Collectibility, A Revenue Recognition Condition

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MANAGING EDITOR
DeLynn Deakins
ddeakins@tscpa.net
972-687-8550
800-428-0272, ext. 250

TECHNICAL EDITOR
Brinn Serbanic, CPA, CFP®
Brinn_Serbanic@baylor.edu

COLUMN EDITORS
Jason B. Freeman, CPA, JD
Mano Mahadeva, CPA, MBA
C. William (Bill) Thomas, CPA, Ph.D.

WEB EDITOR
Wayne Hardin
whardin@tscpa.net

CONTRIBUTORS
Ali Allie; Melinda Bentley; Rosa Castillo; Jerry Cross, CPA; Anne Davis, ABC; Chrissy Jones, AICPA; Rhonda Ledbetter; Craig Nauta; Catherine Raffetto; Patty Wyatt

DIRECTOR, MARKETING & COMMUNICATIONS
Janet Overton

CLASSIFIED
DeLynn Deakins
Texas Society of CPAs
14651 Dallas Parkway, Suite 700
Dallas, Texas 75254-7408
972-687-8550
ddeakins@tscpa.net.

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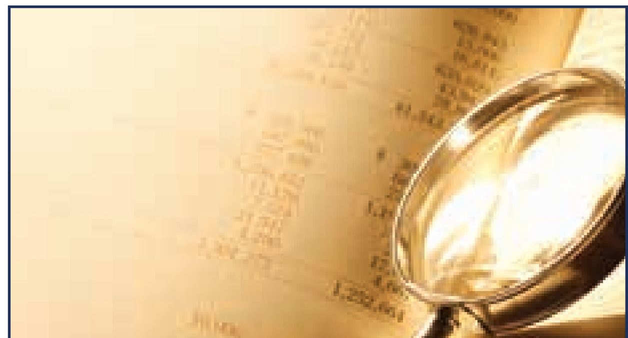

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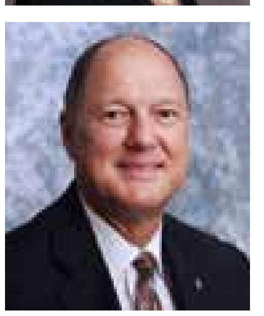
Preparing for Tax Season 2016

By **Allyson Baumeister**, CPA | 2015-2016 TSCPA Chairman and **John Sharbaugh**, CAE | TSCPA Executive Director/CEO

The 2016 tax season is expected to be another challenging one. The IRS is continuing to face budgetary constraints this year and Congress did not address dozens of lapsed and expiring tax provisions until mid-December, 2015. Although Congress considered tax extenders legislation earlier in 2015, no legislation had been passed, causing businesses and individuals to be faced with uncertainty and difficulty in planning and compliance.

Just a few of the other issues affecting taxpayers and practitioners include the *Affordable Care Act*, final tangible property regulations, the *Trade Preferences Extension Act of 2015*, new IRS policies to combat the increase in identity theft, and the Supreme Court's ruling on same-sex marriage. In addition, the Texas Legislature enacted several state tax bills that are in the process of being implemented and the comptroller has made changes in management, rules and administrative procedures.



TSCPA is here to assist you in keeping current during tax season and throughout the year. The weekly electronic *Viewpoint* newsletter, Federal Tax Policy blog and TSCPA at the Capitol blog provide updates on the latest issues. TSCPA's monthly *Tax Issues* e-newsletter is a source of useful information and narrative. The e-newsletter is free for members and you can subscribe by contacting TSCPA's Patty Wyatt at pwyatt@tscpa.net.

The Tax Issues Community on the website contains links to information, tax-related documents and news alerts. There are also links to register for TSCPA's upcoming tax seminars and to read the Tax Topics column from *Today's CPA* magazine, written by **Jason B. Freeman**, CPA-Dallas, who provides insightful commentary on issues of significance to tax practitioners. To visit the community, go to TSCPA's website at tscpa.org. Under Resource Center, scroll down to Member Communities, select Tax Issues, and log in as a member.

TSCPA's Advocacy Efforts

TSCPA's regulatory and political advocacy efforts are used to create opportunities for dialogue between CPAs and legislators, accounting standards-setting bodies and regulators. The Federal Tax Policy Committee (FTP) gives feedback to regulators on actual and proposed federal tax legislation, regulations and administrative pronouncements. The Relations with the IRS Committee maintains communications between TSCPA and the IRS to exchange ideas and information on topics related to the administration of federal tax laws and regulations.

In October, 2015, TSCPA advocated for urgent action on the expired and expiring federal tax provisions in a letter to the Senate Finance and House Ways & Means Committees. Also in October, the FTP commented on the effect that the new Financial Accounting Standards Board and International Accounting Standards Board financial accounting revenue recognition standards will have on taxpayers' tax and accounting reporting.

In November, Rep. Kevin Brady (R-Texas) was selected to serve as chairman of the powerful House Ways and Means Committee. It is the chief tax-writing committee in the House of Representatives, and is regarded as one of the most powerful panels on Capitol Hill, with jurisdiction over taxes, trade, health care and Social Security.

In September, TSCPA sent a letter to the House Committees on Ways & Means, Energy & Commerce, and Education & The Workforce in support of H.R. 2911, the *Small Business Healthcare Relief Act*, for small employers' relief from Section 4980D excise tax on certain employee health arrangements. The staff of the bill's sponsor, Louisiana Congressman Charles Boustany, asked TSCPA to assist them with contacting another state CPA society for support. TSCPA also sent a letter to the Senate Finance Committee in support of S. 1697, the companion bill to H.R. 2911.

The FTP created a new International Tax Subcommittee. In August, the subcommittee initiated a letter from the FTP to U.S. Treasury Secretary Jacob Lew regarding burdensome international financial account reporting requirements and related noncompliance penalties that hinder taxpayers' ability to fully participate in international business.

Other activities included the FTP and Relations with IRS Committee sending a joint letter to the Assistant Treasury Secretary for Tax Policy Mark Mazur for further guidance and relief needed on Section 4980D excise tax. The Treasury Department replied to the FTP's concern regarding reimbursement of individual health premiums for 2 percent shareholders by S corporations. Since mobile workforce legislation is important to the accounting profession, TSCPA and other state CPA societies sent several letters to Congress during the year, but no legislation has been passed to date.

You can count on TSCPA to keep you informed on crucial developments and continue the work to protect the CPA designation through ongoing advocacy efforts. TSCPA will work cooperatively with legislative and standards-setting bodies on issues that affect CPAs and the public they serve. ■

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

John Sharbaugh can be contacted at jsharbaugh@tscpa.net.

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The IRS Budget: Taking Stock

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

The Internal Revenue Service (IRS) budget has been cut by nearly one-fifth since 2010 in inflation-adjusted dollars. The steady, five-year decline in IRS funding levels recently ended, however, with Congress passing a year-end omnibus spending bill that generally maintains the current IRS budget. The bill also provides modest funding increases that are earmarked specifically to improve customer service and to prevent identity theft. Unlike the omnibus spending bill, competing proposed Congressional appropriations bills had threatened to further reduce the IRS's 2016 budget, possibly to the lowest inflation-adjusted level since 1990. While those proposed bills did not pass, the threat of future budget cuts continues to loom large over the agency.

Over the past five years, the IRS has seen its workforce reduced by more than 13,000 full-time equivalent employees. (It is losing five employees for every one new employee it brings on board.) At the same time, it has been charged with major new responsibilities, such as implementing the *Foreign Account Tax Compliance Act* (FATCA) and the tax-related provisions of the *Affordable Care Act* (ACA). Its training budget has been slashed by over 80 percent; audit levels are rivaling historic lows; and, according to IRS Commissioner John Koskinen, the agency is operating with outdated information technology (IT) systems that have "many applications that were running when John F. Kennedy was president."

These challenges are real; their implications, even more so. Our nation relies upon the IRS to collect revenue to service its debt and to fund numerous agencies and programs. This past year, the IRS processed nearly 200 million tax returns and collected over $3 trillion, 93 percent of the federal government's revenue. That revenue is used to fund everything from national defense and disaster relief to Social Security, Medicare and veterans benefits, to servicing the nation's debts. In this respect, the IRS plays a unique role among our federal agencies. It is unique in another way as well: It may be the only federal agency whose budgetary dollars actually generate a direct financial return on investment (ROI). In more respects than one, it seems, the IRS budget is not a zero-sum game – and it may be the single most important policy issue that we face in the world of tax administration.

Without question, in recent years the IRS has been asked to do more and more with less and less. But, of course, it does not immediately follow that a bigger budget is the answer. Increasing efficiency, some argue, is another solution. Many who support IRS budget cuts also point out the need to exercise oversight and control over (if not punish) the agency, particularly in light of recent allegations against it. They also cite the need to control the federal deficit.

On the other side of the debate, however, many counter that Congress already has significant oversight authority over the IRS and that "[t]he victims of ... underfunding are not the IRS and its employees – the victims are U.S. taxpayers." Such critics also argue that budget cuts, if intended to address the deficit, will prove "shortsighted and counterproductive." A lack of funding, the argument goes, will lead to a significant drop in tax collections – actually *increasing* the federal deficit and harming long-term compliance levels.

The IRS is unique when it comes to the budgetary calculus since it may be the only federal agency that produces a direct financial ROI. Every dollar appropriated to the IRS actually generates more than a dollar of revenue in return. This is the so-called "multiplier effect." The IRS reports an overall multiplier of $4 for every dollar allocated to its budget, and the effect is even more pronounced in some areas, such as major enforcement programs.

It achieves this ROI in many ways: For example, by conducting audits, which are currently at levels that rival historic lows, engaging in other enforcement activities to ensure that taxes owed are converted to taxes paid and providing various taxpayer assistance programs. The latter is a sometimes overlooked, but extremely important, part of the equation. The IRS has historically helped taxpayers who want to comply with their tax obligations (but who often do not know how) through programs like Taxpayer Assistance Centers and helplines. All of these activities play an important role in the effort to increase voluntary compliance – the backbone of our tax system.

The IRS Workforce

Personnel costs account for about three-fourths of the IRS's budget. So it should come as no surprise that in light of these budget cuts, the agency has been forced to dramatically reduce its workforce. In fact, it is operating with approximately 13,000 fewer full-time-equivalent employees than it had in 2010. As mentioned previously, it is losing five employees for each one it brings on board.

To add insult to injury, since the IRS's training budget has been slashed, this affects the productivity of those employees who do remain. The training budget, although up slightly from FY 2014, remains 83 percent lower than its 2010 levels. That is a particularly difficult fact for an agency that administers a tax code that undergoes, on average, more than a change a day.

The consequences of these drastic cuts in staffing levels and training expenditures are real. For instance, IRS customer service representatives are currently unable to even answer about 35 percent of phone calls (a figure that is actually a year-over-year improvement because calls to the IRS have dropped sharply); the IRS is unable to process or answer over half of taxpayer correspondence in a timely manner (a 2,045 percent jump in the wrong direction since 2005); and it has now discontinued return preparation services through Taxpayer Assistance Centers, a change that disproportionately affects low income, elderly and disabled taxpayers.

Technology and Other Challenges

There are also serious IT challenges. The IRS desperately needs to modernize its IT systems, which account for nearly 20 percent of its budget. It is largely operating on what can be described, perhaps charitably, as outdated legacy systems, some of which are running applications that the IRS commissioner says were in place before we set foot on the moon.

The IRS relies on its information systems to process tax returns, send bills, issue refunds, select returns for audit and to provide a host

of telecommunications services for its business activities. Without the necessary investments to modernize its IT systems, the IRS will never perform these functions at optimal levels. And without making such outlays, its ability to meet the challenges posed by many 21st century threats – such as cyber-security attacks and identity theft – will remain inadequate.

These challenges, daunting as they are, are in many ways just the beginning. Despite the budget cuts, in recent years the agency has been tasked with new (and growing) core responsibilities. Under FATCA, the IRS's new responsibilities include collecting and analyzing data from more than 150,000 financial institutions and over 100 countries. Under the ACA, the IRS is required to administer the ACA's premium tax credit, as well as its "individual mandate" and "employer mandate." These are major undertakings that require substantial training and IT investments. It is not clear, however, that those investments are being made.

The Future

To be frank, the IRS budget debate is perhaps the single most important policy issue that we face in the world of tax administration. The IRS serves a unique and important role among our nation's federal agencies, and we depend on the revenues that it generates to run our entire federal government. It cannot generate those revenues without adequate funding. At the same time, it must be acknowledged that many of the concerns that have been voiced about the agency manifest deep concerns that our country has held about the power of taxation since its founding. Those concerns cannot be ignored, just as the calls to fix the budget cannot.

As the Taxpayer Advocate has aptly remarked, the reality is that while "[t]he IRS will never be a beloved federal agency, because it is the face of the government's power to tax and collect[,] . . . it should [nonetheless] be a *respected* agency." Striking the balance necessary to turn this aspiration into a long-term reality remains a difficult proposition – particularly insofar as the budget goes. The fact remains that the IRS is struggling in the current budgetary environment. Its responsibilities continue to grow, while its budget fails to keep pace, its workforce declines and its technological challenges continue to mount. At some point, something will have to give. The question, of course, is what? ■

Jason B. Freeman, JD, CPA is a tax attorney with Meadows Collier Reed Cousins Crouch & Ungerman 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.

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The Agitators

By Mano Mahadeva, CPA, MBA | Column Editor

The prospects of rich rewards continue to keep activist shareholder campaigns proliferating. Just over the past several months, hedge fund managers took positions to demand change at companies such as Apple, Microsoft, PepsiCo, Yahoo, AIG and Sysco. By persuading management, other shareholders or both of the wisdom of their approach, activist funds apply pressure on a company to reduce costs, split up, increase share repurchases, unload a flagging unit or even sell the entire business, due to differing business philosophies.

Within the past year, Trian Fund Management suggested that Sysco has not lived up to its potential and wanted a board seat to push for changes. Carl Icahn, who has taken aim at companies ranging from Apple to AIG, has set his sights on Xerox, arguing that shares of Xerox are undervalued. Pershing Square Capital Management's William Ackman believed Mondelez should cut costs or sell itself, due to inefficiencies. 21st Century Fox nominated Jeffrey Ubben, chief executive of Value Act Capital Management, where ValueAct agreed not to launch a proxy fight against the company for the length of the board term. GM reached a deal with an investor group that averted a proxy fight over its balance sheet. And in a rare move of support, in October, Trian Fund Management said it had taken a stake in GE as its seal of approval on the conglomerate's decision to narrow its focus.

Hedge funds have become an attractive segment of the alternative investment market with appeal to private wealth and institutional investor groups. This loosely regulated investment vehicle takes many forms, which add to their appeal. Initially created to reduce net market exposure as in a typical "hedge," today's hedge funds have broader applications. Each application is based on a strategy to take advantage of specific market opportunities. Activist funds, now boasting more than $100 billion under management, are funds with this type of strategy.

As market returns diminish and other successful strategies get replicated, activist funds have become increasingly active and ambitious in their selection of targets and inventive in their choice of tactics. Large institutional funds hoping to improve their returns are now routinely seen working with activist funds. Sophisticated media campaigns are used to help convince investors of needed change. Even independent board members have been more receptive to activist proposals.

Is hedge fund activism good or bad for the market? Can they change American capitalism for the better? This discourse is certainly heated on both sides of the aisle. Critics say that activists and their funds destroy value by loading up debt, reducing head count, reducing research and development, and pumping up short-term profits. Much has also been said about the use of complex financial engineering to ring up results. Critics call these activists the corporate raiders of old as depicted by the movie *Wall Street*. Supporters argue that corporate governance in companies is dysfunctional and that it is designed to protect the board and management from being accountable. They argue that in most cases, the stocks of companies sought after are undervalued due to mismanagement or the failure of the board or CEO to enhance value. They also state that holding an "active" position does not necessarily involve additional debt, more fees or in premiums to shareholders.

As this rhetoric continues, there have been failures and successes recorded as defined by different constituencies of the activists' performance. Even though these activities have been limited to public companies, it is important for us to learn from them and prepare ourselves and our company in a "prevention versus cure" approach. Toyota used the word "paranoid" in its approach to business years ago. And the word paranoid meant that regardless of how well they performed, they were fearful a competitor would do better than them, so they remained "paranoid" all the time.

