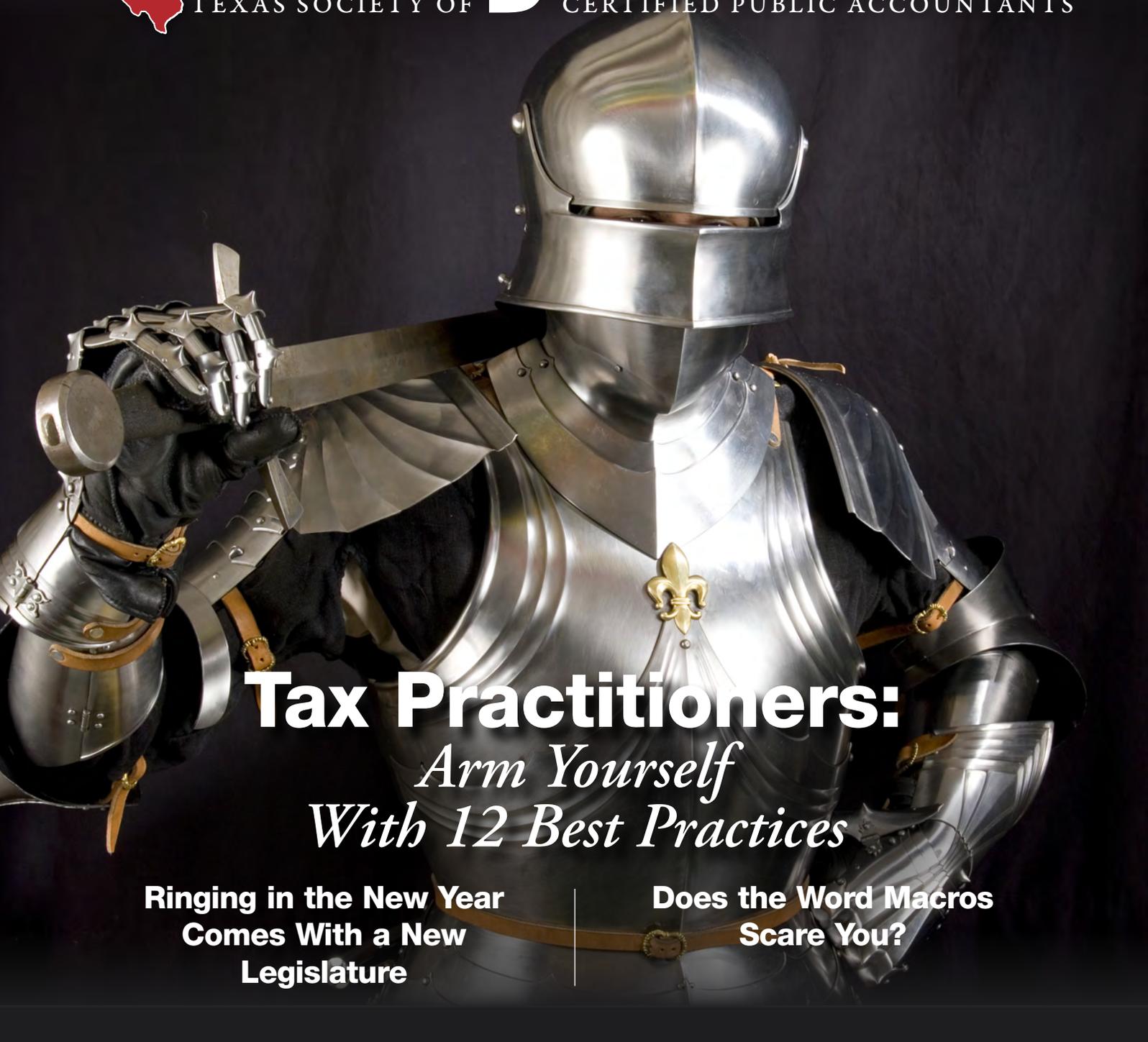


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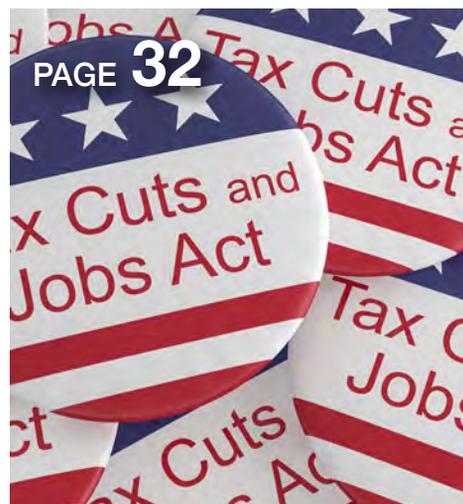


COVER STORY

**25 Due Diligence Best Practices
for Tax Return Preparers**

FEATURES

- 9 Three Common Invoicing Scams
and How to Avoid Them**
- 22 Capitol Interest**
A New Year and a New Legislature
- 30 European Union General Data
Protection Regulation:**
How Can It Impact U.S. CPA Firms
and Their Clients?
- 32 Tax Cuts and Jobs Act:**
The Impact on Settlement of
Employment Claims



CONTENTS

VOLUME 46, NUMBER 4 **JANUARY/FEBRUARY 2019**

- 38 CPE Article: FASB Simplifies the
Test for Goodwill Impairment**
- 44 CPE Quiz**

COLUMNS

- 4 Chairman's Message**
Happy New Year
- 5 Tax Topics**
The IRS and Big Data: The Future
of Fighting Tax Fraud
- 7 Accounting & Auditing**
Auditor's Report is Scheduled for
Remodeling
- 10 Technology Issues**
Are You Intimidated by Macros?



- 16 Chapters**
San Antonio Chapter Funlympics
Celebrates 35 Years
- 18 Member Spotlight**
Lara Akinboye, CPA, CFE, CMA

DEPARTMENTS

- 20 Take Note**
- 41 TSCPA CPE Course Calendar**
- 45 Classifieds**

✱ CHAIRMAN'S MESSAGE



What do you think!

I want to hear your feedback and questions during my chairmanship at TSCPA. Drop me a note at chairman@tscpa.net. I'd love to hear from you!

Happy New Year!

By TSCPA Chairman **STEPHEN PARKER**, CPA-Houston

Each new year brings new opportunities, new resolutions, new excitement and, yes, a new audit busy season (tax season, as well). This new year also includes our biennial legislative session in Texas. There's no doubt your professional plate is already looking very full for 2019.

So, how do you stay ahead (or sometimes just keep up) with so much coming your way? While it may seem contradictory, TSCPA wants you to resolve to get more engaged and informed about your TSCPA resources and connections. Whether your calendar includes busy season (audit and/or tax) and deadlines for you and your clients or reporting and month-end deadlines for you and your company, TSCPA is the perfect place to turn.

Invest time reading your communications from TSCPA and your local chapter in order to stay on top of both professional issues and, more importantly, the outcome of the legislative session and how TSCPA is representing your interests and protecting your

license. Take advantage of your member discount on thousands of CPE offerings to help you achieve your professional development goals or get up-to-speed on the latest issues, such as tax reform and cybersecurity. Dive in to TSCPA Exchange to ask your questions, participate in current discussions and lend your expertise to fellow members. Connect with your community through local chapter involvement and give back. Our profession is based on service, to the public, our communities and our profession, and TSCPA is the conduit to help you give and grow.

I hope to see many of you at our upcoming Advocacy Day and Midyear Board of Directors and Members Meeting in Austin on Jan. 29-30. It will be a great way to kick off your year as a Texas CPA and get a head start on those professional resolutions.

I have seen my personal and professional success thrive through TSCPA. I want the same for each of you. If you don't know where to start, let us help. We're here to help you have the best year and career you can have!

Stephen Parker, CPA is a partner in PwC's Houston assurance practice. He can be contacted at stephen.g.parker@pwc.com.

THE IRS AND BIG DATA: THE FUTURE OF FIGHTING TAX FRAUD

By JASON B. FREEMAN, JD, CPA | Column Editor

Welcome to the world of big data, a world where an estimated 2.5 quintillion bytes of data are being produced every day, a world where 90 percent of the world's data has been created in the last two years, and a world that creates enormous challenges – and opportunities – for regulators.

The IRS receives and processes more than 250 million tax returns a year – data that is statutorily protected and that comprises a vast reserve of information. In recent years, it has been tasked with increasing responsibilities, such as implementing tax reform, the Affordable Care Act (ACA) and Foreign Account Tax Compliance Act (FATCA) to name a few. Yet, it is operating on a budget that has been steadily cut since 2011 and facing unprecedented workforce attrition as it fights a tax gap estimated to exceed \$450 billion annually.

The solution? It's to work smarter and more efficiently. The IRS is making an investment in big data analytics. And it is seeing a return on that investment. In a recent report, for instance, the IRS' Criminal Investigation Division reported that, despite significant workforce cuts, it had identified approximately 400 percent more tax fraud than in the prior year and over 1,000 percent more in proceeds from other financial

crimes compared to the prior year. The IRS credits the prioritization of data, including its use of data analytics, algorithms and "predictive policing," as drivers behind these major strides.

A Thumbnail History

The IRS first began using computers to select tax returns for audit in 1962 and soon thereafter developed the Taxpayer Compliance Measurement Program (TCMP), a program based on in-depth audits designed to obtain data for developing audit-selection strategies. By 1969, it was employing the automated Discriminant Function Analysis (DIF), a computerized, statistical method that rates tax returns based on their so-called "DIF" score and selects them for audit based on the probability that they contain an error or evasion. The DIF system has been refined over the years and is currently the IRS' primary statistical method for selecting tax returns for audit.

In 2002, the IRS began its National Research Program (NRP), which replaced the discontinued TCMP. The NRP represents an effort to comprehensively measure compliance across different types of taxes and taxpayers. Rather than rely on the line-by-line audits that were conducted under the TCMP to gather taxpayer data, NRP audits generally focus on specific sections of the tax return. The IRS applies the data gained through its NRP to update its DIF model.

In 2011, the IRS formed the Office of Compliance Analytics (OCA), which was charged with creating a more data-driven and analytical culture through the use of advanced analytics programs; it represented a modern approach to tax enforcement. In 2016, the OCA was reorganized and merged with the Office of Research, Analysis and Statistics (RAS) to form the Research, Applied Analytics and Statistics (RAAS) organization. The current mission of the RAAS "is to lead a data-driven culture through innovative and strategic research, analytics, statistics and technology services in partnership with internal and external stakeholders." This office serves as a key driver behind the IRS' adoption and implementation of big data analytics.

What is the IRS Currently Doing?

Data mining is the process of extracting information from large sets of data to analyze relationships in the data. Data mining models come in two general forms: predictive and descriptive. Predictive modeling creates a model based on data in order to make predictions. Descriptive models summarize patterns and properties in a data set.

The IRS has access to unprecedented amounts of data, although its collection and maintenance of data can raise constitutional and other concerns, such as privacy considerations. The



IRS is able to mine data from various public sources, including social media outlets such as Facebook, Twitter and LinkedIn, as well as other public internet data from sources such as Google Maps.

Reports have indicated that the IRS has even used “spiders” – automated computer programs – to review social media sites. Reports have also indicated its use of phone tracking technology, including a cell-site simulator known as Stingray. In addition, the IRS maintains vast troves of data through its more traditional means, such as the NRP and Individual Master File database. The IRS, in other words, has access to many data sets.

The IRS is cross-referencing and using these data sets to run pattern recognition algorithms to identify trends and understand the relationships in its data. It has employed a number of advanced techniques and tools in this effort, such as anomaly detection, advanced clustering and even neural networks. These tools are aimed at improving case selection and coordination among IRS divisions. Ultimately, data analytics and “predictive policing” will help the IRS identify tax-reporting anomalies and identify tax evasion on a much larger scale.

Areas of Likely Focus in the Future

Developments over the past decade point toward several areas where the IRS’ investment in big data analytics is

likely to generate a particularly good return. International tax enforcement is one such area. For instance, the IRS has obtained unprecedented amounts of data through international tax enforcement efforts, such as the Offshore Voluntary Disclosure Program, the Swiss Bank Program and numerous high-profile data leaks, such as the “Paradise” Papers, Panama Papers and Offshore Leaks. This data has led to massive databases that the IRS is still unpacking.

Information reporting through the FATCA and information-sharing agreements have led to remarkable structural changes in the global exchange of tax-related information. These developments will be further strengthened in the future by initiatives such as the Joint Chiefs of Global Tax Enforcement, known as the “J5,” a collaborative effort by the IRS and several countries to combat the threat of international tax crimes and cryptocurrency.

Those developments hint at another area that is ripe for development: Cryptocurrency. The IRS believes that cryptocurrency-related tax compliance is abysmal. In the past year, the IRS successfully forced Coinbase, the largest domestic virtual currency exchange, to turn over data on several thousand taxpayers’ cryptocurrency transactions. During the Coinbase proceedings, the IRS alleged that “only 800 to 900 taxpayers reported gains related to bitcoin” between 2013

and 2015, even though it estimates that perhaps millions should have. The IRS is now actively mining this newly received data.

The IRS has also partnered with third parties, such as Chainalysis, a contractor that utilizes data pulled from public forums, the dark web and other sources to trace cryptocurrency to its owner and remove the perceived cloak of anonymity. Enforcement in these areas and others is likely to see particular benefit from the IRS’ investment in data analytics.

