

PPP Forgiveness: Where we are today and the impact to our financial statements

November 17, 2020

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Disclaimer

- *This presentation is for educational purposes only. It should not be construed or relied on as legal advice or to create any client, advisory, fiduciary, or professional relationship between you and CLA. You should consult with your legal counsel if you have questions or concerns regarding your eligibility to participate in the Paycheck Protection Program (PPP) or other PPP-related issues.*
- *This presentation considers guidance provided by the SBA and US Department of the Treasury through 11.3.2020. Additional guidance is being provided on a regular basis, please refer to the US Department of the Treasury website (<https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses>) for recent updates.*

Learning Objectives

- Identify where we are today and the impact to our financial statements?

Paycheck Protection Program - History

History never looks like history when you are living through it.

John W. Gardner

History is a relentless master. It has no present, only the past rushing into the future. To try to hold fast is to be swept aside.

John F. Kennedy



Paycheck Protection Program - History

Coronavirus Aid, Relief, and Economic Security (CARES) Act

Paycheck Protection Program (PPP) was established by the CARES Act which was signed into law on March 27, 2020. The PPP created a loan program through the Small Business Administration (SBA) to enable businesses and nonprofit organizations with 500 or fewer employees to obtain federally guaranteed loans to be used for payroll, rent, utilities and other specified costs. PPP loans can be 100 percent forgivable if employers maintain specified employment and wage levels, as measured by the number of full-time equivalent employees and wage levels over an eight-week “covered period.”



Paycheck Protection Program - History

Paycheck Protection Plan Flexibility Act

Timeline

- June 3 - PPP Flexibility Act passed by Senate
- June 5 - signed by President
- June 10 - Guidance issued to clarify key provisions
- July 6 - SBA resumed accepting application and extended the deadline to 8/8

Key Changes

- Increased the forgiveness period from 8 weeks to 24 weeks after the disbursement of the loan or Dec. 31, 2020, whichever is earlier.
- Revised the 75/25 requirements so at least 60% of PPP funds must be used for payroll costs for the borrower to be eligible for any loan forgiveness
- 10 months from end of the covered period to request forgiveness
- More options if unable to return to 2/15 levels of FTE



Paycheck Protection Program - History

- PPP closed at the end of day 8.8.2020. SBA no longer accepted PPP applications from participating lenders on that date.
 - Approved loans: 5,212,128
 - Approved dollars: \$525,012,201,124
 - Average size of loan: \$100,729
- SBA opened its portal 8.8.2020 to begin receiving forgiveness applications from banks
- Latest Paycheck Protection Program Loans FAQs – 10.7.2020
- Latest Paycheck Protection Program Loan Forgiveness FAQs – 10.13.2020



Loan Forgiveness Applications

SBA Form 3508 (updated)

- Changes date for safe harbor from 6/30 to earlier of submission or 12/31
- Clarifies how the \$100k cap applies for 24 week period
 - \$46,154 for employees
 - \$20,833 for owners

SBA Form 3508 EZ (issued 6.16.2020)

- Self-employed with no employees.
- Business owners that did not reduce the salaries or wages of their employees by more than 25%, and did not reduce the number or the hours of their employees, OR
- Business owners that experienced reductions in business activity as a result of health directives related to the pandemic, and did not reduce the salaries or wages of their employees by more than 25%.

Loan Forgiveness Applications

SBA 3508S (released 10.8.2020)

- This form is only for borrowers who received a PPP loan of \$50,000 or less, and requires less paperwork and calculations than the previous two forms.

Loan Forgiveness Applications – Recent Activities

On 10.26.2020, the Small Business Administration (SBA) issued a notice related to two new forms developed to collect information for determining the necessity of a Paycheck Protection Program (PPP) loan for borrowers with loans in excess of \$2 million.

- SBA Forms 3509 (for-profit) and 3510 (nonprofit) shed light on how the SBA is likely to assess economic necessity for borrowers with PPP loans of \$2 million or more.
- The loan necessity forms do not introduce any new eligibility standards, but provide previously unknown details on factors to be addressed in the economic necessity assessment.
- Until these forms are published on the SBA website, consider them as drafts, subject to change.
- Comment period for this notice ends 11.25.2020



Accounting for a Forgivable Loan under the PPP

What accounting standards apply when accounting for PPP loans?

In June 2020, the AICPA issued [Technical Question and Answer \(TQA\) 3200.18](#), *Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program*, and in July 2020, GASB issued [Technical Bulletin 2020-1](#), *Accounting and Financial Reporting Issues Related to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and Coronavirus Diseases*.

What accounting standards apply when accounting for PPP loans?

Standards	Applicability	Applies to For Profit?	Applies to Nonprofit?
ASC 470, Debt	This is an option for any PPP loan.	Yes	Yes
ASC 958-605, Revenue Recognition (Not-for-Profit Entities)	Option if meets eligibility criteria and concludes PPP loan represents, in substance, a grant that is expected to be forgiven	Yes *	Yes
ASC 450-30, Gain Contingencies	Same as ASC 958-605	Yes *	No
GASBS 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees	Governmental entity (e.g., nonprofit that reports under GASB)	No	Yes

* While these standards normally would not apply, AICPA as stated they may analogize.



How does accounting differ under these options?

Standard	Initial Recognition	Interest	Derecognition
ASC 470	Financial Liability	Accrue Interest	Debtor has been “legally released” or pays off loan. Forgiveness is recorded as a gain on extinguishment.
GASBS 70	Loan	Accrue Interest	Debtor has been “legally released” or pays off loan. Forgiveness is recorded as an inflow of resources in the reporting period to the extent that the entity is legally released from debt.

Under ASC 230, *Statement of Cash Flows*, the amount borrowed under a PPP loan is shown as a cash inflow from financing activities, principal repayments as cash outflows from financing activities, and interest payments as outflows from operating activities. Any amounts of principal forgiven are shown as noncash financing activities, and interest forgiven is shown as a reconciling item between net income and cash from operations.



How does accounting differ under these options?

Liabilities under ASC 470 and GASBS 70 would be classified based on a combination of PPP Flexibility Act of 2020, the loan agreement, and the amortization schedule.

Loan Term is based on the loan agreement. PPP loans mature between two and five years.

Payment Deferral is based on the PPP Flexibility Act of 2020. The following repayment terms are for all PPP loans:

- Borrowers that apply with their lender within 10 months after the end of the loan forgiveness covered period will not have to make any payments of principal or interest on the loan before the date on which SBA remits the loan forgiveness amount to the lender (or notifies the lender that no loan forgiveness is allowed).
- If a loan forgiveness application is not submitted to the lender within 10 months after the end of the loan forgiveness covered period, borrowers must begin paying principal and interest.

Amortization after the Deferral Period is based on the loan agreement and amortization schedule

How does accounting differ under these options?

Standard	Initial Recognition	Interest	Derecognition
ASC 958-605	Refundable Advance	n/a	Contribution recognized once the conditions of release have been substantially met or explicitly waived.
ASC 450-30	Liability	n/a	Grant proceeds recognized when all of the contingencies related to receipt of the assistance have been met and the gain is realized or realizable.

Liabilities under ASC 958-605 and ASC 450-30 would be classified based on the anticipated timing of meeting the derecognition criteria. We generally expect these to be classified as current liabilities.



How does the timing of GAAP recognition of forgiveness impact debt covenants?

It is very important to carefully read debt agreements to understand the impact of PPP on covenants. Covenants impacted by PPP loans may not be cured simply because the GAAP financial statements have recognized income:

- o The legal form of the PPP funding is debt. Therefore, legally the borrower has a loan agreement outstanding until “legally released” or paid off.
- o Derecognition of the liability under GAAP does not necessarily mean the entity has been legally released.

For example, if the entity has covenants in other debt instruments that restrict debt, a PPP loan would likely violate the covenant. This is true despite an entity calling it a refundable advance and potentially derecognizing it earlier than the legal release.

- o Additionally, we should consider how income from PPP loan forgiveness impacts debt covenants. In many cases, loan forgiveness or other income is excluded from financial covenants. Entities may need to clarify with lenders how calculations should be applied.

How do transactions (i.e. Buy/Sell) impact PPP loan forgiveness?

The SBA released a Procedural Notice related to [Paycheck Protection Program \(PPP\) Loans and Changes of Ownership](#) on October 2, 2020. The Procedural Notice sets forth a PPP borrower's responsibilities in the event of a change of ownership, including clear guidance on when SBA prior approval is required and the procedures to request such approval.

How do transactions (i.e. Buy/Sell) impact PPP loan forgiveness?

Change in ownership definition

For purposes of the PPP, a change in ownership will be considered to have occurred when one of these conditions are met:

- At least 20 percent of the common stock or other ownership interest of a PPP borrower is sold or otherwise transferred, whether in one or more transactions, one including to an affiliate or an existing owner of the entity
- The PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value), whether in one or more transactions
- A PPP borrower is merged with or into another entity

How do transactions (i.e. Buy/Sell) impact PPP loan forgiveness?

In the event of a change of ownership structured **as an asset sale**, SBA approval will be conditioned on the buyer assuming all of the PPP borrower's obligations under the PPP loan. The purchase or sale agreement must include appropriate language regarding the assumption of the PPP borrower's obligations under the PPP loan by the buyer.

In the event of a change of ownership structured **as an ownership sale**, the original PPP borrower will remain subject to all obligations under the PPP loan.

Transactions introduce an additional **element of uncertainty** as to whether or not an entity would qualify for PPP loan forgiveness. This is especially true if the new affiliates would negatively impact PPP eligibility. Based on this, it would be less likely that an entity involved in a transaction would record income prior to the loan being legally released.

How should an entity account for deferred taxes when accounting for PPP loans?

Temporary difference between U.S. GAAP and tax basis reporting of assets and liabilities result in **deferred taxes**.

The main consideration is whether the entity is planning on reflecting PPP forgiveness for tax purposes in the same year as GAAP. This is tricky for PPP because both U.S. GAAP and tax provide some flexibility on timing (independent of one another).

How should an entity account for deferred taxes when accounting for PPP loans?

Based on the potential flexibility for both tax and book timing, deferred taxes may need to be recorded.

- If tax expenses are disallowed BEFORE book income is recorded, then it results in a deferred tax asset.
- If book income is recorded BEFORE the tax impact is reflected, then it results in a deferred tax liability.
- If book income is recorded in the same year the tax impact is reflected, then there is no timing difference.

This guidance is not intended to address every situation. You should consult with our tax professionals to consider the specific matters addressed above when considering current and deferred taxes. In addition, there may be upcoming revisions in tax law, so check back for future developments.



Financial Statement Disclosures

Regardless of the accounting approach followed by a borrower, if the PPP loan is material to the financial statements, the borrower should disclose in the footnotes how the PPP loan was accounted for and where the related amounts are presented in the financial statements, including the statement of cash flows. Additionally, the borrower should consider the disclosure requirements of the specific accounting guidance applied to the PPP loan (that is, ASC 470, ASC 450-30, or other guidance).

In addition, all entities should consider whether conclusions regarding their ability to remain a going concern are premised upon receiving debt forgiveness for the PPP loan.



Nonprofit Specific - COVID Assistance & Single Audits

- PPP Loan – not subject to single audit
- SBA EIDL – is subject to single audit
 - \$750K in total federal financial assistance (incl. EIDL) for single audit threshold to apply

Double Dipping Prohibited

- Office of Management and Budget (OMB): June 2020 *Administrative Relief Exceptions for COVID-19 Crisis*
 - Payroll costs paid with PPP loans or any other Federal CARES Act programs **must not** be charged to current Federal awards as it would result in the Federal gov't paying the same expenditures twice
 - Awarding agencies must require recipients to maintain appropriate records and cost documentation



Double Dipping Prohibited (cont.)

- OMB position analogizes to other grant awarding agencies
- *If there are questions on grant award and PPP interplay, talk to the grant awarding agency*
 - *Budget/grant modifications*
 - *Grant extensions*



Resources

- Treasury Website –

<https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses>

- SBA Website –

<https://www.sba.gov/funding-programs/loans/coronavirus-relief-options>

- CLA's COVID Relief Center

Bi-weekly Livestreams

- AICPA – Technical Questions and Answers
(Nonauthoritative)



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Pittsburgh 2020 Year-End Update

November 17, 2020

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COVID-19 Payroll Tax Relief

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Learning Objectives

- Discuss with participants the most recent Treasury and IRS updates and how these will impact the HR department of the business.

FFCRA Emergency Sick Leave & Family Medical Leave

- Employers with fewer than 500 employees
 - Exemption: businesses with fewer than 50 employees
 - ◇ Providing child care-related emergency paid sick and emergency family medical leave would jeopardize the viability of the business as a going concern
- ALL employees are eligible (FT, PT, Temporary)
 - On payroll for least 30 days

Emergency Paid Sick Time (PST)

If employee qualifies the employer must pay:

- 80 hours PST for FT employee
- At the employee's regular rate of pay or minimum wage
- Capped at \$511 per day and \$5,110 total (self)
- Capped at \$200 per day and \$2,000 total (care of others)



Emergency Family & Medical Leave (E-FMLA)

- 12 weeks of leave for employees who cannot work (or telework) to care for minor child(ren) because of school/care closure
 - Online instruction considered closure
 - If employer agrees, can be taken intermittently
- First 2 weeks unpaid (can use PST or other PTO)
- After 2 weeks paid 2/3 of regular rate of pay capped at \$200 and \$10,000 total



Tax Credits

- Available for both PST & E-FMLA
- Refundable
- Dollar-for-Dollar
- Health insurance costs also included

Tax Credits – Self Employed

- Meets the same factors as employee
 - E-FMLA days multiplied by the lesser of:
 - ◇ \$200 (same limitations as for employees), or
 - ◇ 67% of average daily self-employment income
 - Net earnings from self-employment for the taxable year divided by 260
 - PST days multiplied by the lesser of:
 - ◇ \$511 (self)/\$200 (family) (same limitations as for employees), or
 - ◇ 100% (self)/67% (family) of average daily self-employment income

FFCRA – Documentation (IRS FAQ #44)

- Employer should maintain
 - Employee's name
 - Date or dates for which leave is requested
 - A statement of the COVID-19 related reason the employee is requesting leave and written support for such reason
 - A statement that the employee is unable to work, including by means of telework, for such reason
- Name of the governmental entity ordering quarantine or the name of the health care professional advising self-quarantine



FFCRA – Documentation (IRS FAQ #44)

- School closing or child care provider unavailability
 - Name and age of the child (or children) to be cared for
 - The name of the school that has closed or place of care that is unavailable
 - Representation that no other person will be providing care for the child during the period for which the employee is receiving family medical leave



FFCRA – Add'l Documentation (IRS FAQ #45)

- Documentation to show how PST & E-FMLA was determined
 - Including records of work, telework and qualified sick leave and qualified family leave
- Documentation to show how qualified health plan expenses were allocated to wages
- Copies of any completed Forms 7200
- Copies of the completed Forms 941
- Retain for at least 4 years



CARES Act Employee Retention Credit

- 50% of first \$10K of comp (incl. health benefits) paid from 3/13/20 to 12/31/20
- Available if:
 - Operations fully or partially suspended due to COVID-19 or
 - Gross receipts <50% of same quarter in prior year (until gross receipts >80%)
- ER > 100 EE: only comp paid to out-of-work EE
- ER ≤ 100 EE: any comp paid during one of two situations
- Not available if ER uses paycheck protection loan



Full/Partial Suspension of Operations

- Essential business not suspended
 - Unless:
 - ◇ More than a nominal portion of its business operations are suspended
 - ◇ Supplier of essential business suspended
 - ◇ Required to reduce hours of operation
- Teleworking - comparable operations
- Credit only available for wages paid during the period the order is in force



Gross Receipts – Tax Exempt

- IRS FAQ 46 – updated 6/19/2020
 - Include gross receipts from all operations
 - ◇ Not just UBI
 - Includes:
 - ◇ Total sales (net of returns and allowances)
 - ◇ Amounts received for services
 - ◇ Investment income:
 - Dividends, rents, and royalties
 - Contributions, gifts, grants, and similar amounts,
 - Dues or assessments from members or affiliated organizations.



Employer Credit Comparison

	Paid Sick Leave Credit	E-FMLA Credit	Employee Retention Credit	45S - Employer Credit for Paid Family & Medical Leave	Work Opportunity Tax Credit
Enabling Legislation	Families First Coronavirus Response Act	Families First Coronavirus Response Act	Coronavirus Aid, Relief, and Economic Security Act	Internal Revenue Code Section 45S	Internal Revenue Code Section 51
Number of Employee Limitations	Employers with fewer than 500 employees	Employers with fewer than 500 employees	The credit can be claimed by employers with an average of more than 100 employees for all employees who are retained but not currently working as a result of COVID-19. For employers with 100 or fewer employees, all wages paid qualify for the credit so long as they meet other requirements related to suspension of business or reduction in gross receipts.	Any size employer	Any size employer
Type of Employer	Eligible employers that are entitled to claim the refundable tax credits are businesses and tax-exempt organizations that: (i) have fewer than 500 employees, and (ii) are required under the FFCRA to pay "qualified sick leave wages" and/or "qualified family leave wages."	Eligible employers that are entitled to claim the refundable tax credits are businesses and tax-exempt organizations that: (i) have fewer than 500 employees, and (ii) are required under the FFCRA to pay "qualified sick leave wages" and/or "qualified family leave wages."	Private employers and 501(c) employers exempt from tax under 501(a)	Private employers	Private employers
Type of Credit	Refundable Payroll Credit or Self-Employment Tax	Refundable Payroll Credit or Self-Employment Tax	Refundable Payroll Credit	General Business Credit	General Business Credit or Refundable Payroll Credit for Tax-Exempt Employers
Effective Dates	April 1, 2020 through December 31, 2020	April 1, 2020 through December 31, 2020	March 13, 2020 through December 31, 2020	January 1, 2018 through December 31, 2020	Through December 31, 2020
Credit Calculation	Emergency paid sick leave at the employee's regular rate of pay, up to \$511 per day and \$5,110 in the aggregate, for a total of 10 days OR For employers who pay wages to an employee to care for a child whose daycare is closed, a payroll tax credit for 100% of employee's qualified sick leave, capped at \$200 per day for 10 days (\$2,000 total); plus eligible employers may receive a tax credit determined based on costs to maintain health insurance coverage for the eligible employee during the leave period. Any included health care costs are subject to the same overall dollar limitations, so it is not an additional credit.	Eligible employers may receive a payroll tax credit of 100% of eligible wages paid, capped at \$200 per day up to \$10,000 per employee in total. Up to 10 weeks of qualifying leave can be counted towards the child care leave credit. Qualified health plan expenses can be added to the wages to determine the credit.	The credit is computed on a calendar-quarter basis and equals 50% of qualified wages up to \$10,000 paid to each employee or \$5,000 in actual credit. The credit is provided for the first \$10,000 of compensation, including health benefits, paid to an eligible employee. Wages paid under the FFCRA are not included as "qualified wages."	The credit is a percentage of the amount of wages paid to a qualifying employee while on family and medical leave for up to 12 weeks per taxable year. The minimum percentage is 12.5% and is increased by 0.25% for each percentage point by which the amount paid to a qualifying employee exceeds 50% of the employee's wages, with a maximum of 25%. In certain cases, an additional limit may apply.	The credit amount is computed for qualifying employees as a percentage of wages determined by total hours worked and qualifying category of eligibility. The maximum potential credit per employee ranges anywhere from \$2,400 to \$9,600.



Employer Credit Comparison Continued

	Paid Sick Leave Credit	E-FMLA Credit	Employee Retention Credit	45S - Employer Credit for Paid Family & Medical Leave	Work Opportunity Tax Credit
Qualifying Employee	All employees	Full- or part-time employees who have been employed for 30 days or longer	No limitations	A qualifying employee is any employee under the Fair Labor Standards Act who has been employed by the employer for one year or more and who, for the preceding year, had compensation of not more than a certain amount. For an employer claiming a credit for wages paid to an employee in 2018, the employee must not have earned more than \$72,000 in 2017.	A qualifying employee meets one of 9 criteria, unless for a tax-exempt employer, in which case only eligible veterans will qualify: <i>Short-term Temporary Assistance for Needy Families (TANF) Recipient (Group 1); Qualified Veteran (Group 2a); Disabled Veteran (Group 2b); Unemployed Disabled Veteran (Group 2c); Unemployed Veteran - 4 Weeks (Group 2d); Unemployed Veteran - 6 Months (Group 2e); Qualified Ex-felon: (Group 3); Designated Community Resident (Group 4); Vocational Rehabilitation Referral (Group 5); Food Stamp Recipient (Supplemental Nutrition Assistance Program - SNAP) (Group 6); Supplemental Security Income Recipient (Group 7); Long-term Family Assistance Recipient (Group 8); Qualified Long-term Unemployment Recipient (Group 9).</i> Employers must submit paperwork for qualifying employees within 28 days of start day in order to be eligible for credit amounts.
What is qualifying leave?	Under the FFCRA, an employee qualifies for paid sick time if the employee is unable to work (or unable to telework) due to a need for leave because the employee: 1. is subject to a federal, state, or local quarantine or isolation order related to COVID-19; 2. has been advised by a health care provider to self-quarantine related to COVID-19; 3. is experiencing COVID-19 symptoms and is seeking a medical diagnosis; 4. is caring for an individual subject to an order described in (1) or self-quarantine as described in (2); 5. is caring for a child whose school or place of care is closed (or child care provider is unavailable) for reasons related to COVID-19; or 6. is experiencing any other substantially-similar condition specified by the Secretary of Health and Human Services, in consultation with the Secretaries of Labor and Treasury.	Under the FFCRA, an employee qualifies for expanded family leave if the employee is caring for a child whose school or place of care is closed (or child care provider is unavailable) for reasons related to COVID-19.	N/A	This is leave for one or more of the following reasons: 1. Birth of an employee's child and to care for the child; 2. Placement of a child with the employee for adoption or foster care; 3. To care for the employee's spouse, child, or parent who has a serious health condition; 4. A serious health condition that makes the employee unable to perform the functions of his or her position; 5. Any qualifying exigency due to an employee's spouse, child, or parent being on covered active duty (or having been notified of an impending call or order to covered active duty) in the Armed Forces; 6. To care for a service member who is the employee's spouse, child, parent, or next of kin.	N/A
How do the credits intersect?	Can be taken in connection with E-FMLA credit, but not with Retention Credit. Wages taken into account for this credit cannot be taken into account for purposes of the 45S credit.	Can be taken in connection with Paid Sick Leave Credit, but not with Retention Credit. Wages taken into account for this credit cannot be taken into account for purposes of the 45S credit.	May be taken with other credits, but not for same wages. In that event, must choose among credits for best answer.	Will apply to different employers than covered under FFCRA. May not be taken with Retention Credit. Wages included in Paid Sick Leave or E-FMLA Credits do not qualify.	May be taken with other credits, but not for same wages. In that event, must choose among credits for best answer.





Social Security Tax Deferrals and the New 941

Scott Hess

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Deferral of Employer Social Security Taxes

- ER share of social security tax deferred (6.2%)
 - 50% due 12/31/21 and 50% due 12/31/22
- Applies to deposits/payments from March 27, 2020 to December 31, 2020
 - Including deposits due in January 2021 related to wages paid in December 2020
- *PPP Flexibility Act – PPP loan forgiveness no longer limits deferral*



Timing of Deferral

- Deferral of deposits and payments, not liability
 - Amounts already paid in are not refundable, however
 - You can consider prior deposits during a quarter as first being deposited for other employment taxes
- The maximum amount that can be deferred each quarter is the smaller of
 - Your employer share of social security tax, or
 - The excess of (a) line 10 (reduced by the amount, if any, on line 11a) over (b) line 13a (i.e. total taxes less your deposits)



Repaying the Employer Deferral

- One-half due December 31, 2021
- Remaining deferral due December 31, 2022
- May be repaid via EFTPS, credit or debit card, or check
 - EFTPS is preferred
 - Enter EIN, Form 941 and calendar quarter of deferral on check
- Any payments or deposits made prior to December 31, 2021 are first applied against your payment due on that date



Deferral of Employee Social Security Taxes

- Executive Order signed August 8, 2020
- Defers withholding, deposit and payment of employee social security taxes
- Wages paid September 1, 2020 through December 31, 2020
- Available to employees whose wages are generally less than \$4,000 in a bi-weekly pay period (pre-tax basis)
 - Amount is a cliff determined on a period by period basis
- Participation voluntary and up to employers



Repaying the Employee Deferral

- Employer is ultimately responsible
- Withhold from employees wages ratably from January 1, 2021 to April 30, 2021
- Risk if employee goes on unpaid leave, quits or is terminated
 - Employer must pay to the IRS by May 1st regardless of collection
 - Deduct from final paycheck
 - Enter into a repayment plan



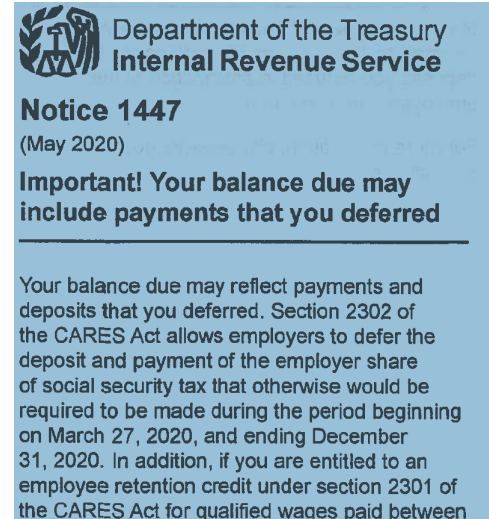
New Form 941

- Updated for COVID-19 Payroll Tax Relief
- More than 40 new lines on form and worksheets
- Worksheet 1 added for COVID-19 related credits
- Updated Form was not ready for Q1
 - Q1 notices going out for deferrals of social security tax
 - Q1 employer retention credits reported on Q2 return
 - ◇ Do not amend Q1



Q1 Tax Notices

- Notice 1447
- Taxpayers that reduced deposits
 - Deferral of social security taxes
 - Anticipation of employer retention credits
- Contact the IRS
 - Writing or phone call
 - Provide details on reduced tax deposits
 - CLA authorized if valid Form 8655 in place



Reporting Employee Retention Credits

- Q1 employer retention credits reported on Q2 return
 - Q1 qualified wages and health plan expenses reported on lines 24 and 25 for purposes of Q2 credit reporting only
 - Do not include Q1 ERC wages on lines 5a-e for social security and Medicare tax purposes (reported in Q1)
- Returns can be amended in order to claim the credit
 - Beginning with Q2



Form 7200 Advances

- Form 7200 used to claim advance refund of paid leave and employee retention credits
- Advances received from filing Form 7200 reported on line 13f
 - If you filed a Form 7200 before the end of the quarter, but you haven't received the advance before filing Form 941, don't include that amount
 - Advance payment requests on Form 7200 for a quarter won't be paid after your Form 941 is processed for that quarter
 - A taxpayer will receive [letter 6312](#) if the IRS either rejected Form 7200 or made a change to the requested amount of advance payment



Additional Reporting Requirements

- IRS [Notice 2020-54](#)
 - Employers will be required to report the amount of qualified sick and family leave wages paid to employees on Form W-2, Box 14, or in a statement provided with the Form W-2



General FASB/GAAP Update

Dustin M. Wehman, CPA, CFE

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Learning Objectives

- At the end of this session, you will be able to:
 - **Identify**
 - **Recognize**
 - **Evaluate**
 - **Implement**
 - **Future**



High Level Overview



Things to look for...

