.
- **Policy Provisions that Remove an Employee's Presumption of Privacy** – These provisions address the fact that the company provides employees with the tools necessary to perform their job functions (computer, email, mobile phone, tablet, desk, office space, vehicle, etc.) and that these items have no presumption of privacy associated with them. The provisions state that all company-provided items are subject to search with reasonable probable cause.

Company leadership can model ethical responsibility by committing to periodic updates or reviews with the workforce, adherence to the standards themselves and consistent handling of fraud suspicions in accordance with these policies. As with any company policy, all policies should be developed in conjunction with company legal counsel.

Communicating these policies on a regular basis raises the level of overall fraud awareness. A potential perpetrator knows what is expected, knows what policy provisions are in place, knows that all other coworkers are aware of this information and can effectively answer the Stage 2 question, "Yes, I probably will get caught."

Other Physical Controls

We rarely enter an establishment that doesn't have some type of security system. The system usually includes the bubble lens cameras used to monitor customer and employee activity. This is a physical, visual control that lets an employee know that he/she could be seen performing some type of nefarious act.

Previously, I stated my recommendations for increasing the perception of detection were inexpensive. If a complete bubble lens security system is not immediately fiscally possible, consider a dummy bubble (think empty patrol car). It still contributes as a deterrent, as it creates an environment of watchfulness.

Physical controls can also include various analytical software that monitors email and internet usage. The programs can perform text analytics like text categorization, text clustering, sentiment analysis, lexical analysis, etc. The descriptions and applications of these programs can certainly go far beyond Stage 2 intervention. But simply having them and communicating the organization's access to them, is a control in and of itself. If a potential perpetrator knows his/her email and internet usage might be monitored, he/she will understand the chances of getting caught rise exponentially.

Keys to Preventing Fraud

Whether controls are fully established or still developing, if they are perceived to exist, the perception of detection has increased and internal fraud can be prevented. Through education, targeted control processes, effective reporting, the modeling of ethical leadership and the existence of other physical controls, I believe companies can efficiently implement processes that serve to raise the level of fraud awareness.

Without abandoning the Stage 3 Wall of Internal Controls that should be under constant construction, we can attempt to interrupt potential perpetrators earlier in their thought process. We can give them ample evidence to conclude "Yes, I will get caught" when considering a scheme.

The ideal is an environment where no employee is bold enough to step up to the Stage 3 Wall. Instead, if the financial need is great enough, the desired result is an employee who finds another way to handle life's struggles by seeking help, and remaining a productive, valued employee and person.

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AUDITORS' CAM DISCLOSURES, A MANAGEMENT PERSPECTIVE

By Josef Rashty

CURRICULUM: Accounting and Auditing

LEVEL: Basic

DESIGNED FOR: CPAs in public practice and industry

OBJECTIVES: To address the implications of Critical Audit Matters (CAMs) reporting from the management perspective of public business entities (PBEs), and discuss some of the concerns and cautionary views on CAM disclosures from the management perspective of PBEs.

KEY TOPICS: New auditing standard, AS 3101; SEC guidance and effective date of the standard; scope and management perspective on CAMs; and overview of CAMs identified most often

PREREQUISITES: None

ADVANCED PREPARATION: None

In 2017, the Public Company Accounting Oversight Board (PCAOB) adopted – and the Securities and Exchange Commission (SEC) approved – a new auditing standard: AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion.* This standard requires the auditors of public business entities (PBEs) to identify and disclose their clients' Critical Audit Matters (CAMs). The presumption is that CAMs will improve the relevance of an audit by providing more insight about the most significant matters that auditors have encountered during their audit.

The objective of CAM is to make the auditor's report more informative and relevant to investors and third-party users. PCAOB defines CAMs as matters arising from the current period audit of financial statements that: (1) the auditor communicates or is required to communicate to the audit committee, and (2) relates to accounts or disclosures that are material to the financial statements, and involves especially challenging, subjective or complex auditor judgment.

This article addresses the implications of CAM reporting from the management perspective of PBEs. There is a purported argument that CAM reporting reduces the information asymmetry among investors; however, some have expressed a lukewarm view of CAM disclosures. This article discusses some of the concerns and cautionary views on CAM disclosures from the management perspective of PBEs, but nevertheless its goal remains not to take naysayers' position.

