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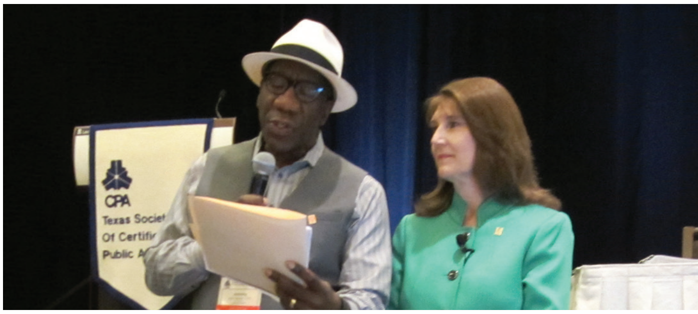

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# The Centennial Year

*Editor's Note: In the final* Today's CPA *issue of TSCPA's fiscal year, Chairman **Allyson Baumeister**, CPA-Fort Worth, takes a look back at 2015-2016.*

**By Allyson Baumeister**, CPA | 2015-2016 TSCPA Chairman

It was my pleasure to serve as TSCPA chairman during the Society's centennial anniversary year. It was on a late-October day in 1915 that TSCPA was formed by a small group of CPAs dedicated to establishing and protecting their profession. This 100-year anniversary is indeed a significant accomplishment. The 2015-2016 year was filled with a number of activities that commemorated our anniversary.

One of the real highlights of serving as your chairman was being able to travel and meet with members throughout Texas. It was great to see old friends and colleagues. I've been impressed by the energy coming from the TSCPA chapters. Wherever I traveled, I saw CPAs with a strong commitment to their profession.

TSCPA's leadership and volunteers continued this year to diligently focus and advance the objectives of the Strategic Plan. The objectives include: Professional Competency; Career Success; Advocacy; Culture and Community; and Organization Excellence. Following is a summary of some accomplishments that supported the Strategic Plan objectives.

> "MOST OF ALL, I WANT TO THANK EACH OF YOU FOR GIVING ME THE OPPORTUNITY TO SERVE AS YOUR TSCPA CHAIRMAN."

An important and influential aspect of TSCPA as an organization is the strength of our voice when representing the CPA profession to legislative and regulatory bodies. The Society's governmental affairs achievements included work at the state and national levels to protect the CPA certificate in Texas. Several TSCPA committees and the CPA-PAC completed advocacy activities throughout the year.

A new initiative was the proposed joint venture between AICPA and CIMA. AICPA and CIMA created the Chartered Global Management Accountant (CGMA) designation in January 2012 to assist with the needs of CPAs who work in business and industry. Last October, AICPA Council voted to join forces with CIMA and expand the availability of the CGMA credential in the U.S. to qualified non-CPAs who satisfy specified education, examination and experience requirements. In January, the TSCPA Board of Directors adopted a resolution supporting the expansion of the joint venture and approved a new affiliate member category called the Non-CPA CGMA Affiliate.

The Young and Emerging Professionals Committee sponsored the first-ever TSCPA Day of Service in 2015. The committee has plans to promote a month of service later in 2016. These service opportunities show the commitment of the young CPAs to have a positive impact on the communities in which they live and work.

In the area of recruitment and retention, TSCPA's programs welcomed new licensees to the organization and placed emphasis on the various segments of the membership in their respective areas of accounting practice. Student membership programs also remained important as we look toward the future of the profession.

The CPE Foundation continued to provide timely, quality and convenient education. Live conferences and seminars are offered, and hundreds of programs are available online and through other formats. We also continued to provide the popular free professional issues webcasts. These webcasts cover the latest issues facing the accounting profession while giving participants two hours of CPE credit.

For more information and an overview of the year's accomplishments supporting the Strategic Plan objectives, be sure to read "TSCPA's 2015-2016 Year in Review," which is our cover story in this issue of *Today's CPA*.

Most of all, I want to thank each of you for giving me the opportunity to serve as your TSCPA chairman. TSCPA has such a super group of volunteers I'm proud to call friends who do so much for our members. Without this community of Texas CPAs, TSCPA would not be able to continue its work to offer programs and services that we need for the next 100 years and beyond. I feel fortunate to have worked with such an outstanding team. ■

**Allyson Baumeister, CPA** can be contacted at allyson.baumeister@CLAconnect.com.

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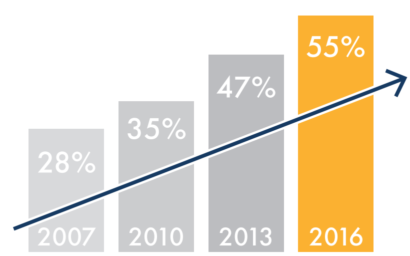


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# Internet Tax Freedom: State Taxation and the Internet

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

On Feb. 24, 2016, President Obama signed into law the Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA), which permanently bans state and local jurisdictions from imposing taxes on Internet access or imposing multiple or discriminatory taxes on electronic commerce. The act made permanent a temporary moratorium on such taxes that has been in place – thanks to multiple short-term extensions – since the Internet Tax Freedom Act of 1998 (ITFA). Notably, the new act phases out a "grandfather" clause that has protected a handful of states (Texas is among them), allowing those states to tax Internet access despite the general ban against such taxes. Under TFTEA, that right will be phased out by June 30, 2020, and states like Texas (in fact, Texas more than any other state) will feel the tax-revenue impact.

While the act furthers many important goals, like ensuring that low-cost Internet access is available to low-income households, the permanent extension of ITFA's ban against state and local taxes on Internet access also challenges the principle that states should be free to determine their tax bases (so long, of course, as they stay within constitutional bounds). Federal prohibitions like ITFA, which remove an entire tax base from state taxation – generally as an exercise of Congress's "Commerce Clause" authority – are actually quite rare, and they implicate the delicate balance of power between the federal and state governments.

The extension of ITFA may also give rise to some interesting tax disputes in the future. For example, traditional telecommunications services are generally fair game for state taxation. And they are a significant source of many states' tax revenues, being subject, on average, to substantially higher overall tax rates than are other goods and services. But as many elements of our economy evolve away from conventional telecommunications delivery models towards ITFA-protected broadband, state tax bases may begin to shrink even more as a result of the act. This may prompt some states (particularly those that have, to date, enjoyed grandfather status) to advance aggressive interpretations of the ban. On the other side of the coin, taxpayers (again, particularly taxpayers in grandfathered states) may find opportunities to challenge some state taxes as, in effect, indirect taxes on Internet access services.

## The Beginnings of the Ban

ITFA was first enacted in 1998. At the time, it provided for a three-year moratorium on the taxation of Internet access by states and local jurisdictions. Notably, however, it contained a "grandfather" exception for states that imposed and enforced a tax on Internet access prior to Oct. 1, 1998. While there were originally 13 "grandfathered" states, several voluntarily eliminated such taxes, and the number of grandfathered states dropped to seven. Those seven states – again, Texas is among them – currently collect over $500 million a year from taxes on Internet access, and it is estimated that other states forego some $6.5 billion annually by not imposing such taxes.

In 1998, the Internet (as a public phenomenon) was still in its commercial infancy. At that time, the Department of Commerce estimated that less than 20 percent of U.S. households had Internet connections. The then-temporary moratorium was, therefore, largely viewed as a necessary step to incubate and protect the fledgling Internet industry and to allow for the development of a fair, uniform and coordinated sub-federal taxing regime.

While ITFA was originally poised to sunset three years after its enactment, it was extended multiple times over an 18-year period. And despite the fact that the Internet is obviously no longer a fledgling, nascent industry, ITFA's provisions were finally made permanent in 2016, indicating that lawmakers may now favor other justifications for the ban.

## The Competing Policy Issues Lurking Beneath the Surface

Interestingly, the permanent extension of ITFA in 2016 was not particularly highly publicized, even in the tax world. Perhaps, at least in part, that is because it came on the heels of other recent, higher-profile political debates on Internet-related issues, debates on everything from cybersecurity and data privacy to big-picture debates about net neutrality and spectrum policy. However, the permanent extension of ITFA is an important development and one that, while widely supported, has garnered differing points of views.

Those who have long favored the permanent extension of the moratorium cite the continued need to protect and foster the growth and use of the Internet, perhaps history's greatest political, cultural and economic engine and invention to date. Such proponents particularly note the Internet's power as a democratizing force. In that vein, they cite the fact that demand for Internet access is elastic, and even a small increase in its cost could unduly limit access in lower income households, widening the so-called "digital divide" between those with access and those without.

Proponents of the new act also cite that without the permanent ban on such taxes, Internet service providers would be required to comply with unique tax rules across thousands of state and local taxing jurisdictions. These tax compliance nightmares – a problem in their own right – would, as a byproduct, indirectly drive up the cost of Internet access, exacerbating the first concern.

On the other side of the debate, however, some have been quite critical of the moratorium. The list of formal opponents against the ban includes the National Governors Association, the National Association of Counties and the Multistate Tax Commission, among others. Some such opponents have pointed out that the reasons for the original moratorium no longer exist; the Internet simply no longer needs the protections that the moratorium was originally designed to provide. It is now a ubiquitous part of our economy and day-to-day life. People will use it regardless, so states should be free to tax it, they say. These opponents also cite the fact that Internet access has thrived even in states that have continued to tax Internet access under ITFA's grandfather clause.

Opponents of the ban also argue that prohibiting states from imposing taxes on specific categories of transactions infringes on traditional notions of state sovereignty and taxing authority. It represents, in other words, a shift of power from the states to the federal government. States have traditionally enjoyed significant autonomy to choose their tax base, as long as they do not run afoul of the Constitution. Congressional bans against state taxes (like the ban here) set a precedent of sorts and raise the classic slippery-slope question: What tax base might Congress ban next?

Finally, opponents of the ban argue that it creates an unfair economic playing field and distorts market choices by giving a competitive advantage to providers of services that are delivered through the Internet. An often-cited example is the difference between a traditional telecommunications phone service, which is generally taxable, and services like Skype, whose users may escape taxation if Internet access is not taxed. The two models provide similar services, though they are delivered through different technological mediums. One, however, is subject to tax and the other is not. Opponents of the ban argue that this kind of inequality violates the fundamental tax policy norm of horizontal equity, which holds that tax systems should treat similarly situated taxpayers in the same manner.

## Consequences Remain to be Seen

TFTEA's permanent extension of ITFA's ban against state and local taxation of Internet access and multiple or discriminatory taxes on electronic commerce is a significant development in the state and local tax world – and in the tax policy world in general, for that matter. Although supported by many, it is not without its detractors, and it raises interesting policy issues.

While the act furthers important and fundamental goals that actually go to the heart of our democratic values, it also pushes on a pressure point when it comes to the balance of power between the federal and state governments. And its ultimate fiscal consequences remain to be seen. It will certainly have an immediate impact on grandfathered states like Texas once that status is phased out, but other states may also see shrinking tax bases as technological innovation drives an economic shift from conventional telecommunications delivery models to ITFA-protected mediums. ■

**Jason B. Freeman, JD, CPA** is a tax attorney in Dallas, Texas and an adjunct professor of law at Southern Methodist University's Dedman School of Law. He can be reached at jfreeman@meadowscollier.com.

# Ulterior Motives

By Mano Mahadeva, CPA, MBA | Column Editor

Share buybacks have helped keep alive the bull market of eight years. True, buybacks are not as jazzy as developing new products or building new state-of-the-art facilities, but the pressure on public companies to grow earnings in a period of anemic growth rates in an uncertain economy have companies returning money to shareholders at full tilt.

Investors have witnessed record buybacks in recent years. Just within the past three months, Wells Fargo's Board of Directors was granted authority to repurchase an additional 350 million shares of common stock potentially valued at $17 billion. Bank of America will add $800 million to its existing authorization and J.P. Morgan Chase is increasing its buyback authorization nearly $1.9 billion. The mantra of maximizing shareholder value is in full force; buybacks are being used as a versatile tool within the corporate finance playbook.

> **"STRATEGIC IN NATURE, DEBT BUYBACKS ARE THE REPAYMENT OF OUTSTANDING SYNDICATED BANK DEBT OR DEBT SECURITIES AT BELOW PAR PRICES."**

Much has been written about buybacks and many debate whether they are a good or bad use of cash. Depending on one's view, management's actions have been vilified or supported. In recent years, activist fund managers have supported buybacks – think Icahn and Apple or Harry Wilson and General Motors – as a way to return excess "idle" cash back to investors. Others view this "return" of cash as a poor choice, due to a whole host of reasons.

Buybacks do create opportunities for companies. But there are several key factors that need to be considered in making this decision, such as strategy behind the buyback, future company growth prospects, performance metrics, lender covenants, shareholder rewards, anti-takeover measures, cash generation, share price support, incentive plans and valuation to name some, making this decision a complex process.

On the opportunistic side, finance leaders need to answer many questions to reach a sound conclusion. Does the company have excess cash in the mid-term, over and beyond what it needs for internal projects or capital expenditures? Does the company experience sustainable growth and can it keep this up for the foreseeable future? Is the excess cash generated by growth a drag on the company's return on capital? Is the company presently under siege or a potential take-over target? Does the company need to have its capital structure readjusted? Has the company faced an adverse event that created the need for share price support?

Similarly, there are pointers that help clarify questionable aspects on buybacks. Are we doing so to mask an issue? Will boosted earnings add stress to the balance sheet? Is the company paying more in dividends and on buybacks than available free cash flow? Does syphoned cash take away from research, development and future investments in growth? Will an over reliance on the balance sheet create future financial issues? Is the leadership addicted to those temporary "pops" as a result of buybacks? Are pay plans connected to EPS targets?

These questions will need to be looked at collectively. For example, adding debt to buy back stock may be wise, since interest expense is a tax shield. We stock up our treasury account to help ward off a takeover; we change our capital structure by adding debt used to pay for the repurchase, and we reward shareholders with tax flexibility by offering them when they might incur the tax liability. However, by doing so, we add stress to the balance sheet, which may not be in the best interest of the company long term. We buy shares at very high prices to lower returns and we do so to neutralize dilution of incentive plan redemptions. We potentially succumb to our behavioral biases like overconfidence and we signal that the company has limited future growth opportunities.

A company facing financial challenges can also be opportunistic by using debt buybacks as executed by Deutsche Bank, Barrick Gold and Anglo American. Deutsche Bank is planning to buy back $5.4 billion of its senior unsecured debt to bolster investor confidence in its liquidity, as well as in the value of its securities. Barrack Gold and Anglo American are doing so to address concerns over their leverage as they try to deal with the effects of a global commodity slump.

Strategic in nature, debt buybacks are the repayment of outstanding syndicated bank debt or debt securities at below par prices. It is an opportunistic tool typically useful to deploy during a downturn, when consumer demand slows and other capital investment opportunities are unlikely to offer reasonable returns.

The longevity of the company is what matters. As such, finance leaders need to hold their nerve against short-termism so that they can make it long term. They should articulate when the company plans to buy back shares, under what circumstances this may happen and the targeted capital structure. Clarity in communication is critical.

Prudent investors need to question a company's motives behind its share purchase plans to determine the reason for the buyback. If a company has strong sustainable cash flows, has a stock that is clearly undervalued and has sufficient cash to spend on critical internal projects, then using excess cash for buybacks could be considered a good option. This would be positive for the shareholders. On the other hand, if it is merely cosmetic in form, beware! ■

**Mano Mahadeva, CPA** is chief financial officer with Solis Health in Addison, Texas. He serves on the editorial board for TSCPA. Mahadeva can be reached at mmahadeva@solishealth.com.

# FASB Streamlines Transition to Equity Method Accounting

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

In the March/April 2016 issue of *Today's CPA*, the Accounting and Auditing column focused on changes made to Generally Accepted Accounting Principles (GAAP) measurement and reporting requirements for financial instruments. In a related move in March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-7, *Simplifying the Transition to Equity Method Accounting*.

Both of these standards are part of FASB's simplification initiative. ASU 2016-7 eliminates the previous GAAP requirement to retrospectively adjust investment assets, as well as results of operations and retained earnings whenever an investor's interest in an unconsolidated affiliate increases to the point it crosses the threshold of significant influence, thus requiring the use of the equity method of accounting.

## What Was the Problem?

Under previous GAAP, accounting for equity investments evidenced by securities fell into three categories, based on the investor's percentage ownership in the investee.

