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CPE NETWORK

ACCOUNTING & AUDITING REPORT

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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Susan Longo, CPA, explores the critical aspects of identifying, evaluating, and documenting uncertain tax positions, a key requirement under GAAP. Emphasis is placed on the importance of rigorous assessment, proper documentation, and understanding the more-likely-than-not standard for recognition and disclosure, covering topics like tax basis differences, state and local tax considerations, and documentation requirements with an aim to equip professionals with the knowledge to address these complex issues effectively. *[Running time: 50:12]*

Learning Objectives: Upon completion of this segment, the user should be able to:

- Recall the fundamental principles of accounting for uncertain tax positions.
- Analyze and document uncertain tax positions effectively.
- Apply best practices in evaluating tax positions across different entities and jurisdictions.
- Enhance financial statement disclosures related to tax uncertainties.
- Implement effective risk assessment and control measures for tax-related uncertainties.

PART 2. SMALL BUSINESS

Chris Martin, CPA, discusses the Acts Discreditable Rule which applies to all members and addresses a wide range of professional and personal behaviors that can impact the integrity and reputation of the accounting profession. The discussion includes exploring some specific acts that are considered discreditable to the profession, their implications, the responsibilities imposed on CPAs, some real-world examples, avoidance techniques, and actionable insights to ensure compliance with the profession’s ethical standards. *[Running time: 44:29]*

Learning Objectives: Upon completion of this segment, the user should be able to:

- Identify acts considered discreditable under the AICPA Code of Professional Conduct.
- Evaluate the impact of personal and professional actions on the integrity of the accounting profession.
- Develop strategies for compliance with ethical standards.
- Understand regulatory expectations and disciplinary actions.

ABOUT THE SPEAKERS

Susan Longo, CPA, provides financial reporting services to industry and CPA practices throughout the United States and Canada. Having been recognized as an "Outstanding Instructor" by the AICPA and numerous state CPA societies, she has authored, edited, and instructed courses in accounting, auditing, nonprofits, and governmental entities for leading providers in the continuing professional education field. In addition, she has served as director of development for the AICPA and as accounting department/MBA chair for two universities. Her practice expertise is in compliance auditing for nonprofit organizations, governmental entities, employee benefit plans, HUD, financial institutions, broker-dealers, CIRAs, and contractors. After graduating from the University of Michigan, she joined a national accounting firm, where she received extensive auditing experience with governmental agencies, Fortune 500 companies, and in business consulting.

Chris Martin, CPA, is a self-employed CPA who offers financial management, accounting, and education practitioner/consultant services to clients throughout the US and internationally in Bermuda and India. He has 30+ years in the accounting and accounting education professions, having worked with Checkpoint Learning since 2003. His public accounting career included such positions as senior manager at Andersen and as CFO for an SEC-registered communications company based in Atlanta.

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PART 1. ACCOUNTING

Bi-Monthly Accounting Alert

Welcome, everyone, to our first session on the A&A portion of this month's program.

In this session on accounting for uncertain tax positions, we'll explore the critical aspects of identifying, evaluating, and documenting uncertain tax positions, a key requirement under GAAP. We'll emphasize the importance of rigorous assessment, proper documentation, and understanding the more-likely-than-not standard for recognition and disclosure. We'll cover topics like tax basis differences, state and local tax considerations, and documentation requirements with an aim to equip professionals with the knowledge to address these complex issues effectively.

Now let's join Susan Longo, CPA, who will lead us as we delve into accounting for uncertain tax positions.

Ms. Longo

Welcome everybody to the Bi-Monthly Alert. As you do know, this year what we have done is the odd months are our Accounting Alerts, and the even months are Auditing Alerts. This being September, this is an Accounting Alert.