Adopting that mindset, a company should remain "paranoid" and on an ongoing basis, review its mission, strategy and governance issues in light of its circumstances and needs, and regularly adjust them to meet changing market conditions. Company leaders should play their part by actively communicating their company's long-term strategy for growth, articulating what capital they seek, defining what real value is, explaining how this value is measured, and determining when the investments will deliver returns.

So rather than being told what to do to make us successful, why not proactively do this ourselves and possibly prevent a crisis? A forward looking, resilient and capable business will help position your company for success into the future. This will also help create a vibrant vision of the future that helps inspire people and make it attractive to those long-term investors who will help lead you to sustained success. ■

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.

What's Material? Don't Ask FASB

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

Materiality is a concept that is essential to the application of the fundamental qualitative characteristics of accounting information included in the conceptual framework for financial reporting. Proper application of the materiality concept establishes the threshold for relevance of an item in financial disclosure decisions.

The Financial Accounting Standards Board (FASB) has received feedback in recent years that the definition of materiality included in the conceptual framework is inconsistent with the legal concept the U.S. Supreme Court has established. In response, FASB has issued two exposure drafts dealing with materiality. One is a proposed amendment to Chapter 3, Qualitative Characteristics of Useful Financial Information, of Concepts Statement 8, *Conceptual Framework for Financial Reporting*. The other is a proposed update, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*.

Amendment to the Conceptual Framework

Proposed amendment to Chapter 3, Qualitative Characteristics of Useful Financial Information, of Concepts Statement 8, *Conceptual Framework for Financial Reporting* has an objective to ensure that the materiality concepts, as defined by FASB, are consistent with the legal concept of materiality. The amendment modifies the current definition of materiality and adds that it is a legal concept.

The current definition of materiality is as follows: "Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report."

FASB has omitted the above definition of materiality and inserted the following definition. "Materiality is a legal concept. In the United States, a legal concept may be established or changed through legislative, executive or judicial action. The board observes but does not promulgate definitions of materiality. Currently, the board observes that the U.S. Supreme Court's definition of materiality, in the context of the antifraud provisions of the U.S. securities laws, generally states that information is material if there is a substantial likelihood that the omitted or misstated item would have been viewed by a reasonable resource provider as having significantly altered the total mix of information."

In other words, FASB is no longer taking responsibility for what is determined to be material. "The board cannot specify or advise specifying a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation." Entities must follow the Proposed Accounting Standards Update, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material* when using discretion on what to include in the notes to the financial statements.

ASC Topic 235

Proposed Accounting Standards Update, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, has an objective to improve the effectiveness of disclosures in the notes to the financial statements. FASB wants to clarify the information required by generally accepted accounting principles (GAAP) that is most important to users of the financial statements. To achieve this objective of improving the effectiveness of notes to the financial statements, FASB has developed a framework that promotes consistent decisions about disclosure requirements. Reporting entities must apply this framework appropriately and use proper discretion.

The main provisions in this update draw attention to the role materiality plays in making decisions about disclosures. The proposed update explains that materiality would be applied to quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements as a whole. Therefore, some, all or none of the requirements in a disclosure section may be material. The update also states that materiality would be identified as a legal concept and the omission of a disclosure of immaterial information would not be an accounting error.

The Next Steps

Comments on both of the above mentioned proposed updates, *Notes to the Financial Statements (Topic 235): Assessing Whether Disclosures Are Material* and proposed amendment to Chapter 3, Qualitative Characteristics of Useful Financial Information, of Concepts Statement 8, *Conceptual Framework for Financial Reporting* were due on Dec. 8, 2015. FASB is re-deliberating its proposed changes based on feedback received through the comment letter process. For more information on this topic, visit fasb.org.

Auditors Still on the Hook

It should be noted that these proposed changes do not impact the auditing literature. Therefore, the definition of the term and its applications under U.S. and international auditing standards is expected to remain as it has been in the past. ■

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.

Reporting Tools Are Changing

By Randy Johnston

Getting the right information out of a system can be difficult and time consuming. Relief may be in sight. Technology vendors continually release new generation products and you can be the beneficiary.

Most of us have conceded that to get the reports we need, we have to use the universal reporting tool from Microsoft Excel. We use Excel as the Swiss Army knife of reporting, choosing to create reports, even when this is not the best, repeatable choice. The tool is inexpensive and many users have at least some command of how to run the product. Excel is certainly flexible and produces attractive graphics when needed. Particularly with Tables, PivotTables and Power BI, the reporting engine has vastly improved over the last 15-20 years.

Reporting relief comes in the form of other updated tools as well. From BizNet to Palo Alto LivePlan, or Aplos to Xero, we are seeing systems be more meticulous in actionable management information through standard financial reporting and by providing appropriate dashboard and Key Performance Indicators (KPIs) that can be assembled to fit our needs.

Tools and Programs

It is clear in the profession that the pace of change is accelerating. Vendors have made significant inroads into collaborative accounting and reporting. Examples include:

- FreshBooks – invoicing for Schedule C type clients
- SageOne – accounting and project management
- Wave – accounting with inexpensive payroll
- Xero – accounting with payroll and accountant friendly tools
- Accounting Power – an accountant-centric system with good payroll
- QuickBooks Online – the major focus of Intuit for accounting
- NetClient CS with ACS and Client Access – Thomson's client accounting system
- CYMA – notable payroll and human resources management
- Intacct – mid-market system supporting multiple verticals
- Sage 300 Online – a robust system updated for online use
- Open Systems – a robust system with NFP, construction and other vertical support
- Epicor Online – a strong distribution and manufacturing system

However, accounting and the reporting within those systems is only part of the battle. To provide useable information, there are interesting additional tools for planning, reporting, expenses and more. Many of these can be used with QuickBooks or other accounting products or as stand-alone applications. Examples include:

- Palo Alto LivePlan – a budgeting and planning tool
- BizNet Software – an Excel-based reporting tool
- BizTools Professional – a multidimensional analytics tool
- Tallie – expense reporting with forms recognition
- Avalara – Sales and use tax software to support a SALT practice
- Results CRM – Business development integrated to QuickBooks and other products, with project management

If you note the first list above, you'll see a number of applications that are providing browser-based Software as a Service (SaaS) accounting with increasing levels of capabilities and complexities. Firms can build a client facing, recurring revenue practice with one or two of these products. The second list adds capabilities that many clients and business owners value and need. These products usually work standalone or with one or more other systems. For example, making accurate forecasts is a difficult business at best and clearly, cash flow is a primary reason for business failure. Palo Alto LivePlan provides a budgeting and forecasting tool that can be used effectively with small to medium businesses. Almost no system provides sufficient reporting by itself, and BizNet helps create powerful supplemental reports by automating data connections into Excel and providing accounting functions like prior quarter. Avalara is the leader in sales and use tax, and interfaces with more small and mid-sized products than any other offering. Further, the professional filing support is strong. Selecting the right tool(s) from this list can extend and improve your reporting capabilities.

Why the Right Reporting Tools Make a Difference

Reporting should be repeatable, convenient, consistent and provide sufficient detail to make informed decisions. Our reporting must provide the information to implement our management strategies. We know we can't believe vendor claims that by using a particular product, you will have success.

However, if you don't have the right program to get the job done, you'll work much harder than needed. Having the right tools and processes enable your firm to measure the results of business performance.

The right programs can save time, effort and money. However, in your selection process, you should spend enough time at the beginning of the process to understand your needs, what you have today and the expected improvement. Most of us have concluded we can create almost any report in Excel, but is there a better way? Or, at least, can we automate the process of getting current numbers into Excel?

If you have not updated or changed your reporting tools or techniques in the last few years, you could be wasting significant effort. Investigate your options, and consider supporting your changes through TSCPA's CPE courses. To learn more and register, go to the CPE section of the website at tscpa.org. ■

Randy Johnston and his NMGI team provide IT consulting services and recommendations to accountants 24/7, coast to coast. His K2 Enterprises' team provides CPE through TSCPA and other state CPA societies via live classroom delivery, webinars and in-house training.

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El Paso Chapter Turns 75 in Style

By Rhonda Ledbetter | TSCPA Chapter Relations Representative

On April 23, 1940, a small group of El Paso Certified Public Accountants met at the Hilton Hotel and organized the El Paso Chapter of the Texas Society of CPAs. Those present at the organization meeting were **Guy Douglas, Florence Buckner, Henry Bollman, J. Glenn Bixler, Sam Meyers, C. L. May and O. C. Moore** (all deceased).

Douglas was elected as chairman and **Buckner** as secretary-treasurer for the remainder of the current fiscal year that ended June 30. A tentative program was outlined for future activities ...

... and 75 years later, the El Paso Chapter celebrated, in large fashion, all that it has accomplished in that time; all CPAs who have come and gone and who continue to serve in the community; all members young and old; and all accounting students preparing to join the CPA profession and continue the tradition.

Planning for the gala began in July 2014 by gathering a committee that included chair **Sean Ihorn, Teri Reinert, Terri Rutter, Tony Benitez, Kerry Lore, Ruth Elizondo, Rey Cardenas, Dahlia Garcia** and **Hugo Olivares**. After much discussion, it was decided that this would be a fun event focusing on celebration and entertainment rather than CPE or sedate presentations.

Additionally, it seemed fitting to further the chapter's mission of scholarship opportunities for local accounting students and make the evening a fundraiser to help the newly created **Dr. Sidney "Sid" P. Glandon** Endowed Scholarship in Accounting at UTEP, which honors Glandon, a long-active chapter and TSCPA board member.

The date was selected: Friday, May 8, 2015. The location was determined: Sunland Park Racetrack & Casino. Over the course of the next few months, many fun details were added to the schedule, including dinner, dancing, a silent auction, stand-up comedy and a live auction featuring "Eligible Bachelors and Bachelorettes in Accounting."

Jonathan Kraftchick, a CPA from Raleigh, North Carolina, agreed to perform his stand-up comedy and host the live auction. He proved to be the star of the night. Kraftchick had previously won the 2014 Search for the South's (Triangle's) Funniest Accountant and his video made it online, where the event committee discovered him. When they approached him, he was hesitant at first, but he got caught up in the chapter's excitement and said he would be honored to be included. He even said he was going to take some of the ideas – with permission, of course – back to his local CPA society.

The Young CPA Committee had a ball organizing the live auction and provided four willing participants. The segment raised about $500 of the total auction monies raised, almost $2,700. More than anything, the live auction raised a ton of laughs. Kraftchick's natural ability to make everyone laugh and the participants' willingness to ham it up made for a really great time.

The fun continued with dancing to live music provided by El Paso's own FM Junkies and maybe a little peeking into the casino by some of the attendees during the evening. The highlight of the silent auction was a guitar signed by B.B. King.

TSCPA CEO/Executive Director John Sharbaugh; El Paso Chapter Executive Director Beverly Longoria; 2014-15 Chapter President Sean Ihorn, CPA-El Paso; and TSCPA's 2014-15 Chairman Mark Lee, CPA-Houston.

El Paso Chapter President-elect Terri Rutter, CPA; Past President Tony Benitez, CPA; and Letty Benitez.

The entire event raised more than $4,200 for the Endowed Scholarship Fund, which will be fully funded within the next four years.

The chapter had some special guests at the festivities. TSCPA CEO/Executive Director **John Sharbaugh**, CAE, and TSCPA's 2014-15 Chairman **Mark Lee**, CPA-Houston, both spoke and were bestowed with "Run From Your Taxes" El Paso Chapter 5k Race shirts. Also in attendance were TSCPA past chairmen **Willie Hornberger**, CPA-Dallas, and **Jeff Gregg**, CPA-Wichita Falls.

There were more than 100 people at this momentous occasion, which garnered local TV coverage and was featured in the area business publication. The chapter also received a proclamation, signed by the mayor of El Paso, declaring CPA Day in honor of the chapter's 75th anniversary celebration. And, last but not least, the chapter also received a resolution from the Texas State Board of Public Accountancy signed by **William Treacy**, executive director, and **Thomas Prothro**, presiding officer, honoring the chapter for its long history of serving as a central source of information for its members; offering professional education programs; representing CPAs before state and federal regulators and legislators; and promoting the image of the CPA with the general public, media, legislators, educators and students.

Here's to the El Paso Chapter!

Editor's Note: Special thanks goes to El Paso Chapter Executive Director Beverly Longoria for her work on this issue's Chapters column.

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San Antonio / June 1-2

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Dallas / July 16

Advanced Health Care Conference
San Antonio / July 19-21

Texas State Taxation Conference
Houston / August 12-13

Advanced Estate Planning Conference
San Antonio / August 27-28

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Texas CPA Tax Institute
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Looking Back With Pride

Longtime TSBPA Executive Director Reflects on Board and Personal History

By Anne McDonald Davis

As the Texas State Board of Public Accountancy (TSBPA) celebrated its centennial in 2015, the profession recognized TSBPA's widely respected Executive Director **William Treacy** for his 25th service anniversary. Once quoted as saying, "Our philosophy is compliance over condemnation, prevention over punishment, and the public interest over the public intimidation of CPAs," Treacy has seen everyone justly served by that approach over the years.

"Our board regularly receives positive feedback," he asserts. "That tends to be unusual for a state agency. I believe the compliments we receive from the public are a testament to the board's ability to serve the public and licensees with respect and courtesy."

The executive director is pleased to report that the number of complaints continue to diminish over time, largely due to a proactive approach. For instance, the board sends upcoming CPE requirement reminders and early warning notices to licensees. As a result, many disciplinary actions are dismissed on the basis of voluntary compliance. Proactive programs such as CPE ethics requirements and peer review also impact compliance. With an ever-increasing volume of licensees, Treacy is gratified there isn't a corresponding increase in disciplinary actions.

He comments: "The board has always done a superb job of administering the Act and Board Rules, even with limited resources. In recent years, the board has been very fortunate in the way it has received resources; this has greatly enhanced our effectiveness. TSBPA prides itself on standing as a model for other boards of accountancy around the country."

Treacy has observed a definite correlation between the board's reputation and accomplishments, and the relationship that exists with TSCPA. "Considering the caliber of the sincere, dedicated CPAs and public members who are appointed, our agency has a very bright future," he smiles. "When there are more applicants willing to serve than there are positions available on the board, we can be assured that the excellent quality of the members will continue."

Those who've had the opportunity to meet Treacy and work with him over the decades know that the slight lilt in his voice can be traced back to his Cork City, Ireland, birth. A naturalized U.S. citizen since young adulthood, he tries to find time to return to the Emerald Isle for regular visits.

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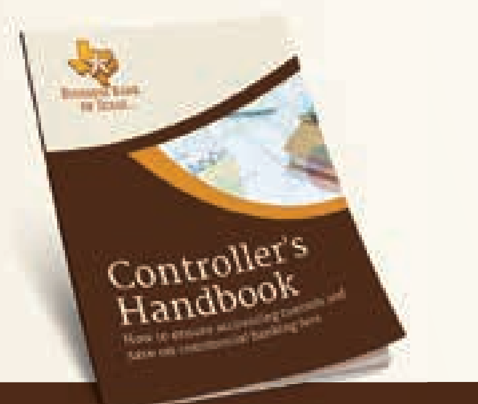

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He recalls: "Growing up, we didn't have the means or opportunity to do much sightseeing. Some of my older siblings had never seen some parts of Ireland. On a recent trip, we visited areas of the country that were new to them. I took them out to the Dingle Peninsula, among other places. With the help of GPS, I even took my brother-in-law to an old farm that once belonged to his uncle. He used to go to the farm during the summer when he was a boy. We also traveled the back roads of west Cork and marveled at its beauty." When teased about Ireland's regular mists and drizzle, Treacy jokes, "I always think of Ireland as a chilly version of Hawaii."

Grandfather to five, he and wife, Renée, have also taken their extended U.S. family to contemplate drisheen, barmbrack and leprechauns (none spotted recently). He laughs: "The grandchildren are getting older – the twins are in college. All five are in Lubbock, so I do my best to try and keep up with them via texts and social media. Took the older ones over a few years ago ... still need to organize a trip for the others."

Aside from rooting for Notre Dame during football season, Treacy's interests include literature and music. He recently acquired an acoustic guitar and has started taking lessons.

"My dad was very learned in music and self taught," he reminisces. "From an early age, music was part of my life. One of my first jobs was selling programs at the local opera house. So I'm inspired to learn (the instrument) because of him and those memories. I also relish Tony Mottola's classical Spanish guitar, and Vivaldi's just wonderful to listen to."