1. Less than 20 percent owned:
   - Trading investments (initially recorded at cost, adjusted to fair value at the end of the reporting period, with unrealized gains and losses being recognized in current income); accounted for as current assets.
   - Available-for-sale (initially recorded at cost, adjusted to fair value at the end of the reporting period, with unrealized gains and losses being recognized in other comprehensive income); accounted for as either current assets or long-term assets, depending on investor's intent and ability.
2. At least 20 percent, but less than 50 percent owned equity method of accounting.
3. 50 percent or more owned consolidated basis of accounting.

Assume that in period 1, Company A makes an initial investment in 5 percent of the voting stock of Company B. Company A's intent is to eventually gain significant influence (about 20 percent of voting stock) of Company B. It makes incremental purchases of 5 percent per year of Company B's voting stock over the next three years. Previous GAAP would require that Company A's equity interest in Company B be accounted for as an available-for-sale investment in periods 1 through 3, requiring adjustment to fair market value at the end of each period, with unrealized gains and losses being reported in other comprehensive income. At the end of period 4, as Company A's investment in Company B crosses the "significant influence" threshold, GAAP would require that Company A change its method of accounting to the equity method. Consistent with the rules over accounting changes, former GAAP would require Company A to retrospectively adjust its investment in Company B from fair value to the equity method, and to retrospectively restate its earnings for the entire four-year period as if the equity method had been used over the entire period.

The facts of this illustration are very straightforward, but still, accounting for such a change after a "creeping acquisition" can take an excessive amount of time and be quite costly, in comparison with the marginal benefits. In addition, such incremental investments are not always acquired with cash, but may also occur as the result of retirement of voting stock or other exchanges. Making retroactive adjustments to the equity method in these circumstances can cause errors. Sometimes, investors do not have all the necessary financial information readily available to retroactively apply the equity method, which creates challenges and results in inaccuracies.

## What's Changed?

The new rules are much simpler. Upon reaching the threshold of significant influence, the equity method investor adds the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest. Then, the equity method of accounting is used from that point forward. No retroactive adjustment of the investment account, earnings or retained earnings is required. If the investment was previously accounted for as an available-for-sale investment (and thus has any accompanying adjustments to accumulated other comprehensive income), whatever net unrealized gain or loss on the investment that remains will be transferred into current earnings at that date.

## Effective Date

The effective date for ASU 2016-07 is fiscal years, and interim periods within those fiscal years, beginning after Dec. 15, 2016. Under ASU 2016-01, unrealized gains and losses from available-for-sale equity investments will no longer be included in accumulated other comprehensive income, but rather will be reflected in current earnings. The effective date for ASU 2016-01 is periods ending on or after Dec. 15, 2017 (2018 for smaller and nonpublic entities). The issue of how to account for unrealized gains and losses in accumulated other comprehensive income for an available-for-sale investment that becomes eligible for the equity method will only exist until an entity adopts the amendments in ASU 2016-01. ■

**C. William Thomas, CPA, Ph.D.** is the J.E. Bush professor of accounting in the Hankamer School of Business at Baylor University in Waco. Thomas can be reached at Bill_Thomas@baylor.edu.

# Which Business Intelligence Tool is Right for You?

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

Business Intelligence (BI) is one of the most important management trends to emerge in the past 50 years. As organizations of all sizes collect and store increasing volumes of data, the question of how to convert this data into a competitive advantage moves to the forefront. Increasingly, business professionals are turning to BI tools – including Excel and Tableau – to assist them in converting "big data" into actionable information. In this article, you will learn about both of these tools, including their relative strengths and when one option might be preferable to the other.

## Focus on Outcomes First

When planning a BI initiative and selecting tools to support that initiative, the first step is to define your desired outcomes, for these outcomes will become critical drivers in your technology selection process. At a high level, the goals of your BI initiative will be to provide data to your teams to help drive productivity and enhance decision-making. At a more granular level, it is acutely important that the information you provide through your BI tools is 1) business critical, 2) goal oriented, 3) highly visible, 4) graphical and interactive and 5) real-time. If your BI tools cannot help deliver information possessing these five characteristics, you will face monumental challenges to your BI initiatives delivering the results you expect.

At least four of the five characteristics defined above will depend on the capabilities of your BI tools. First, your BI tools must allow you to create reports and dashboards that are *goal oriented*, measuring actual results against specific, desired performance. Second, your BI tools must be capable of making information *highly visible* within your organization, "pushing" actionable information into the hands of information consumers, without requiring them to request it or search for it. Third, because "a picture is worth a thousand words," your BI tools must be *graphical and interactive* in nature, allowing team members to query and filter dashboards on-demand to access precisely the information that is important to them. Finally, presenting *real-time* or near real-time information is an absolute must in today's ultra-competitive world; BI tools that cannot access information in real-time from underlying databases and other data sources will likely not help you realize the full measure of benefits provided by successful BI initiatives.

## Excel as a Business Intelligence Tool

Largely because of its massive number of users, Microsoft Office Excel is the leading BI tool in use today. Many Excel users have built BI dashboards using various components of Excel's core functionality, including Open Database Connectivity queries, PivotTables and PivotCharts, tables, sorting and filtering, the extensive function library, macros, and charting and graphing options. However, in many cases, the BI dashboards and reports generated with Excel do not provide all of the functionality necessary for successful BI. For example, sharing Excel-based BI dashboards with other team members is often a source of frustration, as is attempting to query, summarize and analyze large volumes of data from multiple data sources. Consequently, though many business professionals attempt to use Excel as a BI tool, oftentimes the results are less than optimal.

Recognizing the desire of many Excel users to leverage their investment in Excel and their knowledge of the product, Microsoft has added specific BI features to selected versions of Excel 2013. Free tools such as Power Query, Power Pivot, Power View and Power Maps can help you overcome many of the limitations you might face when attempting to use Excel as a BI tool.

You can use Power Query to access and query information from traditional data sources, such as your accounting software database, and non-traditional data sources, such as Facebook, Salesforce.com and the Microsoft Azure Marketplace. Once you query the information, you can then use Power Pivot to "crunch" the data, even if you are dealing with extremely large data models. Further, you can use Power View and Power Maps to create and present visualizations of the data, including interactive dashboards that allow users to filter the dashboards on the fly. Clearly, those attempting to build BI models with Excel should take advantage of these tools to improve Excel as a BI tool.

In addition to the Excel tools mentioned above, Microsoft makes available Power BI, a web-based suite of tools that interacts with Excel and the add-ins mentioned above to transform Excel into a BI tool that businesses of all sizes can use. With Power BI, you can work in the familiar environments of Excel, Power Query, Power Pivot, Power View and Power Map to create your BI reports and dashboards and then publish them so that they are accessible virtually anywhere on any device.

Other key advantages associated with Power BI include the ability to explore your BI dashboards using natural language queries, free mobile apps to access your BI dashboards on iOS and Windows mobile devices, scheduled data refreshes and integration with Active Directory to manage sharing and access control. In sum, Power BI – in concert with Power Query, Power Pivot, Power View and Power Maps – does truly extend Excel to the point where it is a "true" BI tool and can help you to realize the results you desire of your BI initiative. Individuals and organizations seeking to capitalize on their existing investment in Excel and their knowledge of the ubiquitous spreadsheet tool should likely consider Power BI when planning a BI initiative. Likewise, Power BI is a compelling option for those attempting to implement BI without making substantial monetary commitments to a specific platform.

## Tableau, Another Powerful BI Option

Another well-respected provider of tools for generating business intelligence is Tableau. For three consecutive years, Tableau has been listed in the "Magic Quadrant" of Gartner's annual report on business intelligence and analytics, signifying the company as one of the leaders in this market.

Tableau offers a number of products to help professionals in organizations of all sizes generate and distribute BI reports and dashboards. Tableau Desktop allows users to connect to external data sources to query data and quickly convert the data into interactive dashboards that other team members can access. The Desktop solution is available in two editions, Professional and Personal. As an extension of Desktop, Tableau makes available the free Tableau Reader tool. With Reader, you can access dashboards created by other users in Desktop, including filtering and drilling in to the details, without having to invest in additional licenses.

Tableau Server is a mobile and browser-based version of the company's BI platform. Using Server, you can connect to the same data sources as you can using a Desktop, but you access the platform from a web browser or a mobile app, instead of your desktop. Server facilitates functionality such as distributing dashboards throughout an organization and embedding dashboards in company portals. An alternative to Server is Tableau Online, which is simply a Software as a Service (SAAS) version of Server.

Tableau is probably best suited for organizations that might have more complex BI needs, including advanced visualization requirements. Additionally, Tableau Server and Tableau Online are attractive options for those who want IT staff to maintain a greater degree of control over BI deployments. However, if you are considering implementing Tableau, you should carefully plan and budget for the deployment as you might experience significant upfront software acquisition costs, along with annual maintenance expenses.

## Outstanding Tools

BI efforts are growing exponentially in most organizations and many outstanding tools are available today to facilitate your BI initiatives. Working with Excel and various Excel add-ins, Microsoft's Power BI engine is a compelling option for those who want to remain Excel-centric and are looking for a low-cost option for deploying BI. The suite of tools available from Tableau provides outstanding visualization capabilities and numerous deployment options, though these tools will likely cost a bit more than a Power BI deployment.

No matter which tool you might choose, you should find that you are able to generate and communicate BI efficiently and effectively helping your organization to convert big data into actionable information and gain competitive advantages along the way. ■

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

# A Look Back … and a Fond Farewell

*Editor's Note: After decades of dedicated service, Houston CPA Society Executive Director Nancy Rutledge is retiring. As follows, Rutledge shared some thoughts with TSCPA Chapter Relations Representative Rhonda Ledbetter.*

**By Rhonda Ledbetter** | TSCPA Chapter Relations Representative

It is with great pride that I reflect on 38 years with the CPAs in Texas and the beloved members of the Houston CPA Society. The changes at all professional levels – social, business, communications, delivery of continuing education, Internet and research – have been phenomenal. The ongoing diminished involvement of the national firms and rapid increase in firm mergers have created a changed dynamic. Local firms becoming regional in focus have created a different type of competitive environment and changed how the professionals relate to each other. It is encouraging, though, to see that the entrepreneurial spirit is still very much in existence, with new small firms and niche practices surfacing to make their mark within the Houston CPA Society.

**Significant Changes Impacting Profession.** Technology continues to be the most challenging, creating information overload. The impact is most noticeable in teleconferencing and the lack of in-person meetings, which results in no personal connection and diminished total engagement in meetings and follow-up initiatives. It does, however, also have its positive attributes, such as the introduction of audience-response software into seminar/conference environments to engage participants in polling and submitting questions anonymously.

CPE goes the way of technology, due to time commitments and increasing city traffic. Conferences with multiple speakers and topics will continue to be attractive, as they provide variety and opportunity to network.

Another significant change is Internet presence. Keeping the website up-to-date technologically is an ongoing budget challenge as leaders continually work to stay current. Members actively utilize the website to register for events and view the calendar for scheduled activities.

Nancy Rutledge

Comparing the needs of members in business and industry to those in public practice has an impact. They have perhaps become similar, to some degree. Many public practitioners have developed niche specialties within a general practice that require specialized continuing education. This is similar to what is faced by business and industry members, where every industry has distinct needs. It is a challenge to identify a large enough niche to provide a CPE program with enough attendees to justify the time of a volunteer speaker.

**New Initiatives.** Satellite groups were a way to involve outlying members either where they worked or lived. Over the years, there have been six satellite groups covering the vast Houston area (Bay Area, North, Northeast, Northwest, FM 1960 and Southwest) sponsored and staffed by the Society. Only one group remains today: the Northwest Business Roundtable, which meets almost every month. The success of this group can be attributed to movement of the general population and business to the northwest area. For the first time, in January an all-day Tax Update was held there, with 75 attendees.

**Services Added.** After 33 years in two different locations within the same building, the CPA Society moved its offices five years ago. The current location was designed after a focus group had an all-day brainstorming session with the architects. The space is like a five-star Starbucks, with a beverage bar lounge, a business channel TV, WIFI, electronic screens, ceiling microphones for teleconferencing, hearing-impaired equipment, etc. Everyone enjoyed our facilities previously, but the current space is at a whole new level.

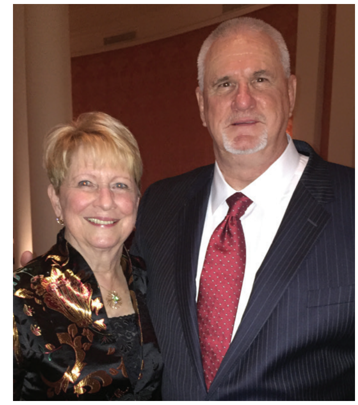
**Attracting Young Professionals.** Social networking with other young professional groups, community service projects, an all-day seminar along with a regularly scheduled happy hour . . . keep this group going. As members "age out" of it, they stay involved and connect with other committees.

**Membership Recruitment.** Recruitment efforts begin with representation at Texas State Board swearing-in ceremonies by members of the Membership Development Committee, followed by an open house at the CPA Society office to introduce new CPAs and new members to all the opportunities available to them. There is also a Welcome Subcommittee of the Membership Development Committee, which personally contacts the new members.

**Direction.** The new horizons for the profession from a continuing education standpoint are, as yet, not totally developed, but are way beyond anything experienced in the past. Combine nano-learning with the prospects of including the CGMA in the world of the CPA poses real challenges for the future leaders of the profession. The Vision Project of the 1990s seems very minor in comparison.

**CPA Relevance.** To keep the perception of being a CPA relevant requires concentrated initiatives at all levels of education, communicating to students the vast array of career opportunities available as a result of having the CPA designation. It also requires a dedicated commitment from CPAs to be visible in the community and the schools, demonstrating leadership and being a mentor to potential future CPAs. ■

Nancy with the Rutledge Cup, given to the winner of the CPA Society's tournament within the Make-A-Wish® Golf Classic.



Nancy and Dick Rutledge

CPA Society Office

# A Writer's Life

## Longtime Society Leader Continues to Chronicle the CPA Journey

By Anne McDonald Davis

Past TSCPA Chairman **Carl Chilton Jr.** has embodied many personas in his 90 plus years: World War II bomber pilot, certified public accountant, local historian and, through it all, writer. "I always enjoyed writing, and began sending in short articles to *The Journal of Accountancy* for a department called 'The Practitioners Forum,'" recounts Chilton. "Prentice Hall, a large publishing company, began reading this material and asked me to consider writing a book. This challenge appealed to me and in the 1970s, I wrote two books on accounting practice for them, books that were sold nationally."

He mentions, wryly, "I wrote these books on something called a typewriter."

Chilton sustained his prolific wordsmith standing through regular columns and articles for *Today's CPA* magazine, among other professional publications, and even tomes on the history of Brownsville, where he has spent much of his life. Most recently, he decided to write a story describing the types of work performed by accountants in public practice.

"I wanted to describe some of the interesting and challenging situations that CPAs face," muses Chilton who says that, in his 37 years of practice, serving a mixture of clients in different lines of business proved interesting and challenging. He recalls, "I had to deal with people, to communicate effectively and to find ways to help clients solve their problems."

