NOV/DEC 2016

Today's CPA

TEXAS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

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What Have We Accomplished in Private Company Financial Reporting?

Also:

The 85th Session of the Texas Legislature

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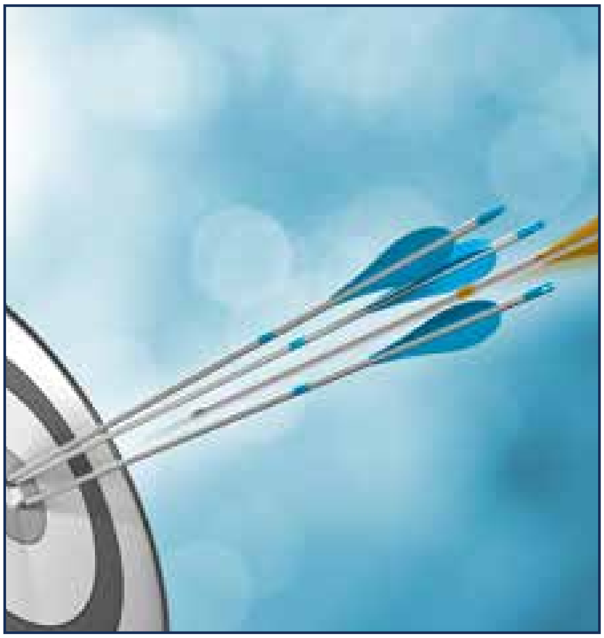

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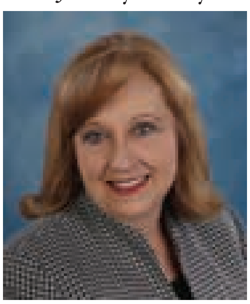
TSCPA's Agenda for the 2017 Legislative Session

By Kathryn W. Kapka, CPA | 2016-2017 TSCPA Chairman and **John Sharbaugh**, CAE | TSCPA Executive Director/CEO

While many CPAs are beginning to turn their attention to the upcoming tax season and year-end audits, some TSCPA members are also looking ahead to the 85th session of the Texas Legislature that convenes in January. The Texas Legislature only meets in odd-numbered years from January to May and much can happen during that time.



By the time the session begins, TSCPA will be ready with a legislative agenda. The Legislative Advisory Committee (LAC), with volunteers from all across the state, considers the legislative landscape as it impacts the accounting profession and recommends a specific agenda for TSCPA prior to each session. Once approved by the Executive Board, all the volunteers involved in the legislative process become acquainted with the agenda.

At its October meeting, the LAC recommended that the agenda items include TSCPA seeking to repeal Gov. Code Sec. 2266, *Texas Exception to GASB Statement 45 requiring reporting liabilities for Other Post-Retirement Benefits* (OPRB). In 2009, the Legislature passed a bill that excused state and local governments in Texas from complying with Governmental Accounting Standards Board (GASB) Statement 45, which requires reporting liabilities for OPRBS. Although TSCPA opposed the bill, we were unable to keep it from passing. However, we were successful in getting the bill amended so that it was not mandatory and each local government could choose whether or not to comply with the requirement.

The law established a new acceptable accounting standard for something called "pay as you go" accounting, which simply meant you didn't have to recognize liabilities if you didn't want to. As a result, CPAs would not be able to give an entity using this exception a clean opinion, because the entity would not be complying with generally accepted accounting principles (GAAP).

The first year the law was in effect, the state of Texas and Travis County tried to use the exception. The state auditor refused to give the state a clean opinion unless they revised the statements, which resulted in the state issuing two sets of financial statements, one of which complied with GAAP and got a good opinion from the state auditor; the other was not reviewed by the state auditor. Travis County's auditor was unable to give a clean opinion on the county's financials.

GASB would like the law to be repealed, but to do so will require a repeal of Government Code Section 2266.

> **"THE TEXAS LEGISLATURE ONLY MEETS IN ODD-NUMBERED YEARS FROM JANUARY TO MAY AND MUCH CAN HAPPEN DURING THAT TIME."**

The other item the LAC proposed for TSCPA's legislative agenda is to oppose any efforts to levy a sales tax on professional services. Opposition to sales taxes on professional services has been a long-standing legislative position for TSCPA and we will be monitoring all new tax bills in case it becomes an issue during the upcoming session.

The LAC also considered possible changes to the Texas Public Accountancy Act (TPAA) as follows, but decided to defer those changes until 2019 when the TPAA will undergo sunset review:

- firm mobility,
- unilateral international credential recognition,
- retired CPA status,
- transfer of CPA exam credits, and
- response to a North Carolina Dental Board case.

Please see the Capitol Interest article of this *Today's CPA* magazine for more details about the upcoming legislative session. While this is the proposed agenda, no session passes without issues arising that were not anticipated. TSCPA has a monitoring system in place to detect bills of potential interest and a network of CPAs who volunteer as key persons for individual legislators. These efforts enables us to take action as needed if bills in any way impact CPAs and the accounting profession.

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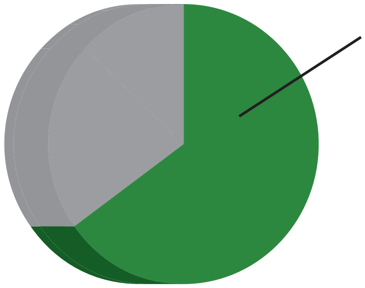

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Employment Tax Enforcement is on the Rise

By Jason B. Freeman, JD, CPA | Column Editor

For the past year, the Internal Revenue Service (IRS) and the Tax Division of the Department of Justice (Tax Division) have touted a renewed and increased emphasis on employment tax enforcement – both civil and criminal. Indeed, employment tax enforcement is currently among the IRS' and Tax Division's highest priorities. Earlier this year, the Tax Division publicly warned that it has "sharpened its focus on civil and criminal employment tax enforcement" and is "waging a public campaign in an effort to educate employers and their representatives about the serious nature of employment tax violations." This renewed focus is now translating into increased employment tax audits and criminal investigations.

The reason is simple. Employment taxes and taxes collected through employer withholding are vital to the integrity of our tax system. Employment taxes account for about one-third of the revenues collected by the IRS. Withholdings from employee wages (which include both employment and income taxes) represent nearly 70 percent of IRS revenues. But, according to the government, these numbers could and should be even higher. The IRS estimates that there are nearly $60 billion of unpaid taxes reported on Forms 941 and, on the whole, unpaid employment taxes make up an estimated $72 billion of the country's annual tax gap. So, it appears, there is much room for improvement.

When an employer fails to collect, account for and deposit taxes that are supposed to be withheld from employee wages, the government views that employer as committing a theft and as having gained an unfair advantage over law-abiding competitors. And the government has some very powerful weapons at its disposal to combat such violations. For example, on the civil enforcement side, in addition to penalties that apply to the business, it is often able to hold owners, officers, managers, key employees and sometimes even bookkeepers personally liable for taxes that the business withheld and failed to pay over to the IRS through the so-called Trust Fund Recovery Penalty (TFRP). Many taxpayers are completely unaware of this exposure, but TFRP enforcement is one of the major prongs of the IRS' renewed attack.

On the criminal enforcement side, severe penalties can apply, as well. During the last fiscal year, for example, over three-quarters of those charged in employment tax evasion cases were sentenced to prison terms and the average sentence in those cases was a 24-month term. There is likely to be a noticeable increase in the number of employment tax prosecutions.

Employment Tax Obligations

Employers are required to withhold federal income taxes and Social Security and Medicare taxes (FICA taxes) from employees' wages, as well as the Additional Medicare Tax where required. These withheld taxes are commonly referred to as "trust fund taxes," because they are held by the employer in "trust" for the benefit of the United States until paid over. In addition, employers

are required to pay a matching portion of FICA taxes. This portion is commonly referred to as the employer's portion and is a direct obligation of the employer; it is, therefore, not part of the "trust fund taxes" described above. Self-employed individuals are required to pay the equivalent of the employee and employer portions through the Self Employment Contributions Act (SECA) system. Employers are also responsible for the Federal Unemployment Tax (FUTA).

Employers are required to deposit employment taxes according to a monthly, semi-monthly or next-day deposit schedule. An employer who fails to deposit or pay employment taxes in accordance with the appropriate schedule may be subject to failure-to-deposit and failure-to-pay penalties. Employers are also required to file quarterly Forms 941, *Employer's Quarterly Federal Tax Return* and an annual Form 940, *Employer's Annual Federal Unemployment Tax Return*. Some taxpayers may be required to file other returns (e.g., employers who employee agricultural workers may be required to file a Form 943). A failure to file a required return may subject a taxpayer to a failure-to-file penalty.

A Renewed Focus on Employment Tax Compliance

Over the course of the past year, the government has deliberately signaled a strong and renewed focus on enforcing these obligations and cracking down on employment tax fraud. That focus is likely to translate into more employment tax related audits – particularly worker-classification audits and TFRP investigations – and criminal investigations. Anecdotal evidence has shown this author that we are, indeed, currently seeing a rise in both civil and criminal employment tax enforcement in practice.

The renewed focus makes sense. The IRS and Tax Division have had a heavy focus in recent years on combatting offshore tax non-compliance, tax shelters and identity theft. Having made substantial headway on those fronts, they have turned their attention to one of the next most likely sources for noncompliance: employment taxes.

The focus has not been all talk either. For instance, the Tax Division sought nearly as many employment tax related injunctions during the first quarter of this year as it did during the entire past year. It also dedicated beefed-up resources to employment tax prosecutions, made substantial updates to the employment tax section of its Criminal Tax Manual and proposed changes to the Federal Sentencing Guidelines with respect to employment tax charges. And as mentioned above, it has seen a strong success rate, with the vast majority of employment tax prosecutions resulting in prison terms carrying an average of 24 months. These dynamics all signal a systemic and dedicated focus on employment tax enforcement.

There is also a particularly difficult reality here that can affect some taxpayers: In the employment tax context, the line between civil and criminal violations is often very thin and proving a willful violation can be relatively straightforward. The standard for imposing civil penalties is very similar to the standard that the government must meet for criminal enforcement. Indeed, the elements necessary to impose a TFRP under IRC Section 6672 are virtually identical to the elements necessary to impose liability under that section's criminal counterpart, Section 7202. That means that many who face TFRP assessments inevitably exhibit many of the characteristics that the government looks to in order to justify a criminal referral.

As a result, greater TFRP scrutiny could, itself, give rise to increased criminal enforcement activity – particularly in the current environment. The government will likely leverage this reality to gain an even greater deterrent effect and increase voluntary compliance, which explains why TFRP enforcement will continue to be an important part of its employment tax enforcement initiative.

Educating Clients

This past year has seen the IRS and Tax Division give a concerted and renewed focus to employment tax enforcement. The renewed focus is now coming to fruition in the form of greater numbers of employment tax civil audits and criminal investigations and prosecutions.

The trend is likely to only increase. With the greater scrutiny being given to employment tax violations, tax practitioners can provide tremendous value to clients by educating them about, and reinforcing, the importance of complying with the employment tax laws and the risks that come with noncompliance. ■

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Health Care Update

By Mano Mahadeva, CPA, MBA | Column Editor

The 2016 presidential election became a slug-fest, one of the more ferociously fought political contests in recent American history. The Republican nominee, Donald Trump, and the Democratic nominee, Hillary Clinton, both polarizing figures, set record-breaking unfavorable ratings. On almost every issue, it was clear that both nominees would take us in very different directions.

The presidential platforms were vast and varied – but neither nominee spent significant time or offered detailed plans regarding the future of health care reform and the Patient Protection and Affordable Care Act (PPACA), an area of particular intrigue to many. Donald Trump vowed to repeal the PPACA on his first day of the presidency and replace it with "something great," but did not discuss any details. Hillary Clinton, taken to the far left by Sen. Bernie Sanders, proposed a "public option" health care plan without much detail. She also proposed expanding Medicare to allow those age 55 and over to opt into the program.

A Little History on the PPACA

The PPACA, enacted in 2010, was created as a first step to address the historically unsustainable and dysfunctional health care system that limited access to care, offered inequitable care, had rising numbers of uninsured, was volume (not quality) driven and was fraught with waste. At the time of its enactment, health care costs ran 16 percent of gross domestic product, with a projection of 20 percent by the year 2017.

This bill was intended to increase health insurance quality and affordability, lower the number of uninsured and reduce health care costs. Individuals could choose from plans that were similar to those offered by employers, with a focus on patient access, quality and cost. The main pieces of the law were enacted three years ago and have already resulted in a record reduction in the levels of the uninsured. Many individuals were able to gain access to coverage, based on income levels through the exchanges or via government subsidized programs such as Medicaid. Individuals were offered protections on pre-existing conditions. The new plans had no maximum limits and equalized differences between gender.

However, the plans are not without their drawbacks and challenges. Significant spikes in premiums, insurer dropouts and low enrollment numbers create concern for the viability of the law. Insurance giant Aetna announced plans to limit all but a few exchanges due to losses of greater than $400 million in the exchange business. Other giants, such as United Healthcare and Humana, made similar announcements earlier this year. Only Blue Cross and Blue Shield has stated they are offering plans across all counties in 2017, but they're accompanied with a steep hike in rates. So, in 2017, some individuals will be faced with a very limited choice in their markets.

Equally as disheartening, the original law was premised on adding many young, healthy enrollees – both via the exchanges and through the successful implementation of the individual mandate – but many of the young and healthy did not sign up and the implementation of the individual mandate was unsuccessful. Payers ultimately set premiums too low which, in turn, did not provide enough revenue to offset the more-costly treatment of the new enrollees, who tended to be unhealthier than planned. The law's risk corridors, which were designed to cover some of the insurer's losses, were derailed by Congress and the expected conversion of employer provided health plans to the exchange did not occur as overall health care costs stabilized due to plan design changes.

The insurers that remain in the mix have adopted health maintenance organization (HMO) plans or Exclusive Provider Organization (EPO) plans – both types offer limited choices of physicians and hospitals through the use of narrow networks and many have extra red tape, such as having to request a referral to see a specialist. The tradeoff for lower rates equates to less freedom of choice.

Is There a Future for These Plans?

The Obama Administration knows that for the law to survive, young adults must find a renewed interest in its offerings and has launched targeted digital messaging campaigns to get young adults to sign up this fall. This is a major focus and a must for the law to survive. Congress could always approve more in subsidies, but this would need Congressional approval, which is highly unlikely. Payer networks interested in continuing in the exchanges will likely take a rigorous approach to control costs by providing a limited network of physicians and hospitals, with very close management of a patient's health.

Regardless of the results of the presidential election, there is one thing that neither political party disputes – both know that health care reform is needed. The present model is dysfunctional, costly and unsustainable. Persistent economic and social pressures will accelerate changes to health care costs, delivery, access and quality over time. These challenging times provide a great opportunity for finance leaders to provide valuable guidance to their health care constituents. ■

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FASB Issues New Standard for Financial Statement Presentation by NFPs

By C. William (Bill) Thomas, CPA, Ph.D.

On Aug. 18, 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-14 (ASC Topic 958), which has the stated objective of improving existing standards for financial statement presentation by not-for-profit entities (NFPs). Specifically targeted for improvement are the following areas:

- Net asset classification
- Liquidity and availability of resources
- Expenses and investment returns
- Operating cash flows

Why the Changes?

ASU 2016-14 represents the first major set of changes to NFP financial statement presentation standards since the issuance of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, in 1993. FASB originally initiated the project based on recommendations of its NFP Advisory Committee (NAC) in 2011.

The project is part of FASB's ongoing review of Generally Accepted Accounting Principles (GAAP) to ensure that they continue to meet the evolving needs of a dynamic financial reporting environment. In issuing the standard, NAC stated its belief that although existing financial reporting standards for NFPs are sound, they could be updated and improved to better enable NFPs to "tell their financial story" to constituent groups, such as donors, grantors and creditors.

Which Entitles are Affected?

ASU 2016-14 affects substantially all NFPs, including charities, foundations, private colleges and universities, nongovernmental health care providers, cultural institutions, religious organizations and trade associations, among others.

Following is a brief overview of the targeted financial statement presentation areas and changes.

Net Asset Classification

The current model contains three classifications for net assets of the NFP: (1) unrestricted, (2) temporarily restricted and (3) permanently restricted. FASB research revealed that users felt that these classifications were often overly complex and broadly misunderstood.

The new financial presentation model replaces these three classes with two new classes: (1) *without donor* restrictions; and (2) *with donor* restrictions. In addition, the new standard adds a further disclosure requirement that net assets *without* donor restrictions also disclose the amount, purpose and type of *board designations* within this category.

"Underwater endowments" (those in which the original endowment amount exceeds the current fair value of net assets in the fund) are required to be reflected in net assets *with donor restrictions*, rather than without such restrictions (as required in the current standard). In addition to the current requirement to disclose aggregate amounts by which funds are underwater, the new standard requires disclosure of the aggregate original gift amounts for such funds, fair value and any governing board policy or actions being taken that concern future appropriations from such funds. (In other words, what the board is doing about the underwater condition.)

The new standard also requires that for gifts of cash restricted for acquisition and construction of property and equipment (in the absence of explicit donor restrictions), all NFPs would be required to use the "placed in service" date as the date of releasing these assets from restriction. Thus, the previous "over time" approach for the expiration of restriction on capital gifts is eliminated.

Liquidity and Availability of Resources

ASU 2016-14 includes specific requirements directed at improving a user's ability to assess the NFP's available financial resources and management of its liquidity and risk. Specifically, all NFPs are required to provide:

- Qualitative information (generally footnote) on how liquid available resources and liquidity risk are managed; and
- Quantitative information (usually in the body of the statements) that communicates the ability of the NFP's financial assets at the balance sheet date to meet its cash needs for general expenditures within one year. In plain English, the NFP is required to describe how it is managing its funds to help ensure that it can pay its bills as they become due.

Expense Reporting and Investment Returns

The new standard requires that the NFP report expenses, either on the face of the financial statements or in the footnotes, by (1) function (i.e., HR, services, instruction, etc.); and (2) natural classification (i.e., travel, salary, benefits, etc.). The current standard requires categorization only by function. The new standard requires a separate expense analysis (probably footnote) by both function and nature. It also requires the NFP to provide qualitative disclosures about the methods it used to allocate costs among program and support functions.

NFPs are required to present investment returns on endowment funds *net of all related external and direct internal* expenses. NFPs will no longer be required to disclose the *components* of investment returns (i.e., interest, dividends, gains/losses and expenses).

