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TODAY'S CPA

Texas Society of Certified Public Accountants

COVID-19

CPA FIRMS TAKE ON THE FINANCIAL CHALLENGES

TXCPA'S 2019-2020 YEAR IN REVIEW

COVID-19 AND CARES ACT

ROBOTIC PROCESS AUTOMATION

MAY
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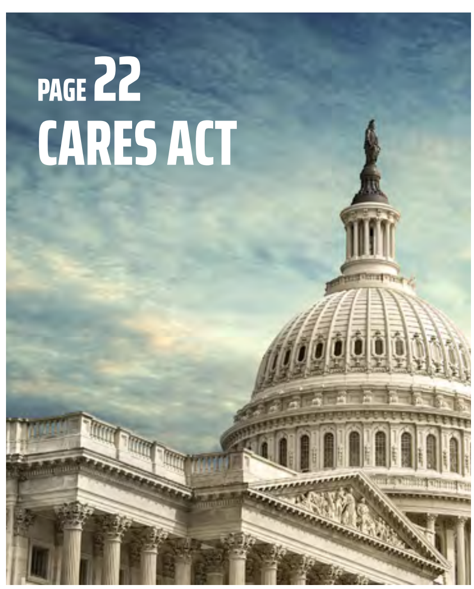

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UNPRECEDENTED TIMES

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 May/June digital issue of *Today's CPA*. This issue is traditionally focused on celebrating our successes as a professional community as we close out our membership year on May 31. But these are unprecedented times – nothing is traditional right now for any of us.

We had many successes over the past year, very worthwhile and exciting developments that absolutely deserve celebration and we've highlighted some of them on the following pages. But we would be remiss if we didn't focus this issue on what you need most from us – updates on how the COVID-19 pandemic is affecting our profession and information about where we go from here as we serve those who are counting on us to know what's next.

As you click through the pages of this digital issue, please take time to learn about the resources and programs available to you as a benefit of membership. I know many members have leaned on their TXCPA connections, the TXCPA Exchange forums and member communications more in the last few months than ever before. We intend to continue to deliver the latest news, as well as uplifting stories about how our members are adapting and leading in these unprecedented times.

You'll also find in this issue updates on how we delivered on the five priorities we set last June as we kicked off what we now know will be a year we'll never forget. Thank you for the opportunity to serve as your chairman in 2019-2020 and thank you for the part you've played in all of our achievements. Your continued trust in, and dedication to, TXCPA ensures that we continue to benefit from the strength in our numbers as we come together to lead our clients, employers and communities into recovery.

TXCPA'S 2019-2020 YEAR IN REVIEW

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

As we began 2019-2020, who could have imagined how much the world would change in the last few months of the year. The coronavirus (COVID-19) is presenting serious concerns and challenges that impact our lives, how and where we work, and the global economy.

There were five priorities that incoming Chairman Lei D. Testa, CPA-Fort Worth, CGMA, outlined for 2019-2020 under the three pillars of success – Community and Connection, Professional Excellence and Advocacy – that are the cornerstones of TXCPA's dynamic three-year strategic plan. Here's a summary of the priorities and key successes for the year:

- **Engage the next generation of CPAs** – Through our outreach on campuses and with our faculty ambassadors, we're growing the number of students who are involved in the Society; this year, in addition to hosting events on campuses across the state, we have eliminated student membership dues, making it easier than ever to welcome the next generation of CPAs to TXCPA;
- **Enhance state and chapter collaboration** – We expanded our chapter leader training opportunities and made an investment in technology resources that are also available to our chapters; an online portal provides chapter leaders and staff with valuable membership data and archived leadership training videos;
- **Extend the brand to promote the profession** – We've had a great response to our new TXCPA branding and the focus this year has been on extending the brand to promote the profession; our new campaign, The CPA Advantage, provides an online toolkit of new resources that members can use to build and promote their business and an advertising campaign focused on promoting the value of CPAs to the public and encouraging students to pursue the CPA credential;
- **Expand digital learning opportunities** – Two significant digital learning opportunities for members were launched, the TXCPA Passport, a subscription for on-demand CPE, and a free ethics course that nearly 3,000 members completed this year; we're continuing to add to the options members have for earning CPE credit, including offering our live events in a webcast format, new webcasts covering issues related to COVID-19 and our new Facebook Live Friday events.
- **Educate stakeholders on the significance of professional licensing** – A number of anti-licensing measures were introduced in the last Texas legislative session and there were others across the U.S.; the CPA profession is part of the Alliance for Responsible Professional Licensing, a coalition focused on advocating for licensing, and TXCPA is monitoring the environment for any professional licensing issues that could impact CPAs in Texas.

TXCPA launched a membership survey last fall to gather member input and feedback. The results helped us gain more insights and perspectives on what our members need and want. We were thrilled to see an overall satisfaction rating of 8.23, which is up from 8.20 in 2018 and 7.91 in 2017.

As TXCPA works through our triennial strategic planning process, the member survey data becomes even more valuable. The survey outcomes, combined with input from all 20 chapters and TXCPA leadership, provide our Strategic Planning Committee with a framework for building an effective three-year plan focused on you, our members.

Nearing the end of the 2019-2020 year, TXCPA is continually monitoring the impact of the coronavirus on members, students, CPA Exam candidates, our staff and the accounting profession. Our governmental affairs team and the Federal Tax Policy Committee have done an incredible amount of work bringing attention to issues that have the potential to impact CPAs and the profession, and providing extensive feedback to the IRS and other government regulators.

We recognize the significance of being your trusted resource for information and guidance for the changing business landscape both in Texas and nationally. We created a dedicated and comprehensive COVID-19 resource page on our website that is updated daily. TXCPA Exchange is more active than ever with member-to-member questions and conversations. And readership of our member communications is at an all-time high as we deliver the latest news directly to your inboxes.

In these extraordinary and difficult times, TXCPA is here for CPAs as you focus on helping your communities, clients, customers and employers recover. We thank you for your TXCPA membership and support.

COVID-19 ECONOMIC FALLOUT HIGHLIGHTS IMPAIRMENT AND GOING CONCERN ISSUES

By Don Carpenter, MSAcc/CPA

The economy began 2020 at a breakneck pace, with unemployment at record lows and the major stock indices at record highs. Everything pointed to a banner year until the Covid-19 virus put the brakes on "business as usual."

Some businesses such as many retailers had to temporarily close completely while others like the airline industry have seen unprecedented reductions in demand. Commodity prices have plummeted, with oversupply and consumer spending no longer fueling robust demand.

It's unclear at this point what the longer-term implications of this pandemic-driven recession will be. But in the short term, the prevailing economic conditions require that companies and their auditors review both impairment and going concern guidance to determine what adjustments to financial statements or disclosure might be required.

FAS 121 requires that goodwill and other long-lived assets be tested annually for potential impairment. However, if a triggering event occurs, interim period testing may be necessary. A triggering event is any change in facts or circumstances that could affect the fair value of the asset under review. Events such as loss of a major customer, change in law or increased competition are examples of a triggering event. Once a triggering event has been identified, impairment testing is accelerated.

In addition, Accounting Standards Update (ASU) No. 2011-08 allows companies to conduct qualitative analysis in lieu of quantitative cash flow modeling for impairment testing of goodwill. ASU No. 2012-02 extended qualitative analysis to other long-lived assets. The intent of the ASUs was to avoid costly analytical modeling when conditions had not changed sufficiently to call into question prior determinations of fair value.

But given the dramatic change in economic conditions, companies should consider whether they can rely on the qualitative approach for their analysis. In addition, if annual testing does not occur until later in the calendar year, a determination as to whether current prevailing

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circumstances constitute a triggering event that necessitates an accelerated testing schedule may be necessary.

These issues are particularly relevant to businesses that rely heavily on commodity prices for profitability, such as oil. As of the date of writing this article, oil prices have fallen to below $30 a barrel and the forward curve has the price staying below $40 a barrel for at least the next two years. The guidance does not allow affected companies to take a wait and see approach in hopes that prices will recover before the annually scheduled testing cycle comes around. Further, relying on the qualitative approach will be difficult given the marked change in economic conditions.

In a similar vein, the current economic conditions may increase the disclosures required under ASU 2014-15 with regard to the going concern standard. The ASU requires management to perform an assessment of a business's ability to continue as a going concern for at least one year from the date financial statements are issued. Additional disclosure is required if the assessment raises "substantial doubt" about the operation's ability to continue as a going concern.

Substantial doubt exists when facts and circumstances considered in their entirety indicate it is probable that an entity will be unable to meet its obligations as they become due over the next year. The standard gives several examples of events that may create doubt:

- Negative financial trends, such as recurring operating losses, working capital deficiencies or negative operating cash flows;
- Denial of trade credit by suppliers, default on loans or arrearages on dividends;
- Work stoppages or the need to significantly revise operations.

Under AU Section 341, the Public Company Accounting Oversight Board (PCAOB) requires the company's auditors to independently assess whether substantial doubt exists as to the viability of the business over the next 12 months. If the auditors believe that there is substantial doubt, they are required to review management's plans and determine the likelihood that the plans can be effectively implemented. Such plans can include actions such as:

- Plans to dispose of assets to increase liquidity;
- Plans to borrow from existing lines of credit or the likelihood of accessing new sources of financing;
- Plans to delay expenditures;
- Plans and ability to increase equity.

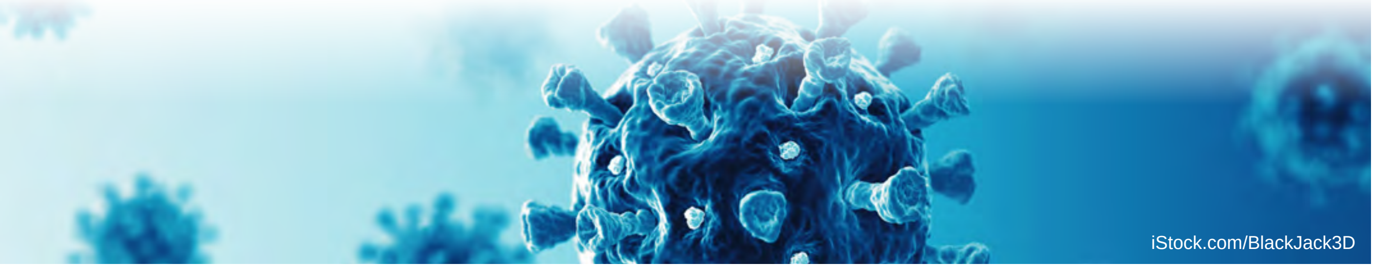
THE OUTCOME OF THE GOING CONCERN ASSESSMENT HAS IMPLICATIONS FOR BOTH FINANCIAL STATEMENT DISCLOSURES AND THE AUDITOR'S REPORT.

The outcome of the going concern assessment has implications for both financial statement disclosures and the auditor's report.

If the substantial doubt as to going concern is adequately addressed by management's plan, disclosure should be made regarding the conditions that led to the substantial doubt assessment, management's evaluation of the circumstances and its plans to alleviate the concern. If substantial doubt remains, the disclosure above should be supplemented with a statement that there is "substantial doubt about the entity's ability to continue as a going concern."

If the auditor concludes that substantial doubt remains as to the entity's ability to continue as a going concern after reviewing management's plan, he/she must include a paragraph in the audit opinion explaining the circumstances and including a statement that is very similar to the one required in management's disclosure.

Given the dramatic impact on businesses across all spectrums of the economy, management, accounting departments and attest firms would be ill-advised to take a wait and see approach to these issues. Becoming familiar with the guidance on these matters and preparing documentation to support decisions is critical. And as always, open and honest dialogue between the company and its auditor will lead to better, more efficient conclusions on these very technical matters.