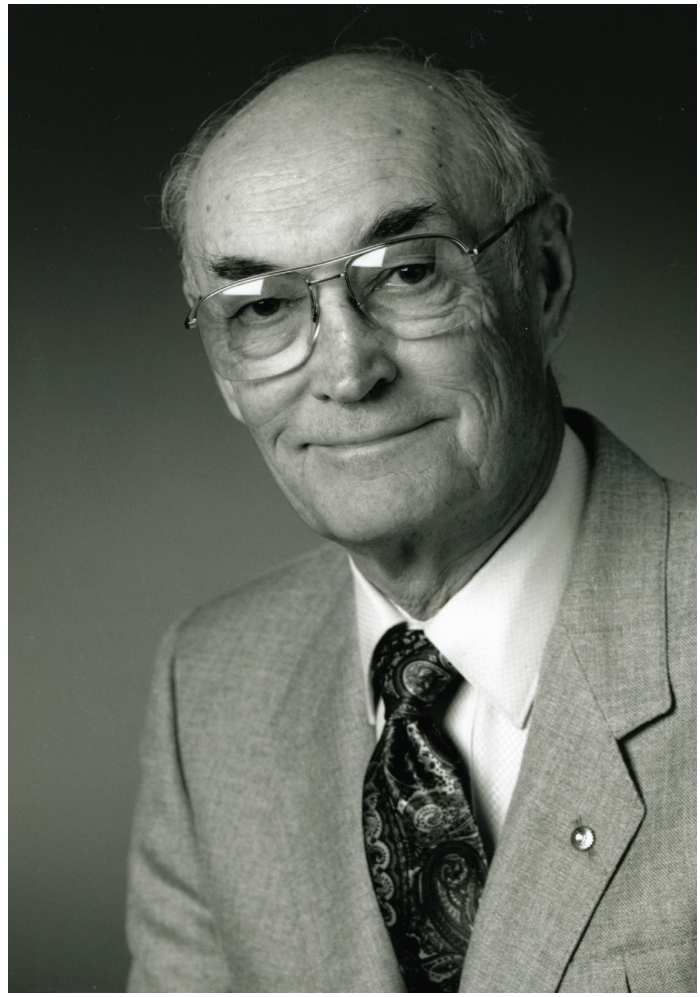
The book chronicles the work of Harlon Blake, CPA, whose experiences as a partner in a local CPA firm mirror many of Chilton's. For instance, in the third chapter, Blake serves not only as the accountant for a family lumber business, but as their trusted advisor. When the patriarch and company president falls ill and dies, Blake ultimately helps different family members weather the emotional conflicts and compromises often involved in such business transitions:

*"That's pretty much what Mom has been telling me. I guess it is what we need to do," Charles relaxed and smiled.*

*"I figured you and she had been discussing this all along. I thought accountants just worked with numbers." With a twinkle in his eye, Harlon said: "I know how to work with numbers, but along the way I had to learn some things about working with people and about running a business. I learned to listen when people want to discuss their problems. That's mostly what I have been doing – listening to you and Julie work your way out of this."*

Throughout the story, Blake interacts with bankers, lawyers, tax authorities and a myriad of clients while also managing the firm.

Chilton says: "Several years ago, I worked on this off and on, then put it aside, and later came back to it and finished it. Several friends have reviewed the book and like it."



Colleague Tom Locke jokes, "It ends the myth that CPAs lead dull lives!" CPA Melissa Frazier adds, "I think this story provides some excellent examples of how CPAs bring value to clients."

As for tackling yet another book in his 90s, Chilton credits his good physical and mental health to being fully involved in life at each stage. He reports: "Ruth and I have been married nearly 65 years. We have two daughters, sons-in-law, five grandchildren and one great grandson.

"My philosophy is that a person who is retired should remain active both physically and mentally, and engage in constructive activities. That is what I have tried to do. ■

**Harlon Blake, CPA: A Challenging Career**

**Copies of "Harlon Blake, CPA: A Challenging Career" can be ordered from: Gorgas Science Foundation, 8435 Sabal Palm Road, Brownsville TX 78521. (Enclose a check for $25.)**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## TSCPA Thanks 2015-2016 Student and Faculty Reps

As part of TSCPA's outreach to accounting students, the Society utilizes volunteer campus reps to maintain a presence at Texas colleges and universities. The campus rep program serves to promote TSCPA student membership, share information and gain valuable feedback from students. A special thanks goes to those students and faculty members who represented TSCPA so well throughout the year.

**Faculty Reps**

Larry G. Stephens – Austin Community College
Paula Miller – Collin College
Anthony B. Ross Sr. – Concordia University Texas
Debra Moore – Dallas Baptist University
Michael R. Daub – Howard Payne University
Ricardo Colon – Lamar University
Karen Russom – Lone Star College System
Bob Thomas – Midwestern State University
Lisa Hull – Tarleton State University – Waco Campus
Caroline Hayek – Texas A&M University – Commerce
Kendra Huff – Texas A&M University-Kingsville
Mary Stanford – Texas Christian University
Kim Webb – Texas Wesleyan University
Art Agulnek – The University of Texas at Dallas
Veronda Willis – The University of Texas at Tyler
Amy Foshee Holmes – Trinity University
Rob Walsh – University of Dallas
Tiffany DeLuze – University of Mary Hardin–Baylor
Allison McLeod – University of North Texas
Ramon Fernandez – University of St. Thomas
Giorgio Gotti – University of Texas at El Paso
Linda R. Vaello – University of Texas at San Antonio
April R. Poe – University of the Incarnate Word

**Student Reps**

Mark Franklin – Austin Community College
Sara Piracha – Dallas Baptist University
Caroline Stanley – Hardin-Simmons University
Carolina Martinez – Houston Baptist University
Miles Wilson – Houston Community College
Bethany Lyons – Lamar University
Alan Hester – Prairie View A&M University
Hannah Evans – Schreiner University
Ianelli Guerra – St. Mary's University
Luz Arias – Texas A&M San Antonio
Cameron Vander Zanden – Texas A&M University–Corpus Christi
Weston Silverberg – Texas A&M University–Kingsville
Rahman Muhammad – Texas Southern University
Keenya Kelley – Texas Woman's University
Yana Dimitrova Shaleva – The University of Texas at Dallas
Kimberly Wallace – The University of Texas at Tyler
Caroline Cramer – Trinity University
Hyunjung Kim – University of Houston
Van Vo – University of Houston
Sarah DeVore – University of Texas at Arlington
Roy Padilla – University of Texas at El Paso
Neil Horie – University of Texas at San Antonio

## Disciplinary Actions

**As a result of a decision by a hearing panel of the Joint Trial Board, the following member had his TSCPA membership expelled:**

- **Harris W. Arthur of Houston was found guilty of violating AICPA Code of Professional Conduct, Rule 501- *Acts Discreditable* and TSCPA *Bylaws* Article III, Section (8)(b) for failure to comply with the directives of the trial board. He was expelled from AICPA and TSCPA effective March 31, 2016.**

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

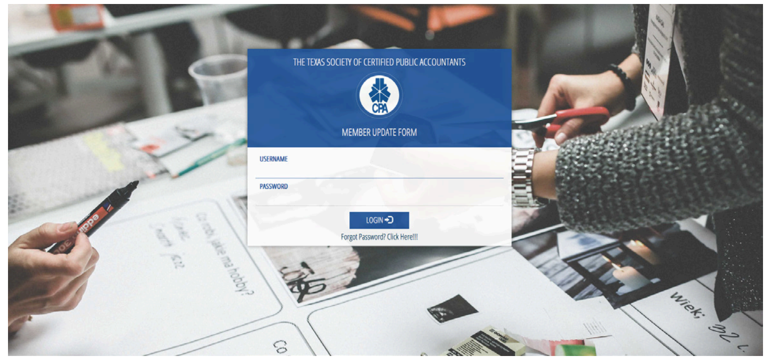
- **Elizabeth B. Reeder, Austin**
- **James Reese, Dallas**

**The following people have had their membership in TSCPA suspended by the Executive Board for a period of three years for non-compliance with TSCPA *Bylaws* Article III, Section (4A) for non-compliance with the Texas State Board of Public Accountancy's continuing professional education requirements.**

- **Andy Atalis, CPA, Dallas**

## Accountants Confidential Assistance Network Seeks Volunteers

The Accountants Confidential Assistance Network (ACAN) program befriends a number of CPA candidates around the state as part of the ACAN peer assistance program. ACAN supports Texas CPAs, CPA candidates and/or accounting students who are addressing alcohol, chemical dependency and/or mental health issues. Can you help? Please contact Craig Nauta at 800-428-0272, ext. 238; 972-687-8538 in Dallas or at cnauta@tscpa.net.




## Online Version of *Today's CPA* Available on TSCPA's Website

Each issue of ***Today's CPA*** magazine is available online for members. ***Today's CPA*** is posted on the website in a digital format, as well as .PDF files that can be downloaded. The magazine can be accessed from the home page on tscpa.org. Click on the link on the right-hand side of the home page just below News Alerts and the CPE Catalog. Then click on "Members Only: See articles and archived issues of ***Today's CPA***" and log in to read featured articles and recent issues.

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## Member Vote on AICPA-CIMA Joint Venture Proposal

In January 2012, AICPA and the Chartered Institute of Management Accountants (CIMA) created the Chartered Global Management Accountant (CGMA) designation. This international designation recognizes management accountants worldwide and gives them a suite of valuable resources and benefits.

The AICPA Council voted last October to expand the availability of the CGMA credential in the U.S. to qualified non-CPAs who satisfy education, examination and experience requirements set by the AICPA Board. The two organizations have proposed creating a new accounting association that would integrate operations and represent the entire accounting profession, while preserving AICPA's and CIMA's membership bodies. Together, they would provide members with enhanced advocacy, expanded resources and additional education opportunities.

The new association would not replace AICPA or CIMA. Each organization would continue to serve the unique needs of its member community. The members of AICPA and CIMA would keep all of the same benefits they currently enjoy and have automatic dual membership in the new association for no additional dues. The new association would be a powerful advocate for the world's accountants, speaking with the voice of more than 600,000 professionals to fight against onerous, unnecessary regulation increasingly originating overseas that do not protect the public interest. It would offer a broader platform to promote the accounting profession to the next generation.

AICPA's Board of Directors and Governing Council have endorsed the proposal and 51 state CPA societies, including TSCPA, have passed resolutions of support so far. AICPA members must now weigh in through an online vote taking place between April 18 and June 16. CIMA members are also voting on whether to approve the proposal.

Members of AICPA began receiving their electronic ballots to vote on the proposal during the week of April 18. There are two ways for AICPA members to vote. The fastest is to access their personal and confidential ballot link sent from the third-party AICPA independent tabulator the week of April 18. If that link is not immediately accessible, please visit www.directvote.net/aicpa to enter or retrieve your unique voting credentials. Members will have until 5 p.m. EST, June 16, to vote.

Provided that the memberships of both organizations give it the go ahead, the changes will begin to be implemented as of January 2017. It would be a methodical process to ensure that all value is maintained. Please visit AICPA.org/Horizons for more information about the proposal and to share feedback.

## Notice of 2016 TSCPA Annual Meeting of Members and Board of Directors Meeting July 1-2, 2016 Moody Gardens Spa and Convention Hotel, Galveston

The Moody Gardens Hotel, Spa and Convention Center offers the finest lodging accommodations on the island. All of the spacious 500 square foot guestrooms feature a variety of panoramic views of the Pyramids, Galveston Bay, marinas and the residential communities of Galveston. Indulgent amenities like plush bathrobes, lighted vanities, full length mirrors, extra pillows and nightly turndown service compliment the hi-tech appointments, which include two, two-line telephones, wireless Internet and in-room safes. Guestrooms have complimentary Wi-Fi and mini refrigerators. A parking garage with a covered walkway is attached to the convention center. A fully equipped business center is available 24-hours a day.

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www.moodygardenshotel.com

Rate: $219 single to quad, 15 percent occupancy tax
Check-in: 4 p.m.
Checkout: Noon
Hotel Cut-off Date: June 6, 2016*

* The number of rooms available in our block is not unlimited. The block may sell out prior to this date. Make your reservations as early as possible to ensure that you are accommodated.

# WHAT CAN YOU EXPECT FROM TSCPA BESIDES

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Cutting-Edge Professional Information and CPE

Enhancing the Image of the CPA Profession

Recruiting New Members to the Profession

Protecting the CPA Certificate

**You can expect special deals and discounts**

## Featured Member Benefit

Radiate360 is an easy-to-use digital marketing platform that enables CPAs to manage their web presence, social media accounts, business directory listings, online reputation and digital/mobile media campaigns – all within one interface. For more information, a demo or to set up a meeting, visit http://www.radiate360.com/tscpa, or contact Robert Hernandez at 866-825-9005 or Robert.Hernandez@RadiateMedia.com.

### Pearl Insurance
TSCPA has partnered with Pearl Insurance to offer the TSCPA Member Insurance Program. The program offers a variety of personal and professional insurance plans, including the TSCPA Private Health Care Exchange.
Go to http://tscpainsure.org/.

### TSCPA Magazine Subscription Program
Discounts on magazine subscriptions
800-603-5602

### Texans Credit Union
Full service financial institution
800-843-5295, www.texanscu.org

### Paychex Partner Program
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Discounts on credit card processing 888-227-9856

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### Infinet, Inc.
AntiSpam/AntiVirus Protection
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### Accurate Forms & Supplies
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### Monroe Systems for Business
Discounts on calculators and other supplies
www.monroe-systems.com

### Bank of America
TSCPA credit card programs – BankAmericard Cash Rewards™ Visa Signature Credit Card, CPA logo and other benefits.
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### FedEx Office
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### Liberty Mutual
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ID Number: 7026. 800-524-9400

### Becker CPA Review Direct Bill Program
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### CPA Exam Review Discounts
For a complete list of exam review discounts available, visit the Member Benefits Marketplace at tscpa.org.

### InterCall
Exclusive rates on audio and web conferencing services. 1-800-636-2377

### YourMembership Career Center
Online career center for accounting and finance professionals. tscpa.careerbank.com

### Framing Success
Discounts on professional framing of all certificates.
800-677-3726

### Office Depot
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### AXA Equitable
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800-523-1125, x2122 www.axa2plan.com

### Hertz
Discounts on car rentals -
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800-654-2200, www.hertz.com

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Ten percent off standard room rates. Discount code: TXSCPA. 800-531-5900, www.lq.com

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www.savewithups.com/txscpa

### Roger CPA Review Direct Billing
Receive all the enrollment benefits associated with TSCPA membership and have the cost of the course billed to your firm. Visit the Member Benefits Marketplace at tscpa.org.

Texas Society of Certified Public Accountants

**Please visit the Member Benefits Marketplace at tscpa.org for complete information and links to each of our Member Discount Programs.**

**Questions?** Contact the Member Benefits Administrator at 1-800-428-0272 ext. 216 or craffetto@tscpa.net.

# An Update on *Today's CPA*

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

In each year's May/June issue of *Today's CPA* magazine, we include a short review of the activities of TSCPA's Editorial Board, and the work being done to keep the magazine as timely and relevant for members as possible.

In the past year, *Today's CPA* has addressed many impactful changes in our profession, from the Affordable Care Act implementation to the issuance of new revenue recognition standards to the decline of the oil and gas market. SSARS No. 21 became effective, and the BBA of 2015 introduced a new partnership audit framework. With major developments cropping up in multiple practice areas, there is no shortage of material to cover.

Looking ahead, tax return due dates are undergoing a monumental shift in 2017. A new United States president and administration will no doubt present unique challenges and opportunities for businesses and our economy. *Today's CPA* will continue to supply insightful discussion and analysis of these developments, navigating the waves of our profession alongside our members.

## Overview

*Today's CPA* is a bi-monthly, peer-reviewed magazine. The articles submitted for consideration are reviewed by members of TSCPA's Editorial Board. The Editorial Board represents a cross-section of the overall membership of TSCPA, including representatives from industry, public practice and academia. Their names are listed in the magazine's masthead each issue.

We attempt to balance the magazine's content to cover the various interest areas of TSCPA's membership. Articles may include a technical analysis and/or informed commentary on the topic, and each issue includes an article that provides continuing professional education (CPE) credit. This article is peer reviewed, and the quiz is pre-tested by reviewers prior to publication.

Figure 1 is a comparative summary of our activities for the past three calendar years. Submissions increased in 2015 and continue to tick upwards in 2016, allowing the reviewers to be more selective.

### Figure 1. Summary of 2013 - 2015 Activity

| Articles | 2015 | 2014 | 2013 |
|---|---|---|---|
| Received | 36 | 28 | 32 |
| Accepted | 21 (58%) | 20 (71%) | 21 (66%) |
| Rejected | 11 (31%) | 6 (21%) | 5 (16%) |
| In Review | 4 | 2 | 6 |
| Invited Short Articles | 2 accepted | 2 accepted | 5 accepted |

The key to maintaining high-quality material in our journal is increasing the number of submissions. We are continuing our efforts to solicit more submissions from both practitioners and academics.

If you or someone in your organization would like to write an article for *Today's CPA* or have an idea you feel can be developed into an article, we encourage you to contact us. If you would like to receive our editorial guidelines, please contact DeLynn Deakins at ddeakins@tscpa.net.