- Topic / Subtopic
- Who's affected?
- When?



FASB's Big Plans

- Small Changes
- Corrections
- Clarifications



GAAP vs IFRS

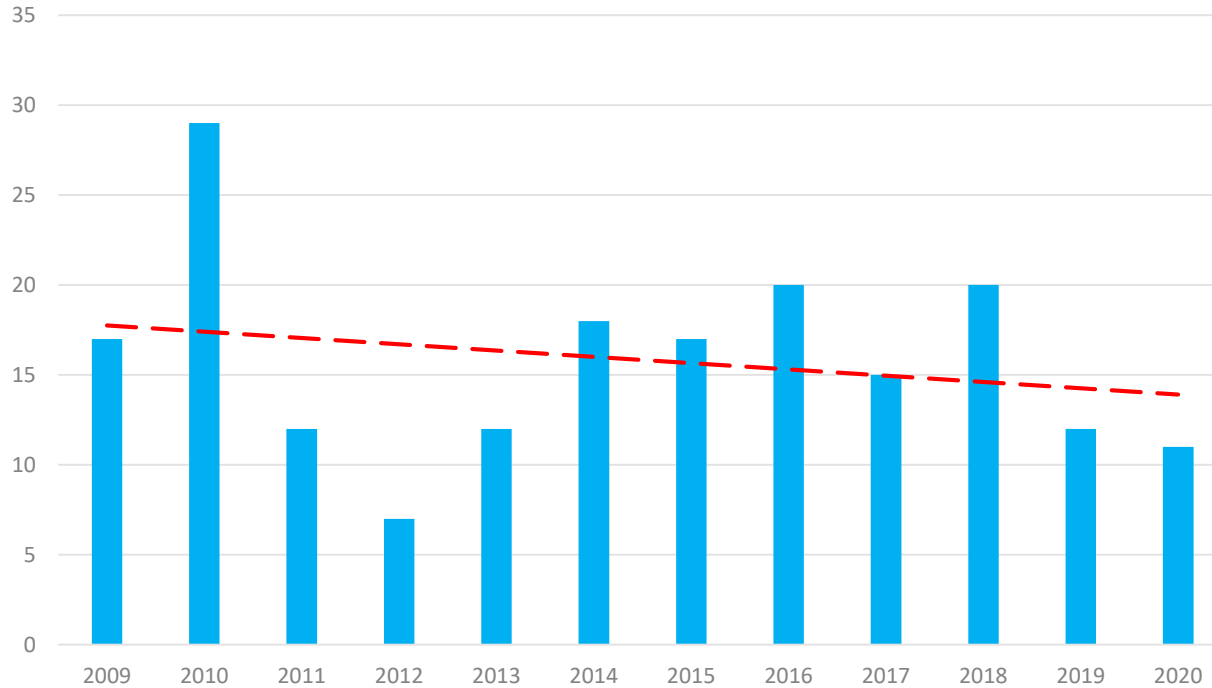
Not fully aligned.

Will not align in near future.



Change is Inevitable...

of Standards Issued





Intangibles – Goodwill and Other (Topic 350)

ASU 2017-04

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Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment [ASU 2017-04]

- **The Why:** Simplification of the test for goodwill impairment by eliminating Step 2 from the test.
- **Who is affected?** Public business entities & not-for-profit entities. Permissible to be adopted by private companies.
- **Effective Date:**
 - Private companies including not-for-profits → fiscal years beginning after December 15, 2021.



Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment [ASU 2017-04]

- **Main Provisions**

- Simplify, eliminate Step 2
- Annual impairment test
- Reporting units with \$0 carrying value
- Qualitative testing still applicable

Elimination of Step 2 of Goodwill Impairment Testing

- **BEFORE:** Two Step process, Analysis then Assessment
- **NOW:** Annual comparison, fair value versus carrying value (One Step)



Goodwill Impairment Testing

Quantitative Impairment Test

- The first (and only) step
- $FV > CV = \text{No Impairment}$
- $FV < CV = \text{Impairment}$



Goodwill Impairment Testing (Example – Non-Deductible)

Goodwill impairment – Example – Non-deductible Goodwill

Given Information

Net Assets	\$60
Tax basis	\$35
Tax Rate	40%
Goodwill	\$40
Fair Value	<i>\$80</i>

Net Assets	\$60
- Tax basis	\$35
<hr/>	
	\$25
X Tax Rate	40%
<hr/>	
Net deferred tax liabilities	\$10

*Selling reporting unit –
non-taxable transaction*

<i>Net Assets</i>	<i>\$60</i>
<i>+ Goodwill</i>	<i>\$40</i>
<i>- Net deferred tax liabilities</i>	<i>\$10</i>
<hr/>	
<i>Carrying Amount</i>	<i>\$90</i>

Goodwill Impairment Testing (Example)

BEFORE

- Step 1 – Indication of Impairment
- Step 2 – Assessment

NOW

- Single Step

ASU 2017-04 Goodwill Impairment

Carry Value	\$90	Goodwill (book value)	\$40
- Fair Value	\$80	- Goodwill Impairment	\$10
<hr/>		<hr/>	
Impairment	\$10	Goodwill	\$30



Goodwill Impairment Testing (Example)

If impairment exceeds carrying value...

ASU 2017-04 Goodwill Impairment

Carry Value	\$90	Goodwill (book value)	\$40
- Fair Value	\$80	- Goodwill Impairment	\$50
<hr/>		<hr/>	
Impairment	\$10 \$50	Goodwill	\$30 \$0



Goodwill Impairment Testing (Example – Deductible)

Goodwill Impairment – Example 2* (Deductible Goodwill)

Reporting Unit			
Assets & Liabilities			
Goodwill	\$ 400	Carry Amount	\$1,000
Tax basis of goodwill	\$ 900	- Fair Value	\$900
Other net assets	\$ 400		
Tax basis of other net assets	\$ 400		
Deferred tax	\$ 200		
Total carrying amount	\$ 1,000	Impairment	\$100 If non-deductible
Tax rate	40%		
Fair Value	\$ 900		

If goodwill = tax deductible

- Goodwill impairment → need to solve circular calculation
- Why? ↓ book value = ↑ deferred tax assets



Goodwill Impairment Testing (Example – Deductible)

Goodwill Impairment – Example 2* (Deductible Goodwill)

Total Impairment - Simultaneous Equation

$$\begin{array}{rcl}
 \text{Initial Impairment} & & \$100 \\
 / 1 - \text{tax rate} & 1 - 40\% = 60\% & / 60\% \\
 & & \hline
 \text{Total Impairment} & & \$167
 \end{array}$$

Deferred Tax Asset

$$\begin{array}{rcl}
 \text{Total Impairment} & & \$167 \\
 - \text{Initial Impairment} & & \$100 \\
 \hline
 \text{Deferred Tax Benefit} & & \$ 67
 \end{array}$$



Goodwill Impairment Testing (Example – Deductible)

	Carrying Amount	Fair Value	Initial Impairment	Adjustment for equation	Carrying Amount After Impairment
Goodwill	\$ 400		\$ (100)	\$ (67)	\$ 233
Deferred Taxes	200			67	267
Other Net Assets	400				400
Total	1,000	900	(100)	-	900

Partial offset –
deferred tax asset –
\$67

* Based on Example 2A in ASU 2017-04

9 / 14



Disclosure Requirements of ASU 2017-04

- For each period in which a Statement of Financial Position is presented:
 - Disclose changes in carrying amount of goodwill
 - Multiple entities with \$0 carrying value
 - Impairment loss disclosures



Private Companies previously using Alternative Treatment

- Private companies alternative 2017-04, no need to justify preferable treatment
- If intangibles included
 - Need to justify the change as preferable
 - Must adopt the change retrospectively





Intangibles – Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958) Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets for Not-for-Profit Entities

ASU 2019-06

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Intangibles – Goodwill and Other (Topic 350) et al, [ASU 2019-06]

- **Why?** Extend scope of alternatives to NFPs
- **Who?** NFPs
- **Effective Date:**
 - Effective upon the issuance of the update



Extension of Private Company Alternatives from Topic 350 and Topic 805

- Topic 350:
 - 10 year amortization
 - Policy election
- Topic 805:
 - Include customer-related intangibles
 - If 805, must also 350



Topic 350

BEFORE

- Annual impairment test
- Qualitative

NOW

- Amortize
- Test for impairment upon triggering event

Topic 805

BEFORE

- Included identifiable intangible assets

NOW

- Recognize fewer separate items

Disclosure Requirements for ASU 2019-06

- Additions to Goodwill
- Goodwill Impairment Loss
- General
 - Carrying amount
 - Accumulated amortization
 - Accumulated impairment loss
 - Aggregate amortization expense





Fair Value Measurement (Topic 820) Disclosure Framework – Changes to Disclosure Requirement for Fair Value Measurement

ASU 2018-13

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Fair Value Measurement (Topic 820) Disclosure Framework – Changes to Disclosure Requirement for Fair Value Measurement [ASU 2018-13]

- **The Why?** Improve disclosures
- **Who?** All entities with fair value disclosures
- **Effective Date:** Fiscal years beginning after December 15, 2019.

Disclosure Requirements on Fair Value Measurements in Topic 820, Fair Value Measurement

Removals

- Transfers
- Policy
- Valuation process (Level 3)
- Unrealized gains and losses (nonpublic entities)

Disclosure Requirements on Fair Value Measurements in Topic 820, Fair Value Measurement

Modifications

- Level 3 measurements
- NAV (net asset value)
- Uncertainty

Disclosure Requirements on Fair Value Measurements in Topic 820, Fair Value Measurement

Additions

- Unrealized gains and losses
- Significant unobservable inputs



Not-for-Profit Entities (Topic 958)

ASU 2019-03

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Not-for-Profit Entities (Topic 958), ASU 2019-03

- Why? (Topic) – Definition of **Collections**
- Who? NFP (mostly) with **Collections**
- When? **Fiscal years beginning after December 15, 2019**



Not-for-Profit Entities (Topic 958), ASU 2019-03

- Main Provisions
 - Policy for use of proceeds when item removed from collection (deaccessioned).



Not-for-Profit Entities (Topic 958), ASU 2019-03

- Current GAAP
 - Need not recognize if certain conditions are met
 - ◇ Including: Policy for proceeds to acquire other items
 - Three options
 - ◇ Capitalization
 - ◇ Prospective capitalization
 - ◇ No capitalization



Not-for-Profit Entities (Topic 958), ASU 2019-03

- Improved GAAP
 - Eliminate diversity in practice



Not-for-Profit Entities (Topic 958)

ASU 2020-07

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Not-for-Profit Entities (Topic 958), ASU 2020-07

- Why? (Topic) – Increase transparency of contributed nonfinancial assets.
- Who? NFPs
- When? **Fiscal years beginning after June 14, 2021**



Not-for-Profit Entities (Topic 958), ASU 2020-07

- Main Provisions
 - Presentation: Separate line item
 - Disaggregation





Income Taxes (Topic 740)

ASU 2019-12

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Income Taxes (Topic 740), ASU 2019-12

- Why? (Topic) – Increase transparency of contributed nonfinancial assets.
- Who? All entities within scope (Topic 740)
- When? **Fiscal years beginning after June 14, 2021**



Income Taxes (Topic 740), ASU 2019-12

- Main provisions
 - Remove exceptions
 - ◇ Intraperiod tax allocation
 - ◇ Equity method with foreign sub
 - ◇ DTL with foreign sub
 - ◇ Interim period calculation, losses



Income Taxes (Topic 740), ASU 2019-12

- Main provisions
 - Simplify
 - ◇ Franchise Tax
 - ◇ Goodwill step up basis
 - ◇ Allocation of deferred tax expense to subs
 - ◇ Tax law changes on interim reporting
 - ◇ ESOPs and investments in qualified affordable housing projects



Reference Rate Reform (Topic 848)

ASU 2020-04

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Reference Rate Reform (Topic 848), ASU 2020-04

- Why? (Topic) – LIBOR going away; replacement
 - **Stakeholder concerns**

Reference Rate Reform (Topic 848), ASU 2020-04

- Who? All entities with contracts/agreements referencing LIBOR or other discontinued rate.
- When? **Effective for all entities as of March 12, 2020 through December 31, 2022.**
 - (caveats for specific types of contracts)



Reference Rate Reform (Topic 848), ASU 2020-04

- Main provisions
 - Optional expedients and exceptions
 - ◇ Contracts
 - ◇ Hedging relationships
 - ◇ Other transactions (LIBOR)



Reference Rate Reform (Topic 848), ASU 2020-04

- Contract Modifications
 - ASC 310 Receivables
 - ASC 849 Leases
 - No need to reassess original conclusions



Reference Rate Reform (Topic 848), ASU 2020-04

- Exceptions to Topic 815 Guidance Related to Changes in Critical Terms of a Hedging Relationship
 - Changes in critical terms
 - Rebalance or Adjustment
 - Cash flow hedge – change in method



Reference Rate Reform (Topic 848), ASU 2020-04

- Optional Expedients for Excluded Components
 - Change in method
 - Recognize change in FV through Current Earnings



Reference Rate Reform (Topic 848), ASU 2020-04

- Optional Expedients for Fair Value Hedges
 - Change in designated benchmark interest rate
 - Disregard certain qualifying conditions



Reference Rate Reform (Topic 848), ASU 2020-04

- Optional Expedients for Cash Flow Hedges
 - If affected
 - ◇ Disregard potential change
 - ◇ Continue if highly effective
 - Shortcut method – may disregard qualifying conditions



Reference Rate Reform (Topic 848), ASU 2020-04

- One-Time Election to Sell or Transfer Debt Securities Classified as Held to Maturity





Debt--Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging— Contracts in Entity's Own Equity (Subtopic 815-40)

ASU 2020-06

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Debt....., ASU 2020-06

- Why? (Topic) – Complexity of GAAP application, instruments with liability and equity characteristics

Debt....., ASU 2020-06

- Who?
 - Any entity with
 - ◇ Convertible instruments
 - ◇ Contracts in entity's own equity

Debt....., ASU 2020-06

- When?
 - Fiscal periods beginning after December 15, 2023

Debt....., ASU 2020-06

- Provisions – Convertible Instruments
 - Current GAAP, Five accounting models
 - Amendments provide simplification

Debt....., ASU 2020-06

- Provisions – Convertible Instruments
 - Improve transparency and usefulness
 - ◇ Disclosure objective
 - ◇ Events or conditions
 - ◇ Control
 - ◇ Alignment of disclosure requirements
 - ◇ Individual vs. aggregate FV disclosures

Debt....., ASU 2020-06

- Provisions – Contracts in an Entity's Own Equity
 - Scope Exception
 - ◇ Indexed to entity's own stock
 - ◇ Contract is equity classified

Debt....., ASU 2020-06

- Provisions – Contracts in an Entity's Own Equity
 - Revised guidance
 - ◇ Removes conditions from settlement guidance
 - ◇ Penalty payments do not preclude equity classification
 - ◇ Certain fair value measures
 - ◇ Application: freestanding instruments only
 - ◇ Scope: both freestanding instruments and embedded features



Codification Improvements

ASU 2020-10

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Codification Improvements, ASU 2020-10

- Why? (Topic) – General minor updates and clarifications
- Who? All entities affected
- When? **Fiscal years beginning after December 15, 2020**



Codification Improvements, ASU 2020-10

- Provisions
 - Section B of the update
 - Section C of the update
 - *Yes, there was a Section A, omitted from final ASU*



Codification Improvements, ASU 2020-10

- Provisions
 - Section B of the update **Examples**
 - Amendments to Subtopic 205-10, Presentation of Financial Statements—Overall



Codification Improvements, ASU 2020-10

- Provisions
 - Section B of the update **Examples**
 - Amendments to Subtopic 220-10, Income Statement—Reporting Comprehensive Income—Overall



Codification Improvements, ASU 2020-10

- Provisions
 - Section B of the update **Examples**
 - Certain Income Tax Effects within Accumulated Other Comprehensive Income



Codification Improvements, ASU 2020-10

- Provisions
 - There are 24 total codifications section modifications





Lease Accounting

ASU 2016-02

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Lease Accounting – Under the New Standard

- ASU 2016-02 Leases
 - Issued February 25, 2016
 - ASU 2019-01 Leases
 - ASU 2020-05 Contracts with Customers and Leases
- ASC Topic 842 Leases

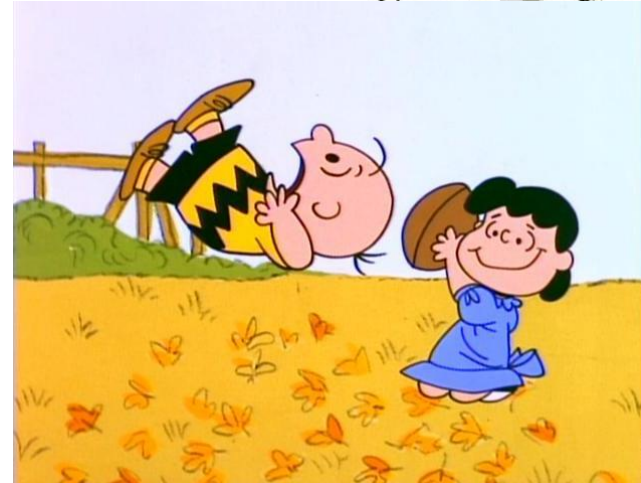
Lease Accounting - Background

?? Why ??

- Operating leases represent off-balance sheet financing
- Convergence of lease standards between GAAP and IFRS

Lease Accounting - Background

- Goal #1: Achieved!
 - Operating lease type transactions will now include an asset and liability on the balance sheet.
- Goal #2: Fail!
 - Differences persist between US GAAP and IFRS



Lease Accounting – New Rules

- Lessee should recognize a liability to make lease payments (“lease liability”) and an asset (“right-of-use” asset).



Lease Accounting – New Rules

- Measurement
 - Optional Periods
 - Reasonable certainty



Lease Accounting – New Rules

- “Reasonably Certain”
 - A high threshold
 - Evaluated on the basis of relevant economic factors



Lease Accounting – New Rules

- Measurement
 - Interest Rate
 - ◇ Implicit or Incremental Borrowing Rate
 - ◇ Risk-Free Rate (nonpublic entities)



Lease Accounting – New Rules

- Measurement, Right-of-Use Asset
 - Initial lease liability
 - Plus payments at or before commencement
 - Plus initial direct costs

Lease Accounting – Finance Lease Criteria

- Transfer of ownership
- Purchase option certainty
- Lease term majority of useful life
- Present value majority of Fair Value
- No alternative use



Old GAAP

**Transfer of
ownership**

**Bargain
Purchase Option**

Lease Term

**Minimum Lease
Payments**

New GAAP

**Transfer of
Ownership**

**Option to
Purchase**

Lease Term

Present Value

**Specialized
Nature**



Lease Accounting – Finance Leases

- Recognize at present value
- Recognize interest separately
- Cash Flows:
 - Repayment = financing activity
 - Interest = operating activity



Lease Accounting – Operating Leases

- Recognize at present value
- Single lease cost, straight-line
- Cash Flows = Operating activity.





Lease Accounting, Example

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Lease Accounting – Example, Finance Lease

- 5 Year equipment lease
- \$500,000 equipment
- Incremental borrowing cost 5%
- \$50,000 down payment due at commencement
01/01/2020
- Initial costs \$15,000

Lease Accounting Example

Finance Lease

Initial Journal Entry

Dr. Equipment	\$ _____	
	Cr. Lease Liability	\$ _____
	Cr. Cash	\$ _____

Lease Accounting Example

Cash

- \$50,000 down payment
- \$15,000 initial costs
- Total cash expended at commencement date \$65,000

Lease Accounting Example

Finance Lease

Initial Journal Entry

Dr. Equipment	\$ _____	
	Cr. Lease Liability	\$ _____
	Cr. Cash	\$ 65,000

Lease Accounting Example

Right-of-Use Asset

- \$450,000 lease liability
 - \$50,000 down payment
 - \$15,000 initial costs
-
- Total Right-of-Use Asset
 - \$ 515,000

Lease Accounting Example

Finance Lease

Initial Journal Entry

Dr. Equipment	\$ 515,000	
Cr. Lease Liability	\$ 450,000	
Cr. Cash	\$ 65,000	

Lease Accounting Example: Finance vs. Operating

					Finance Lease			
	Interest		Principal		Lease Payment	Depreciation	Asset	Lease Liability
2020	\$ 7,000	\$	88,000	\$	95,000	\$ 103,000	\$412,000	\$ 362,000
2021	6,000		89,000		95,000	103,000	309,000	273,000
2022	5,000		90,000		95,000	103,000	206,000	183,000
2023	4,000		91,000		95,000	103,000	103,000	92,000
2024	3,000		92,000		95,000	103,000	-	-
	\$ 25,000	\$	450,000	\$	475,000	\$ 515,000		



Lease Accounting Example: Finance vs. Operating

	Operating Lease					
	Lease Expense	Liability Change	Lease Payment	[Depreciation]	Asset	Lease Liability
2020	\$ 108,000	\$ 88,000	\$ 95,000	\$ 101,000	\$ 414,000	\$ 362,000
2021	108,000	89,000	95,000	102,000	\$ 312,000	273,000
2022	108,000	90,000	95,000	103,000	\$ 209,000	183,000
2023	108,000	91,000	95,000	104,000	\$ 105,000	92,000
2024	108,000	92,000	95,000	105,000	\$ -	-
	\$ 540,000	\$ 450,000	\$ 475,000	\$ 515,000		



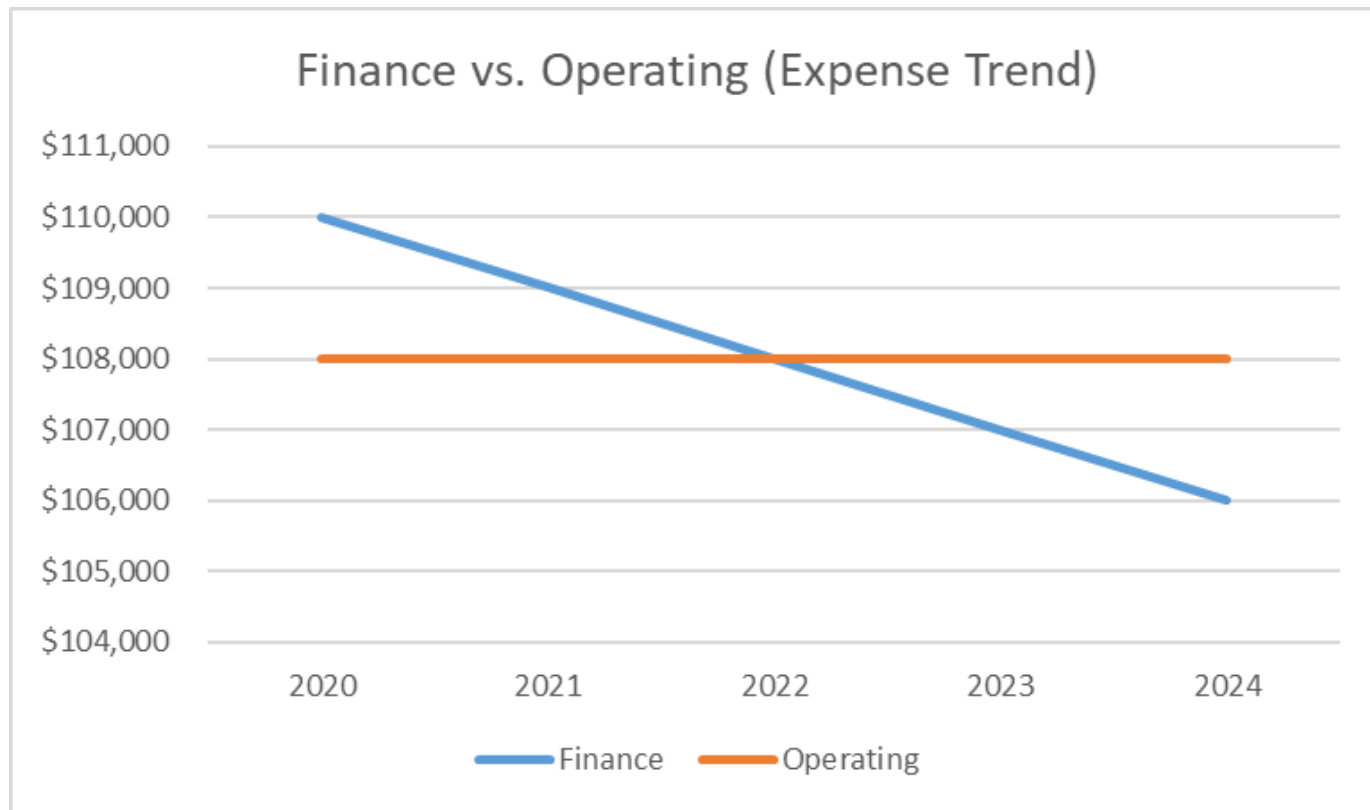
Lease Accounting – Finance vs. Operating

Finance Lease – Separate Depreciation and Interest

Operating Lease – One Lease expense line item



Lease Accounting –Finance vs. Operating



Lease Accounting – New Rules

- Short-Term Leases
 - < 12 Months, exclude
 - Disclose policy
 - Straight-line lease expense

Lease Accounting – Effective Date

- Nonpublic entities
 - Fiscal years beginning after December 15, 2021
 - ◇ Calendar Year 2022
 - Early adoption permitted





Leases (Topic 842)-- Targeted Improvements No. 2020-700 | October 20, 2020

Exposure Draft

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Leases (Topic 842)-- Targeted Improvements

- Amendments
 - Sales-type leases with variable lease payments—lessor only (Issue 1)
 - Option to remeasure lease liability—lessee only (Issue 2)
 - Modifications reducing the scope of a lease contract (Issue 3).
- Comment period open until December 4, 2020



Revenue Recognition

ASU 2014-09, ASC 606

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Overview

- Objectives of the new standard
 - Remove inconsistencies
 - Robust framework
 - Improve comparability
 - Useful information
 - Simplify preparation

Overview

- Core Principle (ASC 606-10-10-2)
 - Depict transfer to customer reflective of consideration

Five Step Revenue Recognition Model

Step 1: Identify the Contract

Step 2: Identify separate performance obligations

Step 3: Determine transaction price

Step 4: Allocate transaction price

Step 5: Recognize revenue as performance obligations are satisfied



Disclosures

- Revenue recognized
- Impairment



Disclosures - Disaggregation of Revenue

- Categories of revenue
- Quantitative disclosures (optional for nonpublic entities)



Disclosures – Disaggregated Revenue Examples

- Type of good or service (e.g. major product lines)
- Geographical (e.g. by country or region)
- Market or type of customer (e.g. government vs. non-government)
- Type of contract (e.g. fixed-price, time & materials, etc.)
- Contract duration (e.g. short-term / long-term)
- Timing of transfers (e.g. point in time vs. over time)
- Sales channels (e.g. B2B, B2C, etc.)