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ROBOTIC PROCESS AUTOMATION IMPLEMENTATION IN BUSINESSES

By Claire Bing

Robotic Process Automation, commonly known as RPA, is the use of software and machine learning capabilities to handle various tasks that once required human interaction to be performed.[1] Every day, society interacts with RPA bots to complete tasks.

For example, Siri, Alexa and Google Dot are robots that respond to various commands that humans speak to perform simple tasks, such as calling people, turning lights on and off, and searching for simple information. Online shopping websites also implement RPA bots to locate orders on actual repositories. These bots help to quickly and accurately dispatch items to the customer.

The benefits of RPA are numerous. The most notable, explained by Automation Anywhere, a top RPA development company, is the ability to navigate complex digital landscapes in a non-invasive, scalable way, while having the ability to integrate with other systems of an enterprise.[2]

Other widely used software, such as Excel macros, are able to complete various tasks just like RPA. However, they are unable to integrate with other systems of an enterprise, such as HR, payroll and accounting software. This limits the use of macros strictly to Excel functions and decreases the use and return on investment for implementation of such software.

RPA bots are able to integrate with other software used in insurance, health care, finance and manufacturing, among others. RPA bots are also able to provide flexibility, speed, accuracy and detailed data capture.[3] In a study of an insurer, there was a particular process where it previously took two days to handle 500 premium advice notes. It now takes only 30 minutes with the use of RPA and it is also now an error-free process.[4] Without the need for human interaction, these bots will be able to perform tasks at an accelerated pace as they work around the clock, without human error.

Due to the varying capabilities of RPA bots, many fear the implementation of RPA in businesses will replace humans and decrease job opportunities. In reality, with the use of bots, humans will no longer be required to complete monotonous, repeatable tasks but will instead be allowed to spend time on more challenging, thought-provoking tasks.

The shared perspective of those who develop bots and those who have experienced implementation of bots in a business setting is that RPA "takes the robot out of the human." Studies have shown that use of bots increases employee morale because those who were once spending weeks on mindless tasks now have the chance to create and improve processes.[5] This adds value and a sense of purpose as employees go to work every day.

THE USE OF BOTS WILL ENABLE PEOPLE TO WORK ON FEWER MONOTONOUS, REPEATABLE TASKS.

RPA Implementation in Businesses

Multiple RPA bots have been deployed in businesses to complete various tasks, including collecting email attachments, extracting PDF data and copying it into Excel, logging Excel data into web-based forms, and confirming process completion via email. The use of bots in the business setting reaches far beyond what the world can imagine as the development of RPA continues to grow.

When a company considers implementing RPA in various lines of business, its business analysts must study specific tasks to determine which tasks are best suited to be replaced by bots. Automation Anywhere, for

By iStock.com/metamorworks

example, uses analysts who study the Process Maturity Model (PMM) to consider the costs and benefits of implementing RPA. PMM helps potential users study their processes in an organized and methodical way to determine if RPA implementation will be beneficial to the company.[6] Figure 1 lists the steps of the PMM and the following paragraphs describe each of the steps.

Figure 1: Process Maturity Model (PMM)

Automation Pipeline (1)	Feasibility Analysis (2)	Complexity Assessment (3)	ROI Analysis (4)	Automation Design (5)

Step 1: Study the Automation Pipeline. The automation pipeline identifies and prioritizes processes eligible for automation with candidate identification, top-level benefit analysis and candidate prioritization. In the "candidate identification" phase, analysts study the volume and manual use of a process to determine which processes have the potential to be automated. Then the "top-level benefit" analysis lists and weighs processes based on organization focus areas like regulation, saving manual labor and quality.

In the "candidate prioritization" phase, the analyst studies each process by considering basic information, manual hours, business priorities, complexity to automate, and output. The processes are then sorted by "business priority" score, "manual dollars saved" score and "complexity to automate" score, to determine which processes to automate first.

Step 2: Perform a Feasibility Analysis. This phase evaluates whether a process in the automation pipeline is feasible to automate, based on technical needs and financial feasibility.

An example of a feasible process would be the extraction of electronic PDF data from an invoice for a consumer product company that would then be copied into an Excel spreadsheet. This process is rules based and high in volume because a consumer product company would receive multiple standardized invoices per day.

In addition, this process uses the digital data from the PDF, not handwritten data, and is initiated when an invoice is submitted. On the other hand, if there were any question about what information would need to be captured and copied, it would require a judgement call and therefore result in fuzzy logic.

If the invoices were handwritten, the bot would have to read multiple different styles of handwriting, which could also result in an error of bot performance. These are examples of ways that a process would be infeasible to automate. See Figure 2 for characteristics of processes that are feasible and infeasible to automate.

Figure 2: Feasibility Analysis

Characteristics of Feasible Processes	Characteristics of Infeasible Processes
• Rules based • High volume • Data trigger-initiated • Processes using digital data • Functional and stable process	• Judgment calls • Fuzzy logic • Use of handwritten documentation • Mandatory date pickers • Use of captcha codes

Step 3: Complete a Complexity Assessment. A complexity assessment helps the analyst understand the skills needed to automate a process. This phase estimates development and standardization, which in turn helps to plan automation design and development. In addition, analysts consider the different coding and development backgrounds needed based on the complexity of a given task.

Step 4: Perform a Return on Investment (ROI) analysis. The ROI analysis looks at the cost of developing and implementing bots in a business unit or enterprise as a whole and benefits that the company would see within a certain time range. In addition, during this phase, the analyst studies what is needed to maintain and update the bot as company processes and software usages change.

Step 5: Automation Design. This final phase consists of everything from installing the software that creates the bots, to creating the bot, developing a monitoring plan and preparing infrastructure.

The decision to develop and implement RPA in a company is a lengthy process. Because the process is long and time consuming, it is best that one studies how bots will be implemented into their company before beginning development to ensure that they will maximize the use for RPA bots. Development and implementation can be costly and should be carefully considered when deciding which tasks to automate.

The Risks Associated with Implementing RPA Bots

As RPA is implemented within a company, management and executives must be aware of the risks associated with the implementation of RPA. Some of the most common risks with RPA bots include:

- Business process changes with failure to update the bot;
- Unauthorized access to the robot, which could allow for opportunity to alter the bot; and
- The likelihood that the bot produces errors that become systemic and widespread as the bot continues operation.

PWC has studied specific risk of RPA bot implementation and has defined five categories into which these risks fall.[7]

1. Executive risk is related to ownership for the RPA initiative within a company as a whole. When considering executive risk, companies should consider implementing a companywide governance framework to promote efficiencies and reduce duplication of efforts.

One way this can be implemented is through a Corporate RPA charter with a specified operating model. This charter should list standards and policies related to the selection, development and use of bots within the organization. These would include success measurement criteria and key performance indicators, ensuring that the company is producing expected results from the implementation of bots.

2. Technical risk is related to the control of robots' access system, as well as testing of the robots to ensure they are functioning as intended. With changes to IT platforms, the bot will not automatically adjust but will need to be recoded and edited to account for various changes. Depending on the extent of implementation of RPA bots within a company, technical changes will have a major impact on the workforce.

3. Change management risk considers the impact of RPA on human resources and how this information will be communicated to employees. Without communicating effectively to employees about changes that will take place, companies will experience resistance and a decrease in employee morale. The change of replacing positions with bots also creates the potential for gaps in various roles and problems with accountability in the company.

4. Operational risks need to be considered and companies should implement controls to monitor bot performance and ensure that bots are up to date with regulation requirements. Bot-related errors can affect validity of various regulatory reporting processes and cause inadvertent violation of laws by the bots.

Management must ensure that internal controls are put in place to address the operational risks associated with the bots to ensure that they are designed and operating

effectively. Proper control frameworks should include controls of the entire transaction cycle, including source data, bot outputs and points where human intervention is required, such as investigating exceptions or making judgments.

Providing additional education and training programs is also beneficial to help management and auditors develop a sufficient understanding of how bots affect risk and to determine which controls are necessary for automation monitoring.

5. Functional risk is the last risk associated with RPA bots. This risk considers who designs the bots, their knowledge and expertise, along with the scalability limitations and core systems infrastructure.

In addition to these risks, management should consider how the development and implementation will affect the audit process. External auditors must understand how the RPA bots work in order to provide reasonable assurance of the quality of the financial statements to various users.

One way that companies can help this process is by holding regular planning meetings and providing regular and periodic updates specifically relating to bots that are being used in the internal controls of financial reporting process.[8] Through these meetings, management can help auditors align their planning and thinking regarding risk assessment. This can be done with the use of process-flow diagrams, and internal-control documentation that clearly articulate where and how bots are used within the accounting and finance organization.

As bots are developed, management should maintain a list of bots along with an explanation of the nature of the impact of bots employed by the accounting and finance organization. This will help auditors focus their procedures on those most relevant to the financial statements.

As a company considers the development and implementation of RPA bots within its business, it is important for those employees involved in the decision-making process to consider the various risks associated with RPA. Due to the costly nature of implementation, RPA bots are not something a business should take lightly when analyzing whether it is the next best step for the organization.

So Now You Want to Automate

The financial gains for bot implementation are seen when more than one bot is implemented. For RPA, the average one-time acquisition cost for the bot is anywhere from $5,000 to $15,000. While this is a high initial cost, the financial returns of implementation have potential to be exponential.

A company consisting of 2,500 employees began the automation process within the HR department. It began with the automation of a single process and within the first month of implementation, the company was able to save 120 hours of manual labor.[9] By saving manual labor, the organization was able to reduce salaries and wages expenses for that process. Employees were able to focus on more thought-provoking tasks.

In addition, as processes change, the bots are able to be edited and updated to accommodate change, so there will always be ways that companies can put them to work.

As RPA is continuing to grow, there are many different ways companies can implement them into their workforce. One of the most common ways to do this is through an RPA provider. There are multiple providers today that develop and deploy bots for companies of all different sizes, from family owned businesses to *Fortune* 500 companies. In a recent article by Forrester Research, Inc., 30 different RPA providers were evaluated and ranked based on current offering, strategy and market presence. Of the 30 companies studied, UiPath, Automation Anywhere and Blue Prism emerged as market leaders.[10]

AS RPA CONTINUES TO GROW, THERE ARE MANY WAYS COMPANIES CAN IMPLEMENT THEM INTO THEIR WORKFORCE.

Big 4 accounting firms have relationships and alliances with the top RPA providers to bring RPA solutions to their clients. These alliances help ensure that the bots are being used efficiently and are being implemented with proper internal controls. The endorsement of these providers from Big 4 accounting firms attest to the integrity of the robots that these providers develop.

In addition to implementation with providers, many of these companies offer community editions about bots at no charge or give subscribers access to libraries of bots for a low cost. If a company is looking to implement RPA in a few processes at a lower cost, it can consider hiring a specialist in coding and development to create bots. With knowledge and expertise of bots, community editions have proven to be user friendly and easy to manage. Rather than outsourcing the development, a company should consider training and hiring an individual for small scale integration of RPA bots.

Many businesses currently have multiple processes and tasks that can be performed by RPA bots. Implementing them to run these tasks allows for accurate results within a shorter time frame than if humans were completing the task. RPA is continuing to grow and develop every day and will soon be a significant competitive factor of the workforce across all industries. The sooner a company invests in RPA on any scale, whether for a few processes or multiple processes, the greater their return on investment.

ABOUT THE AUTHOR:

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TXCPA'S NEW DIRECTOR, GOVERNMENT AFFAIRS/SPECIAL COUNSEL

KENNETH BESSERMAN, J.D., LL.M.