## Acknowledgements

We would like to thank the members of the **Editorial Board** for volunteering their time and considerable efforts to review articles for publication, pre-test CPE quizzes and participate in meetings and on conference calls. We also recognize and thank our copy editor and contributing writer, **Anne Davis**, and the column editors and contributors: TSCPA Chairman **Allyson Baumeister**, CPA-Fort Worth; **Jason Freeman**, CPA-Dallas; **Mano Mahadeva**, CPA-Dallas; **C. William (Bill) Thomas**, CPA-Central Texas; TSCPA Chapter Relations Representative **Rhonda Ledbetter; Bob Owen**, CPA-Dallas; and TSCPA Executive Director/CEO **John Sharbaugh**.

We also thank the accounting and financial professionals who author articles for *Today's CPA*. Authors from all practice areas are invited to submit articles for consideration in the magazine.

# You Thought the Primary Elections Were Over

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

One of Yogi Berra's often quoted phrases was "It ain't over until it's over." That quote might apply to the Texas primary elections. Although the primary election date of March 1, 2016, has long since come and gone, many of the candidates did not win outright and face runoff elections on May 24, 2016.

Despite the March 1 primary having one of the largest voter turnouts in many years (Republican primary turnout: 2,812,935, which represents 19.75 percent of registered voters, and Democratic primary turnout: 1,409,641, which is 9.89 percent of registered voters). Yes, that's a lot more Republican voters than Democrats, even more than prior years – but this is Texas. Only a fraction of those voters will return to the polls on May 24. The key to winning a runoff election is getting your supporters out to vote rather than convincing voters you are the best candidate.

Only a fraction of those overall voters who voted for a presidential candidate actually voted in down ballot races, according to the *Texas Tribune*. The *Tribune* says a total of 1.4 million voters did not vote in down ballot races.

There seem to be a lot of runoffs this year, in part because quite a few incumbents chose not to run for re-election, including long-term legislators and five House committee chairs. The 25 legislative races without an incumbent resulted in over 70 new legislative candidates, with nine of those contests resulting in a runoff: seven House races and two Senate races.

It helps to be an incumbent. While incumbents were not immune to a loss or runoff, only three legislative incumbents face a runoff election. Thirty eight incumbents won their primary elections outright.

Incumbency carried the day in judicial elections as well, where all incumbent Supreme Court Justices won their primary elections. There will be Republican primary run-offs in two Court of Criminal Appeals races.

The strength of incumbency was evident in the Texas Congressional races where every incumbent won without a runoff, even though 19 of the 35 had primary challengers. Despite a presidential election that appears to cater to an electorate that wants to throw out the existing "bums" in Congress, Texans evidently still have confidence in their own incumbents.

Although there were not many statewide races this year, there will be runoffs for Railroad Commissioner and the State Board of Education.

## Report from the TSCPA Political Action Committee

The TSCPA PAC supported 17 legislative candidates during the primary election, with 16 wins and one loss. For many legislative contests, there were no primary contests and, generally speaking, PAC contributions in those races will be made before the November general election.

## Republican Party Battle

It's no news to those of you who follow Texas politics that the Republicans dominate Texas politics, holding all statewide offices plus large majorities in both the House and Senate. For the past several elections, pundits have said Texas is a three-party state, with two different Republican parties and the Democrats. There has been a continuing effort by the conservative wing of the Republican Party to oust Republican incumbents who are not deemed "conservative enough." That effort continued with mixed success this election season.

For ease of reference, I will refer to the conservatives challenging more moderate Republicans as Tea Party candidates. In these contests, the incumbency advantage seemed to hold sway. In other words, for the most part, the incumbents won regardless of which Republican Party they represent. While there were some exceptions, the overall balance in the legislators who make up the House and Senate did not change.

For the next legislative session, the Senate will continue to be controlled by the Tea Party faction, while the House remains in the hands of more traditional Republicans.

The main aim of the Tea Party in Texas House races has focused on supporters of Speaker Straus. While the Tea Party candidates have had some success, they still do not have anywhere near the numbers to threaten Straus; he undoubtedly will remain as speaker at least until the 2018 elections.

Straus himself had two Tea Party primary opponents, evidently in the false hope they could force Straus into a runoff where he might be more vulnerable, because only a fraction of the primary voters stick around for the runoff. Straus beat both opponents handily to win without a runoff.

Although Straus will almost certainly continue as speaker of the House, his leadership team will have many new members. Six to eight of the current committee chairs will not be returning in 2017, some of them very key leadership positions, such as chairs of Appropriations, Public Education and Public Health.

In contrast to the House, the Senate is now dominated by Tea Party senators, led by Lt. Gov. Dan Patrick. Two open Senate races are headed to runoffs. SD 1, previously held by Senator Kevin Eltife of Tyler, will likely be filled with a Tea Party leaning candidate. Eltife was one of the last moderate senators.

SD 24, formerly held by Senator Troy Fraser, will possibly be filled by a more conservative candidate, although it's too early to tell if the Tea Party moniker will apply. Sen. Fraser was a very conservative senator, but not part of the Tea Party. The Senate was a very conservative body in 2015 and promises to be even more so in 2017.

After the runoffs, the makeup of the House and Senate will pretty much be determined. Because of the way legislative districts are drawn, most districts are won in the primary, with only a few districts in play in the general election between Republicans and Democrats. The *Texas Tribune* says, "You can safely tell your friends and family that the Texas House will have at least 59 Republicans and 38 Democrats when members are sworn in next January, and that at least six Democrats and six Republicans are joining the 15 senators already seated."

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


There are statewide runoff elections for Railroad Commissioner and State Board of Education members. If you live in one of the following districts, there is a runoff election:

**Republicans**

- Senate Districts 1 and 24
- House Districts 5, 18, 33, 54, 73 and 128

**Democrats**

- House Districts 27, 120 and 139

# TSCPA's 2015-2016

# Year in Review

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

With TSCPA's fiscal year end approaching, it's time to report on some of the events, activities and other highlights of 2015-2016. In 2015, TSCPA celebrated the 100-year anniversary of the Society and the accounting profession in Texas. The Texas Legislature enacted the first Texas Public Accountancy Act in 1915 at the urging of TSCPA's predecessor organization, the Texas State Society of Public Accountants, and TSCPA was created that same year.

TSCPA kicked off a year of commemoration activities at its Annual Meeting of Members in Dallas. The actual birthday on Oct. 29, 2015, was celebrated at the Young CPAs and Emerging Professionals free CPE conference in Fort Worth, which was open to all TSCPA CPA members and available via webcast. A reception was then held at the Reata Restaurant in Fort Worth following the conference.

A special section of the website was created at tscpa.org that included details about scheduled events, profiles of those who shaped the organization's history and a list of centennial celebration sponsors. A history book recognizing the centennial and TSCPA logo gear continue to be available for purchase online. TSCPA's chapters also celebrated with events throughout the year. The finale of the anniversary campaign will be at the upcoming Annual Meeting of Members in July.

## New Initiative – AICPA's Joint Venture with CIMA

To help address the needs of CPAs working in business and industry, the American Institute of CPAs (AICPA) formed a joint venture with the Chartered Institute of Management Accountants (CIMA) and created the Chartered Global Management Accountant (CGMA) designation in January 2012. This international designation recognizes management accountants worldwide and provides them with a suite of resources and benefits.

In October of 2015, AICPA Council voted to expand the availability of the CGMA credential in the U.S. to qualified non-CPAs who satisfy education, examination and experience requirements set by the AICPA Board. Under the proposal, AICPA and CIMA would join forces to create a new accounting association, while continuing to operate with their current membership bodies. The non-CPA CGMAs would be non-voting associate members of AICPA and participating state CPA societies.

As part of the joint venture, AICPA will be establishing a new partnership model for state societies to recruit this new non-CPA market for the CGMA. States will have an opportunity to work on a 50/50 basis to recruit these individuals, and a national dues rate will be established that will be equally shared between AICPA and participating state societies. Recruitment of these new CGMA members will begin in 2017.

At the TSCPA Midyear Board of Directors meeting in January, the Board adopted a resolution of support for the expansion of the joint venture between AICPA and CIMA. The Board also approved a new affiliate member category called the Non-CPA CGMA Affiliate, which is defined as a non-CPA who holds the CGMA designation in good standing. The affiliate membership would terminate if the individual no longer holds the CGMA designation. This category will complement other current non-CPA affiliate membership categories at TSCPA for non-CPA employees and non-CPA academics. The dues for a non-CPA CGMA affiliate will be established on a uniform, national basis by AICPA, and TSCPA will receive 50 percent of the established national dues rate.

For AICPA to move forward with this proposal, a member ballot is required. CIMA has a similar requirement. AICPA Council authorized a member ballot on this matter and all AICPA members will be able to vote starting the week of April 18. The ballot will be open for voting for 60 days. Members are encouraged to visit aicpa.org/horizons to learn more about the proposal and the member vote.

## TSCPA's Governmental Affairs

TSCPA's advocacy efforts for Texas CPAs are at the state and national levels. In the last legislative session, TSCPA's Legislative Advisory Committee, State Taxation Committee and Key Persons succeeded in opposing sales taxes on professional services and eliminating redundant filing requirements for limited partnerships and professional associations. In addition, TSCPA's governmental affairs team partnered with other professions to eliminate the $200 annual professional license fee.

The 2016 Campaign Treasurer's Handbook and Income Tax Guide for state legislators were updated and distributed. The State Taxation Committee has met with the comptroller's office to discuss tax-related issues.

With the elections being held in 2016, the CPA-PAC Committee provided chapters with information and recommendations for PAC contributions to legislative candidates. Contribution decisions are based on each candidate's position on issues of importance to CPAs, the strength of their opposition, the level of the candidate's influence, their need for funds and incumbency.

The CPA-PAC is TSCPA's Political Action Committee. As an important part of TSCPA's advocacy efforts, the CPA-PAC allows TSCPA to have a strong presence in Texas legislative and political affairs. Directed by the TSCPA PAC Committee, the CPA-PAC is non-partisan and is registered with the Texas Ethics Commission. The PAC Committee works closely with local chapters and their Public

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Affairs committees to determine which policymakers should receive contributions.

To ensure CPAs' voices are heard in the political process, make an online donation on the website at txcpapac.org.

TSCPA's Federal Tax Policy Committee (FTP) is a representative voice for Texas CPAs to the U.S. Congress, Department of the Treasury and the Internal Revenue Service (IRS) on U.S. tax matters. This year, the committee sent comment letters on significant issues to the IRS, Secretary of the Treasury Jack Lew and members of Congress. They included letters to the IRS with comments on Notice 2015-40 regarding the effect of new Financial Accounting Standards Board (FASB) and International Accounting Standards Board financial accounting revenue recognition standards on taxpayers' tax and accounting reporting, as well as comments to the IRS on Notice 2015-57, implementation of consistency provisions for reporting values of assets received from a decedent.

A letter was sent to Treasury Secretary Lew regarding burdensome international financial account reporting requirements and related noncompliance penalties that hinder taxpayers' ability to fully participate in international business. The FTP joined with TSCPA's Relations with IRS Committee to send a letter to Treasury Secretary Lew and IRS Commissioner John Koskinen to expose the "future state" plan and Concept of Operations for public comment.

TSCPA also joined AICPA in requesting that the Treasury Department and the IRS delay the estate basis reporting due date from March 31, 2016 until May 31, 2016, to give taxpayers, executors and practitioners adequate time to become familiar with the new filing requirements. In a win for the FTP and the profession, the due date for estate basis reporting was changed to June 30, 2016.

Letters were sent to members of Congress throughout the year. The FTP prepared a letter that TSCPA sent to Senate Finance and House Ways and Means Committees to urge immediate passing of expired and expiring federal tax provisions.

The FTP assisted with letters urging support of H.R. 2315, the *Mobile Workforce State Income Tax Simplification Act of 2015*, and S. 386, the mobile workforce legislation. The FTP also urged House Committees on Ways and Means, Energy and Commerce, Education and the Workforce to support H.R. 2911, the *Small Business Healthcare Relief Act* for small employers' relief from Section 4980D excise tax on certain employee health arrangements. A letter was prepared that TSCPA sent to the Senate Finance Committee in support of S. 1697, the *Small Business Healthcare Relief Act*, a companion bill to H.R. 2911.

The FTP has received national recognition within the accounting profession and serves as a resource for other state societies. For updates on the work of the FTP, please see your weekly electronic *Viewpoint* newsletter and *Tax Issues* e-newsletter, and visit the Federal Tax Policy Blog on the TSCPA website.

## Professional Standards Committee

TSCPA's Professional Standards Committee (PSC) responds to exposure drafts issued by accounting and auditing standard-setting bodies that have an impact on the practice of accountancy in Texas. In the 2015-2016 year, the PSC submitted a letter to the Public Company Accounting Oversight Board on PCAOB Rulemaking Docket Matter No. 029, *Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits*.

The PSC also responded to FASB on the exposure draft Government Assistance (Topic 832), *Disclosures by Business Entities about Government Assistance* and to AICPA's ARSC Proposed Statements on Standards for Accounting and Review Services, *Compilation of Prospective Financial Statements, et al*.

To view the proposals and read the PSC's letters of comment, please go to TSCPA's website at tscpa.org. Under the Resource Center tab, scroll down to Member Communities and select Professional Standards Committee.

## TSCPA's Foundation: The Membership

TSCPA continued the free membership program offering complimentary membership to new licensees for the fiscal year in which they received their CPA certificates. TSCPA and the chapters worked to connect these new members with activities and to reinforce the benefits of membership. Through the program, the Society had the opportunity to reach new licensees from a variety of backgrounds. In addition, a recruitment brochure was mailed to nonmember CPAs licensed in the last three years who were not eligible for the free membership program. They received a special introductory rate for state and chapter dues.

In another effort to strengthen member retention and recruitment, TSCPA continued to offer a single invoice renewal option for organizations with more than one member on staff. This option enabled annual dues for multiple members to be renewed in one easy process, so the organizations could eliminate burdensome reimbursements internally. The option also resulted in recruitment of new members, since some of the organizations identified CPAs on staff who were not yet TSCPA members. As of press time, 220 organizations had expressed interest in participating in this renewal option. Of those, 63 had not previously used it, and if all 220 organizations complete the process and pay for their entire rosters, it was estimated that 75 new TSCPA members would be added.

TSCPA's Rising Stars Program had a successful year recognizing CPA members 40 years old and younger who demonstrated exceptional leadership skills and active involvement in the Society, the profession and/or their communities. Nominations were received from across Texas, and a task force made up of TSCPA Executive Board members served as the selection committee. After receiving over 70 nominations in 2014-2015, they selected 18 up-and-comers, who were honored at the 2015 Annual Meeting of Members and featured in the September/October 2015 issue of *Today's CPA*.

There were also activities and programs focused on business and industry (B&I) members. A brochure was sent to B&I members promoting TSCPA's value, resources and upcoming education. Again this year, the month of April was designated as B&I month, and it featured a theme that recognized TSCPA's 100-year anniversary. Profiles of members working in a variety of capacities across the state were gathered to highlight the 100s of different ways CPAs can use their CPA credential, expertise and backgrounds.

Other efforts for B&I members included networking and CPE events in the Austin, Dallas, Fort Worth, Houston and San Antonio chapters. Behind-the-scenes events were held, which included presentations from financial professionals at the organizations that were visited.

Looking to the future of the profession, TSCPA continued student membership initiatives. As of April 1, 2016, the Society has 1,665 student and candidate members. The Campus and Faculty Rep Programs remained active, providing TSCPA with an opportunity to work with Texas students and educators to serve as a connection on college and university campuses. For more information on these programs, please visit the website at txcpa2b.com and go to the TSCPA Membership tab at the top of the page.

Through the Accounting Career Education (ACE) program, TSCPA members can share their knowledge about accounting careers with students. Available tools include career guides, videos and lesson plans for educators. Volunteers from across the state visited schools and shared information on jobs available in accounting. TSCPA hosted special panel presentations for community college students in Austin and accounting students at the University of Texas at Dallas. These events gave students more insight into the variety of career options available to CPAs, as well as the steps necessary for certification. If you are interested in serving as an ACE program volunteer, please contact your chapter.

## Hundreds of Choices for CPE

Convenience. Variety. High quality. Information packed. Cost effective. Scheduling flexibility. All of these words describe the comprehensive selection of Continuing Professional Education (CPE) programs provided by the TSCPA CPE Foundation. From live programming to web-based delivery formats, members can depend on TSCPA for hundreds of CPE programs on timely accounting profession topics that meet their educational needs.