Tip of the Iceberg

The IRS has entered the future of fighting tax fraud. It has embraced big data analytics – and we have likely only seen the tip of the iceberg. With a reported year-over-year increase in its detection of tax fraud of more than 400 percent and its more than 1,000 percent increase in the identification of proceeds from other financial crimes, the IRS is likely to up the ante on its bet on big data. ❁

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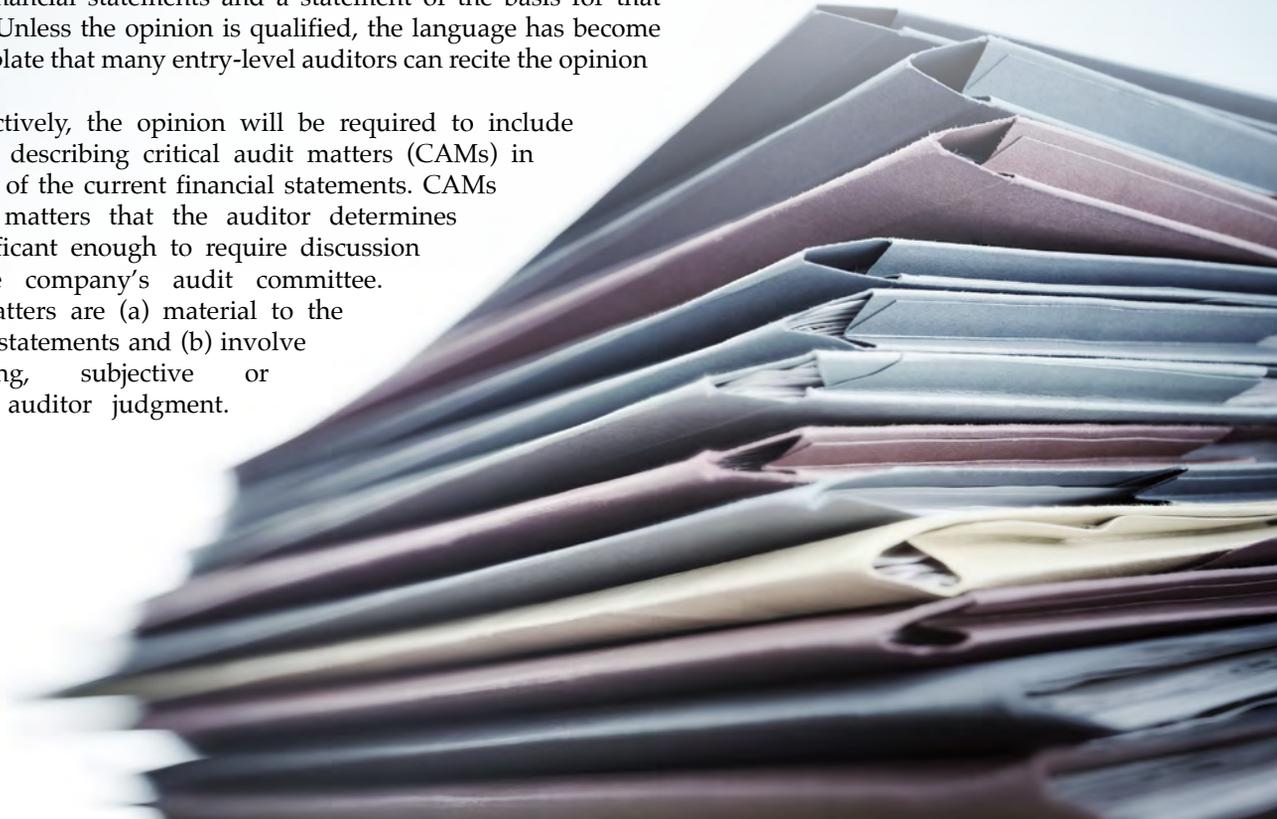
Auditor's Report is Scheduled for Remodeling

By DON CARPENTER, MSAcc/CPA

As with a homey den's well-worn cushions and threadbare rugs, there is a certain comfort that comes with reading the time-tested auditor's report. However, the homogenous nature of the standard (unmodified) auditor's report has rendered it almost nondescript – just a page in the package to be leafed over, necessary to be sure, but not really seen. Reader, beware – a makeover is coming.

The Public Company Accounting Oversight Board (PCAOB) released AS 3101 in June 2017 that will require a major overhaul of the auditor's report. Currently, the report expresses an opinion on the financial statements and a statement of the basis for that opinion. Unless the opinion is qualified, the language has become so boilerplate that many entry-level auditors can recite the opinion verbatim.

Prospectively, the opinion will be required to include a section describing critical audit matters (CAMs) in the audit of the current financial statements. CAMs are any matters that the auditor determines are significant enough to require discussion with the company's audit committee. These matters are (a) material to the financial statements and (b) involve challenging, subjective or complex auditor judgment.



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

AICPA's Auditing Standards Board has a similar concept called Key Audit Matters for non-public audit opinions, but the disclosure is not mandatory.

CAMs may fall within several categories:

1. An item in which estimates are critical to measurement of financial statement results, such as contingent liabilities, impairments or recognition of long-term contract losses.
2. An item for which timing of recognition is subjective, such as reserve reversals, contingent gains or tax loss/credit carryforwards.
3. An item that requires specialized skills to reflect the financial statement impact or make adequate disclosure, such as purchase price allocations, pensions accruals or environmental liabilities.

It is likely that, after initial disclosure, certain CAMs will be carried forward in successive years' reports. Actuarial assumptions for material post-retirement benefits or economic projections for goodwill impairment testing may qualify as recurring matters.

Other matters, such as the financial statement implication of a major acquisition or divestment, will generally only be included in the year of the transaction. A third category of matters may appear only sporadically, such as impairment testing for oil and gas properties, which are dependent on the ebb and flow of oil prices.

There is a presumption that every year's audit report will include at least one CAM. In addition to identifying each CAM, the report must include a description of the considerations that led the auditor to determine that an item qualified as a CAM, how the matter was addressed in the audit and a reference to the financial statement accounts or disclosures that relate to the matter. The auditor's report could obviously become quite lengthy if it contains multiple CAMs.

The new requirements are effective for large accelerated filers for fiscal years ending after June 30, 2019, and for all other companies for fiscal years ending after Dec. 15, 2020. Even though companies and their audit firms will generally have at least one more reporting period before CAMs must be disclosed, it is not too early to start preparing.

Although the report is the responsibility of the auditor, firms should anticipate that their clients will have a perspective on how CAMs are described and what specific information is disclosed. At least annually, auditors typically discuss matters that require

The new requirements are effective for large accelerated filers for fiscal years ending after June 30, 2019, and for all other companies for fiscal years ending after Dec. 15, 2020.

significant judgment or specialized resources with their client's audit committee. This often takes place in conjunction with the presentation of audit fees. The matters included in this discussion should be reviewed to determine if any or all of them will qualify as CAMs.

It might then be advisable to draft the CAM section of the auditor's report with these items well in advance of the fiscal year end to allow for review by the client. It would be beneficial for the client to concur that no confidential or competitive information is being disclosed unnecessarily, although ultimately it is the auditor's responsibility to determine appropriate disclosure under independence requirements.

In cases where an audit firm may have multiple clients in the same industry, the service teams should coordinate a review of the various clients' CAMs. There should be some commonality between these clients for issues that are endemic to the industry both in terms of how the auditor addresses the matter and how the matter is reflected within the financial statements and related disclosures.

Finally, the auditor and client should begin to discuss on a regular basis any unusual transactions or events that might not be a recurring CAM, but might qualify within a specific year. This discussion could be included in the reviews that occur in conjunction with the preparation of the unaudited quarterly financial reports.

PCAOB's intent with the overhaul of the auditor's report is to give investors more insight into how the auditor views the relevant financial statements and where even a high-quality audit may be able to provide only limited certainty on material matters. As with the remodeled den, it will be incumbent upon readers to stop and take notice of the changes and get a fresh perspective on an "old friend." ❁

Three Common Invoicing Scams and How to Avoid Them

By JOSEPHINE MCCANN

Invoicing and payments fraud can take a variety of forms: invoices from fictitious companies, invoices for products that were never delivered, charges for unusually high amounts, or a phishing scheme. As a business grows and its vendor list gets larger, how do you stay on top of the validity of each invoice? Below are some common invoice fraud schemes and how you can prevent them.

CEO Impersonation

Imagine that you receive an email from your CEO with a request for an urgent payment. He/she is finalizing the acquisition of another company and needs you to wire money immediately to close the deal. You receive a follow-up phone call from a third party with the wiring instructions and authorize the payment as instructed. Only later do you find out that the email wasn't really from the CEO, and both the email and the phone call were an orchestrated scam.

This type of fraud, known as "business email compromise," "CEO fraud" or "CEO impersonation" was responsible for over \$675 million in losses in one year alone, according to the 2017 FBI Internet Crime Report. Using a spoofed email address (a common method for phishing schemes), fraudsters specifically target individuals responsible for wire transfers or invoices within an organization and solicit payments from them. They thoroughly research a company's recent activity and target companies that conduct a lot of foreign transactions via wire transfer, since those payments are difficult to reverse. The authority of the sender, the urgency

of the request and the spoofed email address create a very convincing hoax.

Vendor Impersonation

Fraudsters may also impersonate trusted vendors. Using a spoofed email, they may send notice that they've recently changed addresses or ACH routing information along with a fake invoice. Similar to CEO impersonation, this type of fraud happens when someone impersonates a vendor you already conduct business with. Fraudsters specifically target an employee within accounts payable, hoping that the payment will go through long before anyone questions its validity.

Awareness is key to prevent CEO and vendor impersonation fraud from happening in your organization. If you receive an email that seems suspicious, pay attention to the tone of the email: Does it sound like something your CEO would send to you? Is it his/her usual tone or is it overly formal? Another thing to consider: Is it unusual for you to receive a wire transfer or urgent payment request from your CEO or this particular vendor? If you're unsure, just ask, especially for large amounts.

Shell Companies

The creation of a shell company is one of the easiest ways for an employee to perpetrate an invoicing fraud scheme. A shell company only exists on paper, provides no services and produces nothing. This type of fraud is often an inside job; the employee might set up the entity in a friend's or relative's name, and invoice his/her employer and collect the payments. Typically, the employee will have information on the way the invoices

are processed (or may even be the one paying them), so he/she knows exactly what threshold to stay under to avoid further approvals, potentially remaining undetected for years.

Shell companies can be difficult to distinguish from real companies, but there are a few red flags. Be wary of invoices that have vague or unspecified services – this doesn't necessarily indicate fraud, but services never rendered are a lot harder to detect than products never delivered.

Are the invoices you receive numbered in sequential order? This may be because they have no other customers and you're the only one receiving the invoices. If you suspect it's a fake invoice from a shell company, keep an eye out for other red flags (typos, grammatical errors, etc.). If it's from a vendor you don't recognize, then be cautious. Look closely at the address, tax ID number and phone numbers – one of these might match one of your employees.

Stay Vigilant

Fraudsters are constantly looking for ways to perpetrate a new scheme. It's important for CPAs to remain vigilant to detect the variety of forms invoicing and payments fraud can take.

ABOUT THE AUTHOR:

JOSEPHINE MCCANN is a senior marketing associate at AppZen, the world's leading solution for automated expense report audits that leverages artificial intelligence to audit 100 percent of expense reports, invoices and contacts in seconds.

ARE YOU INTIMIDATED BY MACROS?

What are two of the most intimidating words for CPAs? Excel macros. Creating and using macros represents the invisible line that separates the average CPA Excel users from the more advanced users. However, this does not have to be the case. Macros are a great tool for any CPA. In this article, you will learn about built-in macros and how to create a custom macro without knowing anything about coding.

A macro takes repetitive actions and automates them. This allows the users to complete dozens of steps in a single keystroke. The benefits of macros are more than just saving time. Macros produce consistent application, avoiding the possibility of skipping a step. They also provide consistent output, especially when formatting large groups of data. For example, a macro can set all columns to a specific width or even encrypt a workbook before sending it to a colleague.

Lastly, a macro has numerous benefits for data that is the same as the previous year. For example, if the same analysis is performed year over year, a macro expedites the process to avoid wasting time trying to match prior years.

What makes macros seem scary is that many CPAs are only familiar with the most complex way to create them. Using Visual Basic for Applications (VBA) coding, an advanced user can design custom macros to do virtually any function. However, gaining the expertise required to program in VBA is prohibitive for many CPAs. This unnecessarily causes some CPAs to shy away from investing time in

By **ABBY KEYES** and **GRACE SLOAN**

learning about macros. Nevertheless, there are two easy strategies to becoming a faux-expert macro user.

STRATEGY 1: USE THE HIDDEN FUNCTION IN EXCEL

Every version of Excel has been built around macros. Novice users are likely familiar with copy and paste shortcuts; however, there are many more, ranging from formatting commands to mathematical formulas.

FORMATTING MACROS

| Function | PC Shortcut | Mac Shortcut |
|---------------------|-----------------|------------------|
| Bold Font | Control b | Command b |
| Add Border Outline | Control Shift & | Command Option 0 |
| Apply Number Format | Control Shift ! | Command Shift ! |

These macros make formatting data easier. Unformatted data is overwhelming. Using the bold function and border outlines make headers stand out. Number formatting provides a quick way to label the currency of the data. Formatting shortcuts organize the data and makes it easier to read.

DATA VISUALIZING MACROS

| Function | PC Shortcut | Mac Shortcut |
|-----------------------|-------------------------|-----------------|
| Group Rows or Columns | Alt Shift Right Arrow | Command Shift k |
| Create a Table | Control t | Shift t |
| Create a Graph | Select all data. FN F11 | FN F11 |

Visual shortcuts like creating a table, graph or grouping rows and columns are important everyday functions for CPAs. Enormous amounts of data are confusing if

background on the information is not available. A graph solves this issue by summarizing data visually. Creating a graph can require multiple keystrokes, but the FN F11 shortcut reduces it to a single keystroke. A visual representation makes the data more understandable and adds value for users.