Disclosures

- **Contract Balances**
 - Balances of receivables, contract assets and contract
 - Revenue recognized, from Contract Liabilities
 - Revenue recognized in Period

Disclosures

- **Transaction Price Allocated to the Remaining Performance Obligations**



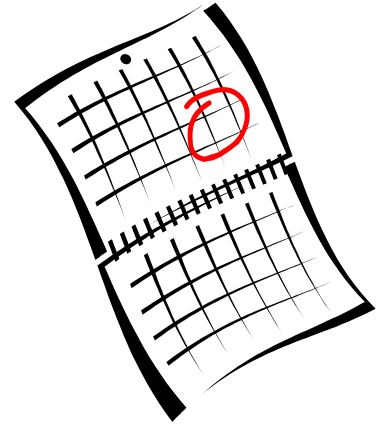


Disclosures

- **Significant judgments in the Application of the Contracts with Customers guidance**

Effective Date

- Public entities
 - Effective for annual reporting periods beginning after December 15, 2017.
 - ◊ Including interim periods within that reporting period.
 - Early application is only permitted as of the original effective date, annual reporting periods beginning after December 31, 2016.





Effective Date

- All other entities (nonpublic entities)
 - Effective for annual reporting periods beginning after December 15, 2018.
 - ◇ interim periods within annual periods beginning after December 15, 2019.
 - Early adoption permitted (in accordance with effective date for public entities).
 - **ASU 2020-05 Contracts with Customers and Leases**



Effective Date

- ASU 2020-05 Contracts with Customers and Leases
 - Retroactive effective date delay
 - One Year
 - Calendar year 2020 effective



Transition – Full Retrospective Application

- Retrospectively to each prior reporting period presented.



Transition

- Practical expedients
 - No restate for completed contracts
 - May estimate variable consideration





Transition – Modified Retrospective Application

- Retrospectively with the cumulative effect of initially applying the new guidance at the date of initial application.



Transition

- *Either transition method may require keeping two sets of books!
- FASB sees Full retrospective application as preferable.





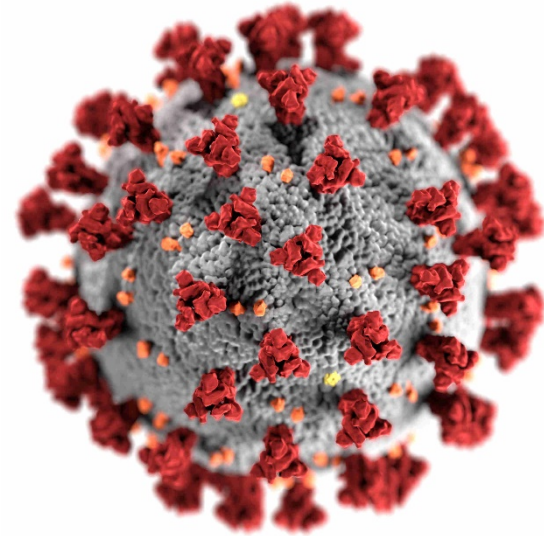
FASB – Looking Forward

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Private Company Council (PCC)

- FASB COVID-19 Response



Private Company Council (PCC)

- Implementation Issues: Revenue Recognition
 - **Practical Expedient for Private Company Franchisors**



Private Company Council (PCC)

- **Implementation Issues: Leases**
 - 1. Sales-type leases with substantial variable lease payments
 - 2. Remeasurement of lease payments based on a reference index or rate
 - 3. Reduction of scope in a lease contract.



Private Company Council (PCC)

- Profits Interests and Their Interrelationship with Partnership Accounting
 - Working Group
 - ◇ Outreach
 - ◇ Identify practice issues
 - ◇ Identify scope
 - ◇ Potential solutions

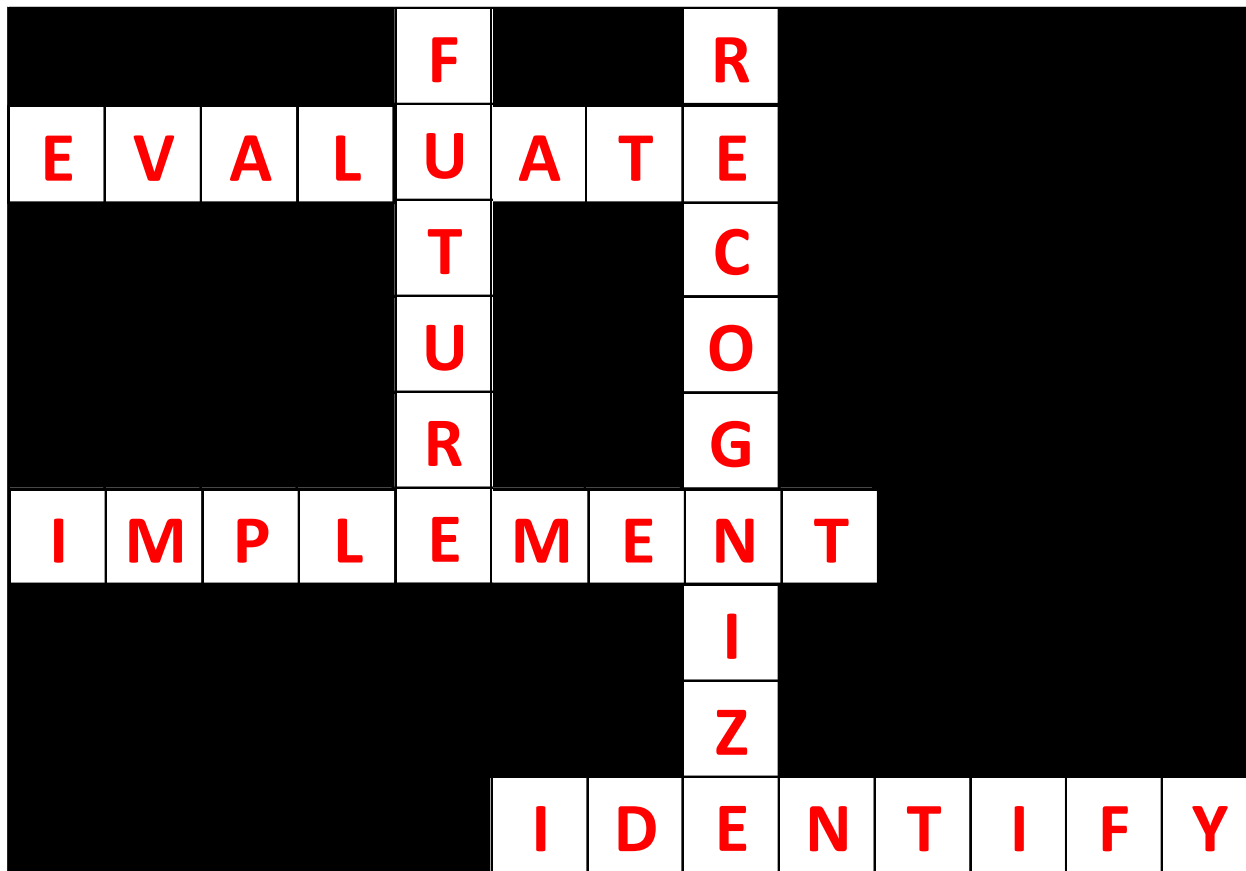


Private Company Council (PCC)

- Disclosure Framework – Income Taxes
 - Income Taxes (Topic 740) – Changes to the Disclosure Requirements for Income Taxes



Takeaways



Building a Strong Core: Assessing and Improving your Financial Operations

11/17/2020

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Create Opportunities

Learning Objectives

1. Identify key symptoms of a faltering finance function
2. Determine ways you might approach assessing your organization's finance function
3. Recognize how a finance department assessment approach has helped other organizations increase efficiency and effectiveness.
4. Identify the framework for a Finance Department Assessment
5. Discuss how to shape conversations to achieve support for conducting a Finance Department Assessment
6. Recognize how this approach helped a company improve its efficiency and effectiveness



Session Participants

[INSERT POLL ASKING # OF FINANCE DEPT TEAM MEMBERS]

Finance Function Dysfunction: Symptoms and Causes

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Create Opportunities

Financial Operations: Common Challenges Today



Do you have these questions?

Do we have the right staff?

Do we have the right accounting and financial software?

Are we operating efficiently and effectively?

How do we go paperless?

Why are our financial reports not being completed timely every month?

Why does our staff not rely upon the financial information they receive?

Why are our managers tracking information outside of the Finance Department?

Why is there high staff turnover in the Finance Department?

Why is it so hard to modify or create reports?

How can we be more transparent and nimble as an organization?

Is excel the right tool to track information and prepare reports?



What remedies have you tried?

- Process mapping
- Department restructure
- Outsource specific pieces
- Change/add systems
- Training
- Others?

What we have learned...

- Often the “issues” raised are symptoms of deeper dysfunction. The dysfunction often stems from a combination of **structure**, **process**, and **systems**.
- Addressing one component alone may remedy the challenge(s) for the short-term but is usually not an effective, long-term solution.



Example of Issues Versus Deeper Dysfunction

Initial Issue Raised

We can't seem to get accurate and timely financials; the data is unreliable and old so staff do not use it.

Symptom

Regular reconciliations are not being completed timely or at all.

Symptom

Transactional data is not being entered timely or accurately into the system.

Symptom

Current staffing levels are inadequate to perform necessary functions.

Root Cause

Technology and software systems are inefficient or underutilized.



Finance Function Dysfunction: Financial Department Assessment Framework

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Create Opportunities

CLA approach to Finance Department Assessments

Structure

- Critically review roles and responsibilities, job descriptions and skill set needed, staff capacity and workload, reporting structure, team culture, and other structural components.

Process

- Walk through all core finance processes to identify bottlenecks, opportunities for automation, spots with likely errors, controls concerns, and redundancy. This includes everything from entering an invoice to budgeting and reporting.

Systems

- Seek to understand the key components of the core finance systems, how the systems are structured, where the general ledger is and is not integrated with other systems, and where the organization isn't using systems, but could to help automate or streamline.

Team/Structure- Common Findings

No time for professional development and team skill building

Finance team has not grown; but the operation has

Finance team is missing critical skillsets – often analysis, planning, and compliance

Are issues only within the Finance Department – or are there broader issues impacting the entire organization?



Process- Common Findings

Processes are paper-heavy; manual signatures;
lost documents

Concern re. segregation of duties has overloaded
processes with approval steps

Lack of formal month end close process. Late
financials and mess at month end.



Systems – Common Findings

Assuming automation is too expensive; avoiding add-on systems

External facing systems are prioritized while internal systems fall behind

Chart of account continues to grow; many obsolete accounts

Important things to consider

- The overall goal: better support for the organization
- Engage all finance and related staff in the process
- Frame the discussions as a way for everyone to help shape the future of the finance function; not as an “audit” or restructuring
- Gain insight from users of the financial outputs too
- Once you identify opportunities for improvement, go the next step and develop an actionable, **yet realistic plan** to implement the changes



Finance Function Dysfunction: Case Study

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Create Opportunities

DIGITAL AUTOMATION COMPANY

Digital Automation Company (DAC) professional services firm approached us because while all of their compliance reporting data was well maintained, management did not feel like they had useful information for decision-making. Financial reporting was all historical and lacked analysis relevant to their industry.



Background and Situation

- Digital automation company with entities in the US and Europe
- Both for-profit and nonprofit entities with related-party ownership structure
- Current budget of approximately \$12 million & rapidly growing
- 1.5 people currently focused on finance function
- Finance Director very compliance driven, but no one driving analysis
- Financial data outdated and not particularly useful for making strategic decisions



What we learned

- Finance Director good at compliance, but did not have background and skill set for the financial analysis and strategic modeling required by the company.
- Client was still using Quickbooks, requiring multiple sets of QBs to handle their multi-entity, multi-currency requirements.
- Numerous Excel-based workflows for review and approval of things that should have been done within the appropriate system, e.g. time and AP approvals.
- Systems did not integrate. Data was often re-keyed multiple times, creating huge inefficiencies and risk of error.
- KPI's were produced via a time-consuming weekly process of manually aggregating data into PPT reports for management.



Recommendations

- Hire a fractional CFO for higher level strategy and analysis.
- Update general ledger system to be able to handle the multi-entity, multi-currency requirements of the organization, as well as electronic approvals.
- Integrate time-keeping with an integrated project management system to track KPI's such as staff realization and utilization within the systems.
- Move approval workflows into the appropriate systems and stop re-keying data into Excel.
- Develop Dashboards for KPI's within the financial systems, for real-time transparent reporting information for managers.



Impact

- New CFO will assist with development of industry-specific KPI's and financial modeling to help management with strategic decision making.
- New systems will free up at least .5 FTE in finance function, to allowing them to scale without significant staffing increases in the near term.
- With the recommendations, internal controls will be enhanced, including better segregation of duties, less risk of human error and documented approval workflows.





Thank you!

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[youtube.com/CliftonLarsonAllen](https://www.youtube.com/CliftonLarsonAllen)

Occupational & Financial Reporting Fraud

Dustin M. Wehman, CPA, CFE
November 17, 2020

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**CERTIFIED FRAUD
EXAMINER**

Create Opportunities

Learning Objectives

- Identify the three areas of the fraud triangle and how to apply them to your internal control environment.
- Identify various types of fraud schemes
- Recognize how to develop action items to create or enhance fraud prevention in your organization



2020 Report to the Nations Statistics

- The charts, graphs and statistics were produced by the ACFE: “*2020 Report to the Nations on Occupational Fraud and Abuse*. Copyright 2020 by the Association of Certified Fraud Examiners, Inc.”
- Available to download at www.acfe.com





What are today's Key Concepts and Takeaways?

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Key Concepts and Takeaways

- Elements of the Fraud Triangle

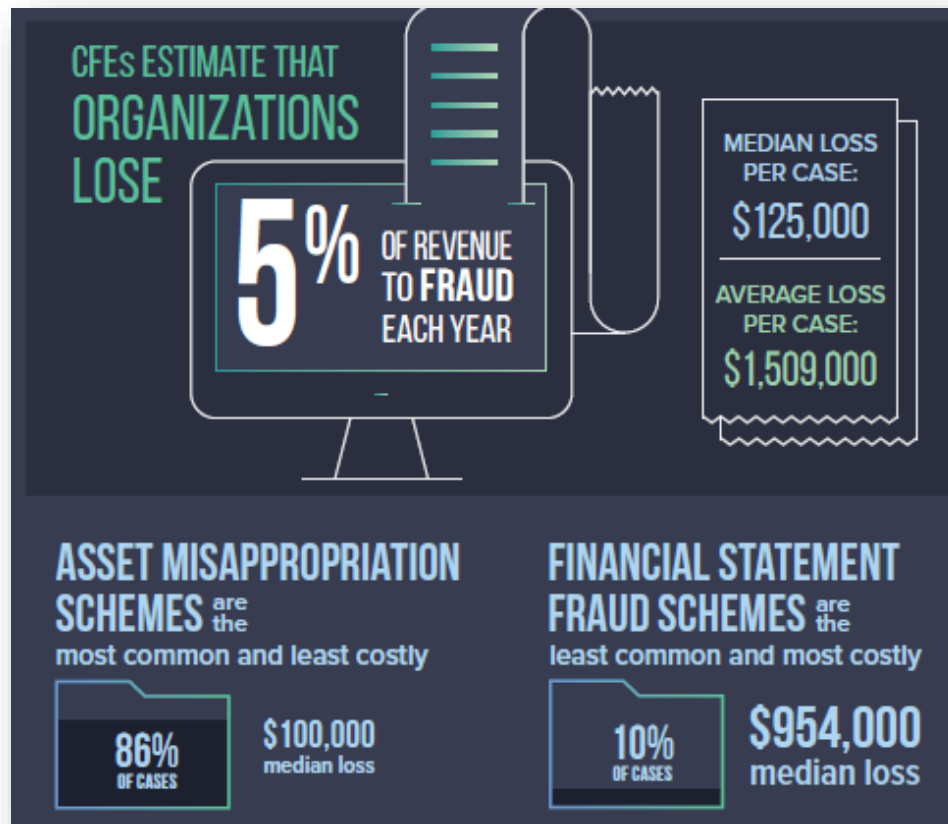
Motive

Opportunity

Reconciliation

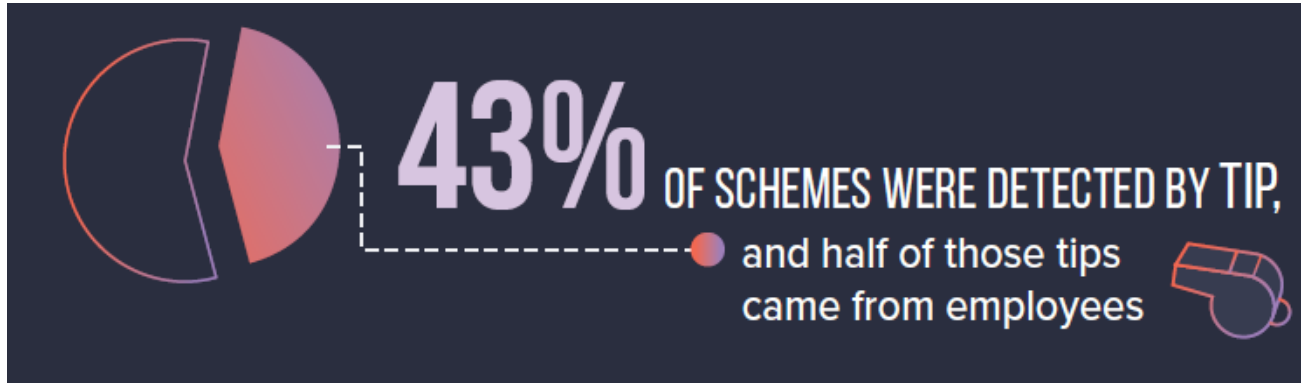
Key Concepts and Takeaways

- Stats



Key Concepts and Takeaways

- ***Tips*** from ***Employees*** most common initial detection method.



Key Concepts and Takeaways

- **Perception of Detection**
- **Fraud Prevention Program**



REPORT TO THE NATIONS[®]

2020 GLOBAL STUDY ON OCCUPATIONAL FRAUD AND ABUSE

OUR STUDY
COVERED



2,504 CASES

from



125 COUNTRIES

Causing total
losses of more than
\$3.6 BILLION

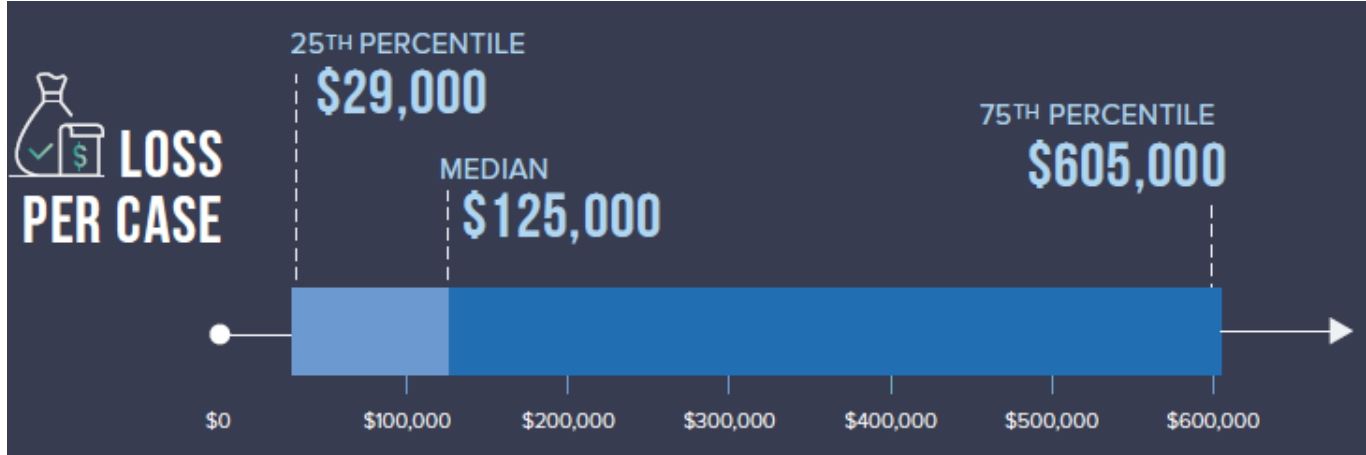


Create Opportunities

What is Fraud?