So what we want to talk about today is Accounting for Uncertain Tax Positions. I think that what has happened is that this has become a, pretty much boilerplate that people don't really understand the risks related to an uncertain tax position. They have not properly evaluated uncertain tax positions. There isn't any documentation of that evaluation. And what we have just devolved to is a little statement in the tax status that says, you know, there aren't any uncertain tax positions. The fact of the matter is uncertain tax positions are all over the tax return and all over the financial statements. The concern is that they have not been evaluated to know if they rise to the level of either an extended disclosure or the actual recording of a liability. So the intent with today's webinar is to spend time to make sure that the appropriate evaluation has been performed and that it is properly documented. Step back a minute and let me remind you, this is a GAAP requirement. So it does not matter if it is a compilation, including a compilation without disclosures, a review, or an audit. So it has nothing to do with the level of service we're providing. It has everything, everything to do with the financial statements. And for those of you that say, "I'm not worried about it because all my clients do tax basis financial statements," remember the rule: if the transaction is GAAP-like, then the disclosures are GAAP-like. So because the tax positions are in the tax basis financial statements, all of the disclosures would likewise be included in those statements. All right.

So a reminder that the adjustment to, and the addition to, the income tax topic, which is Topic 740, was included so that we were not trying to go through the contingency evaluation of, "is it probable and estimable," but it is instead a "more-likely-than-not standard." The more-likely-the-not standard says it's greater than a 50% probability that we in fact have an uncertain tax position that would be sustained upon examination that results in an additional liability. And the additional liability can be a direct settlement, or it can be the reduction of what had been booked as a deferred tax benefit.

So how do we start looking for these things? How do we begin our evaluation process? And the first thing to do is to recognize that these, the analysis is very much a corollary to the analysis that you would be using when we're looking at an estimate, and the tax calculation is nothing more than an estimate. So what we have to do is look at the data and the assumptions behind that data for the estimate called taxes. And then we're going to figure out whether or not we have an additional liability. So we start with an understanding of all the tax positions that are sitting in our entity's tax returns. And we use, you know, 1120 for corporations, as an example, but it is not limited to that type of entity. So make sure you understand that uncertain tax positions, for instance, would just as easily be included in Form 990 for a nonprofit. And therefore the uncertain tax position disclosure would likewise be there, even though the nonprofit itself may not pay taxes at the federal level, there are, that is a determination. Determination that the entity is tax exempt, is a tax position. A determination that certain types of income for a nonprofit are exempt and others are unrelated business income and therefore taxable, that is a tax position. We find these things not just at the federal level, but at state and local levels. And one of the important things to think about there is we have certain allocations that are done at state and the local levels. Also, we need to recognize that some of the state taxes look a little different. So we don't necessarily call it an “income tax,” but we do recognize, like in the state of Texas, we have the same kind of issues about tax positions and the various taxes paid in that jurisdiction. We look at our work papers. We look at any kind of communications from taxing authorities. We do some internal interviews, as long as people really understand what, what this means.

Related party transactions are also things that we would look at and understand that the transfer prices among entities would be something that would create an uncertain tax position. And then the ability to shelter certain income between tax jurisdictions, especially between foreign and domestic, is something we would look at. We would look at any kind of opinions and correspondence and memoranda available. We look at all the tax elections. We look at tax holiday agreements, settlement agreements, notices of assessments, tax rulings. There's just a wealth of information that gives us an understanding of where those estimates might be.

So some of the things that have to be evaluated. The fair value calculations that we have, and particularly those related to marketable securities, because there is a book/tax difference between when we create the realized and unrealized gains and losses on the tax return versus when we do it on the financial statements. The allowance for uncollectible accounts: I just want to make sure that everybody understands that this has really been expanded so that what we're now talking about is credit losses, and the credit losses, the approach to measurement of credit losses, is very different than it used to be. So once we're starting to look at things like a reasonable forecast to build into that allowance, that estimate looks very different than what we have on the tax side. Any impairments of notes receivable: I do remind you that that would also include the shareholder receivables, and that becomes, I think for some entities, problematic in that there are no payments being made and no intention for the payments to be made. There's a difference in the GAAP accounting for installment sales. We have to look at inventories and the valuation of inventories. That valuation and timing related to long-term contracts, especially if you are in the construction world. The tax basis of equity investments versus the GAAP basis. Capitalized advertising costs.