PCAOB Standard

PCAOB, in its principles-based standard, touted CAM as an investor protection tool and argued that, "[t]he communication of critical audit matters would inform investors and other financial statement users of matters arising from the audit that required especially challenging, subjective or complex auditor judgment, and how the auditor addressed these matters" (Release No. 2017-001). Furthermore, it argued that there is a certain level of "information asymmetry" in financial reporting of public PBEs, where some insiders and certain parties have more and better information than others – CAM's credo is to eliminate or at least reduce such information asymmetry.

PCAOB states that the determination of CAMs is based on the facts and circumstances of each audit. AS 3101 is a principles-based standard and, as such, it does not specify any matters that always constitute CAMs. PCAOB expects that in most CAM-applicable audits, auditors identify at least one CAM; however, it would be plausible to envision that there would be audits in which the auditor determines there are no CAMs.

In July 2018, the Center for Audit Quality in, *Key Concepts and FAQs for Audit Committees, Investors, and Other Users of Financial Statements*, recommended the following introductory language in an audit report:

> The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

In March 2019, PCAOB in its Staff Guidance Bulletin, *Implementation of Critical Audit Matters: The Basics*, recommends that auditors in the CAM section of the audit report disclose the following:

- Identify CAM(s);
- Describe the principal considerations that led to the identification of a CAM;
- Describe how the audit report addresses the CAM; and
- Make references to financial statements and related disclosures that relate to CAM disclosures.

SEC Guidance

In October 2017, the SEC in its Release No. 34-81916 approved the earlier PCAOB CAM release and concluded that the proposed rules are consistent with the Sarbanes-Oxley Act of 2002 and the securities laws, and are necessary or appropriate in the public interest or for the protection of investors.

Effective Date of the Standard

PCAOB in its Release No. 2017-001 requires that provisions related to CAM will take effect for audits of fiscal years ending on or after June 30, 2019, for large accelerated filers, and for fiscal years ending on or after December 15, 2020, for all other companies to which the requirements apply.

Scope of the CAM

PCAOB in its Release No. 2017-001 notes that the final standard generally applies to audits conducted under PCAOB standards for PBEs. However, it does not require communication of CAM for audits of brokers and dealers reporting under the Securities Exchange Act of 1934 Rule 17a-5, investment companies other than business development companies, employee stock purchase and other benefit plans, and emerging growth companies (EGCs), as defined in Section 3(a)(80) of the 1934 Securities Exchange Act.

Management Perspective on CAMs

The following subsections describe certain areas that management of PBEs needs to focus on, pursuant to CAM implementation and disclosures in their audit reports.

Management Responsibility for Disclosures

There is an argument that the preparation and disclosure of financial information is primarily the responsibility of the registrants and the auditor's role, by contrast, is to audit the issuers' financial statements and to provide a report thereon. This is certainly a valid argument and it appears, at least on the surface, that CAM has exceeded the traditional auditor's role and has thereby encroached the responsibilities of management.

PCAOB and the SEC have responded to this claim by arguing that having an absolute view on the distinct roles and responsibilities for registrants and auditors is not pragmatic and there is nothing that prohibits exceptions to such a perspective if it exists.

Furthermore, they argued that the unique perspective of auditors in their CAM disclosures provides investors and other users of financial statements valuable insight about their audits. In reference to AS 3101, SEC Release No. 34-81916 states that the auditor is not generally expected to provide information about a company that management has not already made available publicly; however, there are instances that some information may be necessary to describe the principal considerations that led the auditor to determine that a matter is a CAM or how the auditor addressed the matter in the audit.

Conflict Between Management and Auditor Disclosures

Registrants in the Management Discussion and Analysis (MD&A) section of their annual filings provide a discussion of critical accounting estimates (CAEs).

PCAOB, in Appendix to Auditing Standard No. 16, defines a CAE as "An accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material."

CAEs and other management disclosures have some overlap with CAMs, but they are not the same thing. While some CAEs may be subject to CAMs, CAMs generally have a broader scope and are independent of CAEs. In other words, the auditor may identify matters as CAMs that management has not disclosed as CAEs. If CAMs are simply duplication of CAEs, then the usefulness of CAM disclosures becomes questionable. Clearly, from the investors' perspective, there is a benefit in receiving information about the audit directly from the auditors' point of view independent of management.