With an extensive lineup, there were 15 conferences scheduled this year. Members were encouraged to take advantage of early bird discounts to receive savings on the registration fee. An optional pre-conference workshop for the Advanced Health Care Conference was well received and will be offered again prior to the conference this July. The workshop was held the afternoon before the conference and attendees received an additional four hours of CPE credit.

Two delivery methods, live and online, were available for six of the conferences. These formats gave participants the option to attend the conferences at a time that was convenient for them.

For CPAs looking to combine learning with leisure time, CPE clusters were again offered in Galveston, San Antonio and South Padre. The clusters were designed to provide mix-and-match CPE, with courses covering the hottest topics. By attending the clusters, attendees can earn CPE and then have some fun and relaxation after classes conclude.

New on the calendar was a free course titled, "Drive Your Competitive Edge with Audit Quality." The course examined the requirements of the Auditing Standards Board's Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control*. SQCS No. 8 addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice.

The popular free, two-hour professional issues webcasts continued this year. The speakers included TSCPA Chairman **Allyson Baumeister**, CPA-Fort Worth; TSCPA's 2014-2015 Chairman **Mark Lee**, CPA-Houston and TSCPA Executive Director/CEO **John Sharbaugh**, CAE. They discussed the latest issues affecting the profession, including federal legislative and regulatory affairs; AICPA, PCAOB, FASB and IRS matters; issues concerning the state comptroller's office and more. The next professional issues webcast is scheduled for May 25, 2016, during TSCPA Leadership Day.

TSCPA sends a CPE calendar to members each week via email. It lists the upcoming courses and has links to register online. Members can also use the CPE catalog that is available on the website at tscpa.org to review the courses available and register online. For assistance, members can call the TSCPA staff at 800-428-0272 (972-687-8500 in Dallas).

## Focus on Social Media

TSCPA is active on the social media outlets Facebook, Twitter and LinkedIn. All outlets are updated several times per week with professional news and articles, member news, infographs, blog posts and other helpful information for members.

TSCPA also has a Twitter account for student and candidate members, @TXCPA2B, which provides student-oriented information, such as exam updates, accounting news and career advice. In addition to these efforts, several TSCPA chapters have their own Facebook, Twitter and LinkedIn pages to share local events, member news and photos.


In the past year, TSCPA has increased the following across all social media channels, gaining more than 470 Twitter followers, nearly 200 Facebook followers and more than 300 LinkedIn members. With more than 2,890 members, LinkedIn continued to be TSCPA's most popular and most followed social media channel.

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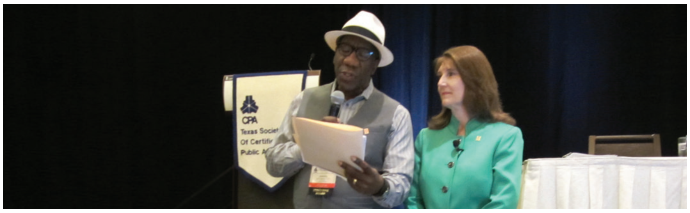
Central Texas Chapter members Nancy Miller, Carol McIntosh and Teri Meyers

Fred Timmons, CPA-San Antonio, and TSCPA's Executive Director/CEO John Sharbaugh



John Baines, CPA-Dallas, and TSCPA Chairman Allyson Baumeister, CPA-Fort Worth

Dallas Chapter members Sam Cheng, Bill Sims and Chris Gummer

This year, TSCPA hosted several member engagement contests and activities on Facebook to celebrate the organization's 100-year anniversary. These activities included a trivia competition, "Name That Accounting Artifact," and a photo caption contest.

To further increase social media engagement, TSCPA began live-tweeting from CPE conferences using the hashtag #TXCPE2015 and, if available, the speaker's username and/or the username of his/her company. This has significantly increased the number of "likes," re-tweets and followers by members and non-members alike. The initiative will continue in 2016 using the hashtag #TXCPE2016.

Members can also stay current on Society and accounting profession news through TSCPA's blogs. The blogs include:

- Executive Director/CEO John Sharbaugh at www.thesharblog.org
- TSCPA at the Capitol at tscpaatthecapitol.com
- Federal Tax Policy Committee at tscpafederal.typepad.com/blog
- TXCPA2B blog, written by accounting students or soon-to-be Texas CPAs, at www.txcpa2b.com
- Business and Industry blog at www.industry-issues.com, which began featuring posts written by guest bloggers from TSCPA's chapters.

## Consumer Financial Literacy Program

With the importance of educating consumers on personal finance and sound money management skills, the 360 Degrees of Financial Literacy program was continued this year. TSCPA's consumer finance website offers free personal finance resources, FAQs, articles, tax tips and other helpful information. The site is available at ValueYourMoney.org. The following activities supported the program:

- Maintained the Tax Talk section for the 2016 tax season with resources and tools to assist Texas taxpayers
- Developed materials and promoted 2016 Financial Literacy month in April
- Updated content for all life stages on ValueYourMoney.org
- Continued the workplace financial education initiative to inform Texas employees about the program and other workplace financial literacy resources
- Distributed TSCPA's free, monthly personal finance e-newsletter, *Take Off!* which features articles and advice on saving, budgeting, tax planning and more
- Updated ValueYourMoney's Facebook and Twitter accounts with personal finance articles, resources and helpful tips, especially during tax season.

Encourage your colleagues, family and friends to check out all the resources available on the site at ValueYourMoney.org, and to follow ValueYourMoney on Facebook and Twitter.

## What's on the Horizon

TSCPA's Executive Director/CEO **John Sharbaugh**, CAE, will be retiring from the Society at the end of the 2016-2017 year. A task force of members, chaired by former TSCPA Chairman **Mark Lee**, CPA-Houston, was appointed to make the selection for this important position. The task force will be working with an executive search firm over the next several months. TSCPA will communicate with members when a new executive director/CEO is hired.

The website at tscpa.org is currently being redesigned. A task force made up of staff members from each department within the Society was formed. TSCPA's Information Technology Committee advised and provided direction to the task force, and a consultant was hired to act in an advisory role. To assess member needs and opinions, TSCPA sent a survey to a representative sample of the membership consisting of three segments: CPAs 40 years and under; CPAs 41 years and over and to leadership. The input was used by the task force in development of the new website. The new site is scheduled to debut in the summer of 2016.

The upcoming July/August 2016 issue of *Today's CPA* magazine will include an introduction of TSCPA's incoming Chairman **Kathryn Kapka**, CPA-East Texas. She'll be discussing the Society's plans and goals for the new year.


YOU'VE GOT THE
SMARTS. NOW GET
THE SAVVY.

# The Cost of Retirement in Financial Plans

By Jack Zook

There are many retirement articles written on the accumulation and distribution phases of retirement. Asset allocation, annuities, deferred accounts and the often debated 4 percent lifetime distributions are among the key topics. An essential component of retirement planning is undertaking a thorough analysis and forecast of what expenditures will be in the retirement life of a client. This is essential to estimate the amount of funds required to be available once the client retires.

This article will provide guidance to those financial planners who provide advice on retirement to their clients. It will look at the matrix of retirement costs in terms of categories and duration, and provide a methodology to determine the present value of those expenditures, as well as an example of using that methodology. When done correctly, it will put in place objectives that financial planners must meet to provide the greatest level of assurance to their clients that they will not run out of money in their lifetimes. It may also provide insight as to postponing retirement, if possible, such that their accumulation phase is properly aligned with their future anticipated expenditures.

## Factors to Consider

An analysis of some key factors will provide the background necessary to formulate any client's expected expenditures in retirement. The key factors are as follows.

a.) Inflation. Inflation is the hidden danger that is often forgotten given its benign behavior for the past 25 years.

However, inflation could be the one factor that crashes many financial plans unless it is provided for properly.

The effect of inflation on retirees is significant. In fact, for over three decades, the Bureau of Labor Statistics (BLS) has maintained an experimental CPI for the elderly (CPI-E)[1]. The CPI-E from December 1982 through December 2011 exceeded the basic CPI index by about 7 percent. The increased inflation for the elderly results from increased spending on health care and housing – both of which have inflation rates that exceed the overall rate of inflation.

To be conservative, financial plans that are projecting out 30 years should provide for an inflation rate that reflects changing economic conditions over an extended period of time. For the example provided herein, the CPI for the 50-year period 1965-2015 was applied.

b.) Life Expectancy. Life expectancy is the unknown variable that plays havoc with all financial plans. Everyone wants to live a long life, and modern medicine is providing great assistance in doing so. However, longer life spans weigh heavily on financial planning computations.

Based on statistical data provided by the Society of Actuaries, at age 65, a woman has a 45 percent and 23 percent probability of living to age 90 and 95, respectively; a man has a 34 percent and 17 percent probability of living to age 90 and 95, respectively; and if a woman and man are married at age 65, there is a 63 percent and 36 percent chance that one of them will live to age 90 and 95, respectively.

c.) Retirement Age. The average age of retirement in the United States is age 62.[2] However, the average age at which non-retirees *expect* to retire is age 66.

Based on factors in b.) and c.) above, there is an approximate 30-year life span for retirees. This span should be viewed in three 10-year phases: the Go-Go Phase (age 66-75); the Slow-Go Phase (age 76-85); and the No-Go Phase (age 86-95 or above). A client's needs change during each phase; similarly, the costs associated with those needs also change. Therefore, it is essential to look beyond the initial years of retirement (i.e., the Go-Go Phase ((age 66-75)) to properly estimate a client's total retirement expenditures.

## Lifestyle in Retirement

As part of the expenditure plan, it is important to ascertain a client's expected lifestyle during retirement. Does the client intend to maintain the same lifestyle as in pre-retirement years? Expenditures for country clubs, new cars, expensive vacations, a second home, etc., are important factors in determining future needs. Additionally, how long does the client expect to continue any of the aforementioned expenses? When, if ever, will the client choose to simplify his/her lifestyle, limiting or eliminating the aforementioned expenses?

Answers to the above questions will assist in developing a forecast of expenditures. A helpful exercise is to ask the client to list categories of all expenditures for the past three years (a software like Quicken would be great for this task). Once the categories are determined, separate them into nondiscretionary, discretionary and unexpected/extraordinary expenses (see below). The client should review the categories and determine whether they will remain in place upon retirement or be replaced with other expenditures. The client should determine whether the level of expenditures is expected to increase, decrease or remain constant, as well as the approximate timing of such changes (i.e., in which years will these changes occur).

Developing these categories of expenditures may be difficult to do as a client does not know what tomorrow may bring, let alone the next 30 years. However, the client will have an appreciation for the categories of expenditures and the amount of expenditures he/she will face in retirement. This exercise is very worthwhile.

Once this forecast is in place, the client should give retirement a trial run well in advance of making the almost irrevocable decision to retire. It is a good idea for a client to test this forecast of expenses for at least three years before retirement. If actual spending data materially differs from what was projected, the client needs to re-evaluate what was established for the next 30 years.

## Spending in Retirement by Phase

Financial planners need to assume that their clients will live for 30 years during retirement. This 30-year life expectancy will be broken into three phases: the Go-Go Phase, the Slow-Go Phase and the No-Go Phase.

**Go-Go Phase.** The Go-Go Phase, encompassing years 66-75, is the most active in terms of travel and entertainment. Still young and mobile enough to enjoy what the world has to offer, the cost of this additional fun would more than replace the cost of going to work, so there is essentially no savings during this phase. Therefore, most debt obligations should be completed before the start of this phase.

There is always the possibility of children and/or grandchildren returning to the nest, particularly during this phase. Financial planners should query whether this is a possibility for their clients, to make sure they have taken this into account when planning. In addition, their clients may need to fund a parent who is ill or needs financial assistance during this phase. Again, financial planners should query whether this is a possibility for their clients, to make sure the expense of caring for a parent has been factored into the plan.

**Slow-Go Phase.** The Slow-Go phase of retirement, encompassing years 76-85, would likely involve less travel and a more sedentary lifestyle. As such, this phase tends to be the least costly phase of retirement. Members of the Slow-Go Phase may be downsizing a residence, reducing the amount of charitable giving and realizing a lesser need for material items.

**No-Go Phase.** The No-Go Phase of retirement, encompassing years 86-95 and beyond, will most likely be the most costly for any client. The No-Go Phase poses the

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potential for significant medical bills, nursing home expenses and costs of caregivers. Determining an approximate amount of available funds to see a client through this phase is critical to the success of the entire financial plan.

## Spending in Retirement by Major Category

Financial planners must identify their clients' spending patterns as they now exist and use this information to project what the next 30 years will bring. Figure 1, the Matrix of Retirement Spending, provides an analysis of the direction (increase/decrease) of various spending categories over time. Within each category exists subsets that should be used to identify the expected costs through the respective phases. Certainly, these categories will present differently for each client. Figure 2 includes an overview of health care costs in retirement. Accompanying Excel worksheets on retirement spending and planning are available on the TSCPA website. To access the worksheets, go to tscpa.org and click on *Today's CPA* magazine.

**Nondiscretionary.** Nondiscretionary expenses (e.g., housing, utilities, food and clothing) will always be present. The one factor that will change dramatically over time is the housing component. A client may decide to sell the large residence and downsize to a smaller residence or rent in lieu of ownership.

The major nondiscretionary costs are likely to come in the No-Go Phase when decisions have to be made about whether clients can stay in their existing confines or whether they need to make major renovations to their homes for handicap access. Most of these basic costs may be inclusive within the total cost of assisted living facilities, or an independent living complex, as part of a continuing care community. However, circumstances may require extended time in a skilled nursing facility or a memory care facility, as well.

**Discretionary.** Discretionary expenses (e.g., expenses for travel, vacations, automobiles, entertainment, transportation, charitable contributions and gifts to family) will be present at the different phases of retirement. During the Go-Go Phase, there probably will be a significant amount spent on vacations and family reunions. Otherwise, most expenditures in this phase will be declining. Financial planners need to determine their clients' wishes and desires relative to each component of discretionary expenses. Keep in mind that gift giving and charitable contributions may be modified from current giving to deferred giving via their estates.

**Unexpected/Extraordinary.** This category is the most difficult to predict. Circumstances that trigger unexpected/extraordinary expenses may include the financial need of a child or grandchild; a family member moving back into a home; the financial support of an aging parent; nursing home costs for clients and/or their spouses; extended assistance for a client or spouse with Alzheimer's, a stroke or a major protracted illness; and out-of-pocket costs for prescription drugs related to any medical condition or illness. It is helpful to consider health care costs and life insurance costs when analyzing this category of expenditures.

The cost of health care is a critical component of all three phases. Health insurance usually consists of Medicare Part B and prescription drug coverage premiums, which are determined by reference to a client's modified adjusted gross income from income tax returns two years prior and a Medicare supplemental insurance policy.[3] These costs can be significant and most likely will always be increasing in retirement. Potential co-pays and deductibles must be considered, the costs of which will be the client's responsibility. A careful examination of the policies will be invaluable in assisting a client's insurance selection.

To illustrate, it is estimated that a client at age 65, with an average life span of 20 years, would incur health care costs of about $146,400 over that period, which amount includes health care costs not covered by the federal government (i.e., Medicare).[4] If the client's life expectancy at age 65 is increased to 25 years (or age 90), then the costs are estimated to be $220,600. These estimated costs do not include any expenditures for long-term care that some retirees may incur. Retirees suffering from certain chronic conditions (e.g., cancer, circulatory conditions, etc.) may end up with health care costs not covered by Medicare that may exceed $300,000.

Life Insurance – The cost and number of life insurance premiums to be paid will depend on the type of insurance issued, either term or whole life and the term of the policy. For whole life policies, the premiums should remain constant or end if that is a provision of the policy. On the other hand, term insurance premiums will continue to increase with age and the policy coverage may end with the attainment of a specific age.