Capitalized leases. And when we look at property, plant, and equipment, this is a prime example, and I think an easier example, to identify the fact that when we're evaluating tax positions, we’re not evaluating it at the gross number. We have to really look at the composition, if you will, of the estimate. So for property, plant, and equipment, an estimate is the basis, an estimate is the depreciation, an estimate is related to capitalized interest, etcetera, etcetera, etcetera. And so I think that too often we get a kind of a simplistic view of the various tax positions by virtue of the fact that we just do a quick comparison at the financial statement level and kind of move on when we really need to dig a little deeper. Sometimes we need to disaggregate by a component. So property, plant, and equipment is an example where we would have to look at things quite differently for the building, the equipment, the vehicles, and whatever. And so in the tax positions, we need to be sure that we really do have an appropriate and comprehensive inventory of those tax positions.

Intangibles, the same way, we have to look at the various types of intangibles, those that are amortized and those that are not and the basis for them, and then make sure that we have the various GAAP rules properly accounted for and be able to identify the difference on the tax side. Share-based compensation: the FASB’s been working a lot on that, and the basis of a lot of different things are quite different there.

So the tax position, they're just, you literally will walk your way down. What, you will literally walk your way down the balance sheet and the income statement to find all of these. So somebody asks, “Does it apply to pass-through entities?” And the answer is “Yes” and “Yes, but.” So we do have a, an adjustment to the Topic 740 that said, if you are a pass-through entity and you're not required to pay taxes, that the allocation of current and deferred taxes to those entities, if they are a component part of a consolidated return, doesn't have to occur, but you can elect to do so. So the answer is “Yes.” But if you've made that election, and it is an election, so therefore that would have to be documented, that those charged with governance, not you the practitioner, those charged with governance have elected this exception. But more importantly, the tax positions taken at the state and local level for these pass-through entities will look quite different, and therefore, when we're evaluating this, it is not just at the federal level, but it is at the state and local level, and the rules are quite different and therefore more likely to generate these tax positions.

So again, as I said, what you're -- I've just given you kind of a menu of items. Remember, you have to document the evaluation. It's not the fact that you come up with an answer that says, “We don't have any of these things, and therefore we don't have a liability, and we don't have any disclosures.” You have to document the evaluation. So you need an actual workpaper that includes all of the tax positions that should be evaluated. And then for those that are applicable, we see the evaluation. For those that are not evaluated, we need the documentation as to why that tax position is not an issue. So please understand, the evaluation is both the tax positions that are evaluated and the tax positions that are not. So I need the evaluation, which is a conclusion, and the basis of that conclusion. And we're not seeing a complete evaluation.

Now at the meta level, please don't forget that we can, you know, play with the numbers, but I have to start with some major global kinds of positioning, if you will. First of all, did you actually file a tax return or not? And it may well be that there's a decision that in a particular jurisdiction there isn't nexus and therefore we don't need to file a tax return. That is a tax position. That is a tax position that can be challenged. So again, you need to document the tax position that says, “No, you know, we are going to file in these five states, but not in these four states where we actually do have operations, but they don't meet the definition of nexus.” That's an example. The allocations between tax jurisdictions is a tax position. And please remember that the allocations can be looking at the income-tax piece of it, but there are other taxes that operate like an income tax. It's just that the state opts not to call it that for political reasons, you know, “We don't pay income taxes in this state.” Well, if anybody has ever done any tax analysis as to which states are more costly for the total tax burden, those that don't have an income tax don't come out as cheaply as they have advertised the simplistic view that, “We don't have an income tax.” The characterization of income means, “Do you have it as an ordinary income bucket or as a capital bucket?” And that is particularly important in Topic 740. It is particularly important in the evaluation here. The decision to exclude certain types of income or to limit the income. So the exclusion and the limitation are all parts of the tax code, and they do look quite different when we compare what's happening on the GAAP side. And then the decision to classify transactions, entities, or other positions as tax exempt. And we're not talking about a tax-exempt entity. It's beyond that. So, yes, it's the entity, but it's also transactions and other positions. So all of that needs to be evaluated. So you have to document the evaluation. So once you've got a list of the things that can be tied directly to the financial statements, then we need to look at these net issues as well.