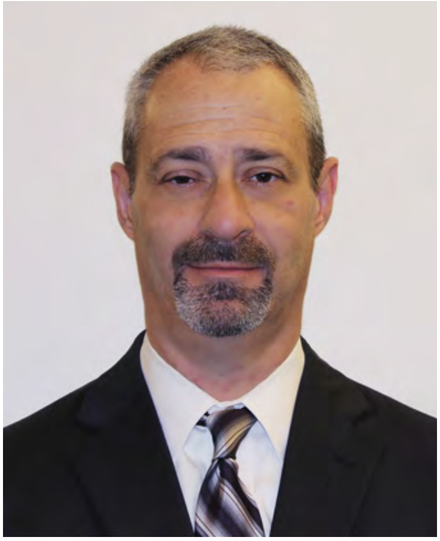
In March, Kenneth Besserman, J.D., LL.M., joined TXCPA's staff as the director, government affairs/special counsel. His office is located in Austin, and he has over 25 years of legal experience in state government and private practice.

As general counsel to the Texas Restaurant Association, Besserman handled legal and regulatory matters affecting the association and restaurant industry, as well as government relations and lobbying efforts for TRA at the state capitol. He previously served as assistant general counsel with the Comptroller of Public Accounts and general counsel and chief of staff for Texas State Senator Rodney Ellis.

He graduated from the University of Houston Law Center and earned his LL.M. degree from the London School of Economics. In this issue of *Today's CPA*, we're excited to introduce you to Besserman, and share some details on his background, career and new responsibilities at TXCPA.

What is your background? You grew up in Austin?

I grew up in Austin and went to grade school and high school in Austin. I was born in Winnipeg, Canada, where my father was doing his pediatric surgery residency. After Canada, we moved to New York and New Jersey, finally settling in Austin in 1972. Austin was then a small sleepy college town. After high school, I went to college at Tulane University in New



KENNETH BESSERMAN

Orleans, then law school in Houston. I worked as a young attorney in Houston for a few years before making my way back to Austin.

Why do you think that work in governmental affairs is so vitally important for TXCPA and the accounting profession?

Like many other regulated and licensed professions, the accounting profession has seen an uptick in legislation impacting the practice and licensing credentials ...

Like many other regulated and licensed professions, the accounting profession has seen an uptick in legislation impacting the practice, the licensing credentials and who can practice. It is important to protect the profession from this type of legislation. Government affairs is the tool that the Society can use to best defeat this type of legislation but also a place to lobby for industry needs and to seek legislation that protects the profession. Having good relationships at the state capitol and in elected officials' districts are important in educating legislators on the importance of the profession to the state of Texas and the Texas economy.

You joined the TXCPA staff during an exceptionally busy time as news was breaking of the coronavirus. Describe some highlights of TXCPA's efforts in the advocacy area as our state and federal governments, the IRS, our members and the public responded to this unprecedented outbreak.

Yes, they have been very strange and interesting first several weeks on the job. Since it has been mostly virtual (Zoom, emails, chats), I have not had a chance to meet with everyone in person. That will come in time. My first week on the job, I was focused on the number of local and county shelter-in-place and stay-at-home orders and emergency declarations to make sure that accounting and the profession were deemed an "essential service." Without a statewide order, we were on our toes monitoring the orders and working with local officials to include the protective language.

TXCPA's long history and great advocacy work have enabled the Society to maintain close contact with state and local elected officials to make sure that our voices are heard; compliments to years of great advocacy.

What work is on your desk today?

On a daily basis, I'm getting up to speed on the legislative and government affairs issues that are facing the profession. I've been on numerous conference calls and webcasts to learn the issues. I'm also reaching out to my new colleagues to learn what they do, how the Society operates and to learn more about the government relations team.

What influenced you to pursue a career in governmental affairs?

I grew up in a family that was very interested in politics. I always had an interest in public affairs and policy issues. After law school, I gravitated back to Austin and found a job at the state capitol working on a Senate staff that was highly energetic and involved in many areas of public policy from criminal justice reform to the state budget to regulatory matters. I've always had a good ability to work with elected officials and in each of my jobs in Austin (state Senate, Texas Comptroller's office, Texas Restaurant Association), I've worked closely with members of the Legislature to craft policies that benefit the office for which I was working.

Tell us about your family.

I've been married to my wife Anna-Karin for over 20 years. Anna-Karin is from Sweden and we met in London when we were both studying there. We get back to Sweden every summer for a few weeks. Our daughter, Rebekah, is 15 years old and a freshman in high school. I'm currently teaching her to drive, which is a little easier the last few weeks with the roads much emptier as a result of the shelter-in-place order in Austin.

What is your favorite book and why?

I read a lot of spy and espionage books – both fiction and nonfiction. One of my favorite books is *Harlot's Ghost* by Norman Mailer. It's a very comprehensive fictional take on the establishment of the CIA and many of the personalities and scandals that plagued the agency in its early years.

Renew Your Membership

Over the past several weeks, we have seen our membership of 28,000 become even more engaged and connected as we have come together to navigate the impacts of COVID-19. You are critical to our strength moving forward as we continue to support CPAs and be a trusted resource for the latest news and updates, virtual CPE programming and more.

If you haven't already renewed your membership for the 2020-2021 year, now is the time! You can renew online at http://dues.tscpa.org. Please reach out to our member service team if you need personal assistance or would like to discuss your options for membership renewal. We are grateful for the opportunity to work with and for you in 2020-2021!

Coronavirus Crisis Resources for TXCPA Members

TXCPA has the resources and information you need to help you manage the business implications of COVID-19. Go to our dedicated COVID-19 resource page on TXCPA.org.

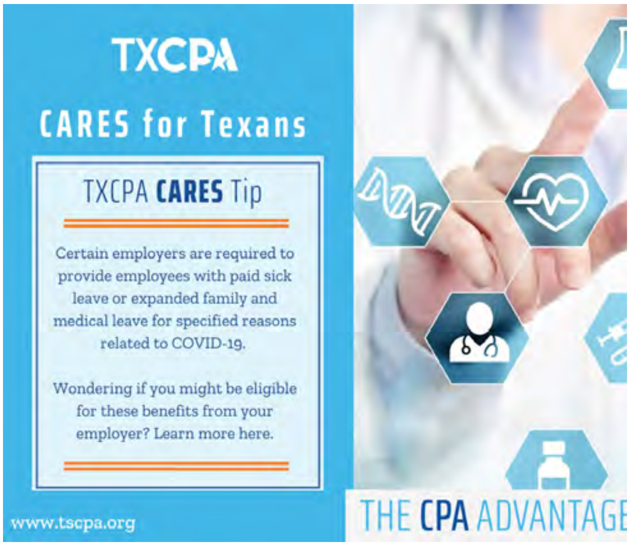
Building Community on TXCPA Exchange

More than ever, members across the state are building community and connecting on TXCPA Exchange! The impacts of COVID-19 on your organization make it extremely important to maintain the connection to your professional community. In addition to our general All Member Forum, there are three interest-area communities – Tax Issues, CPA Practice Management and Nonprofit Accounting.

Log in today to join the conversation, discuss critical issues and actively exchange ideas with your fellow TXCPA members. Don't miss out on this valuable member benefit.

New TXCPA Cares for Texans Campaign Promotes the Profession

TXCPA's promotional campaign – The CPA Advantage – was created to help CPAs, future CPAs and



our chapters promote Texas CPAs to the public. An online digital toolkit provides a variety of helpful resources for TXCPA members and a public-facing ad campaign launched by TXCPA is sharing messages across the state about the value of CPAs.

In April, we added the new TXCPA Cares for Texans campaign under The CPA Advantage. This outreach is focused on sharing short, impactful messages on COVID-19 resources with the public to help them navigate recent legislation and how it affects them as individuals and business owners. It's another opportunity to highlight CPAs as a resource to the public.

You can download and take advantage of these new resources available exclusively for members. Log on today at https://www.tscpa.org/resources/the-cpa-advantage.

Submit an Article to *Today's CPA* Magazine

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

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

TXCPA Annual Meeting of Members

Friday, June 26, 2020 | 9 a.m. - 12 p.m.

With the health and safety of our members as our highest priority and in consideration of revised filing deadlines related to COVID-19, TXCPA's Annual Meeting of Members is moving to an online format.

Members of the TXCPA Board of Directors and members-at-large are invited to participate in this interactive meeting. Hear updates on Society business and help us honor our 2019-2020 award recipients during a virtual awards ceremony.

Watch your email and TXCPA member communications for registration details coming soon!

COVID-19

CPA FIRMS STEP UP TO TAKE ON THE FINANCIAL CHALLENGES OF THE CORONAVIRUS

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

These continue to be frightening times as the coronavirus pandemic sickens people and wreaks financial havoc for businesses, employees, families and communities. CPAs are in a unique position to help people cope with the unprecedented uncertainty.

We asked three TXCPA members to discuss how they're responding to the challenges of these historic times, what guidance they're providing, their current business risks, the effects this pandemic may have on the profession in the future, and more. Our thanks to Sara Averett, CPA-Fort Worth, Melanie Kirk, CPA-San Antonio, and Josh LeBlanc, CPA-Southeast Texas, for sharing their insights.

What are or have been the most urgent challenges to tackle as a result of COVID-19's impact on your business?

Sara Averett: We've had a significant increase in the number of questions from not only clients, but from the general public. They've asked questions like when they'll receive their stimulus check or questions about the Paycheck Protection Program (PPP). Our tax work has been a challenge. Although the tax deadlines were pushed back, the same amount of work needs to be done and we're now also doing the work that's normally done after tax season.

Melanie Kirk: Everyone has been working remotely since the middle of March. We've had to make sure our team had what they needed to work more effectively from home. We already had good remote technology, but added more monitors, video capability and better chairs. We're also working hard to stay on top of the rapidly changing legislation and keep our clients informed.

Josh LeBlanc: It's been challenging to get information on a very rapid developing and changing legislative environment. There are so many different offices writing legislation simultaneously, it can be challenging to pick through, in many cases, conflicting regulations and guidance.

What changes has your firm made to respond to the crisis and in what ways are you assisting your clients in addressing their concerns?

Sara Averett: We are cross training and pulling people over from other departments to assist with the tax work since it has increased exponentially. We're reaching out to clients to help calm their fears and using technology whenever possible.

Melanie Kirk: We formed a COVID-19 team. They have spent countless hours researching the guidance on the different stimulus packages so we can help our clients understand the resources available and what best fits their situation.

Josh LeBlanc: We're using more remote work platforms for staff. We're making sure to be available to clients in these challenging times. Some of the toughest conversations pertain to closing businesses permanently, layoffs/ furloughs, and business consolidations with limited resources available in this process.

What steps are you taking to help mitigate the business risks to your firm and do you see opportunities to provide additional assistance to the community?

Josh LeBlanc: Adopting the trusted advisor model, many of our clients will phone us before their attorney. We are in the middle of a lot of communications with various clients facing a variety of issues. Seasonal work all but halted a few weeks ago to help focus on more immediate financial concerns of our clients. Every one of our clients has been understanding of the timetable disruption. There's plenty of consulting opportunities available right now, and I don't

Sara Averett
CPA-Fort Worth

Managing Partner, Accounting Services

Averett Financial

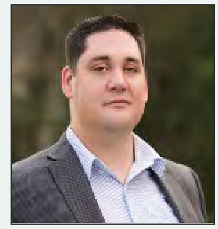
TXCPA Member Since 2003

Melanie Kirk
CPA-San Antonio

Managing Partner

ATKG LLP

TXCPA Member Since 1985



Josh LeBlanc
CPA-Southeast Texas

Shareholder

Edgar Kiker & Cross PC

TXCPA Member Since 2009

know of any CPA who is actually slow or running out of work to do currently.

Sara Averett: It's difficult because we won't know the financial fallout until after October 15. With the extended tax season and work being pushed back, our normal financial benchmarks have been affected.

Melanie Kirk: We've reassessed our processes to be as effective as possible with everyone working remotely. Also, our recruiting group has received a lot of inquiries during the shutdown. We're hoping to add some new team members!