100-year Anniversary of TSBPA

March 2015 marked the centennial anniversary of the Public Accountancy Act (the Act). The Act was created in 1915 by the Texas Legislature to form the Texas State Board of Public Accountancy. The Act mandates the board to protect the public and ensure competence in accounting practice by administering exams, issuing certificates and licensing CPAs.

Treacy adds: "My late brother ... we were close ... used to play the bagpipes and accordion. I miss him to this day. There's a certain spirituality in music that makes life worth living."

As for literature, Treacy considers his latest read, *The Alchemist* by Paulo Coelho, to be primarily about pursuing personal dreams. He explains: "We all have personal dreams, but sometimes the road of life takes us on a zigzag path to unexpected places and differs from what we had originally envisioned. However, if we really use our imaginations, we can make connections between our personal dreams and our careers. I once dreamed of being a ship's captain. In a sense, that's what I am. That dream is fulfilled by my ability to serve the public as the executive director of the board." ■

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MEETING INVESTMENT MANAGEMENT NEEDS ACROSS TEXAS AND BEYOND

Politics, the PAC and the Profession

By Diane Joiner | Manager, TSCPA Governmental Affairs

No doubt you know there is a presidential election this year. It is nearly impossible to escape the ads, the articles, the debates and the entertaining shenanigans of all the candidates. Even if you wanted to ignore the propaganda, it would almost be impossible to do so. You can't avoid it, so here's a little humor to help you through the next 10 months:

"When I was a boy, I was told that anybody could become president; I'm beginning to believe it."

—Clarence Darrow

"We'd all like to vote for the best man/woman, but they are never a candidate."

—Kin Hubbard

"George Washington is the only president who didn't blame the previous administration for his troubles.

—Author Unknown

"The best thing about this group of candidates is that only one of them can win."

—Will Rogers

But seriously now, don't let all the presidential monkey business distract you from paying attention to the statewide elections that we'll also have right here in Texas this fall. Sure, the campaigns will be less flashy and entertaining, but no less important. Candidates elected to the 150 Texas House seats and 16 Texas Senate seats will be weighing in on issues that affect CPAs, their clients and their valued profession.

The filing deadline for state elections was Dec. 14. One notable name missing is CPA and TSCPA member **Rep. John Otto** (HD18), current House Appropriations Committee chairman, who announced back in July he would not run for re-election in 2016. He has been an outstanding legislator throughout his career, including being recognized as one of the top 10 legislators for the 2015 session. He has also been a successful advocate for CPAs during his legislative tenure. TSCPA wishes him well in his new endeavors; he will be sorely missed.

CPA incumbents, **Angie Chen Button** (HD112) current Economic and Small Business Development Committee chair, **Phil Stephenson** (HD85), **John Frullo** (HD84) current Insurance Committee chair, **Scott Sanford** (HD70) and **Charles Perry** (SD28) current Water and Rural Affairs Committee chair, have all filed for re-election. As of this writing, we're combing the list of candidate filings to see if any other of your CPA brethren will be running for a statewide position in Texas. Who better understands Texas business and the profession than a CPA? Supporting these and other worthy candidates is essential to preserving your profession and the economic climate in which you operate.

Which brings me to the TSCPA CPA-PAC, your professional organization's Political Action Committee. I know the word "PAC" turns a lot of people off, but the fact is that political campaigns cost money, lots of money. The best way to protect the profession from the consequences of unwanted regulatory and legislative decisions, is to financially support candidates and incumbents who understand the importance of a sound Texas economy and the critical role of the CPA in preserving the state's business climate.

REGISTER to VOTE

REGISTER to VOTE by Feb 1, 2016. The TEXAS PRIMARY election is Tuesday, March 1, 2016.

A few facts about the CPA-PAC that might make the idea of contributing more palatable include:

- The CPA-PAC is directed by the TSCPA PAC committee, whose volunteer members are appointed by the TSCPA chair.
- 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 Affairs committees to determine which policymakers should receive CPA-PAC contributions.
- Of all the funds contributed to the CPA-PAC, **75 percent goes directly back to chapters for donation to their local lawmakers**, while the remaining 25 percent is donated to candidates in campaigns for statewide office.
- Administrative expenses involved in the CPA-PAC's day-to-day operations are underwritten by TSCPA.
- Contribution decisions are based upon 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.
- It's easy to contribute – online donations can be given at txcpapac.org.

Remember, to ensure that the CPA profession continues to have a strong presence in Texas' legislative and regulatory activities, as many members as possible must be involved in the political process. And that process starts with the CPA-PAC and election of friendly office holders.

As Plato said: *One of the penalties for refusing to participate in politics is that you end up being governed by your inferiors.* Let's not allow that to happen. Stay informed and participate in the process. ■

For those CPAs who might want to run for office at some point in the future, AICPA has developed a two-part video and brochure that provides CPAs with information on running for political office. These can be found on their website at http://www.aicpa.org/Advocacy/State/Pages/CPA4Office.aspx.

New Appointments to the Texas State Board of Public Accountancy

We usually concentrate on legislative issues, but we shouldn't forget that we have regulators, as well as legislators. The Texas State Board of Public Accountancy (TSBPA) is the agency responsible for keeping CPAs on the straight and narrow. This group of volunteer board members does an excellent job of enforcing the Public Accountancy Act and protecting the public. Part of that public protection is to be sure that professional services are provided by qualified CPAs.

Gov. Greg Abbott has named **J. Coalter Baker**, CPA-Austin, as presiding officer of TSBPA. Additionally, he appointed **Ben Pena**, CPA-Rio Grande Valley; **Rosie Morris**, Ph.D., CPA-Austin; **Kimberly Wilkerson** of Lubbock; **Timothy LaFrey**, CPA-Austin; and **Ross T. Johnson**, CPA-Houston, to the board for terms set to expire on Jan. 31, 2021.

TSBPA protects the public by ensuring that persons issued CPA certificates possess the necessary education, skills and capabilities, and that they perform competently in the profession of public accountancy.

J. Coalter Baker is a self-employed CPA and personal financial specialist in Austin. He is a member of AICPA and TSCPA, and a board member of the Stephen F. Austin Society and Austin Boys and Girls Clubs Endowment Fund. He is a past member of the AICPA Professional Ethics Executive and Tax Responsibilities committees, and the National Association of State Boards of Accountancy Nominating and Ethics committees. Baker was appointed to TSBPA in 2003, where he served in various leadership roles, including presiding officer, until 2008. The governor reappointed him in 2011 to serve through 2017. He is also past president and past executive director of the West Austin Youth Association, a past member of the Greater Austin Chamber of Commerce Education Committee, and is a graduate of Leadership Austin. He has been honored to serve on AICPA's Tax Practice Responsibilities and Professional Ethics Executive Committees. Baker has served as a graduate school lecturer at the University of Texas, McCombs School of Business in taxation. He received a Bachelor of Business Administration degree in accounting from the University of Texas.

Ben Pena is a partner with Burton, McCumber & Cortez, LLP in Brownsville. He currently serves as director-at-large for TSCPA. He is a member of AICPA, the Association of Certified Fraud Examiners and the Institute for Internal Controls. He also serves as vice president of the Brownsville Community Foundation, as well as a director of the Brownsville Chamber of Commerce and steering board member of Leadership Rio Grande Valley. Pena received his Bachelor of Business Administration degree in accounting from the University of Texas-Pan American.

Dr. Rosie Morris is a professor at the McCoy College of Business Administration, Department of Accounting at Texas State University. Her teaching awards include the 2011 FBD Distinguished Educator Award, TSCPA's Outstanding Accounting Educator Award for 2002, the Texas State College of Business Administration's Teaching Excellence Award for 2000, and the Technology Innovation Award from Accounting Instructors' Report in 2001. She has also served on AICPA's Pre-Certification Education Executive Committee. Morris was honored as an inductee into the San Marcos Women's Hall of Fame in 2001 for her civic contributions and has been a nominee to the Texas Women's Hall of Fame. She received a Bachelor of Science in mathematics from Texas Christian University, a Master of Science degree in accounting and a Doctor of Philosophy in Business Administration from the University of Houston.

Kimberly Wilkerson is a shareholder with Hund, Krier, Wilkerson & Wright, P.C. For the past 20 years, she has represented clients throughout Texas in matters ranging from employee benefit compliance issues and audits by the Internal Revenue Service and the U.S. Department of Labor, to counseling clients on issues related to design and operation of qualified retirement plans, welfare benefit plans and non-qualified deferred compensation plans and arrangements. She is a member of the State Bar of Texas, the Lubbock County Bar Association and the Lubbock County Women's Bar Association. Wilkerson received a Bachelor of Arts degree in political science from Texas Tech University and a Juris Doctor from Southern Methodist University School of Law.

Tim LaFrey is the executive vice president of strategy and business development at Seton Healthcare Family in Austin. Currently, he is chairman of the Board of Directors of Seton Insurance Services and the Seton Health Plan. He served on the Seton Board of Trustees for more than six years before joining the organization as an employee. Previously, he served as president and was a member of the Board of Directors of American Physicians Service Group, Inc. During his tenure, the company was recognized by *Forbes* and *Fortune* magazines as one of the country's fastest-growing public companies. He has served as a member of TSCPA's Board of Directors and the Travis County Bar Association. LaFrey received his Bachelor of Business Administration degree in accounting from Texas A&M University and a Juris Doctor from the University of Texas School of Law.

Ross T. Johnson is an audit director with Deloitte & Touche LLP in Houston. He is a member of AICPA and TSCPA. He is a deacon at Tallowood Baptist Church in Houston and previously served as a member of the Planning & Zoning Commission of the City of Spring Valley Village, Texas. Johnson received a Bachelor of Business Administration degree in accounting from Texas A&M University.

The other continuing CPA members of the board are: **John**

continued on next page

MEET THE BOARD MEMBERS

Broaddus, El Paso; **Rocky Duckworth**, Houston; **Donna Hugly**, Addison; **Bob McAdams**, San Antonio; and **Steve Pena**, Georgetown. All are members of TSCPA.

The continuing public members of the board are: **Jonathan B. Cluck**, Esq., Fair Oaks Ranch; **Susan Fletcher**, Frisco; **Bill Lawrence**, Highland Village; and **Phil Worley**, Hebbronville.

If you know any of these board members, be sure to express your appreciation for their service. They serve six-year terms with extensive time commitments. For more information about the board and its various committees, visit www.tsbpa.state.tx.us.

TSCPA wishes a very happy 25th anniversary to TSBPA's Executive Director Bill Treacy. He is highlighted in the Spotlight on CPAs article in this issue of *Today's CPA* magazine. We thank him for his years of service to the profession! ■

Diane Joiner is TSCPA's manager of governmental affairs. Contact her at djoiner@tscpa.net.

Disciplinary Actions

The following people have had their membership in TSCPA expelled by the Executive Board under TSCPA *Bylaws* Article III, Section (4B)(1). This action was a result of the revocation of their CPA certificate by the Texas State Board of Public Accountancy.

- **Robert Bourgeois, Fort Worth**
- **Howard T. Lay, Houston**

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)(1) for non-compliance with the Texas State Board of Public Accountancy's continuing professional education requirements.

- **Michael A. Lawanson, CPA, Houston.** ■

TAKE NOTE

Celebrating TSCPA's Centennial Anniversary

TSCPA began with a small gathering of accountants in 1915. Today, TSCPA has 20 chapters across the state, with a membership of nearly 28,000 members. Be sure to check out the special 100th anniversary page on the website at tscpa.org where you'll find details about planned celebrations, a way to order a copy of TSCPA's newest history book, profiles of those who shaped our history, and an impressive list of sponsors who have helped make the celebration special. Many of the local chapters are also celebrating this milestone, so check in with your chapter for ways you can celebrate close to home. ■

Membership Suspension

Norman L. White, Longview, entered into a settlement agreement under the Joint Ethics Enforcement Program in lieu of further investigation and proceedings of alleged violations of the Code of Professional Conduct of AICPA and the Texas Society of CPAs. Without admitting or denying any wrongdoing, White was suspended from membership in TSCPA for a period of two years, effective Oct. 15, 2015. ■

2016 Outstanding Accounting Educator Award Nominations Due March 1

Do you know an accounting educator who deserves recognition? TSCPA is accepting nominations for 2016 Outstanding Accounting Educator Awards. This award recognizes Texas accounting educators who have demonstrated excellence in teaching and have distinguished themselves through active service to the accounting profession. The award recipients will be honored during TSCPA's annual Accounting Education Conference, and each recipient will receive a $500 award, a recognition plaque and complimentary registration to the Accounting Education Conference. The deadline for nominations is March 1, 2016. Go to https://www.tscpa.org/eweb/DynamicPage.aspx?Webcode=STUEdAward or contact TSCPA's Catherine Raffetto at craffetto@tscpa.net or 800-428-0272, ext. 216 (972-687-8516 in Dallas) for more information. ■

Accountants Confidential Assistance Network

The Accountants Confidential Assistance Network (ACAN) is a peer assistance program that supports Texas CPAs, CPA candidates and/or accounting students who are addressing alcohol, chemical dependency and/or mental health issues. ACAN provides a confidential phone line at **1-866-766-ACAN** to help people who need assistance. You can also contact TSCPA's Craig Nauta at cnauta@tscpa.net. To learn more about the program, please go to TSCPA's website at tscpa.org. Under the Resource Center tab, scroll down and click on Accountants Confidential Assistance Network. ■

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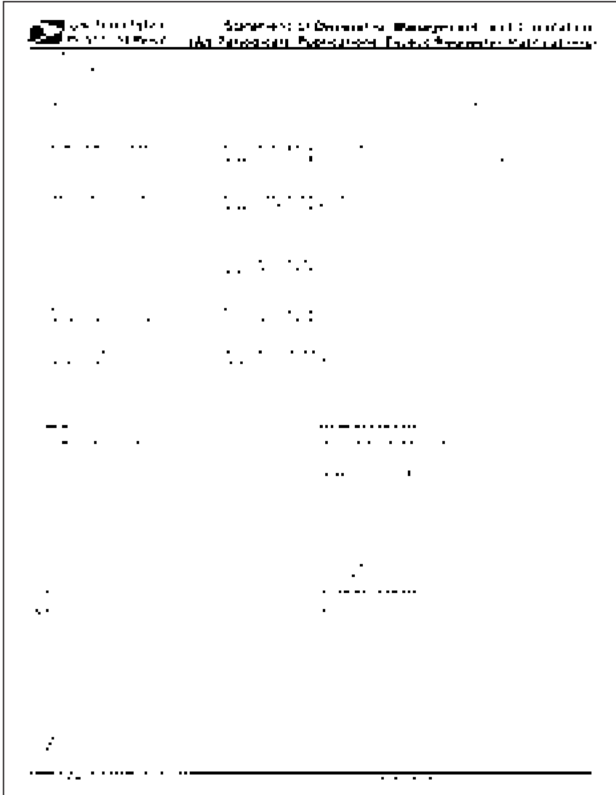

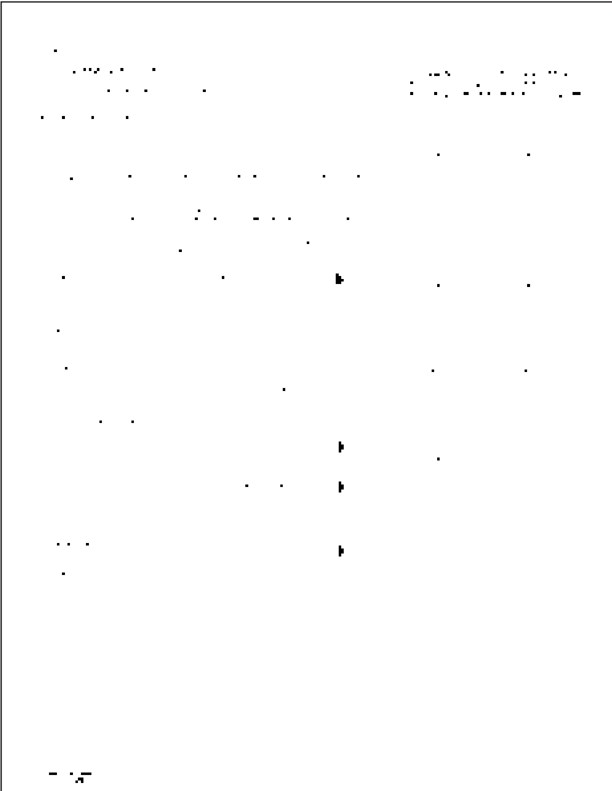

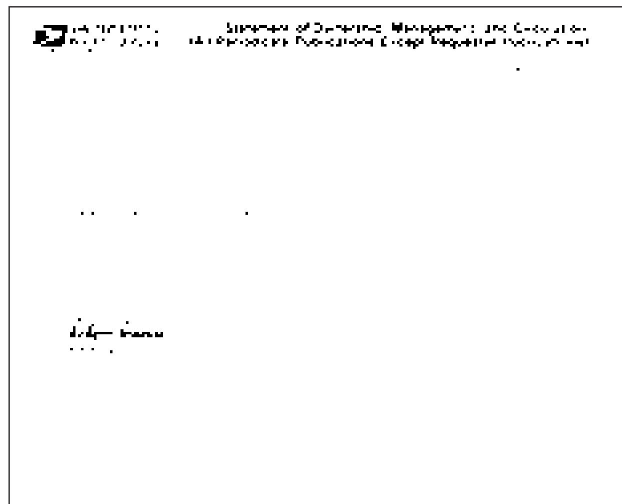

CGMA Designation: AICPA Proposes Expansion of Joint Venture with CIMA

TSCPA and AICPA are currently working on a wide variety of initiatives to enhance the relevance and vibrancy of the accounting profession far into the future. In 2011, AICPA formed a joint venture with the Chartered Institute of Management Accountants (CIMA) in response to the needs of members working in corporations of all ownership structures and sizes. In January 2012, the two organizations launched the Chartered Global Management Accountant (CGMA) designation.