Nevertheless, CAE disclosures or any other disclosures outside the financial statements need to maintain a fine line and complement the CAMs – the two need to be juxtaposed to get an optimum result. There is a general consensus that CAMs should not overlap management disclosures, but at the same time CAEs and other management disclosures should provide context for CAM disclosures and should not exhibit any confusing and contradictory views. All of this requires a delicate balance, and management and legal counsel should advise the audit committee and opine on the context of CAM disclosures even though such disclosures ultimately remain the responsibility of auditors. The users ultimately benefit from hearing both management and auditors' perspectives on particular matters in the context of their respective roles.

Management's SOX 404 Disclosures and CAM

A significant deficiency or material weakness in the internal control over financial reporting of a company does not necessarily initiate a CAM disclosure. The standard for measuring whether an internal control deficiency is a material weakness for financial reporting purposes is that a deficiency or combination of deficiencies could result in a material misstatement of a company's financial statements. Audit response for significant deficiencies and other less severe deficiencies is usually less extensive than material weaknesses.

There are innumerable ways that internal control deficiencies may occur. When there is a deficiency, the auditor adjusts the audit plan to determine the impact of such deficiency on the financial statements of the company. The severity and frequency of a deficiency determines if a significant deficiency or a material weakness exists, but they are not, in and of themselves, considered CAMs. However, a significant deficiency or material weakness could be among the principal considerations that potentially impel the auditor to determine that a matter is a CAM.

THE STANDARD FOR MEASURING WHETHER AN INTERNAL CONTROL DEFICIENCY IS A MATERIAL WEAKNESS FOR FINANCIAL REPORTING PURPOSES IS THAT A DEFICIENCY OR COMBINATION OF DEFICIENCIES COULD RESULT IN A MATERIAL MISSTATEMENT OF A COMPANY'S FINANCIAL STATEMENTS.

Thus, the evaluation and determination process for SOX 404 control deficiencies (AS 2201 and AS 1305) does not necessarily prompt any CAM disclosures, but if the audit response involves especially challenging, subjective or complex judgment, the auditor may decide on CAM disclosures. Nevertheless, for the purposes of evaluating whether a matter falls within the scope of CAM disclosures, the auditors assess the risks of material misstatement, including significant risks, to determine whether a matter requires especially challenging, subjective or complex auditor judgment for a CAM disclosure.

If CAM disclosure was due to significant deficiency, the auditor may disclose the control issue in the broader context of CAM without referencing the "significant deficiency" terminology. However, in case of material weakness, since the company has already reported it in its filings, the auditor can use the term "material weakness" in its CAM disclosures.

For example, if the auditor has detected a significant deficiency in calculation of deferred tax assets, the auditor describes the relevant control-related issues over calculation of deferred tax assets in the broader context of the CAM without using the term significant deficiency. However, if the control deficiency was a material weakness, the auditor can describe the deficiency as a CAM and reference the term material weakness since the company should have already disclosed the material weakness in its filings.

Early Dialogue Between Management and Auditor

As the auditor determines how best to comply with the disclosure requirements of CAM, it must decide on how to discuss and treat sensitive information with the audit committee. CAM disclosures bring increased user attention and can potentially trigger litigations.

Such increased attention may eventually exert an incremental focus on some aspects of management's inadequate or faulty disclosures. This requires an early dialogue between and among management, legal counsel, audit committee and the auditor on how CAMs should be disclosed and presented in an audit report. CAMs' proposed disclosures have an impact on CAEs and significant accounting policies (SAPs) disclosures in Form 10-Ks.

Therefore, the legal counsel and management must ensure that CAM disclosures do not conflict with their CAE and SAP disclosures in their Form 10-Ks. On the other hand, if CAMs are simply duplication of CAEs and SAPs, then the usefulness and applicability of CAM disclosures becomes questionable.

Clearly, from the investors' perspective, there is a benefit in receiving information about the audit directly from the auditors' point of view, but at the same time management needs to establish a workable nexus to avoid any conflict between management's and auditor's disclosures. Any conflicts or surprises in CAE and SAP disclosures can potentially initiate concerns and possibly evoke litigations.