What plans are in place to be able to return to more normal operations when the crisis is over?

Melanie Kirk: We're starting with a small number of people back in the office each day.

Sara Averett: It's hard to know now what the long-term impacts will be. It's possible that many of the changes we've made in our firm recently might become permanent.

Josh LeBlanc: This is an ongoing topic of discussion. For many mid-sized regional firms that didn't have complete remote capabilities in place, this crisis has certainly accelerated many businesses, including CPA firms, into the future. It's possible that this has vaulted us five years ahead on technology. We have many clients struggling to make a switch to a more paperless environment, and this has accelerated acceptance of email, portals and digital signatures. It's one giant leap for technology in bridging the remote gap between many firms and some of their client base.

How has your experience and knowledge as a CPA helped you in your response to this crisis and in your adaptation to new ways of doing business in an ever-changing environment?

Sara Averett: The CPA brand carries weight. We are experts on these tax and other issues, but we need to back that up by understanding the implications of the changes. Clients are coming to us with questions daily. We have to take what we've learned and be able to explain to clients what the impact will be on them.

Melanie Kirk: My experience greatly helped during this time. Public accounting is typically fast paced and involves complicated and constantly changing rules and reporting requirements. We are also accustomed to working with many different clients in a variety of different industries and situations.

Josh LeBlanc: "Crisis" is usually associated with some form of "hysteria or panic." Many locations in the country face various forms of economic shutdown due to natural disasters (be it blizzards, tropical events, wildfires, tornado outbreaks or earthquakes) and have unfortunately become all too accustomed to calm reaction and patience in times of crisis. Southeast Texas certainly has had its share of events in recent years. Adapting to new ways of doing business is certainly something that has been embraced here for the last decade. What is unique about this event is the whole country and the entire economy are facing struggle. With my knowledge and experience as a CPA through these natural events, I've come to expect tax legislation in favor of those affected and a delay in deadlines. Patience is key in some aspects, as well as reprioritizing work and tasks to assess what needs to take precedence, which is currently SBA loan assistance and PPP applications.

How do you see the CPA profession being involved in the recovery process for Texans and their communities?

Josh LeBlanc: As both federal and state legislators begin to think about turning things back on and writing legislation to help underwrite these events, our input is going to be more valuable than ever. Often times, there are impacts that they cannot see simply because they do not practice where we do. My experience in the profession has shown that our legislators are always open to receiving our input and feedback, as they are not looking to have unintended consequences in what they are doing.

Melanie Kirk: CPAs are in a great position to help during the recovery process. We can use our financial skills to make sure companies or other organizations understand their financial situation and assist with things like cash flow planning or the calculations involved with their PPP loans. CPAs also have a wealth of business experience to help organizations analyze their operations and adjust their strategic plan for the future.

Sara Averett: It's tough to navigate clients through these waters. The tax implications are causing the sheer volume of work to be staggering. Some CPAs who were nearing retirement might not want to continue working in such a difficult environment. Those who are at retirement age might retire if they can, resulting in a change in the number of CPAs available to do the work. This will likely lead to more opportunities for those who remain.

FEATURE

CARES ACT

PROVIDES TAX BENEFITS AND INCENTIVES TO BOTH BUSINESSES AND INDIVIDUALS TO EASE THE ECONOMIC IMPACT OF COVID-19

By Tim Thomasson, Don Carpenter, Jennie Beyer, Sarah Cornish and Katherine Gunter

In just a matter of weeks, U.S economic performance turned from a historic period of expansion to one of the sharpest declines since the Great Depression. But as Americans were becoming familiar with terms like "shelter-in-place" and "essential business services," the U.S. Congress moved at record speed to pass the Coronavirus Aid, Relief, and Economic Security (CARES) Act that President Trump signed into law on March 27, 2020.

This $2 trillion relief package contains an array of provisions such as small business loans and enhanced unemployment assistance. But the focus of this article is the tax provisions within the Act that provide financial assistance focused on liquidity to both businesses and individuals.

Corporations See 2017 Tax Changes Temporarily Altered

The Tax Cuts and Jobs Act of 2017 (TCJA) introduced sweeping changes to the corporate tax system. In exchange for a lower corporate tax rate, significant limitations were placed on the ability of corporations to utilize net operating losses (NOLs) and interest expense. And while the TCJA repealed the alternative minimum tax for corporations, any existing minimum tax credit carryforward was refundable over a four-year period from 2018 through 2021.

The CARES Act temporarily alters these limitations on NOLs and interest expense, and accelerates the recovery of any minimum tax credit carryforward. The provisions should provide additional liquidity to corporations that are struggling to retain employees, pay creditors and protect investors.

Additional Opportunities to Utilize NOLs

The TCJA eliminated any carryback of NOLs in exchange for allowing an indefinite carryforward period. In addition, under the carryforward provisions, the NOL could only offset 80% of taxable income in any future year. The CARES Act provides two opportunities for corporations (and other taxpayers) to utilize a NOL.

First, NOLs for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2021 (2018 – 2020 for calendar year corporations) can now be carried back five years. The indefinite carryforward period remains unchanged. This carryback period is considerably more generous than even the pre-TCJA two-year carryback provision. Although not widely applicable, the CARES Act prohibits NOL carryback to any tax year when the taxpayer was a real estate investment trust (REIT) and any losses from tax years when the taxpayer is a REIT are not eligible for carrybacks.

The carryback provision offers two obvious advantages:

1.) Acceleration of the tax refund for utilization of tax losses arising in 2018 through 2020.
2.) Increase in the amount of refund as the carryback will offset income taxed at prior corporate rates of 35% rather than future rates of 21%. This second advantage will likely have a financial statement benefit, as well.

Less obvious may be the implications of a carryback on the prior years' returns. For example, elimination or reduction of an earlier year's taxable income could reduce foreign tax credits that may otherwise expire or alter other tax benefits like the domestic production activities deduction.

Consideration should also be given to the limitations placed on carrybacks from merger and acquisition transactions. For these reasons, for each loss year, taxpayers are allowed to make an irrevocable election to forego the carryback and continue carrying forward the NOL indefinitely.

Special rules will apply to REITs, insurance companies and carrybacks to taxable years with Sec. 965 income inclusions from foreign subsidiaries.

The second additional opportunity to utilize a NOL under the CARES Act is a suspension of the 80% of taxable income limitation for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2021. This will allow corporations with enough NOLs to offset 100% of taxable income during this period. The 80% of taxable income limitation will continue to apply for post-2020 tax losses.

With regards to NOLs, the CARES Act introduced two technical amendments to the TCJA that will answer certain open questions of corporations and their tax advisors.

1. Pre-2018 NOLs were not subject to the 80% taxable income limitation under the TCJA. Uncertainty existed as to how to apply the 80% taxable income limitation in a year in which both pre-2018 and post-2017 NOLs are utilized. The CARES Act resolves this uncertainty by verifying the 80% taxable income limitation must be calculated after such income is reduced using pre-2018 NOLs.
2. For purposes of calculating the 80% limitation, the taxable income base will not consider the Sec. 199A qualified business income (QBI) deduction and the Sec. 250 FDII and GILTI deductions.

Both items above will be more relevant when the 80% limitation is reinstated for post-2020 years.

Interest Expense Limitations

Under the TCJA, the deductibility of interest expense is generally limited to 30 percent of adjusted taxable income (ATI) for a tax year. Adjusted taxable income is roughly equivalent to earnings before interest, taxes and (for taxable years beginning before Jan. 1, 2022) depreciation and amortization (EBITDA). The CARES Act provides relief to corporations (and certain other taxpayers) in deducting business interest expense in three ways.

First, the CARES Act temporarily increases the limitation to 50 percent of ATI for tax years 2019 and 2020. Second, when calculating the deductible interest expense for 2020, taxpayers may elect to use the 2019 tax year's ATI as the base since COVID-19 restrictions may reduce 2020 ATI dramatically. An election is permitted for taxpayers to forego the increased limitation.

Finally, the ability to use excess business interest expense from a partnership is enhanced. Although the 30% of ATI limitation for partnerships remains unchanged for 2019, it is increased to 50% of ATI in 2020. Additionally, 50% of excess business interest expense from a partnership in 2019 can be deducted in 2020 by the partner, without limitation. The remaining 50% of disallowed interest expense from a partnership remains subject to the limitations of TCJA.

For a taxpayer with a NOL in 2019 or 2020, the increased limitation may increase the NOL, allowing additional offset of higher taxed income in earlier years from the five-year carryback provisions discussed above.

Alternative Minimum Tax Credits

While the provisions impacting NOLs and interest expense are applicable to both corporate and non-corporate forms of business, one important aspect of the CARES Act specifically applies to corporations. The TCJA repealed the alternative minimum tax (AMT) for corporations for post-2017 tax years. In addition, any remaining AMT credits became refundable over the period from 2018 - 2021. The CARES Act accelerates the refund of these credits to either 2018 or 2019. The refund can be accelerated by claiming it in 2018 (via amended return or a tentative refund claim) or including it on the 2019 tax return.

In IRS Notice 2020-26, the IRS has extended the time for filing a Form 1139, Corporation Application for Tentative Refund, for the 2018 tax year until June 30, 2020. In addition, the IRS has indicated that refund of AMT credits can now be made using the Form 1139. In keeping with the current times, the IRS provided a toll-free fax number, recommending that all refund claims made on a Form 1139 related to these NOL carryback and AMT credit provisions be faxed versus paper filed.

Individual Taxpayers Are Not Overlooked

Individual taxpayers are provided several benefits under the CARES Act that are intended to provide liquidity, protect retirement savings and encourage philanthropy. The provisions include advanced refunds of a temporary tax credit, acceleration of excess business loss deductions, adjustments to the taxation of retirement distributions and a more generous limitation for charitable contributions.

Advanced Refunds Accelerate a Special 2020 Credit

Qualifying individual taxpayers will receive "recovery rebates" similar to the economic stimulus payments that followed the 2008 financial crisis. These rebates are immediate payments received by taxpayers as advanced refunds of a tax credit that will be granted on tax returns filed for 2020. The maximum amount of the tax credit is $1,200 for single filers and $2,400 for joint filers along with a $500 credit for each qualifying child.

The maximum tax credit is allowed for single filers with adjusted gross income (AGI) of not more than $75,000, head of household filers with AGI of not more than $112,500 and joint filers with AGI of not more than $150,000. The credit is reduced by $5 for every $100 of AGI that exceeds the above thresholds. Thus, the credit is entirely phased-out when the taxpayer's AGI is greater than $99,000 for individual taxpayers, $146,500 for heads of household and $198,000 for joint filers.

A $500 credit is also provided for each child under 17 years of age who is claimed as a dependent. To qualify, the child must have a Social Security number. The child tax credit is also subject to phase out based on the above schedule.

The amount of the advanced payment is based on a taxpayer's most recently filed tax return. With the extension of the 2019 due date to July 15, this may be the 2018 return in many cases. Because this is an advance of a 2020 credit, any correction of the payment amount will presumably be adjusted upon the filing of this year's tax return. For example, the advanced payment will not include any credit for children born or adopted since the filing of the last tax return. Also, AGI in 2018 or 2019 may be considerably different than 2020 AGI.

The recovery rebate credits are only allowed for qualifying individual taxpayers. Nonresident aliens, estates, trusts and individuals who are being claimed as dependents by another taxpayer are among those who do not qualify for this refund. The last category described (dependent taxpayers) will apply to college-age students claimed as dependents by their parents. However, no $500 child credit will be provided if the student is 17 years of age or older.

Limitations on Business Losses Are Removed

The TCJA limited post-2017 business losses for non-corporate taxpayers. Taxpayers were allowed a deduction of $250,000 for individuals and $500,000 for joint filers for any loss from an active trade or business to the extent that it exceeded the aggregate trade or business gross income from other business ventures of the taxpayer. The taxpayer could carryforward any NOL resulting from excess business losses indefinitely to offset 80% of future taxable income.