This international designation recognizes management accountants and provides them with reports, tools, webinars and research that can keep them at the forefront of the profession. The number of CGMA designation holders is now more than 150,000 worldwide, with over 50,000 in the United States. Now, AICPA and CIMA are beginning a conversation with their respective members about a proposal to integrate their operations, strategy and management through a newly formed association. For more information on the proposal to expand the venture with CIMA, please visit AICPA's website at aicpa.org. ■

Multiple TSCPA Members in Your Firm or Company?

TSCPA offers a single invoice renewal option for organizations with more than one TSCPA member on staff. Be sure all those who are eligible for membership can easily belong to the organization that serves as their advocate by renewing their annual dues in one easy process. Not only will you show your staff that you're committed to their personal and professional development, but you'll also eliminate burdensome reimbursements internally. For more details about how you can receive a single invoice to renew memberships for all TSCPA members in your organization, contact Stephanie King by calling 800-428-0272, ext. 233 or emailing sking@tscpa.net. ■

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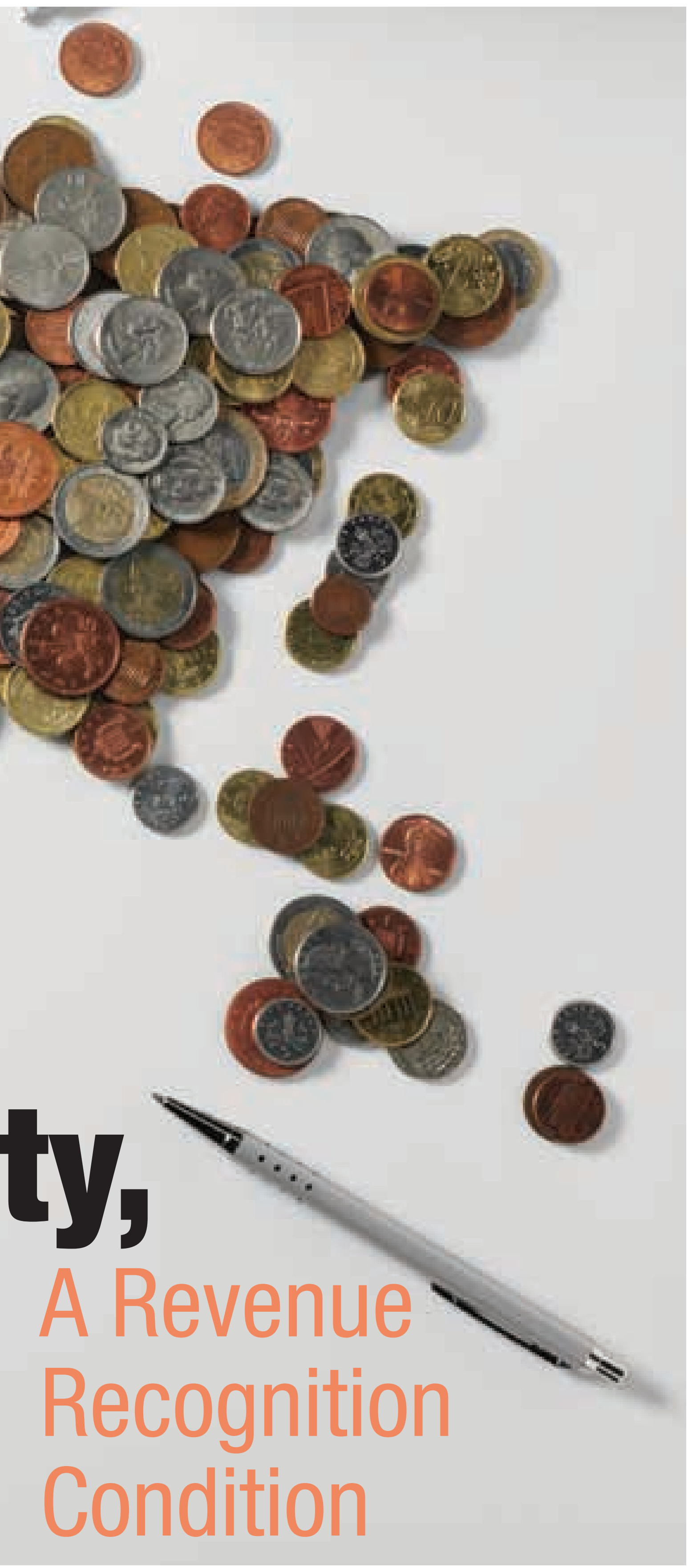


By Josef Rashty

In May 2014, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) jointly released their standard for revenue recognition. The new guidance may constitute the biggest accounting change ever for some companies. This recently issued guidance is a converged standard with the aim of fostering consistency in accounting practices globally. Companies in all industries and around the world will use the new five-step model for recognizing revenues from contracts with customers.

This article focuses on the criterion of collectibility in revenue recognition guidance and identifies a key major difference between the new standard (ASC 606) and the existing guidance (ASC 605).

In August 2015, FASB issued ASU 2015-14 to defer the effective date of the new revenue standard by one year, but also permitted entities to adopt one year earlier if they choose to do so (i.e., the original effective date). The deferral would result in the new revenue standard being effective for public business entities for fiscal years and interim periods within those fiscal years beginning after Dec. 15, 2018. The nonpublic entities would be required to apply the new revenue standard for fiscal years and interim periods within those fiscal years beginning after Dec. 15, 2019.

Current U.S. GAAP Revenue Recognition

In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) 104, *Revenue Recognition* (codified under Topic 605), which outlines the general principles of revenue recognition under the existing guidance. SAB 104 has remained the point of reference for revenue recognition guidance since then. The guidance per se does not create anything new, but simply summarizes the staff's views on applying the existing revenue recognition guidance.

ASC 605 requires the following four criteria for revenue recognition:

- Persuasive evidence of an arrangement exists.
- Delivery has occurred or services have been performed.
- The seller's price to the buyer is fixed and determinable.
- Collectibility is reasonably assured.

Assessment of collectibility is the fourth and final criterion for revenue recognition. The nature of this assessment is similar to assessment that a company makes to determine whether certain accounts receivable has become uncollectible and subject to a bad debt provision.

If, at the outset of an arrangement, a company assesses that collectibility of the debt from a customer is questionable, it cannot recognize any revenues until it receives the amount due or the circumstances change so that collectibility becomes reasonably assured. Thus, in certain instances, a company can use a cash-basis method to satisfy the collectibility condition of revenue recognition.

New Revenue Recognition Guidance

The core principle of the new guidance is that revenue recognized should reflect the transfer of promised goods or services to customers in an amount that reflects the consideration for transfer of such goods

continued on next page

or services. The revenue recognition criteria under ASC 606 are as follows:

- Identification of contract(s) with customers (ASC 606-10-25-1 through 25-13).
- Identification of performance obligations (ASC 606-10-25-14 through 25-22).
- Determination of the transaction price (ASC 606-10-32-2 through 32-27).
- Allocation of the transaction price to performance obligations (ASC 606-10-32-28 through 32-41).
- Recognition of revenue as the company satisfies performance obligations (ASC 606-10-25-23 through 25-30).

In the earlier version of the new guidance exposure draft, any reference to collectibility criterion was conspicuously missing. FASB's subsequent outreach to constituents supported the idea that collectibility criterion has a place and plays a role in revenue recognition. As a result, in the final guidance, one of the conditions for a bona fide contract is its collectibility. Paragraph (e) of ASC 606-10-25-1 states that in a contract, it should be probable that an entity will collect the consideration that it is entitled to collect. U.S. GAAP defines probable as "likely to occur" – generally a threshold of 75 percent to 80 percent. IFRS, on the other hand, defines probable as "more likely than not" – generally a threshold greater than 50 percent under IFRS 15, *Revenues from Contracts with Customers*. In evaluating whether collectibility of an amount consideration is probable, an entity shall consider the ability and intention of the customer to pay the amount of consideration when it is due.

ASC 606 requires that companies assess the probability of collection at the inception of the contract, based on the customer's ability and intent to pay the amount due. If a company determines that collection is not probable, it cannot recognize any revenues, even if it receives cash, until either of the following conditions is met (ASC 606-10-25-7):

- The customer has no remaining obligations and all, or substantially all, of the contract's consideration has been received and is nonrefundable.
- The contract has been terminated and the amount received deemed to be nonrefundable.[1]

The collectibility assessment is based on transaction price (the amount that the entity is entitled to receive) rather than contract price. Variability is an element that makes the contract price different from transaction price. There are instances when variability is explicitly stated in the contract; for example, if certain events occur, the company may offer a transaction price concession (ASC 606-10-32-7(a)). There may also be other facts and circumstances present that indicate a company's intention to offer a transaction price concession to the customer; for example, due to unfavorable economic conditions, the company may decide to offer a transaction price concession to the customer (ASC 606-10-32-7(b)).

In these scenarios, the company estimates the amount of variable consideration (the transaction price) based on "the expected value" or "the most likely amount" (ASC 606-10-32-8). The collection assessment must be made based on the amount of variable consideration (transaction price) and the company's expectation for a price concession and accepting a lower amount of consideration from the customer (ASC 606-10-55-100).

The new guidance highlights a major difference in collectibility criterion in ASC 606, as compared to existing guidance (ASC 605) – the cash-basis method can no longer be used for revenue recognition purposes. It can be argued that elimination of the cash-basis method better reflects the economic substance of transactions when collection is deemed to be not probable since the objective of a collectibility assessment is to evaluate whether the contract as a whole is valid and reflects a genuine transaction.

Formation of TRG

FASB and IASB formed a Joint Transition Resource Group (TRG) to solicit, analyze and discuss stakeholders' issues regarding implementation of new revenue recognition guidance, and to inform FASB and IASB of such issues. In its January 2015 meeting, the TRG discussed 11 issues related to the new revenue recognition guidance, including the criterion of collectibility. TRG members generally concluded that FASB's staff position on the issue of collectibility was reasonable.

However, some TRG members commented that the elimination of the cash-basis method may not properly reflect the economic substance of certain transactions. For example, in a long-term contract where services are performed monthly and the customer has a poor credit record and pays for amounts due on services monthly, the vendor cannot recognize any revenues until the contract is complete or terminated. They argued that such interpretation of guidance does not fully conform to the substance of the transaction. FASB and IASB may decide to discuss this issue further or conduct an outreach with stakeholders.

Latest Development

On Sept. 30, 2015, FASB issued an exposure draft titled *Narrow-Scope Improvements and Practical Expedients* for Topic 606; comments were due on Nov. 16, 2015. In this exposure draft, among other things, FASB clarifies the objective of collectibility criterion in revenue recognition.

The exposure draft would add a new clarity to paragraph 606-10-25-7 that allows an entity to recognize revenue in the amount of consideration (cash) received when the following conditions exist: (1) the entity has transferred control of the goods or services; (2) the entity has stopped transferring additional goods or services; (3) the entity has no obligation to transfer additional goods or services; and (4) the consideration (the amount of cash) received from customer is nonrefundable.

Thus, this exposure draft confirms the original intention of FASB in ASC 606 and the consensus of the TRG regarding collectibility condition. The author believes that FASB will approve and finalize the guidance in this exposure draft in early 2016.

Illustration

In this illustration, Entity A enters into a contract at the beginning of the first quarter to sell 1,000 units of product A to Entity B (an underfunded startup company) at $1,000. Entity A determines at

the outset that collection is not probable (ASC 606 terminology) or probability of collection is not "reasonably assured" (ASC 605 terminology).

Entity A ships 600 units of product A to entity B during the first quarter in good faith and Entity B pays Entity A $500 (non-refundable), but collectibility at the end of the first quarter still remains not probable.

The following scenarios occur in the second quarter:

Scenario A: Entity B cannot secure any additional financing and decides to close its business. Entity A does not ship any additional products to Entity B during the second quarter and terminates the contract.

Scenario B: Entity B secures additional financing and Entity A deems collection to be probable at the end of the second quarter. Entity A does not ship any additional product to Entity B during the second quarter.

Scenario C: Entity A ships the additional 400 units to Entity B. Entity B does not secure any additional financing, but manages to pay the remaining $500 of the contract to Entity A before the end of the quarter. Entity A considers the contract complete upon receipt of second payment.

Table 1 includes the journal entries that reflect the transactions described in this illustration.

Table 1:

	ASC 605		ASC 606	
1st Quarter	Dr. Cash	$500	Dr. Cash	$500
	Cr. Revenue	$500	Cr. Deferred revenues	$500
2nd Quarter	None		Dr. Deferred revenues	$500
Scenario A			Cr. Revenues	$500
2nd Quarter	Dr. Accounts Receivable	$100	Dr. Accounts receivable	$100
Scenario B	Cr. Revenues	$100	Dr. Deferred revenues	$500
			Cr. Revenues	$600
2nd Quarter	Dr. Cash	$500	Dr. Deferred revenues	$500
Scenario C	Cr. Revenues	$500	Dr. Cash	$500
			Cr. Revenues	$1,000

Bad Debt Provision

If collectibility is probable at the outset, but subsequently facts and circumstances change such that collection from the customer is no longer probable, the amount of the debt deemed to be uncollectible should be written off as a bad debt expense or the company should provide a bad debt provision for the account, as it is appropriate. Topic 450, *Contingences,* provides guidance to determine if it is probable that amounts will or will not be collected. The company should account for any impairment of its existing receivable in accordance with Topic 310, *Receivables*.

THE NEW GUIDANCE HIGHLIGHTS A MAJOR DIFFERENCE IN COLLECTIBILITY CRITERION – THE CASH-BASIS METHOD CAN NO LONGER BE USED FOR REVENUE RECOGNITION PURPOSES.

Final Remarks

The new revenue recognition guidance is a principle-based standard. Therefore, for revenue recognition to occur, a contract must exist and for a contract to exist, the collectibility must be probable. As a result, partial cash collection per se does not establish the collectibility status of the whole contract, since if probability of collectibility is not assured, the existence of the contract cannot be determined. Therefore, partial cash collection can be a criterion for revenue recognition if and only if the contract is completed or terminated, as defined by FASB ASC 606 and its recently issued exposure draft.