MATHEMATICAL MACROS

| Function | PC Shortcut | Mac Shortcut |
|---------------------------------------|-------------|-----------------|
| Auto Sum | Alt = | Shift Command t |
| Toggle Relative & Absolute References | FN F4 | Command t |
| Insert a Function | Shift FN F3 | Shift FN F3 |

Mathematical functions create functions quickly without having to type in the formula. CPAs must often calculate totals and

cross foot records; therefore, utilizing auto sum and inserting function shortcuts streamline their work. Toggling relative and absolute references allows the user to drag formulas across cells while retaining the function's cell integrity.

STRATEGY 2: RECORDED MACROS

Most CPAs often find themselves manually completing the same task several times throughout an engagement, because there is no built-in function that meets their specific client needs, addresses the issues with the data or that complies with firm/supervisor-specific requirements. When the CPA is a coding expert, he/she may program a custom macro to meet his/her needs. However, there is another option: recorded macros.

A recorded macro records every keystroke and mouse click from when users press start until they press stop. These macros require no coding knowledge and are created in just a few minutes. Even expert coders may find that it is more efficient to record macros rather than write them. A CPA can record his/her first macro in five simple steps.

Step 1: Plan

It is key to know the macro's purpose before recording. If the intentions are unclear, creating a macro may not have intended results. For example, imagine a macro that changes the sign of the value in each cell. Was the intention to make all the numbers negative or switch the signs? What if there was a negative number in the data set and, by using this macro, it made the negative number positive? This macro does not have the intended results. Therefore, it

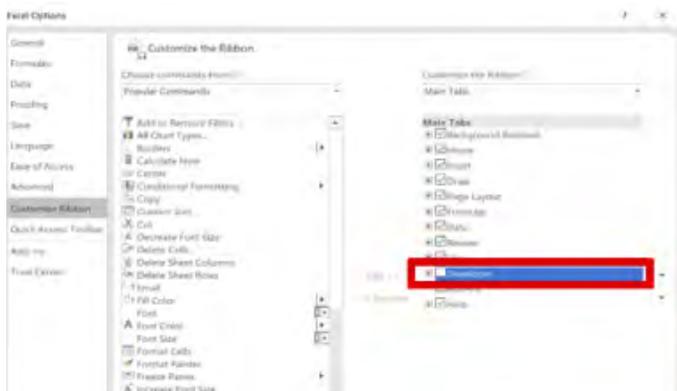
is of paramount importance to have a clear purpose before beginning.

Step 2: Setup

Next, with Excel open, make sure the “Developer” tab is activated. This is in the Excel ribbon at the top of the workbook. The ribbon includes tabs such as Home, Insert, Page Layout, Formula, Data and Review. If Excel has a “Developer” tab, then proceed to Step 3. PCs and Macs have different setups for adding the “Developer” tab, so both are included.

PC: Right click any green tab (such as the “Data” tab) and select “Customize the Ribbon.” When the dialogue box appears, look for “Developer” on the right side under “Customize the Ribbon.” Check the box to the left of “Developer” and press “OK.” See Figure 1.

FIGURE 1. CUSTOMIZE RIBBON FOR PC



Mac: Select “Excel” in the top ribbon. Select “preferences.” From there, click “Ribbon and Toolbar.” On the right side are all the options to customize the ribbon. Select “Developer” and then press “Save.”

Now click on the “Developer” tab and the world of macros is opened.

Step 3: Implement

Once the planning and setting up steps are completed, click on “Record Macro.” See Figure 2.

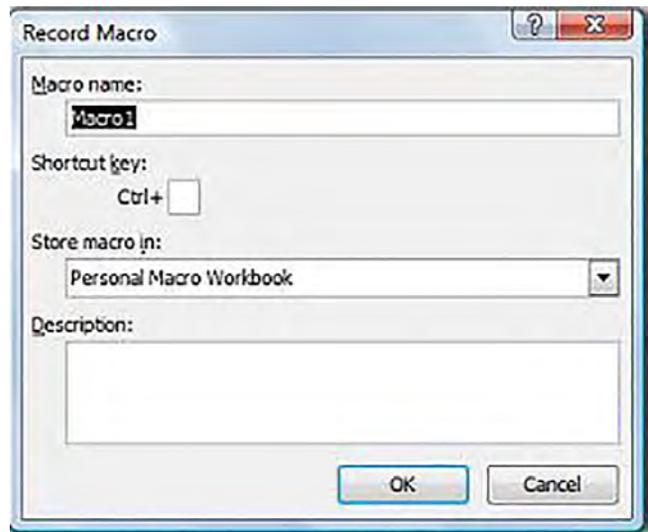
FIGURE 2. DEVELOPER TAB



From there, a dialog box appears. See Figure 3. Enter the macro name, shortcut key and macro description. When choosing a unique name for a macro, do not include any spaces. Be mindful when picking a shortcut key; it overrides any preprogrammed shortcuts. For example, using the shortcut Ctrl+S overwrites the save-shortcut function. It is not mandatory to have a shortcut key.

The default setting is to store the macro in the active workbook alone. However, users can select an option to make this macro available in other workbooks on this computer by saving the macro to the “Personal Macro Workbook.” If the macro is reusable, it is best to save it to this workbook. This adds the macro to the personal library of custom macros. See Step 5 for instructions on accessing macros from the “Personal Macro Workbook.” It is recommended that the description summarizes the task the macro performs. Finally, press “OK” and the macro starts recording every keystroke or mouse click.

FIGURE 3. MACRO DIALOG BOX



Now, perform the automated task normally. Remember when creating a macro, the number of keystrokes or mouse clicks does not matter. Creating a macro makes the task effective, but running a macro makes it efficient. Once the task is completed, go back to the “Developer” tab and click “Stop Recording.” See Figure 4. This completes the macro.

FIGURE 4. DEVELOPER TAB



Step 4: Verify and Run Macro

Now on a clean set of data, test the macro. Testing the macro ensures its effectiveness and protects actual data. Beware: once a macro is run, the “Undo” button no longer works. In other words, any changes made by the macro must be manually undone or the users must revert to a previously saved version of the data. If the macro is programmed to remove data, the data is permanently deleted, so a previously saved copy of the data must be recalled to restore it. To run the test macro, either use the shortcut key or create a button.



To create a button, return to the “Developer” tab in the ribbon. From there, select “Insert.” The button is the first option in the drop-down menu. Select it and drag and drop the button anywhere on the spreadsheet. Once this is complete, assign the macro to the button. Make sure the correct macro is assigned. Then rename the button to

If the created macros were saved in the “Personal Macro Workbook,” these macros are available to be applied to other workbooks. Running the “Personal Macro Workbook” in the background allows those macros to be run on any other open worksheet.

describe the macro. Click anywhere on the spreadsheet to deselect the button. Multiple buttons are allowed per worksheet. Simply press the button to run the test macro on a clean set of data. Once it has been determined that the macro will perform the correct task, repeat this step on the real data.

Step 5: Review

If the created macros were saved in the “Personal Macro Workbook,” these macros are available to be applied to other workbooks. Running the “Personal Macro Workbook” in the background allows those macros to be run on any other open worksheet. To use the macros, go to the “Developer” tab and select “Macros.” See Figure 5.

FIGURE 5. VIEW MACRO LIBRARY

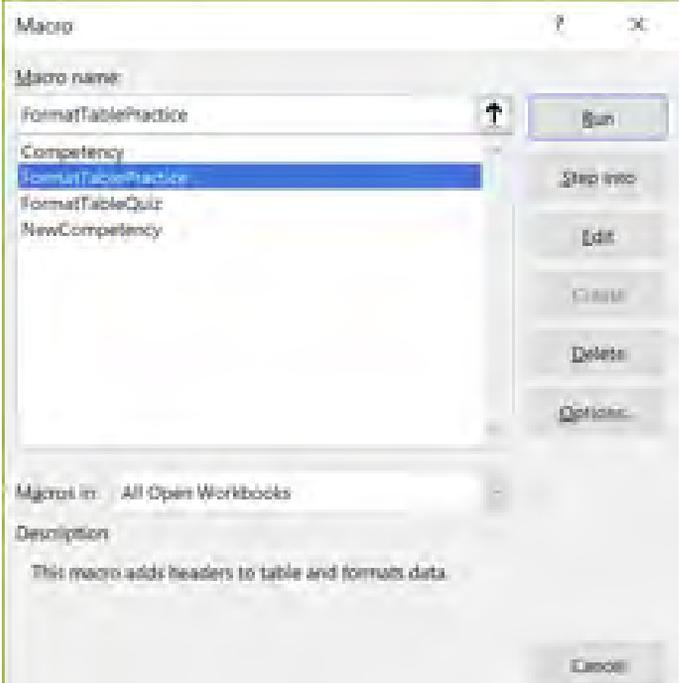




Using the recording function simplifies macros, saves time and makes the CPA's life easier.

This opens a dialog box allowing users to run any available macro on a set of data. See Figure 6. Make sure the macro selected is applicable to the data. Select the macro and click "Run" to apply it.

FIGURE 6. MACRO DIALOG BOX



ARE MACROS STILL INTIMIDATING?

Hopefully not! Using the recording function simplifies macros, saves time and makes the CPA's life easier. In a competitive industry, this differentiates you from a novice user. If we (two graduate students who think technology is always against us) can figure it out, so can you!

TABLE 1. FIVE EASY MACROS TO GET STARTED

| Macros | CPA Functionality |
|-------------------------------------|--|
| Highlight greater/less than values | Easily point to numbers that are outside of your designated threshold |
| Unhide all hidden worksheets | Easily unhide all worksheets that an earlier user may have intentionally hid |
| Create a backup of current workbook | Excel loves to crash; this is a wonderful way to quickly protect yourself |
| Add workbook to mail attachment | Easily send a document you have been working on to a coworker |
| Save selected range as a PDF | Quick way to send something to the client so he/she cannot edit your work |

ABOUT THE AUTHORS

ABBY KEYES and GRACE SLOAN are graduate accounting students at Baylor University and will be starting full time with Deloitte in Fall 2019. They can be reached at abby_keyes@baylor.edu and grace_sloan@baylor.edu.



Left: Ed Roth, CFA, CPA, CFP®, CEBS • Charlotte M. Jungen, CPA, CFP® • Wade D. Egmon, CPA, CFP® • Steven R. Goodman, CPA, CFP® • Chris A. Matlock, CPA, CFA



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San Antonio Chapter Funlympics Celebrates 35 Years

The San Antonio Chapter marked a big milestone in 2018, as volunteers held the 35th annual Funlympics for local children from economically challenged families. Since 1984, thousands of children participating in summer community center programs have enjoyed a half-day of games and friendly competition, followed by a cookout and distribution of backpacks filled with school supplies.

The effort involves several hundred volunteers each year, many of whom are chapter members. The chapter also relies on volunteer teams from businesses, such as Broadway Bank, Frost Bank and USAA. It takes scores of volunteers to perform traffic direction, check-in and registration, kid wrangling, grilling hot dogs and serving lunch, passing out backpacks, and cleaning up the grounds afterwards.

In addition, subcommittee volunteers begin meeting immediately after the April tax deadline to coordinate transportation, food, games, prizes, contacts with the

community centers, school supplies/t-shirts/caps and recruiting more volunteers.

Two days before Funlympics, which is traditionally the last Saturday in July or first Saturday in August, an army of volunteers shows up to stuff 400 backpacks with paper, glue, pencils, notebook paper, erasers and everything else on schools' supply lists. Each child also receives a size-appropriate t-shirt commemorating the day, plus a Funlympics ball cap.

When Funlympics first began, it was held at McGimsey Scout Camp in Castle Hills, which offered lots of wide-open spaces, but very few trees for shade from the summer heat. Event participants enjoyed the campus-like environment of St. Peter-St. Joseph Children's Home near Mission Concepcion on the South Side for the next 17 years, additionally welcoming residents of the group home.

Committee leaders made the decision in 2017 to branch out to the rolling fields of Boysville, another group home for

By Guest Columnist AMANDA BURRUS TALAAT, Assistant Executive Director, TSCPA's San Antonio Chapter



children. This venue provided almost unlimited space for games and friendly competitions, plus a covered picnic pavilion, ample parking and outreach to northeastern Bexar County.

Innovations added over the years have included a deejay to spin upbeat music during the games, as well as a “hype guy” to get the children amped up and ready to play. In 2018, there was a special appearance by the San Antonio Spurs Coyote – always a fan favorite in this part of Texas! Other special guests included Alamo re-enactors and superhero characters dressed in costume.

“I believe it was successful due to the collective efforts of the Funlympics committee in tandem with the support of our surrounding community. There are key leaders within various organizations who greatly contribute to our goal of impacting these kids and we couldn’t do this without them,” said 2018 Funlympics Co-chair Raymond Johnson, CPA, manager at Slattery Perkins Ramirez.

Funlympics is truly a special tradition that brings as much joy to the chapter volunteers as to the children they host. ❁

Editor’s Note: A special thanks to Amanda Talaat for authoring this Chapters column.



Lara Akinboye, CPA, CFE, CMA

“Success is the sum of small efforts – repeated day in and day out.” – ROBERT COLLIER

Lara Akinboye approaches her goals with the quote above in mind. Lara is senior advisor at Durbin Bennett Tax Advisors Inc. in Austin. We recently caught up with her to learn more about her background, the path she took to become a CPA, why her volunteer work with TSCPA is so important, and more.

Where were you born and where did you grow up?

I was born and raised in Lagos, Nigeria. The city of Lagos, which derives its name from the state, is lively and thrives on lots of activities. The hustle and bustle lifestyle on the mainland, where I grew up, can be compared to New York. Growing up in Lagos was fun and exciting. Kids came up with innovative ways to play outside with friends, such as creating makeshift goal posts out of bricks to play soccer on sandy streets. Neighbors treated one another like family and believed the saying that it takes a village to raise a child.