Operating Cash Flows

ASU 2016-14 permits NFPs to continue to choose either the direct or indirect method of computation of operating cash flows. Unlike the current standard, however, the new standard eliminates the requirement for a reconciliation to the indirect method for those NFPs that choose the direct method.

Effective Date

These sweeping changes are scheduled to take effect for annual financial statements issued for fiscal years beginning after Dec. 15, 2017, and for interim periods within fiscal years beginning after Dec. 15, 2018. NFPs are encouraged to get started early with a program of informing board members and staff. For a detailed copy of the new standard, see www.fasb.org. ■

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Office 2016: Next Steps

By Thomas G. Stephens Jr., CPA, CGMA, CITP

Though it's been months since Microsoft made Office 2016 available to the public, many individuals and organizations have yet to adopt the new suite of desktop productivity applications. For some, it is a matter of waiting on an Information Technology (IT) staff to give the green light. For others, it is a matter of the perceived time and hassle associated with upgrading, including determining whether investing in a new computer and/or Windows 10 is necessary. Still, for others, it is a matter of determining whether the new features are worth the cost of upgrading.

Regardless of where you might fall into this "upgrade spectrum," read on and you will learn what next steps might be best for you and your team regarding Office 2016.

First, the Features

In my opinion, we should view expenditures on technology not as "expenses," but rather as "investments." If we adopt this mindset, we should seek to maximize our return on investment (ROI) in technology and, relative to Office 2016, this translates into determining whether the new features will be useful to us and our team members.

While not intended to be an all-inclusive list of new and improved features in Office 2016, following are some of the ones that are likely to provide the greatest ROI to business users.

- **Co-Authoring in Word and PowerPoint.** Using this feature, multiple users can access and edit Word documents and PowerPoint presentations simultaneously, facilitating real-time collaboration.
- **Clutter in Outlook.** Outlook's new Clutter feature learns how you work with your email and places low priority messages in a separate folder, allowing you to stay focused on the most important items of the day.
- **One-Click Forecasting in Excel.** With one click of the mouse, you can forecast based on historical data, including identifying 95 percent confidence intervals. Many business professionals will find this feature to be very useful when performing budgeting tasks.
- **Six New Chart Types in Word, PowerPoint and Excel.** Six new chart types – histogram, treemap, waterfall, Pareto, box and whisker, and sunburst – are available to help you transform raw data into more meaningful and actionable information.
- **Improved Version History in Word, PowerPoint and Excel.** If you store Word, PowerPoint or Excel data in SharePoint or OneDrive for Business, you can look at prior versions of your documents and even restore a prior version, if necessary.
- **View and Edit across Multiple Devices and Multiple Platforms in Word, PowerPoint, Excel, OneNote and Outlook.** Most Office 2016 applications are now available across multiple platforms – Windows, iOS, Mac and Android – meaning you can access your tools and your data regardless of what device you happen to have in your hands at any point in time.

In addition to the new features outlined above, and many not listed here, if you upgrade to Office 2016 from Office 2010 or prior, all of the enhancements made to Office 2013 will appear to be new to you. Key among these are the following:

- The ability to open and edit PDF documents in Word;
- Recommended PivotTables and Charts in Excel;
- Excel's Flash Fill tool;
- A drastically improved Presenter View in PowerPoint;
- Slicer filters on Tables in Excel;
- In-line replies to email messages in Outlook; and
- Business intelligence tools, including Data Models, Power Query and Power Map in Excel.

Clearly, for those who choose to upgrade to Office 2016 – particularly if upgrading from Office 2010 or prior – a wealth of new features mean that the opportunity exists to realize a substantial ROI.

What About the Hassle? What About the Hardware? Must I Also Upgrade to Windows 10?

Because upgrades to Office 2016 utilize click-to-run technology, most upgrades from an existing version of Office take only a few minutes to complete; in fact, my upgrade from Office 2013 completed in less than 10 minutes. Further, because the user interface is largely the same as it was in Office 2010 and newer, most users will likely not experience any significant "learning curve" and should be able to get to work right away in Office 2016. Additionally, Office 2016 identifies key settings in your current version of Office and carries these over to the new environment. All told, the hassle associated with the upgrade is virtually non-existent.

Because Microsoft released Office 2016 just two months after Windows 10, there is some confusion in the marketplace about whether Windows users must upgrade to Windows 10 prior to upgrading to Office 2016. The short answer is "no." In fact, Windows users need only to have Windows 7 Service Pack 1 installed on their computers to run Office 2016.

Other key system requirements include a 1GHz or faster processor, 2 GB of RAM and 3 GB of hard disk space available; however, Mac users will need 4 GB of RAM and 6 GB of hard disk space available in order to upgrade. In other words, if you have a computer that is less than five to seven years old, there is a very strong likelihood that it has the "horsepower" to run Office 2016.

Why Is My IT Staff Dragging Their Heels?

Many end-users get frustrated by the seemingly slow responses from IT staffs when upgrades such as Office 2016 become available. However, keep in mind that IT staffs must ensure that an upgrade does not cause problems elsewhere and to do this, thorough testing is often necessary in corporate environments before upgrades roll out en masse.

One particular Office 2016 issue that many IT staffs are struggling with is how Microsoft plans to push security and feature updates to Office 2016 users. More specifically, your organization obtains Office 2016 through an Office 365 subscription plan so your IT staff must wrestle with what Microsoft deems "Current Branch" and "Current Branch for Business" update models. If you are in the Current Branch model (which includes Office 365 Business and Office 365 Business Professional subscribers), you will receive monthly updates, which can include security patches, bug fixes, and new and improved features. You can choose not to deploy an update, but if you do so, you will not receive future security updates.

If you are in the Current Branch for Business model (which includes Office 365 E3 and E4 subscribers and Office ProPlus subscribers), you will receive monthly security updates and feature updates every four months. If you are in the Current Branch for Business update cycle, you can choose to defer updates for up to eight months, but must accept them at that time or you will no longer receive security updates.

While many businesses – particularly smaller ones, with relatively straightforward computing applications – will benefit from this new support methodology, larger businesses may face challenges with the mandatory updates and their potential impact on other applications that integrate with Office 2016. For this reason, many IT managers are currently taking a wait-and-see approach to Office 2016, especially if they are considering deploying it through an Office 365 subscription plan.

Your Next Steps

Given all that you read above, what are your next steps? For many individuals and small business users, taking the plunge and moving forward as soon as possible will pay significant dividends, particularly if you are upgrading from Office 2010 or prior. Further, if you are already running Windows 7 or newer, the upgrade to Office 2016 should be relatively fast and painless, and likely will not require hardware upgrades.

However, if you integrate Office 2016 with other applications – for example, exporting financial statements into Excel – you should first test to ensure that these integrations continue to work before upgrading your entire team. In larger organizations, this testing strategy is likely to take some time. Couple that with the uncertainty surrounding mandatory updates in Office 365 environments and we may find that Office 2016 upgrades for these organizations are still some time away.

> **"IT IS A MATTER OF DETERMINING WHETHER THE NEW FEATURES ARE WORTH THE COST OF UPGRADING."**

Thomas G. Stephens Jr., CPA, CGMA, CITP is a shareholder in K2 Enterprises, where he develops and presents continuing professional education programs to business professionals throughout North America. You may reach him at tommy@k2e.com.

Out of Africa: One Chapter President's Personal Journey

By **Adelaide Odoteye,** CPA-Abilene, Guest Columnist

As an avid reader growing up in Zimbabwe, her childhood ambition was to be a librarian, preferably isolated on an island that stocked an endless supply of books. In high school, that goal morphed into a desire to pursue medicine. Yet **Adelaide Odoteye** ended up as a CPA and the president of the TSCPA chapter in Abilene, Texas.

Odoteye was born in Accra, the capital city of the West African country of Ghana. She is the second of three children born to Emmanuel, a mechanical engineer, and Dorothy, a teacher. Her late sister Sylvia was about a year older (one year, two months, one week, two days older to be exact – but who's counting?) and her brother Derek is three years younger. She grew up bilingual in English and a little-known Ghanaian language called Ga. When Odoteye was 6 years old, her family moved to Harare, Zimbabwe, in Southern Africa. What a culture shock! Food, clothing styles, cultural norms, currency and indigenous languages were all different. However, because both Ghana and Zimbabwe are former British colonies, they have English in common as the official language – the language for education, business and formal transactions.

Her journey to accounting was far from linear. In her youth, Odoteye's creative side was very dominant. She participated in choir, public speaking, theater, debating, wrote fiction and poetry, and enjoyed drawing and sewing. The arts were an intuitive outlet that allowed free reign to originality, with few prescribed formulae or rules. Odoteye was most content when immersed in a book, transported by words on the written page and a vivid imagination. This love of literature bred a childhood desire to be a librarian, based on the misconception that a librarian's sole task was to read all day. As reality and maturity intruded on this fantasy, she began to develop an interest in the sciences, particularly mathematics and biology. Due to the fact that she had worn glasses from the age of 10, she was especially fascinated by ophthalmology.

At age 14 at the beginning of high school, she took history as an elective instead of accounting. However, she would hear whispers about debits and credits from the accounting students, and was subliminally intrigued by this mysterious language. Following high school, she endeavored to combine her aspiration to travel the world with pursuing a degree by applying to universities around the globe for degrees in the medical field, particularly ophthalmology, dentistry or physiotherapy. In the meantime, she took a part-time course in accounting at a local college, "just to understand what those debits and credits meant."

The logic, mathematics and writing required for accounting instantly appealed to her, and the focus of her university applications switched to accounting. She chose Tarleton State University in Stephenville, Texas, for several reasons: the personalized attention demonstrated by the International Student Office, the offer of an academic scholarship, the small-city setting and the mundane, yet significant fact that her aunt had friends who could pick her up from DFW Airport. She landed in January 2002. The United States adventure had begun.

Adelaide Odoteye, CPA-Abilene

There were many humorous moments of adapting to a different culture: what on Earth is this tasty, but unidentifiable slab of meat called "chicken fried steak;" what is the definition of "fixin' to;" and is such abundant affability from total strangers completely normal in Texas? The more subtle challenges included curbing the urge to spell "colour" instead of "color," searching the Internet to convert liters into gallons or animatedly explaining that she wanted a "trolley" at the grocery store, also known as a shopping cart.

During college, Odoteye participated in the accounting Society, various honors societies and served as an editor of a student arts publication, which featured student poetry, prose and artwork. In 2005, she graduated summa cum laude and as valedictorian with her Bachelor of Business Administration degree, and with a Master of Business Administration degree in 2006, each with a 4.0 GPA. Thereafter, she began employment with Davis Kinard & Co, PC in Abilene. She obtained her CPA license in 2010.

She credits her employer's strong history of involvement with TSCPA for introducing her to professional volunteerism. Because the firm encourages its professional staff to be members of TSCPA's Abilene Chapter, she gradually became involved with the organization and the community. With a legacy of past TSCPA chairmen and past chapter presidents, there are many stellar examples within the firm from whom to draw inspiration and obtain advice.

Adelaide Odoteye's sister Sylvia

Adelaide Odoteye's family: Sister-in-law Sandra, brother Derek, mother Dorothy, father Emmanuel, niece Alanna and Adelaide.

Odoteye still finds creative outlets for her right-brained persona: she still writes fiction and composes poetry, enjoys music and singing, and is an indomitable Manchester United Football Club (soccer) supporter. She is an enthusiastic food lover (both cooking and eating), an adventurous traveler and a recent fan of Indian cinema. She is the proud aunt of 18-month old Alanna.

However, accounting satisfies her need for logic, organization and client service, in addition to being a versatile discipline that is the foundation for many career options. Serving as chapter president provides an opportunity to collaborate with like-minded individuals, to serve the profession and the community, and to hone her leadership skills. She would advise new CPAs to remember that the profession is what they do, not the sum total of who they are. Like anything worth doing, be willing to devote the dedication required to succeed, but enhance that with other interests. Most importantly, savor each step of the journey, for who knows where it will take you?

Editor's Note: This column was written by its subject, Adelaide Odoteye, in her creative third-person voice.

What Glass Ceiling?

Gender Bias (Almost) a Thing of the Past in Texas Accounting

Editor's Note: In this Spotlight article, *Today's CPA* magazine highlights three successful women who have made it to the highest executive levels at three of the Big Four firms in Houston.

By Anne McDonald Davis

"We're definitely at a point where no role is unattainable for women in our industry," Anne Taylor enthusiastically asserts. Taylor, a vice chairman and Houston managing partner at Deloitte, is one of several women heading up Big Four firms in the city. Each took some time to share the view from the top (and on the way up) with *Today's CPA*.

Taylor's buoyancy is not without qualification: "There remain unseen barriers that can keep some women from getting to the next level. I believe that it's our job as leaders to help women maneuver through the obstacles that can prevent their reaching the highest levels of an organization."

Tandra Jackson, office managing partner at KPMG in Houston, concurs: "The glass ceiling has definitely lifted, although it's been somewhat of a slow process. There's no limit to what women can accomplish in our profession – we're seeing more women in executive positions. But there's still a way to go."

Aim for the Bleachers

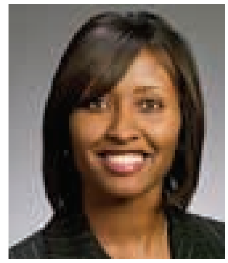
One of Taylor's favorite sayings is: "You never get a hit if you don't swing the bat." However, getting up to bat can be tricky.

Deborah Byers learned that lesson a long time ago. Today, in addition to being EY's managing partner in Houston, she is U.S. Energy leader and a transactions tax partner. Once upon a time, though, she was just trying to do what she recommends to all young people growing a career.

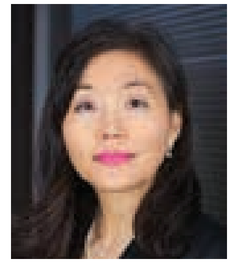
"Male or female, you need to figure out what you are passionate about," she explains. "For me, that was M&A (mergers and acquisitions), but I hit a wall of 'that's not what women do.' So I kind of scratched my head. It was the first time I'd encountered that kind of barrier. Now mind you, I wasn't told I *couldn't* do it, just sort of discouraged. So I went home and thought about it some more and decided, 'No, I excel at this!' When I went back and made my case, they said 'yes.' This showed me early on, as a new manager, you have to speak up for what you want."

That reflects Taylor's perspective: shards of the glass ceiling remain stubbornly in place because of "a cultural gravitation toward less challenging assignments for women." This view competes with a popular mindset, which crystalized in the 1990s, the gist being that most women who might have been executive material leave the business world to start families – that a lack of flexibility and work/life balance explain the dearth of women in corner offices; also that perhaps women couldn't handle the pressure.

"They weren't buckling under pressure; they were stifled," Taylor says. "Many left because the opportunities just didn't seem to be there. They weren't on the fast track to the best client assignments or the best industries to showcase their talent. Fortunately, we now have fabulous programs to support taking family leave, about flexibility. But those focus on taking time *away* from work. We also need to focus on being flexible with women to help them be successful while they're *at* work … or we'll lose that talent."



Tandra Jackson



Deborah Byers

Anne Taylor

"Young women often don't see it coming when they are benevolently steered in less challenging directions. Then three to five years later, they find themselves without the expertise and opportunities they need to move up."

Follow the Leaders

Although she did start a family, Jackson didn't fall prey to the "Mommy Track." Having spent several years in industry with an accounting degree, she eventually found herself irresistibly drawn to the fresh challenges that KPMG offered. So she took a leap of faith and credits excitement over her new career path with the right guidance and support within the firm.

She recalls: "I had a difficult pregnancy – bed rest at 20 weeks, in the hospital for five weeks. Childbirth at 27 weeks, followed by a two-month hospital stay for our son. That was a big part of my second year as a senior manager. Then the very next year, they put me up for partner! Kind of blew my mind. (Laughs). It took strong mentorship to solidify that confidence in me, to take the next step at that time in my life."

Jackson allows that as a new mother, she did "honestly question" whether she could be the kind of mother she wanted to be and the kind of partner she wanted to be. "There weren't a lot of partners at the time who were mothers … but one of my mentors, a male partner, convinced me I could do it. That was absolutely a pivotal moment and I will always be grateful to him."

Also a mother, Taylor hopes that "younger women looking at us will realize that you can have a family if you want and still get to the senior level in our firms." She, as well, recognizes a key mentor for helping that happen. But which comes first, the mentor or the mentee? In Taylor's case, it's hard to say. When she was "the new girl" at Deloitte, she raised her hand to volunteer for a committee that didn't much appeal to her reluctant peers. Turns out that seemingly low-profile committee was quite important to the firm's then regional managing partner … who later tapped Taylor for leadership as he fired up a brand new business within the firm … and who eventually became Deloitte's CEO. Luck? Not exactly.

She counsels: "You don't have to say 'yes' to everything, but when you do, remember *why* you were asked to do it and have the right attitude. Show up. Perform with excellence. It matters."

Of course, that relentless can-do spirit is what probably led to Taylor having a similar postpartum experience to Jackson's. While on maternity leave with her fourth (yes, you read that right) child, she received a phone call from her sponsor asking if she was bored.

"Bored," guffaws Taylor. "Home with three children and a new baby? 'Bored' was not the word I would have chosen." Turns out he was wondering if she was bored in her job. What?! Taylor was certain she had the perfect plan to keep doing exactly what she was "comfortable with" for the foreseeable future and the man was talking about her heading up … e-business?

"I honestly didn't want to do it," she admits. "But I knew that if he asked, I couldn't say 'no.' That was the biggest risk I ever took, a job that I didn't know how to do at a time that seemed inconvenient. But that was what led to national and global roles."

Remember Where You Came From

Behind every great woman, or at least these women, was at least one family member who was apparently gender blind. Jackson muses: "It's funny but growing up, I never thought about limitations on women. It was my mother. She instilled in me the value of hard work and education. She never led me to believe there was anything different about me that would stop me in life. My mom (laughs) … if only you knew her. I remember her telling me, 'Oh you're great in math. You're going to college and you're going to be an accountant.' I just trusted that she was right because she usually was."

For Byers, it was an entire family pushing her forward. A Korean family. She smiles: "Me? I grew up thinking I could do whatever I wanted to. I came here when I was six years old with the same old immigrant's dream – to have a better life. My family sent me to have opportunities they didn't. So it was hammered into me: you're here for a special reason."