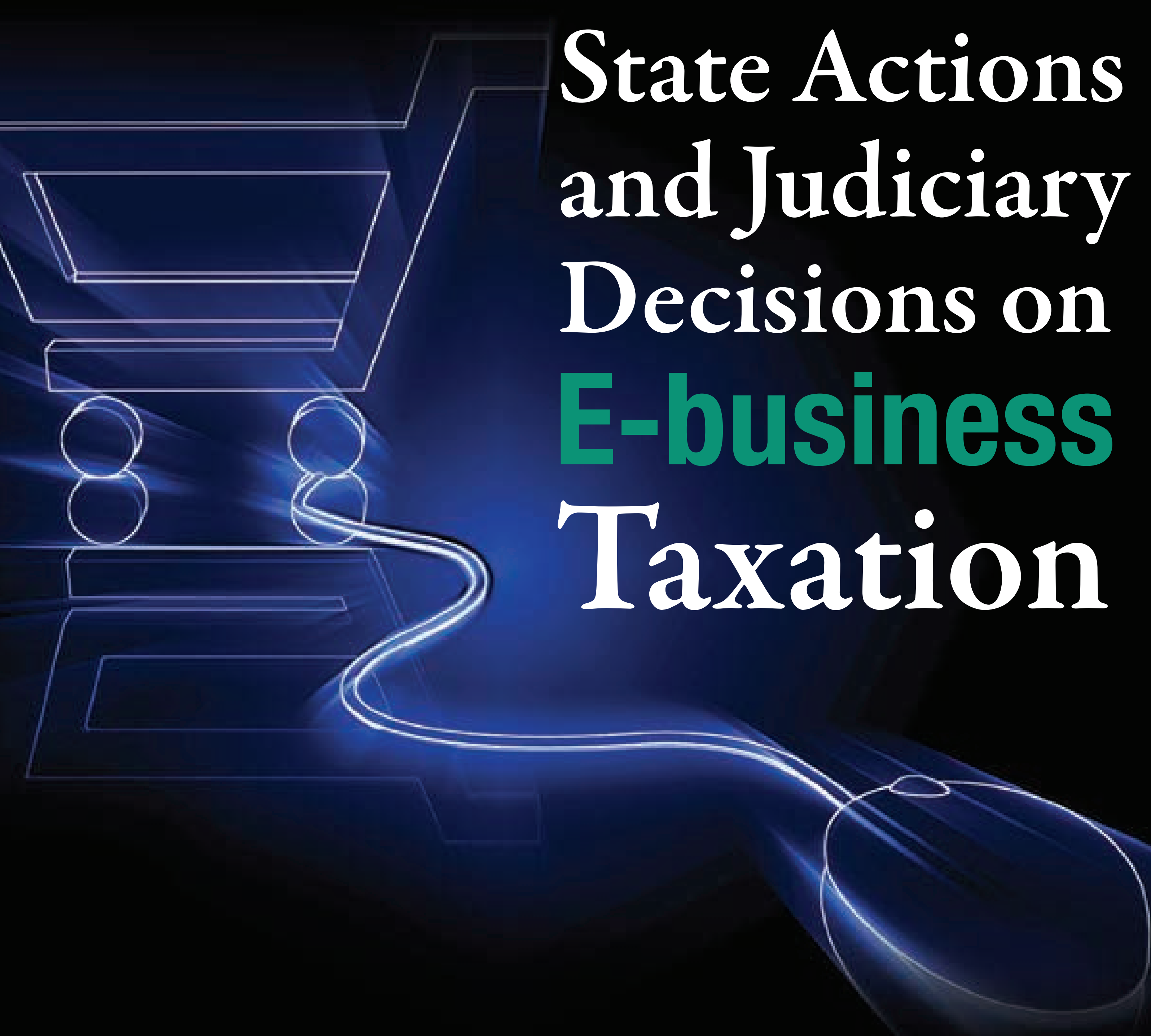
The author believes that accommodating the view of minority TRG members regarding long-term contracts with customers that have poor credit records (discussed earlier in this article) is against the spirit of the guidance and changes a principle-based standard to another rule-based standard, and that is exactly what FASB and IASB have been trying to avoid.

Footnote

1. Termination **means** that an entity can stop a contract based on the terms of the contract or through legal means; for example, by ceasing to transfer the remaining goods or deliver remaining services to customers. Thus, termination has an accounting rather than a legal connotation. In this context, termination implies that a company is allowed to recognize revenues for the amount of cash collected and meanwhile can pursue collection of the remaining balance, if any.

Josef Rashty, CPA is a member of the Texas Society of CPAs and has held managerial positions with several high-technology public companies in the Silicon Valley region of the Bay Area in California. He is also an adjunct lecturer of accounting at Santa Clara University in Santa Clara, California. He may be reached at j_rashty@yahoo.com.

State Actions and Judiciary Decisions on E-business Taxation



By James G. S. Yang, M.Ph., CPA, CMA, and Leonard J. Lauricella, LLM, JD, CPA

Internet commerce is a driving engine in today's economy. Annual e-business had reached $297 billion, totaling 6.4 percent of retail sales as of 2014, with a growth rate at 15.7 percent a year.[1] Problematically, sales tax is the purview of state and local governments. When seller and buyer reside in different states, responsibility for collecting sales tax is unclear. State governments have no authority over out-of-state sellers, whereas in-state buyers frequently ignore their use tax paying duties. Thus, state governments stand to lose a huge amount of sales tax revenue, by recent estimate, up to $23 billion a year.[2] The problem will only grow as most businesses today move to the Internet.

A sales transaction gives rise to sales tax. If the seller and buyer reside in the same state, it is the seller's responsibility to collect sales tax. If they reside in two different states, can the buyer's state government require an out-of-state seller to collect the sales tax? The 14th amendment of the U.S. Constitution requires due process to do so. The due process is meant to be nexus between the seller and the state. Evidently, what constitutes nexus becomes the key issue. The criteria are ambiguous and controversial. In the past six decades, 12 cases went to the U.S. Supreme Court for rulings. This article will review some of the major ones.

The guiding principle in making these court decisions was the concept of "physical presence." Nevertheless, in the last decade many state legislatures have been evolving to "economic nexus." This article will explain the differences between them. It will review four states and will also explore the most recent decisions by the U.S. Supreme Court. It will further offer an overview of the requirements of the new "Marketplace Fairness Act of 2013." The purpose is to point out that the developing trend of Internet commerce taxation has been shifting from the principle of "physical presence" to "economic nexus."

Transactions crossing a state border involve interstate commerce affecting almost all e-business transactions. States cannot require out-of-state sellers to collect tax unless there is a nexus between the seller and the state that satisfies the Commerce or Due Process clauses. For the state to impose tax collecting duties on an out-of-state seller, there must be a minimum connection between them.

Current Status of E-business Taxation by U.S. High Court Decisions

In the last six decades, the U.S. Supreme Court made at least a dozen rulings on tax collection from out-of-state sellers. Some of the major ones are:

- Mail orders of a company with a branch in the buyer's state constitute physical presence requiring tax collection. *Nelson (Iowa) v. Sears, Roebuck & Co.* (1941),[3] and *Nelson (Iowa) v. Montgomery Ward & Co.* (1941).
- Mail orders of a company without a branch or any contacts in the buyer's state are not subject to tax. *National Bellas Hess Co. v. Illinois Department of Revenue* (1967),[4] and *Quill Corp. v. North Dakota* (1992).[5]
- Sending traveling salespeople to a buyer's state subjects the seller to tax. *General Trading Co. v. Iowa State Tax Commission* (1944).[6]
- A dispute involved whether customers from a neighboring state should give rise to physical presence. The decision was negative. *Miller Brothers Co. v. Maryland* (1954).[7]
- Independent contractors in the buyer's state subject the seller to tax. *Scripto, Inc. v. Carlson* (Florida1960).[8]

These decisions were based on the principle of "physical presence," which defined the requirement of "due process." The business environment operates differently now.

By 2008, the principle of "physical presence" started to change. The Internet age had arrived. Computers connected with one another. An email can reach a targeted customer, replacing a salesperson. Employee physical presence is unnecessary. The transaction is executed online in real time. Many products can be digitized and downloaded from one computer to another, such as e-books. Offices, warehouses and branches are unnecessary.

In all these cases, despite the lack of physical presence, the seller derived profit from the buyers. The requirement of physical presence between the seller and the state becomes questionable. As a result, the concept of "economic nexus" began to evolve. As long as an out-of-state seller receives benefits from the state, it must be required to collect tax from the in-state buyer. The action comes from the state governments. The sellers always claim lack of physical presence to avoid collecting sales tax, costing state governments a huge amount of sales tax revenue. So far, many actions have been taken by state governments. The following section reviews four major ones.

New York's Amazon Tax Involving an Affiliate's Website Link

In 2008, the state of New York's Legislature enacted a new tax statute as follows:[9]

"The term *vendor* includes persons who solicit business within the state through employees, independent contractors, agents or other representatives and, by reason thereof, make sales to persons within the state of tangible personal property or services that are subject to sales tax."

An out-of-state seller is required to register as a vendor and collect sales tax if the following two conditions are met:

- The seller enters into an agreement(s) with a New York resident(s) under which, for a commission or other consideration, the resident representative directly or indirectly refers potential customers to the seller, whether by link on an Internet website or otherwise. A resident representative would be indirectly referring potential customers to the seller where, for example, the resident representative refers potential customers to its own website, or to another party's website, which then directs the potential customer to the seller's website.
- The cumulative gross receipts from sales by the seller to customers in New York as a result of referrals to the seller by all of the seller's resident representatives under the type of contract or agreement described above total more than $10,000 during the preceding four quarterly sales tax period.

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The statute deals with online sales as follows:

"Also, an e-commerce retailer that uses persons to act as its representative in the state to solicit sales or to make and maintain a market in return for commissions, referral fees or other types of compensation is considered to be soliciting business within this state through the use of independent contractors or representatives. Therefore, the e-commerce retailer must register as a vendor for New York State and local sales tax purposes."

However, the statute provides for exceptions as follows:

"In addition, an agreement to place an advertisement does not give rise to the presumption described above. For this purpose, placing an advertisement does not include the placement of a link on a website that, directly or indirectly, links to the website of a seller, where the consideration for placing the link on the website is based on the volume of completed sales generated by the link."

STATE GOVERNMENTS HAVE NO AUTHORITY OVER OUT-OF-STATE SELLERS, WHEREAS IN-STATE BUYERS FREQUENTLY IGNORE THEIR USE TAX PAYING DUTIES.

Amazon.com's headquarters is in Seattle, Washington. It has no branch in New York and no "physical presence." However, it did enter into agreements with many affiliates in New York to put its website link "amazon.com" on the affiliates' websites so customers could order merchandise from Amazon by using this link. The statute cites the website link as an evidence of "nexus" between Amazon and New York. The concept of "nexus" now means "economic nexus," since Amazon derives benefits from New York.

Many other companies have affiliates in New York, including overstock.com, eToy.com, luggage.com, RitzCamera.com, geeks.com, etc. There are 200,000 such affiliates nationwide, generating $14 billion in sales revenue. They have earned $6.5 billion in commissions. Lost sales tax revenue in New York by Amazon alone was $73 million in 2009. New York is not the only state to enact this tax statute. Other enacting states include Arkansas, California, Colorado, Connecticut, Florida, Kentucky, Illinois, Missouri, New Jersey, Nevada, North Carolina, Ohio, Pennsylvania, South Carolina, Texas, Tennessee and Virginia.[10]

State Judiciary Decision on New York's Amazon Tax Law

On July 16, 2008, amazon.com and overstock.com filed suit against New York in the New York Supreme Court, arguing that "Amazon had no physical presence – no real estate, employees or sales agent – in New York, and it therefore indisputably lacked a substantial nexus with the state. It had only website advertising affiliates and their in-state activities in Amazon's behest did not create a substantial nexus. Indeed, the physical location of Amazon associates was irrelevant and unknown to Internet consumers. Those websites could draw "hits" from anywhere, and there was nothing New York-centric about such advertising posting.[11] Amazon argued the affiliates are not Amazon's employees. Amazon had no control over them. All computers are connected today. The website link is nothing more than an "advertising channel." It should not be construed as physical presence and, hence, there is no nexus. This argument attempted to portray the affiliates as independent contractors who were paid commissions under contract. But per the *Scripto* case, independent contractors constitute physical presence.

New York countered that "… Amazon's business model depended on a closer relationship with its representatives than the simple publication of advertising; that Amazon's compensation plans for its representatives rewards them for actively marketing rather than passively placing links on websites; that Amazon does authorize its representatives to solicit business in New York for Amazon through means beyond the placement of links on websites …"

On Jan. 12, 2009, the court ruled in favor of New York. Amazon.com and overstock.com appealed to the New York Supreme Court, Appellate Division. On Nov. 4, 2010, the court ruled again in favor of New York.[12]

The "New York Amazon Tax Law" has completely changed the landscape of Internet commerce taxation by introducing the concept of "economic nexus." A seller having no physical presence in a state, but having derived profit from it, would be construed to have nexus. The seller is then required to collect sales tax from the buyer. It has also changed the interpretation of the requirement of "due process." As a consequence, many online retailers have terminated agreements with their affiliates in New York, such as amazon.com, overstock.com, eToy.com, luggage.com, RitzCamera.com, geeks.com, etc. This may have a devastating impact on the state's economy.

Illinois Also Adopts "Amazon Tax," but Rejected by Court

In line with New York's "Amazon Tax Law," on March 10, 2011, the Illinois General Assembly enacted Public Act 096-1544. It provided that "1.1. Beginning July 1, 2011, a retailer 'maintaining a place of business in the state' now includes a retailer having a contract with a person located in this state under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by a link on the person's Internet website. The provisions of this paragraph 1.1 shall apply only if the cumulative gross receipts from sales of tangible personal property by the retailer to customers who are referred to the retailer by all persons in this state under such contracts exceed $10,000 during the preceding four quarterly periods ending on the last day of March, June, September and December."[13]

This provision means that any out-of-state online seller with affiliates in Illinois is required to collect sales and use tax from the buyers in

Illinois. It is the same as New York's law. However, the Performance Marketing Association immediately filed a lawsuit against the Illinois Department of Revenue to the Circuit Court of Cook County. The court ruled against the state of Illinois on the grounds that an out-of-state online seller has no substantial nexus with Illinois under the Commerce Clause. The state appealed to the Supreme Court of Illinois. It was again ruled against the state on the basis that the Illinois statute discriminates against out-of-state sellers.[14] The statute was ruled to be in violation of the Internet Tax Freedom Act of 1998.[15]

The decision by the Illinois Supreme Court was obviously in direct contradiction to the decision by the New York Appeals Court on the same subject. Not to be deterred, the Illinois Legislature passed a revised act in 2014 that imposes the obligation to collect Illinois sales tax on out-of-state retailers that are deemed to have a taxable presence in the state even though they don't have a physical presence.[16] Amazon had decided as a corporate matter that it would build several facilities in Illinois by 2017, including one to be built in 2015. Thus, it announced it would comply with the law and withhold Illinois sales tax. Other out-of-state retailers wishing to not collect the tax would have to challenge the Illinois statute as a violation of the Commerce Clause, and the cost of the challenge may just be sufficient to deter any action on their part.

North Carolina Requirement – Customers' Personal Information

Amazon engaged in at least 50 million transactions between 2003 and 2008 in North Carolina, but never collected sales tax due to lack of physical presence. On Dec. 1, 2009, the North Carolina Department of Revenue ordered Amazon to supply buyers' names, addresses, nature of products and amounts of purchase, for the purpose of tracking down the buyers and demanding payment of use tax. The order covered all products, including video. Amazon released the nature of products and amounts purchased, but not the names and addresses. On March 19, 2010, North Carolina sent out a second request threatening to subpoena Amazon's records. Amazon immediately filed a petition to the United States District Court Western District of Washington, claiming that North Carolina violated both the First Amendment and the Video Privacy Protection Act.

"The First Amendment protects a buyer from having the expressive content of her purchase of books, music and audiovisual materials disclosed to the government. Citizens are entitled to receive information and ideas through books, films and other expressive materials anonymously."

The Video Privacy Protection Act makes it illegal for a video tape service provider to disclose "personally identifiable information concerning any consumer."[17]

On Oct. 25, 2010, the court ruled in favor of Amazon granting declaratory relief. "The court therefore declares: to the extent the March Information Request demands that Amazon disclose its customers' names, addresses or any other personal information, it violates the First Amendment and 18 U.S.C. §2710, only as long as the Department of Revenue continues to have access to or possession of detailed purchase records obtained from Amazon (including ASIN numbers)."[18]

Notwithstanding the above, for reasons unexplained, Amazon started collecting sales tax on North Carolina purchases in 2014. Once again, it seems like the states may be losing the battles, but winning the war.