## Methodology

Financial planners need to develop a detailed projection of expenditures for the next 30 years. While this may sound staggering to do, with the following suggested methodology, anyone should be able to properly advise clients on financial planning.

a.) Determine Net Disposable Income. A client's net disposable income prior to retirement must be determined. This can be done by calculating the post tax and retirement savings funds that are available based on their final year(s) of earned income. Keep in mind a client's lifestyle will probably not change immediately for most expenditures other than travel, which will increase during the Go-Go Phase.

b.) Categorize Expenditures. Obtain a breakdown by category of the client's annual expenditures at the time of retirement and determine if there are any expected major changes going forward. Estimate the length of time the client will incur each category of expenditures and when the expenditures will increase, decrease or be eliminated (e.g., life insurance premiums may only last 10 years, while health insurance premiums will last a lifetime). Consider major changes, such as downsizing a residence or moving into a continuing care community. This

## Figure 1. Matrix of Retirement Spending

| | *Go-Go Phase* | *Slow-Go Phase* | *No-Go Phase* | *Notes* | *Summation* |
|---|---|---|---|---|---|
| **NONDISCRETIONARY** | | | | | |
| Housing and Utilities | Possibly mortgage payments; real estate taxes, maintenance (interior and exterior); insurance. **INCREASING COSTS** | Disposition of primary home; possible downsizing or move to adult community or continuing care retirement community. **DECREASING** or **CONSTANT COSTS.** | Final move into assisted living facilities or nursing home. **INCREASING COSTS THAT MAY BE EXTRAORDINARY.** | Downsizing in the Go-Go or Slow-Go, but may require modification to existing home for health issues. Final move to a continuing care retirement community, an assisted living facility, or a nursing home in the No-Go Phase. | CHANGING COSTS IN THE Go-Go and Slow-Go Phases, THEN **INCREASING** IN THE No-Go Phase. |
| Food, Clothing & Personal Expenditures | **INCREASING COSTS** for food; clothing and personal expenditures should remain constant or **decrease**. | **INCREASING COSTS** for food; clothing and personal expenditures should remain constant or **decrease**. | **INCREASING COSTS** for food unless they are included in costs of assisted living or nursing facilities. | No-Go Phase may require additional costs for personal expenditures and special clothing for medical reasons. | Mixed costs with some **INCREASING** and some **DECLINING**. |
| **DISCRETIONARY** | | | | | |
| Travel, vacations, auto, transportaion, charitable contributions, gifts to family | **INCREASING COSTS** in the Go-Go Phase with travel plans and entertainment being a major expenditure. | **DECLINING COSTS** as lifestyle and travel become more restricted. | Dependent on family circumstances and wherewithal to make gifts. | Transportation costs may be supplemented by continuing care retirement community, but usually a distance limitation. Spending on grandchildren and large family milestone vacations may increase spending. | **DECLINING** |
| **"UNEXPECTED/ EXTRAORDINARY"** | | | | | |
| Health Care Costs | **INCREASING** | **INCREASING** | **INCREASING** with the most significant costs occur in the No-Go Phase. | BIGGEST ISSUE ON THE BOARD. | **INCREASING** |
| Life Insurance | Life insurance premiums may continue. Constant if whole life, increasing if term. | Life insurance premiums may continue. Constant if whole life and term will end. | Life insurance premiums may end. | Viatical settlement utilization. | **MAY INCREASE OR REMAIN CONSTANT UNTIL THE No-Go Phase.** |

analysis should be done with each category of expenditures.

c.) Establish a CPI. Establish a cost of living factor (CPI) to be used. Determine different CPI rates for different types of expenditures (e.g., medical costs will probably increase at a greater rate than the normal CPI). Project these expenses forward for a 30-year period. Once the amount and period of duration for these expenditures is established, apply the CPI factor to each category. This will result in inflation-adjusted expenses for the client projected out for the next 30 years.

d.) Determine Fixed Income Stream(s). Determine any fixed income stream of payments that a client expects to receive upon retirement (e.g., Social Security, defined benefit plans, annuities, etc.). Then, apply the inflation factor to that stream for the next 30 years or the time frame of the fixed payment (i.e., a period certain annuity).

e.) Net Inflation-Adjusted Stream of Expenditures. Subtract the inflation-adjusted stream of income in section d.) above from the inflation-adjusted stream of expenditures in section c.) above to determine the net inflation-adjusted expenditures for the 30-year period.

f.) Present Value. Once the net inflation-adjusted expenditures in section e.) above has been determined, discount them back to the expected retirement date. The discount rate to be used will depend on the estimated rate of return on a client's investments. If a client has an estimated 6 percent IRR, then use this as the discount rate. (In essence, it is the client's

continued on next page

**Figure 2. Health Care Costs in Retirement for Single Retiree, 2013**

| | | | | | |
|---|---|---|---|---|---|
| Current age | | 65 | | Cash flow | - |
| Life expectancy | | 85 | | —PV | - |
| Discount rate | | 0.00% | | | |
| Trend rates: | | | | | |
| Year 1 | 3.1% | Year 6 | 5.3% | | |
| Year 2 | 3.4% | Year 7 | 5.0% | | |
| Year 3 | 2.9% | Year 8 | 5.2% | | |
| Year 4 | 6.4% | Year 9 | 5.5% | | |
| Year 5 | 4.7% | Year 10 | 5.8% | | |
| | | Year 11+ | 5.7% | | |
| Starting costs: | | | | | |
| Pre-65 total | 4,838 | | Post-65 | | |
| | | | Medical | | 2,033 |
| | | | Part B premium | | 1,259 |
| | | | Drugs | | 741 |
| | | | Part C premium | | 371 |
| | | | Total post-65 | | 4,404 |
| Retirement Age | Life Expectancy | | | | |
| - | 75 | 80 | 85 | 90 | 95 |
| 55 | $206,200 | $276,300 | $372,400 | $501,500 | $672,500 |
| 60 | 123,400 | 176,500 | 249,300 | 347,200 | 476,800 |
| 65 | 50,900 | 91,200 | 146,400 | 220,600 | 318,800 |
| 70 | 23,000 | 53,700 | 95,500 | 151,800 | 226,200 |

opportunity cost.) This will determine the amount of funds a client will need at retirement to meet future expenditures.

## Example

The following example applies the above methodology to various assumptions. The assumptions contained herein were designed to provide a conservative approach, as the goal is not to outlive your retirement funds. Naturally, assumptions may vary depending on individual circumstances.

a.) Net Disposable Income Determined. Assume a married couple at 66 years of age (full retirement age for Social Security) with a final year gross compensation of $150,000. Their *disposable income* (i.e., post federal income tax, Social Security tax and retirement savings) is $112,795 in their final year of employment prior to retirement. No state tax was deducted, based on the assumption the couple resides in Texas.

b.) Expenditures Categorized. The assumption is that the spending allocation of their *disposable income* will be in line with the spending allocation for 65-year-olds based on the BLS 2013 data[5]. For instance, housing and utilities represent 25.9 percent of disposable income for a 65-year-old individual, while food represents 12.5 percent.

Each category of expenditures was evaluated for duration, increases, decreases, changes in lifestyle and location of living. Spending for housing and most other nondiscretionary expenditures decreased by 30 percent in the Slow-Go Phase. Most spending decreased by 30 percent at age 75, as evidenced by the BLS 2013 data. For the housing category, it was assumed downsizing in 10 years to 70 percent of what current costs would be then.

For the Go-Go Phase, it is assumed the retired couple will spend between $10,000 to $20,000 per year for the next nine years on travel, vacations and family reunions. Those expenditures then decline in the Slow-Go Phase to a range of $5,000 to $7,500 per year. There are no expenditures for travel or entertainment in the No-Go Phase.

The most significant changes were expected to occur in the No-Go Phase. It was assumed that one spouse would need assisted care at various stages beginning at age 85 (year 2035). Current costs were obtained for adult day care for two years ($18,200 per year), a home health aide for the next two years ($41,610 per year), assisted living for three years ($47,688 per year)[6] and ultimately a nursing home for the final three years ($78,475 per year)[7]. The current costs for this assistance and these facilities for the state of Texas at Austin for 2013 were based on data from John Hancock Insurance.[8]

c.) CPI Applied. Once the amounts and duration of the expenditures were completed, apply a CPI of 4.2 percent[9] for all expenditures except medical insurance and out of pocket medical costs, adult day care, home health aides, assisted living and nursing homes, where a 7.5 percent CPI is applied.[10] The result was an inflation-adjusted stream of yearly expenditures for the next 30 years.

d.) Fixed Income Stream Determined. It was assumed that the couple had only one future stream of fixed income, Social Security, for which they would begin at age 66 (full retirement age) with one spouse receiving the maximum per year of $31,956 and the other receiving a spousal benefit of 50 percent of $15,978, total of $47,934.[11] This could be adjusted for payments from a defined benefit plan, an annuity, or any other fixed stream of payments that would be available. This future stream of income was adjusted for inflation at 4.2 percent for the next 30 years.

e.) Net Inflation-Adjusted Expenditures Determined. The amount of inflation-adjusted future stream of income in section d.) above was then subtracted from the inflation-adjusted future stream of expenditures in section c.) above. This provides a net future stream of expenditures that would have to be paid for from other funds.

f.) Present Value Applied. Using a discount rate of 6.7 percent[12], the net future stream of expenditures was discounted to today's dollars and arrived at an amount of $1,488,768. This number represents the amount of funds that the couple would need to have at retirement to meet the future cost of retirement under the assumptions that have been set forth.

With data in place, financial planners are able to determine possible scenarios and adjust their assumptions accordingly.

## Options to Consider

The above example omits the option for either a long-term care insurance policy or annuities, or both. These options would assist in reducing the future impact of retirement expenditures by providing some form of income. These alternative funding sources should be considered well in advance of retirement.

Long-term care insurance is a hedge against the potentially significant costs of various stages of assisted care as seen in the above example. These policies are expensive and the premium costs are continuing to increase. The overall costs of long-term care insurance coverage increased by 8.6 percent over the past year according to the 2015 Long-Term Care Insurance Price Index.[13] These insurance products are complicated and contain many alternatives that need to be examined prior to committing any money. There is also concern in the long-term care industry that more companies are withdrawing from the marketplace due to higher than expected costs and lower returns on investments. In addition, underwriting standards are being tightened for new buyers.[14]

Annuities, while fee-loaded and expensive, are a means by which clients can obtain some degree of guaranteed income. They are complicated contracts with many alternative components that may produce thousands of different types of products that need to be evaluated prior to investing.[15]

## A Thorough Analysis

Following the above methodology, financial planners should be able to determine the estimated present value of the amount of funds needed to be acquired during the accumulation phase. The result of this analysis may be: the need to maintain active income for a longer period of time (i.e., push back the retirement age); to realign the future savings stream; adjust the portfolio strategy; rethink lifestyle in retirement; or any combination thereof.

The need for financial planners to provide their clients with assurance that they will not run out of money in their lifetimes is predicated on the ability to appropriately project future expenditures over several decades. While it is impossible to predict all future expenditures in retirement, a sound and thorough analysis should maximize the ability of your clients to succeed in not outliving their money. ■

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## Footnotes

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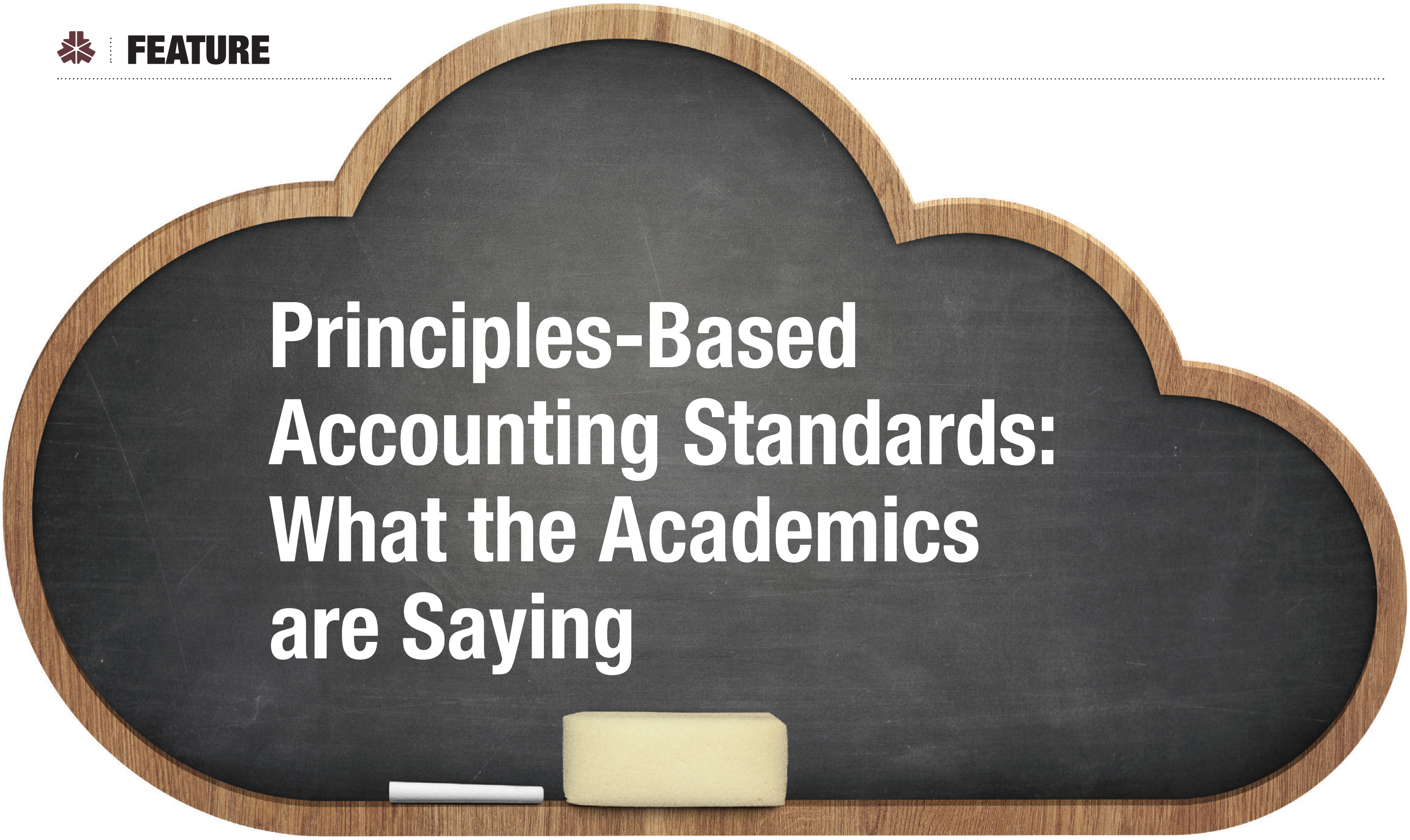

# Principles-Based Accounting Standards: What the Academics are Saying

By Konrad E. Gunderson

The Securities and Exchange Commission (SEC) directed the Financial Accounting Standards Board (FASB) in 2003 to adopt a principles-based approach to accounting standard setting[1]. Each accounting standard under this approach must have a clearly stated objective, and a moderate amount of implementation guidance. Standards with extensive implementation guidance are referred to as rules-based standards, which is characteristic of current U.S. Generally Accepted Accounting Principles (GAAP) and standards with minimal implementation guidance are referred to as principles-only standards, a criticism of some pronouncements of the International Accounting Standards Board (IASB).

The SEC anticipates that there may be instances where companies' requests for additional guidance will not be granted, thus placing responsibility on companies to interpret and apply objectives and existing implementation guidance. The SEC admits that, while such an approach allows for some variability in how standards are applied, this is preferable to the current situation that focuses on technical compliance with detailed guidance. The SEC asserts that, overall, comparability will be improved under the new regime, because accounting professionals, pursuing objectives in good faith, will produce accounting that is consistent with the economic substance of transactions and business arrangements.

How will CPAs in the United States react to the new environment envisioned by the SEC? Will U.S. accounting increasingly report results in accordance with economic substance, as envisioned by the SEC? This article reports on two accounting research studies that provide empirical evidence on this question. Both studies make use of the current differences between leasing rules under GAAP and under International Financial Reporting Standards (IFRS). The studies make use of the leasing rules, because they are considered classic examples of rules-based and principles-based standards respectively.

## Accounting Research

Accounting academics frequently talk of their research as falling into two categories: behavioral, on the one hand, and archival, on the other. The terms are somewhat misleading in that archival research deals with human behavior every bit as much as behavioral research. The terms actually refer to two types of research methodology. Behavioral research uses human subjects in a controlled experiment to investigate accounting issues. The advantage of behavioral research is that findings can be said to have been caused by the experimental manipulation induced by the researcher. Its weakness is the uncertainty as to whether its findings generalize to real world situations.

Archival research has the advantage of using data generated in the real world – the data reflect facts that have actually occurred in a live business setting. The limitation of archival studies is that controlled experiments cannot be done; researchers must opportunistically look for business situations that involve some kind of change that can be isolated and studied for likely effects. This evidence is more circumstantial in nature, and cause-and-effect relationships cannot be inferred with certainty. The two accounting research studies discussed here include one behavioral and one archival.