Nigeria has a warm climate, so my first winter in Tennessee was definitely a culture shock. I moved to the United States in 2009 to attend college at Lee University with a double major in accounting and business administration. I graduated in December 2012 and passed the CPA exams the following year. After a few years of working in Tennessee, I moved to Texas in January 2016 to join Durbin Bennett and became involved with the Austin Chapter after my license reciprocity went through.

Tell us about your family.

I am the second of four girls, which meant my dad was definitely outnumbered when it came to “important” household voting decisions, including how or where to celebrate the next birthday party. Education was very important in our household, because my mom was a teacher. We started school at a very early age, so I was younger than most of my classmates.

My mom also operated a retail store. Whenever I was home for a long holiday in high school, I would go with her to the store and perform inventory counts and reconcile the physical counts to the records kept by the sales associate. I think that was my first real-world



accounting experience. I often joke that my true accounting experience predates my official resume. I have not started my own family yet, but I plan to someday. At this time, I am exploring Austin and building my professional network.

How is being a CPA different from how you imagined it would be?

The CPA profession thrives on networking. Being a part of TSCPA has exposed me to a large network of people, who are working in different sectors of the economy. Students often have the misconception that the CPA is limited to public practice; however, the

possibilities are endless – one could work in industry or government.

Furthermore, advocacy is very important for the profession. The Texas State Board of Public Accountancy has policies in place to protect the integrity of the profession, such as the ethics and compliance requirements to ensure CPAs are held to a higher standard. TSCPA not only keeps members informed, but also acts as a voice on legislative matters that could affect the future of the profession.

What advice would you give students who aspire to become CPAs?

Write down your goals and work diligently to achieve them in a set timeline. The journey to becoming a CPA goes beyond just passing the exams; it is everything in-between and afterwards. I was working full time when I studied for the exam, so I had to make a reasonable study plan within the confines of my busy schedule and be self-disciplined enough to stick to it.

The certification is the culmination of the efforts put in throughout the process. The entire process can be daunting to some, but if one treats the exam like a series of small tasks rather than a big mountain that one has to climb, it will be much easier to achieve one’s goal, which is what I did. Each day, I woke up with the mindset that if I study for a few hours today, I will be one step closer to being a CPA. The discipline and diligence with which one studies for the exam will shine through in how one approaches the job and life responsibilities.



Why is volunteering in TSCPA and your community so important to you?

Serving the community has been ingrained in me since I was a college student. Lee University emphasized the importance of benevolence and provided a lot of opportunities for students to give back to the community. For example, the accounting department ran the Volunteer Income Tax Assistance program every year



during tax season and encouraged the upperclassmen to participate. I volunteered for two years. That experience exposed me to tax and prepared me for my job as a tax accountant after graduation.

When I moved to Austin, I was very excited to actively get involved in my local TSCPA chapter so that I can continue to give back to the community. I expressed my interest by actively participating in events and the chapter followed up with lots of opportunities for me to serve and lead. I participate in student outreach programs and events involving young professionals at the chapter, because I think it is important to communicate with the next generation of CPAs by sharing my journey while answering their questions and promoting the profession.



Who is or was your role model and why?

I have had several mentors throughout my career. People have stepped in for various reasons mostly because of my positive attitude and willingness to learn. However, the person who solidified my CPA path was one of my college professors, a CPA who not only encouraged me to aspire to be greater, but also stepped in to evaluate my progress from time to time.

What do you like to do on weekends or when you're on vacation?

I was drawn to Austin partly because of the live music scene. During non-busy season, my weekends often consist of music-related events, volunteering and mingling with other young professionals through groups such as the Austin Young Chamber and Texas Young Professionals.

My favorite vacations are trips involving family or close friends. I was fortunate to have a great group of friends from college who have now become like family. We kept one another grounded while in school, so it's only natural that we stuck together afterwards. Although we all live and work in different parts of the country now, we plan a few trips together every year to catch-up and celebrate our latest achievements. ❁



2019 Outstanding Accounting Educator Award Nominations Due March 1

Do you know accounting educators who deserve recognition? Be sure to nominate them for a 2019 Outstanding Accounting Educator Award! TSCPA is accepting nominations through March 1, 2019.

This award recognizes Texas accounting educators who have demonstrated excellence in teaching and have distinguished themselves through active service to the accounting profession. The 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.

For more information and to complete the nomination form, please go to the TSCPA website at <https://tscpa.secure-platform.com/a/organizations/main/home> or contact TSCPA's Catherine Raffetto at craffetto@tscpa.net or 800-428-0272, ext. 216 (972-687-8516 in Dallas) for more information.



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TSCPA Peer Assistance Foundation Celebrates 25 Years of Serving the Profession

For the past 25 years, the TSCPA Peer Assistance Foundation has made a positive impact on the CPA profession in Texas through administration of the Accountants Confidential Assistance Network (ACAN). ACAN provides a confidential conversation with CPA volunteers who have first-hand experience with mental and physical health issues.

This year, we celebrate ACAN and the work they do to help CPAs, exam candidates and accounting students learn how to merge healthier living with a demanding accounting career. For more information about ACAN, call 866-766-2226 or visit www.tscpa.org/advocacy/acan. Watch your TSCPA communications for wellness tips from ACAN to help you enjoy a healthier 2019!

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A New Year and a New Legislature

By JOHN SHARBAUGH, CAE, TSCPA Managing Director, Governmental Affairs

The Texas Legislature convenes on Jan. 8, 2019 and will meet for 140 days during the regular session. There are a number of new faces in the legislature this year. Thanks to various retirements and election defeats for some incumbents, the make-up of the legislature this year will be one where a significant percentage of the legislators will have no or little experience in serving in this elected body.

Election Results – House and Senate

In the Senate, the Democrats picked up two seats. Even with these losses, the Republicans still hold a large enough majority to bring any bills to the Senate floor for a vote. Without Republican defections, the Democrats will not be able to advance any issues on their own and the Republicans will control the agenda and the outcomes in that chamber.

On the House side, the Democrats did very well and picked up 12 seats. Thus, the numbers there will shift from

a 95-55 Republican majority to one of 83 Rs and 67 Ds. Again, with this size majority, the Republicans will control the chamber unless some Republicans join forces with Democrats on an issue.

While the Republicans still hold sizeable margins in both chambers, some feel the outcome of 2018's election will serve as a wake-up call for the party. This may translate into a less conservative agenda in the legislative session in 2019, with a greater focus on business issues rather than social issues.

Statewide Offices

The last time a Democrat won an election in Texas for a statewide office was 1994. November's election did not change that fact. All of the statewide offices were once again captured by Republicans. But this year's results were much closer.

During the last midterm election in 2014, Republicans won all statewide races by an average of 19 points. That

John Sharbaugh, CAE, is TSCPA's managing director of governmental affairs. Contact him at jsharbaugh@tscpa.net.

was not the case in 2018. While incumbent Gov. Greg Abbott fared reasonably well defeating his opponent Lupe Valdez by approximately 13 points, several other Republicans had much closer races when compared to the historical standards of the past several elections.

Incumbent Republican Dan Patrick won his race for lieutenant governor over his Democratic opponent – Mike Collier, CPA-Houston. But his margin of victory was a little less than five points. The race for attorney general was also close, where incumbent Ken Paxton, plagued by outstanding legal problems, only won by 3.5 points. In the race for agriculture commissioner, Sid Miller won by about five points. George P. Bush (land commissioner), Glenn Hegar (comptroller) and Christi Craddick (railroad commissioner) all won their races by about 10 points.

We will have to wait four years to see if these closer statewide results are a new trend in the politics of the state or an aberration caused by particular candidates (like Beto O'Rourke) and/or the attitude of voters about Washington, D.C. and the current occupant of the White House.

New Speaker

Another change in this year's legislature is a new speaker of the House. At press time, it was anticipated that Rep. Dennis Bonnen (R), Angleton, would be elected shortly after the House convened. Bonnen was a late comer to the discussion of possible replacements for Speaker Joe Straus (R), San Antonio, who had announced in 2017 his decision to step down and not run for re-election.

After Straus announced his decision to retire, a half dozen other House members declared their intentions to run for speaker and observers anticipated a major battle within the Republican Caucus to determine Straus's replacement. But Bonnen announced his interest for the position in early November and very quickly assembled a large number of endorsements (109 out of the 150 House members), which all but assured his victory when the legislature convened.

Bonnen has served in the House for 20 years and was the youngest person ever elected to the House at the age of 24 in 1997. In the last session, he served as the chair of the very powerful Ways and Means Committee. Known for "not suffering fools gladly," it will be interesting to see how Bonnen handles this new role. He will certainly have a different style than his predecessor and leans farther to the right, as well. Bonnen is expected to stand up for the House in relation to the Senate to assure it is an equal player in the legislative process. How he will work with, and relate to, the lieutenant governor and governor could have a major impact in how things get done in this session.

A large part of TSCPA's advocacy effort is to play defense against negative legislation for the accounting profession.

Major Issues

With the legislative session just getting started, it is still not clear what major issues will create the most debate and deliberation. Going into the session, property tax relief and school funding were the two big issues garnering attention and in essence, these two issues are tied together and would need to be solved simultaneously.

While the financial standing of the state looks better than it did two years ago, in a growing state like Texas there is never enough money to accomplish everything legislators and the public would like. So, getting agreement on a budget will be another challenge as it has been in past sessions.

TSCPA Agenda

The priority for TSCPA in this legislative session is to assure that the sunset legislation to continue the Texas State Board of Public Accountancy (TSBPA) gets passed. This will assure the continuation of TSBPA for another 12 years, until its next sunset review in 2031. TSCPA may seek a few changes to the bill that was sent to the legislature by the Sunset Commission. As it goes through the legislative process, we hope to add a provision about firm mobility and we may also look at adding some other issues as well, depending on the chances for success.

In addition to the sunset bill, we will monitor other legislative activity that could have a detrimental effect on CPAs. Historically, several thousand bills get introduced each legislative session, so a large part of our advocacy effort is to play defense against negative legislation for the profession.

To monitor what is happening this session, check out the TSCPA advocacy efforts by going to: <https://www.tscpa.org/advocacy>. ❁



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This is a follow-up article to “Due Diligence Requirements for Tax Return Preparers” published in *Today’s CPA* magazine last year. This article suggests 12 good due diligence practices that tax preparers can utilize to avoid mistakes and minimize their exposure to preparer penalties.

12 Due Diligence Best Practices for Tax Return Preparers

By PAUL M. BUDD, J.D., LL.M., MBA

As a brief recap, the general rule is a tax preparer will only be assessed preparer penalties when a tax return understates the taxpayer’s tax liability and the preparer “knows or should have known” that a position on the tax return was unreasonable and may result in an understatement.¹ If the tax preparer has “reasonable cause” for the understatement on the return and the preparer acted in “good faith” while preparing the return, the preparer generally will not be penalized for the understatement.²

A preparer will usually satisfy this “reasonable cause and good faith” exception to penalties if he/she exercised an appropriate level of due diligence when preparing the return, but nevertheless, an understatement still occurred. While there is no certain, foolproof method for satisfying this standard, implementing the following due diligence practices should strengthen a practitioner’s case against preparer penalties.

¹ IRC § 6694(a).

² IRC § 6694(a)(3)

1

Establish a Diligence Checklist for Returns and Always Follow It

Establishing a checklist of due diligence measures (i.e., normal office practices) to follow while preparing a return is the most important due diligence measure a CPA can take because it establishes the foundation of the return preparation process for every return. All of the rules that regulate tax preparers point to “normal office practices” as one of the most important factors to consider when determining whether a preparer should face penalties for an error on a return.

By having a diligence checklist of normal office practices to follow for every tax return, a preparer is less likely to make a negligent error while preparing a return and if an error does occur despite following the checklist, it is more likely the IRS will view the error as an isolated anomaly. If a checklist is always followed, it is more likely that the preparer acts in good faith while preparing returns.

While a diligence checklist is important, it can serve as a double-edged sword if it is not used diligently on every return. In *Brockhouse v. United States*, a commonly cited preparer penalty case, a factor the court cited in support of assessing penalties was that Brockhouse, the tax preparer, failed to follow his own diligence procedures for the tax return at issue when he did not send a routine data questionnaire to his taxpayer-client.³ Further hurting his case was the fact that Brockhouse wrote an article in a journal for tax practitioners in which he said: “[e]xamples of good office procedures include a system to promote accuracy and consistency in the preparation of returns. The system might include a preparation checklist, a method for obtaining the necessary information from the taxpayer, examination of prior returns and review procedures”⁴ Thus, despite advising other practitioners to strictly adhere to a diligence checklist, Brockhouse failed to follow his own advice.

2

Document and Retain Records for Everything

This is another very important diligence measure that is repeated throughout these tips. While a diligence checklist helps prevent careless errors and protects the tax preparer if an error does occur, the primary purpose for documenting and retaining records is protection when something goes wrong. If the IRS charges a tax preparer with taking an unreasonable position on a return, he/she has the burden of showing the IRS the information or advice that was relied on for the unreasonable position. A tax preparer may rely in good faith on advice or information provided by the taxpayer or other trustworthy sources.

3 *Brockhouse v. United States*, 577 F. Supp. 55, 58 (N.D. Ill. 1983) (“Also illustrative of Brockhouse’s lack of due diligence in preparing Dr. Busch’s 1978 return is his failure to follow procedures which both Goldman, Weiss as an accounting firm and he as an individual accountant recognized as necessary to obtain complete information from a taxpayer. As previously noted, Goldman, Weiss had “adopted a practice” (Stipulation, para. 10) of sending a data questionnaire to its clients as a means of collecting information, a practice not utilized in preparing Dr. Busch’s 1978 return.”)