So we need to be sure that everybody understands that we are looking at tax positions on an individual basis. So it is not a case of netting and saying, “Well, the net position is.” You look at each position, so each of the items that we were listing. We need to understand that to evaluate, there needs to be a certain amount of support for that position. I think that practitioners have been lucky in their lobbying, that the documentation rules on the financial statement preparation side have never been applied to the tax side. And I think that some practitioners should admit to themselves that the quality of documentation in support of a tax return is something considerably less than in a support of the financial statements. And often times it's nothing more than some sort of tax organizer with a bunch of forms that have been, you know, stapled to the thing, and not, that the rigor of what we've got is not quite the same. So we do need to make sure that each position has what would be considered appropriate support, and we need to make very sure we understand that the taxing authority has its own view. And for those of you who work in this area, you are very much aware of the work programs that taxing authorities utilize upon examination and the kind of support that they may ask to be generated. And it would be nice if we were doing it before the fact instead of after the fact. We will look at the reporting unit. The reporting unit may be the entire entity, or it may be some subpart of it, a division or subsidiary or department or whatever. It literally has to be evaluated at the transaction level and at the line-item level. So when I talk about, “you can't aggregate,” it means that I don't have a tax position for inventory. I don't even have a tax position by inventory category. I don't even have a tax position by invoice that generated the inventory measurement. I have it by line item on the invoice. So that is the unit of measure I get all the way down to a line item on an invoice. And again, it depends upon how the tax return is prepared to know the extent to which I have particular sub-entities, groupings, and that sort of thing, that is included in the tax return.

So you have to understand, again, that multiple transactions can be challenged individually. So when I literally say that we're down to a line-item on an invoice, I literally mean on a line-item invoice. So there may be a challenge to inventory. There may be a challenge to revenue, and it does not mean that the taxing authorities are going to look at that aggregate number, but it will be broken down by the type of inventory. It'll be broken down by the type of revenue. It'll be broken down by a customer because its contracts with customers. It will be down to a sales invoice and multiple lines on that invoice. So it is challenged at the micro level. We do have to remember that there are documentation requirements, and those documentation requirements have to be followed. We find that particularly difficult in any fair value measures because we don't generally see the appropriate support. A broker-dealer statement is not support. It's not audit evidence. It's not going to be support here, either. And so the documentation requirements and the tax position that says this is a derivative, it is effective as of the beginning of that relationship with the counterparty. And we have documented that it is a derivative. At that point, you know, all of that kind of thing gets a little bit squishy. People just don't have that documentation unless you're larger entities. And so we have to recognize the requirements for that, the documentation, the GAAP requirements, and the tax requirements and make sure that we do have that. We need to look at the appropriate tax opinions. What I tend to remind people here is that those opinions apply in certain tax jurisdictions, and what we tend to see is we get a favorable opinion in Texas and we're going to try to apply it in New York, and that won't work. So it does, the opinions do have to work, to look at the tax jurisdictions, and then you closely have to look at the facts in the case because what often happens is there are some unique wrinkles that don't apply for your client and then you're not on solid ground and to say, “Look, I have support for the tax position.” You also need to know that for some clients, the challenges to their tax positions in the tax return occur quite frequently. This is just the sort of the normal, ordinary. I remember when I was first starting to do a lot of the consulting in this area that I met up with somebody as a potential client and they said, “You have to understand my perspective.” And I went, “OK.” And she said, “I understand completely what you're talking about are these tax positions, but from my perspective, when I file a tax return, it's my first offer to the IRS, and then we start to negotiate.” So we need to make sure that -- there are clients out there that have had a lot of history where their tax positions quite frequently are challenged and now they are, in some cases, quite successful and they really wind up sort of arguing the same case, and successfully, year-after-year. And because, you know, the IRS takes different positions from year-to-year and examiners changes from year-to-year. So we have prior history and know the success rates.