- Fraud (Generally Accepted Auditing Standards) – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit. [AU-C Section 240]
- Black's Law Dictionary Definition
- Tort





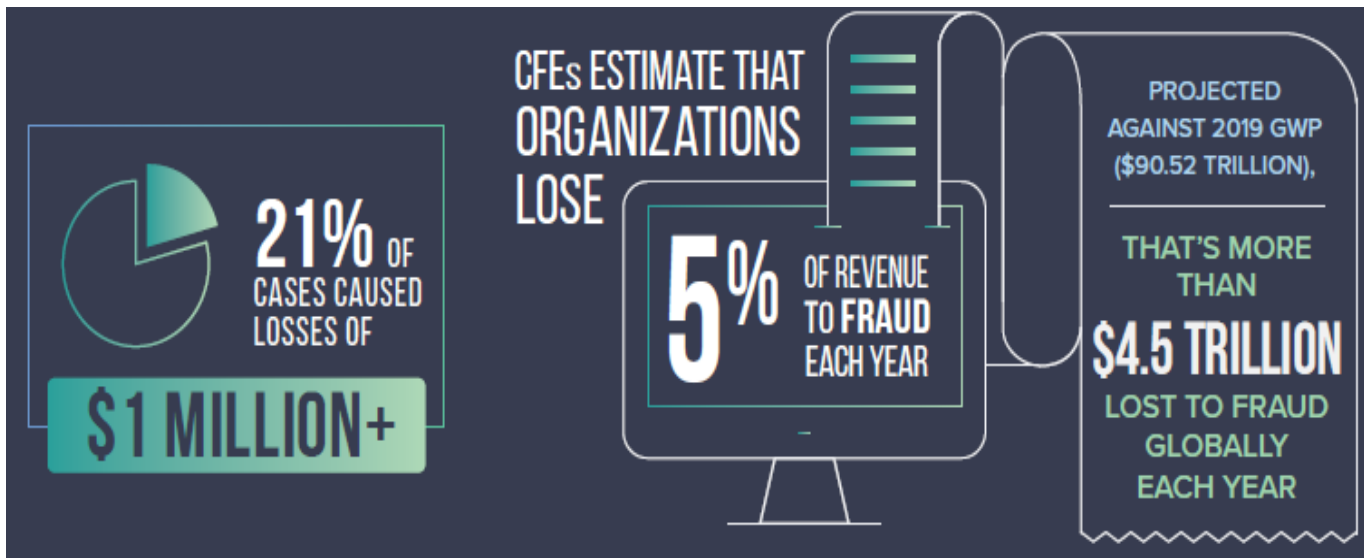
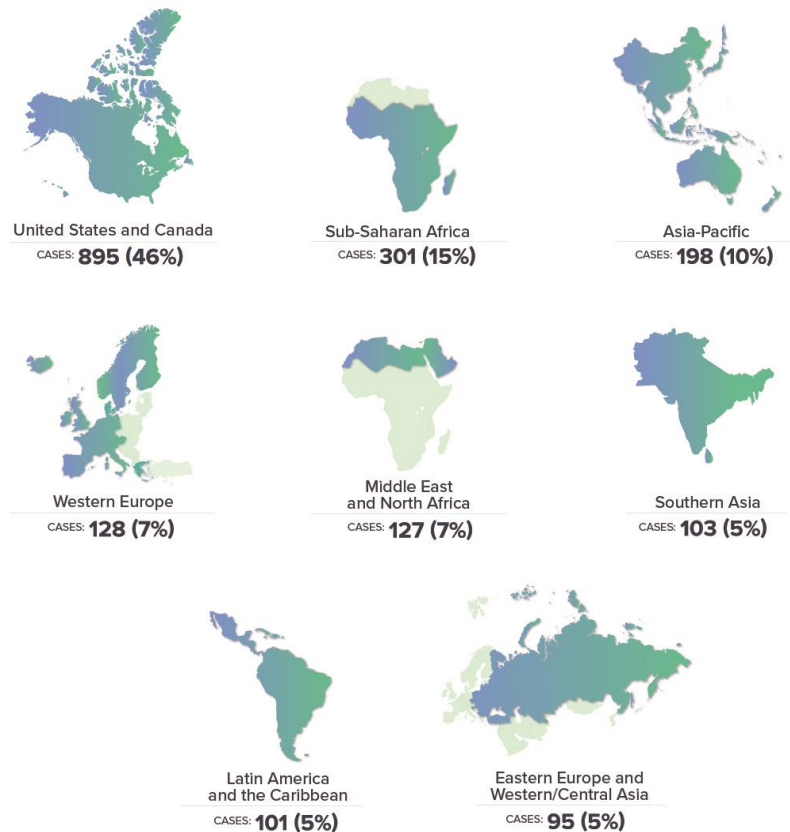


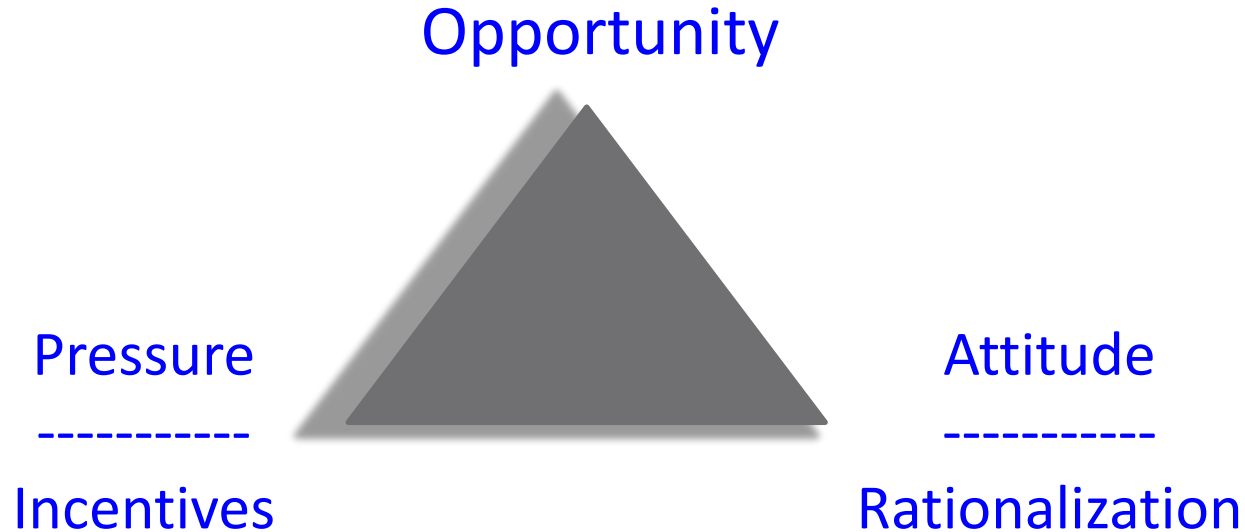
FIG. 1 Reported cases by region



ACFE 2020 Report To the Nations

2020 Report to the Nations

Understanding the Fraud Triangle



History of the Fraud Triangle

- Edwin H. Sutherland



History of the Fraud Triangle

- Donald R. Cressey



History of the Fraud Triangle

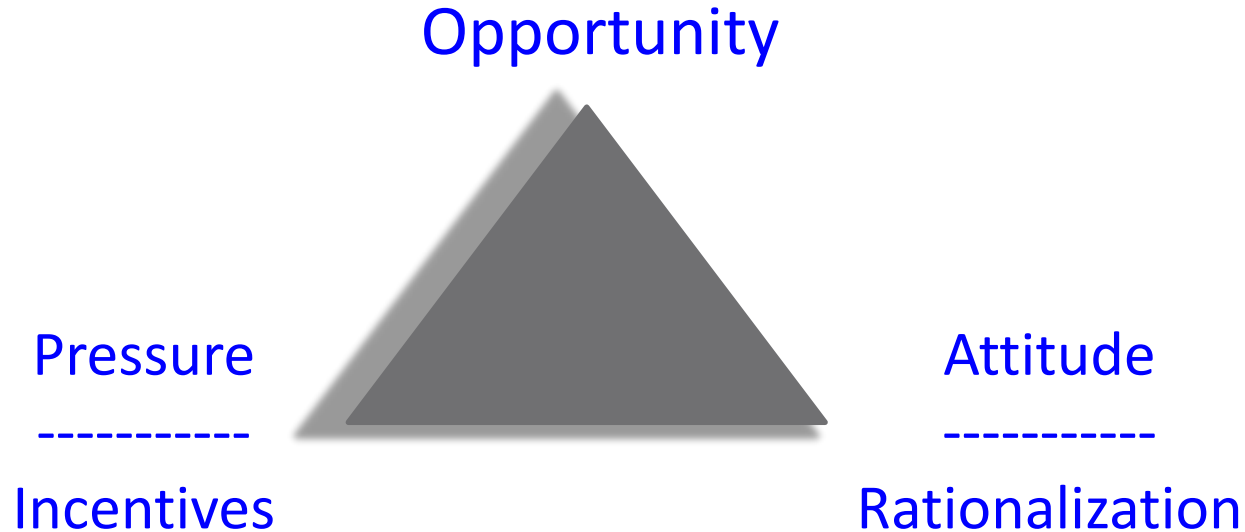
- Cressey's six basic subtypes of “nonsharable” problems:
 1. Violation of ascribed obligations
 2. Problems resulting from personal failure
 3. Business reversals
 4. Physical isolation
 5. Status gaining
 6. Employer-employee relations

History of the Fraud Triangle

- Dr. W. Steve Albrecht



Understanding the Fraud Triangle



Understanding the Fraud Triangle



Opportunity

Circumstances that are ***perceived*** to allow a fraud to be perpetrated.

Key Concepts:

- Perception
- Perception of Detection

Understanding the Fraud Triangle



Opportunity

- Inherent Risk
- Control Risk
- Only real area of control (from company/organization perspective)

Understanding the Fraud Triangle



Pressures / Incentives



Key Concept:

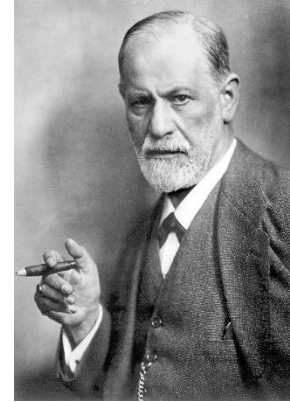
- **Motive**

Understanding the Fraud Triangle



Pressures | Incentives

- Behavior
- Circumstances
- Environment

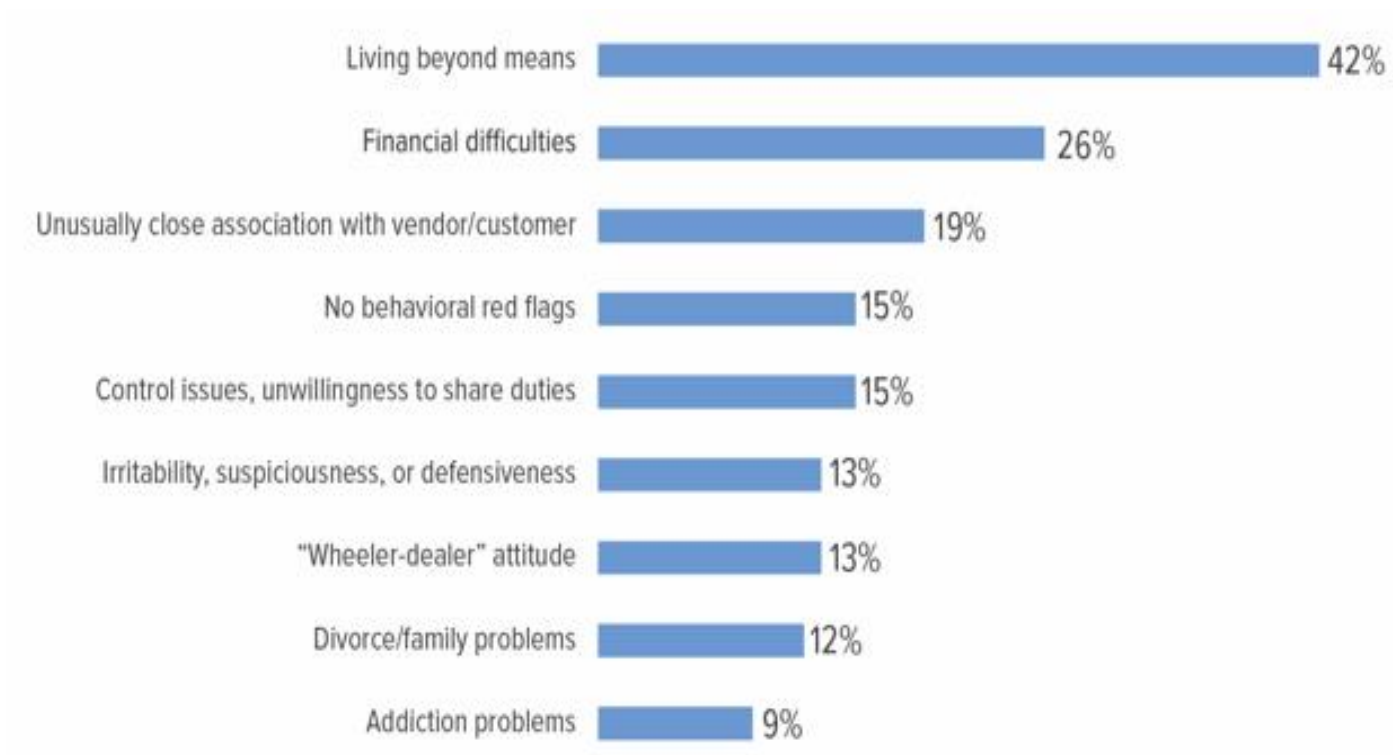


Understanding the Fraud Triangle

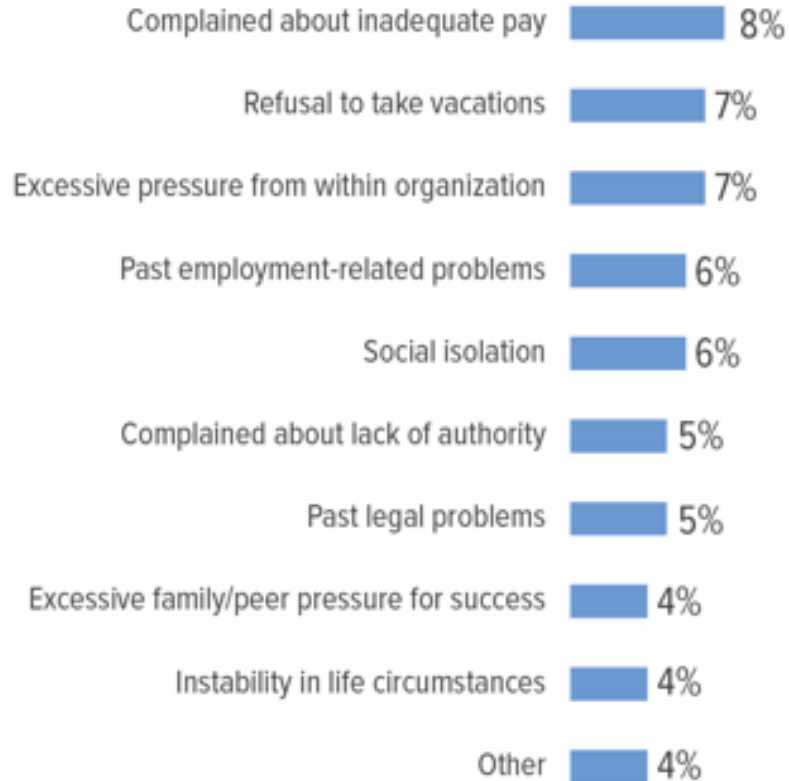
What are some **Red Flags** the might indicate a person is committing fraud or where a pressure or incentive to commit fraud exists?



Red Flags



Red Flags (Continued)



Behavioral Red Flags of Fraud

Recognizing the behavioral clues displayed by fraudsters can help organizations more effectively detect fraud and minimize their losses.

85% OF ALL FRAUDSTERS displayed at least one **BEHAVIORAL RED FLAG** while committing their crimes.

7 KEY WARNING SIGNS



42%

Living beyond means



26%

Financial difficulties



19%

Unusually close association with vendor/customer



15%

Control issues, unwillingness to share duties



13%

Irritability, suspiciousness, or defensiveness



13%

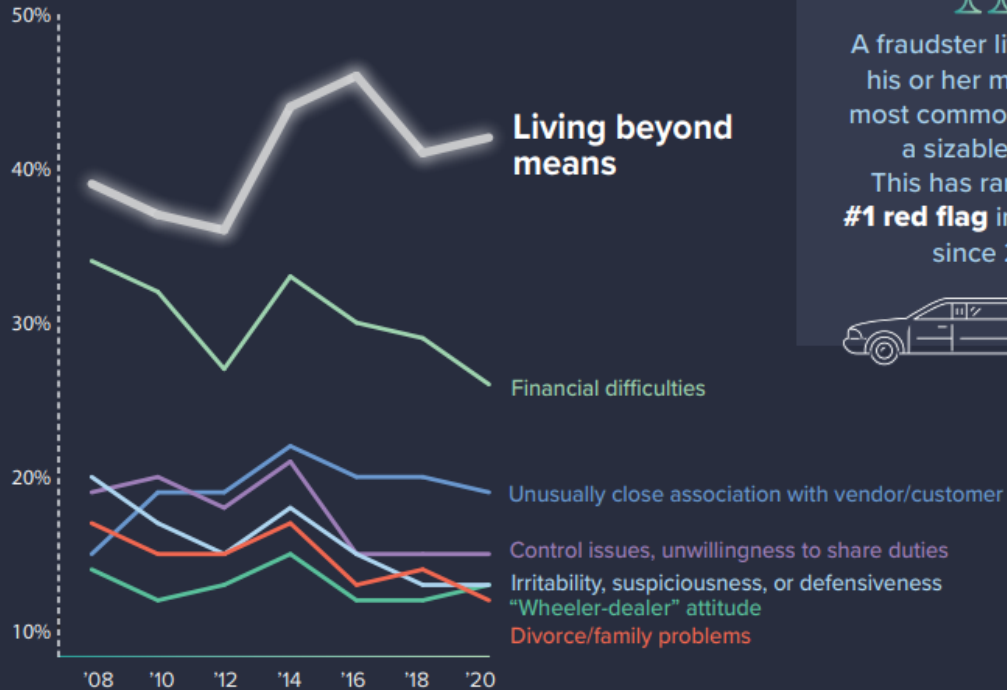
"Wheeler-dealer" attitude



12%

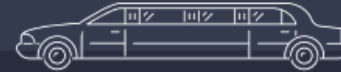
Divorce/family problems

LIVING BEYOND MEANS



A fraudster living beyond his or her means is the most common red flag by a sizable margin.

This has ranked as the **#1 red flag** in every study since 2008.



Understanding the Fraud Triangle



Attitude | Rationalization

The attitude, character, or set of ethical values that allow the perpetrator to commit a dishonest act.

Understanding the Fraud Triangle



Attitude | Rationalization

- Attitude
- Rationalization

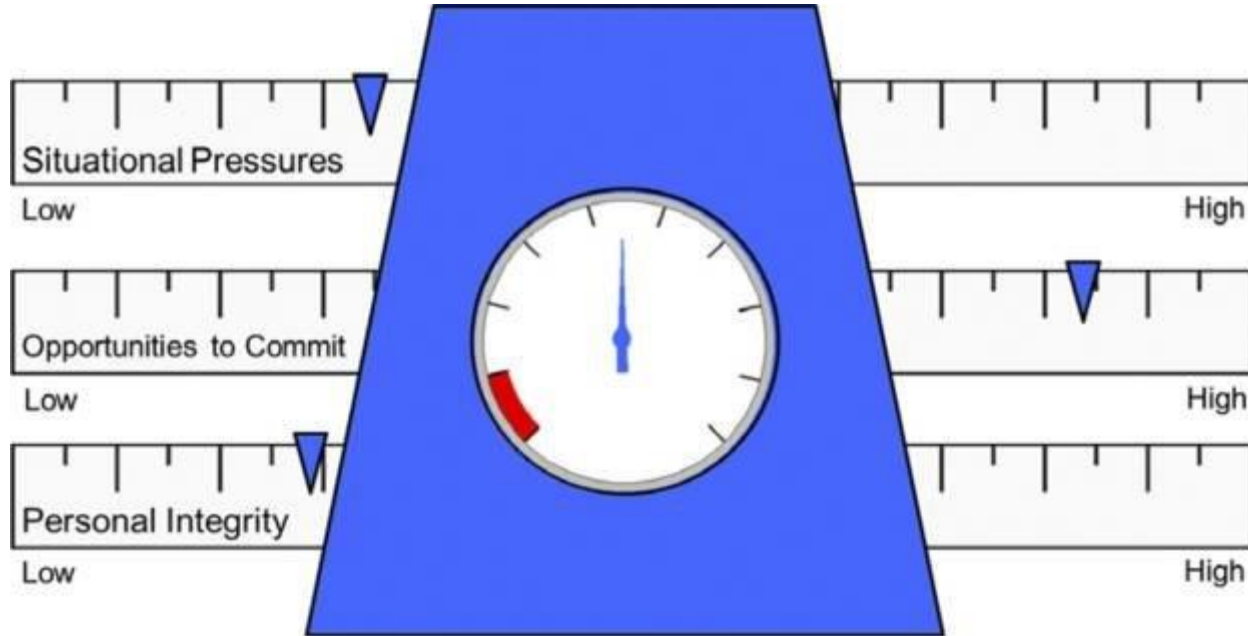
Understanding the Fraud Triangle



Attitude | Rationalization

- **Key Concept**
 - **Reconciliation**

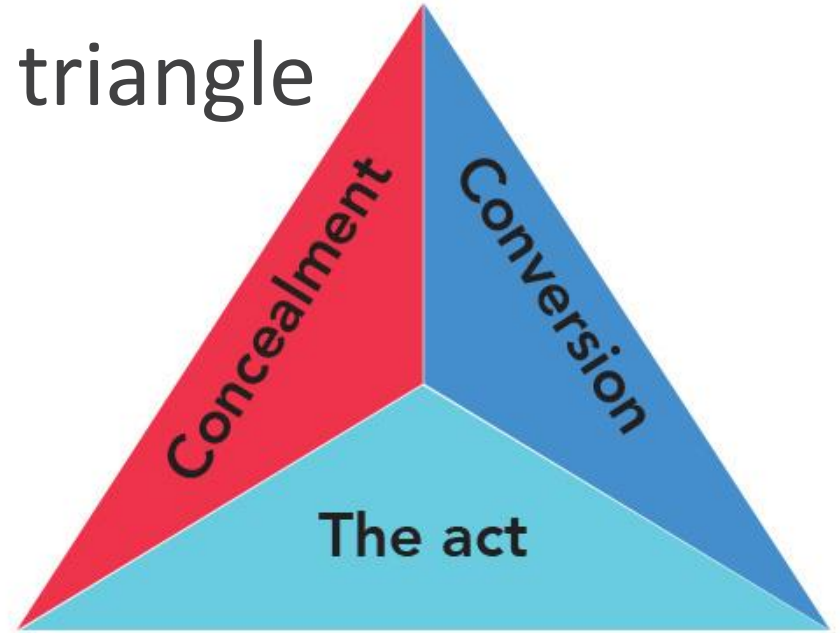
The Fraud Scale



Source: Adapted from Albrecht *et al.* (1984)

Understanding the Fraud Triangle

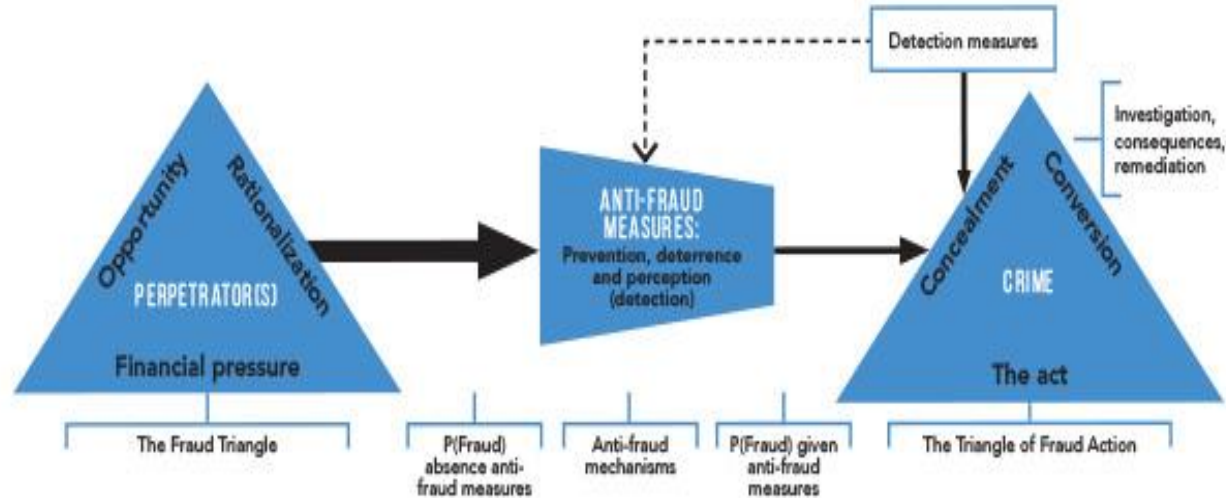
- Evolution of the fraud triangle
 - Triangle of Fraud Actions



“The Evolution of Fraud Theory”, by Jack Dominey, A. Scott Fleming, Mary-Jo Kranacher and Richard a. Riley Jr., Issues in Accounting Education, Volume 27, Issue 2, May 2012.