That drive and sense of duty, instilled from such an early age, served Byers well as she encountered a culture that didn't always reward her for being a tomboy, for looking different than most of the other kids in the neighborhood, for being a science and math nerd before that was "cool for a girl."

She grimaces and also laughs: "People picked on me, picked on me all the way through high school. Know what? It galvanized me. I never thought about 'what girls do.'"

Neither did Taylor. Early on, she didn't get shows like "Leave It To Beaver" that showed mom vacuuming in pearls and waiting for dad to come home from the office. She says: "I didn't realize that I had truly remarkable parents until I was in my 20s. I thought everyone was expected to optimize their potential, pursue education, nurture their family and engage in their community. I saw that both members of a marriage should do those things in some combination. I watched both of my parents pursue degrees, work outside the home."

So as a youngster, Taylor felt perfectly at ease exploring many avenues considered male territory, except sports because, as she laments, "it was before Title IX." When she chose engineering as her first course of study, her friends decided she must be from Mars.

"It was my parents," she nods.

Keep Dancing, Keep Rowing

It's rare that anyone who "makes it" does so without an exceptional ability to persevere when faced with the unexpected. Jackson likes to quote, "Life is like a disco; no matter how the music changes, just keep dancing." Byers' related philosophy, "If there's no wind, row."

When advising young people setting out in the world, Taylor cautions: "Think really carefully about the kind of work you want to do and who you want to do it with. Present yourself in a way that's going to make you look, sound and act credibly. Learn something every day. You're opening doors for the next day and the next year."

Byers likes to remind: "Know that your career is a marathon. I completely understand being driven and impatient. But if you think about it: You're 22 – retirement will be in your 60s (maybe). That's a really long time. Keep perspective on your job and your life. We tend to look at everything in small bites in our goal-oriented society, which can bring a series of dissatisfied moments instead of long-term growth. You don't have to make things too complicated. Work hard; be nice."

"Your profession, your life, is full of ebbs and flows," Jackson adds. "You have to keep moving, keep giving it your all. I try to instill that in my son, Braylen, although at 10 (laughs) he thinks he already knows that."

Pay it Forward

Jackson is her firm's advocate for diversity initiatives in Houston plus serves on KPMG's African American Network National Advisory Board. She speaks at forums such as the National Women's Council Houston Conference and the Women in Leadership Symposium.

Byers feels the most satisfaction while mentoring and sponsoring men and women of all ranks, both internally at EY and through her involvement in community and industry organizations. She is particularly passionate about championing a pipeline of women in STEM and in the energy sector.

She explains: "One of our recent studies found that just 11 percent of the oil and gas industry's top global executives are women. What's more, only 19 percent of undergraduate engineering degrees in 2013 went to women. How are we going to continue to build and transform this global industry without leveraging diverse viewpoints? And it's not just oil and gas. Diversity of thought, of experience, of perspective – it makes businesses better."

Taylor, who works with a large variety of civic and community organizations, expresses surprise and frustration that many of the young women she encounters no longer see the point of being active in women's organizations, as if gender bias has miraculously vaporized.

She observes: "When I gave birth to three daughters, I expected the need for women's initiatives to be moot by the time they entered the workforce. They are now in their 20s … and I believe these programs are still needed. Women do not have pay parity. Women are not represented proportionally at the top. When you look at those kinds of data, it's clear that something's still not right. We have to continue with the kinds of initiatives that move young women forward. They need coaching in combatting the unconscious biases and barriers that persist."

And if women hit the glass ceiling, Taylor advocates opening a window. "This shouldn't be 'survival of the fittest' – not all women were raised the way I was. Some facing certain barriers or obstacles are not willing, or able, to put up the same fight. We need to ask, 'Is the window open?' For me it was. We need to open it for other women too." ■

Anne McDonald Davis, ABC is a freelance reporter, writer and editor based in Dallas, Texas.

TSCPA Selects Incoming Executive Director/CEO

TSCPA announced the selection of our incoming Executive Director/CEO Jodi Ann Ray, CCE, IOM, who will step into the role on Jan. 1, 2017. She comes to TSCPA from Meeting Professionals International (MPI) where she was the vice president of membership and volunteer experience responsible for governance, as well as community development, which encompassed membership and more than 90 chapters and clubs in 24 countries.

Prior to joining MPI, she served as the CEO for chambers of commerce in Connecticut, North Carolina and Texas, where she oversaw all operations, including membership, government affairs, economic development and finance. An article highlighting Ray will be included in the January/February 2017 issue of *Today's CPA* magazine.

November is the Statewide CPA Month of Service

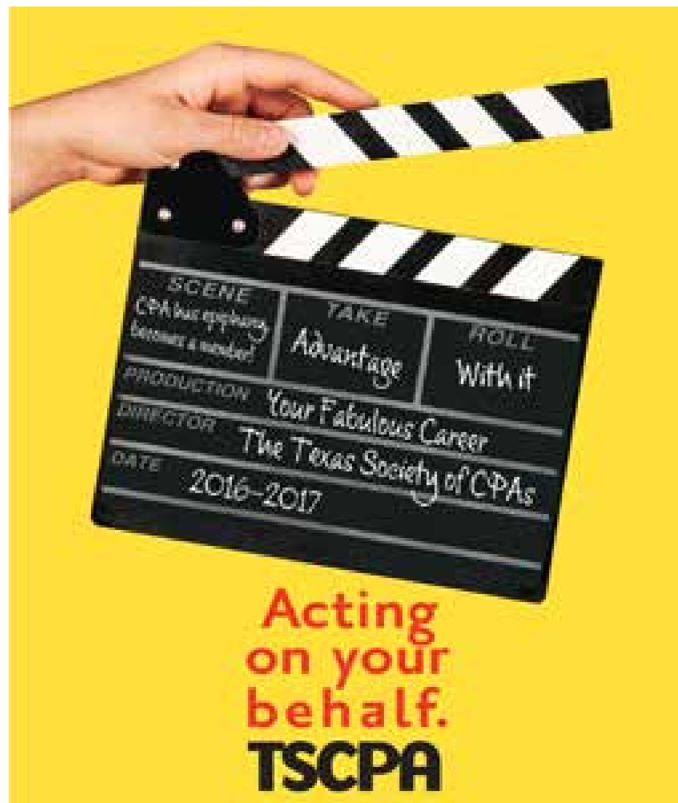
TSCPA and the Young CPAs and Emerging Professionals Committee for TSCPA are hosting the statewide CPA Month of Service this November. It's an opportunity for members to help those in their community by participating in a volunteer activity of their choice. Members can register as an individual, get a group together in their firm or company, or volunteer with their TSCPA chapter.

For more information about the CPA Month of Service, visit your chapter's website or contact TSCPA's Catherine Raffetto at craffetto@tscpa.net or 800-428-0272, ext. 216 (972-687-8516 in Dallas). Don't forget to use the hashtag #TXCPAService to share your photos and videos on social media.

Students Win Tuition/Book Reimbursements

In a random drawing of 2016-17 student members majoring in accounting, four student members recently won $250 tuition/book reimbursements provided by the Accounting Education Foundation of TSCPA, Inc. TSCPA congratulates these four students:

- Zhixiang Zhu – University of Houston
- Grace Wright – Texas A&M University
- Nawal Abdeladim – Austin Community College
- Eric H. Conley – Texas A&M University-San Antonio



Membership Recruitment Campaign: $119 Introductory Rate for New Members

TSCPA is acting on your behalf to provide you with high-quality CPE, professional advocacy, member resources, discounts and networking opportunities. Now, CPAs who have never been members of TSCPA can join with the introductory dues rate of $119 for state and chapter dues through May 31, 2017.

Encourage your friends and colleagues to visit http://bit.ly/tscpa to complete the application and take advantage of this special offer! The mobile-friendly application makes it even easier to join. If you have any questions about the member recruitment campaign, please contact Melinda Bentley at mbentley@tscpa.net; phone 800-428-0272, ext. 279 or 972-687-8579 in Dallas.

TSCPA Launches New Website

TSCPA is excited to have launched a new and improved website. Our renovated online home was designed especially for you! The user-friendly site gives you access to a variety of professional resources and features benefits that are only available to members, so you can access the information you need quickly and easily.

We hope you'll take a minute to click through our cleaner, fresher, mobile-friendly online environment at tscpa.org. If you have trouble finding something in our new website, please don't hesitate to send us a message at membership@tscpa.net or give member services a call at 800-428-0272.

Outstanding Educator Award Recipients Recognized

TSCPA presented four top Texas accounting professors with the organization's 2016 Outstanding Accounting Educator Award. The awards recognize accounting educators in Texas who have demonstrated teaching excellence and have distinguished themselves through active service to the profession. The recipients for 2016 are:

- **Dr. Suryakant T. Desai, CPA – Cedar Valley College**
- **Dr. Veronda F. Willis, CPA – The University of Texas at Tyler**
- **Dr. Nikki L. Shoemaker, CPA, CGMA – Stephen F. Austin State University**
- **Diane M. Eure, CPA – Texas State University**

Criteria for judging include instructional innovation, student motivation and learning opportunities, professional and student accounting organization involvement, research and publications. At a ceremony held during the TSCPA Accounting Education Conference, the winners each received a $500 award and a recognition plaque provided by the TSCPA Accounting Education Foundation. For more information about the Outstanding Accounting Educator Award, please visit TSCPA's website at tscpa.org.

Follow Up to *Today's CPA* Article 'Education Credits: Beyond the Basics'

By Dana Bell, EA

There are two changes in IRS regulations following publication of the article "Education Credits: Beyond the Basics," which was included in the September/October 2016 issue of *Today's CPA* magazine. In the article, the requirement for taxpayers to have received a Form 1098-T was noted. Because current regulations allow institutions to forego sending the 1098-T to many students, some taxpayers would not be able to claim the credit they would otherwise have qualified for. The IRS has released proposed regulations[1] that address that discrepancy by requiring institutions to send 1098-T to most students. Comments were received until Oct. 31 and a public hearing is not scheduled until Nov. 30, so changes may not be final until into 2017. In the interim, the regulations also provide the following reprieve:

Until the proposed regulations under §§ 1.25A–1(f) and 1.6050S–1(a) are published in the Federal Register as final regulations, a taxpayer (or the taxpayer's dependent) (other than a non-resident alien) who does not receive a Form 1098–T because its institution is exempt from furnishing a Form 1098–T under current § 1.6050S–1(a)(2) may claim an education tax credit under section 25A(a) if the taxpayer (1) is otherwise qualified, (2) can demonstrate that the taxpayer (or the taxpayer's dependent) was enrolled at an eligible educational institution, and (3) can substantiate the payment of qualified tuition and related expenses.

Secondly, in 2017 additional due diligence requirements go into effect for returns claiming education and other credits. The IRS has released a draft Form 8867.[2] Paid preparers claiming the American Opportunity Tax Credit are required to answer the questions in the AOTC column on the form.

Footnotes

1. https://www.irs.gov/irb/2016-33_IRB/ar11.html
2. https://www.irs.gov/pub/irs-dft/f8867--dft.pdf

National Taxpayer Advocate Nina E. Olson

Panel Discussion at the Public Forum in San Antonio

TSCPA Members Speak at National Taxpayer Advocate's Public Forum

Throughout 2016, National Taxpayer Advocate **Nina E. Olson** held public forums in cities across the U.S. The forums were intended to provide an opportunity for Olson to hear from taxpayers through panel discussions with congressional and community representatives and comments from the audience about what they want and need from the IRS to comply with their tax obligations.

In August, she and U.S. Rep. Lloyd Doggett (D-Texas) held a public forum in San Antonio. TSCPA's Chairman-elect **Jim Oliver**, CPA-San Antonio, and TSCPA members **Jim Smith**, CPA-Dallas and **Jaime Vasquez**, JD, CPA-San Antonio, served on the panel. Oliver and Smith also provided testimony on behalf of TSCPA, its Federal Tax Policy Committee and the San Antonio Chapter.

Issues Covered by TSCPA Members

As part of his testimony, Oliver discussed the issue of inadequate staffing at the IRS. He said the lack of staffing impacts many taxpayers, particularly older or lower-income individuals, who may not have Internet access or online skills and must rely on telephone or face-to-face meetings. The lack of staff often means waiting on the phone or in line for long periods when they visit an IRS Taxpayer Assistance Center. Unfortunately, many important taxpayer service functions previously performed by local offices have been pared back.

Another problem resulting from inadequate staffing occurs in correspondence audits, which are particularly frustrating for taxpayers dealing with IRS personnel who often take a long time to respond. He recommended that the IRS improve its website and e-communications systems.

In his testimony, Smith said that as the IRS fulfills its responsibility for administrating the tax system, it must also cope with the following issues: limited funding and the resulting personnel shortages; expanded responsibilities imposed by new laws; the impact of information technology; accelerating complexities in the tax law; and the negative reaction many, including members of Congress, have to it. How the IRS manages these challenges is critical to the viability of the U.S. tax system.

Smith continued by saying that to effectively and efficiently administer our federal tax law, the IRS should focus transparently and with public input on four important areas: inadequate staffing; identity theft; technology; and the future state plan. He addressed each of these areas separately, and said he hoped his comments would be viewed as constructive and supportive of the IRS in its essential role in our government.

A Voice in the Process

In addition to written statements submitted by panel members, each public forum has been transcribed to ensure there is a written record of all discussions on taxpayer needs and preferences when dealing with the IRS. The National Taxpayer Advocate will use these recorded conversations to further the discussion of the IRS future state vision and to ensure that U.S. taxpayers have a voice in the process.

Additional information and the transcripts are available on the Taxpayer Advocate Service's website at https://taxpayeradvocate.irs.gov. To read more about the forum held in San Antonio, please visit https://taxpayeradvocate.irs.gov/news/forum-on-taxpayer-service-in-san-antonio-tx.

Accountants Confidential Assistance Network

The Accountants Confidential Assistance Network (ACAN) supports Texas CPAs, CPA candidates and/or accounting students who are addressing alcohol, chemical dependency and/or mental health issues. ACAN provides a confidential phone line at **1-866-766-ACAN** to help people who need assistance or you can also contact TSCPA's Craig Nauta at cnauta@tscpa.net.

ACAN groups and Friends of Bill Wilson meet regularly at the following times and locations.

Austin
Covenant Presbyterian Church
3003 Northland Drive
Noon on the third Friday of the month

Dallas
Saint Michaels and All Angels Church
8011 Douglas Ave.
6:15 p.m. every Monday

Houston
LCL/ACAN Meeting
Wortham Tower Cafeteria
2727 Allen Parkway
Monday mornings at 7:30 a.m.

San Antonio
Eileen Lanagan, P.C.
11950 Starcrest, Ste. 201
210-828-1467
I410 and Broadway
Second Monday evening at 6 p.m. ■

Submit an Article to *Today's CPA* Magazine

Do you have expertise in a certain practice area that would be important to cover in ***Today's CPA*** magazine? The editors are currently seeking articles for consideration in upcoming issues. We are soliciting technical submissions in all areas, including taxation, regulation, auditing, financial planning, ethics and corporate governance, information technology, and other specialized topics.

The magazine features articles and columns that focus on issues, trends and developments affecting CPAs in all facets of business. If you would like to submit an article for consideration or to learn more, please contact managing editor DeLynn Deakins at ddeakins@tscpa.net or technical editor Brinn Serbanic at Brinn_Serbanic@baylor.edu. ■

Disciplinary Actions

Reprimand:

Jeffrey L. Lyon, Waxahachie, entered into a settlement agreement effective Aug. 30, 2016 under the Joint Ethics Enforcement Program in lieu of further investigation and proceedings of alleged violations of the codes of professional conduct of the Texas Society of CPAs and the American Institute of CPAs. Without admitting or denying any wrongdoing, Lyon is hereby reprimanded by TSCPA. He was the subject of a Consent Order of Permanent Injunction issued by the U.S. District Court for the Northern District of Texas in a case brought by the U.S. Commodity Futures Trading Commission.

The following person had his membership in TSCPA ***expelled*** by the Executive Board under TSCPA *Bylaws* Article III, Section (4B). This action was a result of the revocation of his CPA certificate by the Texas State Board of Public Accountancy.

- **Gregory L. Brown, Houston**

As a result of decisions by TSCPA's Executive Board, the following members had their TSCPA membership:

Suspended:

- **Wayne R. Gray** of Dallas for a period of one year retroactive to March 10, 2016. The suspension was effective Sept. 18, 2016. The action was based on an administrative order by the Securities and Exchange Commission (SEC), whereby Gray was suspended from appearing or practicing before the SEC as an accountant for one year.
- **David M. Martin** of Waco for a period of three years retroactive to July 14, 2016. The suspension was effective Sept. 18, 2016. The action was based on a three-year suspension of Martin's license by TSBPA in connection with an administrative order by the SEC, whereby Martin was suspended from appearing or practicing before the SEC as an accountant for three years effective Feb. 11, 2014.

Expelled:

- **Juan E. Rivera** of Port Isabel effective Sept. 18, 2016. The action was a result of the revocation of Rivera's CPA certificate by TSBPA in lieu of further disciplinary proceedings on peer review and firm license findings. ■

CGMA® Designation: Employers Demanding Extensive Strategic Skills from Finance Professionals

A new era of business is dawning as organizations look for finance staff – from the C-suite to entry-level – with a broader mix of competencies. Employers are demanding finance professionals with management accounting skills, business skills and the ability to be strategic business partners. Just as importantly, they are seeking individuals with strong people and presentation skills who can effectively communicate to influence change within the organization.

"It's all about people," said Nick Araco, CEO of the CFO Alliance, in *CGMA Magazine*. "Most of the dialogue we're having is going back to talent. Regardless of whether we're talking about strategy or capital structures or regulatory environments, the people side pops into every conversation." The fact is, there is a shortage of finance professionals with the people, business and leadership skills necessary for success in today's volatile business climate.

Investing in the Future

While employers search for the right fit for their open positions, they may do well to look at their existing employees and consider implementing training for these newly demanded skills. Thirty-one percent of the staff-level CPAs surveyed by AICPA and Robert Half said that they love their current jobs and want to continue to build skills and take on challenging projects. And while they responded that they would like to grow in some fundamental accounting areas like tax, Excel and budgeting, respondents also said they want the opportunity to learn soft skills like public speaking, management and communications.