So an uncertain tax position is recognized in the income tax return, in the financial statements, in any of the tax adjustments, and in our income tax provision. So that uncertainty is there. It is a reminder, it is there. The question is, “Does it rise to the level where we need to do something?”

So recognition could occur at any point, but we need to recognize the criteria, and the criteria is a “more-likely-than-not.” So first of all, we are examination-based. This is not roulette. It is not saying, “Well, will we have an examination or not?” It is assumed that an examination will occur. So we take that off the table. We are not evaluating the probability that there'll be a knock on the door. The assumption is it will happen. The question is, is it more likely than not it'll be sustained, and that more-likely-than-not, is that greater than 50% probability. It requires a qualitative analysis and a quantitative analysis. The quantitative analysis is a series of scenarios, and those scenarios need to be built and documented. And the qualitative is based upon experience or prior positions that have been taken.

So, recognition; the position will be examined. The examination has all the relevant information necessary or can acquire it. You can't offset a plus and a minus. Every position is evaluated. It is based solely on the technical merits, which means it is solely based upon tax law and regulation and opinions and memos and that sort of thing. And the conclusion is based upon the court of last resort. That is that we are assuming that this can go all the way through to the highest levels. And that is what we need to be able to evaluate, that in fact it would be sustained at the highest levels. For measurement, it is based upon the evaluation of all facts and circumstances that s available at the reporting date. And the conclusion is that if it doesn't turn out to the benefit of the taxpayer, the taxpayer recognizes that they will write another check. Tax positions on a consolidated entity means that what we have to do is separate the evaluation into two components. The first component is each of the entities in the consolidation is evaluated separately, and all the analysis occurs for each of the entities. And then the second level is the transactions between the entities. So the evaluation on tax positions for consolidated global entity looks a little bit different.

So the current tax return should include only tax positions that meet that more-likely-than-not criteria. If it doesn't meet that criteria, it should be excluded. And when it's excluded, that means you have a separate liability, so if it doesn't rise to that level, then we automatically book a liability. Now that liability is actually a payable because we have a disallowed tax benefit. That liability can also be viewed as a deferral of a tax benefit until the uncertainty is reduced or eliminated. And it has nothing to do with our initial calculation of deferred assets and liabilities. That is a totally separate calculation. So deferred assets and liabilities are these temporary differences. But these are tax positions and that looks very different.

All right. Tax positions must meet the more-likely-the-not criteria. If it doesn't meet the criteria, then there's no difference between book and tax and no deferred tax asset. The deferred tax asset in all cases gets adjusted for the probability analysis, if that threshold is met. And so we apply this to our temporary differences also to carryforwards and tax credits. The evaluation allowance is not an offset. The liability has to be recognized. It's an actual journal entry for a liability. And any tax planning strategy can be used as long as, again, it meets the criteria of more-likely-than-not.

So here's an example. The financial statements report income before income taxes of 200,000, consisting of revenue of 300,000 and an estimate of expense of 100,000 recorded through the recognition of a liability. We believe that $100 of the estimated expense is not deductible in the current year return but has a tax position that says when the obligation is paid next year, it'll be deducted. Understand it's a pretty simple example, but a pretty realistic one. We got an accounts payable and an expense reported in the current year. Next year it's going to be paid. And the assumption is when it's paid, that's when it becomes deductible on the tax return. So the tax return showing a taxable income $300, reports a tax of $63, assuming a 21% tax rate, and a deferred tax asset, 21 times 100, 21% times 100, of $21. So the journal entry is the current provision and the income tax due, the deferred tax asset and a deferred tax position.