Colorado Makes Seller Responsible for Tax Enforcement

On March 1, 2010, the Colorado House enacted a bill, 10-1193, as follows:

- "(I)(A) Each retailer that does not collect Colorado sales tax shall send notification to all Colorado purchasers by January 31 of each year showing such information as the total amount paid by the purchaser for Colorado purchases made from the retailer

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in the previous calendar year. Such notification shall include, if available, the dates of purchases, the amounts of each purchase, and the category of the purchase, including, if known by the retailer, whether the purchase is exempt or not exempt from taxation. The notification shall state that Colorado requires a sales or use tax return to be filed and sales or use tax paid on certain Colorado purchases made by purchaser from the retailer."
- "(II)(A) Each retailer that does not collect Colorado sales tax shall file an annual statement for each purchaser to the Department of Revenue on such forms … showing the total amount paid for Colorado purchases of such purchasers during the preceding calendar … and such annual statement shall be filed on or before March 1 of each year."

Out-of-state sellers must submit three reports:
- Transactional Notice to in-state buyers informing them the seller did not withhold sales tax from the buyers, and the buyers must pay use tax to the Department of Revenue.
- Purchase Summary to in-state buyers showing all details of each transaction, including the name of the product and the amount of purchase.
- Customer Information Report to the Department of Revenue showing the purchasers' names, addresses, nature of the products and amounts of purchase for all purchasers and all transactions in the current year.

On Aug. 13, 2010, the Direct Marketing Association (DMA) filed a petition to the United States District Court for an injunction to stop enforcement of the Colorado statute. On Jan. 26, 2011, the court ruled in favor of the association. "It is ordered that … Colorado Department of Revenue is enjoined and restrained from enforcing the provisions of §39-21-112(3.5), C.R.S. (2010) and the regulations … 1 Colo. Code regs. §201-1:39-21-112.3.5 (2010) …"[19]

The court stated "… the Direct Marketing Association (DMA) has shown a substantial likelihood that it will succeed in showing that the act and the regulations are discriminatory because, in practical effect, they impose a burden on interstate commerce that is not imposed on in-state commerce." Furthermore, "the act and the regulations impose these burdens on out-of-state retailers who have no connection with Colorado customers other than by common carrier or the United States mail. Those retailers likely are protected from such burdens on interstate commerce by the safe harbor established in Quill." The court concluded, "if, in the end, the act and the regulations are found to be unconstitutional because they violate the Commerce Clause, the affected retailers would be unable to recover these compliance costs from the state of Colorado. Under these circumstances, the compliance costs faced by retailers subject to the act and the regulations constitute irreparable injury." In other words, Colorado is prohibited from requiring the out-of-state retailers to enforce the tax reporting responsibilities.

Colorado appealed the District Court injunction to the 10th Circuit Court of Appeals, which in August, 2013 sent the case back to the District Court with an order to lift the injunction, because federal courts are not allowed to become involved in state tax disputes. The DMA appealed this decision to the U.S. Supreme Court, which in 2015 overturned the 10th Circuit decision. This leaves it up to the 10th Circuit to either send the case back to the U.S. District Court for a hearing on the merits or to refer the case to the Colorado courts based on the principle of comity, which allows one court to defer to another when both courts have jurisdiction. Eventually, this may mean the case on the merits will find its way back to the Supreme Court. As it stands now, Colorado is still prohibited from enforcing its tax reporting responsibilities. Evidently, the status of e-business taxation is currently in the state of confusion.

Most Recent U.S. Supreme Court Decision

The New York Appeals Court decision on the case of the "Amazon Tax" on Nov. 4, 2010, as mentioned earlier, was not over yet. Amazon and Overstock immediately appealed again to the U.S. Supreme Court. On Dec. 2, 2013, the petition was denied. The court did not give any reason. This means that any out-of-state seller with Amazon-type Internet business is required to collect sales tax from an in-state buyer, regardless of whether the seller has "physical presence" in the state. If that is indeed the conclusion, the argument between the "physical presence" and the "economic nexus" has come to an end. Unless a court in a state with a statute similar to New York's comes to a different conclusion and holds for the taxpayer, it is unlikely that the Supreme Court will again become involved in this issue.

This U.S. Supreme Court decision implies that all its own decisions in the past concerning the requirements for physical presence are no longer relevant in deciding the responsibility for collecting the sales tax. Those sellers who have physical presence certainly have "economic nexus." However, those who have "economic nexus" may not have "physical presence." In today's Internet commerce environment, almost all sellers are outside the state. They have economic nexus, but not physical presence. As such, all of them are required to collect sales tax from an in-state buyer. This concept is unusually radical.

In fact, there is another new development. In the midst of the endless debate between the state governments and the out-of-state sellers concerning the sales tax, the U.S. Congress stepped in and enacted the *Marketplace Fairness Act of 2013*, as will be explained below.

Marketplace Fairness Act of 2013

Before the U.S. Supreme Court made the decision on Dec. 2, 2013, as mentioned above, on May 6, 2013, the U.S. Senate passed the *Marketplace Fairness Act of 2013*, though it has not yet been passed in the U.S. House of Representatives, as of Nov. 1, 2015. It attempts to settle the tumultuous arguments as to whether a state government can require an out-of-state seller to collect sales and use tax from the in-state buyer without "physical presence." The answer is affirmative with some conditions. It provides that "each member state under the Streamlined Sales and Use Tax Agreement is authorized to require all sellers … to collect and remit sales and use taxes with respect to remote sales sourced to that member state …"[20] This provision grants authority to the state government to require any out-of-state seller to collect sales and use tax from an in-state buyer, even if the seller has no physical presence in that state.

However, the state government must be a member of the so-called

Streamlined Sales and Use Tax Agreement (SSUTA).[21] What is the SSUTA? If a seller is required to collect and remit the sales and use tax to each state jurisdiction, it is almost an insurmountable task. There are 9,646 such jurisdictions. Each jurisdiction has a different tax base and tax rate. The tax administration is too much a burden. It discourages the sellers to comply with the tax law. To simplify the task, on Nov. 12, 2002, 44 states entered into the SSUTA. It stipulates that:

- Each state can have only one single tax collecting agency.
- Each state can have only one rule for determining what merchandise is taxable and what is nontaxable.
- Each state can have only one sales tax rate.
- Each state can have only one rule in determining what constitutes in-state sales and out-of-state sales, because these two kinds of sales have two different tax rates.

States that are not members of the SSUTA may still benefit from requiring out-of-state sellers to collect sales and use tax, as long as the state meets the above requirements and provides free computer software for the seller to use. It must also enact a law to relieve any liability on the part of the seller caused by the errors in the software or state tax agency. The purpose is to simplify the tax administration task and encourage the seller to collect sales and use tax.

A Changing Environment

This article dealt with the problem of e-business taxation. E-business gives rise to sales tax enacted by state and local governments. It involves the question as to whether the seller or buyer should collect sales tax. Today, e-business is interstate commerce, but a state government has no authority over an out-of-state seller. Under the Commerce Clause, an out-of-state seller is not responsible for sales tax collection unless "due process" is satisfied. However, the concept of due process requires court rulings to define it.

Under many court cases, the principle of "physical presence" had been the criteria for due process. To satisfy due process, the seller must maintain employees or a place of business in the state. In recent years, the business environment has changed. Computers replace employees and transactions are carried out online. Many products can be digitized. Many online retailers don't maintain a physical presence in a state, but still receive benefits from the state. Physical presence evolves to the concept of "economic nexus." As long as an out-of-state seller derives profits from a state, it must be required to collect sales tax from the in-state buyers. Many state governments have taken actions to require this sales tax.

This article reviewed four cases and the new *Marketplace Fairness Act of 2013*. It shows the evolving trend in the principle of taxation on Internet commerce. The act is the most updated and current prevailing law governing e-business taxation today, though it's still pending in the U.S. House of Representatives. Most likely, it will eventually be enacted. ■

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James G. S. Yang, M.Ph., CPA, CMA, is professor of Accounting at Montclair State University in Montclair, New Jersey. He can be contacted at yangg@mail.montclair.edu.

Leonard J. Lauricella, LLM, JD, CPA, is associate professor, Accounting, Law and Taxation, at Montclair State University in Montclair, New Jersey.

The Five Most Important Things Your Clients Need to Know About Sales Tax

By Ray Bigley and Jennifer Warawa

Sales taxes are an increasingly important source of revenue for states seeking to make up for revenue shortfalls. Yet, because sales tax is a pass-through tax, accounting professionals and business owners may disregard it compared to the state and federal income tax landscape.

The risks associated with the failure to comply with sales tax laws should not be underestimated. Sales taxes typically represent more than one third of a state's revenue; in many states, the percentage is much higher. More than likely, your clients are filing returns and paying their fair share, but are you completely certain they are complying in the most efficient manner possible?

As an accounting professional, it makes sense to fully educate yourself on sales tax, learn about the areas where your clients might have exposure and help them understand the implications for their business. Chances are, your clients stand to benefit, but may be unaware that they even have a need.

There are five key points your clients should know about sales tax. Armed with this information, they will be in a better position to reduce the risk of penalty and audit, and improve their accounting practices.

#1: Boundaries and Rules Exist

An understanding of sales tax compliance would not be complete without looking at several factors.

Nexus: In the arena of sales tax collection, one important principle always takes center stage: nexus. In the legal sense, nexus describes the connection between two or more participants, interests or concepts. In the world of sales tax, nexus refers to the connection a company has with a state. Nexus is the legal connection that empowers a state to demand collection and remittance of a business sales tax. If your clients have business in more than one state, nexus laws affect them.

Origin versus Destination: If a sale is taxable, the company must determine which jurisdiction is imposing the tax so it can apply the correct rate, which means the company must first understand the distinction between origin- and destination-based sourcing rules. In origin-based states, any transactions originating *and* terminating within the state are sourced to the origin jurisdiction, so the sale is subject to the local tax rate imposed by the jurisdiction where the sale originated (retail location or ship-from location). Transactions crossing state boundaries are usually sourced to the "destination" regardless of the state's sourcing rule.

Streamlined Sales Tax: In an effort to simplify sales and use tax collection and administration by retailers and states, 44 states, the District of Columbia, local governments and the business community signed on in 2000 to support the Streamlined Sales and Use Tax Agreement (SSUTA). The agreement minimizes costs and administrative burdens on retailers that collect sales tax, particularly those operating in multiple states.

The SSUTA encourages "remote sellers" selling over the Internet and by mail order to collect tax on sales to customers living in the streamlined states, and levels the playing field so that local "brick-and-mortar" stores and remote sellers operate under the same rules. This agreement ensures that all retailers can conduct their business in a fair, competitive environment.

To date, 24 of the 44 states have passed legislation to conform to the SSUTA, yet most of the large states – California, Illinois, New York, Pennsylvania and Texas – have not adopted the agreement.

Recently, states have developed and tested legal theories to push the boundaries of nexus. Some have met with success and some have not; most disconcerting, however, is that some theories are still being vetted in state and federal courthouses.

Attributional Affiliate Nexus (Amazon Laws): If you have clients

selling over the Internet, you'll want to know about the "Amazon Law," an affiliate concept currently being pushed by several states. The "Amazon Law" opens the door for states to require sales tax collection in situations where a company has only limited commercial activities within a state. Amazon.com, for example, is already collecting sales taxes in some states. As Internet marketing becomes more complex and entangled, there are more opportunities for otherwise remote activities to trigger sales tax nexus in a given state.

(Editor's Note: Please see the cover article "State Actions and Judiciary Decisions on E-business Taxation" in this issue of *Today's CPA* magazine for more information on the "Amazon Law.")

#2: Reporting Can Be Complex

Understanding the complex calculation and returns and remittance data that can exist for reporting sales and use tax will go a long way in a company's preparation of its sales tax reports and payments.

Calculation: Rules for taxability and calculation vary from state to state, and in some states, by locality. Keeping up with different sales versus seller's use tax rates for the exact same jurisdiction – and determining applications to a specific sale – can be complicated. Automated solutions that maintain all the rates and rules are a necessity for businesses that operate in multiple states.

Returns and Remittance: Once a business decides who it owes taxes to, it must file state and local returns with various taxing authorities. A listing of basic sales and use tax state and local returns for a business can exceed 450 forms. For a multilocation company in multiple states, it's not uncommon to file more than 100 sales/use tax returns per month, while nationwide retailers can easily file over 1,000 sales/use tax returns every single month! As a result, companies doing business in multiple states with limited resources have no choice but to find an automated returns solution.

#3: Technology to the Rescue

Automation is one option a company has for actually preparing its sales tax reports and payments, but others exist as well.

Manual: In a "manual" calculation environment, clients load state, county, city and local tax rates into their accounting software, manually updating the tax tables for rate changes *every time they occur* in each jurisdiction in which the company files.

Hybrid: Clients subscribe to a rate table update service that populates the tax rates in their accounting software for all jurisdictions in which they file. Individual item taxability and customer exemption status are manually updated.

Manual and hybrid solutions are cumbersome and mistakes easily occur if work is not checked and double-checked. In addition, these solutions generally cannot determine when to apply seller's use tax instead of sales tax, and do not allow for accurate calculation of tiered tax rates.

Fully Automated: Locally loaded solutions and hosted, cloud-based solutions allow for more accurate calculation, offering automated tax return preparation or returns prepared and filed through a service provider. Locally loaded solutions are typically two-tiered: 1) the application that actually calculates the sales tax when sales are made, and 2) data used from the first tier to automatically prepare sales tax returns. Automated solutions should be SSUTA-certified to ensure complete compliance.

#4: Cloud Solutions Provide Total Automation, Effortlessly

Hosted solutions for sales tax preparation leverage significant advantages of the cloud. These solutions are ideally suited to handle the constant rate and jurisdiction changes that are the norm in sales tax compliance. Many solutions also offer turn-key sales tax compliance. Here, taxes are not only calculated by the hosted provider, but the returns and payments can all be made by the same provider without the need to transfer data from one system to the other. All changes are tracked and applied by a central service accessed through the cloud. There is no need to load software, perform monthly updates or provide hardware to run a cloud solution; all of this is done by the service provider.

As with locally loaded solutions for sales tax calculations, hosted solutions require setting a company's nexus, product taxability, and customer- or use-based exemptions within the system, and ensuring that they are properly connected to the business's accounting software at the appropriate points. When done properly, the client receives effortless consistency and accuracy with every sales tax calculation.

#5: Communication and Information Are Key

Open communication and information are vital and affect all parties involved in any sales tax relationship. CPAs and their staffs should be aware of sales and use tax collection obligations, but in some cases, there may never have been a conversation on that topic between the advisor and the client. Why?

In general, many CPAs are *not* focused on sales tax because they might think their clients are handling sales tax reporting and compliance on their own. Conversely, from a client's perspective, there may be a presumption that because their CPA is a tax professional, reporting and compliance will be done as simply another component of a typical tax engagement.

As a CPA who is educated in sales tax laws, compliance and reporting, you will be able to transfer your knowledge to your clients. By establishing and maintaining an open dialogue with your clients, you help arm them with the ability to address compliance, reporting and technology issues that may arise – *and* keep them out of tax trouble. ■

Resources for More Information

State Departments of Revenue:
www.govspot.com/tax/staterevenue.htm.

AvaTax Rates:
www.avataxrates.com.

Avalara Accountants Resource Center:
http://auth.avalara.com/portals/accountants-resource-center-aw.

Ray Bigley is vice president of Business and Corporate Development for Avalara. Contact him at ray.bigley@avalara.com.

Jennifer Warawa is global vice president, Product Marketing for Accountants, with Sage. Contact her at jennifer.warawa@sage.com.

Tax Trap for the Unwary: The Passive Foreign Investment Company

By Andrew M. Brajcich, JD, LLM, CPA

In an effort to curtail perceived abuses of U.S. investors in foreign mutual funds, Congress enacted the Passive Foreign Investment Company (PFIC) regime in *The Tax Reform Act of 1986*. Prior to this legislation, U.S. investors were able to place investments in foreign corporations while avoiding U.S. taxation. Domestic mutual funds, i.e., regulated investment companies, are required to pay at least 90 percent of income to shareholders as dividends or be subject to tax at the corporate level. In contrast, a foreign corporation serving in a similar capacity was beyond the jurisdiction of U.S. tax authorities unless receiving U.S. source income. Further, the wide dispersion of shareholders typically seen in these types of investment vehicles would not trigger anti-deferral provisions of Controlled Foreign Corporations (CFCs). Thus, by investing in foreign mutual funds, U.S. taxpayers were able to avoid U.S. tax unless and until the foreign corporation paid dividends.