Upskilling your current employees is a one-two punch: Your current staff tends to have a good understanding of your business. By providing them with training in soft skills and business partnering, you are helping to strengthen your finance team. Furthermore, investing in your staff and presenting them with opportunities for learning and growth increases employee engagement, which is always good for the bottom line.

A Framework for Development

AICPA recognized the imperative for supporting finance and accounting professionals who seek to further enhance their competencies in strategic thinking and business partnering skills. In 2012, AICPA and the Chartered Institute of Management Accountants (CIMA), the world's largest professional body of management accountants, launched the Chartered Global Management Accountant® (CGMA®) designation to help these professionals develop the competencies necessary to drive sustainable business success.

More than 150,000 accounting and finance professionals today have the CGMA, making it the most widely held management accounting designation in the world. The CGMA distinguishes professionals who have advanced proficiency in finance, operations, strategy and management. They have the acumen to view businesses holistically and understand myriad complexities from a broad perspective to drive better decision making within their organizations.

Earning the Designation

Finance and accounting professionals attain the CGMA designation by meeting rigorous education, exam and practical experience requirements. CPAs, because of their extensive education and deep expertise, have an expedited pathway. They must sit for the final CGMA strategic case study exam, which simulates a real-world business scenario and assesses proficiency across multiple disciplines. In advance, they can enroll in the self-paced CGMA Program that offers learning and exam preparation and carries more than 50 CPE credit hours. Through the CGMA Program, candidates fine-tune their skills in areas such as strategy development, leading and influencing, and presenting and communicating information.

The CGMA designation is underpinned by extensive global research to maintain the highest relevance with employers and develop competencies most in demand. CGMAs must commit to lifelong education and adhere to a stringent code of ethical conduct. Through the CGMA, AICPA and CIMA have introduced the CGMA Competency Framework, the Global Management Accounting Principles and the AICPA I CIMA Competency and Learning platform to provide a structured approach to talent development and help management accountants and their employers identify competency gaps. To learn more about the CGMA Program and designation, please visit www.cgma.org. ■

TSCPA Seeks Faculty and Student Campus Reps for 2016-2017

TSCPA is looking for students and faculty members to represent the Society on campuses across the state. In exchange for serving as a campus rep, students will receive free membership for the year, recognition in relevant TSCPA communications and more.

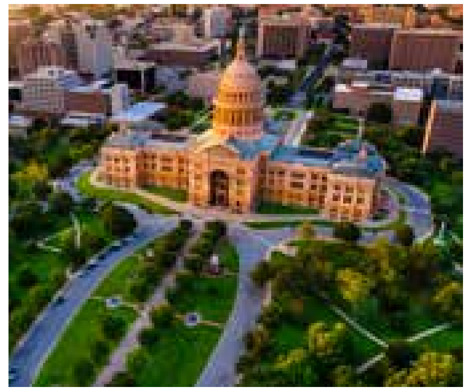
If you or someone you know is interested in becoming TSCPA's link to your college or university, please contact Catherine Raffetto at craffetto@tscpa.net for more information. ■

Notice of Midyear Board of Directors Meeting

Includes Legislative Briefing
Jan. 31- Feb. 1, 2017
Sheraton Austin Hotel, Austin, Texas

Welcome to the Sheraton Austin Hotel at the Capitol! After undergoing a multimillion dollar overhaul, the hotel offers guest rooms with HDTVs, an updated lobby and meeting spaces, and an inviting spot in which to reconnect with old friends or meet new ones at Link@Sheraton experienced with Microsoft.

Featuring distinctively modern architecture and majestic views of downtown Austin, this landmark hotel is situated in the cultural heart of Austin, next door to the famed Capitol. It is also just steps from the University of Texas and the allure of the Sixth Street/Warehouse District.



Sheraton Austin Hotel
at the Capital
701 East 11th Street;
Austin, TX 78701
512-478-1111
$205 single or double
(plus hotel tax)

Cutoff date is Friday, Jan. 6, 2017 or when the block is filled, whichever occurs first.

Leadership Nominations Results for 2017-18 Positions

Terms Commence June 1, 2017

TSCPA's Nominating Committee recently chose the candidates for 2017-18 leadership positions, directors-at-large and Nominating Committee members. In accordance with TSCPA *Bylaws* Article IX, the candidates' election will be conducted through a secure electronic ballot on a TSCPA website area approved by the Executive Board. The electronic ballot will be open to all eligible members to vote. The voting is planned to take place in November through December 2016. TSCPA will send communications to members regarding the electronic voting and will post information about it on the website at tscpa.org. The following persons were nominated for terms beginning in fiscal year 2017-18 and have consented to serve if elected by the members.

Chairman-elect: Stephen G. Parker *(Houston), (Chairman in 2018-19)*
Treasurer-elect: Benjamin C. Simiskey *(Houston), (Treasurer in 2018-19)*
Secretary: Lucretia Diane Terrell *(Abilene), (Beginning June 2017 and expiring May 2018)*
Executive Board Members *(Three-year term expiring May 2020)*
Michele M. Heyman *(Austin)*
Susan S. Roberts *(Fort Worth)*

Director at Large *(Three-year term expiring May 2020)*
C. Wayne Barton *(East Texas)*
Anne M. Carpenter *(Panhandle)*
Caitlin J. Chupe *(Corpus Christi)*
Phillip C. Davis *(Permian Basin)*
Sheri K. DelMage *(Southeast Texas)*
Jose L. Luna *(Dallas)*
Misty G. Mata *(Corpus Christi)*
Jay H. Neukomm *(Victoria)*
Norman B. Robbins *(Fort Worth)*

Director at Large *(Continued)*
Joan E. Schwartz *(San Angelo)*
Sean V. Skellenger *(Austin)*
Sally W. Wolfe *(Central Texas)*

Nominating Committee *(2017-2018)*
Brandon R. Booker *(Fort Worth)*
Michael L. Brown *(Central Texas)*
Kristy A. Everitt *(East Texas)*
Renee D. Foshee *(San Antonio)*
Jimmy J. Hudson *(Permian Basin)*
Kelly J. Hunter *(Houston)*
Joshua LeBlanc *(Southeast Texas)*
Adelaide A. Odoteye *(Abilene)*
John N. Perkins *(Dallas)*
Ekaterina (Kate) I. Rhoden *(Austin)*

As TSCPA Immediate Past Chairman in 2017-2018, Kathy Kapka *(East Texas)* will serve automatically as chair of the 2017-2018 Nominations Committee. Michael Brown *(Central Texas)* was appointed as vice chair.

AICPA Council
The Nominating Committee also recommends that the names of the following individuals be forwarded to the American Institute of Certified Public Accountants as representatives from Texas to serve on the AICPA Council:
Michael L. Brown *(Central Texas)* – One-year designee (2017-2018)
Kathryn W. Kapka *(East Texas)* – Three-year term expiring 2020
Jeanette P. Smith *(Rio Grande Valley)* – Three-year term expiring 2020
Jerry D. Spence *(Corpus Christi)* – Three-year term expiring 2020

Here We Go Again – The 85th Session of the Texas Legislature

By Bob Owen, CPA | TSCPA Managing Director, Governmental Affairs

The 85th session of the Texas Legislature convenes on Jan. 10, 2017 for 140 days of laid back to frenetic pace as the session progresses. The first 60 days of the session are spent getting organized and filing bills; the next 100 days are jammed with committee hearings on close to 6,000 bills that are likely to be filed. Each bill has to go through committee hearings in both the Senate and House and ultimately be passed by both bodies with the exact same language. Many bills die in the committee hearing process. Many bills will pass each house with sometimes substantially different provisions, resulting in a joint House/Senate committee to resolve the differences; then both bodies must vote again on the compromise legislation. You can see why the pace becomes hectic during the last days of the session.

The system is designed to make it difficult to enact new legislation (we can all be thankful for that) and only a fraction of the approximately 5,000 to 6,000 bills filed will ultimately pass and be signed into law.

It seems like the same issues are debated from session to session, and to some extent that is very true. The only bill that must be passed each session is the Appropriations Act, which funds the state government for the next two years. It is usually one of the last bills to pass with the added pressure of a veto by the governor if the budget doesn't suit his fancy. Every year, budget issues are negotiated, intensely debated and reported on prominently in the press. If this bill does not pass, a summer special session is assured.

The Legislature is limited in its spending discretion by the comptroller of public account's revenue estimate for the upcoming biennium and a constitutional limit on the budget increase from one biennium to the next. These restrictions more or less insure a balanced budget, something the Feds don't have to worry about. Even in Texas, money can be borrowed for some purposes, like building roads, but at least there are some limits on government spending in Texas.

While similar issues arise in each session, the environment of each session is different and the ability of legislators to deal with issues is significantly impacted by that environment.

In 2011, the state faced significant revenue shortfalls and the legislators had to pass a truly bare bones budget. In 2015, the state's economic picture had reversed to the extent that legislators actually had more money to spend than the Constitution would allow.

While we won't know the full picture until the comptroller issues the revenue estimate (probably sometime in January), it is clear the Texas economy is not generating revenue to the state at the level of the previous biennium and that we will fall short of the comptroller's revenue estimate for the current biennium. This budget-writing session will be much more difficult than 2015. As reported in the *Dallas Morning News*, "It is going to be a very challenging session," said Texas Taxpayers and Research Association President Dale Craymer, a budget watcher who advised former Govs. Ann Richards and George W. Bush. "There will clearly be budget cuts."

What's the Same and What's Different?

Other than the significant budget environment, which will also affect many other issues and legislation, what can we expect to be the central issues for the 2017 session?

The session will begin with much the same environment as the last session:

- The Republicans will control both the House and Senate by substantial majorities.
- The Senate will remain more conservative than an admittedly conservative House; Democratic senators will have limited influence.
- The Senate and House will have substantial disagreements on approaches to resolving legislative issues, but in the end, Senate views will likely prevail on final legislation, although the House will undoubtedly prevent some Senate legislation from passing.
- Rep. Joe Straus (R-San Antonio) will continue as Speaker of the House.

Some of the major issues will also be the same:

- Public school funding will continue to be debated, despite the Texas Supreme Court ruling that school funding as it stands is constitutional "for now." Funding equity and "Robin Hood" distributions from property wealthy school districts will be revisited, but true reform may still be a pipe dream. School finance is very complicated. "The current formula used to determine school funding is too complicated. No one understands it," says Sen. Kel Seliger (R-Amarillo) as quoted in the *Amarillo Globe News*. Despite the complications and difficulty, Speaker Joe Straus (R-San Antonio) wants school finance reform on the table and has given special charges to both the Public Education Committee and the Appropriations Committee; joint hearings have already started. Despite this attention, school funding could actually face cuts, due to reduced state revenues.
- Property tax relief is a stated legislative priority for Lt. Gov. Dan Patrick and other state senators. This is also a complicated issue since property taxes are levied by local governments and school districts, not the state. Historical efforts have been to offer legislation making it more difficult for school districts to increase property tax rates and to offer more state funding to schools to offset mandated property tax rate limits. It's hard to see the latter being available in the current budget climate.
- Roads are a perennial issue, with more questions about toll roads this session being front and center. Some legislators are also raising rural versus urban issues in road funding priority. TxDot

is accused of spending more money in urban areas (where there are more cars and more traffic) at the expense of ignoring rural road needs. Senator Kel Seliger (R-Amarillo) and Rep. John Smithee (R-Amarillo) are as quoted in the *Amarillo Globe News*, "Both agreed that transportation funds often neglect the needs of rural areas to better serve the needs of metropolitan centers like Dallas-Fort Worth.

- Efforts to divert so-called "Rainy Day" funds to budget or infrastructure uses will continue; with reduced revenues, more invasion of the fund might prevail, but with the decline in oil-price contributions to the Rainy Day Fund, which come from oil and gas severance taxes, fund sources will also decline.
- Bills will be filed to let Texas participate in federal funding of Medicaid, in part because current Medicaid expenditures are substantially exceeding what was anticipated, but they will likely fail to pass.
- Border security will continue to be addressed with the DPS asking for over $1 billion more than was authorized last session.
- The *Dallas Morning News* reported in a story headlined, "GOP senators renew push for Texas to let students attend private schools at state expense." School vouchers will continue to be pushed by Patrick and others, although the new terminology is Education Savings Accounts. Like past sessions, the prospect for such bills passing is very low.

Is there anything new?

- Bathrooms. As headlined in the *Austin American-Statesman*, Dan Patrick's legislative priority: 'Keeping men out of ladies' rooms.' The article further explained that Patrick said "he would resist allowing individuals to use the bathroom of their gender identity, rather than their sex at birth." This will likely prove to be the most controversial and media reported issue of the session. The Texas Association of Business has already come out opposing such legislation as being very bad for business as has proven to be the case in other states. Extensive floor debates on this and other social issues could doom other legislation because there is only so much time in the 80 days available for floor debate.
- Vulnerable children. This is another important issue for Straus. As reported by the *Texas Tribune*: Texas House Speaker Joe Straus said "Ensuring that children and other vulnerable Texans are not left behind as the state grows should be the focus of the next legislative session." Both the cost and funding of higher education will be debated this session. Until the last decade or so, state university funding was seen as a responsibility of state government and substantial university funding was included in the biennial budget. Indeed, substantial university funding is still included in the budget, but during a budget crunch session or two, the Legislature gave up some control over state universities and in return let the universities set their own tuition, changing the basic funding methodology. Since then, state university tuition has skyrocketed, students are graduating with mountains of school tuition debt and the public is not happy. Some legislators blame the schools for runaway spending and poor fiscal management and the schools say legislators don't understand the current higher education environment.
- Bullet train controversy. A proposal for a high-speed train, initially from Dallas to Houston, will be vigorously debated in the Legislature despite that the promoters of the project say they will not ask the state for any money to build it. The controversy will be urban versus rural. Urbanites want another people movement alternative between big cities, but farmers, ranchers and rural communities say they don't want to lose their land or serenity to a bullet train. Look for legislation to either prevent high-speed rail development or to make it so expensive as to be impossible to build.
- High-cost consumer lending will also be in the crosshairs for some legislators. These are the small loans made to consumers who can't qualify for normal bank lending. The loans are for very short periods of time with fees and interest charges that some legislators (and newspaper editors) think are exorbitant. THz industry argues they provide a vital service to people who need immediate funds and can find them nowhere else. The industry appears to have a well-funded lobby and will be ready for battle.

There Will be Other Issues

My crystal ball has its limits. I'm sure there will be other important issues that develop between now and session end, so stay tuned.

You may have noticed I've made no mention of CPA or franchise tax issues. There are some things in the wings. Check out the next Capitol Interest article in January to find out if there's anything you need to know. Please also see the Chairman's and Executive Director's Message in this *Today's CPA* for TSCPA's legislative agenda.

Bob Owen, CPA is TSCPA's managing director of governmental affairs. Contact him at bowen@tscpa.net.

Exercising Professional Skepticism: How to Behave Like a Skeptic

By Charles E. Davis, Ph.D., and Kathy Hurtt, Ph.D.

Professional skepticism. It's found throughout the professional accounting literature. Statements on Auditing Standards (SAS) #57 *Auditing Accounting Estimates*, SAS #67 *The Confirmation Process* and SAS #109 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* all state that auditors should exercise professional skepticism throughout the audit process.

The Public Company Accounting Oversight Board's (PCAOB's) Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in Audits* (hereafter SAP Alert No. 10) posits that "Professional skepticism is essential to the performance of effective audits…" (p. 1). The Center for Audit Quality (CAQ) also writes extensively about skepticism in its publication *Deterring and Detecting Financial Statement Fraud: A Platform for Action*. With all this focus on professional skepticism, you would think it would be easy to find a definition of professional skepticism in the professional literature. Unfortunately, that is not the case.

The closest thing to a definition is found in SAP Alert No. 10: "Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence" (p. 1). Using this definition, PCAOB has cited a lack of professional skepticism in dozens of its inspection reports, and the Securities and Exchange Commission (SEC) has cited a similar deficiency in hundreds of Accounting and Auditing Enforcement Releases. In fact, a recent study funded by the CAQ examining SEC sanctions against auditors from 1998 to 2010 found that 60 percent of the audits where the SEC alleged fraudulent financial reporting involve a lack of professional skepticism (http://www.thecaq.org/new-report-financial-reporting-fraud-released). Lest you think this is just a problem in the United States, regulators in several other countries have also expressed concern in their inspection reports about a lack of professional skepticism.

Characteristics of Skeptics

Auditors need to understand and practice six fundamental characteristics of skeptics. First, and perhaps most important based on PCAOB standards, skeptics exhibit **a questioning mindset**. This means that skeptics have a disposition towards inquiry – they keep asking questions, with some sense of doubt, until a sufficient explanation is found. In an auditing setting, this can be illustrated by the auditor who continues to question management and asks for documentation to support management's assertions, particularly if the documentation looks somewhat unusual.

Skeptics **suspend judgment** until appropriate evidence is obtained. They listen to any position or argument, but they wait for sufficient confirming and disconfirming evidence to convince them about the correctness of any position, and they withhold judgment until that evidence is present. Auditors don't begin the audit assuming that there is a problem; however, they also don't blindly accept the first explanation offered for their findings. It's also important to remember that as Mautz and Sharaf pointed out in their 1961 treatise *The Philosophy of Auditing*, the volume of evidence alone does not make it sufficient; different types of evidence are needed.

Curiosity is essential for skeptics, and they are interested in almost everything. This curiosity leads to a search for knowledge that investigates beyond the obvious, with a desire to corroborate what's been found. Skeptics collect information and that information could be related to a task at hand or simply be general information. They realize that a casual conversation overheard in the coffee room might (or might not) provide a link to later questions or issues. This trait helps skeptics keep the bigger picture in mind and not focus so much on the task at hand that they miss what is staring them in the face.

At the heart of people's actions are their **motivations and perceptions**, and these core characteristics may lead someone to provide biased or misleading information. Skeptics have a desire to understand others' motivations and to consider why provided information might not be accurate. Auditors must develop an understanding of the client's environment and the "tone at the top," and must consider why individuals might be motivated to provide information or explanations that are not necessarily accurate.

Skeptics operate with a sense of **autonomy and self-direction**. They are comfortable and convicted to decide for themselves rather than accepting the claims of others, even if it means departing from the accepted norm. He/she is the person who doesn't care what popular opinion asserts, and who thinks issues through and makes his/her own decisions. For auditors, this may mean adjusting, or even adding steps to, the audit plan until he/she is independently convinced about the reasonableness of a position or a value.