Understanding the Fraud Triangle

Meta-Model of Fraud

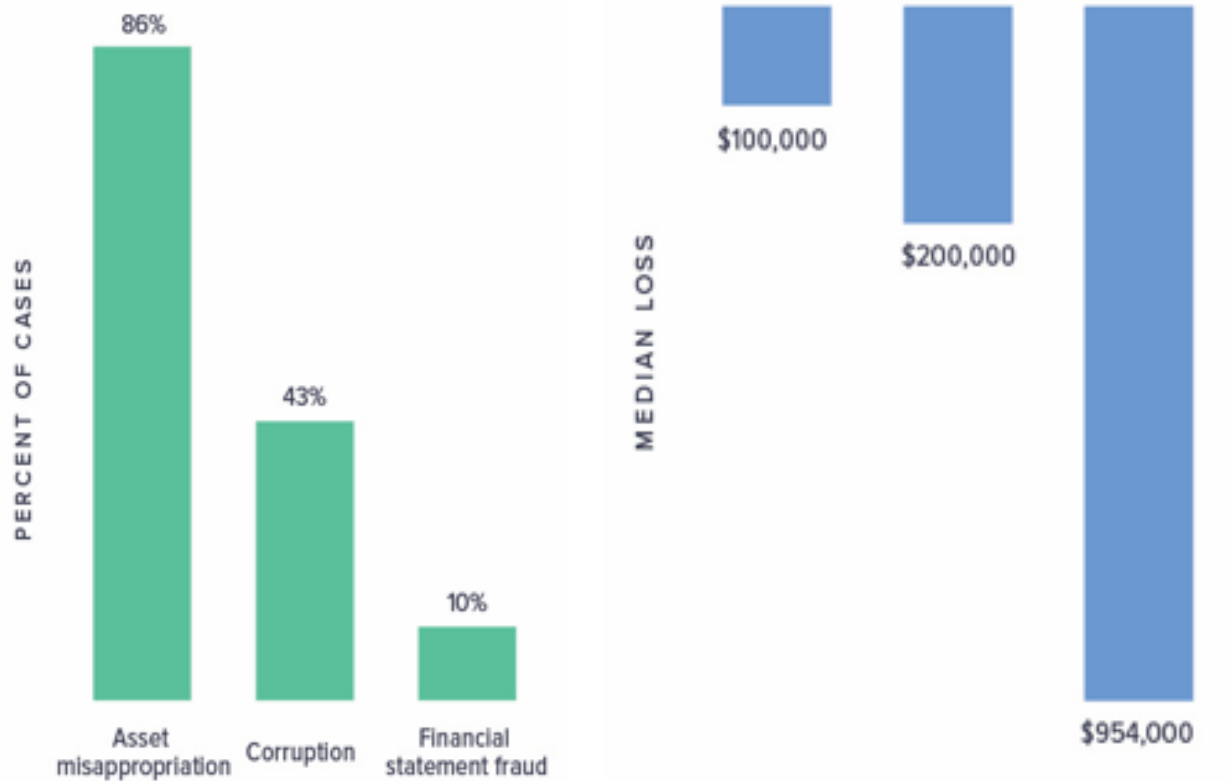


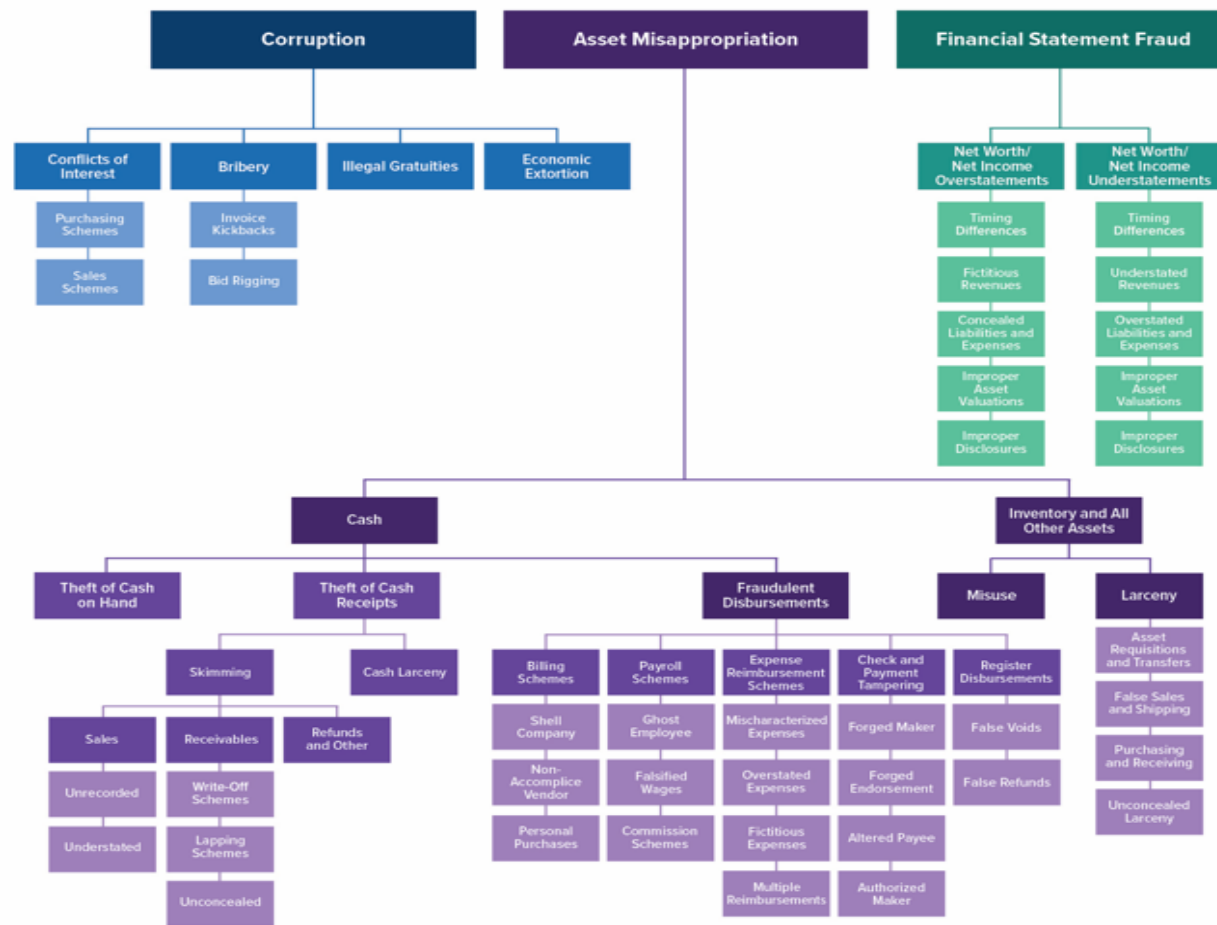
“The Evolution of Fraud Theory”, by Jack Dominey, A. Scott Fleming, Mary-Jo Kranacher and Richard a. Riley Jr., Issues in Accounting Education, Volume 27, Issue 2, May 2012.

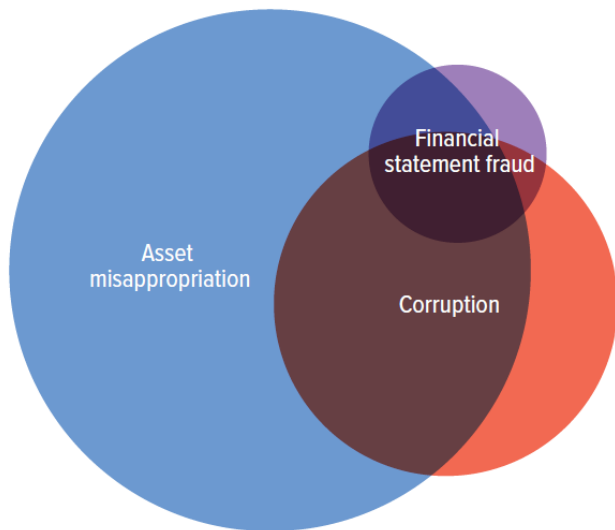
Types of Fraud

- Asset Misappropriation
- Financial Statement Fraud
- Corruption

FIG. 2 How is occupational fraud committed?







Asset misappropriation only	53%
Asset misappropriation and corruption	26%
Corruption only	11%
Corruption, asset misappropriation, and financial statement fraud	5%
Asset misappropriation and financial statement fraud	3%
Financial statement fraud only	2%
Corruption and financial statement fraud	1%

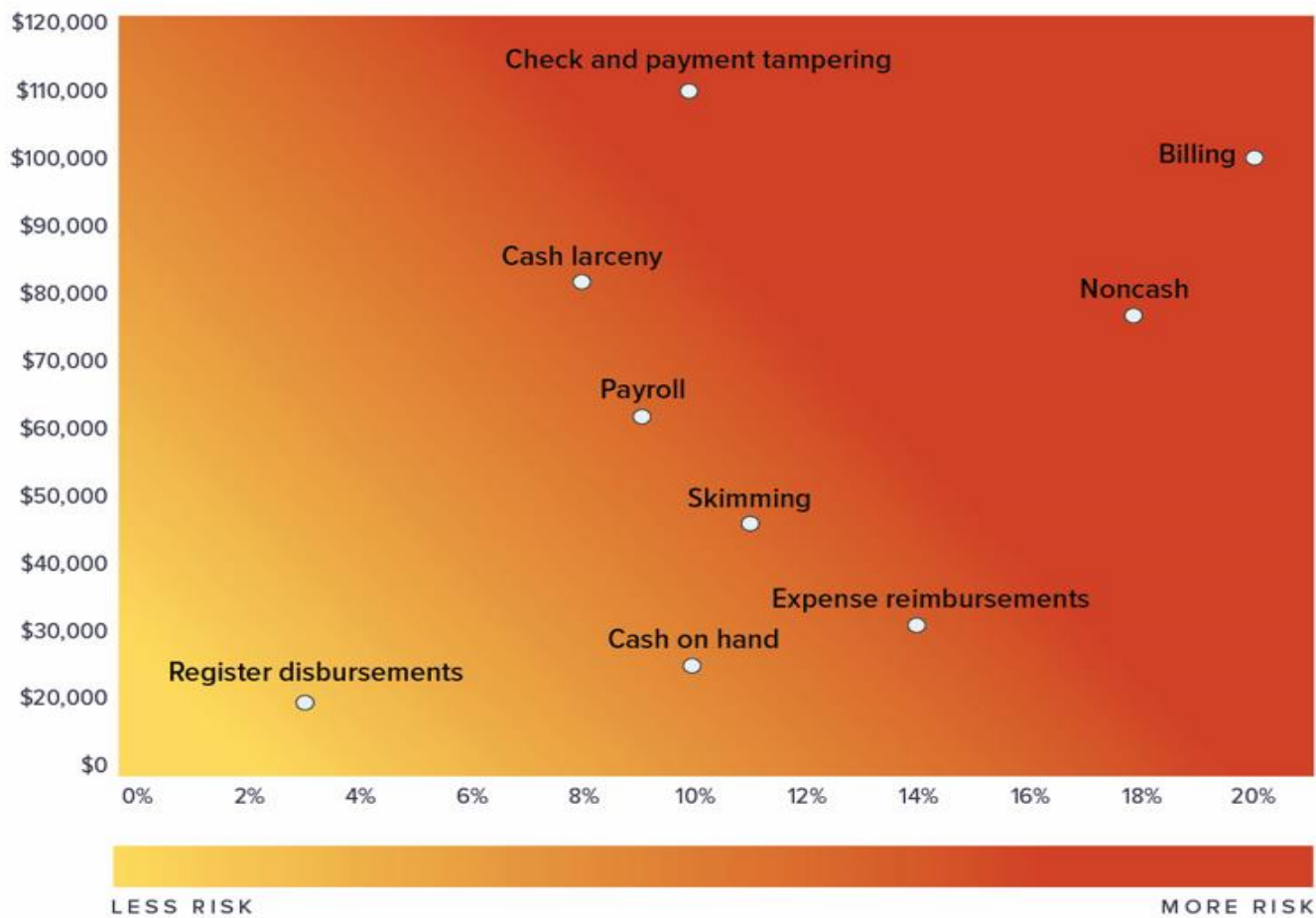
Types of Fraud

- Asset Misappropriation
 - Cash
 - Inventory and All Other Assets

Asset Misappropriation

- Opportunity
- Pressure | Incentive





Types of Fraud

- Financial Statement Fraud
 - Asset/Revenue Overstatements
 - Asset/Revenue Understatements

Financial Statement Fraud

- Opportunity
- Pressure | Incentive



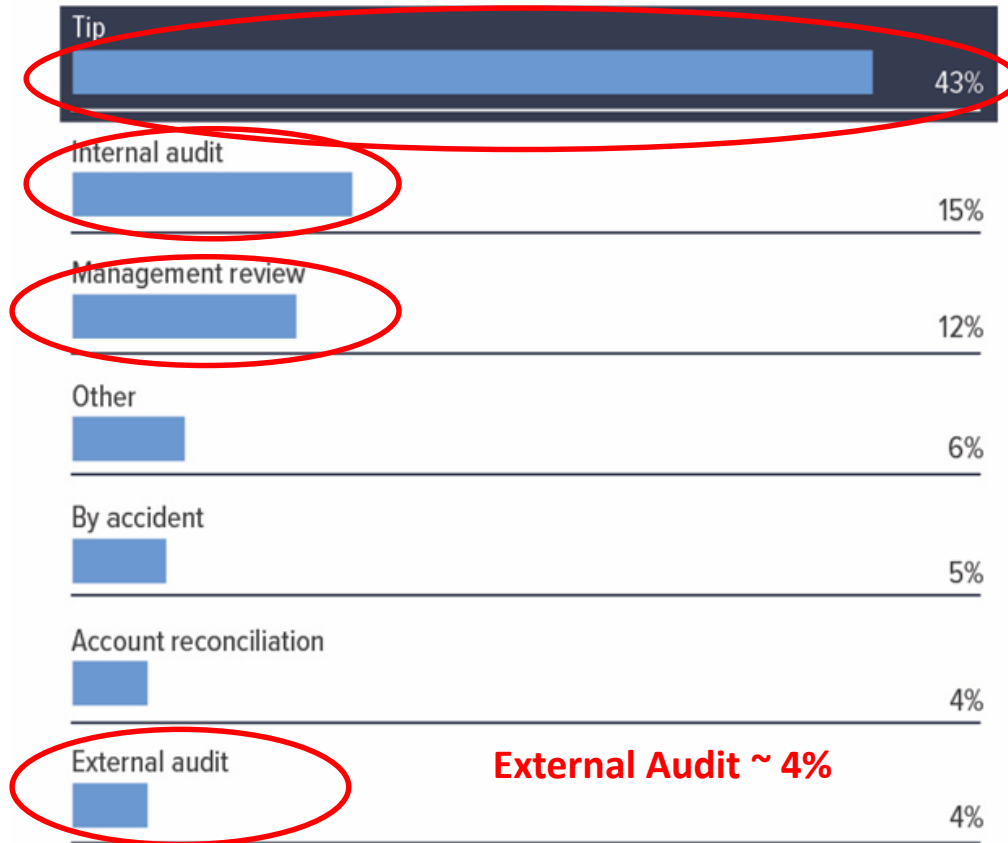
Types of Fraud

- Corruption
 - Conflicts of Interest
 - Bribery
 - Illegal Gratuities
 - Economic Extortion

Survey Question #1

- What is the most common initial detection method for occupational fraud?
 - Internal audit
 - By accident
 - External audit
 - Tips
 - Other

FIG. 9 How is occupational fraud initially detected?

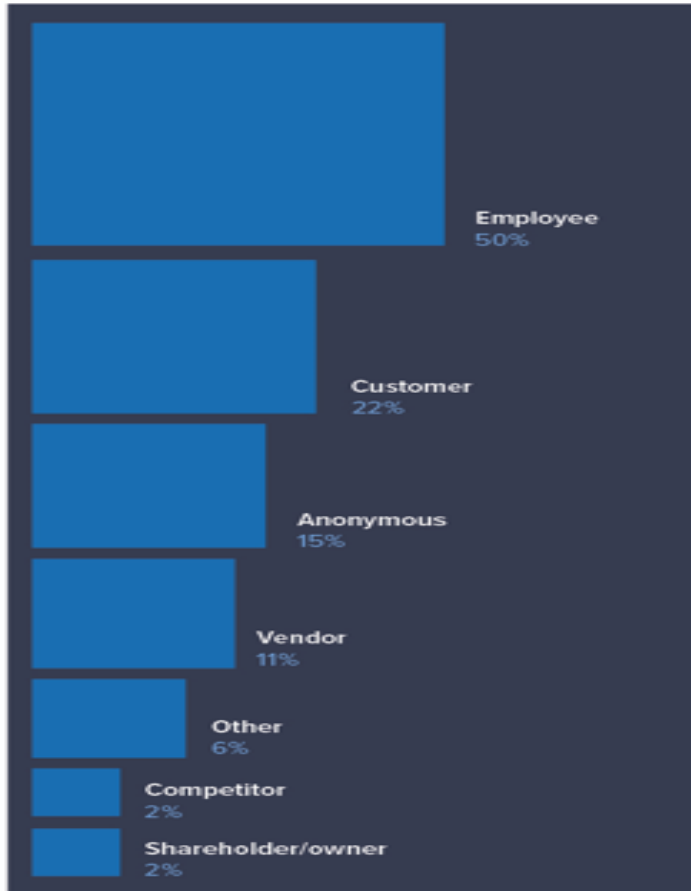



Tips ~ 43% +

Internal Audit ~ 15%

Management Review ~ 12%

External Audit ~ 4%



 **64%** OF
VICTIM ORGANIZATIONS
had hotlines

MEDIAN LOSSES WERE NEARLY
DOUBLED AT ORGANIZATIONS
WITHOUT HOTLINES

\$100,000
with hotlines

\$198,000
without
hotlines

Organizations with hotlines
detect frauds **MORE QUICKLY**
than those without hotlines

WITH HOTLINES **12 MONTHS**

WITHOUT HOTLINES **18 MONTHS**

MEDIAN DURATION



Public Perception

- What is the public perception about external auditors detecting fraud?



Public Perception: The Headlines



- **Judge Rules PricewaterhouseCoopers Must Pay \$625.3 Million in Damages**
 - *WSJ, July 2, 2018*
- **Where was KPMG, Wells Fargo's auditor, while the funny business was going on?**
 - *Market Watch, August 21, 2017*
- **Audits Didn't Catch Decade of Theft by Clerk**
 - *Courthouse News Service, 10/22/2015*
- **Petrobas Investors Claim PWC Ignored Red Flags of Fraud**
 - *BloombergBusiness, 03/30/2015*
- **Lawsuit Targets Skoda Minotti for Failing to Detect Credit Union Fraud**
 - *Crain's Cleveland Business, 03/28/2015*
- **Koss Corp. Sues Its Auditor for Failing to Detect Fraud**
 - *Daily Finance, 06/25/2010*

Reality

- Approximately 4% of identified instances of fraud are detected through external audit.
 - *2020 Report to the Nations on Occupational Fraud and Abuse*, Association of Certified Fraud Examiners



Reality

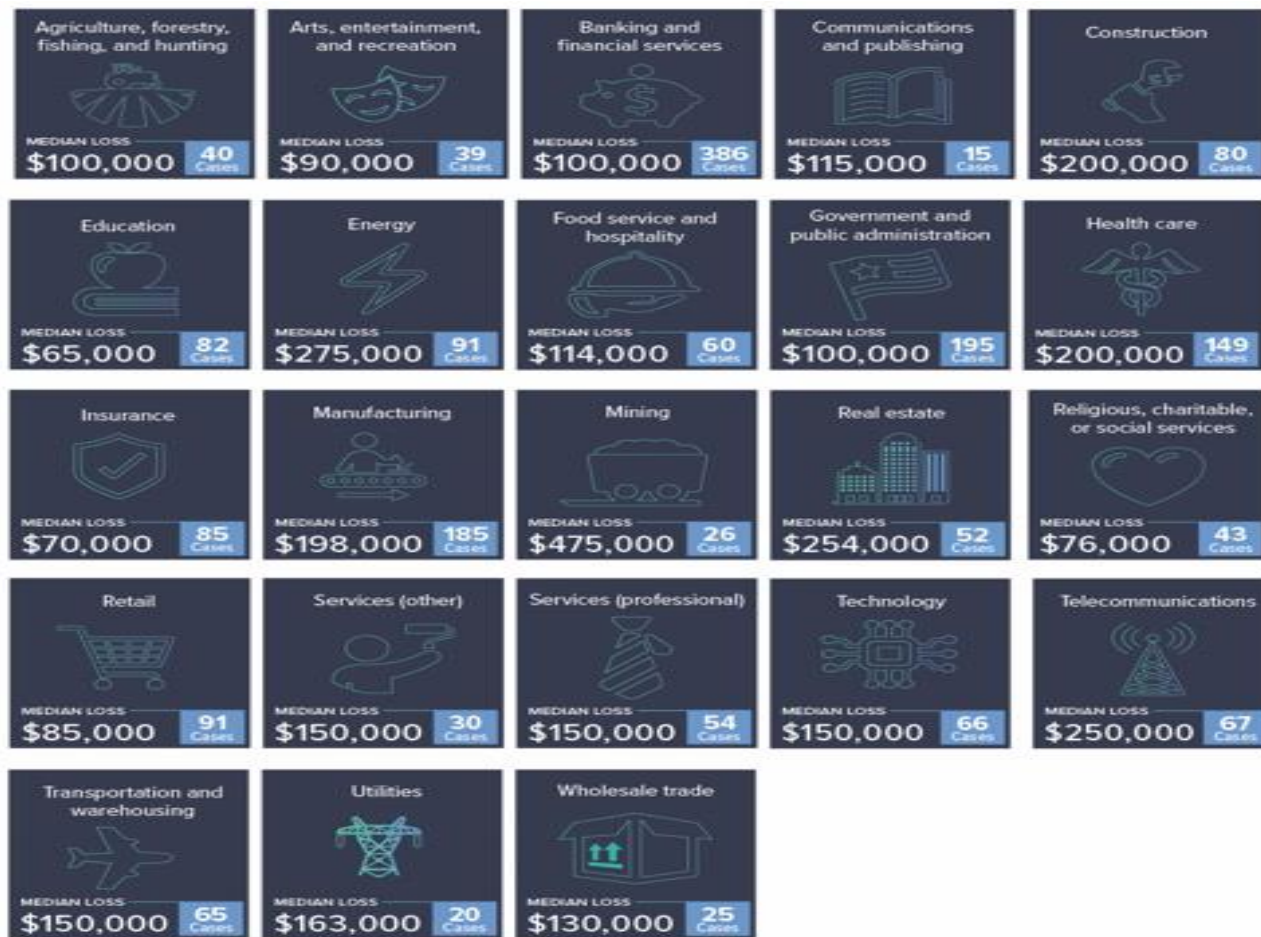
AU 240 .05 –
inherent limitations
unavoidable risk

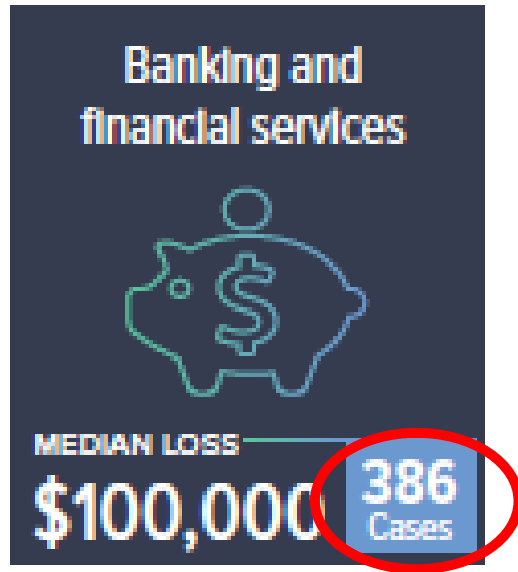
Professional Standards Related to Fraud

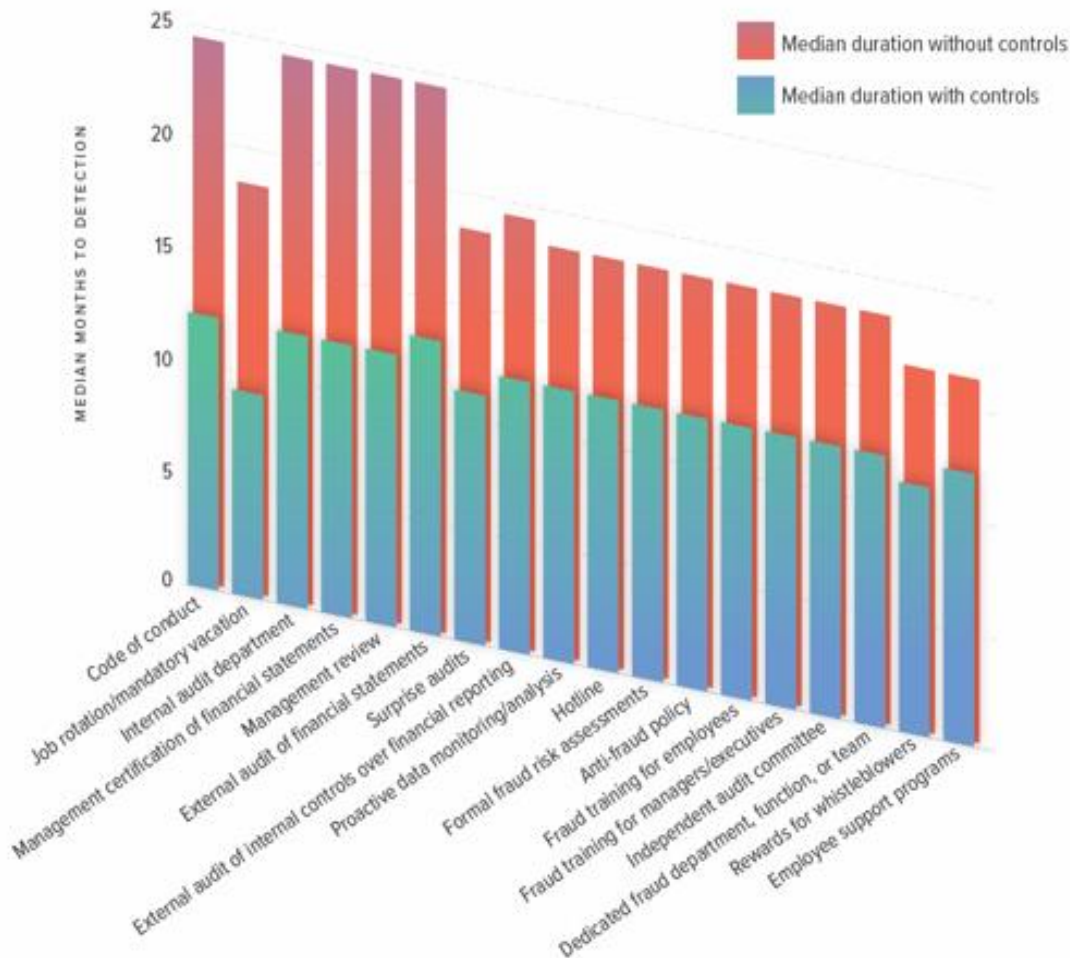


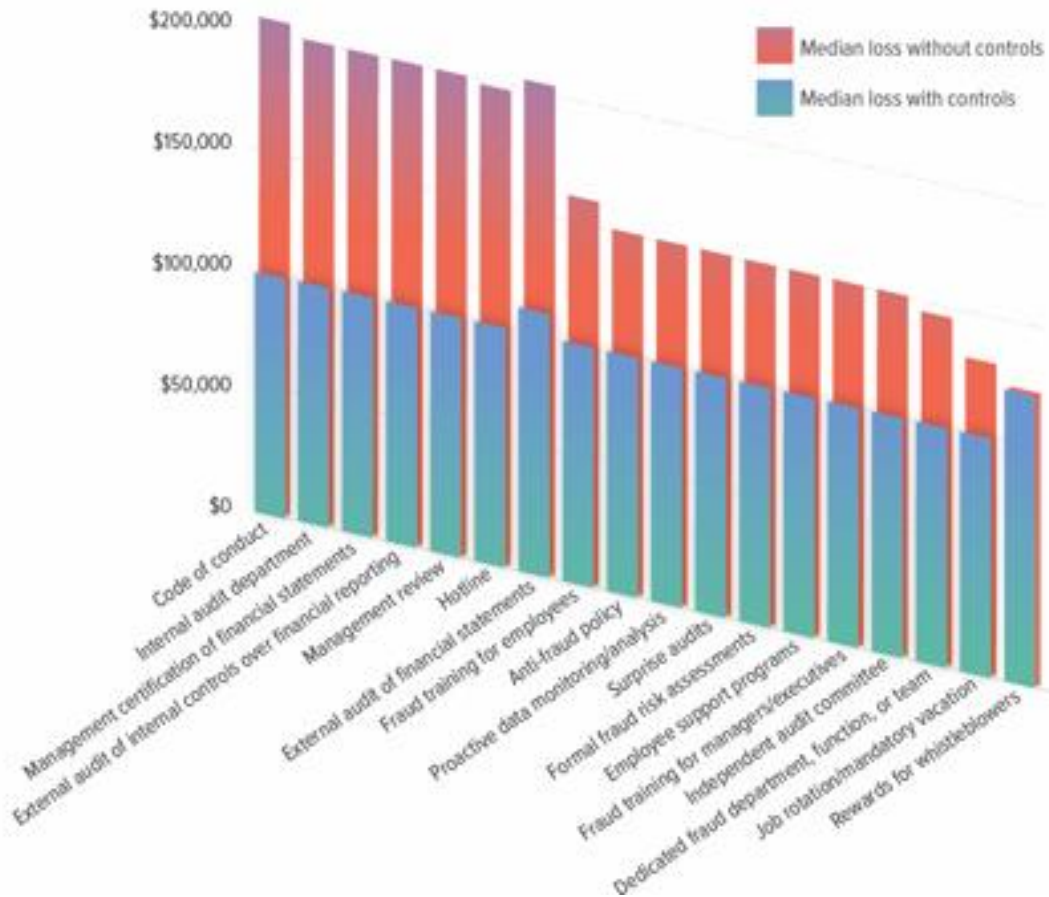
Survey Question #2

- Which industry had the most fraud investigations?
 - Manufacturing
 - Health Care
 - Banking & Finance
 - Construction
 - Government & Public Administration
 - Real Estate









Fraud Case Studies



- Identify the three points of the fraud triangle.
- Each case is a real instance of fraud.
- Reflect on your organization's internal controls.