## Principles-Based Accounting – A Behavioral Study

Three researchers led by Christopher Agoglia, University of Massachusetts-Amherst[2], conducted an experiment in 2011 in which 96 highly experienced U.S. accounting professionals were asked to make a lease classification decision based on the well-known economic life criteria. All participants in the study read a description of a lease contract for an asset with a 10-year economic life, a non-cancellable lease-term of seven years and an optional one-year extension at 90 percent of the initial rental rate. Ninety percent is the point at which a survey of *Fortune 500* company controllers consider professional judgment necessary to decide whether an extension represents a bargain and thus is appropriately included as part of the lease term for classification purposes. Forty-nine professionals were asked to classify the lease using GAAP criteria and 47 were given the IFRS rule as their decision criteria. The decision criteria and reporting decisions under the two regimes is summarized in Table 1.

Of professionals using GAAP, 39 percent capitalized the lease and 61 percent decided for operating treatment; for professionals using IFRS, 85 percent capitalized the lease and 15 percent classified it as an operating lease.

Professionals applying GAAP are significantly more aggressive by treating the contract as an operating lease. Professionals applying IFRS more conservatively capitalize the lease. This difference occurs despite the fact that professionals in the study are likely aware that normal practice under IFRS is to use the same criteria; i.e., 75 percent, in applying the economic life test[3]. However, GAAP includes the precise criteria in the standard, whereas under IFRS it is an interpretation of the wording in the standard; this appears to cause the more conservative reporting decision of accountants in the IFRS condition.

This result is consistent with concepts in law and economics that predict professionals will be more conservative when confronting risk that their judgments will be second-guessed. For example, a professional in the IFRS condition who considers the effective lease term to be seven years may nevertheless capitalize the lease since seven years might be interpreted by others as constituting "the major part" of a 10-year economic life. In contrast, the same accountant under GAAP would likely have no hesitation to opt for operating classification, since the 75 percent criteria is specifically stated in the standard.

We assume the difference in reporting decisions between the two groups is caused by the experimental manipulation. All the case materials regarding the lease are the same; the only difference is the accounting guidance provided to the two groups. It is possible that some personal characteristic of the professionals caused the difference. For example, suppose that a certain number of the 96 professionals in the study previously had their professional judgment questioned in a litigation case at some point in their career. If a disproportionate number of these professionals were in the IFRS condition, this could invalidate the assumption that the results were caused by the difference in the accounting guidance. However, this is a remote possibility as it would require that almost all of the conservative professionals happened to be in the IFRS group. As long as these professionals are reasonably represented in both groups, there is a strong case for the assumption of cause and effect related to the accounting guidance.

What is less certain is whether the behavior observed in the study would generalize to actual practice. Would these professionals render the same decisions in an actual case involving their company? Other factors may come into play in the actual decision context. Researchers try to design case materials that reflect all major factors that would exist in a real decision context. For example, Agoglia included information about the impact of lease classification on the earnings and financial ratios of the hypothetical company in the case. Despite such efforts, experimental researchers can never be certain that their findings will be duplicated in practical situations. To measure what happens in actual practice, accounting researchers turn to archival studies.

## Principles-Based Accounting – An Archival Study

Two professors at Texas Tech University[4] (Collins and Pasewark), along with a former graduate student (Riley), published a study in 2012 of the actual lease reporting behavior of a set of 32 matched companies, 64 companies in all, with 32 reporting under GAAP and 32 reporting under IFRS. The sample of companies was chosen from industries in which leasing of operating assets is common. For each U.S. company, a matching European company of similar size from the same industry was selected. From the financial statements, the total dollar amount of capitalized leases was obtained for each firm. Then, using disclosures about operating leases, the capital lease obligation related to operating leases was calculated.

From this data, it is then possible to calculate a lease capitalization ratio (LCR); i.e., the capital lease obligation reported in the financial statements, divided by the total lease obligation including both capital and operating leases. It is a measure of financial reporting behavior in that it reflects a company's tendency to capitalize its leases and report them in the statement of financial position. Two years of data, 2008 and 2009, were collected for the 32 companies; mean and median lease capitalization ratios for the two groups are provided in Table 2. The results show a higher tendency to capitalize leases under IFRS in comparison to GAAP. These results appear to confirm the earlier finding of Agoglia that under a principles-based regime, financial reporting decisions tend to be more conservative, with a preference for capitalization versus operating classification. The results of the two studies appear to be consistent.

The finding of the Collins study, however, is difficult to interpret, because we do not have access to the details of the lease contracts underlying each firm's reported amounts and disclosures, and we do not know to what extent the findings reflect judgments about "close call" situations as in Agoglia. Rather, it seems likely that the study reflects something about how companies write or negotiate lease contracts under the two reporting regimes. Companies know the classification rules and they may well negotiate lease contracts to achieve particular financial reporting results.

To illustrate, start with a company that negotiates leases with only business purposes in mind, negotiating in each case what percentage of the asset's economic life they wish to retain for operational needs. Assume the company has an evenly distributed series of 12 lease contracts, starting with a lease for a very small portion of the leased asset's economic life, say 5 percent, and increasing until the longest lease, in percentage terms, near 100 percent of the leased asset's life. The financial reporting outcome in this situation is for eight leases to

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## Table 1

| Panel A – Economic Life Decision Criteria Under GAAP and IFRS | |
|---|---|
| GAAP | IFRS |
| A lease shall be capitalized if the lease term is equal to or greater than 75 percent of the economic life of the leased asset. | A lease shall be capitalized if the lease term is for the major part of the economic life of the leased asset. |
| **Panel B – Reporting Decisions Under GAAP and IFRS** | |
| GAAP (49 professionals) | IFRS (47 professionals) |
| Capital 39% | Capital 85% |
| Operating 61% | Operating 15% |

## Table 2

| Lease Capitalization Ratio (LCR) Data | | | | |
|---|---|---|---|---|
| | GAAP (32 Companies) | | IFRS (32 Companies) | |
| | 2008 | 2009 | 2008 | 2009 |
| Average (mean) | 9% | 9% | 12% | 14% |
| Median | 3% | 3% | 10% | 10% |

be treated as operating, and four capitalized, as shown in Panel A of Table 3. Instead, a company might decide to go against what they prefer from an operating standpoint, in favor of a desired financial reporting outcome. In Panel B, the company has negotiated shorter lease terms for two contracts so that they come in at 74 percent of the economic life, thus avoiding capitalization. If a company was intent on managing its financial position to the greatest extent possible, it might pursue an aggressive strategy, negotiating with lessors so that all lease contracts come in under the 75 percent criteria (see Table 3, Panel C).

While both GAAP and IFRS companies may engage in this type of behavior, it is certainly a different game to play under GAAP than under IFRS. With GAAP, there is the safe harbor of the 75 percent threshold in the standard whereas under IFRS, as previously noted, 75 percent is an interpretation subject to second guessing. One response on the part of an IFRS company is to "not play the game." This corresponds to Panel A in Table 3 where leases are written with only business purposes in mind. If an IFRS company's behavior corresponds to Panel A while a GAAP company engages in strategic behavior, the IFRS company will likely have a higher lease capitalization ratio (LCR).

Even if an IFRS company engages in no strategic behavior, it still may seek protection against second guessing by lowering the threshold for capitalization, to say 65 or 70 percent, resulting in additional leases being capitalized. Here too, the IFRS company will tend to exhibit a higher LCR than a similar GAAP company using the 75 percent criteria.

Strategic behavior is likely exhibited to some degree by both GAAP and IFRS companies. In this regard, data in the Collins study show that 10 of the 32 GAAP companies had lease capitalization ratios of 0 percent (corresponding to, for example, Panel C in Table 3). Of the 32 IFRS companies, four had LCRs equal to zero. These companies appear to be using leasing as a form of off-balance-sheet financing, but with more GAAP companies doing so in comparison to IFRS companies.

As an archival study, one should ask what factors other than the proposed one (i.e., different accounting regimes) could be responsible for the observed difference in lease capitalization rates. IFRS contains one criteria requiring capitalization that GAAP does not have. This rule requires capitalization if the leased assets are unique such that only the lessee can use them. While this rule no doubt applies in specific instances, it is unlikely that it could account for the overall differences we see in the sample of 64 companies.

Could there be legal, regulatory or taxation differences between the U.S. and Europe that could account for the difference? Collins addresses these factors by examining whether the overall level of leasing activity differs between the two groups in their sample. They calculate the percentage of total assets that are obtained by leasing for the two groups, both operating and capital, and find that there is no significant difference in leasing activity between the two. This increases our confidence that differences in lease reporting outcomes are related to accounting rules, rather than other institutional or regulatory factors.

### Summary of Behavioral and Archival Studies

The two studies provide complementary evidence about how a principles-based regime impacts financial reporting behavior in comparison to a rules-based regime. In the behavioral study, the accountant decides how to classify a specific lease contract, one that could reasonably be classified as either capital or operating. It shows how reporting regime influences professional judgment in situations that are "close calls." The principles-based regime has the effect of making accountants more conservative, tending toward capitalization, the decision that gives the company a less favorable financial profile. In the archival study, we find that lease contracts are written with less strategic behavior under the principles-based regime, with more leases being capitalized, which again is more conservative.

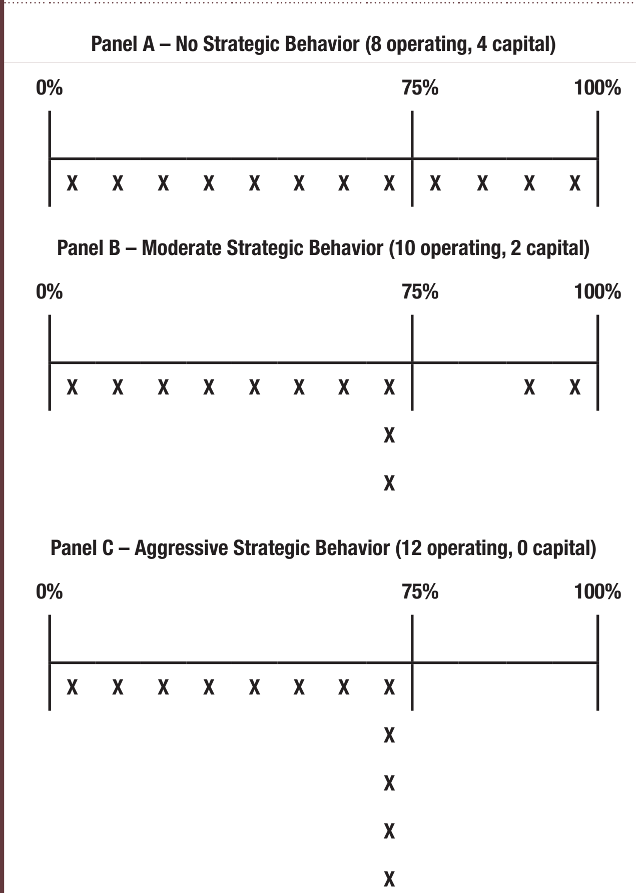
Both of these findings are consistent with a "second guessing" phenomenon associated with a principles-based regime. By removing detailed guidance, the principles-based regime requires the exercise of more professional judgment, which increases the uncertainty the professional faces as to whether his/her decisions may subsequently be questioned or second-guessed. The reaction to this uncertainty is more conservatism on the part of the accountant.

### Discussion of Results

How do these results relate to the SEC's vision for principles-based standards in the U.S. as expressed in their seminal 2003 document? The SEC does anticipate the possibility for increased professional liability as a result of adopting a principles-based regime in the United States. The evidence thus far indicates that CPAs would respond by becoming more conservative. However, the SEC's vision is that eventually CPAs will experience decreased professional liability. CPAs will achieve this because by faithfully pursuing the objectives of principles-based standards, they will report the economic substance of events and this

## Table 3

Lease Term as a Percentage of Economic Life for 12 Leases




will be a defensible position. Does our evidence thus far provide any insight into this vision?

If we assume that capitalizing leases is a better reflection of economic substance than operating treatment, then we have some evidence that the principles-based regime does provide a better outcome. Both of the studies suggest that increased capitalization of leases would occur under a principles-based regime. This situation can be interpreted as increased conservatism in accordance with the "second guessing" concept. It could also reflect a desire on the part of the CPA to report the economic substance of leasing activity. Each study provides some evidence concerning this question.

In the Agoglia study, after making their lease classification decision, participants were asked to rate, on a 10-point scale, reasons for their choices. For the accountants in the principles-based condition, "desire to convey the economic substance of the lease" was given an average rating of 7.2 as a reason for their classification decision. Accountants in the rules-based condition gave this reason a much lower average rating of 4.3. In contrast, when asked if "desire to present the company in a favorable financial light" was important to their decision, principles-based accountants averaged 3.4 while those under the rules-based regime gave this an average rating of 6.9. This finding provides support for the SEC's vision that a principles-based regime will bring about a greater focus among U.S. accountants on reporting the economic substance of transactions.

The archival study data reflects that in actual practice, a mixed response would occur. The data shows that capitalization of leases, despite being higher under IFRS than GAAP, is still rather low, with at best 14 percent of all leases being capitalized (Table 2). Companies under both regimes structure leases to avoid capitalization, but with somewhat less frequency under IFRS than under GAAP. Thus, under the principles-based regime, increased reporting of economic substance exists alongside continuing transaction structuring by some companies (Panels B and C of Table 3). Transaction structuring is contrary to reporting economic substance, as reflected in the following quote: "The clustering of transactions on either side of bright-line rules associated with a rules-based regime results in different accounting treatment being given to arrangements that are fundamentally the same" (SEC, 2003).

In summary, our two studies present some evidence of optimism for the SEC vision, but also indicate a limitation in that some companies still feel an imperative to do what they can to report a positive financial profile. The behavioral study reveals positive decisions in reporting of economic substance, with 85 percent deciding for capitalization, and a positive attitude toward the need to report economic substance as a basis for this decision.

The archival evidence indicates that a principles-based rule does achieve a moderate improvement in reporting of economic substance, even when a rule exists that provides the possibility to report a better financial profile. This is significant. The less precise rule does encourage companies to "not play the game," focusing on business needs rather than financial reporting outcomes. Nevertheless, some companies still engage in transaction structuring, which frustrates the goal of reporting transactions of similar economic substance consistently from company to company. ■

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### Notes

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# Going Concern Assessment: Not Just the Auditor's Responsibility Anymore

**Curriculum:** Accounting and auditing

**Level:** Basic

**Designed For:** Public Practice; Business and Industry

**Objectives:** To inform readers of changes in financial accounting standards requiring company management to periodically assess the ability of entities to remain a going concern and contrasting the accounting rules with requirements for auditors under generally accepted auditing standards.

**Key Topics:** Going concern, disclosure, and accounting and auditing

**Prerequisites:** None

**Advanced Preparation:** None

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

**One of the foundational conventions of accounting measurement and disclosure is the going concern assumption. Simply put, to be a going concern means that the reporting entity is expected to remain in business long enough to be able to pay its debts as they become due. Continuation as a going concern is the assumption upon which the historical cost principle rests.**

A business entity is assumed to be a going concern unless liquidation is imminent. If and when that happens, the entity is required to abandon historical cost and switch to the liquidation basis of accounting for its financial statements. Surprisingly, before 2014, there was no accounting standard that required financial management of an entity to make periodic formal assessments of the entity's ability to remain a going concern. In contrast, for years, Generally Accepted Auditing Standards (GAAS) have required auditors to make a going concern assessment as a part of an entity's annual audit and to notify management whenever there is substantial doubt as to whether the assumption holds.

In August 2014, the Financial Accounting Standards Board (FASB) plugged the gap in the financial literature by issuing Accounting Standards Update (ASU) 2014-15. Applicable to business entities of all sizes that follow Generally Accepted Accounting Principles (GAAP), this ASU adds Subtopic 205-40 (*Presentation of Financial Statements – Going Concern*) to FASB's Accounting Standards Codification (ASC). Effective for annual periods ending after Dec. 15, 2016, ASC 205-40 formalizes the requirement that financial statement issuers assess their reporting entity's ability to remain a going concern on an ongoing basis and to make proper disclosures whenever it appears to be in doubt. The purpose of this article is to summarize the requirements of ASC 205-40, and to discuss some specific new areas of guidance it gives concerning management's responsibility to disclose an entity's ability to remain a going concern.