Finally, skeptics possess a **high level of self-esteem**, which provides the foundation to resist persuasive arguments, and to challenge assumptions and conclusions. Even though it can be

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Exhibit 1. Scale to Measure Professional Skepticism

The Hurtt Skepticism Scale (Kathy Hurtt, "Development of a Scale to Measure Professional Skepticism," *Auditing: A Journal of Practice and Theory*, vol. 29 (1), pp. 149-171, 2010) is the first attempt to measure an individual's level of skepticism. Completing this scale will provide insight into your level of professional skepticism.

To assess your level of professional skepticism, visit http://bit.ly/1X0d1pz and complete the scale. You will receive your results along with information about who you compare to the CPAs that completed the scale during its development. You will also be given the opportunity to provide additional information anonymously that will help researchers further understand professional skepticism.

difficult to continue to pursue additional evidence until one is independently satisfied, skeptics have a fundamental belief in the validity of their own thought processes. That belief allows them to trust themselves when their internal judgment continues to ask questions. For an auditor, this means not accepting management's explanations as absolute truth, but weighing those explanations while pursuing evidence to confirm or refute managements' assertions.

Behaviors of Skeptics

Given the characteristics of skeptics discussed above, how does professional skepticism influence behavior? Research suggests four behaviors that are influenced by one's level of skepticism – search for information, identification of contradictions, generation of alternative hypothesis and examination of interpersonal knowledge.

Highly skeptical people seek more information to support a conclusion than people who have low levels of skepticism. Skeptical auditors will seek information to support or refute management claims. SAP Alert No. 10's emphasis on the importance of careful examination of audit areas involving significant management judgments or transactions outside the normal course of business supports the skeptical auditor's increased information search through modification of planned audit procedures. The use of third-party confirmations, specialists, recalculations, internal control evaluations and examination of independent documentation are all ways that skeptical auditors engage in additional information search.

The skeptic will seek out information that contradicts the initial expectation. Among the audit deficiencies found by PCAOB are cases where auditors did not consider contradictions to management's assertions. For instance, the auditor should consider how management's decision to not test a significant portion of its property and equipment for impairment will affect the company's financial statements.

Research finds that the average person considers between three and five hypotheses to explain an outcome, and the only hypotheses that are considered are those that are judged the most likely to occur. The result of this behavior is a failure to consider the full range of hypotheses. Skeptical people, on the other hand, generate more potential hypotheses to explain data patterns. Particularly relevant to auditors is the tendency for people to generate fewer alternative explanations when under time pressure.

Finally, skeptics are concerned about who provides information and evidence. Knowing something about the person and his/her motives for providing information will influence the evaluation of that information when making a judgment. A skeptic is always considering the motivations and credibility of the people who provide evidence and explanations during an audit.

Barriers to Skeptical Behavior

Much of an auditor's work involves making professional judgments and the profession is certainly interested in learning how professional skepticism affects those judgments. A large body of research exists describing the use of heuristics in judgment and the decision biases that may result. While many of these studies rely on general decision-making tasks, these same heuristics and biases may impede an auditor's use of professional skepticism.

Most people have fallen prey to selective perception; they tend to see what they want to see or what they expect to see. As a result, they often miss red flags that should influence their judgment. In this biased decision, known as the confirmation bias, decision makers seek out information that confirms a judgment when they should actually be seeking disconfirming evidence.

Imagine how the confirmation bias might arise during an audit. Client management has offered an explanation for an account variation. The auditor, armed with that explanation, seeks additional evidence to confirm the client's assertion. When that information is found, the auditor concludes that the client's explanation is valid and ends the search for audit evidence. The auditor fails to design tests and evaluate evidence that would disprove the client's assertion, and potentially a fraud remains undiscovered.

Often decision makers must make point estimates of a value. If the decision maker is provided a starting point for making that estimate, the ultimate point estimate will be affected by that value. This well-documented decision bias is referred to as anchoring and adjustment.

How can anchoring and adjustment bias affect an audit? It's common for auditors to look at last year's work papers and make predictions about the current year's balances. When this happens, the auditor focuses on the old balance and then makes "adjustments" to develop the expected balance. Research demonstrates that when the auditor receives that balance from last year, it serves as an "anchor" and affects the final account balance estimate. The same could be true if management provides its valuation estimate of an infrequently traded security to the auditor. If management provides an estimate of $50,000, the auditor will generate an estimate that is different from the one that would be developed if management had provided an estimate of $400,000, regardless of what the underlying evidence indicates is the proper balance.

In addition to decision biases, auditors may also use decision heuristics, or rules of thumb, as they sift through voluminous audit evidence. Use of these heuristics may prematurely truncate the information search process. The availability heuristic leads people to assess the probability of occurrence of an event or the frequency of an event based on how easily they can recall instances of that event. While this may be a good strategy in many cases, using this heuristic in auditing may result in a biased decision.

Research has shown that auditors have limited knowledge of accounting errors and what they do know are the most frequently occurring errors. The availability heuristic, then, would lead auditors to choose the most available explanation, which might be the most recent or most memorable hypothesis rather than one that actually explains the evidence. This emphasizes the need for an auditor to thoroughly understand the business processes of each client, and to develop an expertise in the problems and issues in specific industries.

“RESEARCH HAS SHOWN THAT AUDITORS HAVE LIMITED KNOWLEDGE OF ACCOUNTING ERRORS AND WHAT THEY DO KNOW ARE THE MOST FREQUENTLY OCCURRING ERRORS.”

Enhancing Your Professional Skepticism

Knowing the characteristics and behaviors of skeptics and the biases that might affect your decisions, you can take actions to increase your own level of professional skepticism. The first step is to understand your natural tendency for skeptical behavior. (See Exhibit 1 to discover a way to assess your own level.) Knowing your tendencies will allow you to identify behaviors that come naturally and those that may need more deliberate attention. As you find yourself in situations requiring professional skepticism, be aware of those areas in which you score low and be conscious of practices, such as those we identify below, that can increase your use of skeptical behaviors.

A low score on interpersonal understanding could indicate that you are less aware of issues of employee morale and individual

continued on next page

Exhibit 2. Resources for Additional Reading
Professional Skepticism in Auditing

- Douglas Boyle and Brian W. Carpenter, "Demonstrating Professional Skepticism: Insights from Recent Research for Auditors of Financial Statements," *The CPA Journal*, vol. LXXXV (3), pp. 31-35, 2015
- Richard Coppage and Trimbak Shastri, "Effectively Applying Professional Skepticism to Improve Audit Quality: Learning from Past Audit Failures," *The CPA Journal*, vol. LXXXIV (8), pp. 24-28, 2014
- Steven M. Glover and Douglas F. Prawitt, *Enhancing Auditor Professional Skepticism*. http://www.thecaq.org/docs/research/skepticismreport.pdf, November 2013
- *IAASB Professional Skepticism in an Audit of Financial Statements*, http://www.ifac.org/sites/default/files/publications/files/IAASB%20Professional%20Skepticism%20QandA-final.pdf, February 2012
- Institute of Chartered Accountants in Australia, *Practical Ways to Improve the Exercise and Documentation of Professional Skepticism in an ISA Audit*, http://www.frascanada.ca/canadian-auditing-standards/resources/reference-material/item74244.pdf, May 2013
- PCAOB Staff Audit Practice Alert No. 10, http://pcaobus.org/Standards/QandA/12-04-2012_SAPA_10.pdf, Dec. 4, 2012
- Sam Ranzilla, Robert E. Chevalier, George Hermann, Steven M. Glover and Douglas F. Prawitt, *Elevating Professional Judgment in Auditing and Accounting: The KPMG Professional Judgment Framework*, http://www.kpmguniversityconnection.com/ProfessionalJudgment/CurriculumSupport/Monographs/ProfJudgment.aspx, 2011

Judgment and Decision Making

- Dan Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions*, Harper Perennial, 2010
- Christopher Chabris and Daniel Simons, *The Invisible Gorilla: How Our Intuitions Deceive Us*, Crown Publishers, 2009
- Daniel Khaneman, *Thinking, Fast and Slow*, Farrar, Straus and Giroux, 2011
- Daniel Kahneman, Paul Slovic and Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases*, Cambridge University Press, 1982
- Scott Plous, *The Psychology of Judgment and Decision Making*, McGraw-Hill, Inc., 1993
- Rebecca Fay and Norma Montague, "I'm Not Biased, Am I?" *Journal of Accountancy* (http://www.journalofaccountancy.com/issues/2015/feb/auditing-judgment-bias.html), Feb. 2015
- Benjamin Luippold, Stephen Perreault and James Wainberg, "5 Ways to Overcome Confirmation Bias," *Journal of Accountancy* (http://www.journalofaccountancy.com/issues/2015/feb/how-to-overcome-confirmation-bias.html), February 2015

motivations of behavior. This means you may discount or even fail to consider why client personnel might behave in a certain manner. One practice that may help you to better assess individuals' motivations and how that motivation might lead to questionable behaviors is to set a daily goal of writing down one to three new pieces of information about the interpersonal relations you observe among client personnel. Reviewing this list periodically will help develop your understanding of the employees' motivations and morale.

If autonomy is your weak area, you may be more susceptible to group think and less likely to develop your own conclusions. Be more deliberate about asking yourself, "Are there any places where I know that I am going along with the rest of the team or client while I still have some nagging questions?" Create a list of your remaining questions, outstanding areas and areas where you don't understand something. Wait until you have clearly identified these uncertain items for yourself before talking with other members of the audit team or participating in brainstorming sessions. Be sure you are really convinced of your conclusions and understand the purpose of your test work. Don't just perform audit tests because they are in the audit plan.

If you score low on suspension of judgment, you are more quickly persuaded or are anxious to make a determination about the adequacy of evidence. One exercise to overcome this tendency is to force yourself to step back before signing off on any audit area and ask, "If I was to testify in court about the steps I took in this area, would what I have done be adequate to persuade anyone else?" In other words, could someone else look at the same evidence and make a different decision or be unwilling to conclude based on the work you did? If you conclude that your testimony would be weak and others might reach a different conclusion, you may want to consider additional hypotheses and evidence before settling on your conclusion.

You may not be as naturally curious as others, and this tendency would be indicated by a low search for knowledge score. Step back and think about anything "odd" that you have encountered. Maybe it's as simple as asking if you really understand how the client makes money. Or maybe you remember taking a plant tour and now wonder "what is that pile of stuff under the tarp I saw in the warehouse?" If you overheard a conversation that made you go "hmmm?," place it in context and make sure you understand what was being said.

If you have a low score on self-esteem or self-confidence, it may be more challenging for you to believe in yourself enough to raise questions, identify contradictions and resist reaching a conclusion until you personally are convinced about the adequacy of the evidence. Periodically ask yourself what your real or true opinion is, or remind yourself who you represent and who you are protecting in your role as an auditor. If you think of the auditing profession's contract with society and yourself as a protector of trusting investors (the public good), you may be able to raise your level of self-confidence and to begin asking the questions you need answered.

Most auditors score high in the area of questioning mindset, as a questioning mindset is included in the definition of skepticism found in the auditing standards. However, if you score lower in this area, you should think about doubts you should have. Ask yourself, "Are there assertions or statements that I should be doubting based on what I've seen?" Also, confirm that you tested and obtained information for unspoken or underlying assumptions.

These are just a few examples of ways you might step back and rethink your evaluation of audit evidence. Other tools for improving your use of professional skepticism might be to do additional reading in the psychology of decision making or take a philosophy class that examines skepticism. Exhibit 2 provides a starting point for this additional discovery.

While this article is couched in an auditing context, steps you take to improve your use of skepticism in an audit may also be used to improve your decision making in other areas. Begin to monitor your decision-making processes and focus on eliminating biased judgments, and if you do find that you made a poor decision, reexamine your process and look for problem areas where a bias or lack of skepticism may have been present. Conduct a root-cause analysis to determine why the bias was present, not for the purpose of placing blame, but to learn to improve future decisions.

Professional skepticism is fundamental to the audit process and is the basis for evaluating all audit evidence. Yet PCAOB continues to find deficiencies in the application of professional skepticism in audits. These deficiencies can only be eliminated if individual auditors understand, develop and consciously apply adequate levels of professional skepticism. To do your part, take the time to follow up on the resources identified in this article. Engage in a dialog with fellow practitioners and academics you know. Perhaps your dialog will be a key to solving this problem. ■

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Selling Your Accounting Practice?

Avoid the Costly Mistake of Choosing the Wrong Buyer

By Harry L. Olson, CPA

The largest transfer of firm ownership in the history of the accounting profession is now underway. Owners of CPA practices are retiring in record numbers. Regrettably, many of these Baby Boomers have no internal succession plan in place.

Often, the best alternative to an internal succession plan is finding a buyer for the practice. Choosing the wrong buyer can be extremely costly – both in terms of client loss and lower firm value. However, some CPAs have misconceptions about the type of buyer to choose. Others have no idea what to look for in a buyer.

The following buyer selection criteria is helpful to consider when selling your accounting practice to an outside buyer. Failure to heed the following selection criteria can result in professional embarrassment and significant financial loss to the seller. Alternatively, a seller who is mindful of these issues will be better prepared to minimize client attrition and maximize the transformation of accounting practice value into dollars ultimately appearing in the seller's bank account.

Desired Deal Structure and Due Diligence

Sellers often do not achieve the purchase price and terms they desired because the wrong buyers were at the table from the beginning of the process. It is common for a seller to call a couple of respected local competitors to see if they would like to purchase the firm. Assuming these competitors respond favorably to the inquiry, the seller often has no idea what some buyers are willing to pay until near the end of the process ... after the buyer's due diligence is complete.

Allowing the buyer to perform due diligence prior to an offer is completely backwards and subjects the seller to potential problems. Many buyers who utilize this approach impose significant delays in making an offer over many months until just before the seller's busy season. Too late, the seller finds that the buyer is willing to offer nothing more than a low priced deal with a zero-cash-down "earnout" that is 100 percent contingent on collections from the clients of the firm being sold. Due to the timing of the buyer making the offer late in the year, such a seller often has two choices – accept the atrocious deal that has been offered or go through another busy season and attempt to sell the firm again next year.

When it comes to ensuring a favorable deal structure, a better process to determine which buyers should be at the table from a negotiating standpoint is as follows. First, multiple buyers should be identified – not just one or two. Multiple buyers provide a seller with crucial negotiating leverage throughout the process. This is one significant advantage of inserting a CPA practice broker into the process. In fact, most sellers do not have sufficient time to manage the CPA practice while concurrently performing an adequate and confidential promotion of the firm to find enough buyers to enable negotiating leverage.

Next, each buyer should be provided comprehensive disclosure related to the firm only after first signing a confidentiality agreement. If the information provided to potential buyers is comprehensive enough, each buyer will have adequate information to determine what they will be willing to pay for the practice, as well as the terms they are willing to offer.

The seller should conduct meetings only with the best candidates. Any candidate who verbally indicates that the deal would likely include a low cash payment and large contingency should be eliminated immediately. All buyers who are unwilling to issue a letter of intent prior to performing due diligence should also be removed from the process. The letter of intent should state the buyer's price and terms with three contingencies: due diligence, financing and the final definitive agreement.

Assuming that letters of intent are received from more than one qualified buyer willing to pay the seller's price and meet the seller's terms, the seller will be in the ultimate position of negotiating a superior deal for the sale of the firm.

Professional Qualifications

Selling a practice to a buyer who is not professionally qualified is a recipe for disaster. Optimally, the buyer of a CPA practice should have significant experience in the type of work the seller performs. The purchaser should possess the professional gravitas to elicit the immediate respect of the clients and to rise to the challenge of all technical aspects of the CPA firm being sold. This is true whether the buyer is a firm or an individual CPA.

If a buyer has significant professional qualifications, but lacks direct experience in certain highly specialized areas of the seller's practice, then a longer transition with the seller may be necessary. This allows time for the buyer to gain the specialized knowledge to retain the clients of the seller's practice, while providing the same high level of service.

People Skills

Most owners of successful CPA firms believe that the people side of the business is just as important as the technical side. Most accountants probably know at least one CPA who is an exceptional technician, but unfortunately has less than desirable people skills. Selling to a person who does not have good people skills can negatively affect employee and client retention. Fortunately, technical skills and people skills are not mutually exclusive.

When evaluating potential purchasers, a seller should consider whether each buyer has the people skills to elicit feelings of confidence and trust from the clients and employees. The ultimate buyer should make the clients and employees feel at ease and mesh well with the existing culture of the firm.

Excess Capacity to Perform the Client Work Required

It is quite common for a seller who is retiring to work part time for the buyer when so desired, while being paid by the buyer for billable work performed. Although such an arrangement is not required in many transitions, it can often help the transition process go smoothly.

It should be noted that selling a CPA practice should seldom include the seller performing billable work after the sale without compensation. In addition, the seller of an accounting firm should rarely consider a deal that would require the seller to perform the same level of work as before the sale – even when the seller is to be paid for billable work by the buyer. This type of deal almost always results in the seller making less money working for the buyer than the seller would have on his/her own.

The profit incentive necessary to make most deals work from the buyer's perspective is intertwined with the notion that the purchaser will be able to eliminate all or most of the compensation previously paid to the seller, coupled with the elimination of redundant overhead. In many situations, the buyer can reduce the redundant overhead between the two firms. Despite this fact, the redundant overhead elimination is rarely large enough for the buyer to profit from the transaction while paying the seller 100 percent of the compensation the seller was paid prior to the sale.

When elimination of excess seller compensation is a major goal of the buyer, it is clear that the buyer should have the inherent excess capacity to perform all or most of the work that the seller previously personally performed. The buyer's capacity should be analyzed in conjunction with the capacity that will be provided by the employees of the selling firm who will be employed by the buyer. Consideration must be given to the fact that most owners of CPA firms perform significant billable work that his/her current employees are not capable of performing on their own.

Occasionally, some deals falter because the buyer and/or seller overestimated the capacity of the buyer to complete the workload demanded by the seller's former clients. However, carefully selecting a buyer with adequate excess capacity will provide greater assurance that the sale and transition will be profitable for both the buyer and seller.

Financial Qualifications

One absolute truth in the M&A business that some sellers learn the hard way is as follows: The seller cannot receive significant cash at closing from a seemingly willing buyer if that buyer does not have the actual ability to pay significant cash at closing.