Figure 1: Deloitte's Post-Mortem Analyses

Deloitte in its *Heads Up*, Volume 26, Issue 19, August 30, 2019, reports that in filings of the large accelerated filers with fiscal years ending June 30, 2019, the CAMs most often identified were related to goodwill and intangible assets, revenue and income taxes, and on average, 1.8 CAMs were communicated. Overall, it does not appear so far that the guidance has produced any untoward consequences as some had expected.

Deloitte makes the following observations on its post-mortem analyses and makes an argument that CAMs have become the enduring substratum of an audit:

- Practicing the identification and communication of CAMs allows auditors to gain valuable experience to manage their audit process.
- Deciding whether an account or disclosure is a CAM requires significant judgment and is specific to the circumstances of each audit.
- Communicating CAMs that are easily understood by the broad of directors and executive management can be challenging.
- Sharing the initial draft of CAMs disclosures with management, audit committees and legal counsel is important and sets expectations about CAMs implementation process and disclosures.

A Wrap Up and Summary

The requirement for communication and disclosure of CAMs is a significant shift in audit reports. The objective is to make the auditor's report more informative and relevant to investors and third-party users.

A company's management has the ultimate responsibility for financial disclosures, but that does not necessarily prohibit the auditors from disclosing the CAMs from their own perspectives in their audit reports. This is not to say that CAM disclosures give the audit report an unflinching consideration that safeguards users of financial statements for any possible irregularity, but nevertheless it is a step in the right direction and time will tell how effective they can be.

Management's CAEs and SAPs have some overlap with CAM disclosures, but they are not necessarily the same thing. While some CAEs and SAPs may be subject to CAMs, CAMs generally have a broader scope and are independent of CAEs and SAPs. However, management must ensure that their CAE and SAP disclosures do not conflict with their auditors' CAM disclosures.

Even though an internal control deficiency per se does not trigger CAM disclosures, it could be among the principal considerations that potentially lead the auditor to determine that a matter should be considered a CAM. Auditors assess the risks of material misstatement, including significant risks, to determine whether a matter requires especially challenging, subjective or complex auditor judgment for CAM disclosures.

Finally, the sensitivity of CAM disclosures requires an early dialogue and interaction among management, legal counsel, audit committee and the auditor on how CAMs should be described and presented in the audit report. Thus, management must ensure that CAE and SAP disclosures in their Form 10-Ks underpin CAM disclosures and do not conflict with them.

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Please note that when registration is complete,
a confirmation email will be sent and provide a hyperlink to access the quiz.

CPE ARTICLE: AUDITORS' CAM DISCLOSURES, A MANAGEMENT PERSPECTIVE

By Josef Rashty

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. The SEC and PCAOB approved AS 3101 in:
- **A.** 2017
- **B.** 2017 and 2018, respectively
- **C.** 2019
- **D.** 2020

2. PCAOB believes that the CAM standard:
- **A.** is a good addition to the U.S. GAAP
- **B.** is similar to IFRS standards
- **C.** is a principles-based standard
- **D.** will eventually replace the U.S. GAAP

3. ________ concluded that the CAM standard is consistent with the Sarbanes-Oxley Act of 2002.
- **A.** PCAOB
- **B.** FASB
- **C.** PBEs
- **D.** SEC

4. CAM is effective for audits of all PBEs for:
- **A.** fiscal years after December 15, 2019
- **B.** fiscal years after June 30, 2019
- **C.** fiscal years after December 15, 2020
- **D.** none of the above

5. CAM is applicable:
- **A.** to all private companies
- **B.** to all EGCs
- **C.** to most PBEs
- **D.** none of the above

6. The article states that CAEs are reflected in:
- **A.** press releases
- **B.** MD&As
- **C.** audit reports
- **D.** all of the above

7. CAEs are:
- **A.** management disclosures
- **B.** auditor's disclosures
- **C.** both (a) and (b)
- **D.** neither (a) nor (b)

8. A significant deficiency or a material weakness, in and of itself, ________ considered a CAM.
- **A.** is never
- **B.** may possibly be
- **C.** is always
- **D.** all of the above

9. CAMs ________ trigger litigation.
- **A.** never
- **B.** always
- **C.** are the only source to
- **D.** can potentially

10. CAM disclosures are a (an) ________ shift in audit reports.
- **A.** trivial
- **B.** significant
- **C.** expensive
- **D.** troubling