As with many well-intended tax provisions, PFICs fall into the ever-growing category of "tax traps for the unwary." U.S. taxpayers may find themselves unwitting shareholders in a PFIC as a result of how legislation initially intended to curb abuses surrounding foreign mutual funds was drafted to cast a wider net. The tax practitioner may find himself/herself in the position of delivering the bad news to a new client or even worse, informing the client of his/her failure to advise the client properly on certain foreign investments or subsidiaries. To illustrate how this may occur, let's look first at the rules that define a PFIC.

A PFIC is a foreign corporation that meets one of two tests. The income test is met when the foreign corporation has passive income comprising at least 75 percent of gross income. The asset test is met when the corporation has passive assets comprising at least 50 percent of total assets by average market value. Passive assets are assets that produce passive income. Passive income generally includes dividends, interest, royalties, rents, annuities, gain on the sale of passive assets, and certain gains on commodity and foreign currency transactions.

If a U.S. taxpayer is a shareholder of a foreign corporation for any tax year it is determined to be a PFIC, the corporation remains a PFIC with respect to that shareholder even if in subsequent periods it does not meet the income or asset tests. Among international tax practitioners is the saying, "Once a PFIC, always a PFIC." The saying is not entirely true, however, as PFIC taint may be purged in certain circumstances. Nonetheless, it is often too easy for a foreign corporation to become a PFIC unbeknownst to its U.S. shareholders. A formerly operational foreign subsidiary left idle for a year may fall into the PFIC trap, just as a U.S. expatriate investing savings in non-U.S. financial institutions may find himself/herself the (not so proud) owner of a PFIC. So why is owning a PFIC so bad?

First, if no action is taken with respect to the PFIC, the U.S. shareholder is permitted to defer U.S. tax on the PFIC until an "excess distribution" is made. An excess distribution is the total actual distributions made during the tax year to the extent they are in excess of 125 percent of the average actual distributions made in the previous three tax years. In addition, any gain realized on the disposition of PFIC stock is treated as an excess distribution. Excess distributions are allocated pro-rata to the shareholder's holding period in the stock from the tax year it was first a PFIC and are taxed at the highest tax rate in effect for the applicable tax year(s), a particularly costly result for individual taxpayers who otherwise may be subject to preferential rates. Moreover, interest

on underpayment is due as if the excess distributions were actually received by the shareholder ratably over his/her holding period in the stock while it was a PFIC. There is no excess distribution for the first year a stock is a PFIC and for a PFIC distribution in any year, the "in lieu of" foreign tax credit may be claimed on withholding by a foreign government.

Fortunately, there are alternatives to the draconian PFIC regime, although they may initially seem no less draconian. By making an election to be taxed as a qualified electing fund (QEF), the U.S. shareholder of a PFIC is taxed on his/her pro-rata share of PFIC income every year. The PFIC becomes a conduit entity. The character of such income, capital or ordinary, passes through to the shareholder and increases his/her stock basis. For individuals, dividends passed through are not eligible for preferential rates. Any distributions from the PFIC of previously taxed income are a tax-free recovery of basis to the extent thereof. Such distributions decrease basis in the PFIC stock, but not below zero. If the taxpayer lacks the liquidity to pay tax on PFIC income for the year of pass through, he/she may elect to pay at a later date of actual distribution, plus any applicable interest. For corporate shareholders owning 10 percent or more of the PFIC, a deemed foreign tax credit is available on earnings passed through from the PFIC.

If a QEF election is made during the first tax year a foreign corporation meets the definition of a PFIC, the QEF will move forward without any PFIC taint. If the election is made in a year subsequent to its first PFIC year, as is often the case, the QEF carries with it PFIC taint. In other words, the U.S. Treasury does not forget there remains a tax deferral on earnings of the foreign corporation while it was a PFIC prior to the QEF election.

The taint may be purged in one of two ways. First, the QEF electing shareholder may agree to be taxed on a deemed sale of his/her PFIC shares for fair market value on the first day of the tax year. As a result, the foreign corporation with respect to the electing shareholder gets a fresh start, including a new holding period and basis, and is no longer a PFIC, but at a cost. The deemed sale is an excess distribution under the PFIC regime described above and carries the same consequences as any other sale of PFIC stock. Thus, making the QEF election by or before the stock becomes a PFIC may be crucial to a client's tax savings (and overall satisfaction with his/her tax advisor). A taxpayer who neglects to make a QEF election in the first year may make a late election having retroactive effect in certain circumstances or seek special consent from the IRS to do so.

Second, if a QEF carries PFIC taint, the shareholder may make a deemed dividend election where he/she includes as a dividend his/her pro-rata share of PFIC earnings attributable to the stock on the first day of the tax year the QEF election was in effect. While the deemed dividend is taxed as an excess distribution described above, the PFIC taint is purged and the shareholder may move forward with his/her investment free of any lingering PFIC concerns.

When information with respect to PFIC earnings is difficult or too burdensome to obtain, a QEF election may not be a possibility. If the stock has a readily ascertainable market price, a PFIC shareholder may make a mark-to-market election on his/her PFIC stock. Under this election, the shareholder includes as ordinary income the amount the fair market value of the stock exceeds his/her basis on the last day of the tax year. The shareholder's basis is increased by the amount of inclusion. A shareholder may similarly recognize loss when fair market value is below his/her adjusted basis in the stock, but only to the extent of previously recognized gains. If the mark-to-market election is made in a year after the foreign corporation first becomes a PFIC, the inclusion in the year of election will be an excess distribution as defined above.

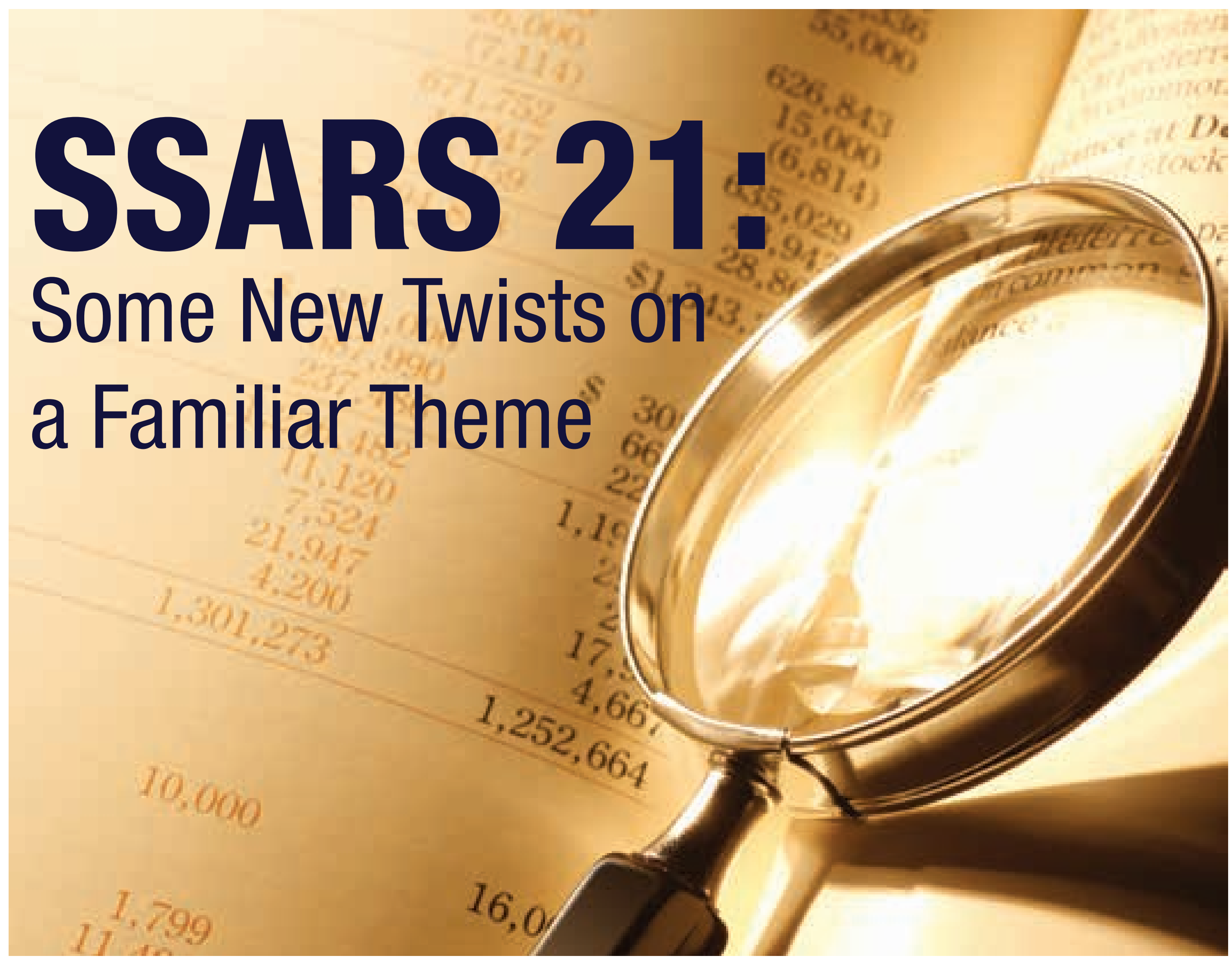
A U.S. shareholder of a foreign corporation that was once a PFIC, but no longer meets the income or asset tests, and who did not make a QEF or mark-to-market election, may wish to purge the PFIC taint. In the absence of one of these elections, the shareholder runs the risk of having his/her investment meet the income or asset test in later years and again becoming a PFIC. Nonetheless, the PFIC taint may be purged by electing to recognize gain on the last day of the last tax year the corporation was a PFIC as if the stock were sold on that day. Such a deemed sale in a prior period will result in interest due in addition to the tax on the excess distribution.

Information on PFIC, QEF and mark-to-market election stock activities is reported on Form 8621 *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*. Taxpayers attach Form 8621 to their annual federal income tax return. Generally, tax-exempt organizations owning PFIC stock are not subject to the PFIC regime unless income from the PFIC is unrelated business taxable income (UBTI). As such, temporary regulations provide an exception for tax-exempt organizations from filing Form 8621, unless there is UBTI.

Previous mention is made of the CFC. It's worth noting that if a foreign corporation qualifies as a PFIC and a CFC, the CFC rules will apply. A CFC is a foreign corporation with U.S. shareholder(s) owning, directly or indirectly, more than 50 percent of its stock by vote or value. For CFC purposes, a U.S. shareholder is a U.S. person who owns 10 percent or more of the foreign corporation's stock. A U.S. person is a U.S. citizen or resident alien, or a business entity organized under the laws of the U.S. U.S. taxpayers owning stock in a CFC are subject to a wide array of anti-deferral provisions that are not explored here.

Discovering that one is a shareholder in a PFIC is never a pleasant experience. Knowing the PFIC rules and tax consequences as a practitioner provides an opportunity to add significant value to client services, as does knowing the options available to purge PFIC taint. As global economies seemingly become more local, PFIC issues no longer touch only those clients served by Big 4 accounting firms. There is an increasing likelihood the boutique firm practitioner will start to see PFIC issues, as well. ■

Andrew M. Brajcich, JD, LLM, CPA is an assistant professor of Accounting at Gonzaga University. Prior to joining academia, he worked in the International Tax Services group of Deloitte Tax in Seattle focusing on outbound tax planning. He may be reached at brajcich@gonzaga.edu.



SSARS 21:

Some New Twists on a Familiar Theme

By Dr. Charles W. Stanley, CPA, and C. William Thomas, CPA, Ph.D.

Curriculum: Accounting

Level: Basic

Designed For: Public practice, primarily those who do accounting and review services

Objectives: To introduce practitioners to some of the major changes from SSARS 21

Key Topics: The new standards; organization of SSARS 21; general principles; financial statement preparation; compilation and review engagements; and other SSARS 21 changes

Prerequisites: None

Advanced Preparation: None

Accounting and review services comprise a major part of the practices of many CPAs. These non-audit services allow CPAs to assist their clients in presenting their financial information in the form of financial statements while providing either limited or no assurance to users. In October 2014, the Accounting and Review Services Committee (ARSC) of AICPA issued Statement on Standards for Accounting and Review Services (SSARS) No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification* (AICPA, *Professional Standards*). In addition to redrafting and clarifying existing standards, SSARS 21 includes significant revisions for CPAs in public practice who prepare financial statements for their clients. This article summarizes these important revisions.

What's New?

Besides redrafting and clarifying existing standards, SSARS No. 21 carves out a new service, "financial statement preparation," and this distinguishes it from a "compilation" engagement. The existing standard (AR Section 80) defines a compilation as "assisting management in presenting financial statements." That standard requires CPAs to submit compilation reports on any such financial statements that are submitted to third parties. In today's business environment, accountants work directly with their clients in differing environments to create financial statements, using interactive technology such as real time "cloud" systems, making it difficult to determine which entity actually "creates" the financial statements. Because of this ambiguity, accountants have often had to use a great deal of subjective judgment in deciding whether they should take credit for the preparation of the financial statements.

SSARS 21 draws a bright line between financial statement preparation (AR Section 70) engagements and compilation (revised AR Section 80) engagements, eliminating the requirement for accountants to issue compilation reports on financial statements they have merely helped prepare. Thus, they will no longer have to rely so much on subjective judgment to determine whether they have created financial statements for their clients.

What Clarification Means

The ARSC's new drafting conventions include the following:

- Establish objectives for each clarified section.
- Include a definitions section, where relevant.
- Separate requirements from application and other explanatory material.
- Number application and other explanatory material paragraphs using A- prefix and present them in a separate section that follows the Requirements section.
- Use formatting techniques, such as bullet lists, to enhance readability.

The issuance of SSARS No. 21 supersedes almost all outstanding Statements on Standards for Accounting and Review Services through No. 20. The exception is SSARS No. 14, *Compilation of Pro Forma Financial Information, as amended (AICPA, Professional Standards*, AR Sec. 120). SSARS 14 is currently being redrafted and will be issued as a separate SSARS when finalized.

SSARS 21 is considered to be a stand-alone standard and does not represent the *Codification of Statements on Standards for Accounting and Review Services*. In addition to the previous SSARS, all compilation and review interpretations have been considered in the development of the clarified SSARS. Therefore, they have been incorporated accordingly or will be considered for inclusion in the new edition of the AICPA Guide *Review, Compilation and Financial Statement Preparation Engagements: Engagements Performed in Accordance with SSARS.*

SSARS 21 is effective for reviews, compilations and preparation of financial statements for periods ending on or after Dec. 15, 2015. Early implementation was permitted for all sections of SSARS 21.

Organization of SSARS 21

SSARS 21 is organized into four separate sections, as follows:

- Section 60, General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services. The purpose of this section is to provide general guidance and principles for accountants when performing SSARS engagements.
- Section 70, Preparation of Financial Statements. Section 70 is a new section that defines the term "financial statement preparation" and provides guidance to an accountant who has been engaged by an entity to prepare financial statements but not compile, review or audit them.
- Section 80, Compilation Engagements. This section revises the definition and provides guidance for any CPA engaged to perform a compilation on financial statements.
- Section 90, Review of Financial Statements. This section provides guidance when the CPA is engaged to perform a review of financial statements.

These four sections of SSARS No. 21 will be codified in the future in AICPA *Professional Standards* as AR-C sections using the same section numbers found in SSARS No. 21. Consistent with the objectives of clarifying the SSARS, each of the four sections that comprise SSARS No. 21 are organized as follows:

- Introduction – Discusses the scope of the section and effective

continued on next page

date. In addition, Sections 70, 80 and 90 also have a discussion concerning the type of engagement involved.

- Objective – Explains the purpose of the section.
- Definitions – Provides a glossary of terms with which the CPA should be familiar.
- Requirements – This segment provides the requirements that the CPA should follow with each type of engagement; this is the primary focus of each section and one on which the CPA should concentrate.
- Application and Other Explanatory Material – This segment provides the CPA with explanations and expansion on the requirements.
- Exhibits – Illustrations of the requirements and their applications.