A seller should not tie up too much time with someone who says that he/she is willing to pay the seller's price and terms, but has not proven the ability to do so. Such buyers often irrationally hope for a miracle during the lending process. Others disingenuously intend to convince the seller to accept a lower percentage of cash later in the process.

The buyer should prove the ability to pay significant cash at closing early in the process prior to the seller accepting that buyer's letter of intent. Alternatively, the buyer should have the financial qualifications to obtain a bank loan for the purchase of the practice. Indicators of adequate financial qualifications for a bank loan would include possessing the bank-required down payment, sufficient working capital and qualifying credit score.

Despite a buyer's verbal and even written affirmations of willingness to pay the seller's price and terms, a buyer who is undercapitalized, or does not provide the seller proof of the wherewithal to obtain a bank loan, should be avoided.

All Criteria Crucial

Whether the buyer is a great fit for the seller's CPA practice will have a significant impact on client retention. As a result, the most important aspect of choosing any buyer is whether that buyer is adequately qualified to perform all technical aspects of the client work while using people skills that will build the interpersonal relationships of the seller's firm.

Regardless of such qualifications, sellers who have chosen a buyer who has little to no skin in the game often find such a buyer to lack the necessary "incentive to perform" when the going gets tough – resulting in the buyer potentially "cherry picking" the top clients while dismissing the remainder of the client list.

The key to choosing the right buyer should include determining whether that buyer meets all criteria identified above, in addition to any other criteria important to the specific practice being sold. A buyer who "fires on all cylinders" is more likely to be identified when a seller has many buyers to choose from early in the process. When the ideal buyer and deal structure has been identified and negotiated, client retention and profit derived from the sale can be maximized for the seller. ■

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What Have We Accomplished in Private Company Financial Reporting?

By Jeffrey S. Zanzig, Ph.D., CPA, and Dale L. Flesher, Ph.D., CPA

In the United States, there have been concerns for many years that the more complicated environment of the public company has resulted in development of accounting standards that place undue complexity on the financial reporting of private companies. In the last decade, concerns over this issue have resulted in much more than just talk. Significant actions have taken place to address what has come to be known as "Little GAAP" (Generally Accepted Accounting Principles).

In 2006, the accounting profession saw the creation of the Private Company Financial Reporting Committee (PCFRC) as a means to clearly demonstrate the commitment of the profession to consider GAAP issues for private companies. In addition, new non-GAAP alternatives for small- and medium-sized entities have been developed by both the American Institute of Certified Public Accountants (AICPA) and the International Accounting Standards Board (IASB).

While running for presidential office back in 1980, Ronald Reagan asked, "Are you better off than you were four years ago?" That phrase has since become a common question in many political campaigns. The accounting profession is surely asking a similar question: Are we better off than we were a decade ago?

Exhibit 1

Recent Events in Little GAAP Standard Setting

Date	Event
2006	Creation of the Private Company Financial Reporting Committee (PCFRC)
2009	Nationwide Listening Tour of the Financial Accounting Foundation (FAF)
2010	Creation of a Blue Ribbon Panel on Standard Setting for Private Companies
January 2011	Submission of Blue Ribbon Panel Report
March 2011	Working Group from FAF solicits further input from private company stakeholders
October 2011	Public Comment on Plan to Create the Private Company Standards Improvement Council (PCSIC)
May 2012	Creation of the Private Company Council (PCC)
December 2013	Issuance of Private Company Decision-Making Framework
November 2015	Three-Year Review of the Private Company Council – Final Report (FAF)

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Exhibit 2

Private Company Reporting Scenarios

Scenario	Reporting Option	Reasoning
Considering Going Public	GAAP with Private Company Options	Minimizes complexity for private companies while closely following the requirements for public companies.
Comprehensive Reporting	Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs)	Makes use of accrual accounting and historical cost measurement with only targeted financial statement disclosures (Durak, 2013).
Minimal Reporting	Other Comprehensive Bases of Accounting (OCBOA)	Cash basis, modified cash basis and income tax basis can work very well with stakeholders having higher levels of internal knowledge of the reporting company.

The purpose of this article is to consider some of the significant accomplishments in the last decade to better meet the financial reporting needs of the private company. To accomplish this objective, the remainder of this article will consider standard-setting accomplishments for private company GAAP, some private company considerations addressed in GAAP, the financial reporting choices facing the private company and some conclusions about what has been accomplished and what the future holds.

Standard-Setting Accomplishments for Private Company GAAP

The road to considering the views of private company stakeholders in the process of financial reporting has received significant attention and has resulted in a series of important developments in the last decade. Some of those events are summarized in Exhibit 1.

In a jointly sponsored effort by the Financial Accounting Standards Board (FASB) and AICPA, PCFRC was created in 2006 to provide recommendations to FASB in regard to both current and future reporting standards where private company GAAP may need to differ from that of public companies. Brackney and Mautz (2008) pointed out that at that time, "the formation of the PCFRC is, arguably, the most significant development to date in the long-running debate about private company reporting in the United States."

In 2009, the Financial Accounting Foundation (FAF) Board of Trustees sponsored a nationwide "listening tour" to consider views on the independent standard-setting process. This tour provided indications that many Americans felt that FASB was not responsive enough to PCFRC recommendations. A primary reason provided was that the two did not have an agreed upon framework to consider GAAP exceptions or modifications for private companies. Because of these concerns, the FAF Board of Trustees worked in conjunction with AICPA and the National Association of State Boards of Accountancy (NASBA) in 2010 to create a Blue-Ribbon Panel on Standard Setting for Private Companies.

In January 2011, the panel submitted its report to the trustees along with a recommendation that a new and separate standard-setting body be created with authority to provide exceptions or modifications to GAAP for private companies. This was followed by another outreach by a working group of FAF trustees and staff members in March 2011 to solicit further input from various constituents regarding private company financial reporting.

Many of the responses to this outreach made points in support of the Blue Ribbon Panel's recommendation for the establishment of a separate standard-setting board for private companies. In October 2011, FAF solicited public comment for a plan to create the Private Company Standards Improvement Council (PCSIC) "with the authority to identify, propose and vote on specific improvements to U.S. accounting standards for private companies." Any such changes would still be subject to a period of public comment and ratification by FASB (2012, FAF). In comparison to PCFRC, the creation of PCSIC would presumably allow for greater influence in regard to how FASB considered issues regarding private company financial reporting.

The Private Company Council

In May 2012, after careful consideration of the views expressed in the public comments regarding the proposed creation of PCSIC, the FAF Board of Trustees decided to create a body known as the Private Company Council (PCC) to replace PCFRC. To support PCC, the FASB technical director is to assign some of FASB's technical and administrative staff to PCC. Some of these staff serve in a dedicated role while others are to be assigned on an as-needed basis for technical expertise. Two primary responsibilities of PCC include:

1. To determine if exceptions or modifications should be made to GAAP to better meet the needs of the users of private company financial statements:
   a. Recommendations approved by PCC and endorsed by a simple majority of FASB are exposed for public comment.
   b. PCC considers the comments and takes a final vote. Approved recommendations move to FASB for a final decision.
   c. If FASB fails to endorse the recommended change, they are to provide PCC with a written response containing the reasons along with changes that could result in FASB endorsement. Any such response would become a FASB public record.
2. To serve as an advisory body to FASB in considering private company issues for items that are being actively considered in FASB's technical agenda:
   a. While FASB considers items in the technical agenda, PCC can vote to see if there is a consensus regarding private company recommendations for FASB consideration.
   b. Such recommendations are considered in FASB deliberations and must be separately documented as to how they were considered in their conclusions.

A Framework for Little GAAP Decision Making

Another one of the recommendations that arose out of the 2011 report of the Blue Ribbon Panel was that a decision-making framework should exist for considering private companies' issues in regard to establishing or modifying GAAP requirements. After consideration of significant input from various stakeholders, FASB and PCC issued an actual framework in December 2013 titled "Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting of Private Companies." The guide points out that its primary purpose is to determine "whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date and transition guidance for private companies reporting under U.S. GAAP."

Three-Year Review of the Private Company Council

In February 2015, FAF developed a "Request for Comment – Three-Year Review of the Private Company Council," generating 52 comment letters from private company stakeholders. After considering the feedback from this review, FAF issued a final report in November 2015 in which it concluded that "a majority of the stakeholders agreed that the PCC has been successful in addressing the needs of users of private company financial statements."

The FAF trustees also felt that the review indicated that targeted improvements could be made to increase the effectiveness of PCC "without significantly changing the PCC's roles and responsibilities." Some of these targeted improvements include:

1. As the need for a review of existing GAAP declines, PCC should shift more if its efforts to "provide input to FASB during deliberations that lead to a proposed or final standard – rather than developing a private company accounting alternative right after FASB issues a new standard."
2. A requirement that PCC proposals to FASB specifically mention the guide described in the prior section and "how the proposed alternative meets the criteria in the guide, and if it does not, why a departure from the guide is warranted."
3. To provide greater outreach to stakeholders, "PCC or a subset thereof should meet regularly (e.g., annually) with private company stakeholder organizations."
4. Both FASB and PCC should take steps to ensure that private company stakeholders are kept informed regarding "progress made on PCC projects, FASB's consideration of private company alternatives recommended by PCC and input PCC provides FASB on active FASB technical agenda projects."

Private Company Considerations in GAAP

Since the creation of PCC, a number of the GAAP requirements now allow specific considerations that reduce financial reporting complexity for private companies, but still allow them to be in compliance with GAAP. However, PCC does not always feel that the accounting issues brought to its attention should require options that deviate from the traditional GAAP for public companies.

Goodwill Amortization with Simplified Impairment Testing

GAAP requires that goodwill be tested at least annually for impairment and does not allow for amortization of the goodwill. In January 2014, FASB passed a provision allowing a private company to elect an alternative to amortize goodwill for a period of 10 years or less. Under this election, goodwill still is to be tested for impairment upon the occurrence of a triggering event indicating "that the fair value of an entity (or a reporting unit) may be below its carrying amount." This goodwill election assists private companies by removing the requirement for annual impairment testing (FASB Accounting Standards Update No. 2014-02).

Simplified Hedge Accounting for Certain Derivatives

Private companies have stated that many of them find it difficult to obtain fixed-rate borrowing. To deal with this issue, "some private companies enter into a 'receive-variable, pay-fixed' interest rate swap to economically convert their variable-rate borrowing into a fixed-rate borrowing." GAAP considers the swap to be a derivative instrument with the requirement that "an entity recognize all interest-rate swaps on its balance sheet as either assets or liabilities and measure them at fair value." In certain situations, entities can elect to make use of hedge accounting to minimize volatility on the income statement due to changes in the fair value of a swap.

A number of private companies have contended that hedge accounting is difficult to understand and that many of them lack sufficient expertise to meet its requirements. This often results in failure to elect hedge accounting and volatility of income statement results. In January 2014, FASB passed an update that allows "the use of the simplified hedge accounting approach to account for swaps that are entered into for the purpose of economically converting a variable-rate borrowing into a fixed-rate borrowing" (FASB Accounting Standards Update No. 2014-03).

Election to Not Consolidate an Entity Using Variable Interest Entities Guidance

GAAP requires that a company consolidate its financial statements with an entity that it has a controlling financial interest in. This could be indicated by "ownership of a majority of the entity's voting interests" or by applying variable interest entities (VIE) guidance. The VIE guidance indicates a controlling financial interest when a reporting entity "has both: (1) the power to direct the activities that most significantly affect the economic performance of the entity and (2) the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the entity."

In March 2014, FASB passed a provision allowing "a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity if (a) the private company lessee and the lessor entity are under common control, (b) the private company lessee has a lease arrangement with the lessor entity, (c) substantially all of the activities between the private company lessee and the lessor entity are related to leasing activities between those two entities and (d) if the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor entity." Under this election, certain disclosures by the lessee would provide information regarding the lessor entities without the complexity of applying VIE guidance (FASB Accounting Standards Update No. 2014-07).

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Election for Non-recognition of Certain Intangible Assets in a Business Combination

In December 2014, FASB passed an option for private companies to no longer have to recognize certain intangible assets separately from goodwill in a business combination. These certain intangible assets include "(1) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business and (2) noncompetition agreements" (FASB Accounting Standards Update No. 2014-18).

Lease Accounting Viewpoint

In a letter dated Dec. 2, 2013, PCC responded to an inquiry from FASB as to whether GAAP requirements for leases should be different for private companies. In this instance, PCC turned down an opportunity to create different rules for private companies.

The Choice for Private Companies

Recent developments provide support for the presumption that there are at least three primary types of scenarios in regard to private company financial reporting (see Exhibit 2).

In considering the development of their Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs), AICPA states that: Unlike the tax or cash bases of accounting, the FRF for SMEs framework has undergone public exposure and professional scrutiny and contains explicit and comprehensive accounting principles. These features result in a reliable and consistently applied financial framework.

So … Are We Better Off?

With the continuing development of private company options in GAAP and the FRF for SMEs, is the accounting profession better off than it was a decade ago? Only time can tell if the profession is on the right course. For the following reasons, it is believed that the profession is better off than it was a decade ago:

- Talk was turned into action with the creation of PCFRC. Although replaced by PCC, the profession learned from the experiences of its initial efforts to advise FASB.
- A Private Company Decision-Making Framework has been developed to consider private company exceptions or modifications to GAAP.
- Advisory bodies to FASB have been successful in getting private company considerations addressed in GAAP.
- FASB has agreed to respond to PCC within a reasonable timeframe. In addition, negative responses are to be accompanied by an explanation that opens the dialog to further discussion.
- A financial reporting void may well have been filled between the alternatives of OCBOA and GAAP financial reporting by recognizing the need for AICPA's non-GAAP alternative: Financial Reporting Framework for Small- and Medium-Sized Entities.

In addition, FAF and FASB are indicating that PCC is being viewed as a valuable addition to the standard-setting process. The 2013 FAF annual report contains the following statement: When the PCC puts an issue on the table, FASB has adopted a policy of considering whether the proposed change may make sense for public as well as private companies – along with not-for-profit organizations. We believe this will promote a continued focus on making GAAP simpler and easier to use for all (FAF Annual Report, 2013, p. 7).

Private companies are better off because they now have major input into the standard-setting process and if the above quote is any indication, all companies both public and private may be better off if FASB considers whether the private company exemptions might also be applicable to public companies. ■

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Transferring Ownership of Small, Closely Held Businesses

By Megan M. Burke, Donna Gossett and Daniel Haskin

Family-owned businesses account for a significant portion of the U.S. economy. Unfortunately, only about 30 percent of these businesses will make it into the hands of the second generation (Stalk and Foley). As the Baby Boomer generation reaches retirement age, an increasing number of small businesses face succession challenges.

While some family-owned businesses develop plans to transfer ownership and executive decision making to other family members, this is not a viable strategy for all small businesses. These firms will need to examine and implement strategies for transferring business ownership to external or internal buyers.

External Buyers

Low Return, Low Probability Options

When discussing succession planning and strategies, it is prudent to briefly mention liquidation and initial public offering (IPO). For small businesses, particularly those that are not profitable, liquidation offers owners a way to divest themselves of the business and pass on any assets while incurring modest losses. While liquidation may be the least complex of the transition options, the owner is unlikely to receive the full value of the business by selling individual assets and many employees will be without jobs. For owners who value loyalty or wish to see their business continue, liquidation is a poor, albeit always available, option.

At the other end of the spectrum, a business could explore the option of an IPO. Going public would allow the business to continue and result in a greater return than selling the individual assets in a liquidation, but not all firms are good candidates for a public offering, particularly small, family-owned businesses. The time and effort required of the management to demonstrate sufficient profitability and create market demand for an IPO, along with the prohibitive expenses associated with underwriting, reporting and accounting, make an IPO a complex and high-risk ownership transference strategy for the majority of small firms.

Between liquidation and an IPO, small business owners can consider an external sale to strategic or financial buyers, which would also allow the business to continue after the owner's departure. Strategic buyers are usually in the same industry and are interested in exploiting the benefits of synergies from technology, special skills, proprietary processes and customers, or creating economies of scale in processing and eliminating duplicate administrative duties. Financial buyers are typically private equity firms or high net worth individuals looking for a return on their investment.

Strategic Buyer

Potential synergies may lead strategic buyers to purchase the firm at a premium. The cost for the price premium is that trade secrets may be revealed to a competitor. This is especially problematic if the deal falls through. Additionally, a direct result of the synergies and economies of scale are the loss of jobs in redundant positions. Industry expertise of the buyer may decrease the complexity of, and time needed to, complete the due diligence process. However, these gains could be offset by the additional time required to arrange financing. Strategic buyers typically purchase 100 percent of the business in either cash or cash and stock of the purchaser's firm, and expect the owner to step down from all leadership roles. Owners who value loyalty of their employees and are hesitant to reveal trade secrets to competitors may wish to consider other buyers.

Financial Buyer

In contrast to strategic buyers, private equity firms are familiar with various valuation methods, due diligence and the closing process, which allows them to conduct the purchase rapidly. These firms also provide flexibility by allowing the owner to determine the role they want to have in their business after the sale. Some owners will want to retire completely from their business and others may want to remain active in a lesser role to transition leadership. Sale to a private equity firm allows the owner to retain an equity stake in the business, and retain a leadership role in some cases. Financial buyers provide discretion by allowing trade secrets to remain private. Whereas strategic buyers may offer a portion of the purchase price in stock, financial buyers may offer all cash.

The cost for added flexibility and discretion is that private equity firms may offer a price lower than what the strategic buyers would offer. However, this may be offset by larger gains related to the future sale of any retained ownership interest or earn outs. Many private equity firms require the new management and key managers to purchase stock in the business. This ownership requirement is a powerful motivator to care and succeed. As private equity firms bring a new perspective and management expertise to the business, the gains from any future sale could be significant.

The reputation of private equity firms has not fared well in the last several years. Private equity firms use higher debt levels in the capital structure of acquisitions and may over-leverage the business. In 2013, private equity firms took out $66.2 billion in dividend payments from acquired firms, which could have been reinvested in the business (Tan). Saddling companies with heavy debt, which is used to finance dividend payments to private equity executives, is one behavior tarnishing the image of private equity firms.

Private equity firms are also perceived as being a driving force for job reduction and elimination. A common practice in restructuring is to replace management and streamline or eliminate positions. This is especially true in cases where the business is not profitable or does not meet performance expectations. This perception of destroying jobs may not be fully deserved. *The Economist* reports direct employment losses two years after a private equity deal average 1 percent (*The Economist*). However, personnel changes and reductions are a common tactic of private equity firms to increase the profits of their investment.