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DATE	COURSE	CITY	CPE HRS
May 21	Governmental and Not-for-Profit Annual Update	Dallas	8
May 22	Preparation, Compilation and Review Engagements: Update and Review	Corpus Christi	4
May 22	Accounting and Auditing Update	Corpus Christi	4
May 22	Not-for-Profit Financial Reporting: Mastering the Unique Requirements	Dallas	8
May 26	Annual Update for Controllers	Houston	8
May 27	Not-for-Profit Financial Reporting: Mastering the Unique Requirements	Austin	8
May 27	U.S. GAAP: Review for Business and Industry	Houston	8
May 28	Governmental and Not-for-Profit Annual Update	Austin	8
May 28	U.S. GAAP: Review for Business and Industry	Dallas	8
May 29	Annual Update for Controllers	Dallas	8

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$635,000 gross. NE San Antonio metro area CPA firm. 53% tax, 56% ind./44% bus., 47% write-up/payroll, staff in place and seller available to assist with transition. TXC1069

$149,407 gross. San Antonio CPA firm. 78% tax (67% ind./26% bus/7% other), 16% bkkpng/PR and sales tax reporting, 6% consult, cash flow 88%. TXC1071

$106,740 gross. San Antonio EA firm. 370 tax returns (320 ind/20 bus), average 10% revenue growth past 2 years, cash flow 40%, primed for growth. TXC1072

$290,000 gross. E/SE Texas CPA firm. Primarily tax (70%), high-quality clientele, solid fee structure, turn-key opportunity. TXN1451

$209,000 gross. NE Texas CPA firm. 70% tax, 30% acctng, ideal size for marketing-oriented buyer to tap existing client base and grow substantially. TXN1491

$364,000 gross. Hurst CPA firm. 89% tax, 11% accounting services, turn-key practice with experienced staff and primed for new owner and smooth transition. TXN1498

$367,000 gross. Abilene CPA firm. 65% tax, 28% acctng, 9% payroll, quality clients, knowledgeable staff in place, strong fee structure, turn-key opportunity. TXN1509

$787,000 gross. East Texas (Tyler/Longview) CPA firm. Accntng (32%), tax (47%), audits (10%), (11%) misc., loyal client base, experienced staff and strong fee structure. TXN1510

$1,060,000 gross. North Texas CPA audit practice. Specializes in two niche industries, strong fees and excellent cash flow near 50%, highly desirable area, turn-key. TXN1517

$288,000 gross. Texarkana EA firm. Tax prep 73%, accounting 20%, tax planning/rep 7%, strong fees, experienced staff, quality client base, primed for growth. TXN1519

$270,000 gross. Burleson CPA firm. 51% tax, 37% acctng/bkkpg, 12% misc., strong cash flow over 50%, staff in place, turn-key opportunity. Available after 4/15/20 TXN1521

$710,000 gross. Southeast TX CPA firm. Revenues nicely balanced between accntng/tax services derived primarily from monthly retainers, high-end client base. TXN1525

$540,000 gross. Greenway-Galleria area CPA firm. Tax 62%, acct/bkkpg 37%, consult 1%, excellent turn-key location, seller available to help with transition. TXS1220

$305,000 gross. SE Texas CPA firm. Tax 60%, bkkpg 40%, turn-key practice with staff in place, friendly clients, owner available to assist through tax season. TXS1232

$67,000 gross. Mid Valley area tax and accounting firm. Bkkpg 72%, tax 28%, friendly client base, turn-key office in ideal location, seller available for transition help. TXS1244

$350,000 gross. W. Houston CPA firm. Prime location, great mix of tax, bkkpg and acctng services, staff in place and seller available to assist with transition. TXS1245

$1,050,000 gross. West Houston CPA firm. Tax 66%, audit/reviews 22%, bkkpg 12%, excellent cash flow, long-term clientele, experienced staff, office available. TXS1246

$209,000 gross. Houston CPA firm. Tax 75%, bkkpg 8%, other 17%, somewhat portable within Houston area, nice fee structure, great cash flow, little annual turnover. TXS1247

$1,512.850 gross. West Texas CPA firm. 53% tax (returns are 70% ind/23% bus/7% other), 35% write-up/comp, 12% audit/reviews, cash flow near 52%, experienced staff in place, location available for lease or purchase, owners available for transition. TXW1025

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