The sections of the article that follow summarize changes in each of the four sections of SSARS No. 21.

Section 60 – General Principles

Section 60 – General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services, is intended to provide the general principles for performing financial statement preparation, compilation and review engagements. This section also provides the definitions of certain terms used throughout SSARSs when describing the professional requirements imposed on accountants performing all such engagements. This section is intended to help CPAs to understand their professional responsibilities when performing engagements in accordance with SSARS. In addition, where additional sections have been established with SSARS 21, additional requirements are based on the principles set forth in the general section. Any requirements that have been added by this section have been incorporated into the additional sections.

The accountant is expected to use professional judgment in all SSARS engagements, as well as comply with all applicable and relevant ethical rules. Section 1.310 of the AICPA *Code of Professional Conduct*, which requires compliance with applicable professional standards, lends authoritative weight to SSARS. In addition, Section 60 provides engagement-level quality controls for accepting and continuing clients for these types of engagements, professional competence, planning and supervision, documentation and reporting.

The application and other explanatory material segment of Section 60 provides examples of professional judgment, ethical requirements and compliance with the relevant AR-C sections.

Section 70 – Preparation of Financial Statements

Section 70 is new. It contains guidelines for CPAs performing engagements that involve preparation of financial statements for clients. Under this section, a CPA in public practice may be engaged by an entity to prepare financial statements, but not to perform an audit, review or compilation. This section *does not* apply to accountants who are not in public practice.

Because the preparation of the financial statements does not involve audit, review or compilation services, *no report is required*. This includes situations in which the financial statements are to be used by, or presented to, third parties. The accountant is required to obtain an *engagement letter* signed by both the accountant and client management, to clarify the type of service being provided. In addition, the accountant is required to include a legend on each page of the financial statements stating *"no assurance is being provided."* If, for some reason, the accountant is unable to provide such a statement on each page, the accountant is required to issue either a disclaimer stating that no assurance is being provided or to perform a compilation engagement and issue a compilation report.

Independence is not required of the client who performs financial statement preparation services. This is consistent with all other non-attest bookkeeping and accounting services engagements. The segments of Section 70 can be applied to the financial statements with or without disclosures (footnotes).

In determining what type of financial statement preparation services the accountant has been engaged to perform, he/she will be required to apply professional judgment. This determination will depend on whether the accountant has been engaged to prepare financial statements or merely assist in such preparation (assisting in the preparation of financial statements is a bookkeeping service that is not subject to SSARS).

Paragraph .A19 of the Appendix to Section 70 provides a table that lists examples of services for which Section 70 would apply and examples of services for which Section 70 would not apply. Although this list is not all-inclusive, examples where Section 70 would apply are:

- Preparation of financial statements prior to audit or review by another accountant.
- Preparation of financial statements for an entity to be presented alongside the entity's tax return.
- Preparation of personal financial statements for presentation alongside a financial plan.
- Preparation of single financial statements, such as a balance sheet or income statement, or financial statements with substantially all disclosures (footnotes) omitted.
- Using the information in a general ledger to prepare financial statements outside of an accounting software system.

Examples of accountant services for which Section 70 would not apply include:

- Preparation of financial statements when the accountant is engaged to perform an audit, review or compilation of such financial statements.
- Preparation of financial statements with a tax return solely for submission to taxing authorities.
- Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant.
- Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings.
- Financial statements prepared in conjunction with business valuation services.

- Maintaining depreciation schedules.
- Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation or leases.
- Drafting financial statement notes.
- Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system.

Section 80 – Compilation Engagements

Section 80 of SSARS No. 21 contains significant changes to the performance of compilation engagements. Under the previous standard, the definition and requirements of the compilation standard applied whenever the accountant was engaged to report on or submitted compiled financial statements. Under the new standard, he/she no longer needs to determine whether the statements met the "submitted" requirement. Under the new standard, the accountant must actually be engaged to perform a compilation service for Section 80 to apply. Again, the terms of the engagement must be documented by an engagement letter signed by both the accountant and the client.

Section 80 states that the objective of the accountant in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements. He/she is also to report in accordance with Section 80 without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Since Section 80 applies when the accountant is engaged to perform a compilation, he/she is always required to submit a compilation report. The suggested format of the compilation report has been streamlined and made more user-friendly than previous report formats. Most compilation reports will now be one paragraph. A number of examples of compilation reports have been included in Appendix C of Section 80.

Independence is still not a requirement for the accountant to perform a compilation engagement. However, the lack of independence must continue to be disclosed as a part of the compilation report. Also, Section 80 applies to financial statements with or without footnote disclosures.

With the issuance of SSARS No. 21 and the addition of Section 70 (Financial Statement Preparation), the accountant should now have a clear distinction in services that involve preparation (Section 70) and reporting (Section 80). There are several similarities and differences between the two sections.

For example, Section 80 applies only when the accountant has been engaged to perform a compilation. On the other hand, Section 70 applies when he/she is engaged to prepare financial statements, but not engaged to perform a compilation, review or audit. Both types of engagements require an engagement letter. While both types of engagements do not require independence by the accountant, compilation engagements do require the accountant to determine whether or not independence has been impaired. No such requirement exists with the financial statement preparation engagement. Likewise, the lack of independence must be disclosed by the accountant in the compilation report. No such disclosure is applicable with financial statement preparation engagements, since these types of engagements do not require a report.

Section 90 – Review Engagements

In Section 90, the ARSC has once again made a number of changes to existing standards. However, many of the previous review requirements are still applicable. For example, the objective of a review is still to allow the accountant to issue a report that expresses limited assurance as to whether he/she is aware of any material modifications that should be made to the financial statements for them to be presented in conformity with the applicable financial reporting framework. This basis is obtained primarily through the performance of inquiry and analytical procedures.

One of the changes implemented by the new Section 90, stated in paragraph .01, is its applicability not only to engagements in which an accountant reviews financial statements, but also to engagements in which an accountant reviews other historical information. Examples of other historical financial information that he/she may be engaged to review, include, but are not limited to, the following:

- Specified elements, accounts or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes.
- Supplementary information.
- Required supplementary information.
- Financial information contained in a tax return.

Section 90 does not apply when the accountant is engaged to review interim financial information when:

- The latest financial audited statements are available.
- The accountant has been engaged to perform an audit.
- The accountant has audited the previous period's financial statements and expects to audit the current year financial statements.
- The entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the audited financial statements.

As before, the accountant is required to obtain an engagement letter to perform a review services engagement. Additionally, the accountant performing review services must be independent from the client. A review is considered an attest engagement, and independence is required on all such engagements.

A significant change in the review report under SSARS No. 21 involves the addition of possible emphasis-of-matter and other-matter paragraphs. Existing review standards stated that emphasis paragraphs were not required. SSARS 21 requires the accountant to include such paragraphs in the review report for the following matters:

- Financial statements prepared in accordance with a special purpose framework.

continued on next page

- A changed reference to a departure from the applicable reporting framework when presenting comparative statements.
- Reporting on comparative statements when the prior period has been audited.
- Reporting on a known departure from the applicable financial reporting framework that is material.
- Reporting when dealing with subsequent discoveries of facts in which management revises the financial statements and such revision becomes known to the accountant after the release date.
- The review report on the revised statements differs from the original review report.
- Supplementary information that accompanies the statements and review report.
- Required supplementary information.

Similar to the clarified standards for audit reports, the accountant performing a review engagement is required to include an emphasis-of-matter paragraph in the review report when it is considered necessary to draw the user's attention to a financial statement matter that is of such importance that it is fundamental to the user's understanding of the financial statements. This assumes that the accountant does not believe the statements to be materially misstated.

Requiring the addition of other-matter paragraphs in review reports is also new under SSARS No. 21. Similar to the clarified reporting standards for audit reports, such a paragraph should be included when it is considered necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the professional judgment of the accountant, is relevant to the user's understanding of the review, the accountant's responsibilities, or the accountant's review report. When these additional paragraphs regarding an emphasis or other matter are included in the report, he/she is expected to communicate with management regarding these paragraphs and their wording. The Appendix to SSARS No. 21 contains more detailed discussion and examples of reporting wording.

Other SSARS 21 Changes

A major addition to SSARS No. 21 is the introduction of the term special purpose framework. Special purpose frameworks may apply to financial statements that are either compiled or reviewed. The term special purpose framework refers to a financial reporting framework **other than GAAP** that includes the following:

- Cash basis.
- Tax basis.
- Regulatory basis.
- Contractual basis.
- Financial reporting framework for small to medium-sized entities (FRF for SMEs).

These were formerly referred to as other comprehensive bases of accounting (OCBOA) in previous standards.

Two newly defined terms are introduced by SSARS 21. These two new terms are: Required supplementary information and designated accounting standard setter.

Required supplementary information – Information that a designated accounting standard setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standard setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Designated accounting standard setter – A body designated by the Council of AICPA to promulgate GAAP pursuant to the "Compliance with Standards" and "Accounting Principles" rules of the AICPA *Code of Professional Conduct*.

Other-matter paragraph is required in the compilation or review report to refer to the required supplementary information and establish requirements for the following:

- The required supplementary information is included and the accountant performed a compilation engagement on the required supplementary information or he/she reviewed the required supplementary information.
- The required supplementary information is included and the accountant did not perform a compilation, review or audit on the required supplementary information.
- The required supplementary information is omitted.
- Some required supplementary information is missing and some is presented in accordance with the prescribed guidelines.
- The accountant has identified departures from the prescribed guidelines.
- The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

Additional CPE May Be Required

This article provides a brief overview of SSARS No. 21. It was developed from material provided by two AICPA publications: *Statements on Standards for Accounting and Review Services: Clarification and Recodification,* AICPA, 2014, and *Developments in Review, Compilation, and Financial Statement Preparation Engagements, 2014-2015*, AICPA, 2014.

CPAs should become familiar with the details of SSARS 21 when performing financial statement preparation, compilation or review services engagements after Dec. 15, 2015. CPAs are advised to take additional CPE courses that provide more in-depth training for these types of engagements. ■

Dr. Charles W. Stanley, CPA is associate professor of accounting at Baylor University.

C. William Thomas, CPA, Ph.D. is J.E. Bush professor of accounting at Baylor University. He can be contacted at Bill_Thomas@baylor.edu.

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SSARS 21: Some New Twists on a Familiar Theme

1 Which of the following previous SSARS issued by the ARSC have not been superseded by SSARS No. 21?

A. SSARS Nos. 1-10
B. SSARS No. 19 only
C. All previous SSARS have been superseded by SSARS 21.
D. SSARS No. 14.

2 Which of the following topics included in SSARS No. 21 is new?

A. Review engagements
B. Financial statement preparation engagements
C. Compilation engagements
D. Audits of financial statements

3 Section 70 of SSARS No. 21 would apply for which circumstances?

A. Whenever the accountant prepares financial statements for an entity regardless of the type of engagement.
B. Whenever the accountant prepares financial statements for review engagements.
C. Whenever the accountant prepares financial statements but is not engaged to perform an audit, review or compilation.
D. All of the above.

4 Which of the following types of services provided by an accountant would be applicable under Section 70 of SSARS No. 21?

A. Preparation of financial statements for an entity to be presented alongside the entity's tax return.
B. Preparation of financial statements with a tax return solely for submission to taxing authorities.
C. Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings.
D. Drafting financial statement notes.

5 Under Section 80, what level of assurance is the accountant expected to provide that there are no material modifications that need to be made?

A. No level of assurance is required.
B. A limited level of assurance is required.
C. Complete assurance is required.
D. Levels of assurance apply only when the accountant performs an audit.

6 Which of the following is a difference between compilation engagements and an engagement to prepare financial statement?

A. Financial statement preparation engagements require independence.
B. Only compilation engagements require an engagement letter.
C. Only financial statement preparation engagements require the accountant to determine if independence has been impaired.
D. While both types of engagements do not require independence, compilation engagements do require the accountant to determine whether or not independence has been impaired.

7 When is the accountant expected to include an emphasis-of-matter paragraph in a review report?

A. When it is considered necessary to draw the user's attention to a matter that has been included in the statements or disclosures.
B. When it is considered necessary to communicate a matter other than those that are presented or disclosed in the statements that is relevant to the user's understanding of the review or review report.
C. Emphasis-of-matter paragraphs occur only in an audit report.
D. Emphasis-of-matter paragraphs occur only in compilation report.

8 Previously, there were acceptable other comprehensive bases of accounting and referred to as OCBOA. What is the new title for these bases of accounting?

A. Special purpose framework
B. Cash basis
C. Tax basis
D. Accrual basis

9 One of the primary purposes of the general principles for engagements performed in accordance with SSARS (Section 60) is to provide help for accountants to:

A. better understand their professional responsibilities when performing an engagement in accordance with SSARS.
B. better understand their professional responsibilities when dealing with AICPA.
C. better understand their professional responsibilities when performing an engagement in accordance with SASs.
D. better understand their professional responsibilities when dealing with their respective state boards of public accountancy.

10 Section 70 of SSARS No. 21, Financial Statement Preparation would not apply for which of the following engagements?

A. Whenever the accountant prepares financial statements for an entity but not engaged to perform an audit.
B. Whenever the accountant prepares financial statements for review engagements.
C. Whenever the accountant prepares financial statements but is not engaged to perform a compilation.
D. All of the above.

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(Please check one.) 5=excellent 4=good 3=average 2=below average 1=poor

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2/16/2016	It Cost What! A Practical Approach to Implementing Activity Based Costing	8	Addison
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2/18/2016	FASB Review for Business & Industry	8	Dallas
2/19/2016	Advanced Controller and CFO Skills	8	Dallas
2/23/2016	Analytics and Big Data for Accountants	8	Dallas
2/23/2016	Personal and Professional Ethics for Texas CPAs	4	Houston
2/24/2016	Transforming Your Role as Controller to Business Partner	8	Dallas
2/25/2016	Analytics and Big Data for Accountants	8	Houston
2/25/2016	Personal and Professional Ethics for Texas CPAs	4	Addison
2/26/2016	Transforming Your Role as Controller to Business Partner	8	Houston
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3/23/2016	Personal and Professional Ethics for Texas CPAs	4	Addison
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May 5-6	2016 Texas CPA Technology Conference (Houston)
May 16-17	Energy Conference (Austin)
May 23-24	Not-for-Profit Organizations Conference (Plano)
June 6-7	Texas School District Accounting and Auditing Conference (San Antonio)
June 15-17	CPE by the Sea Conference (Galveston)
June 20-22	South Padre Island Cluster (South Padre Island)
July 11	Oil and Gas Conference (Dallas)
July 11-13	Hill Country Cluster (San Antonio)
July 18-19	Advanced Health Care Conference (San Antonio)
August 1-3	Galveston Cluster (Galveston)

Date	Conference
August 18-19	Advanced Estate Planning Conference (San Antonio)
September 19-20	Financial Institutions Conference (Dallas)
October 3-4	Single Audits and Governmental Accounting Conference (Austin)
TBA	Accounting and Auditing Conference (Addison)
TBA	Business Valuation, Forensic and Litigation Services Conference (Houston)
November 14-15	Texas CPA Tax Institute Conference (Dallas)
November 14-15	Texas CPA Tax Institute Conference (San Antonio)
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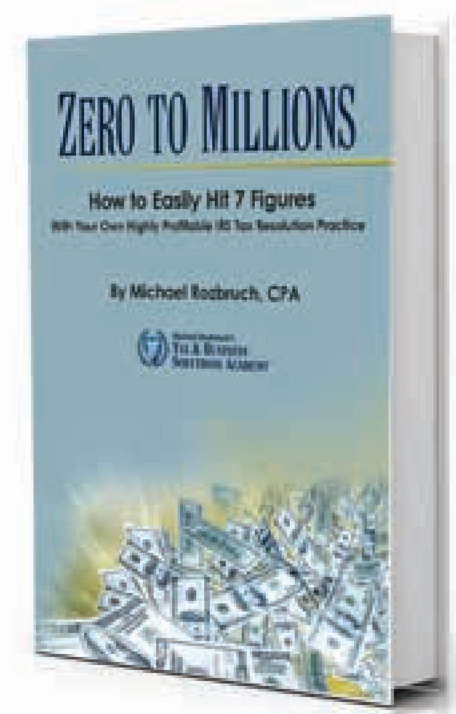

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