Private-to-Private Transactions

A less known function of private equity firms is that of a market maker for private-to-private transactions (Siming). Evidence supports that stable businesses, referring to firms requiring few operational improvements, are being held for longer periods and offered to industrial buyers and other private equity firms (Siming). This market maker function is likely to increase as more Baby Boomer business owners retire or cash out of successful, ongoing businesses.

Business owners will have varying degrees of concern about how the business and employees fare after they exit. An external buyer causes additional investor oversight and results in outsiders being involved in management decisions. Proper seller due diligence should reveal the methods most commonly employed by the external purchaser to manage and increase business earnings. A seller should expect that the buyer will conduct extensive due diligence to investigate their business and the seller should reciprocate this effort. For those sellers who are invested in the livelihood of the business and its employees, a primary goal of this due diligence should be to inform them of the organizational changes that are most likely to occur after the closing.

It is important for the owner to understand the strategic plan for the business and employees before concluding the sale. Many small business owners will have a strong emotional attachment to complement their financial investment in the business. Having an understanding of this fact and facilitating owner due diligence will increase both the success and satisfaction level of a sale to external owners.

Internal Buyers

Owners with a strong management team in place who wish to reward loyal employees should consider selling to internal buyers. While selling the business to current employees may result in a lower price for the business, less due diligence is required, the business will continue beyond the owner, employees will not lose their jobs, the owner can transition the sale and maintain a management role, and trade secrets are not revealed to outside parties. Sales to internal buyers are also attractive if there are limited external markets for selling the company.

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Management Buyout

An owner can sell the business directly to the management team. However, not all businesses will have a management team or group of employees who are motivated to purchase the business. As mentioned previously, the sales price to current managers may be smaller than the price offered by a strategic buyer. Banks that fund loans for management purchases are typically quite conservative on credit underwriting. Employees who are serious about obtaining financing to purchase the business will have to make a significant investment of their own capital. Even for modest businesses, this investment could total between $250,000 to $1 million, depending on the size of the deal (Borkowski). The small business owner will often have to retain a position in the company for lenders to provide the financing for a management or employee group purchase.

Owners can also consider other ways to facilitate the financial ability of an employee team to purchase the company. Owners can arrange low interest rate loans to be repaid from future income. Few managers are entrepreneurs, and many are not willing to accept the high personal financial risk and exposure of an entrepreneur or do not have the funds available for a management buyout.

Although the owner may not be able to get the best price for the business in a sale to management or group of employees, there are other advantages. A direct sale to a group of employees avoids conflicts that often arise between management and outside buyers. The sale can be conducted more quietly and efficiently than a sale to an external buyer. This method of selling is appealing to owners with a strong interest in the future operation of the business and welfare of the employees.

Employee Stock Ownership Plans

The Employee Retirement Income Security Act of 1974 (ERISA) made Employee Stock Ownership Plans (ESOPs) available as qualified retirement plans. ESOPs allow the owner to sell a portion or all of their business interest. There are several tax advantages to the owner and employees to encourage employee ownership of businesses. The tax advantages and market creation for closely held stock are attractive ESOP features for small business owners. Additionally, ESOPs are a compelling option when the owner wants the firm to be controlled by loyal employees, but the management team lacks the resources for a management buyout.

ESOPs help align the interests of the employee and the owner. Research shows that ESOP companies are more productive and more profitable; they also have a higher survival rate (Bergstein). Additional studies found that businesses with shared-ownership plans showed strengthened employee loyalty, higher productivity and better survivability during the recent recession with fewer layoffs (Loten). Research reports overwhelmingly positive results over a 10-year period indicating that ESOPs appear to have increased sales and employment, and are more likely to be in business than non-ESOP companies (Blasi and Kruse). In addition to the ESOP, these firms are more likely to provide other retirement benefits for employees.

The ESOP is a trust that holds shares of stock purchased from, or contributed by, the business owner. This form of tax-qualified defined contribution retirement plan is exceptional in two ways. First, an ESOP invests primarily in the employer's common or convertible preferred stock; second, the leveraged ESOP is allowed to borrow money to purchase the stock. In a leveraged ESOP, the trust borrows money to purchase the shares from the owner. As related party loans are allowed with an ESOP, the company borrows the money from the bank and then loans the funds to the ESOP. In the future, the company will make tax-deductible contributions to the ESOP to repay the loan.

Internal Revenue Code (IRC) Section 4975 provides a tax exemption for the principal payments of qualified ESOP loans. Debt principal payments are generally not deductible for income tax purposes. This tax treatment allows the ESOP to be financed by pretax dollars and any dividends used to service the loan are tax deductible. An additional benefit for companies structured as S corporations is that ESOPs are tax-exempt trusts. Any income attributable to the shares held by the ESOP is exempt from the pass-through income tax.

In an ESOP, the stock is allocated to accounts for each employee and employees are able to contribute to the plan. Any employer-matching program can be completed with stock instead of cash. Upon retirement or exiting the firm, the ESOP will purchase the shares from the departing employee. This allows employees to have an ownership interest in the company, but they do not have control of the company. The employees will only have the right to vote in the event of a merger, liquidation, consolidation, recapitalization, dissolution or sale of substantially all of the company's assets (IRC Sec. 409(e)(3)). If the owner only sells a portion of their ownership interest to the ESOP, they will retain control of the business.

Similar to other retirement plans, employees are able to defer tax until they take a distribution from the plan. The employee can continue to defer tax on the distribution by rolling it into an IRA. ESOP transactions are stock sales, which qualify for capital gains treatment if the proceeds are not invested in an IRA. The ESOP is funded with employer stock by the owner, which means that typically the employee does not need to defer their regular salary to fund the retirement account.

Owners receive a number of benefits from an ESOP, as well. IRC Section 1042 allows the gain on the sale of stock to an ESOP of a C corporation to be deferred as long as the sales proceeds are invested in qualified replacement property, which are stocks or bonds of domestic operating companies. The sale of qualified replacement property will cause a taxable transaction, but if the replacement property is held until the death of the owner, the deferred gain would escape income taxation. The owner is also able to create liquidity while maintaining a controlling interest in the company.

ESOP Caveats

Creating and administering an ESOP is a complex process that requires the resources of lawyers, CPAs, financial planning advisors and independent valuation services, plus the appointment of an independent trustee. ERISA and the IRS place a myriad of compliance duties on the ESOP and the sponsoring business, such as the rules regarding investing options, participant allocation, coverage, nondiscrimination, put options, appraiser independence, and general fiduciary and bonding (IRC Secs 401, 409, 410, 4975, Reg. 54.4975, ERISA, DOL Reg. 29 C.F.R. Sec 2550-408). The costs, compliance issues and complicated administration of an ESOP require a strong desire and commitment of the owner to execute this option.

Critics of the ESOP method of employee ownership charge that many of the plans are based on bloated assessments of the value of the business. Employees also assume significant risk through lack of diversification if an ESOP is their only retirement plan. The ESOP owns shares of the employer, so not only is there a single stock in the retirement plan, but this is also the source of employment. If the company fails, the employee sees a reduction in retirement assets and their employment. In a prime example of this, the retirement accounts of Enron's employees became worthless overnight, causing a great deal of financial difficulties for retirees who relied on those plans as their sole source of income.

An additional issue for an owner to consider before creating an ESOP is that they are not likely to get the highest value for the business. The share price is set by an independent valuation at inception and on an annual basis (How an Employee Stock Ownership Plan Works). This share price is likely less than what the owner would assess or would be offered by a strategic buyer. For an ESOP to be a viable option, the owner must possess a strong desire to reward loyal employees and accept a lower price.

By law, the company must purchase the employee's allocated shares when the employee leaves the company or retires. This requirement could jeopardize a business if many employees retire at the same time and the company is unable to purchase all of the shares. Companies that are not able to meet the purchase requirement face legal sanctions.

In addition, the expenses associated with setting up an ESOP are substantial. The National Center for Employee Ownership estimates costs of $40,000 for the simplest of plans in small companies (How an Employee Stock Ownership Plan Works).

Different Strategies, Different Advantages

The continuation and succession of a business require a great deal of effort and planning to succeed, and there are several strategies available to business owners. Regardless of which strategy is chosen, a successful succession of any firm will address several fundamental issues, most notably the transfer of ownership. The need for facilitators of this transfer of ownership will increase as Baby Boomer generation business owners reach retirement age and require succession plans or divestment options.

There are several strategies available to transfer ownership, typically involving an external or internal buyer. Business size and resources will limit or exclude some of the ownership transfer options available to larger businesses and corporations.

The sale of a firm is frequently a complex transaction with short- and long-term consequences. Many small business owners have most of their net worth tied to the business, and there are many financial and emotional considerations to address in the process of a sale.

The financial, estate and retirement planning factors, as well as complex tax consequences, require consulting skilled advisors before beginning any sale negotiation. Providing adequate consideration of all factors will lend itself to giving better advice, increasing the satisfaction with the results of the transfer of ownership and supplying valuable knowledge during the valuation processes. ■

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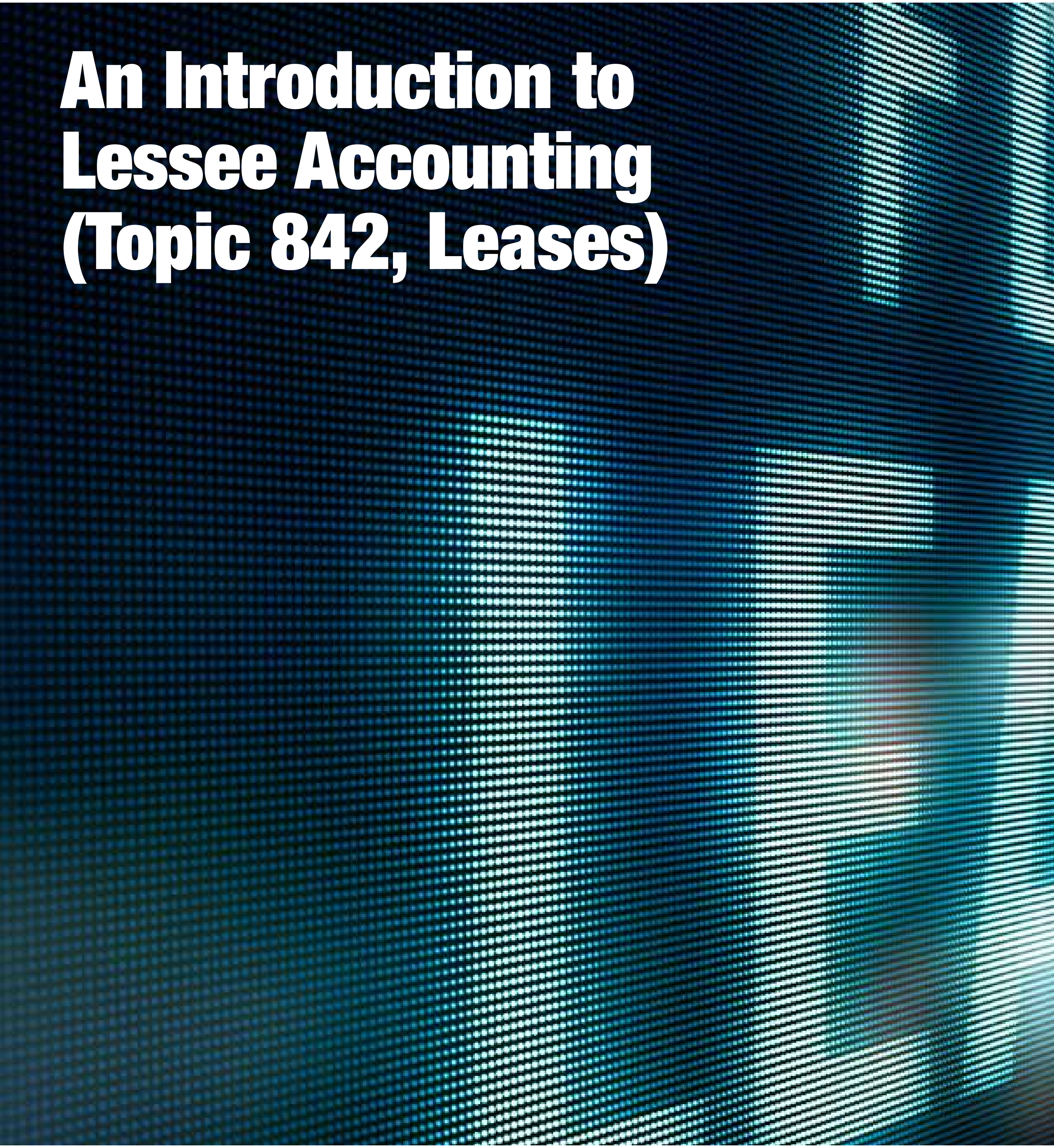
An Introduction to Lessee Accounting (Topic 842, Leases)



Curriculum: Accounting and auditing

Level: Basic

Designed For: Public practitioners and business and industry

Objectives: To provide an introduction to lessee accounting under the new FASB guidance (ASC 842)

Key Topics: Lessee accounting and presentation of financial statements

Prerequisites: None

Advanced Preparation: None

By Josef Rashty and John O'Shaughnessy

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*. The International Accounting Standards Board (IASB) issued its own version of lease accounting earlier (IFRS 16). Although the project was a convergence project, and FASB and IASB (the Boards) conducted joint deliberations, the two standards contain several notable differences. Topic 842 will supersede the existing lease guidance (Topic 840), which has been in effect since 1977.

Under the new standards, both FASB and IASB guidance now require lessees to reflect virtually all leases on their balance sheets and to recognize the expenses from lease contracts in earnings. Since the primary objective of the convergence project was to address "off-balance-sheet" treatment of operating lease obligations by lessees, it appears that the project has been successful in that regard. However, as it will be discussed in this article, the Boards have chosen divergent expense recognition models for lessees.

The task of eliminating off-balance-sheet leases was not trivial and the Boards went through several iterations to achieve that objective. In its November/December 2011 issue, *Today's CPA* published an article on lessee accounting based on the exposure draft, "The Ever-

continued on next page

Changing Lease Exposure Draft" (Rashty and O'Shaughnessy). There are notable differences between the guidance in the exposure draft and the standard that was finally approved. This article is thus an update of the earlier publication.

Definition of a Lease Contract

A lease contract principally gives a customer the right to control the use of the underlying asset for a period of time in exchange for consideration (ASC 842-10-15-3). In a lease contract, a lessee has both of the following characteristics (ASC 842-10-15-4):

- The right to obtain substantially all of the economic benefits from use of the underlying asset.
- The right to direct the use of the underlying asset.

An entity is required at the outset to determine if a contract is or contains a lease agreement, and to reassess its status only in the event of modifications to the contract.

The following lease agreements are not within the scope of the new lease guidance (ASC 842-10-15-1):

- Leases of intangible assets.
- Leases to explore for, or use of, minerals.
- Leases of biological assets.
- Leases of inventory.
- Leases of assets under construction.

Therefore, ASC 842 has diverged from ASC 840 by stating that leases convey the right to control the property rather than the right to use the property. Thus, if control does not exist, a lease does not exist either under the new guidance regardless of the extent of the use of the property. The concept of control in ASC 842 is very similar to the concept of control in the new revenue recognition guidance (ASC 606).

The Major Difference Between FASB and IASB Guidance

FASB and IASB both agreed on the key issue that lessees must reflect lease obligations in their balance sheets. However, IASB decided on a single model of recognition for lessees, while FASB adopted a dual model. Under FASB's model, lessees account for the majority of existing capital leases as finance leases, whereas most operating leases will be accounted for as new operating leases. This is in contrast with IASB's adopted model and the earlier version of lease exposure draft that requires lessees to account for all their leases as finance leases.

Key Provisions of FASB's Model

Lessees are required to recognize a right-of-use (ROU) asset and a lease liability on their balance sheets for virtually all lease obligations (with the exception of short-term leases). Under the new guidance, a lessee can elect (by asset class) not to reflect on its balance sheet a lease whose term is 12 months or less and that does not contain a purchase option that the lessee is reasonably certain to exercise.

FASB has adopted a dual model in lessee accounting that requires leases to be classified as operating or finance leases. Finance leases under Topic 842 (the new standard) are categorically no different than capital leases under Topic 840 (the existing standard). However, there are some differences in their treatments; for example, as will be discussed later in this article, the classification guidance for finance leases are to some extent different than capital leases, but the basic accounting premise remains the same for capital leases under the existing standard and finance leases under the new standard. Operating leases reflect lease expenses on a straight-line basis (similar to operating leases in existing guidance), whereas finance leases will result in front-loaded lease expenses (similar to current capital leases in existing guidance).

The standard is effective for public companies for fiscal years (and interim periods within those fiscal years) beginning after Dec. 15, 2018. For private companies, the standard is effective for fiscal years beginning after Dec. 15, 2019 (and interim periods beginning the following year). The standard permits early adoption and requires use of a modified retrospective transition method.

The new standard also requires extensive quantitative and qualitative disclosures, and discussion of the judgments that management has exercised for adoption of a particular accounting policy. The classification of leases into operating and finance leases under the new guidance is based on certain criteria that are similar to existing lease guidance, but the new standard lacks any bright lines.

Lease Classification

The current standard (ASC 840-10-25-1) requires that lessees consider whether a lease meets any of the following criteria as part of classifying the lease at its inception into a capital or operating lease:

1. The lease transfers ownership of the lease item to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease term is equal to 75 percent or more of the estimated economic life of the leased item.
4. The present value of the minimum lease payments (with certain exceptions) at the beginning of the lease term equals or exceeds 90 percent of the excess of the fair value of the leased item to the lessor at lease inception (with certain exceptions).

However, the new guidance (Topic 842) has eliminated the bright line criteria in (3) and (4) above and has replaced the above criteria with the following five subjective guidelines (ASC 842-10-25-2):

1. The lease agreement transfers ownership of the underlying asset to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset and the lessee is reasonably certain that it will exercise the option.
3. The lease term covers the major remaining economic life of the underlying asset.
4. The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset.
5. The underlying asset has such a specialized nature that is expected to have no alternative use to the lessor at the end of the lease.