Now assuming that the tax position for the $100 tax expense is paid next year doesn't meet the more-likely-than-not criteria. So the entity would record the $63 current tax position and a $63 liability. The tax basis of the liability for financial reporting basis would be $100, the $100 less the zero deduction for the payment, there's no temporary difference so therefore no deferred tax benefit. The tax provision would then consist solely of the $63 current tax provision, which is $21 greater than the 42 that would have been retained by applying the 21% rate to the pretax income in the financial statements. This is the difference due to the fact there's no tax benefit for the $100 expense.

So therefore in the next year what happens is we can report $500 of income and no expense. The tax return for that year, the taxable income of $400, which is the revenue less than deduction of the expense recognized in the prior year, and the return would report $84 of computed tax. The provision is based upon the taxable income excluding the deduction, and the liability, the additional liability is the fact that we do not expect that to actually be sustained upon examination. But please note that that is a line item in the financial statement, and it is a separate line item. So it doesn't get buried in accounts payable, taxes payable, or anything else. It is a separate line item.

So where are we with respect to disclosures? It's important that everybody gets the full perspective, and this is the area where we find that what's going on in the financial statements is much too simplistic. So we have to make sure that the various tax positions are identified and the uncertainties related to it. The GAAP Rules require that we identify and disclose all uncertainties in the financial statements. As of today, it is virtually impossible for a financial statement to be issued without a Risks and Uncertainties footnote. The revenue requires it, the fair value requires it, and I can go on and on. Let me also remind those of you who do compilations, and especially compilations without disclosures, that the answer to this is you may not omit the disclosures if the financial statements would be incorrect, incomplete, or otherwise unsatisfactory. So you need to evaluate carefully whether or not the types of uncertainties rise to the level that we need a footnote. And please remember if you were to omit the disclosure and try to put it in the report, this is one of those disclosures that GAAP would require a reference to a footnote, so you're back to the same thing of selective information. You have to identify the liability separately. You have to identify what constitutes the differences that were evaluated under Topic 740. If this is a requirement to have a tabular reconciliation, you have to describe what is happening from year-to-year, type of roll-forward, distinguish between the uncertainties and the deferred tax assets, and, of course, any related evaluation allowance.

The disclosures are the nature of the item and the nature of the uncertainty. Please remember that this constitutes an estimate, and under our new auditing rules, a requirement that we have a separate inherent risk and a separate control risk evaluation for these uncertainties. So here's a case where, again, often times our documentation is at the line-item audit area where our audit standards now say that all the elements of an estimate, so seven things for revenue, six things for leases, how many things over here, get individually evaluated? So be sure you understand the audit requirement gets quite detailed in terms of inherent and control risk. The probability assessment, so that means we need all the various scenarios that we have created. Do I consider uncollected employee retention credits as an uncertain tax position? That one is a little bit difficult. The assumption is that the government program has been adequately funded and will pay out. Your assumption has to be evaluated that the client has provided the appropriate documentation and that they qualify under the program. So the answer is, “Yes. It is an uncertain tax position.” Does it rise to the level of more-likely-than-not? That is where you, that's what this process is all about. You have to inventory all of the uncertain tax positions. And that's where people are failing in this evaluation. Everything has to be documented. The issue is, “Does it rise to the level where we need to book an additional liability?” That's the question you have. Does it rise to the level of a liability? Does it rise to the level of a disclosure? So we know that the retention credits are an uncertain tax position depending upon the documentation. Now here's an example where I could help you with that. The employee retention credits have not all been paid in one year. Some of them it's taken two and three years for the payments to occur. If we had received payment number one and you’re waiting for the remaining payment, and there's no communication that that remaining payment will not occur because there's been no challenge to it, then I think you're in a different position then where what's happening is the retention payment is for this component of the entity, and now we're waiting for a retention credit for another component of the entity. So I, you know, it again, it's not a simple “yes” or “no.” You will book the separate liability. It will actually show up on the financial statements. We have to make sure everybody understands that that 21 percent is a flat rate. But for some entities that rate, there's a difference between the statutory rate and the effective rate. I recommend that you look at an ASU. It came out last year. That is going to require nonpublic entities to reconcile the difference between the effective and the statutory rate based upon these particular offsets, and that will affect this disclosure. And of course, we've always had to do the open tax years as well.