4 *Brockhouse v. United States*, 577 F. Supp. 55, 58 (N.D. Ill. 1983).

A tax preparer should not only keep copies of written information (receipts, prior tax returns, emails, etc.), but also document and retain copies of all oral information and advice received. This includes conversations with the client and other related parties. For example, if a client tells a tax preparer information that’s relied on while preparing the return, the preparer should immediately type (or handwrite) a note or memo to the client’s file. Additionally, the preparer should document in a note or memo to file any advice given.

By regularly documenting conversations and meetings with the client, there will be written records of oral advice and information exchanged, just in case some of that information leads to an understatement. If a client provided bad information that the preparer relied on, and the client later tries to shift blame to the preparer by saying “I never told the preparer that” or “the preparer never advised/warned me about that,” the preparer will have some documentation to support his/her claim of reasonable reliance on the client’s information or advice.

3

Make Appropriate Inquires and Refer to the Taxpayer’s Prior Returns and Other Relevant Documents

This diligence tip suggests that practitioners should go above and beyond the regulations’ minimal standard of making appropriate inquires whenever the practitioner “knows or should know” that further inquiries are necessary. Practitioners should always play it safe and make appropriate inquires, because the regulations’ “should know” standard is such a vague, unpredictable standard.

AICPA’s SSTS rules already strongly suggest CPAs should make appropriate inquires of taxpayers claiming deductions or credits requiring substantiating records. It also suggests preparers should refer to taxpayer-client’s returns from prior years whenever it is feasible. Tying this suggestion back into the diligence checklist suggestion, a CPA can make reasonable inquires through a uniform questionnaire sent to every client early on during the return preparation. For due diligence purposes, it is always a good idea to ask about anything that may help the preparer compile a more accurate, complete return.

It is also important to remember that a tax preparer is not required to audit his/her client. When making reasonable inquires, all the preparer must do is ask. Once the appropriate questions have been asked, the preparer should be able to reasonably rely on any information, documents or oral answer provided by the client. The only exception to this is if the client provides information that is clearly inaccurate or that the preparer knows is inaccurate.

Preparers may generally rely on taxpayer’s information and are not required to grill their client about their information, question the validity of their information or otherwise challenge his/her trustworthiness. Generally, once the appropriate inquiry has been made, the preparer has satisfied his/her professional duty. If the client responds by providing inaccurate, misleading or fraudulent information that is reasonably relied on in good faith when preparing the return, the liability falls on the client, not the tax preparer.

4

Request Supporting Documents for Positions that Require It

This suggestion is similar to the previous one, but it focuses on taxpayer-clients who are claiming deductions or credits that require substantiating records. This suggestion is that practitioners should actually request the substantiating records from a taxpayer who wants to claim a deduction or credit requiring substantiating records, rather than simply asking if the taxpayer has the records.

AICPA's SSTs rules suggest that CPAs should make inquiries to determine if the taxpayer actually has the necessary records, but the Code's preparer penalties do not necessarily require that. For example, in some instances, taxpayer-clients may claim a deduction or credit on their tax return that requires the taxpayer to have receipts or records substantiating the claim but does not require tax preparers to actually see those records to claim the position on the return. The following example illustrates this unusual situation:⁵ A taxpayer-client tells the tax preparer to claim a business entertainment expense deduction on the taxpayer's tax return. Under the Code, a taxpayer must have receipts and other substantiating documentation to claim a business expense deduction. The preparer, however, merely has to ask the taxpayer if he/she has the necessary substantiating records. Rather than just asking the taxpayer if he/she has the records, a tax preparer should take the extra step of asking the taxpayer to produce the substantiating records.

This extra diligence measure will not only further assist the preparer in preparing the return, but will also provide protection for a messy situation if there are no records and the IRS is curious as to whether the preparer knew or should have known the taxpayer did not actually have the records. If a taxpayer wants to claim a deduction or credit that requires substantiating records, the taxpayer should be able to produce the records for the preparer. "I have them; I just can't find them right now" will not cut it with the IRS, so it should not cut it with a tax preparer who is signing his/her name and reputation on the return.

5

The Bigger the Claim, the Greater the Need for Diligence

One of the regulations' factors to consider when determining if a preparer's understatement error was due to reasonable cause and good faith is the materiality of the error.⁶ If an error results in a small understatement of the tax liability when compared to the taxpayer's total tax liability, it is likely the preparer will not be assessed penalties. On the other hand, if the error results in a large understatement compared to the taxpayer's total liability, the preparer could have a difficult time avoiding penalties.

Thus, as a general rule, the bigger the claim, the greater the need for due diligence. This does not suggest only performing due diligence for large items on a tax return, but rather, it is suggesting that an alarm should go off in a practitioner's head whenever a taxpayer attempts to claim a very large deduction

5 *Supra* Section I.A.2.c.
6 Treas. Reg. § 1.6694-2(e)(3).

or credit. That alarm should tell the preparer "I need to be careful and exercise sufficient due diligence before I sign off on this claim."

6

Always Comply with the Heightened Diligence Requirements for Special Claims or Deductions

There is not really much more to say about this suggestion. If a specific deduction or claim requires a tax preparer (as opposed to just the taxpayer) to follow specific diligence steps before making the claim on a return, the preparer should carefully comply with every diligence requirement. If specific diligence requirements are not followed, the preparer will be assessed penalties regardless of whether there is an understatement on the tax return.⁷ Preparers should always stay current on any requirements that may apply to a deduction or credit, as the Code, regulations and IRS rulings are constantly changing in an attempt to crack down on tax fraud and abuse.

7

Never Consider a Taxpayer's Return Information in Isolation

This suggests that outside facts and circumstances should always be considered when preparing a taxpayer's return. This most commonly applies to tax returns prepared for an individual and the individual's closely held business. In this situation, preparers should be aware how income and tax items for the individual's business affect the individual's personal tax return. Accordingly, a preparer should not consider each return in isolation or be willfully blind to any tax information affecting both returns.

The Brockhouse case provides a good example. In Brockhouse, the court upheld preparer penalties assessed against a CPA who prepared income tax returns for a doctor and the doctor's professional corporation.⁸ The books the CPA used to prepare the professional corporation's return showed that the doctor and a bank loaned money to the doctor's corporation during the tax year.⁹ The books also showed that the corporation paid interest expense on loans during the year, but did not say who specifically it paid interest to.¹⁰ Furthermore, the doctor's individual tax return information made no reference to any interest income received.¹¹ The CPA did not claim any interest income on the doctor's individual return, which resulted in an understatement, because the doctor's corporation had paid interest on the loan to the doctor during the tax year.¹²

The court held that the CPA "should have known" to inquire about any interest income received by the doctor based on the information the CPA knew from reviewing the books for the doctor's professional corporation.¹³ The CPA was assessed preparer penalties, because he considered each

7 IRC § 6695(g)
8 *Brockhouse v. United States*, 577 F. Supp. 55, 55-58 (N.D. Ill. 1983).
9 *Id.*
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*

return in isolation and failed to make appropriate inquiries.¹⁴ The CPA should have considered the tax information he knew about the doctor's business when preparing the doctor's individual return.



Never Give Out Casual Tax Advice

A tax return preparer does not need to sign a tax return for the IRS to assess section 6694 preparer penalties against the preparer. By merely offering some casual tax return advice to a client, the preparer may be subject to penalties. "Off-the-cuff" comments made by email, phone conversation or casual in-person conversations can be traps for the unwary. Preparers should never give out casual advice and should always have a strong grasp of the taxpayer's facts and circumstances before offering tax advice.

Also, whenever possible, practitioners should try to formalize their advice in a typed memo or letter. This will create a clear, written record of the advice given, which the practitioner and taxpayer can refer back to at any time. It is also important that the advice be supported with relevant, up-to-date authority and include any risks, drawbacks or other concerns associated with the advice. This leads into the next suggestion.



Advise Clients of the Benefits, Risks, Drawbacks and Other Considerations Associated with a Position – and Document It

The role of a tax return preparer is to prepare the return in a way that conforms to the client's wishes.

The client makes the final decisions; it is the preparer's job to merely give advice on the most favorable position and make sure the client understands any alternative options that may be available. Thus, when a preparer advises on a position, he/she should make sure the client fully understands the position, along with all of the benefits, drawbacks, risks and any other concerns associated with the position.

To a lesser extent, the Circular 230 rules impose this duty on tax practitioners, requiring practitioners to advise clients of any penalties the client is reasonably likely to face as a result of a position taken on a tax return. Practitioners should do more than just warn about penalties that are reasonably likely. They should also provide advice on the benefits and drawbacks of multiple positions that may be available and make sure the advice is understood.

For example, if a client has an eligible foreign business entity and cannot decide whether to "check the box" on the tax return, the preparer should provide advice on the benefits and drawbacks of making the election as opposed to not making the election. Furthermore, a note or memo to file should be made summarizing the details of the meeting that includes details such as the advice given, whether the advice was understood and any preferences or feedback the client had regarding the advice.

By documenting the exchange, advice and discussions between the preparer and client, there will be records showing the individual was properly advised and understood all the options available. If a client makes a decision he/she later

¹⁴ See *id.*

regrets and tries to claim the preparer did not properly advise him/her before making the decision, the preparer will have a record showing he/she was properly advised and understood the decision before making it. Like most of these diligence suggestions, it is not enough for preparers to merely perform the suggested due diligence; preparers must also document and retain records of their due diligence.



Never Assume What the Law Is

Of all the areas of law, tax laws are most unpredictable and unstable. They are constantly in flux as the federal and state governments debate ways to raise revenue and spur on economic growth, while also combating tax fraud. Despite the complexities of tax law, practitioners still have a duty to maintain their competence in the field. If a tax practitioner is unaware of any changes to a certain law, the practitioner should never assume what the law is. Preparers should always exercise due diligence by performing sufficient research to make sure a position is still supported by good authority.

As stated in the regulations, a preparer has no defense against preparer penalties if he/she takes an unreasonable position on a return and should have known the position was no longer reasonable due to changes in the law.¹⁵



Do Not Prepare a Tax Return Unless Sufficiently Competent

If a tax return preparer has prepared small, individual returns for his/her entire career, he/she should probably not attempt to prepare a *Fortune 500* company's tax return. This is an extreme case, but it illustrates the point of this suggestion. If a tax preparer is not competent to handle a return or particular tax matter, he/she should not accept the project.

Tax laws are complex and wading into unfamiliar waters is a recipe for disaster for the unprepared. A CPA should know his/her limitations and decline projects when he/she lacks the requisite experience or qualifications.



Terminate a Client Relationship if the Client is Unwilling to Listen to Advice or Wants to Take Unreasonable Positions

Keeping a client is never worth losing your license. If someone is asking that unreasonable positions be taken on the return or asking the preparer to cut corners by skipping essential due diligence steps, it is probably best to end the relationship. There is no preparer penalty exception for "yeah I know it was wrong, but my client told me to do it."

As professionals, practitioners are expected to know what is right and wrong in their area of expertise. If a client insists on a tax preparer taking a position the preparer knows is unreasonable or lacks due diligence, he/she should clearly explain why he/she cannot take that position. If the individual is unwilling to listen to reason, there may be no other option than terminating the relationship.

¹⁵ Treas. Reg. § 1.6694-2(e)(6).

If the individual insists on taking an unreasonable position, the preparer should write a memo or formal letter explaining why the preparer cannot take the position.

It is in these types of situations when it is most important for tax preparers to document and retain records of the advice and information exchanged with a client. If the individual insists on taking an unreasonable position, the preparer should write a memo or formal letter explaining why the preparer cannot take the position. If the preparer has a conversation with the client explaining why an unreasonable position cannot be taken, and he/she refuses to accept the advice, the preparer should draft a memo to the client's file summarizing the details of the meeting and clearly stating that he/she was advised the position was unreasonable and that the preparer would not take the position.

It is extremely important to document and retain the documents in these situations, because when a client refuses to listen to a preparer's advice regarding an unreasonable or unethical tax position, there is a high likelihood the individual will take that position regardless. If this happens and the client gets caught, the IRS may come after anyone involved in the preparation of the tainted tax return. In that situation, the preparer may need to produce records or documentation showing he/she refused to take the unreasonable position and advised against it.

Exposure to Risks

These 12 due diligence suggestions are by no means a foolproof way to avoid preparer penalties or professional discipline. Tax return preparation is an extremely challenging, highly complex profession involving high stakes for tax professionals and their clients. In an area as challenging as this, a myriad of unpredictable problems may arise.

There is no easy 12-step solution that can shield a tax practitioner from all the risks associated with the profession. Nevertheless, by carefully performing the proper due diligence on every return, a practitioner can avoid careless mistakes and limit exposure to liability for the mistakes that are bound to occasionally happen. ❁

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TABLE 1.
Due Diligence Best Practices at a Glance

1. Establish a Diligence Checklist for Returns and Always Follow It
2. Document and Retain Records for Everything
3. Make Appropriate Inquires and Refer to the Taxpayer's Prior Returns and Other Relevant Documents
4. Request Supporting Documents for Positions that Require It
5. The Bigger the Claim, the Greater the Need for Diligence
6. Always Comply with the Heightened Diligence Requirements for Special Claims or Deductions
7. Never Consider a Taxpayer's Return Information in Isolation
8. Never Give Out Casual Tax Advice
9. Advise Clients of the Benefits, Risks, Drawbacks and Other Considerations Associated with a Position – and Document It
10. Never Assume What the Law Is
11. Do Not Prepare a Tax Return Unless Sufficiently Competent
12. Terminate a Client Relationship if the Client is Unwilling to Listen to Advice or Wants to Take Unreasonable Positions



European Union General Data Protection Regulation: How Can It Impact U.S. CPA Firms and their Clients?