The CARES Act removes the limitation on business losses for tax years beginning prior to Jan. 1, 2021 (2018 – 2020 for calendar year taxpayers). This provision is extended to tax years beginning before Jan. 1, 2026 for any farm losses. An amended return may be necessary to adjust losses in 2018 or 2019 if returns were filed prior to enactment of the CARES Act. To the extent that business losses result in a NOL, that loss may be carried back to the five previous years and is not subject to the 80% limitation imposed by the TCJA, which is consistent with the corporate NOL provisions discussed earlier in this article.

The business loss provisions are effective for all losses occurring in the relevant years without respect to whether the losses were the result of the pandemic.

Retirement Distributions Provisions Are Liberalized

To provide financial assistance to eligible individuals, the CARES Act temporarily liberalized the restrictions placed on early withdrawals and loans from retirement plans such as 401(k) plans or individual retirement accounts.

Eligible individuals are defined as:

1) Someone who is diagnosed with SARS-CoV-2 virus or COVID-19 disease or whose spouse or dependent is so diagnosed.
2) Someone who experiences adverse financial consequences from being quarantined, furloughed, laid off. This includes individuals who have reduced work hours or are unable to work due to childcare.

For these individuals, the 10% early withdrawal penalty that applies to withdrawals from retirement plans prior to attaining 59 ½ years will not be assessed to the extent the withdrawal occurs in 2020 and does not exceed $100,000. Although not subject to the penalty, the withdrawal is still subject to income tax. The income tax can be avoided if the early withdrawal is repaid to the plan within three years. And to the extent an early withdrawal remains subject to income tax (is not repaid within three years), the resulting tax can be spread over three years.

Likewise, the CARES Act relaxes the restrictions on loans from retirement plans for eligible individuals. The Act doubled the amount a participant can borrow from a 401(k) plan to the lesser of $100,000 or the vested balance in the account. The loan must be made within 180 days of enactment of the CARES Act and must be repaid within five years to avoid income tax. Plan participants are also allowed to defer any payments on pre-existing loans that were due in 2020, although interest will continue to accrue.

It is important to note that these withdrawal and loan provisions are optional. Even plans that currently allow for hardship withdrawals or loans do not have to offer them.

The Act allows taxpayers to waive any minimum required distributions in 2020 from retirement plans. This would typically affect any plan participant who is at least 72 in 2020.

This provision applies to all plan participants and not just "eligible individuals" defined above. Participants have 60 days to return any distributions already received from a plan as a minimum required distribution if they so choose. Foregoing these distributions will allow the funds to remain in the plan and generate tax-deferred growth.

Charitable Contribution Limitations Adjusted to Encourage Giving

With the increase in the standard deduction as part of the TCJA, charitable donations have dropped. To encourage philanthropic response to the pandemic, the CARES Act has made temporary adjustments to the limitations affecting charitable contributions.

The Act allows individuals who do not itemize to deduct up to $300 of cash contributions to qualified organizations to arrive at adjusted gross income (above-the-line deduction). To be eligible, the contribution must be made in cash to a public charity or foundation. Contributions to supporting organizations or donor-advised funds do not qualify.

For those taxpayers who do itemize, charitable cash contributions are limited to 60% of adjusted gross income. The CARES Act removes this limitation, although the overall limit of 100% of adjusted gross income on total contributions (cash and in-kind) remains. To the extent contributions exceed adjusted gross income, the excess can be carried forward for five years.

The Act also increases the limit on charitable contributions for corporate taxpayers. The limitation has been increased to 25% of taxable income (before the charitable and other special deductions) from the previous limitation of 10% (15% for food inventory).

Increasing the income limitation for charitable contributions is not without precedent in times of natural disasters. To qualify for the increased limitation, taxpayers have historically been required to make contributions that directly benefit the relief effort. The CARES Act, however, has no such requirement. All cash contributions are included and not just those that benefit the relief effort for the COVID-19 virus.

Businesses Are Encouraged to Retain Employees Through Payroll Tax Incentives

As businesses have either been closed or experienced dramatic curtailment of trade, many are faced with the difficult decision of how to control costs. With payroll being a major cost category and employees being underutilized, furloughs or even terminations have become common as is evident by the swelling number of unemployment claims.

To reduce these impacts, the CARES Act included several major provisions affecting the payroll tax liability and payment obligations of businesses. These provisions apply regardless of whether the business is a corporation or individually owned.

Retention Credits

The Act provides retention credits to eligible employers (including nonprofit organizations) for 50% of "qualified" wages up to $10,000 per employee for wages paid between March 13 and Dec. 31, 2020.

An eligible employer must:

1) Have been carrying on a trade or business in 2020 and

2) During a payroll tax quarter within the year, either:

   a. Operations have been partially or fully suspended by government order as a result of COVID-19.

   b. Gross receipts for the calendar quarter are less than 50% of the gross receipts for the same calendar quarter in the previous year.

An employer remains eligible until gross receipts for a quarter equal at least 80% of gross receipts for the same quarter in the previous year.

The definition of qualified wages differs depending on whether the employer has more or less than 100 employees. For employers with more than 100 employees, only wages paid to employees who at the times the wages were earned are not providing services due to COVID-19 circumstances. For employers with less than 100 employees, all employee wages are qualified regardless of whether the employees are providing services. Determination of the number of employees is based on the 2019 calculation of full-time employees as required by IRC Sec. 4980H enacted as part of the Affordable Care Act.

Qualified wages are based on the definition of wages for FICA reporting purposes increased by any amounts paid by the employer for health plan costs. Any sick or child leave paid under the Families First Coronavirus Response Act (FFCRA) are specifically excluded from "qualified" wages for the retention credit since the employer is already receiving a dollar-for-dollar tax credit for these payments under that prior act.

Employers receiving Small Business Interruption Loans under Section 1102 of the CARES Act are not eligible to receive the payroll retention credits. In addition, the credit for wages paid to any employee during a period that an employer is allowed a Work Opportunity Credit with respect to that employee are not qualified.

Employers can claim the credit by reducing their federal tax deposit for wages paid to all employees, not just those employees for which the employer is claiming a retention credit. Specifically, the credit can offset the amount withheld from the employees' wages for federal income taxes, as well as both the employee and employer shares of Social Security and Medicare taxes. The credit will be reported as part of the reconciliation of the quarterly Form 941.

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FEATURE

By istockphoto/designer491

ENHANCING AUDIT INTERVIEWS WITH **FAINT**: THE FORENSIC ASSESSMENT INTERVIEW TECHNIQUE

By Emily Seay Keenan, Ph.D., CPA, and Robert A. Seay, DBA, CPA

Auditors routinely rely on oral inquiry, particularly face-to-face interviews, as an important source of audit evidence. Interviews with persons responsible for day-to-day operations, management and governance often contribute valuable information for the assessment of risk and detection of material misstatements.

However, do current audit interview practices produce relevant and reliable oral evidence? Do auditors receive adequate training in interview skills? To what extent should internal audit shops and external audit firms actually depend on this type of evidence? These are important questions considering the billions of dollars in losses and restatements attributed to occupational fraud and accounting errors (ACFE 2018; Alali and Wang 2017).

The value proposition of face-to-face interviews increases as an interviewer becomes more proficient designing questions, assessing verbal cues and evaluating non-verbal behaviors. This requires special training, which may not be supported or readily available. To provide auditors with assistance, this article recommends the use of the Forensic Assessment Interview Technique (FAINT), a validated and highly effective criminal investigation tool. The article also provides a step-by-step implementation guide and a sample internal control questionnaire that incorporates the use of FAINT.

Interview or Interrogation?

The distinction between an interview and an interrogation is critical because the objectives are fundamentally different. For example, an interview's purpose is limited to gathering evidence, while the scope of an interrogation extends to obtaining an admission of guilt (Gordon and Fleisher 2011). When conducting interviews, auditors must take precautions to ensure their clients do not perceive they are the subject of an interrogation. Crossing this line creates enormous potential to disrupt the integrity of the interview and damage its value as a reliable source of audit evidence.

Interviews, by nature, should be less stressful than interrogations and last no longer than 20 to 30 minutes. This is quite different from an interrogation, which often becomes contentious, continues for much longer periods of time and may even lead to the violation of the interrogated individual's personal space. Proficient interviewers behave in a non-accusatory manner, guide the respondent's cooperation and documents findings in a relaxed manner.

During an interview, auditors should make every effort to keep their client in a familiar, comfortable and distraction-free environment. They should promote good faith cooperation, build positive working relationships, and encourage their clients to speak often and freely. However, this does not mean that a person participating in an interview will never feel uncomfortable or become threatened. To the contrary, the value of an interview depends on properly interpreting the verbal cues and non-verbal behaviors when a person perceives a threat that produces "fight or flight" responses. Interviewers must possess the ability to understand a client's reactions to either confront an issue head on ("fight") or attempt to distance themselves ("flight") from the source of stress (Gordon and Fleisher 2011). See Table 1 for a comparison of the characteristics of interviews and interrogations.

Assessing Verbal Cues and Non-Verbal Behaviors

To obtain maximum benefit from an interview, an auditor must be able to identify and interpret verbal cues and non-verbal behaviors that point to truth and deception. Common verbal cues of deceptive persons include evasive responses to questions, a hesitancy to speak when asked and a reluctance to offer any assistance to the interviewer. Deceptive individuals also exhibit slow rates of speech, frequent pitch changes, short responses and long delays before answering questions (Blair and Kooi 2004).

To the contrary, a truthful person normally expresses a strong desire to answer questions honestly, exhibits an emotionally cooperative attitude and is fully engaged in the interview.

Truthful interviewees also refrain from changing or redefining interview questions in a way that, by their own definition of the situation, shows they didn't do anything wrong (i.e., personal coding). For example, a client may have a policy that prohibits anyone from having custody of cash and making bank deposits. The auditor might ask: Do you ever collect cash and make daily bank deposits? After receiving a response to this yes or no question, the auditor should follow up with an additional question asking their responsibilities in the cash receipts process. A deceptive person will frame their answers to these questions in a manner that changes the question to one where they appear to not be violating internal controls.

For example, when asked to elaborate, the client might respond as follows: Well, some days I collect cash and some days I make bank deposits. The client redefining the question in this way is an example of personal coding and thus a sign of deception.

A change in "how and why" by the person undergoing questioning is also a sign of deception. In this case, the interviewee initially denies they have circumvented internal controls. But as the interview continues, the interviewee creates an alternative explanation as to why they are perceived to have not followed proper procedure. For example, a mailroom clerk might answer he/she had to collect and deposit cash receipts because the cashier who deposits the cash was often absent from work (Gordon and Fleisher 2011). See Table 2 for a summary of truthful and deceptive verbal cues.

The assessment of non-verbal behavior is an equally important element of a FAINT interview. Those who are truthful project a relaxed and confident image when subjected to questioning. They also do not produce unnecessary repetitive body movements. To the contrary, deceptive individuals express tense, defensive and restless mannerisms throughout the interview session. They often slouch, cross their arms or legs, and produce evasive body alignment with the interviewer.