Fraud Case Studies: “Say Cheese!”

Payroll Fraud

- Jerry is an administrative assistant
- Large San Antonio hospital.

Excerpt from Corporate Fraud Handbook, 2011, Association of Certified Fraud Examiners, Wells, Joseph T.



Fraud Case Studies: Medical School Treats Fraud and Abuse

Billing Scheme

- Cheryl was an administrative assistant
- College campus in California.

Excerpt from Corporate Fraud Handbook, 2011, Association of Certified Fraud Examiners, Wells, Joseph T.



Fraud Case Studies – A Wolf in Sheep's Clothing

Check Tampering Scheme

- Melissa was an executive secretary at a charitable organization in Nashville.
- She was on of two authorized check signers.
- Loss to the NPO: over \$60k
- Duration of the fraud: approximately five years.
- Detection method – Melissa stonewalled board members asking financial questions, raised suspicion, and triggered a deeper look.
- Fraud method – check tampering scheme
- Result: Termination and restitution

Excerpt from Corporate Fraud Handbook, 2011, Association of Certified Fraud Examiners, Wells, Joseph T.



Fraud Case Studies – A Wolf in Sheep's Clothing

Additional Fun Facts

- Melissa refused to upgrade from her manual check writing system to a computerized system.
- May also have stolen cash from various fundraising activities as there was no documentation of collection prior to Melissa organizing funds for deposit.

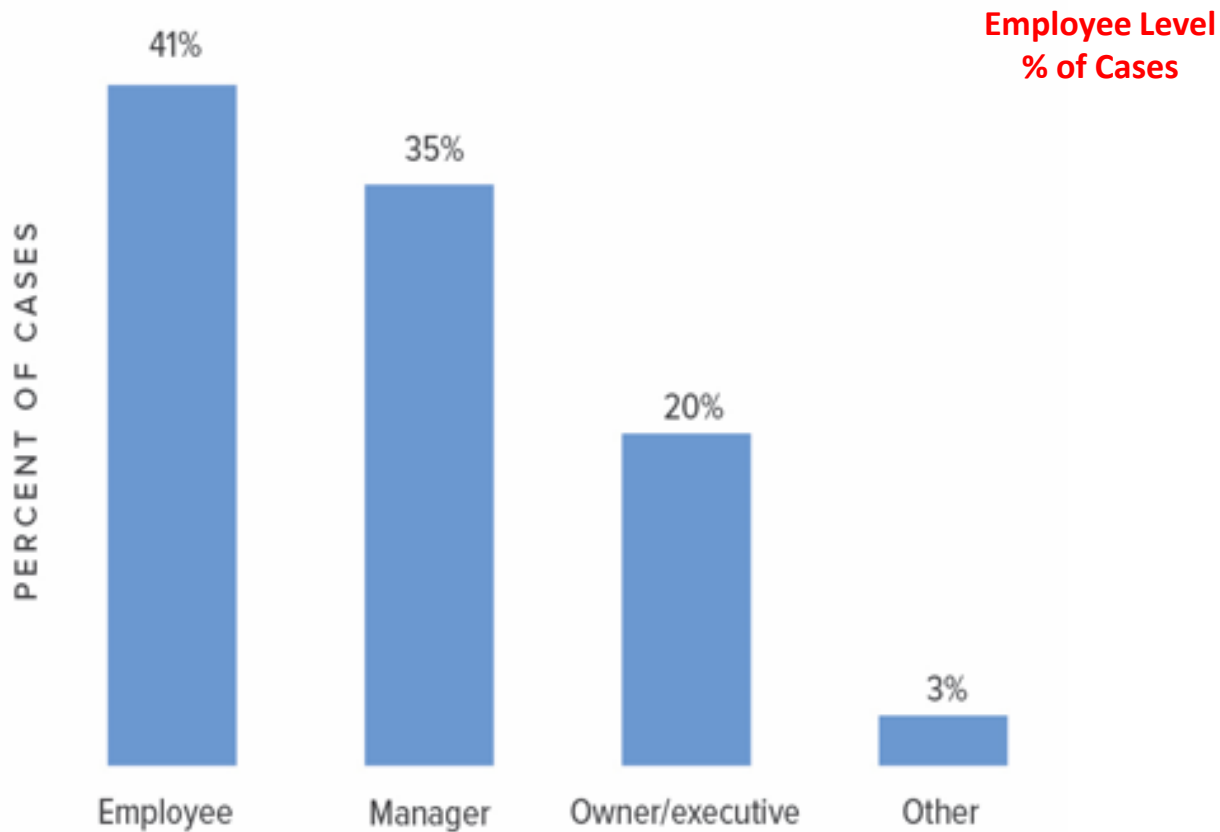
Excerpt from Corporate Fraud Handbook, 2011, Association of Certified Fraud Examiners, Wells, Joseph T.



The Perpetrator

- Position
- Gender
- Age
- Tenure
- Criminal background



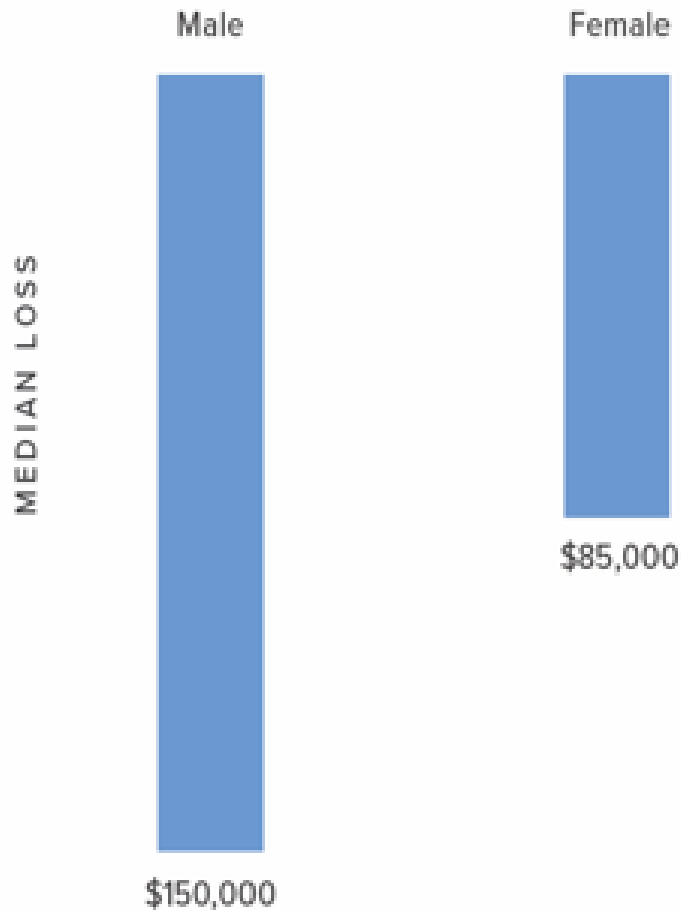




**Employee Level
Losses**

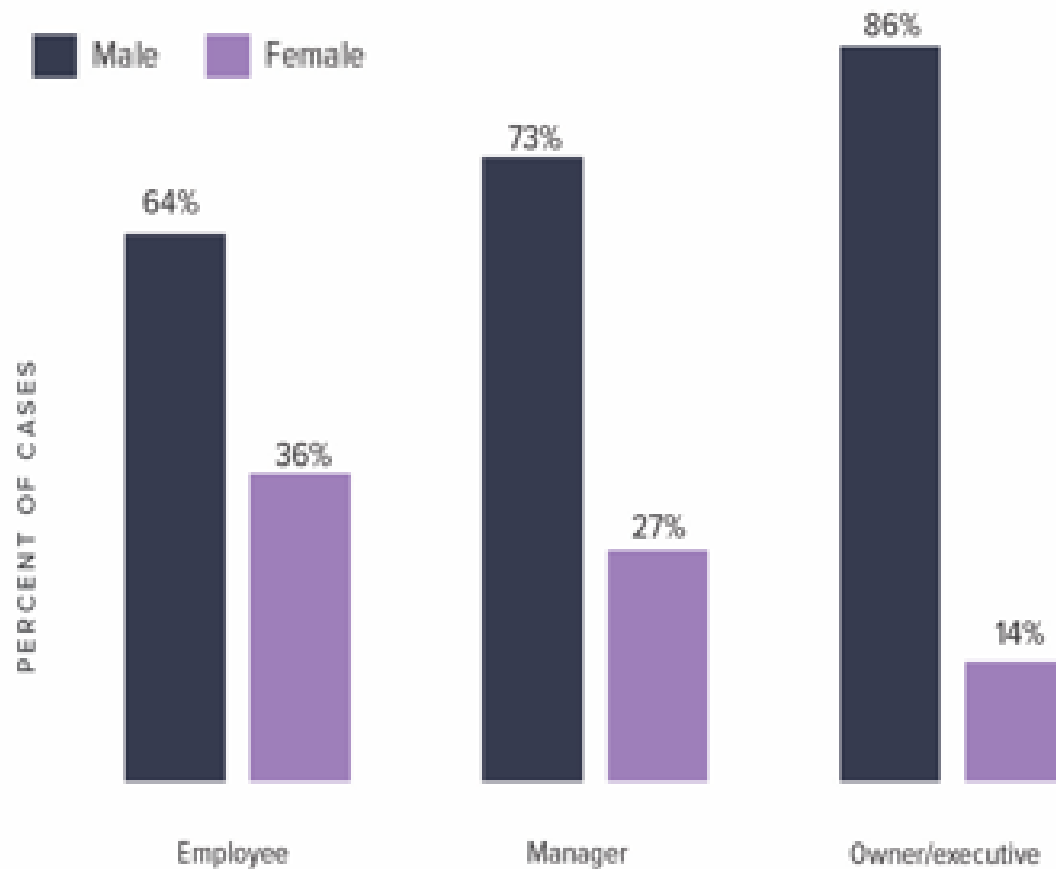


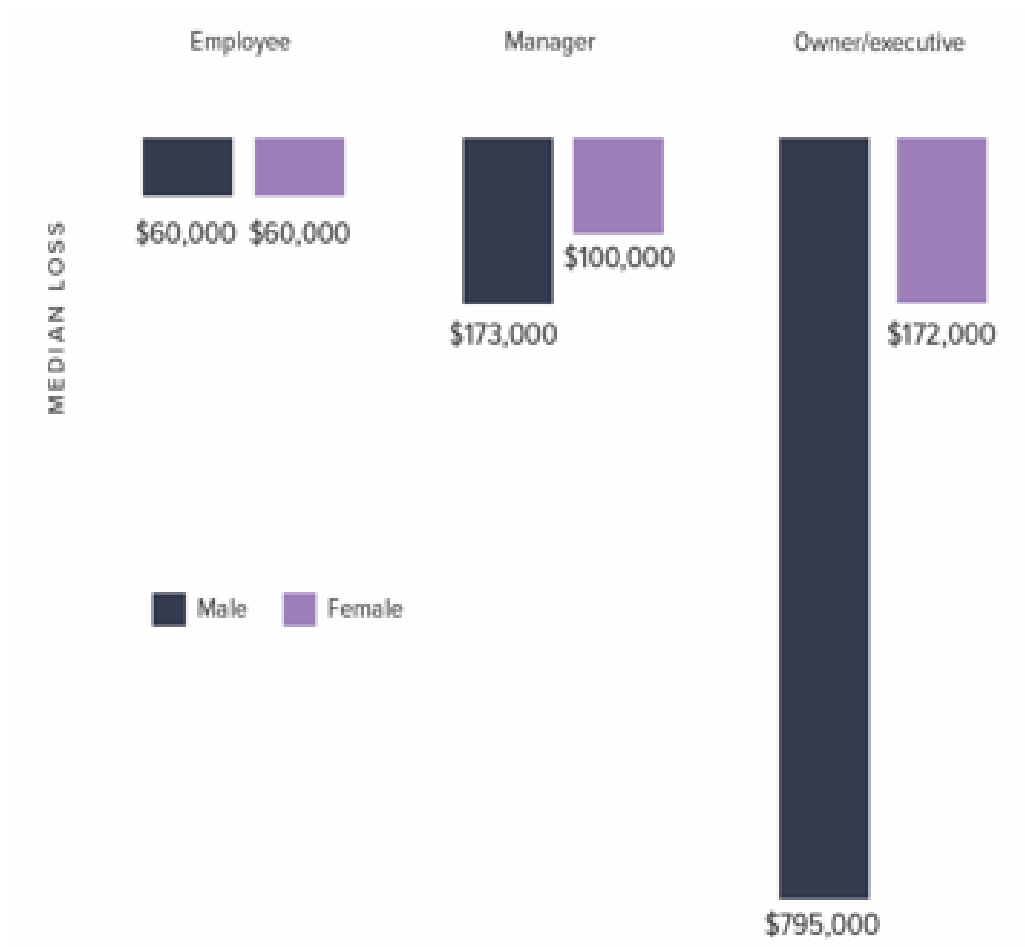
**Gender
% of Cases**

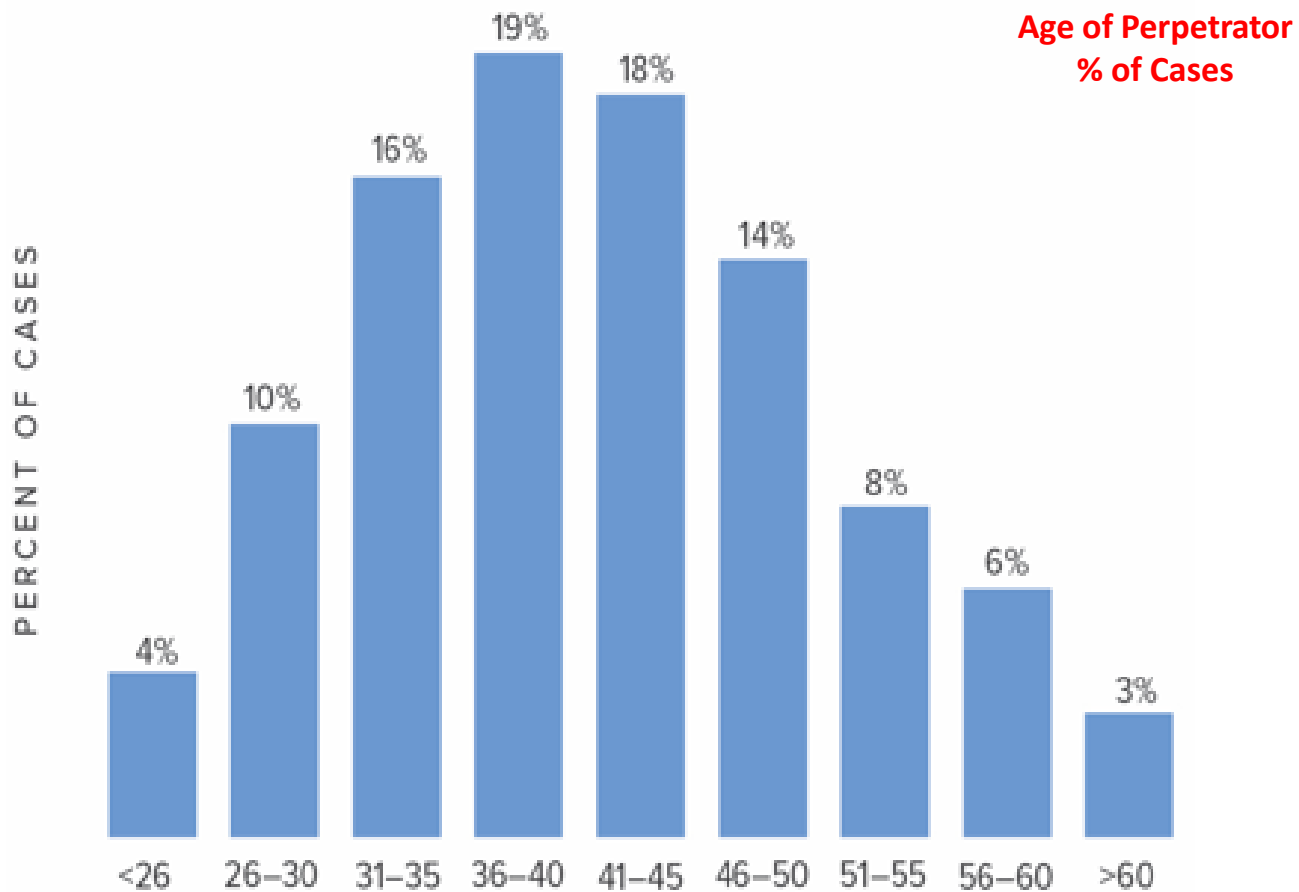


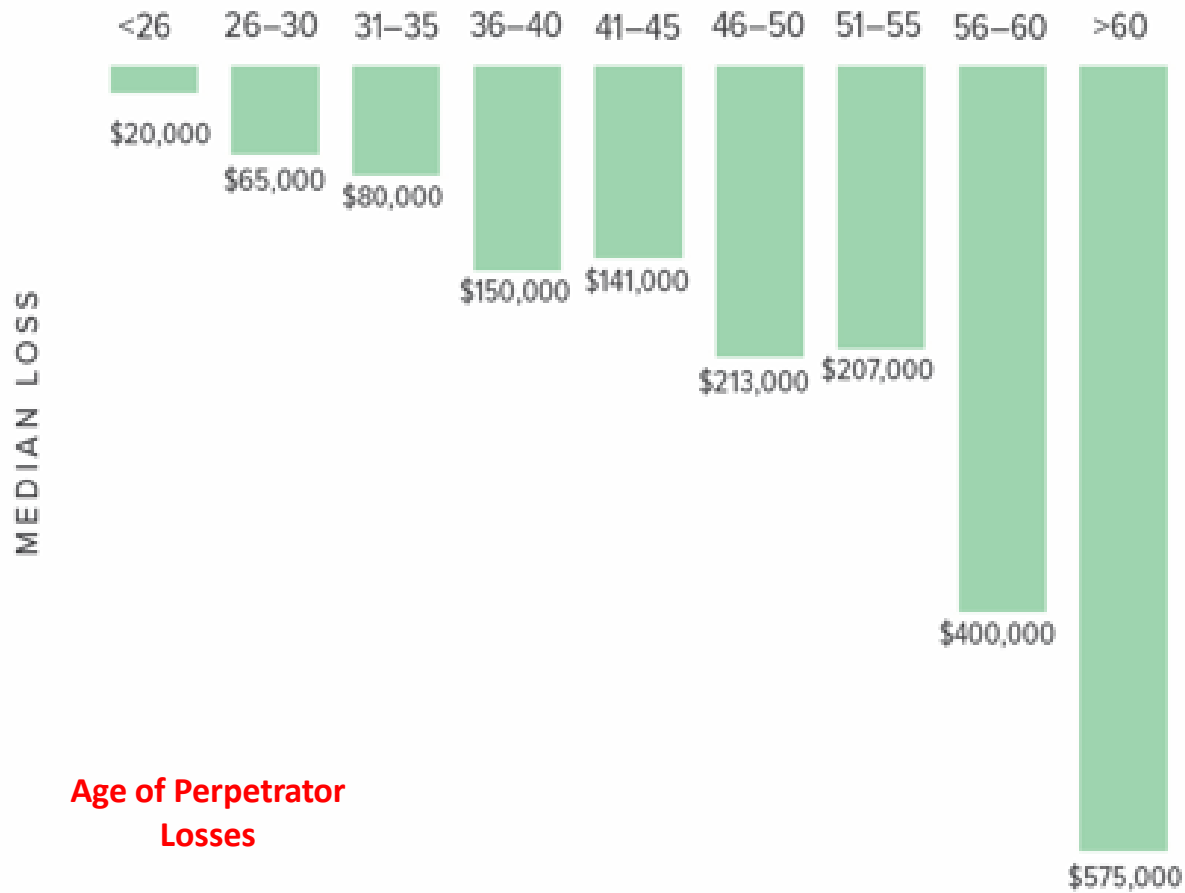
Gender Losses



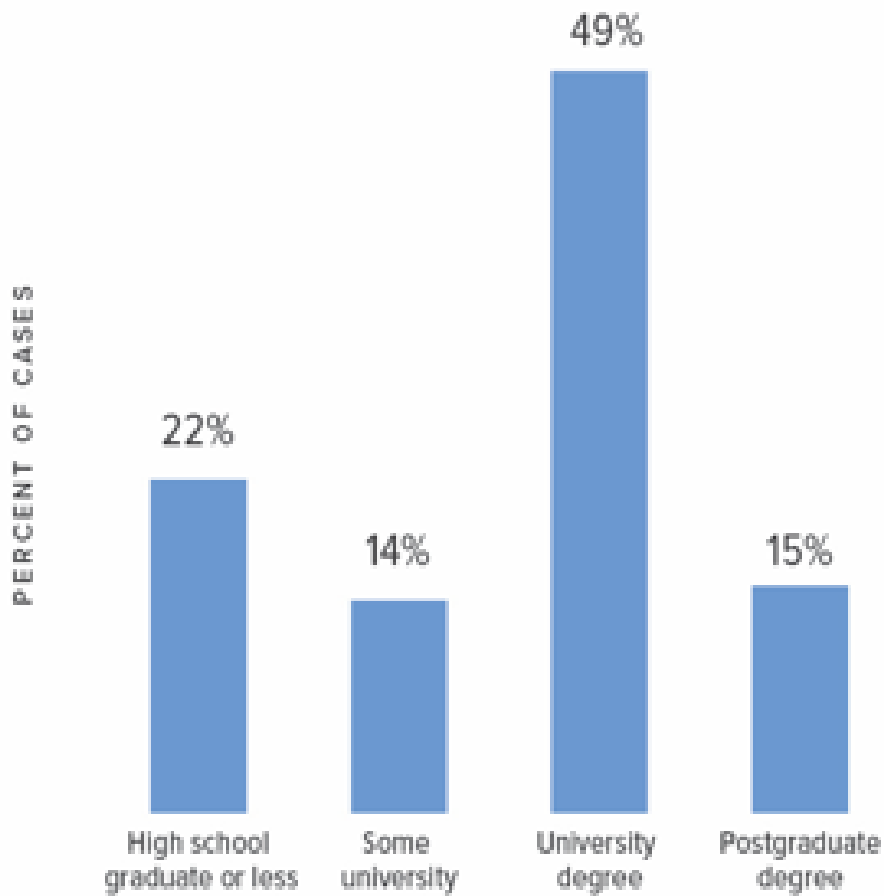








**Age of Perpetrator
Losses**



**Level of Education
% of Cases**

MEDIAN LOSS

High school
graduate or less



\$80,000

Some
university



\$150,000

University
degree



\$175,000

Postgraduate
degree



\$200,000

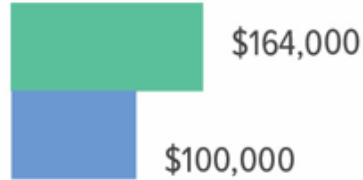
**Level of Education
Losses**



Employee



Manager



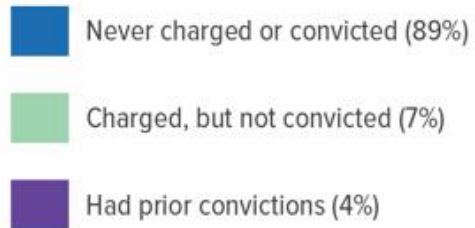
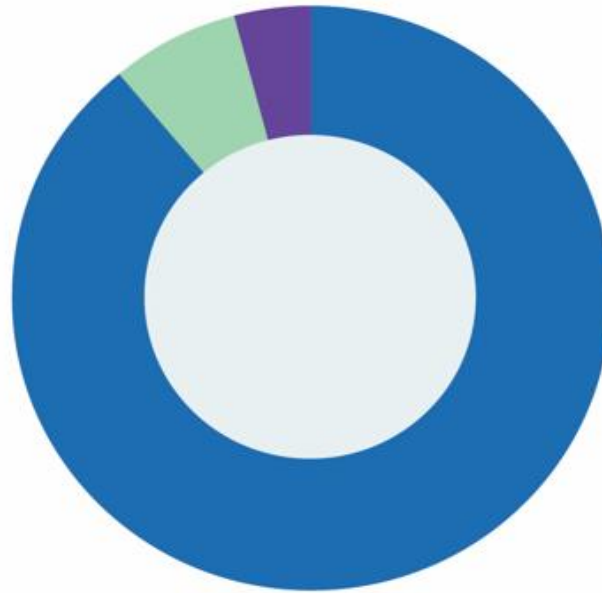
Level of Authority Losses Breakdown by Experience