By STAN STERNA and CATHY WHITLEY

On May 25, 2018, the General Data Protection Regulation (EU-GDPR), adopted by the European Union (EU) in 2016, went into effect and applies to all entities processing the personal data of individuals residing in the European Union, regardless of either the location of the entity or where the data is processed. It is designed to protect the privacy of EU citizens' personal information online. EU-GDPR imposes extensive privacy requirements on companies that have access to or process this information, in addition to reporting requirements in the event of a data breach.

CPA firms that have employees, independent contractors or individual clients who reside in EU member countries, or have access to the personal information of individuals who reside in these countries, are required to comply with the regulation. This includes

the personal information of individuals who reside in the U.S., but maintain citizenship in any of the EU member states.

To understand how CPA firms and clients may be impacted, it is important to first review several definitions included in EU-GDPR.

Personal data "includes data that can be used to identify an individual, either directly or indirectly, ... by reference to an identifier, such as a name, an identification number, location data, online identifier or to one or more factors specific to the physical, physiological, genetic, mental, economic, cultural or social identity of that person."

A *controller* is "the natural or legal person, public authority, agency or other body which, alone or jointly with others, determines the purposes and means of the processing of personal data."

A *processor* is "a natural or legal person, public authority, agency or other body which processes personal

data on behalf of the controller.”¹

CPA firms typically have access to personal data for both their employees and independent contractors utilized by the firm, as well as for individual clients when rendering certain types of professional services. Examples of services that typically include access to this data include:

- Estate planning;
- Family office;
- Financial planning;
- Investment advice;
- Succession planning;
- Tax compliance and planning.

CPA firms should complete an investigation to determine whether any of its employees, independent contractors or individual clients either reside in one of the 28 EU member states or maintain citizenship in them.

Additionally, CPA firms may have access to the personal data of the employees, independent contractors and customers of their clients when rendering the following services to businesses, governmental and not-for-profit entities:

- Employee benefit plan administration;
- Payroll processing;
- Medical billing and coding.

CPA firms performing these services for clients, as well as any other services that allow the CPA firm access to the personal data of the client’s employees, independent contractors or customers, should also complete an investigation with the client to determine whether any of the client’s employees, independent contractors or individual customers reside in one of the 28 EU member states or maintain citizenship in them.

The compliance requirements of EU-GDPR are significant. Following are a few important facts.

Controller or Processor of Personal Data – CPA firms, their third party service providers and their clients may qualify as a controller or processor of

personal data under the regulation. The duties imposed on controllers are broader than those imposed on processors. For example, in the event of a data breach that may impact personal data, a controller is required to notify the supervisory authority in the EU member state without undue delay and within 72 hours of discovering the breach. All 28 member states have their own supervisory authority.

Compliance by Third Party Service Providers – Depending on the level of control exercised, third party service providers that host client data on the internet for CPA firms may qualify as a controller under the regulation when they have access to the personal data of individuals residing in the EU. This includes firms hosting client portals and providers of online tax software. It is recommended that CPA firms investigate what these providers are doing to ensure compliance with EU-GDPR.

Written Contracts – Controllers are required to have written contracts with service providers qualifying as a processor of personal data. These contracts have specific requirements under EU-GDPR. For example, they must specify how the processor handles data and require the processor to both implement appropriate safeguards required under EU-GDPR and agree to submit to audits by the controller as required to ensure compliance with the regulation. CPA firms may receive updated contracts from clients that include these required provisions.

Supervisory Authority – Each of the 28 EU member states have their own supervisory authority under EU-GDPR and have the right to impose fines and sanctions upon businesses found to be in violation, including U.S.-based businesses.

Fines and Sanctions – Fines can range up to 20 million Euros or 4 percent of global revenues, whichever is higher. Sanctions can include suspending data flows to a company, reprimands and bans on processing of data.

EU-GDPR Impact

Both CPA firms and their clients should be analyzing how EU-GDPR

applies to their business operations and evaluating their privacy and security protocols. This will require the collaboration of senior management and company stakeholders, experts in privacy and security, and legal counsel.

While CPA firms are required to maintain client confidentiality under applicable professional standards, and are likely already familiar with federal and state privacy laws, EU-GDPR adds a layer of compliance obligations that clients and CPA firm management may be unfamiliar with. CPA firms should consult with legal counsel possessing expertise in EU-GDPR throughout this process.

Business clients will have varying levels of awareness and knowledge of EU-GDPR and how it impacts them. While many businesses may not operate outside of the U.S., they may process the personal data of individuals in the EU in the context of offering goods or services to people in the EU or monitoring people’s behavior as far as that behavior takes place within the EU.

It is important for CPA firm management to understand the general requirements of EU-GDPR and be prepared to discuss this with clients. Firms that provide client portals that clients can populate with their own data should be made aware that any client portal use agreement they executed remains applicable.

New Service Opportunities

There are extensive external resources available to CPAs and their clients regarding EU-GDPR. Additionally, this presents new service opportunities for CPA firms. Those with expertise in privacy and security consulting services, or the preparation of SOC 2 and 3 reports and SOC for cybersecurity examinations, may be able to assist clients in evaluating their controls over personal data covered by EU-GDPR. ❁

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¹ See Article 4, EU-GDPR
<https://gdpr-info.eu/art-4-gdpr/>

Tax Cuts and Jobs Act

The Impact on Settlement of Employment Claims

By JOE RIVERA, JD, and KYLE KNAS, JD

The Tax Cuts and Jobs Act (the Act) passed by Congress and signed into law by President Donald Trump in December 2017 has been described as the most significant amendment to the federal tax laws since 1986. The Act has generated substantial interest among taxpayers who wish to understand how it will affect them. One such provision is the Act's amendment to IRC 162, which addresses confidential settlement agreements related to sexual harassment or sexual abuse claims.

History of Taxation in this Area

Historically, the taxation of a settlement in a sexual harassment claim was governed by IRC 61(a) and the dichotomy created by IRC 104(a)(2). The familiar language of IRC 61(a) states that gross income subject to taxation includes all income, from whatever source derived, with other sections of the code creating exceptions to this general rule. One such exception, IRC 104(a)(2), states:

(a) In general. Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include – (2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness

This language has been interpreted to require that, to be excluded from taxation, damages or settlement funds must be (1) paid based on a tort or tort-type right and (2) paid “on account of *personal physical injuries or physical sickness.*” See *Wells v. Comm’r*, T.C. Memo 2010-5 (2010).

Anti-discrimination statutes, such as Title VII of the Civil Rights Act of 1964 (as amended by the Civil Rights Act of 1991), which prohibits harassment or discrimination based on sex or membership in other protected classes, generally allows for recovery of compensatory damages, such as past lost wages or benefits and future lost wages and benefits. (See 42 USCS §§ 1981a, 2000e-5.) Because such damages are not “on account of personal physical injuries or physical sickness,” they do not fall within the exception to taxable income created by IRC 104(a)(2) and thus are taxable.

Anti-discrimination laws like Title VII also allow recovery for what are known as “non-pecuniary” damages – damages that do relate to some underlying monetary obligation. Non-pecuniary damages include compensation for things like mental anguish and emotional pain. (See 42 USCS §§ 1981a, 2000e-5.)

Taxpayers have argued that funds paid in compensation for mental anguish or emotional pain suffered due to harassment or discrimination are not taxable, either because mental anguish or emotional pain are “physical injuries or physical sickness” or because mental anguish or emotional pain have caused “physical injuries or physical sickness.” The Tax Court has rejected the former approach, concluding that emotional pain and mental anguish are not “physical injuries or physical sickness.” (See *Wells v. Comm’r*, T.C. Memo 2010-5 (2010); discussing the legislative history of IRC 104(a)(2)); also see *Blackwood v. Comm’r*, T.C. Memo 2012-190 (2012); noting legislative history cited insomnia, headaches and stomach disorders as common symptoms of emotional distress, the

compensation for which should be taxed).

On the latter approach, there is some limited authority that if harassment or other hostility in the work environment causes physical manifestations beyond those typically associated with mental anguish or emotional pain, or exacerbates a physical injury or physical sickness, funds paid in compensation for such manifestations, injury or sickness are not taxable. So, for example, in *Domeny v. Comm’r*, T.C. Memo 2010-9 (2010), the taxpayer suffered from multiple sclerosis, a neurological disorder with symptoms including paralysis and jerking muscle tremors. The taxpayer claimed that a hostile work environment and related stress caused her MS to “flare up,” with the taxpayer suffering symptoms like leg pain, difficulty walking, vertigo and fatigue. A settlement agreement was executed, which covered potential claims for disability harassment and discrimination.

A portion of the settlement proceeds was reported as wage compensation on Form W2 and a portion was reported on Form 1099-MISC as “non-employee compensation” for other aspects of the taxpayer’s claim. The Tax Court held that the taxpayer demonstrated that the hostile work environment exacerbated the taxpayer’s MS, a physical illness, resulting in physical manifestations beyond those normally associated with mental anguish or emotional pain, and thus the “non-employee compensation” was excludable from taxable income pursuant to IRC 104(a)(2).

Other issues that arise in the settlement of a harassment claim are the treatment of punitive damages or attorney’s fees. Punitive damages are carved out of the exception created by IRC 104(a)(2) and are therefore taxable. (See IRS Pub. 4345.) This is true even if the punitive damages are received on account of physical injuries or physical sickness.

Anti-discrimination laws like Title VII also allow for recovery of attorney’s fees. Generally, the tax treatment of attorney’s fees is based on the tax treatment of the underlying claim in connection with which the fees were incurred. *Green v. Comm’r*, 2007 T.C. Memo. 2007-39 (2007).

Common-law tort claims can also be made in the employment context, particularly for sex-based harassment or assault. Common-law assault and/or battery causes of action clearly allow for recovery of compensatory damages for the physical injuries or physical sickness caused by assault or battery, as well as for emotional distress, mental anguish or other aspects of damage. *Gilliland v. Pon Lip Chew*, 401 S.W.2d 137, 139 (Tex. Civ. App. – El Paso 1966, no writ); *Stafford v. Steward*, 295 S.W.2d 665, 667 (Tex. Civ. App. – Eastland 1956, writ dismissed). To the extent that funds are paid as compensation for physical injury or physical sickness caused by a common law assault, battery or similar claim, those funds can be excluded from taxable income under IRC 104(a)(2).

Of course, lawsuits generally involve multiple causes of action and multiple categories of damages. The Tax Court

NON-PECUNIARY DAMAGES INCLUDE COMPENSATION FOR THINGS LIKE MENTAL ANGUISH AND EMOTIONAL PAIN.

Other issues that arise in the settlement of a harassment claim are the treatment of punitive damages or attorney's fees.

has held that when damages are paid in connection with a settlement agreement, it will first look to the language of the agreement to determine whether it expressly states that the damages compensate for "personal physical injuries or physical sickness" excludable from taxation under IRC 104(a)(2) or are instead taxable income. If the agreement is ambiguous or lacks express language specifying the purpose of the compensation, a court will then proceed to examine the intent of the payor, which is evaluated based on all the facts and circumstances of the case, including the pleadings in any lawsuit or other details of the litigation being settled. *Domeny v. Comm'r*, T.C. Memo 2010-9 (2010).

Parties to a settlement agreement that want to achieve desirable tax treatment should expressly address in the settlement documents the nature of the claims being settled, clearly identify any claims that are for physical injury or physical sickness, and specify an amount paid for each claim or cause of action so as to make it clear what portion of the overall settlement relates to claims for physical injury or physical sickness. *Hansen v Comm'r*, T.C. Memo 2009-87 (2009). (Although the taxpayer had sustained some bruises as result of incidents that gave rise to settlement, these injuries were not mentioned in agreement and thus all settlement funds were taxable.)

The Act and Taxation of Confidentiality Agreements

In today's world, it is not uncommon to hear news of an accusation that a celebrity, politician or otherwise high-profile person has engaged in sexual misconduct. #MeToo has been a highly public and powerful social media movement, which seeks to bring attention to the issues of sexual harassment and sexual assault.¹ Of particular concern to the movement is sexual harassment and sexual assault in the workplace.²

Apparently driven by the social context reflected by these phenomena, Congress included in the Act a provision specific to sexual harassment and sexual abuse claims. Specifically,

¹ Edwards, Stephanie Zacharek, Eliana Dockterman, Haley Sweetland. "TIME Person of the Year 2017: The Silence Breakers." *Time*. Retrieved 2018-04-14.

² Smartt, Nicole. "Sexual Harassment in the Workplace in a #MeToo World." *Forbes*. Archived from the original on Jan. 16, 2018. Retrieved Jan. 16, 2018.

section 162 of the Internal Revenue Code addresses confidentiality agreements pertaining to sexual harassment or sexual abuse settlements. This new code section is applicable to amounts paid or incurred after Dec. 22, 2017, meaning that settlements agreed prior to such date, but paid out afterward, are subject to this new law. Section 162(q) of the IRC, as added by the Act, states:

No deduction shall be allowed under this chapter for (1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or (2) attorney's fees related to such a settlement or payment.

This new provision under Section 162(q) is drafted broadly and, like numerous other provisions in the Act, there is yet little guidance as to how the IRS will regulate and enforce the new law.³ As with a great deal of the new Act, practitioners are awaiting Treasury Regulations or other interpretive guidance to provide more clarity to better advise clients as to the ramifications of the new law. Until regulations, publications, case law or other guidance become available, some areas of interest follow.

As discussed above, damages received under a settlement of a claim for harassment or discrimination are subject to the dichotomy created by IRC 104(a)(2), with compensation for physical injury or physical sickness generally excludable from gross income. (See IRC § 104(a)(2).) Compensation for workplace hostility or harassment that causes such a degree of stress that physical injury or physical sickness results is also excludable. (See *Domeny v. Commissioner*, T.C. Memo 2010-9.)