Table 1: Interview vs. Interrogation (Adapted from Gordon and Fleisher 2011, 34)

Variable	Interview	Interrogation
Purpose	Gather information	Get a confession
Demeanor of Interviewer	Non-accusatory	Accusatory
Session Framework	Free flowing	Rigid
Participation Levels	Interviewee speaks 95% of the time	Interrogated speaks 5% of the time
Environment	Comfortable for interviewee	Interrogator's "home field advantage"
Spatial Relationships	"Personal-Social Zone" honored	Starts "Personal," ends "Intimate Zone"
Documentation	Consistent writing	No writing until receive a confession
Duration	Approximately 20-30 minutes	No time limit

Table 2: Truthful and Deceptive Verbal Cues (Adapted from Gordon and Fleisher 2011, 99)

Truthful	Deceptive
Strong desire to resolve issues	Hopes the interview gets nowhere
Talkative	Hesitant to speak
Tries to narrow or assist investigation	Has no information/tries to broaden investigation
Uses appropriate and strong terms	Uses mild/evasive terms
Fully engaged	Detached/distant
Normal speech patterns	Slow rates of speech with frequent pitch changes
No abnormal delays in responses	Long delays with short response times
No use of "personal coding"	Uses "personal coding"
Consistent "how and why"	Changes "how and why"

Illustrators and adaptors are also examples of non-verbal behaviors that are likely to surface in the course of an interview. Illustrators help the interviewer understand what the individual is trying to say. For example, touching one's chest while responding to an interview question is an indicator of truthfulness. Adaptors inhibit an interviewer from understanding verbal responses. For example, an individual may cover his/her mouth when responding to an interview question. This is a sign of deception. See Table 3 for a comparison of truthful and deceptive non-verbal behaviors.

FOR AN INTERVIEW TO BE EFFECTIVE, THE INTERVIEWER MUST SET THE CLIENT AT EASE AND TAKE CONTROL IN A NON-THREATENING WAY.

The Interview: A Step-by-Step Process

Step 1: Build a Relationship and Establish a Baseline

For an interview to be effective, the interviewer must set the client at ease and take control in a non-threatening way. The main goal at this point is to build rapport and establish a baseline of the interviewee's behavior. To accomplish this, the auditor must restrict questions to those that are irrelevant to the audit objectives.

Questions related to the nature, timing and extent of audit procedures must be avoided. The use of closed-end demographic questions (name, current employment position, length of time employed, etc.) allows the auditor to take charge, solicit cooperation and begin the important process of relationship building.

To encourage a positive working relationship, the auditor should guide an honest and free-flowing discussion of a non-controversial topic that both individuals have in common. Perhaps it is a college or professional sports team the two support. Maybe it is a community service organization that brings them together.

Whatever the topic, nothing related to the actual purpose of the interview should be discussed at this stage. The

Table 3: Truthful and Deceptive Non-Verbal Behaviors (Adapted from Gordon and Fleisher 2011, 106)

Truthful	Deceptive
Relaxed and confident	Tense and defensive
Face-to-face body alignment	Evasive body alignment
Increased use of illustrators	Use of adaptors
Natural and settled foot and body positions	Tense, repetitive, restless foot and body movements

objective, at this point, is to create a baseline situation where the interviewer has the opportunity to observe normal truthful behavior when there is not a threatening emotional attachment to the topic.

Step 2: Evaluate Posture and Demeanor

After establishing a baseline, the auditor is now in a position to evaluate the general posture and demeanor of the person being interviewed. This is the initial metric in FAINT. Truthful individuals maintain an upright and forward-leaning posture that is settled and open. Deceptive individuals often slouch, lean back, exhibit restlessness and cross their arms and legs.

An auditor should record a score of +1 in the interview working papers if they perceive the interviewee to be a truthful person or a score of -1 if considered deceptive. A score of zero indicates that the general posture and demeanor signals are mixed and do not lean in either direction. At this point, the interview should be no longer than 5-10 minutes. See the Appendix for an example of an interview working paper that incorporates FAINT scoring.

Step 3: Ask Relevant, Comparison and Projective Questions

The next step is to move toward the actual purpose of the interview. For example: Who is responsible for implementing the internal controls over financial reporting? Who might be involved in efforts to misappropriate assets? Are bank records and cash accounts regularly reconciled? Now is the time to begin probing with questions that might make the client uncomfortable and produce "fight or flight" verbal cues and non-verbal behaviors.

FAINT recommends a mix of relevant, comparison and projective questions dispersed throughout the interview. After each question, an auditor records the client's response and assigns a score of +1 if perceiving the interviewee to be truthful, a score of -1 if considered deceptive or a 0 if truthfulness cannot be determined.

To arrive at these scores, the interviewer assesses verbal cues and non-verbal behaviors independently for each question. Truthful responses receive a positive sign (+) and deception gets a negative sign (-). Indifferent or mixed signals result in a score of zero (0). The interviewer then combines the verbal and non-verbal marks for each question and records a score of either +1 (truthful), -1 (deceptive) or zero (mixed results). See Table 4 for a summary of all possible assessment scores.

Relevant questions, which are sharp and focused, strike directly at the heart of the interview topic. They should solicit a yes or no response and only threaten those who are untruthful.

Table 4: Question Scoring (Adapted from Gordon and Fleisher 2011, 142)

Verbal Cues	Non-Verbal	Assessment Score
+	+	+1
-	-	-1
+	0	+1
-	0	-1
+	-	0
0	+	+1
0	-	-1
0	0	0
-	+	0

Binary responses require these respondents to either lie or admit their deceptive behavior. They also help to prevent deceptive persons from shaping their answers to fit the questions they want to answer instead of the questions that have been asked. Internal control questionnaires and disclosure checklists are common examples of relevant audit interview questions requiring binary responses.

Assume an audit client forbids anyone in the accounting department from having access to daily cash deposits. An appropriate relevant question when assessing risk, testing controls or even investigating missing funds is: Do you ever have physical contact with the daily cash receipts? The person working in the accounting department who follows company policy is not threatened and will answer truthfully with a "no" response. The person in a position to perpetrate a fraud (custody of assets and record keeping) must either lie by answering "no" or answer "yes" and admit to not following company policy.

Persons who are threatened and choose to lie will exhibit verbal and non-verbal behaviors not observed during the baseline phase of the interview. The auditor must be able to properly assess the client's responses to determine truth or deception.

FAINT interviews should also include comparison questions, which are linked to specific relevant questions. For example: Have you ever broken or violated company procedures? Those who lie and deny having access to daily cash deposits when responding to a linked relevant question will answer "yes" to the comparison question.

This occurs because the comparison question is worded much broader than the relevant question and takes attention away from the real issue. Admitting to breaking a company procedure sometime during one's career is not an admission that he/she has not, during the period under audit, violated internal control procedures related to daily cash deposits.

Interestingly, research by Gordon and Fleisher (2011) also shows that individuals who respond truthfully to a relevant question will do the opposite with respect to the comparison question. This happens because, even though they probably have violated company policy at some point, they feel like they must state that they have never done so in order for the interviewer to believe their response to the relevant question.

Finally, projective questions seek to elicit involuntary verbal cues that indicate truth or deception. These questions are based on "what if" scenarios that remind the interviewee of past actions and experiences. For example: What would you, an employee in the accounting department, do if asked by a superior to deposit the daily cash receipts? What would you do if you found out that a co-worker in the cashier's office was skimming daily receipts?

These types of behavioral questions stimulate verbal cues and non-verbal behaviors that provide further evidence of truth or deception. See Table 5 and the Appendix for more examples of relevant, comparison and projective questions.

Step 4: Interpret the Interview Results

FAINT provides a framework to help determine the reliability of client responses to interview questions. Adding a truth/deception scoring metric to audit interviews enhances the ability to interpret the results of interview evidence.

After completing an interview, the auditor totals all truth/deception scores to reach a conclusion. An overall positive score increases the likelihood that the information gathered is trustworthy and reliable. An overall negative score reduces the veracity of the interview results, which will likely expand audit procedures. See Table 5 and the Appendix for a sample internal control questionnaire with FAINT scoring.

Final Remarks

Whether in a criminal case or an audit engagement, the use of personal interviews plays a significant role in the process of collecting evidence. However, truth and deception are often difficult to discern. This article explains how FAINT, a structured and highly effective approach to interviewing, addresses this problem.

How a client responds to an interview question is often just as important as what they say. This makes the assessment of verbal cues and non-verbal behavior, as required by FAINT, extremely important. A failure to distinguish truth from deception may lead to repeat interview sessions, incomplete findings and inaccurate conclusions.

Table 5: Sample Interview Questionnaire Excerpt

	Question	Answer	Verbal Score	Non-Verbal Score	Overall Question Score
1.	Do you always open and count the daily mail receipts with another mailroom employee? **(R)**	Y	+	-	0
2.	Do you and another employee always prepare daily control sheets of cash and checks received? **(R)**	Y	-	-	-1
3.	What would you do if the person with whom you count cash insisted that receipts should not be locked up when taking a lunch break? **(P)**		+	+	+1
	Answer: I would tell them that we must follow policy. **R = Relevant Question, P = Projective Question**				

The need for auditors to properly design and deliver questions, interpret interview results and formulate appropriate conclusions should not be underestimated. Effective oral inquiry, which often contributes and corroborates valuable information to auditors, requires training and development. To capitalize on this, internal and external audit departments should assess their training opportunities and consider the use of FAINT when planning professional development activities that are directed toward operational, compliance, financial statement and forensic audits.

Finally, future research should investigate the extent to which academic and professional education programs adequately address interviewing skills. An assessment of perceived importance and actual financial commitments to oral inquiry could potentially lead to better prepared college graduates and more effective working professionals.

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APPENDIX

Internal Control Questionnaire

Audit Area: Cash
Mailroom Cash and Check Receipts

Client ____ Balance Sheet Date _____________________

Step 1: Build Rapport and Establish Baseline Behavior

Interviewee ____ Title/Position _________________________
Length of Time Employed by Client ______________ Length of Time Employed in Current Position __________
Name/Title of Immediate Supervisor ____

Search for common interests: hobbies, sports teams, civic/charitable organizations, etc. _______________________
____
____

Step 2: Evaluate Posture and Demeanor (Circle one)

Truthful +1 Not Sure 0 Deceptive -1

Step 3: Relevant (R), Comparison (C) and Projective Questions (P)

Cash and Check Receipts – Mail Room Procedures

	Question	Answer	Verbal Score	Non-Verbal Score	Overall Question Score
1.	Do you always open and count the daily mail receipts with another mailroom employee? **(R)**	Y / N			
2.	Do you and another employee always prepare daily control sheets of cash and checks received? **(R)**	Y / N			
3.	What would you do if the person with whom you count cash insisted that receipts should not be locked up when taking a lunch break? **(P)**				
	Detailed Answer:				