Owner/executive

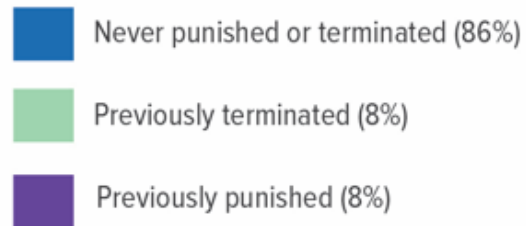
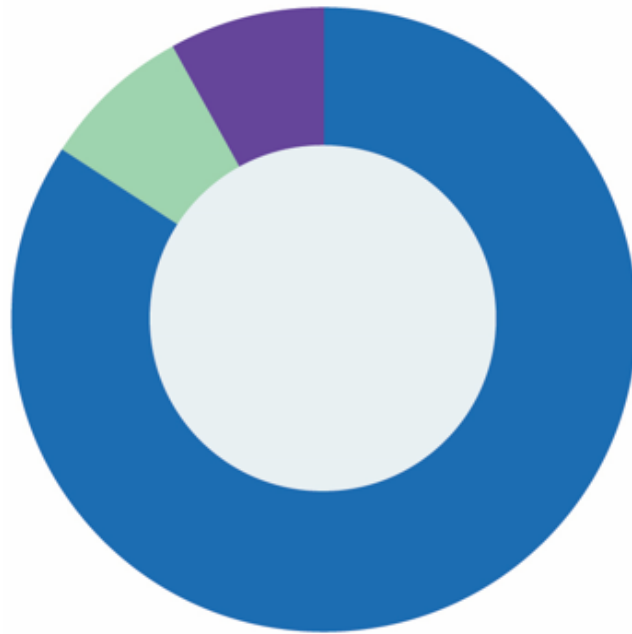


MEDIAN LOSS



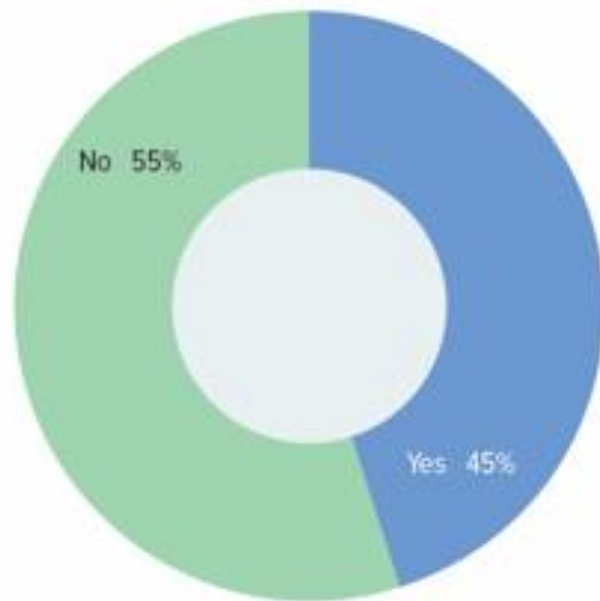


Prior conviction status



Prior Reprimand

FIG. 42 Do fraud perpetrators also engage in non-fraud-related misconduct?



Which forms of non-fraud misconduct are most common among fraud perpetrators?

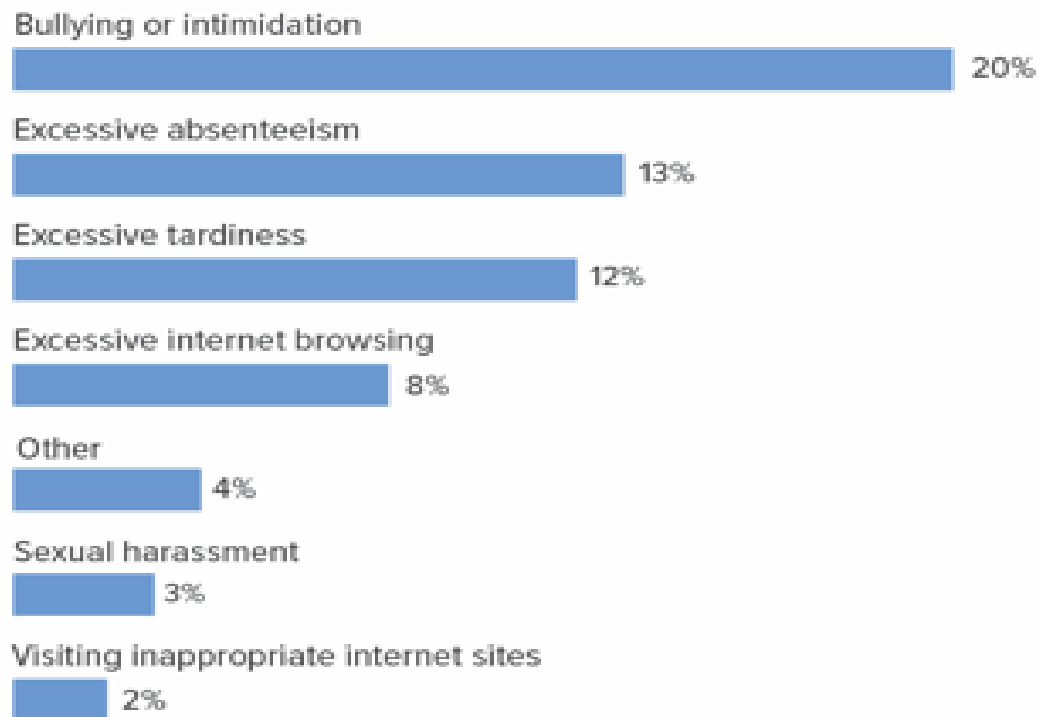
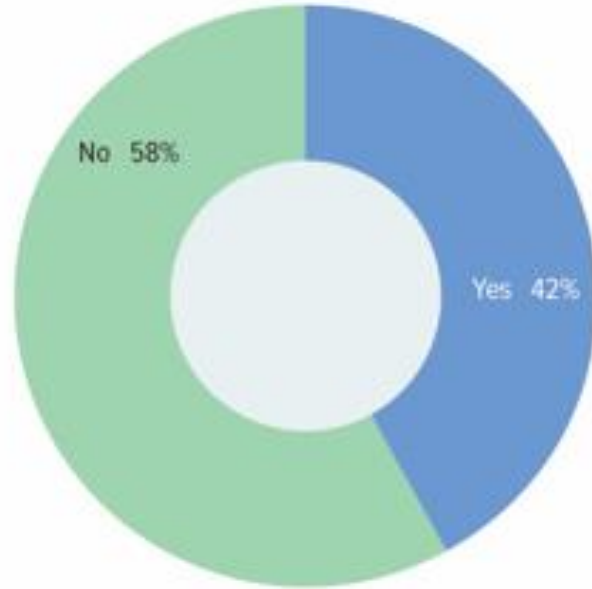


FIG. 43 Do fraud perpetrators experience negative HR-related issues prior to or during their frauds?



Which HR-related issues are most commonly experienced by fraud perpetrators?

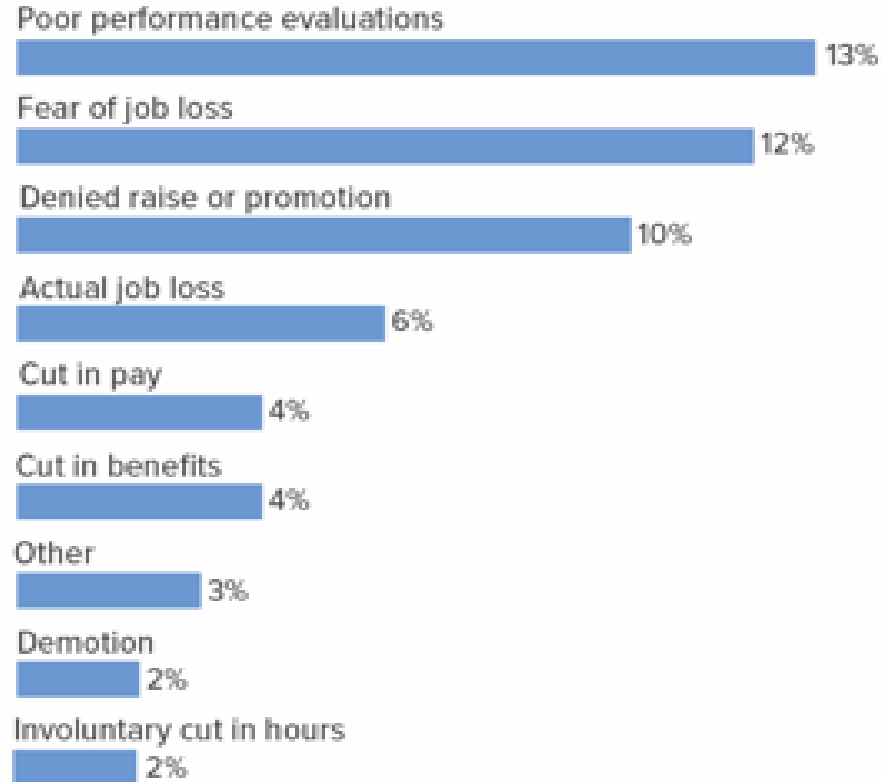


FIG. 44 How do victim organizations punish fraud perpetrators?

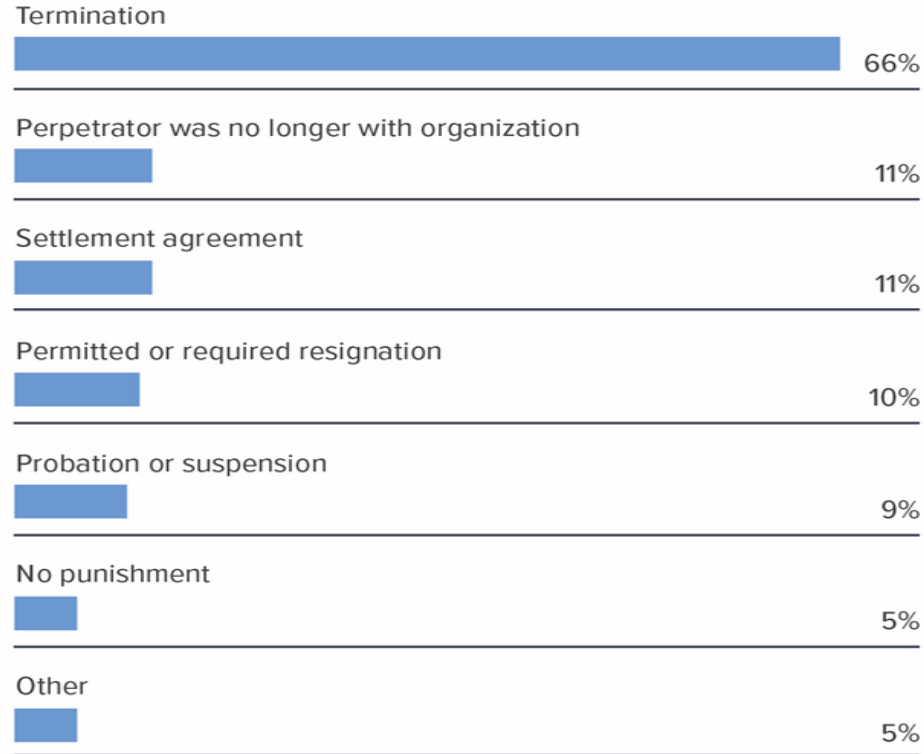


FIG. 45 Why do organizations decline to refer cases to law enforcement?

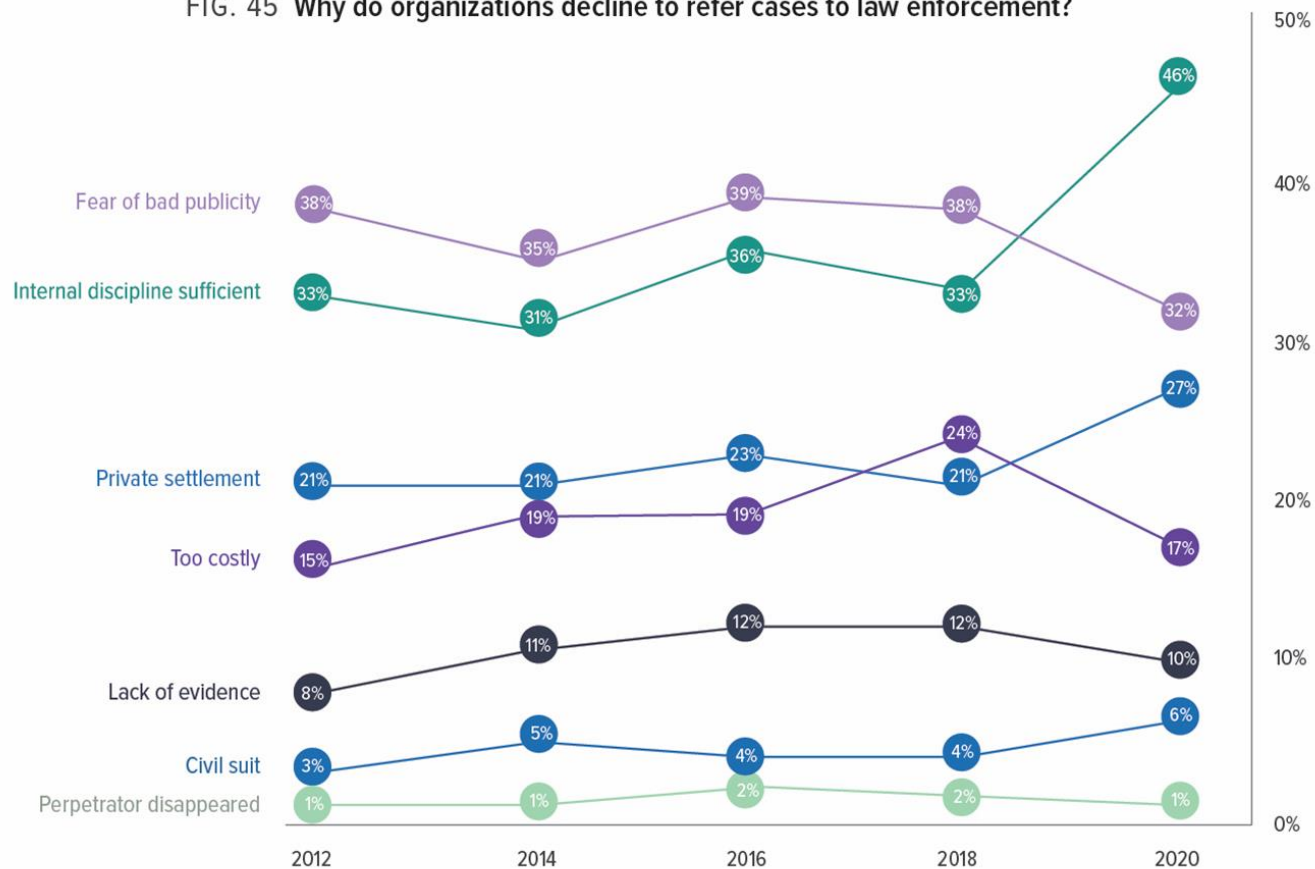
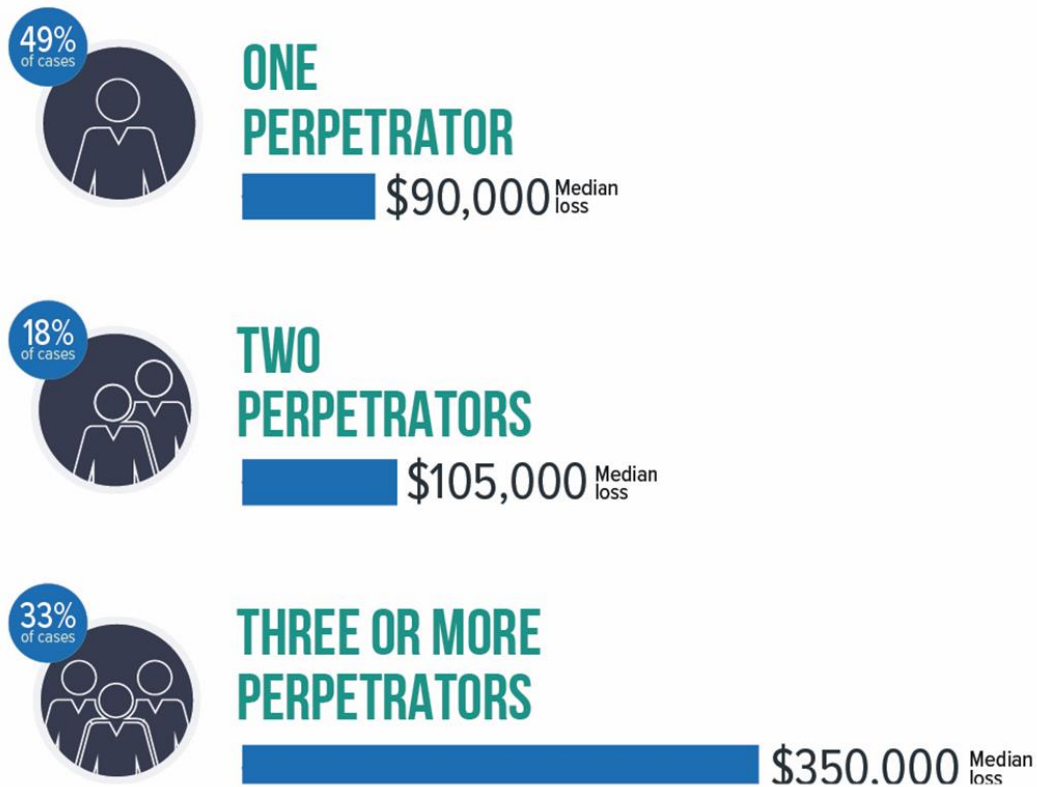


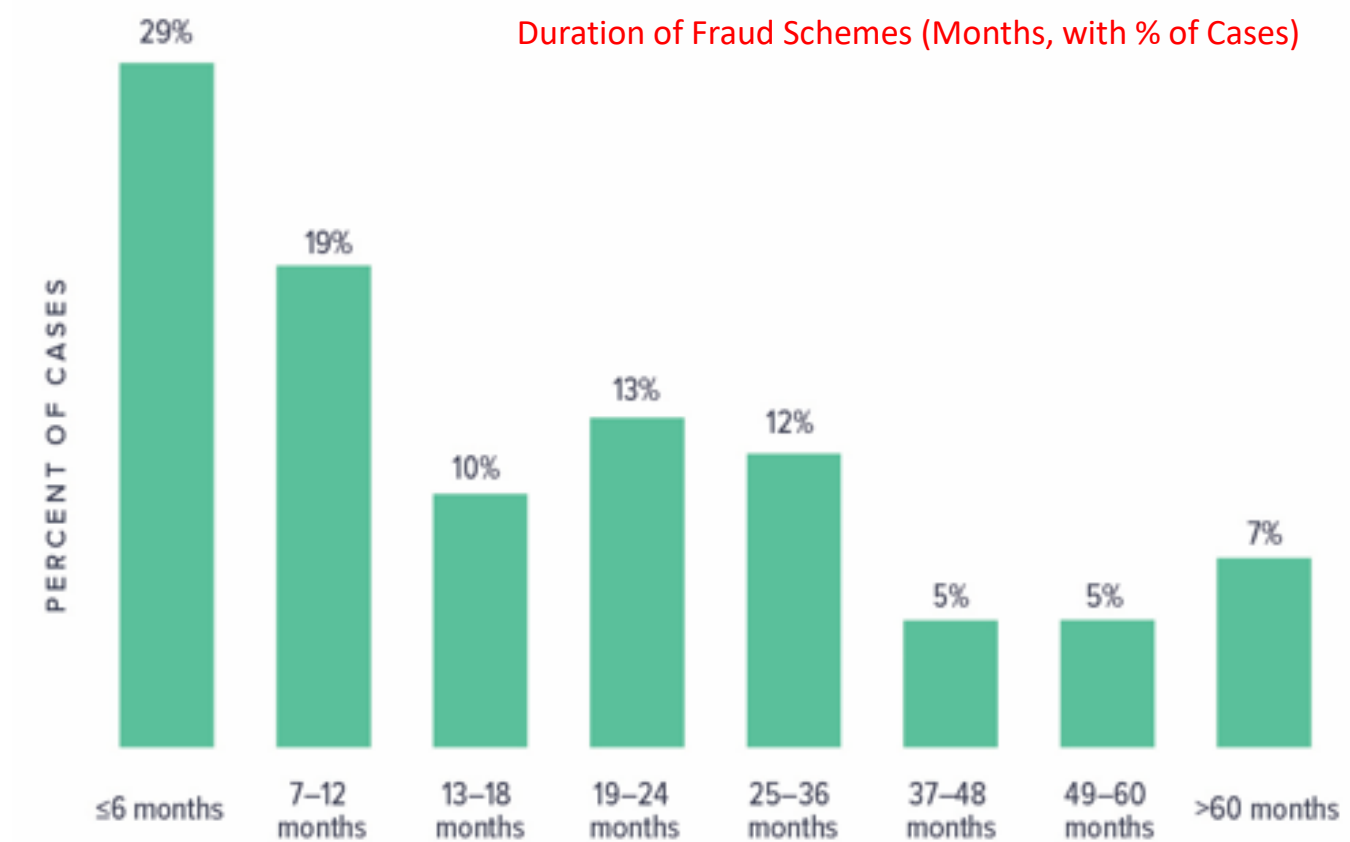
FIG. 38 How does the number of perpetrators in a scheme relate to occupational fraud?