How will mental anguish or physical damages as the result of a sexual harassment or sexual abuse claim be treated? As drafted, the new law seems to disallow the deduction of any damages, regardless of the type, paid in settlement of a sexual harassment or sexual abuse claim, if the settlement is subject to a non-disclosure agreement. That is, IRC 162(q) can be read to override IRC 104(a)(2) and to make even funds paid in settlement of physical injury or physical sickness caused by sexual assault or sexual harassment subject to tax.

There is no guidance addressing this apparent conflict between IRC 104(a)(2) and IRC 162(q). To the extent that

³ One issue beyond the scope of this article presented by IRC 162(q) is its use of the phrase sexual "harassment" as opposed to sexual "discrimination." Sexual harassment is a form of sexual discrimination prohibited by Title VII of the Civil Rights Act of 1964 (as amended by the Civil Rights Act of 1991). See *Jones v. Flagship Int'l*, 793 F.2d 714, 719 (5th Cir. 1986). A cause of action for sexual harassment has specific elements, which are distinct from other forms of sexual discrimination. Given that the motivation for IRC 162(q) appears to be to disincentive confidentiality for settlements of sex-based harassment or abuse, particularly in the workplace, the question arises as to how the IRS would treat a settlement phrased in terms of sexual discrimination or a settlement where harassment is not at issue, but other forms of sex-based discrimination are.

the result of IRC 162(q) is to increase the tax burden on an employee settling a sexual assault or sexual harassment claim, employees and their attorneys will likely try to pass that burden back to employers, demanding a greater settlement payment to offset the tax effect, thereby increasing the cost of settling such claims.

This apparent conflict between IRC 104(a)(2) and IRC 162(q), and potential limitation of the former by the latter, must be assessed in the context of the practice of using global settlements. One benefit to an employer of entering into a settlement or severance agreement with an employee is achieving a final resolution of all claims, known or unknown, being made or that could be made by the employee.

Thus, it is a common practice to include global language in settlement and severance agreements covering all claims that might exist between the employer and employee, including claims for sexual harassment and tort claims (such as assault), even if those claims have not been made or are not really at issue. In light of IRC 162(q), this practice might be revisited, both by employees seeking favorable tax treatment of settlement funds and employers seeking to avoid paying to offset the employee's tax consequences or to maintain settlement agreements as confidential.

Particularly in today's environment, employers have

justifiable concerns about the effect an accusation or settlement might have on the public's perception of the employer. However, IRC 162(q)'s language making funds paid to settle a sexual harassment or sexual abuse claim applies only when the settlement is subject to non-disclosure. In cases where the sexual harassment or sexual abuse aspects of the case are such that the employer believes that confidentiality is essential, the employer will likely have to be prepared to pay a higher settlement amount to offset the tax consequences to the employee of a confidential settlement of such claims.

In many cases, however, the concerns addressed by a non-disclosure or confidentiality agreement can be addressed through other provisions. So, employers seeking to avoid the complications and negative effects of IRC 162(q) could revisit the need for boilerplate confidentiality clauses and use other provisions to achieve similar protections.

A clause could be included specifying that the settlement and its terms are not to be filed in the court where any related lawsuit is pending, reducing the publicity of the settlement. Settlements or severance agreements should include recitals or stipulations that the settlement resolves disputed claims and that the settlement is made to avoid the costs and burdens of litigation and is not an admission of liability.

The settlement could also include a non-disparagement





Particularly in today's environment, employers have justifiable concerns about the effect an accusation or settlement might have on the public's perception of the employer.

clause preventing the employee from making disparaging remarks related to claims of sexual harassment or sexual abuse. The parties could even negotiate an acceptable language for the employee to use in the event a public statement about the settlement is to be made.

In cases where sexual harassment or sexual abuse is not the focus, but the employer believes other aspects of the settlement should be kept confidential, the parties can negotiate and draft a settlement agreement following case law and guidance that already exists under IRC 104(a)(2). As noted above, the courts generally look to the settlement agreement to determine what claims were resolved and what portion of the settlement funds was paid for each in determining the taxability of the settlement funds.

Parties can follow this guidance in an effort to craft a settlement agreement whereby only a specific portion of the overall settlement is allocated to claims of sexual harassment or sex-related tort claims. In this way, the parties can attempt to isolate the sexual harassment or sex-related tort claims, thereby allowing other aspects of the claim to be subject to a non-disclosure or confidentiality provision, but still excluded from taxation to the extent allowed by IRC 104(a)(2).

Even this approach is not without risks given the breadth of the language of IRC 162(q). IRC 162(q) applies not just to payments to settle a claim for sexual harassment or sexual abuse, but also to a settlement "related to" such a claim. Even if provisions to settle a sexual harassment or sex-related tort claim are clearly segregated from provisions to settle other claims, the IRS could take the position that it is all part of an overall settlement and thus all other claims are related to the settlement of claims covered by IRC 162(q).

IRC 162(a) also addresses attorneys' fees. As noted above, whether attorneys fees recovered as part of a lawsuit or settlement are taxable normally depends on whether the damages to which the fees relate are taxable. A plain reading of the IRC 162(q) seems to suggest that both the employer's and employee's attorney's fees are non-deductible if related to the settlement of a sexual harassment or sexual abuse claim, even if the settlement of those claims is not subject to a non-disclosure or confidentiality agreement. Some commentators suggest that this textual reading was not the intent of Congress and that attorney's fees are only non-deductible if the settle is subject to a non-disclosure agreement.

Furthermore, there is a need for additional clarity on other issues pertaining to attorney's fees. Are the fees non-deductible for the claimant and the employer? Are fees still deductible for investigating, responding to, and litigating such claims? Until further IRS guidance is published, practitioners should take caution with the taxability of a settlement and particularly with regard to attorney's fees.

Difficult Choices for Handling Claims

As can be seen, the Act, including IRC 162(q), creates many questions. Practitioners are left to wait on further guidance, from the IRS or from the courts, on how IRC 162(q) will be interpreted and applied.

Particularly with regards to IRC 162(q), it appears that, although past authorities provide some guidance, employees with sexual harassment or sexual abuse claims and employers seeking to settle such claims are faced with difficult choices on how to handle such claims and draft settlement agreements

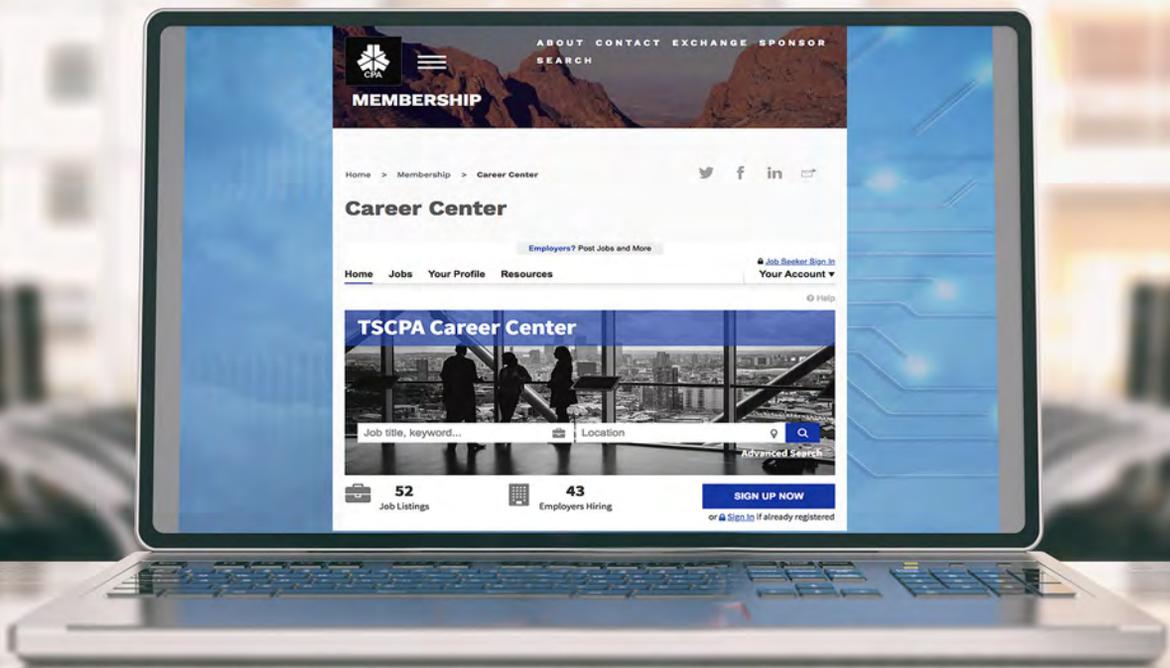


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FASB Simplifies the Test for Goodwill Impairment

By JANE N. BALDWIN, PH.D.

CURRICULUM: Accounting and Auditing

LEVEL: Basic

DESIGNED FOR: CPAs who work for or with public business entities and other entities, and private companies

OBJECTIVES: To compare the new simplified guidance with the current guidance, including FASB's interim responses to concerns over cost and complexity, and explore Board concerns about outcomes from the simplified test

KEY TOPICS: Quantitative and qualitative tests; impairment loss calculation; FASB responses to cost and complexity concerns; private company alternative; new guidance; tax deductible goodwill; reporting units with zero or negative book values; effective dates; and future phase

PREREQUISITES: None

ADVANCED PREPARATION: None

In May 2014, the Financial Accounting Standards Board (FASB) announced a simplification initiative to reduce the costs and complexity of generally accepted accounting principles (GAAP). Among the projects completed under this initiative is the simplification of the goodwill impairment test (ASU 2017-04).

This article will compare the new simplified guidance with the current guidance, including FASB's interim responses to concerns over cost and complexity. In addition, the article will explore the serious concerns that some of the Board members had over possible outcomes from the simplified test.

Current Guidance for Identifying Goodwill Impairment

Under current GAAP for public companies, goodwill is not amortized, but is tested at least annually for impairment. The test includes two steps with the option for the entity to first assess qualitative factors (such as a deterioration in general economic conditions or an increased competitive environment) to determine whether it is more likely than not that the fair value of a reporting unit is less than its book value, including goodwill (sometimes referred to as Step 0).

If the company determines that it is more likely than not that the fair value of a reporting unit is less than its book value, then it will proceed with the quantitative test.

Step 1. Quantitative Test – Fair Value Test on Reporting Unit as a Whole

The first step of the goodwill impairment test compares the fair value of a reporting unit to its book value, including goodwill. If the fair value of a reporting unit exceeds its book value, the goodwill of the reporting unit is considered not impaired. If the book value of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss.

Step 2. Impairment Loss Calculation – Fair Value Test on Goodwill

A company recognizes an impairment loss for the amount by which the book value of the goodwill of a reporting unit exceeds the implied fair value of that goodwill. Because the fair value of goodwill can be measured only as a residual and not directly, an implied fair value is calculated as the difference between the fair value of the reporting unit as a whole less the fair value of the company’s individual assets and liabilities, including any unrecognized intangible assets (excluding goodwill) as if the company had been acquired in a business combination.

The process of assigning a fair value to all of the individual assets, liabilities and unrecognized non-goodwill

intangibles is costly and complex. Please see Figure 1 for Step 1 and Step 2.

FASB’s Interim Responses to Concerns About Cost and Complexity

Since the 2001 issuance of Statement of Financial Accounting Standards No. 142 – *Goodwill and Other Intangibles*, FASB has received input from preparers indicating concerns over the cost and complexity of the annual two-step impairment test. Prior to ASU 2017-04, FASB issued two updates to the original statement to address cost and complexity.

Qualitative Test (ASU 2011-8)

FASB’s update in 2011 provides the optional qualitative assessment (FASB, 2011). If the company finds, based on qualitative factors, that it is more likely than not that the fair value of a reporting unit is not less than its book value, it does not have to proceed with the costly quantitative test. However, a 2013 goodwill impairment study (Tysiac, 2013) found that just 29 percent of public companies and 22 percent of private companies participating used the qualitative assessment, citing the cost of the qualitative assessment and the greater confidence in their conclusions with the quantitative test.

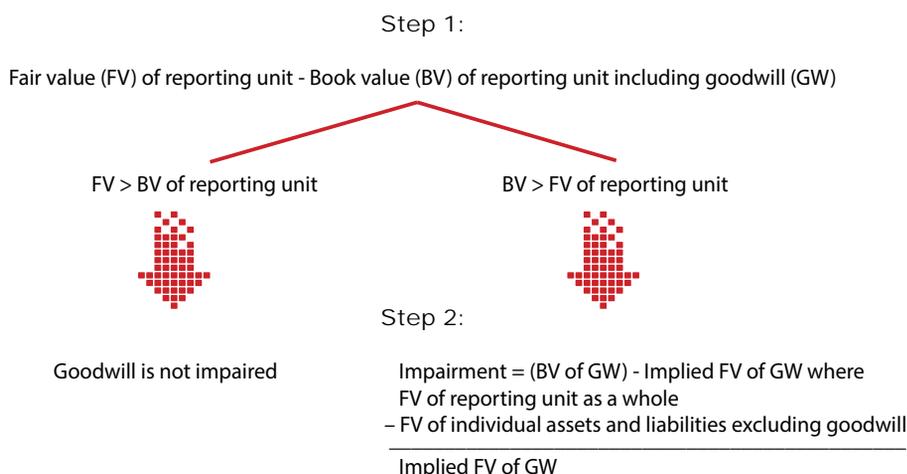
Private Company Alternative (ASU 2014-02)

In 2014, FASB provided an alternative treatment of goodwill for private companies that elect it (FASB, 2014). In ASU 2014-02, FASB makes the following observation regarding the cost and benefit of the earlier guidance for subsequent measurement of goodwill for private companies.