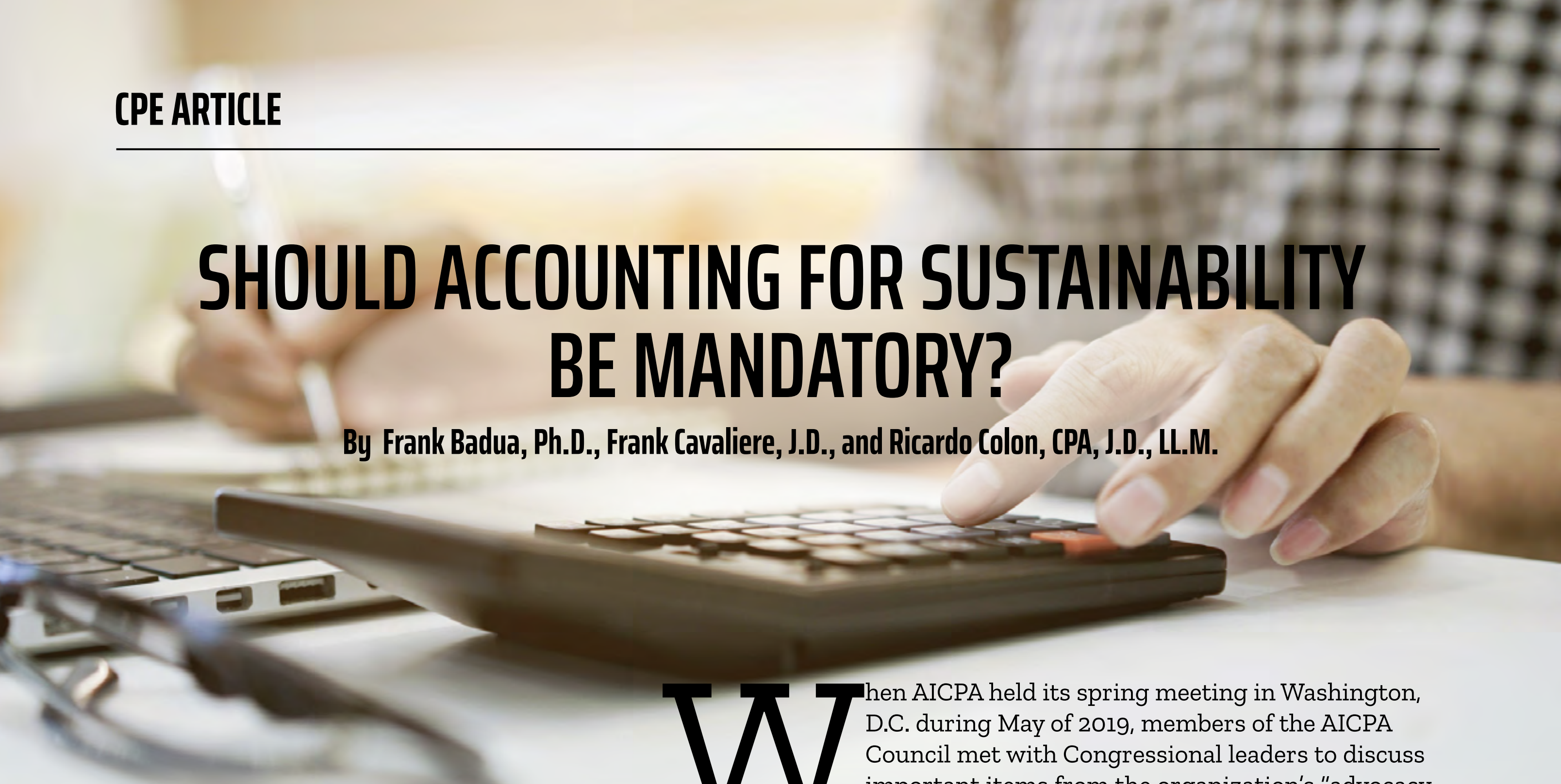
	Question	Answer	Verbal Score	Non-Verbal Score	Overall Question Score
4.	Do you immediately stamp a restrictive endorsement on each check received? **(R)**	Y / N			
5.	Are receipts and control sheets forwarded to the cashier daily in a tamper-proof bag? **(R)**	Y / N			
6.	Have you ever not followed a required procedure because it seemed unnecessary? **(C)**	Y / N			
7.	Does the mailroom forward a copy of all daily control sheets to the accounting department? **(R)**	Y / N			
8.	What would you do if asked by the accounting department to assist with the recording of cash receipts in the books? **(P)**				

	Detailed Answer:				
9.	Does the mailroom retain a copy of all daily control sheets? **(R)**	Y / N			
10.	Does the mailroom have a safe or locking cash drawer? **(R)**	Y / N			
11.	Is access to a safe or locking cash drawer restricted to a small number of individuals? **(R)**	Y / N			
12.	Do you store daily receipts and control sheets in a secure location when unattended? **(R)**	Y / N			
13.	What would you do if you discovered that a mailroom co-worker was working with the cashier to use receipts for personal use? **(P)**				
	Detailed Answer:				
14.	Do you have access to the accounting department records? **(R)**	Y / N			
15.	Do you prepare or have access to bank reconciliations? **(R)**	Y / N			
16.	Do you accompany the cashier when making daily bank deposits? **(R)**	Y / N			
17.	Have you ever knowingly broken a company policy? (C)	Y / N			
18.	Do you have access to the original or duplicate bank deposit slips? **(R)**	Y / N			
19.	Do you compare bank deposit slips with daily control sheets and reductions to the accounts receivable ledger? **(R)**	Y / N			
20.	What would you do if the cashier asked you to assist with preparing bank deposit slips? **(P)**				
	Detailed Answer:				
	Question	Answer	Verbal Score	Non-Verbal Score	Overall Question Score
21.	Are you routinely made aware of policies and procedures regarding daily receipts? (**R)**	Y / N			
				Total Score	

Conclusions:

Internal Control –

Truthfulness of Interviewee –



SHOULD ACCOUNTING FOR SUSTAINABILITY BE MANDATORY?

By Frank Badua, Ph.D., Frank Cavaliere, J.D., and Ricardo Colon, CPA, J.D., LL.M.

CURRICULUM: Accounting and Auditing, Management

LEVEL: Basic

DESIGNED FOR: CPAs in public practice and industry

OBJECTIVES: To address the history and current status of environmental, social and governance (ESG) policies, and the arguments for and against requiring ESG reporting.

KEY TOPICS: History and description of ESG, current rules for sustainability accounting, FASB guidance related to ESG reporting, petition to the SEC in favor of mandatory sustainability accounting, arguments against related initiatives, and environmental sustainability performance and reporting

PREREQUISITES: None

ADVANCED PREPARATION: None

When AICPA held its spring meeting in Washington, D.C. during May of 2019, members of the AICPA Council met with Congressional leaders to discuss important items from the organization's "advocacy agenda."[1] Those items only included seemingly "bread and butter" issues, specifically, taxpayer services, disaster assistance, digital taxes and the fiscal state of the nation. Nowhere in the discussion was a seemingly red-hot issue: the idea that companies should practice and report on their "environmental, social and governance" (ESG) policies.

An outgrowth of the decades-old corporate social responsibility (CSR) movement, ESG is taking the investing world by storm, with trillions of dollars already committed to funds dedicated to this so-called "impact investing." If ESG advocates have their way, accountants will shortly be required to find ways to report and verify the ESG activities of their corporate clients.

A petition was recently filed with the Securities and Exchange Commission (SEC), supported by heavyweights in the ESG movement, to require companies to do just that, but it is highly unlikely it will move forward at this time.[2]

This article will briefly address the history and current status of ESG, and the arguments for and against requiring ESG reporting.

A Brief History of ESG

ESG is generally viewed as an offshoot of the CSR concept that gained popularity following the social turmoil that occurred in the U.S. during the 1960s, characterized by events such as the Watts Riot, Vietnam anti-war protests and the tumultuous 1968 Democratic Presidential Convention in Chicago. It was hoped that companies could, by acting "responsibly," cool the temper of those times, that they could help to fix what was broken in our society.

That effort was idiosyncratic, left to individual companies to work out on their own and the results were, predictably, disappointing. Some would call the whole effort a fool's errand; swimming against a seismic demographic shift - the coming of age of the Baby Boom Generation.

To some, their hoped-for ultimate "top-down" authority is the United Nations. The United Nations in 2000 officially launched its Global Compact stating 10 principles grounded in four subject areas central to CSR, namely, human rights, labor, the environment and anti-corruption. Figure 1 contains a list of those principles. These principles depend upon voluntary CEO commitments of support. In essence, the principles were a more organized, top-down, yet voluntary, approach to CSR.

The desire to harness the power of corporations shifted into a higher gear with the start of the ESG movement, an organized, investment-centric, top-down approach to doing the right thing. The United Nations again took a leading position. In 2005, then-U.N. Secretary-General Kofi Annan brought together a global group of institutional investors and experts to develop Principles for Responsible Investment (the PRI). They developed Six Principles of Responsible Investing, which, like the Global Compact, are voluntary and aspirational.

The Six Principles of Responsible Investing, contained in Figure 2, are aimed at the investing community as opposed to management. If CSR was premised on "do the right thing," ESG can be looked at as following the adage "money talks." Like CSR, ESG is fluid – it is concerned with various "issues," which change with new circumstances. One version of these issues comes from the PRI website and is contained in Figure 3.

As implied by its name, ESG accounting is concerned with measuring firm performance in three very different endeavors, namely: environmental sustainability, social equity and corporate governance. Thus, the metrics used to document and report a company's performance in these three areas will differ significantly from one another and from traditional accounting measures that focus on financial performance.

The next few paragraphs will provide short descriptions of some of the measures and accounts used, the various reports comprised of these measures, and ways by which ESG accounting or its components may be audited.

Currently, those countries that report environmental sustainability performance use one or more of three types of accounts: sustainable cost accounts, natural capital accounts and physical flow input-output accounts. Sustainable cost is the (hypothetical) cost of restoring the Earth to a pristine state before a firm's activities impact it. However, valuing external costs such as pollution are highly problematic, since damage to critical natural capital would, in theory, be valued at infinite cost because it is irreplaceable.

Figure 1: The United Nations Global Compact's 10 Principles

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
Principle 2: Make sure that they are not complicit in human rights abuses.

Labor

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
Principle 4: The elimination of all forms of forced and compulsory labor;
Principle 5: The effective abolition of child labor; and
Principle 6: The elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;
Principle 8: undertake initiatives to promote greater environmental responsibility; and
Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

Natural capital inventory accounting concerns the recording of stocks of natural capital over time, with changes in stock levels used as an indicator of the quality of the natural environment. Measures of distinct categories of natural resources are predominantly non-financial.

Finally, input-output analysis accounts for the physical flow, that is introduction, use and disposal, of materials and energy inputs and product and waste outputs in physical units. It uses a balancing technique familiar to accountants and chemists, applying the principle what goes in must come out, to structure the development of environmental information.

With regards to social accounting, standardized measures, accounts and reports are harder to develop. This is because the social justice objectives towards which a company endeavors will vary, just as an individual's conception of what is socially equitable will differ from others. However, the objectives, and related measures, will often center on issues including working conditions and equitable compensation, skills-sharing, educational opportunities, and overall personal and job satisfaction.

The Current Rules for Sustainability Accounting

The SEC has not adopted specific disclosure requirements applicable to "environmental, social and governance" issues. Today, ESG reporting relies on the concept of materiality. Issues about sustainability that are material to a company's financial condition or results of operations must be disclosed.

TODAY, ESG REPORTING RELIES ON THE CONCEPT OF MATERIALITY.

Similarly, ESG disclosures are required whenever they are necessary to prevent other financial statement disclosures from being materially incomplete or misleading and to inform investor's proxy decisions. Management is in the best position to determine which ESG issues are material to a company.

The current framework on sustainability accounting originates in Securities Act Release No. 5627, issued in 1975, where the SEC reached four conclusions:

1) In formulating disclosure policy, the SEC is not generally authorized to consider the promotion of social goals unrelated to the objectives of the federal securities laws, except to consider the promotion of environmental protection as authorized and required by the National Environmental Policy Act of 1969 (NEPA);

2) The primary focus of the securities laws is on the economic interest of investors and disclosure requirements should be based on the economic significance of information;

3) No showing had been made, at least back in 1975, that disclosure of information describing corporate social practices should be required of all registrants;

4) Disclosures of corporate behavior in socially significant areas may sometimes be necessary to prevent other statements from being materially incomplete or misleading.

The SEC has adopted two rules addressing disclosures related to environmental protection issues. Item 101(c)(1)(xii) of Regulation S-K, Description of the Business, requires companies to disclose, as part of the description of the business, "the material effects that compliance with federal, state and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the [company] and its subsidiaries. The [company] shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the [company] may deem material."

Additionally, Item 103 of Regulation S-K, Legal proceedings, requires companies to disclose

Figure 2: The PRI's Six Principles of Responsible Investing

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles.

Figure 3: ESG Issues Per PRI

Environmental Issues

Climate Change; Water; Sustainable Land Use; Fracking; Methane; Plastics

Social Issues

Human Rights and Labor Standards; Employee Relations; Conflict Zones

Governance Issues

Tax Avoidance; Executive Pay; Corruption; Director Nominations; Cyber Security "administrative or judicial proceeding[s] arising under any federal, state or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary for the purpose of protecting the environment" if the proceeding is material to the business or financial condition of the registrant and certain thresholds are met.