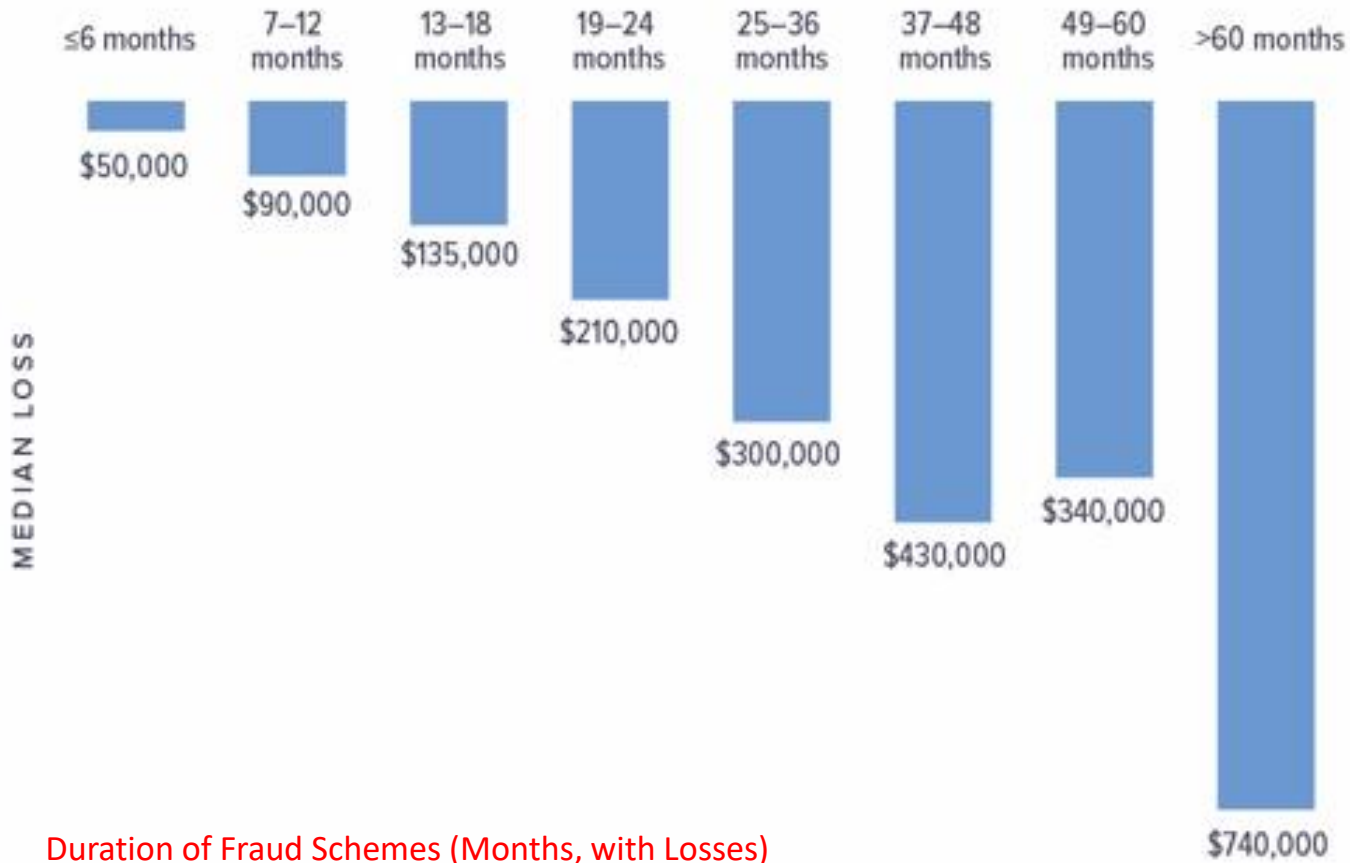


Fraud Prevention and Detection

- What can I do in my organization to prevent and detect fraud?
- How do I help mitigate fraud risk?
- What does the future of fraud look like?







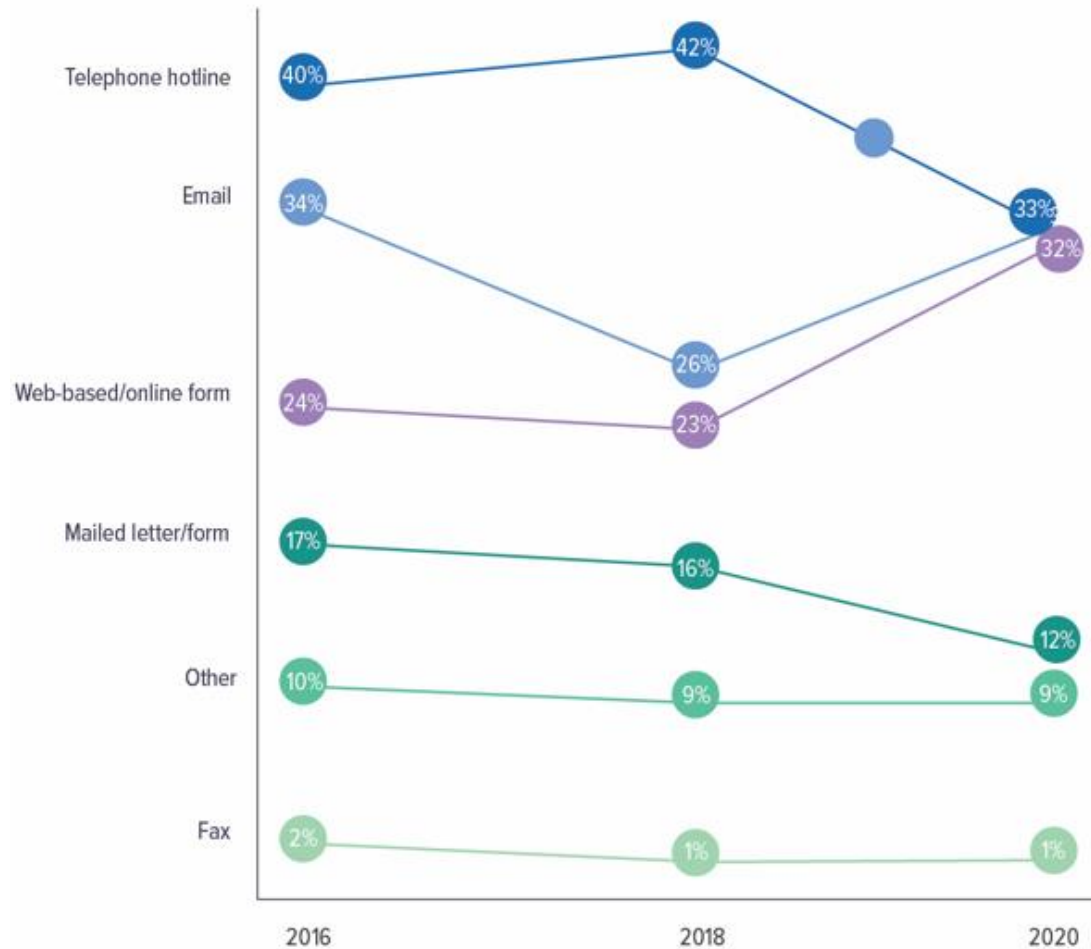
Duration of Fraud Schemes (Months, with Losses)

Fraud Prevention and Detection

Lesson #1: Prevention is far less expensive than detection (and the consequences thereafter).



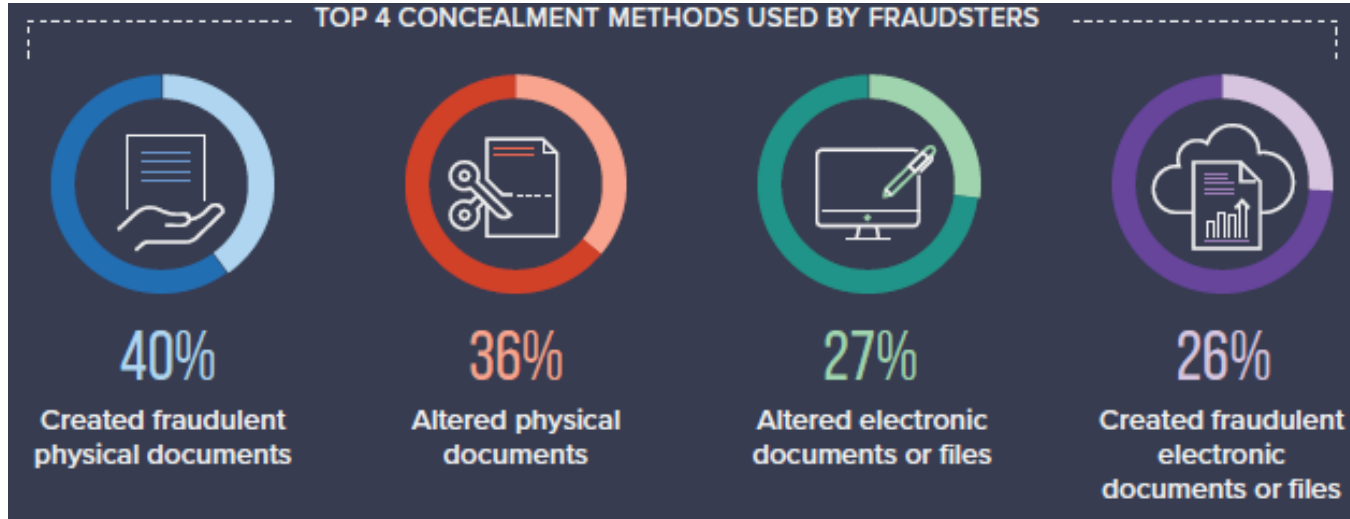




Fraud Prevention and Detection

- Increasing the
“Perception of Detection”
 - Examples
 - ◇ Physical security (cameras)
 - ◇ Known internal controls (management review of information)
 - ◇ Code of Conduct (enforced)
 - ◇ Team Meetings (where fraud is discussed)





Fraud Prevention and Detection

Lesson #1: Prevention is far less expensive than detection (and the consequences thereafter).

Lesson #2: The Perception of Detection is one of the most effective prevention concepts.



Fraud Prevention and Detection

– Proactive Audit Procedures

- ◇ Budget to Actual Analysis
- ◇ Review of Vendor Master File
- ◇ Payroll Audit



Fraud Prevention and Detection

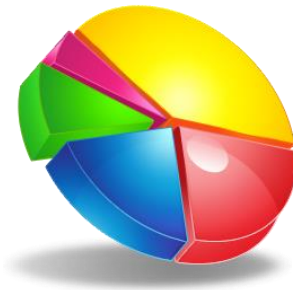
– Use of Analytical Review

◇ Data Analytics

- Benford's Analysis

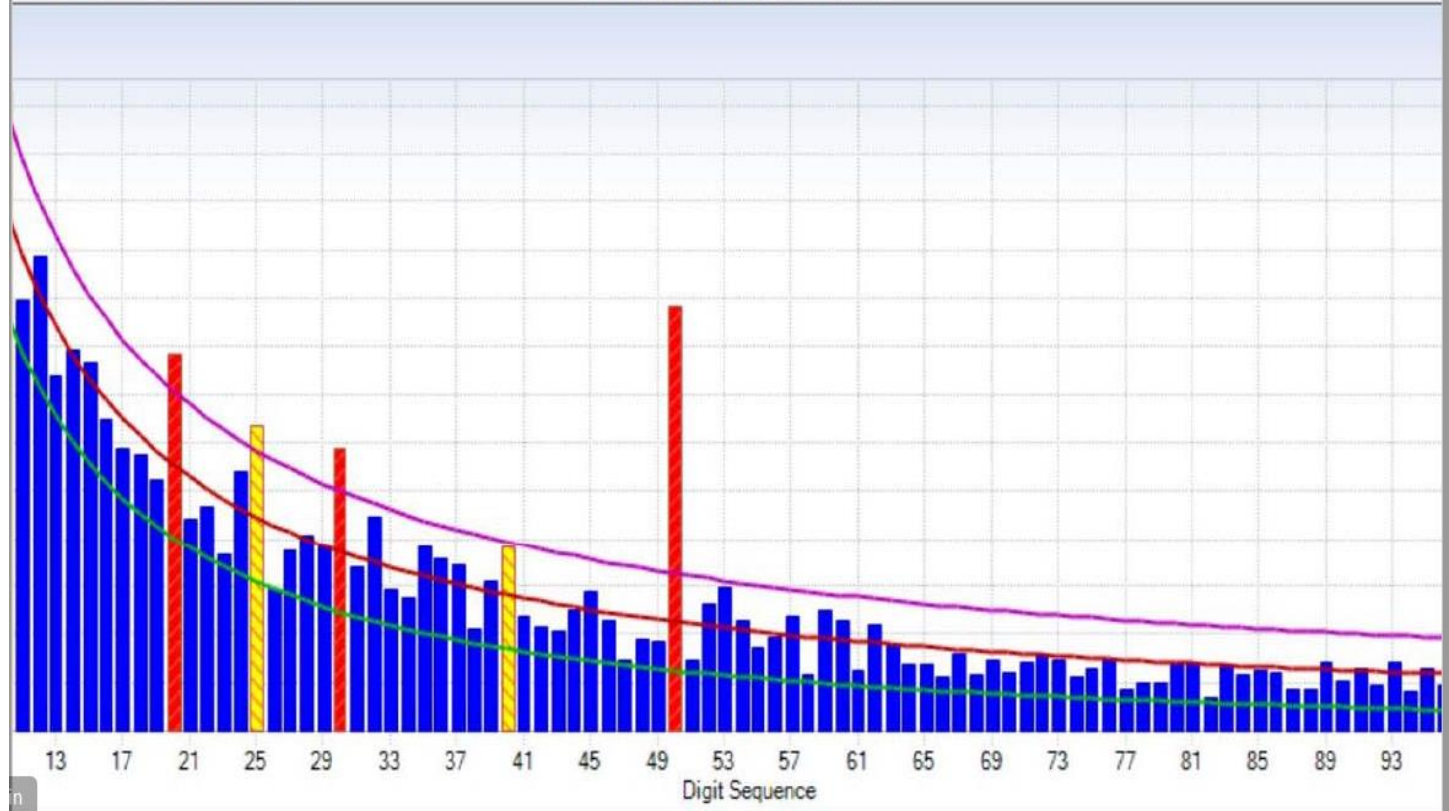
◇ Purchases by Vendor

◇ Journal Entry Dates



ate Deviation: 0.00211
Marginally acceptable conformity

AMOUNT
First Two Digits - Positive Values



Fraud Prevention

- Surprise Audits



Fraud Prevention and Detection

Lesson #1: Prevention is far less expensive than detection (and the consequences thereafter).

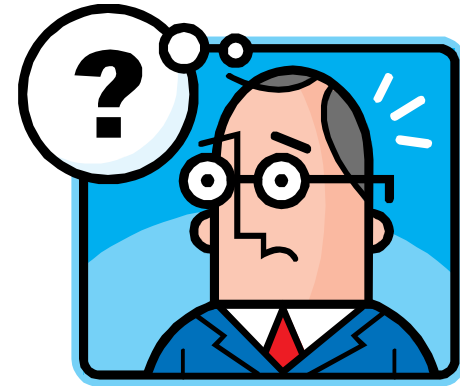
Lesson #2: The Perception of Detection is one of the most effective prevention concepts.

Lesson #C: A formal Fraud Prevention Program is critical to fraud prevention and detection in every organization, regardless of size.



Fraud Prevention and Detection

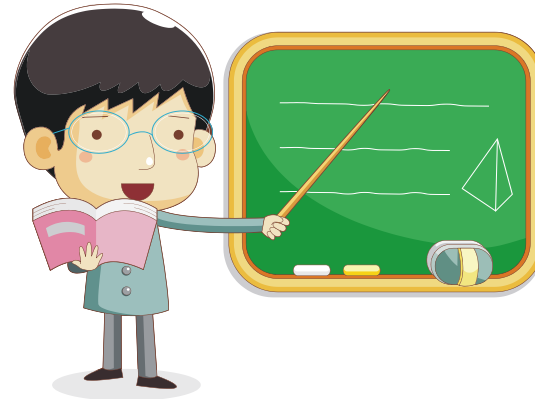
- Fraud Prevention Program
 - Brainstorming
 - ◇ Think like a criminal!
 - Monitoring existing internal controls
 - Implementation of internal controls
 - Policies and procedures



Fraud Prevention

– Employee Anti-Fraud Education

- ◇ Formal training
- ◇ Team meetings
- ◇ Ethics training
- ◇ Code of conduct



The Future of Fraud

The future is here!

- Blockchain technology
- Electronic transactions
- Internet of Things (IoT)
- Cell phone based applications

The Future of Fraud

We'll keep hearing about the classics...

- Check fraud
- Payroll fraud
- Physical theft of assets
- Corruption
- Skimming

Fraud Prevention Checkup



Fraud Prevention Checkup

1. Fraud risk oversight



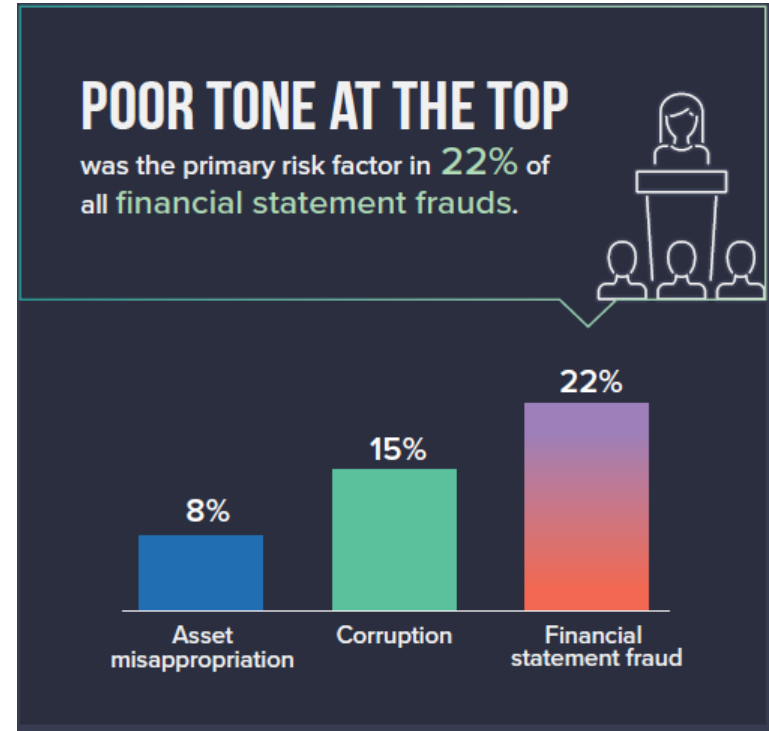
Fraud Prevention Checkup

2. Fraud risk ownership



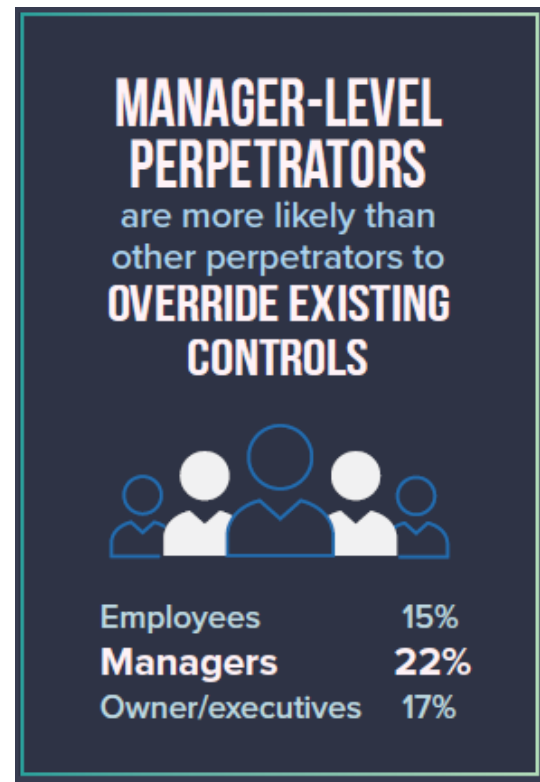
Fraud Prevention Checkup

3. Fraud risk assessment



Fraud Prevention Checkup

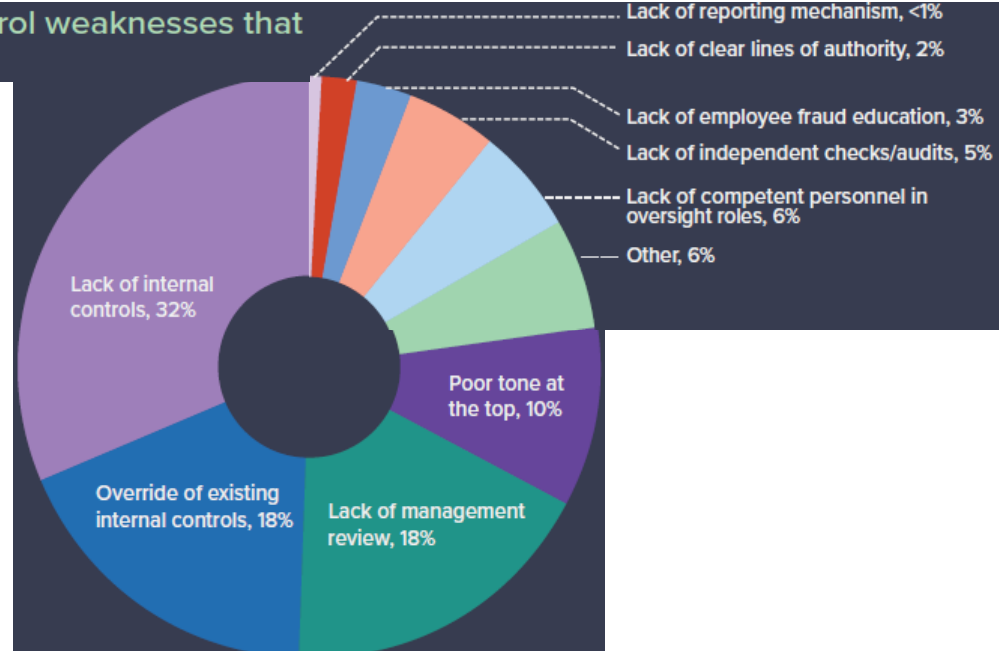
4. Fraud risk tolerance and risk management policy



Fraud Prevention Checkup

5. Process-level anti-fraud controls

What are the primary internal control weaknesses that contribute to occupational fraud?



Fraud Prevention Checkup

6. Environment level anti-fraud controls



Fraud Prevention Checkup

7. Proactive fraud detection

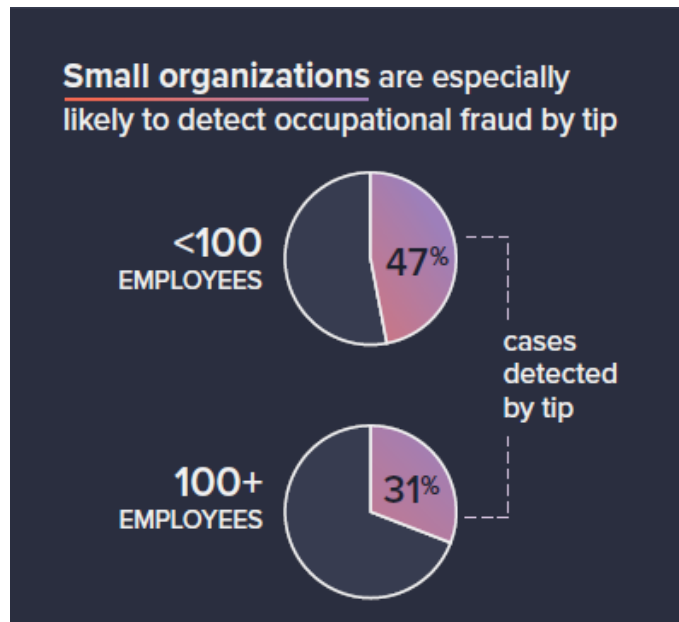


FIG. 16 How does an organization's size relate to its occupational fraud risk?





Key Concepts and Takeaways

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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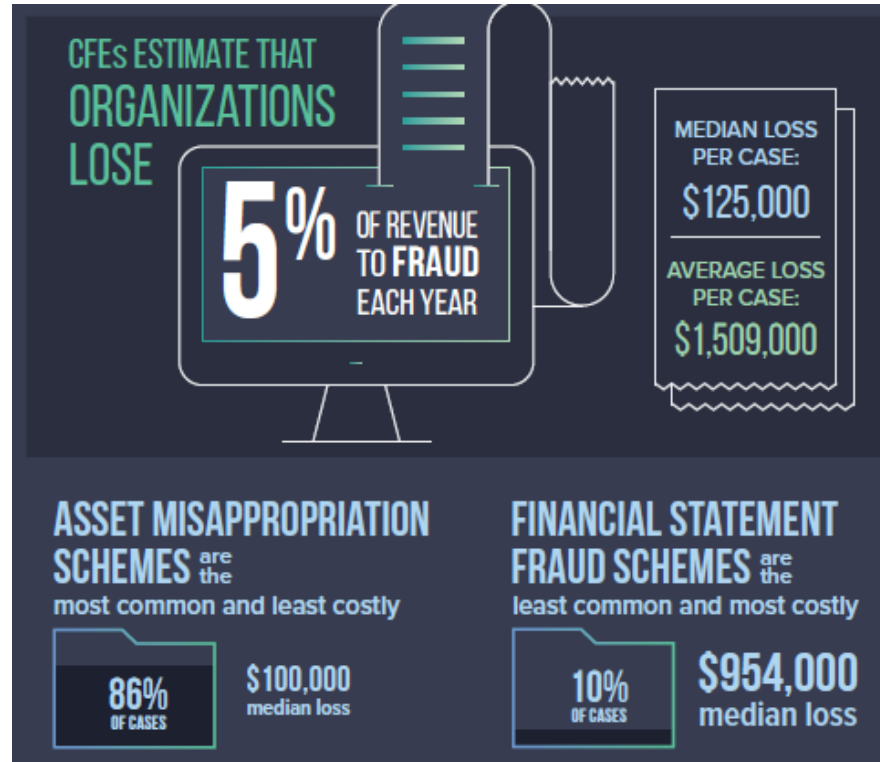
Key Concepts and Takeaways

- Elements of the Fraud Triangle
 - Motive / *Opportunity* / Reconciliation



Key Concepts and Takeaways

- Stats



Key Concepts and Takeaways

- ***Tips*** from ***Employees*** most common initial detection method.

Key Concepts and Takeaways

- **Perception of Detection**
- **Fraud Prevention Program**



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