The objective of ASC 842 is to ensure that the control of the underlying asset is transferred to the lessee, and the lessee has the

Exhibit 1. The Different Lease Accounting Models Under Existing and New Guidance

	ROU	Liabilities	Lease Expenses	Amortization Expense	Finance Charges	Total
Operating leases (ASC 840)						
Inception	- (1)	- (2)	-	-	-	-
First year	-	-	$12,000 (3)	-	-	$12,000
Second year	-	-	$12,000 (3)	-	-	$12,000
Third year	-	-	$12,000 (3)	-	-	$12,000
Capital leases (ASC 840)						
Inception	$33,036 (4)	$33,036 (4)	-	-	-	-
First year	$22,024 (6)	$22,563 (5)	-	$11,012 (6)	$1,527 (7)	$12,539
Second year	$11,012 (6)	$11,619 (5)	-	$11,012 (6)	$1,056 (7)	$12,068
Third year	-	- (11)		$11,012 (6)	$381 (7)	$11,393
Finance leases (ASC 842)						
Inception	$33,036 (4)	$33,036 (4)	-			
First year	$22,024 (6)	$22,563 (5)	-	$11,012 (6)	$1,527 (7)	$12,539
Second year	$11,012 (6)	$11,619 (5)	-	$11,012 (6)	$1,056 (7)	$12,068
Third year	-	- (11)		$11,012 (6)	$381 (7)	$11,393
Operating leases (ASC 842)						
Inception	$33,036 (4)	$33,036 (4)	-	-	-	-
First year	$22,563 (9)	$22,563 (9)	$12,000 (3)	-	-	$12,000
Second year	$11,619 (10)	$11,619 (10)	$12,000 (3)	-	-	$12,000
Third year	- (11)	- (11)	$12,000 (3)	-	-	$12,000

(1) Assets are not reflected on the balance sheet.
(2) Liabilities are disclosed as off-balance-sheet items.
(3) Monthly lease payments under the lease agreement.
(4) Discount value of the total monthly lease payments.
(5) Inception year discount value of $33,036 less subsequent effective interest amortization.
(6) Annual straight-line three-year amortization.
(7) Effective interest rate calculation.
(8) First year discount book value of $22,024 less $11,012 annual straight-line amortization.
(9) Inception discount value of $33,036 less principal amortization of $10,472 (present value calculation not shown).
(10) First year discount book value of $22,563 less principal amortization of $10,944 (present value calculation not shown).
(11) Second year discount book value of $11,619 less principal amortization of $11,619 (present value calculation not shown).

risks and rewards of ownership. Even though FASB has eliminated the bright lines in ASC 840, it does not necessarily prohibit an entity from applying them within the framework of the new guidance.

Lessee Accounting

The lessee at the commencement of a lease reflects the following under the new guidance (Topic 842):

- A liability for its lease obligation measured based on the present value of the future lease payments not yet paid. The lessee uses the effective interest method to subsequently account for lease liability.
- An asset representing the right to use the underlying asset (i.e., right-of-use asset or ROU) and is initially equal to the lease liability. ASC 842 provides for two approaches for amortization of ROU: the finance lease approach and the operating lease approach. The determination of which approach to use is based on the criteria discussed earlier.

ASC 842 financing leases have the potential for being more front-end loaded compared to the ASC 840 capital leases, due to the criteria used for determination of lease terms. ASC 840 capital leases use the initial lease term for capitalization and each new lease option initiates a new lease. ASC 842 finance leases use the most probable lease option for the term used in the initial capitalization of the lease. Therefore, ASC 842 finance leases potentially can

continued on next page

Exhibit 2. Impact of Different Lease Transactions on the Statement of Cash Flows

Type of Leases	Transactions	Impact on Statement of Cash Flows
All leases	ROU and lease liability recognition at the inception of the lease	• Are not reflected on the statement of cash flows, but are disclosed as footnotes to the statement of cash flows.
Operating leases (ASC 840)	Lease expenditures	• Are reflected in the operating activities section of the statement of cash flows.
Capital leases (ASC 840)	Amortization expenses Interest charges Principal payments	• Are added back to net income as non-cash expenditures as part of the operating activities section of the statement of cash flows. • Are reflected in the operating activities section of the statement of cash flows. • Are reflected in the financing activities section of the statement of cash flows.
Finance leases (ASC 842)	Amortization expenses Interest charges Principal payments	• Are added back to net income as non-cash expenditures as part of the operating activities section of the statement of cash flows. • Are reflected in the operating activities section of the statement of cash flows. • Are reflected in the financing activities section of the statement of cash flows.
Operating leases (ASC 842)	Reduction in ROU and lease liability	• Are not reflected on the statement of cash flows, but are disclosed as footnotes to the statement of cash flows.

capitalize a longer stream of lease payments over a longer period of lease terms. As a result, ASC 842 leases may become more front-loaded than ASC 840 capital leases.

Finance leases use the effective interest method for attrition of lease liabilities and straight-line method for amortization of ROUs. Operating leases, on the other hand, use the effective interest method for attrition of lease liabilities, and determine the ROU amortization based on the difference between lease expense and interest expense on a given lease obligation. However, when lease expenses equal lease payments (i.e., lease payments do not change through the term of the lease), the amortization of ROUs equals the effective interest method attrition of the lease liabilities.

Illustration

Exhibit 1 compares and contrasts the four different lease accounting models under the existing and the new guidance.

In Exhibit 1, the lessee enters into a three-year lease agreement and agrees to make a monthly payment of $1,000 a month to the lessor. The initial measurement of the ROU and lease liability to make the lease payments at a discount rate of 6 percent per year is $33,036. The objective of this illustration is to reflect the financial impact of different classifications of the same contract (of course, in practice a lease agreement can only be classified as one category).

Exhibit 2 reflects the impact of different lease transactions in the four lease models of Exhibit 1 on the statement of cash flows (assuming an indirect method presentation).

An Overview and Introduction Only

There are significant judgments involved in selection of a specific lease model under Topic 842. Each model impacts the financial statements of lessees differently and significantly. In this article, the authors provided an overview and introduction to FASB's new guidance. There are many details and fine points that were intentionally left out of the article, as they did not deem to be within the scope of, and relevant to, an introductory article.

In most instances, operating leases under Topic 840 can be classified as operating leases under Topic 842 and capital leases under Topic 840 can be classified as finance leases under Topic 842. However, since the bright lines under Topic 840 have been replaced by subjective judgments under Topic 842, it is quite plausible that leases may receive cross-classification treatment during implementation.

Even though the effective date of the guidance is a few years away, and it may even be possibly further delayed, it is important that companies start planning for implementation of the new guidance as soon as possible, due to its complexity and potential significant impact on the financial statements of the reporting entities. ■

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By Josef Rashty and John O'Shaughnessy

An Introduction to Lessee Accounting (Topic 842, Leases)

1 The article claims that the primary objective of the lease convergence project was to:

A. Address the "off-balance-sheet" treatment of lease obligations.
B. Identify operating leases.
C. Eliminate capital leases.
D. None of the above.

2 The criterion for a lease contact under ASC 842 is to:

A. Identify who carries the risks and rewards.
B. Transfer the risk and reward from lessor to lessee.
C. Give the customer the right to control the underlying asset.
D. Benefit the lessor rather than the lessee.

3 Leases of inventory items are within the scope of ASC 842:

A. On some instances.
B. If lessor elects them to be.
C. If lessee elects them to be.
D. None of the above.

4 The FASB model (ASC 842) adopts _________ for recognition of operating leases or finance leases by lessees.

A. A single model.
B. A dual model.
C. Both (a) or (b).
D. Neither (a) or (b).

5 Lessees are required to recognize a right-of-use (ROU) on their statement of earnings, but a lease liability on their balance sheets.

A. True.
B. False.

6 Under Topic 842, finance leases:

A. Are similar to the existing ASC 840 operating leases.
B. Result in straight-line lease expenses.
C. Are similar to the existing ASC 840 capital leases.
D. None of the above.

7 Which of the following is false?

A. IASB decided on a single model of recognition for lessees, while FASB adopted a dual model.
B. IASB's adopted lease model requires lessees to account for all their leases as finance leases.
C. An earlier version of lease exposure draft required lessees to account for all their leases as finance leases.
D. None of the above is false.

8 Under existing criteria (Topic 840), one of the criteria for capitalizing a lease is, "The present value of the minimum lease payments (with certain exceptions) at the beginning of the lease term equals or exceeds 90 percent of the excess of the fair value of the leased item to the lessor at lease inception." A similar criterion exists in the new guidance (Topic 842), "The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset."

A. True.
B. False.

9 ASC 842 finance leases use the most probable lease option for the term used in the initial capitalization of the lease. This contrasts with the existing ASC 840 capital lease whereby the initial lease term is used for capitalization and each new lease option initiates a new lease. As such, ASC 842 finance leases potentially can capitalize a longer stream of lease payments over a longer period of lease terms and as a result, may become more front-loaded than ASC 840 capital leases.

A. True
B. False

10 Which of the following is false regarding Topic ASC 842?

A. Operating leases use the straight-line method for attrition of the lease liability.
B. Finance leases use the effective interest method for attrition of the lease liability.
C. Finance leases use the straight-line method for amortization of the ROU.
D. Operating leases determine the ROU amortization based on the difference between the lease expense and the interest expense on the lease obligation.

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After completing the exam, please mail this page (photocopies accepted along with your check to: Today's CPA; Self-Study Exam: TSCPA CPE Foundation Inc.; 14651 Dallas Parkway, Suite 700; Dallas, Texas 75254-7408. TSBPA Registered Sponsor #260.

Answers to last issue's self-study exam: **1. C 2. A 3. C 4. B 5. B 6. B 7. D 8. D 9. A 10. A**

TSCPA CPE COURSE CALENDAR - DECEMBER AND JANUARY CPE COURSES

To learn more and register, go to the CPE section of the website at tscpa.org or call the TSCPA staff at 800-428-0272 (972-687-8500 in Dallas) for assistance.

Date	Course	CPE Credit	City
Dec. 1, 2016 - Dec. 2, 2016	2016 CPE EXPO Conference	20	Houston
Dec. 2, 2016	Personal and Professional Ethics for Texas CPAs	4	Dallas
Dec. 5, 2016 - Dec. 6, 2016	2016 CPE EXPO Conference	20	Arlington
Dec. 7, 2016	Group Webcast: Annual Tax Update	8	Various
Dec. 8, 2016 - Dec. 9, 2016	2016 CPE EXPO Conference	20	San Antonio
Dec. 9, 2016	Top Tax Issues for Partnerships and LLCs	8	Houston
Dec. 12, 2016	Fiduciary Income Tax Returns-Form 1041 Workshop	8	Dallas
Dec. 12, 2016	Tax Considerations and Consequences for Closely Held Businesses	8	Houston
Dec. 13, 2016	The Casual Tax Preparer: 1041 Forms Update for 2016	8	Dallas
Dec. 13, 2016	How to Make LLC and Partnership Allocations	8	Fort Worth
Dec. 13, 2016	International Taxation	8	Houston
Dec. 14, 2016	Fiduciary Income Tax Returns-Form 1041 Workshop	8	Houston
Dec. 15, 2016	The Casual Tax Preparer: 1040 Forms Update for 2016	8	Houston
Dec. 15, 2016	Tax Considerations and Consequences for Closely Held Businesses	8	Dallas
Dec. 16, 2016	International Taxation	8	Dallas
Jan. 4, 2017	Federal Tax Update	8	Midland
Jan. 9, 2017	Individual Income Tax Update	8	San Antonio
Jan. 9, 2017	How to Make LLC and Partnership Allocations	8	Dallas
Jan. 10, 2017	S Corporation, Limited Liability and Partnership Update	8	San Antonio
Jan. 10, 2017	Preparing Individual Tax Returns for New Staff and Paraprofessionals	8	Dallas
Jan. 11, 2017	Tax Forms Boot Camp: LLCs, Partnerships and S Corporations	8	Dallas
Jan. 12, 2017	Individual Income Tax Update	8	Houston
Jan. 12, 2017	Personal and Professional Ethics for Texas CPAs	4	Austin
Jan. 13, 2017	S Corporation, Limited Liability and Partnership Update	8	Houston
Jan. 13, 2017	Annual Federal Tax Update	8	Wichita Falls
Jan. 13, 2017	Top Tax Issues for Partnerships and LLCs	8	Fort Worth
Jan. 16, 2017	Individual Income Tax Update	8	Austin
Jan. 16, 2017	Advanced Individual Income Tax Return Issues	8	Houston
Jan. 17, 2017	S Corporation, Limited Liability and Partnership Update	8	Austin
Jan. 17, 2017	Preparing Individual Tax Returns for New Staff and Paraprofessionals	8	Houston
Jan. 17, 2017	Advanced Individual Income Tax Return Issues	8	Dallas
Jan. 18, 2017	Tax Forms Boot Camp: LLC, Partnerships and S Corporations	8	Houston
Jan. 19, 2017	Top Tax Issues for Partnerships and LLCs	8	Dallas
Jan. 23, 2017	Individual Income Tax Update	8	Fort Worth
Jan. 23, 2017	Personal and Professional Ethics for Texas CPAs	4	Dallas
Jan. 24, 2017	S Corporation, Limited Liability and Partnership Update	8	Fort Worth
Jan. 24, 2017	Personal and Professional Ethics for Texas CPAs	4	Houston
Jan. 26, 2017	Individual Income Tax Update	8	Dallas
Jan. 27, 2017	S Corporation, Limited Liability and Partnership Update	8	Dallas


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Positions Available

Rio Grande Valley CPA firm is currently seeking 2 senior tax managers/tax partners for their Valley offices. Please email resume to HRforCPAs@gmail.com.

TAX MANAGER

North Dallas - $250,000 firm serving small business. Take over ownership as sole proprietor retires. Reply to movingup15@gmail.com.

STAFF ACCOUNTANT – DALHART, TEXAS

Firm in a small town in the Texas Panhandle. This job will provide you with a variety of experience in public accounting. You will be preparing federal and state tax returns. Other jobs will include working in QuickBooks to prepare financial statements and tax trial balances. You will be preparing payroll, sales and franchise tax returns. You will also be paying bills and doing bookkeeping for clients. BBA in Accounting or Business with a minor in Accounting. Tax, QuickBooks and Microsoft Office experience a plus. Good computer skills. Excellent oral and written communication skills. Experience in Ultra Tax a plus. Please fax or email your resume with a cover letter and salary requirements to 806-244-7202 or bdcpa@braggdavison.com.

Rapidly growing CPA firm located in the expanding area of southwest Austin wants to hire a tax manager for tax season 2017. Applicant must have 7 to 10 years of experience in review of tax returns, tax planning and non-audit financial reporting engagements. The candidate must be a CPA with a history of proven problem solving. If the candidate is successful at performing all duties and responsibilities during tax season, retirement-minded owner wants candidate to continue managing daily operation with an option to purchase firm after a period of proven success. Please respond with a detailed resume and salary history. Reply to austintaxprofessional@gmail.com.

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$842,000 gross. Central TX CPA firm. Accounting (21%), tax (65%), audit/review/consulting (21%), continued staff and owner involvement to ensure client retention. TXC1060

$343,000 gross. Lufkin CPA firm. Tax (54%), accounting services (46%), high-quality client base, good fee structure, knowledgeable staff in place. TXN1389

$48,000 gross. East Ft. Worth tax firm. Individual and business client base offers opportunity for expansion of services and growth through referrals. TXN1390

$100,000 gross. Weatherford CPA firm. Tax (90%), accounting/bkkpg (10%), loyal client base, experienced staff in place. TXN1391

$83,000 gross. Euless tax and ins. business. Priced to sell below 1xgross! 67% tax, 33% insurance commissions, convenient high-traffic area, loyal client base. TXN1415

$250,000 gross. Van Zandt Co. tax and accounting firm. Stable, loyal client base, primarily tax, but plenty of expansion opportunity. Ideal starter practice. TXN1418

$178,000 gross. Allen CPA firm. 90% derived from monthly bookkeeping and accounting services, year-round cash flow, quality client base. TXN1419

$400,000 gross. McKinney bookkeeping. Strong fee structure, cash flow over 60%, desirable DFW location, turn-key or portable locally. TXN1421

$339,000 gross. SW Dallas suburb CPA firm. Tax 55%, accntng 26%, P/R, franchise and misc. services 13%, reviews 5%, good fee structure and cash flow 54%. TXN1422

$633,000 gross. N. Dallas CPA firm. Accounting (43%), tax (64%), strong fee structure, cash flow near 50%, staff in place, capacity for growth. TXN1423

$160,000 gross. NE TX CPA firm. Tax 45%, accounting 44%, high-quality client base, sold fee structure and tenured staff in place. TXN1424

$216,000 gross. Ft. Worth CPA firm. Nearly 90% derived from monthly accounting services, solid fee structure, location flexible in or around Ft. Worth area. TXN1426

$164,000 gross. NE Dallas CPA firm. Predominately income tax services, loyal client base, strong fee structure and cash flow about 60%, turn-key operation. TXN1427

$283,000 gross. N. Dallas tax firm. Primarily tax work w/light accounting, relatively portable in or around north Dallas, first-rate client base, room to grow. TXN1429

$426,000 gross. Plano CPA firm. Tax 72%, accounting 20%, tax planning/consulting 8%, tenured staff and strong fee structure in place, turn-key opportunity. TXN1431

$1,081,000 gross. W. of Ft. Worth CPA firm. Business tax and accounting 70% of revenues, 60% of total from bkkpg, P/R, and misc. svs., cash flow near 50%. TXN1432

$149,214 gross. East Texas CPA firm. Tax (69%), accounting (31%), quality client base and staff available to assist with smooth transition. TXS1161

$365,800 gross. Near downtown Houston accounting firm. Tax (39%), bkkpng (37%), payroll (11%), other (13%), flexible transition. TXS1174

$1,171,000 gross. W. Houston tax and acctng. IRS svcs (93%), tax (6%), bkkping (1%), staff in place, location available, but also portable after sale. TXS1177

$226,000 gross. Orange Co. CPA firm. Tax 70%, bkkpng 20%, reviews/consult/payroll 10%, support staff in place and seller available to assist with transition. TXS1180

$32,600 gross. Corpus Christi accounting firm. Accounting 74%, tax 26%, part-time operation, low overhead expenses, portable within Corpus or nearby. TXS1184

$475,000 gross. W. Houston CPA firm. Tax 55%, accounting 25%, audit/reviews 20%, strong staff in place, good fee structure and cash flow, ideal starter practice. TXS1187

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