Beyond environmental protection, Item 303 of Regulation S-K, Management's discussion and analysis of financial condition and results of operations, requires companies to provide information about material trends and events that may affect its financial condition, changes in financial condition and results of operations. Furthermore, Item 105 of Regulation S-K, Risk factors, requires disclosure of the most significant factors that make an investment in a company speculative or risky.

Other regulatory actions may affect ESG corporate disclosures. In 2010, the SEC issued an interpretive release to provide guidance to public companies regarding disclosure requirements with respect to climate change matters. According to the interpretive release, if material, companies should consider the following factors with respect to climate change disclosures:

- Significant development in federal and state legislation and regulation regarding climate change;
- Treaties or international accords related to climate change;
- Legal, technological, political and scientific developments regarding climate change;
- The physical impact of climate change, such as effects on the severity of weather, sea levels, the arability of farmland, and water availability and quality, among other factors.

Also, in the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress mandated the SEC to adopt various disclosure requirements pertaining to ESG topics, such as conflict minerals provisions (Section 1502), resource extraction payments (Section 1504), mine safety and health (Section 1503), and employee and CEO compensation (Section 953(b)).

With respect to standards issued by the Financial Accounting Standards Board (FASB), the standard most pertinent to ESG reporting is Accounting Standards Codification (ASC) 450-20, Loss Contingencies. A contingency is defined as "[a]n existing condition, situation or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur."

The Codification provides that an estimated loss contingency shall be accrued by a charge to income if both of the following conditions are met: (1) information available before the financial statements are issued or are available to be indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements; and (2) the amount of loss can be reasonably estimated.

Disclosure shall be made of any loss contingency that is probable as to occurrence but not accrued because the amount of loss cannot be reasonably estimated. Also, companies are required to disclose loss contingencies for which there is a reasonable possibility, but it is not probable, that a loss may have been incurred.

Other FASB guidance related to ESG reporting relates to environmental liabilities and asset retirement obligations (AROs). ASC 410-30 provides a framework for determining whether a contingent liability should be recorded for environmental liabilities. ASC 401-20 discusses AROs, which consist of obligations associated with the retirement of a tangible long-lived asset.

Per ASC 410-20-25-4, companies are required to recognize the fair value of an ARO in the period in which it is incurred if a reasonable estimate of fair value can be made. If a reasonable estimate of fair value cannot be made, the liability should be recognized in the period in which a reasonable estimate of fair value can be determined.

Furthermore, ASC 410-20-25-5 requires companies to recognize an ARO by increasing the amount of the related long-lived asset by the same amount as the liability. As the asset is used in operations, depreciation is recognized on the carrying value of the asset, which includes the present value of closure and removal costs. Also, changes in AROs due to the passage of time are measured using the effective interest method and the amount of the increase of the liability is recorded as accretion expense. Examples of activities that require the recognition of AROs include:

- Dismantling offshore oil and gas facilities;
- Decommissioning of nuclear facilities;
- Closure, reclamation and removal costs of mining facilities; and
- Closure and post-closure costs of landfills and hazardous waste storage facilities.

Although the guidance discussed previously establishes a general framework for ESG reporting, the SEC has not adopted specific rules addressing this topic. Investors have expressed some concerns with the lack of specific ESG reporting requirements, particularly due to the difficulty in making comparisons across companies. The current landscape for ESG reporting has become more difficult to navigate as numerous companies have adopted sustainability disclosure frameworks developed by different organizations. These include the:

- Global Reporting Initiative (GRI);
- International Integrated Reporting Committee (IIRC);
- Task Force on Climate-Related Financial Disclosures (TCFD);
- Carbon Disclosure Project (CDP); and
- Sustainability Accounting Standards Board (SASB).

Thus far, SASB has been widely accepted as a reporting framework that is aligned with the requirements of the U.S. securities laws in terms of ESG disclosures. SASB consists of 77 industry-specific sets of sustainability accounting standards, which were officially codified in 2018. The standards focus on financially material information covering a range of industry-specific sustainability areas of interest to investors, such as water management for beverage companies, data security for technology firms, and supply chain management for consumer goods manufacturers and retailers.

While SASB standards are intended to be a useful guide for disclosure, the final decision as to what is financially material rests with the reporting company. Many companies, including General Motors, Merck, JetBlue, Kellogg's, Nike, Bloomberg, NRG, and Wells Fargo, have adopted SASB standards as the framework for reporting ESG information to investors.

The Petition to the SEC From ESG Heavyweights in Favor of Mandatory Sustainability Accounting

On October 1, 2018, a petition was filed with the SEC. Filed by two distinguished law professors, Cynthia A. Williams of Osgoode Hall Law School, the law school of York University in Toronto, Canada, and Jill E. Fisch of the University of Pennsylvania Law School. It was also signed by 16 additional law professors from the U.S. and Canada, all of whom were designated "securities law specialists."

Additional signatories include 50 individuals and organizations. They are some of the biggest heavyweights in the investing and ESG fields, such as the aforementioned PRI, Morningstar and the California Public Employee Retirement System (CalPERS), which is the nation's largest public pension fund. Even some elected officials signed the petition, including the New York State Comptroller and the Illinois State Treasurer.

As stated in the Conclusion to the 16-page petition, the goal of the petition is to cause the SEC "to promptly initiate rulemaking to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful environmental, social and governance information." The petition recounts a number of perceived positives from requiring mandatory sustainability information, including:

1) It promotes market efficiency by allowing investors to compare companies by their commitment to ESG.

2) It will put the U.S. on an equal footing with other countries that have already made ESG reporting mandatory, such as the United Kingdom and Sweden.

3) It facilitates capital formation by giving capital markets more useful, material information that will "increase confidence in capital markets."

4) It is material and "decision-useful."

5) Standardization will make it easier for companies to disclose this useful information.

6) Voluntary disclosure is insufficient to meet the expressed needs from some of the largest financial services companies, such as Black Rock and Bloomberg.

7) It provides a level playing field by standardizing ESG reporting, which now is subject to a variety of ESG reporting frameworks.

8) Given the number of similar petitions that have been filed with the SEC over the years from a variety of groups, it appears that the time is right to make the move to mandatory reporting of ESG.

Arguments Against Mandatory Sustainability Accounting

Many of the arguments against mandatory sustainability reporting are the same as, or similar to, the arguments that have long been raised against CSR. The main arguments historically raised against CSR include:

1) It is the job of managers to maximize profits;

2) The costs associated with CSR are borne by the stockholders, who may have no voice in the matter;

3) The board of directors and management are taking credit for spending the stockholders' money;

4) Business managers have no innate special abilities to solve society's problems and;

5) Social problems are best left to social workers and politicians.

Many of the same arguments can be raised against ESG initiatives by institutional money managers.

A major contention for both CSR and ESG is the concept of fiduciary duty. Like boards of directors and top managers, fund managers are fiduciaries who have a duty to put the interests of their beneficiaries above their own. The proponents of ESG argue that it is part of the fiduciary responsibility of money managers to take ESG into account; failure to follow its precepts, they argue, is actually a breach of fiduciary duty. Opponents worry that promoting social issues reduces returns to stockholders and plan beneficiaries and violates fiduciary duty.

THERE IS A REAL CONCERN OVER ESG "MISSION-CREEP" BECAUSE OF THE FLUID, EVER-EVOLVING NATURE OF ESG ISSUES.

President Donald Trump issued Executive Order 13868 on April 10, 2019, titled "Promoting Energy Infrastructure and Economic Growth." The Order implies that the president was concerned that some pension managers were taking actions antithetical to the interests of oil companies and plan beneficiaries.

In Section 5(b) of the Order, the Secretary of Labor was instructed to "complete a review of existing Department of Labor guidance on the fiduciary responsibilities for proxy voting to determine whether any such guidance should be rescinded, replaced or modified to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets."

Finally, there is a real concern over ESG "mission-creep" because of the fluid, ever-evolving nature of ESG issues. Some of the leading players in the ESG movement, such as Laurence Fink, the CEO of Black Rock, have expanded the ESG parameters to issues such as gun control, which has angered Second Amendment advocates in the U.S.

More recently, 200 CEOs signed a letter opposing the anti-abortion law passed by the State of Georgia, angering pro-life advocates. It is not a huge stretch to see some ESG proponents considering abortion rights as one of the "Human Rights" issues under ESG. In this time of deep divisions along political and cultural lines, espousing divisive ideas is likely to anger as many investors as it pleases.

ESG Performance and Reporting

It has been argued that voluntary disclosure of ESG performance or corporate performance in any of its components makes good business sense and there is evidence that stocks of corporations that report ESG performance trade at a premium compared with those of non-reporters. And yet, it has also been pointed out that in jurisdictions wherein ESG reporting is not legislatively mandated, such reporting is the exception rather than the rule, notwithstanding lip-service provided by companies and business associations.

Puzzlingly, the stock premium found among ESG reporting corporations is hard to explain and to characterize as providing meaningful and value-adding information to an investor. Is it the reported performance in ESG that leads investors to see value in the firm, derived from its sustainability and equity endeavors, or is it just market hype or do-gooder sentiment, drawing irrationally exuberant attention, and investment dollars, to these corporations? For firms that provide triple-bottom-line reports, which aspect of ESG is regarded as comprising high-information content reporting?

In the current social and political environment, adopting a uniform set of ESG standards may prove to be difficult, due to the risk of over-inclusion or under-inclusion of topics and metrics, and ultimately management is in a better position to determine which ESG issues are material to a particular reporting company.

From an accounting perspective, ESG reporting should continue to be driven by materiality. For now, the most prudent and fairest approach might be to wait and see.

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By Frank Badua, Ph.D., Frank Cavaliere, J.D., and Ricardo Colon, CPA, J.D., LL.M.

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1. ESG reporting refers to the idea that companies should report on their _________ policies.
A. Environmental, shareholder and government
B. Environmental, social and governance
C. Equity, shareholder and government
D. Environmental, social media and governmental

2. Which of the following is not one of the four subject areas of the Global Compact adopted by the United Nations in 2000?
A. Labor
B. Intellectual Property
C. Environment
D. Human Rights

3. There are ____ Principles for Responsible Investment.
A. Two
B. Four
C. Six
D. Nine

4. The Securities and Exchange Commission (SEC) has not adopted specific requirements applicable to ESG issues.
A. True
B. False

5. Currently, ESG reporting relies primarily on the concept of ____________.
A. Cost-Benefit
B. Return on Investment
C. Risk
D. Materiality

6. Regulation S-K requires disclosure of the most significant factors that make investment in a company speculative or risky.
A. True
B. False

7. In the absence of mandatory ESG standards, U.S. companies have adopted sustainability disclosure frameworks developed by different organizations, including:
A. Global Reporting Initiative (GRI)
B. International Integrated Reporting Committee (IIRC)
C. Sustainability Accounting Standards Board (SASB)
D. All of the above.

8. In 2018, ESG heavyweights filed a petition with the Securities and Exchange Commission (SEC) to request the issuance of mandatory ESG rules for public companies.
A. True
B. False

9. Which of the following arguments is used against mandatory sustainability reporting?
A. Allows investors to compare companies by their commitment to ESG
B. Places the U.S. in equal footing with other countries that already require ESG reporting
C. The job of managers is to maximize profits
D. Uniformity will make it easier for companies to disclose ESG information

10. The concept of ______________ requires fund managers to place the interests of their beneficiaries above their own interests when making investment decisions.
A. ESG
B. Fiduciary duty
C. Materiality
D. Corporate Social Responsibility

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$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%), misc. (11%), loyal client base, experienced staff and strong fee structure. TXN1510

$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

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$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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