## The Basic Requirement of ASC 205-40

The basic requirement outlined in Subtopic 205-40 is that, in connection with financial statement preparation for each (1) *annual and interim* period, an entity's management should evaluate whether there are (2) *conditions or events, considered in the aggregate*, that raise (3) *substantial doubt* about the entity's ability to continue as a going concern, (4) *within one year after the date that the financial statements are issued or available to be issued.* [Numbers are added to each key phrase in the requirement for discussion below.]

(1) *Annual and interim period.* ASC 205-40 is applicable to both annual and interim reporting periods, making a much more extensive requirement for management than the requirement for auditors, contained in AU-C 570, which requires only an annual assessment and evaluation by the independent auditor.

(2) *Conditions or events, considered in the aggregate.* ASC 205-40-

50-5 contains a more extensive discussion of quantitative and qualitative information that management should consider in evaluating the entity's ability to continue as a going concern than those contained in GAAS. These include, but are not limited to, the following conditions and events that are either known or reasonably knowable at the date that the financial statements are issued:

(a) The entity's current financial condition, including liquidity sources (available liquid funds and available access to credit);
(b) The entity's conditional and unconditional obligations due or anticipated within one year after the financial statements are issued (regardless of whether those obligations are recognized in the entity's current financial statements);
(c) The funds necessary to maintain the entity's operations, obligations and other expected cash flows within one year after the financial statements are issued;
(d) Other conditions and events that, when considered in conjunction with (a), (b) and (c) above may adversely affect the entity's ability to meet its obligations within one year after the financial statements are issued. Reminiscent of the criteria contained in the auditing standards, examples of these are contained in paragraph 205-40-55-2 and include negative financial trends; recurring operating losses; working capital deficiencies; negative cash flows from operations; default on loans; arrearages in dividends; denial of credit; noncompliance with loan covenants; internal matters such as work stoppages; substantial dependence on particular projects; and external matters such as legal proceedings, legislation or uninsured natural disasters that might threaten the entity's ongoing operations or its ability to pay its debts.

(3) *Substantial doubt*. The glossary of the Accounting Standards Codification has been expanded to define this term as follows: "Substantial doubt about an entity's ability to continue as going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued or available to be issued." For this purpose, probable takes the same meaning as it does in Topic 450, *Contingencies* (i.e., "likely," leaving substantial room for subjective interpretation).
(4) *Within one year after the financial statements are issued or available to be issued*. Subtopic 205-40 extends the required assessment period to a full year after the issuance date of the financial statements, or when the financial statements are available to be issued, whichever is earlier. In this context, financial statements are considered available to be issued when they are complete in a form and format that complies with GAAP and all approvals necessary for issuance has been obtained. So, for example, if a company's board of directors, management, significant shareholders and applicable regulatory authorities have approved financial statements for the calendar year 2015 on Feb. 15, 2016, management's going concern assessment must extend to Feb. 15, 2017.

## Why an Accounting Standard on Going Concern?

Before ASU 2014-15, there was no guidance in GAAP concerning the responsibility of a company's own management to evaluate whether the entity was a going concern. In contrast, GAAS have required independent auditors to evaluate their clients' going concern status for years. This makes it appear that the primary responsibility for assessment of going concern is not management's, but the auditor's. In fact, no one should be more knowledgeable of an entity's liquidity position and profitability than management. It is therefore not only entirely appropriate, but necessary, that management have the primary and formally articulated responsibility for assessment of going concern, just as it does for every other aspect of financial reporting that affects the fairness of presentation of financial statements.

A general lack of guidance in GAAP about going concern, and differing views in application of judgment on the part of auditors regarding when there is substantial doubt about an entity's ability to continue as a going concern, led to a substantial amount of inconsistency on the part of financial statement preparers as to whether, and how, their various entities disclosed the relevant conditions and events in financial statement footnotes. Issuance of ASU 2014-15 should correct this problem.

## More Extensive Responsibilities for Management

Exhibit 1 is a chart that describes the process management should follow in assessing an entity's ability to continue as a going concern under ASU 205-40. The process begins with the question as to whether the criteria have been met for following the liquidation basis of accounting. The liquidation basis of accounting is only appropriate if liquidation of the entity is "imminent," defined in ASU 205-30 as when *either* of the following occurs:

- A plan for liquidation has been approved by those with the authority to make such a plan effective, and the likelihood is remote that any of the following will occur:
  - Execution of the plan will be blocked by other parties (for example, those with shareholder rights);
  - The entity will return from liquidation.
- A plan for liquidation is imposed by other forces (for example, involuntary bankruptcy), and the likelihood is remote that the entity will return from liquidation.

In these cases, there would be no doubt that the entity is not a going concern, and the entity should cease to apply the assumption regarding going concern and instead apply the liquidation basis of accounting, as prescribed in ASC 205-30.

If liquidation of the entity is not imminent, the provisions of ASC 205-40 apply and management is charged with the responsibility of making a going concern assessment, as well as making proper disclosures, if applicable. Each reporting period, management should assess whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to remain a going concern. If the outcome of this assessment reveals no such conditions or events, then no disclosures are required related to uncertainties about the entity's continuing as a going concern. However, the entity

continued on next page

may still have a responsibility to disclose other risks, uncertainties and contingencies in accordance with other accounting standards.

If, however, as a result of its assessment process, management identifies conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, management should consider whether its plans that are intended to mitigate those conditions or events will alleviate the substantial doubt. The mitigating effect of management's plans should be considered by answering the following two questions:

(1) Is it probable that the plans will be effectively implemented?
(2) Is it probable that the plans, if implemented, will be successful in mitigating the going concern issues?

If the answer to both questions is "yes," management still has the responsibility to disclose information that enables readers of the financial statements to understand all of the following:

(a) Principal conditions or events that raised substantial doubt about going concern;
(b) Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
(c) Management's plans that alleviate substantial doubt about going concern.

If the answer to the first question is "yes" but the answer to the second question is "no," management should include a statement in the financial footnotes indicating that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued). Additionally, the entity should disclose information that enables users of the financial statements to understand all of the following:

(a) Principal conditions or events that raise substantial doubt about going concern;
(b) Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
(c) Management's plans that are intended to mitigate the conditions or events that raise substantial doubt about going concern.

## More Guidance on Evaluation of Management's Plans

ASU 205-40-50-8 provides guidance for management in evaluating its plans to mitigate conditions or events that could raise substantial doubt about going concern. Specifically, this subparagraph requires that management's evaluation be based on the feasibility of implementing its plans in light of specific facts and circumstances. Generally, to be considered probable of being effectively implemented, management (or others with appropriate authority) must have approved the plans before the date that the financial statements are issued.

ASU 205-40-55-3 gives examples of plans that management may implement and information that management consider in evaluating feasibility of the plans. These include (a) plans to dispose of an asset or business; (b) plans to borrow money or restructure debt; (c) plans to reduce or delay expenditures and (d) plans to increase equity financing. If management's plans are not probable of being implemented within the appropriate time period, they should not be considered in evaluating whether substantial doubt about going concern is alleviated.

## Co-existence of ASC 205-40 with AU-C 570

A logical question to ask is whether the implementation of ASC 205-40 articulating management's responsibility for assessment of going concern will supersede or modify AU-C 570, which mandates similar assessment of going concern status on the part of the independent auditor. The answer to this question is "no." Therefore, the two standards will apparently co-exist, with the following significant differences between them:

1. The language used in the definition of "substantial doubt" under ASC 205-40 is more precise than current AU-C 570. However, both standards will continue to require the exercise of a substantial amount of judgment on the part of both management and the auditor.
2. The time period for the look-forward assessment of going concern status is more definitive and longer under ASC 205-40 than under AU-C 570. Specifically, the time period for assessment for management under ASC 205-40 is one year from the date of *issuance* of the financial statements. Under AU-C 570.07, the time period of assessment for the independent auditor is a "reasonable period of time," interpreted to mean not to exceed one year from the date of the financial statements. So, for example, if the balance sheet date were Dec. 31, 2015, the auditor's required assessment period would extend to Dec. 31, 2016.
3. The timing of required assessments under ASC 205-40 is more frequent (annual and interim periods) than under AU-C 570 (annual). It is also ongoing; therefore, management must continually apply it every reporting period.

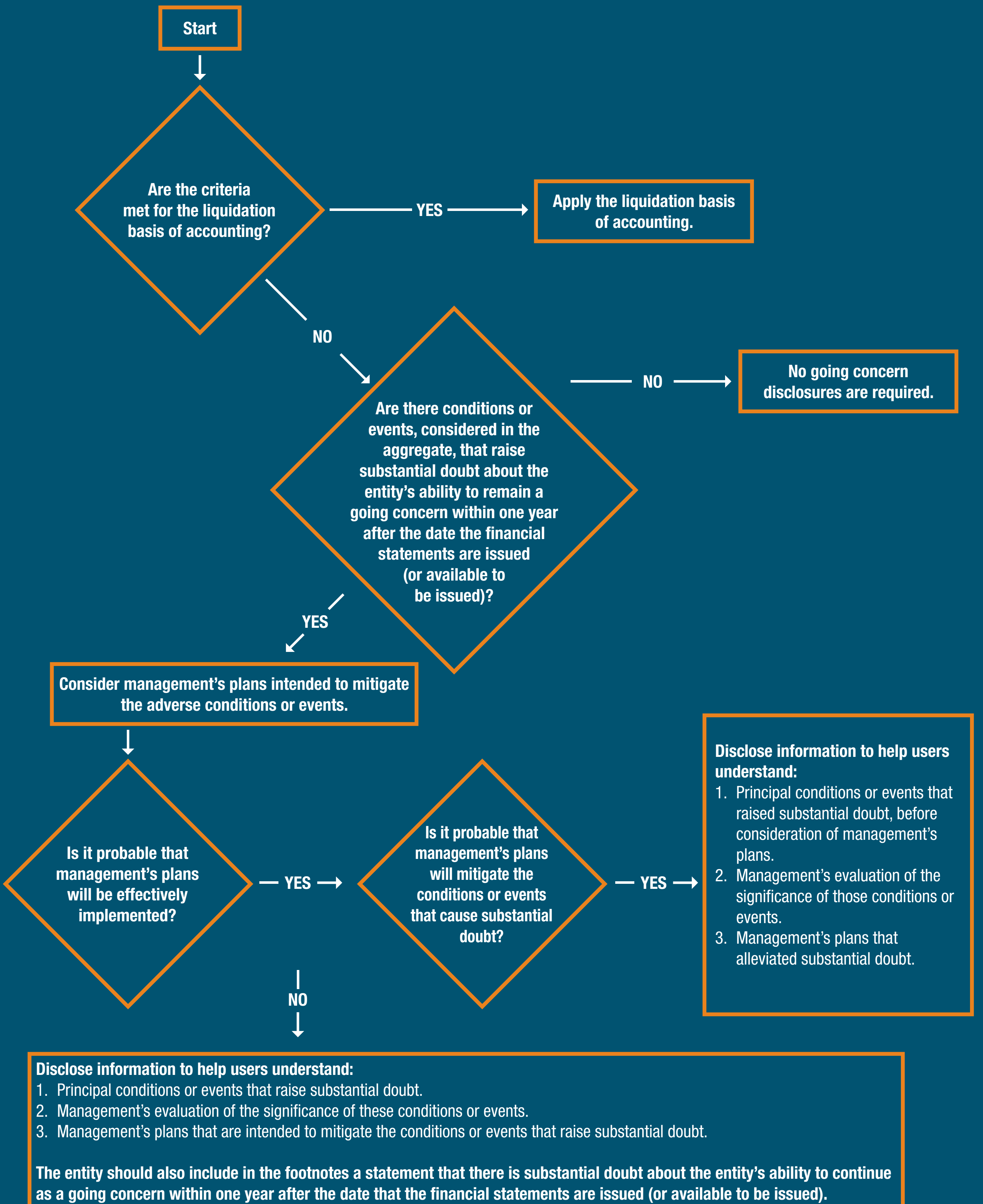
Because of the judgments required of both management and the auditor in applying each of these independent standards, it is feasible that, for a particular set of circumstances or events, management's assessments and conclusions about going concern might differ from those of the independent auditor. For example, when substantial doubt about going concern exists on the part of both management and the independent auditor, management might conclude that it is probable that its plans will mitigate the conditions or events causing going concern problems, and the auditor might conclude they will not. In this case, the auditor's opinion might still be expanded to emphasize this matter. However, from a practical standpoint, because of the give-and-take nature of the audit process, such a chain of events would most likely be rare.

## A Needed Addition to Standards

Beginning with financial statements issued after Dec. 15, 2016, management of all entities with GAAP-based financial statements will be required to assess the ability of those entities to continue as going concerns. The requirements for this assessment, formalized in Topic 204-50 of the ASC, will co-exist with, but be more extensive than, those of independent auditors to perform such assessments for their clients. This article has discussed the justification for, and requirements of, the going concern assessment standard, and has contrasted the financial and auditing standards related to going concern assessment. ■

**C. William (Bill) Thomas, CPA, Ph.D.** is the J.E. Bush professor of accounting in the Hankamer School of Business at Baylor University in Waco. He can be reached at Bill_Thomas@baylor.edu.

## Exhibit 1. Process for Assessment of Going Concern (ASC 205-40)



By C. William (Bill) Thomas

# Going Concern: Not Just the Auditor's Responsibility Anymore

**1 According to ASC 205-40, assessment of the entity's ability to remain a going concern is the responsibility of:**

| | Management | The Independent Auditor |
|---|---|---|
| **A.** | Yes | Yes |
| **B.** | No | Yes |
| **C.** | Yes | No |
| **D.** | No | No |

**2 Going concern is a(n)**

**A.** Assumption upon which the application of historical cost as a measurement method is based
**B.** Principle underlying all of accounting and auditing
**C.** Both A and B **D.** Neither A nor B

**3 Entities that are not going concerns should follow:**

**A.** Historical cost as a basis for measurement and reporting of assets and liabilities
**B.** The liquidation basis of accounting, which assumes liquidation values of assets and liabilities
**C.** The cash basis of accounting
**D.** Financial reporting framework for small and medium-sized entities

**4 ASC 205-40 requires that management evaluate going concern:**

**A.** Annually
**B.** On an interim basis (quarterly)
**C.** Both A and B
**D.** On an ongoing basis, but not necessarily A or B

**5 For what period of time should going concern be evaluated?**

**A.** No specified period of time
**B.** The end of the period in which the financial statements are issued or available to be issued
**C.** Two years from the date the financial statements are issued or available to be issued
**D.** One year from the date the financial statements are issued or available to be issued

**6 The phrase used to describe the circumstances in which going concern might be questioned is:**

**A.** Substantial doubt
**B.** Slight doubt
**C.** Certain doubt
**D.** Professional skepticism

**7 The meaning of the correct phrase used in question 6 is tied to the accounting standard related to:**

**A.** Subsequent events
**B.** Leases
**C.** Contingencies
**D.** Revenue recognition

**8 Circumstances that might raise concerns about an entity's ability to remain a going concern include all of the following except:**

**A.** Liquidity sources
**B.** Access to available credit
**C.** Expected cash flows from operations
**D.** Related party transactions

**9 If management performs a going concern assessment, and if they find adverse conditions or events that raise substantial doubt about going concern, what is the next thing that they should do?**

**A.** Notify their independent auditor
**B.** Consider plans that might mitigate the adverse conditions
**C.** Implement the liquidation basis of accounting
**D.** Notify the SEC

**10 In considering its plans, management must answer the following questions:**

**A.** Is it probable that management's plans will be effectively implemented?
**B.** Is it probable that management's plans will mitigate the conditions or events that cause substantial doubt about going concern?
**C.** Both A and B
**D.** Neither A nor B

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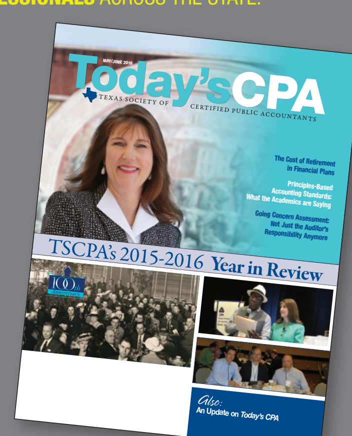

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