During its research and outreach efforts on this issue, the PCC (Private Company Council) obtained feedback from private company stakeholders that the benefits of the current accounting for goodwill after initial recognition do not justify the related costs. Feedback from users of private company financial statements indicated that the goodwill impairment test performed today provides limited decision-useful information, because most users of private company financial statements generally disregard goodwill and goodwill impairment losses in their analysis of a private company’s financial condition and operating performance. The PCC also received input from preparers and auditors of private company financial statements indicating concerns about the cost and complexity involved in performing the current goodwill impairment test. Private company stakeholders acknowledged that the Board’s recent introduction of the optional qualitative assessment has provided some cost reduction in testing goodwill for impairment, but many of those stakeholders stated that the level of cost reduction has not been significant.

The alternative gives private companies the option of straight-line amortization of goodwill over 10 years or less if the company demonstrates that another useful life is more appropriate. The company that elects the alternative must test for goodwill impairment only when a triggering event occurs that indicates that the fair value of an entity may be below its book value. FASB further simplified goodwill impairment testing for private companies that elect the alternative by eliminating Step 2 of the impairment test. The goodwill impairment is calculated as the excess

FIGURE 1: Current Guidance for Identifying Goodwill Impairment



of the entity's book value over its fair value.

New Guidance for Identifying Goodwill Impairment

In 2017, FASB issued ASU 2017-04 that simplifies goodwill impairment testing for public companies and for private companies that have not elected the private company alternative by eliminating the costly Step 2 from the goodwill impairment test (FASB, 2017). Companies will measure impairment losses as the excess of a company's book value over its fair value, removing the requirement of assigning a fair value to all of the individual assets, liabilities and unrecognized non-goodwill intangibles.

An entity still has the option to perform the qualitative assessment to determine if the quantitative impairment test (Step 1) is necessary. See Figure 2.

Under the new guidance, failing Step 1 will always result in a goodwill impairment.

FASB members dissented from the issuance of the update, because they believe that the one-step model could result in the misidentification of an impairment of goodwill.

The new guidance will simplify the impairment test, because it eliminates the need to determine the fair value of individual assets and liabilities. But measuring goodwill impairment based on the reporting unit as a whole rather than on the fair value of specific assets and liabilities could result in an entity recording more or less goodwill

Step 2. Under the new guidance, failing Step 1 will always result in a goodwill impairment.

Other Considerations

Tax Deductible Goodwill

The update requires an entity to consider income tax effects from any tax deductible goodwill on the book value of the reporting unit when measuring the goodwill impairment loss. Goodwill amortization is deductible for some business combinations in certain jurisdictions, leading the acquiring company to record a deferred tax asset or deferred tax liability for the difference in the book basis and tax basis of the goodwill.

A subsequent decrease in the book basis of the reporting unit because of a goodwill impairment results in the related deferred tax asset increasing or the deferred tax liability decreasing. Either of these changes in deferred tax creates an increase in the book value of the net assets without a change in the fair value which could, in turn, trigger another impairment test.

To address the circular nature of the book value exceeding the fair value after the impairment charge, the update requires the acquiring company to apply a simultaneous equation¹ such that the preliminary goodwill impairment charge combined with the adjusted deferred tax effect will create a book value after impairment equal to the fair value of the reporting unit.

Reporting Units with Zero or Negative Book Values

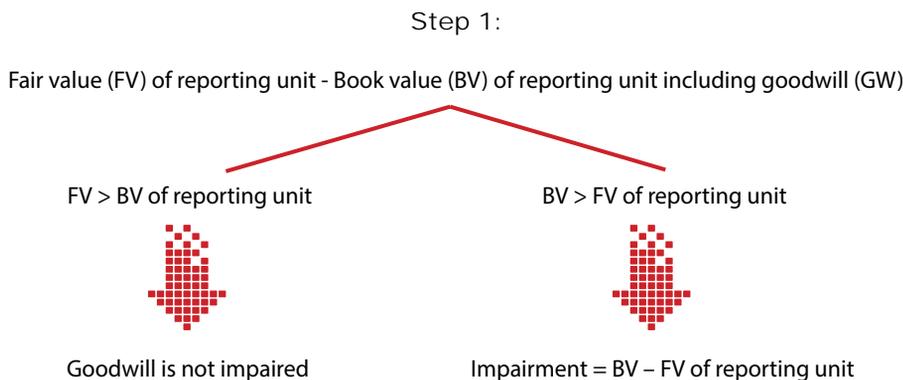
Under existing GAAP, reporting units with a zero or negative book value are required to perform a qualitative assessment to determine whether it is more likely than not that goodwill is impaired. If goodwill impairment is indicated, the entity will perform Step 2 to determine the existence and amount of any impairment.

Under the new guidance, entities with these zero or negative book value

¹ Total goodwill impairment = preliminary impairment + [(tax rate/1 - tax rate) X preliminary impairment]

Continued on page 42

FIGURE 2: New Guidance for Identifying Goodwill Impairment



FASB Members' Concerns Regarding New Guidance

FASB acknowledges that the elimination of Step 2 in many cases could result in a less precise measurement of goodwill impairment, but point out that many users have indicated that the most useful information is in knowing whether an impairment has occurred rather than knowing the precise amount of the impairment. Three out of the seven

impairment than under existing GAAP. For example, the updated guidance could result in a goodwill impairment when in fact, the reason for the decrease in the fair value of the entity is a decline in the fair value of financial assets carried at amortized cost.

Under existing GAAP, it is possible for a reporting unit to fail Step 1, but for goodwill not to be impaired based on the impairment measurement in

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The amendments in the update will be applied on a prospective basis and are effective for public companies that are SEC filers in fiscal years beginning after Dec. 15, 2019.



reporting units are not required to perform the qualitative assessment and Step 2 is eliminated. Because in Step 1 the fair value of the reporting unit is compared to the book value and because fair value is usually greater than zero, reporting units with zero or negative book values will generally be expected to pass the impairment test.

Effective Dates

The amendments in the update will be applied on a prospective basis and are effective for public companies that are SEC filers in fiscal years beginning after Dec. 15, 2019. Public companies that are not SEC filers should adopt the amendments in fiscal years beginning after Dec. 15, 2020, and all other entities that have not elected the private company goodwill alternative are required to adopt in fiscal years beginning after Dec. 15, 2021. Early adoption is permitted after Jan. 1, 2017.

Future Considerations

FASB separated the project on the subsequent measurement of goodwill into two phases. Phase 1 as discussed in this article resulted in ASU 2017-04. Phase 2 will consider permitting or requiring goodwill amortization and other changes for public companies and is postponed while FASB monitors the effectiveness of the current update. ❁

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

CPE Article: FASB Simplifies the Test for Goodwill Impairment

By Jane N. Baldwin, Ph.D.

Today's CPA offers the self-study exam for readers to earn one hour of continuing professional education credit. The questions are based on technical information from the preceding article. If you score 70 or better, you will receive a certificate verifying you have earned one hour of CPE credit – granted as of the date the test arrived in the TSCPA office – in accordance with the rules of the Texas State Board of Public Accountancy (TSBPA). If you score below 70, you will receive a letter with your grade.

1. What was the motivation for FASB's revision of the goodwill impairment test?

- A. Congressional mandate
- B. FASB's simplification initiative
- C. Concern over the cost and complexity of the current standard
- D. Both B and C

2. Which of the following is false regarding the option to first assess qualitative factors related to goodwill impairment before assessing quantitative factors?

- A. The option is sometimes known as Step 0
- B. The option was available under the old standard, but not under the new standard
- C. If the company determines that it is more likely than not that the fair value of a reporting unit is less than its book value, then it will proceed with the quantitative test
- D. In practice, the majority of companies do not apply the option because of its cost and because of greater confidence in the quantitative test

3. What two things are compared in Step 1 of the goodwill impairment test?

- A. The fair value of the reporting unit to the book value of the reporting unit including goodwill
- B. The implied fair value of the goodwill to the book value of the goodwill
- C. The fair value of total intangible assets to the book value of total intangible assets
- D. The fair value of total assets to the fair value of total liabilities

4. In Step 1, goodwill is considered impaired if:

- A. The environment in which the company operates has become more competitive
- B. General economic conditions have deteriorated since the previous year
- C. The book value of the reporting unit including goodwill is greater than the fair value of the reporting unit
- D. None of the above

5. In its research regarding the treatment of goodwill impairment for private companies, FASB found that:

- A. The two-step impairment test provides limited decision-useful information
- B. Users of private company financial statements consider goodwill impairment losses extensively in their financial statement analysis
- C. The complexity in performing the goodwill impairment test is justified
- D. The benefits of the two-step impairment test exceed its cost

6. The alternative treatment of goodwill gives private companies the option of straight-line amortization of goodwill over how many years?

- A. 8
- B. 10
- C. 15
- D. 40

7. Which of the following are important changes for public companies under the new goodwill impairment standard?

- A. Step 2 is eliminated
- B. Companies are no longer required to make a costly measurement of the fair value of individual assets and liabilities
- C. Impairment loss is calculated as the excess of a company's book value over its fair value
- D. All of the above

8. What is the primary concern of the three members of FASB who dissented from the issuance of the new standard?

- A. The updated standard will be more complicated
- B. The updated standard will be more costly to implement
- C. The one-step model could result in misidentification of an impairment of goodwill
- D. The calculation for goodwill impairment will always be smaller under the updated standard

9. Which of the following is true?

- A. A simultaneous equation is required to determine the tax effects from tax deductible goodwill impairments
- B. Under the updated standard, reporting units with zero or negative book values are not required to perform the qualitative assessment
- C. The update does not consider goodwill amortization for public companies, but FASB will address it in Phase 2
- D. All of the above are true

10. The update for the goodwill impairment test is effective for public companies that are SEC filers in fiscal years beginning after December 15, ____?

- A. 2019
- B. 2020
- C. 2021
- D. 2022



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\$700,000 gross. San Antonio CPA firm. 98 1040s, 24 1120s, 148 1065s, 38 1041s, 177 franchise returns, 6 comps, 3 qtrly p/r tax, excellent growth potential, financing negotiable. TXC1066

\$172,000 gross. San Antonio tax practice. 96% tax (63% ind, 37% bus), 4% bkpng/PR, 68% cash flow, lease may be assumable. TXC1067

\$1,523,500 gross. Austin CPA firm. 77% tax (47% inv, 53% bus), 19% acctng, 4% other, turnkey practice with solid cash flow and support staff in place. TXC1068

\$634,000 gross. NE San Antonio metro area CPA firm. 53% tax (56% ind, 44% bus), 47% write-up, experienced staff and seller available for transition assistance. TXC1069

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

\$108,000 gross. Carthage tax firm. All individual tax work, loyal client base, knowledgeable staff person, location flexibility. TXN1470

\$395,000 gross. Grayson Co. CPA firm. (68%) tax, (24%) acctng, (9%) consulting, staff in place, loyal client base, turnkey opportunity. TXN1471

\$400,000 gross. W. of Ft. Worth CPA firm. Almost 50/50 between acctng and tax, strong cash flow, quality client base and knowledgeable staff in place. TXN1480

\$344,000 gross. E. Dallas suburb CPA firm. Tax and acctng nearly 50% each, loyal clients, experienced staff, turnkey practice with capacity for growth. TXN1484

\$232,000 gross. N. of Denton CPA firm. Tax (80%), acctng (20%), strong fee structure, excellent cash flow over 60%, turnkey opportunity. TXN1486

\$60,000 gross. W. Arlington CPA firm. Tax 55%, acctng 45%, strong fees, low overhead, office available or easily transitioned nearby. TXN1489

\$254,000 gross. Plano CPA firm. Loyal clients, great location, 70% tax, 21% acctng, 9% misc., turnkey opportunity. TXN1490

\$569,000 gross. Bryan-College Station area CPA firm. Tax (64%), acctng (26%), other (10%), great paying clientele, excellent fee structure, trained staff in place. TXS1212

\$319,000 gross. N. Houston CPA firm. Excellent fee structure, staff in place and seller available to help with transition. Balance tax and acctng svcs for wealthy individuals and families. TXS1213

\$385,000 gross. Katy area tax and acctng firm. Acctng (63%), tax (34%), misc. (3%), loyal client base, strong fees, growth potential, turnkey practice in great location. TXS1216

\$186,000 gross. SW Houston area CPA firm. Mostly tax using ProSeries, long-term clientele, data handled electronically so practice is portable. TXS1217

\$540,000 gross. Beaumont-Port Arthur area CPA firm. Balanced revenue mix, great fee structure, loyal client base, solid support staff, desirable location. TXS1219

\$510,000 gross. Greenway-Galleria area CPA firm. Tax (62%), acctng (37%), consult (1%), excellent location, seller available to assist with transition. TXS1220

\$72,000 gross. Corpus Christi tax practice. 60% tax, 40% acctng, solid client base with growth potential, seller available to assist with transition. TXS1224

\$650,000 gross. N. of Houston CPA firm. Tax 69%, acct/bkpg 28%, other 3%, excellent fee structure and cash flow, knowledgeable staff in place and seller available to help with transition. TXS1225

\$650,000 gross. NE Houston CPA firm. 72% tax, 24% acct/bkpg, 4% other, strong staff to provide continuity going forward and seller available to assist with transition. TXS1227

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\$50,000 gross. Katy area CPA firm. Tax-only practice serving friendly bus/ind clients, portable within the Houston area. TXS1230

\$164,000 gross. W. Houston tax franchise. 100% tax preparation for individuals and businesses, fully trained staff available as needed, yearly referral growth. TXS1231

\$374,310 gross. Greater S. Amarillo metro area CPA firm. 53% tax (58%) personal, (42%) business related, 23% mthly acctng, 21% p/r and sales tax, 3% consult and IRS responses, turnkey practice with negotiable financing options. TXW1022

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