What we need to do, these requirements are in effect now. This is in effect. This is not something that's coming down the pike. This is what is in effect right now. And what I'm trying to help you understand is that you're not doing this the way you need to be doing it. So there's no, this is no new GAAP. This is a review of what actually exists out there and where the evaluation is not rigorous enough and the disclosures are inadequate. So we have to disclose any increase or decrease in any unrecognized tax benefit, what was taken during the prior period, taken during the current period, settlements, and any lapse of statute of limitations. Be careful. We do need to recognize that certain tax positions are in those open tax years, but we also need to know that there are certain positions that never close and certain tax returns that never close. And so we know that sometimes we have a 3-year rule, sometimes 5-, sometimes 7-, and sometimes it's just open. We need to recognize the calculation, and anything that affects your effective tax rate. We need the policy for classifying interest and penalties. We need the amount of interest and penalties and what will change in the next 12 months. And let me star that one because the new ASU which goes into effect on January 1 of ‘25, that particular disclosure would not be required for ‘25 financial statements. Still isn’t applicable for ‘24 financial statements.

So somebody asked me, do I have a sample disclosure? I would, for those of you who are on Checkpoint, there is a guide there for income taxes that has a lot of discussion about this uncertain tax position and there are some sample disclosures there. I, again, Checkpoint also has some financial statement preparation guides that have some sample disclosures, but Doctor Google has a great way of getting the answers to that because those things do pop up. The other thing that I want to talk to talk about is that there are some large CPA firms, EY, Deloitte, KPMG, PwC, Grant, BDO, RSM, and they all have their income tax guide, and they all have outstanding publications and in those publications are some outstanding sample disclosures. So there are a lot of things that are out there to help you. And that's a review of what we have to do when we have uncertain tax positions.

Bi-Monthly Accounting Alert

by Susan Longo, CPA

There are no supplemental materials for this segment. Proceed to the next page for discussion questions.

GROUP STUDY MATERIALS

A. Discussion Questions

1. What is the significance of the "more-likely-than-not" standard in evaluating uncertain tax positions?

2. How do uncertain tax positions differ across entities like corporations, nonprofits, and pass-through entities?

3. Why is rigorous documentation emphasized for uncertain tax positions, and what are the risks of inadequate documentation?

4. What challenges do practitioners face in applying GAAP disclosure requirements for uncertain tax positions in financial statements?

5. How should tax positions involving state and local taxes, such as Texas's gross receipts tax, be evaluated differently from federal tax positions?

6. How does the requirement to evaluate uncertain tax positions at a micro level (e.g., line-item on invoices) affect the compliance process?

7. What role do historical tax examination outcomes play in assessing current uncertain tax positions?

8. What are the implications of not including uncertain tax positions in a tabular reconciliation in financial statements?

B. Suggested Answers to Discussion Questions

1. The "more-likely-than-not" standard establishes a threshold where there is greater than a 50% likelihood that a tax position will be sustained upon examination. This standard is crucial for recognizing uncertain tax positions in financial statements because it ensures that liabilities or deferred assets are only recognized when supported by strong technical merit. Discussion can focus on how this criterion impacts the documentation process and the implications for tax planning and compliance.

2. For corporations, uncertain tax positions often involve federal, state, and local tax issues. Nonprofits, despite being tax-exempt, have uncertain tax positions related to determinations of unrelated business income. Pass-through entities face uncertainties tied to state and local taxes, as well as consolidated tax return allocations. Discuss how these differences influence the evaluation and documentation requirements and whether participants have observed varying challenges across entity types.

3. Rigorous documentation is essential to substantiate positions during an audit or examination and to comply with GAAP. Without it, entities risk penalties, increased liabilities, or challenges from taxing authorities. Discussion can explore real-world consequences of poor documentation and strategies for improving rigor in practice.

4. Practitioners often struggle with inadequate disclosures that fail to meet GAAP requirements, such as not including risks and uncertainties footnotes. The challenge lies in thoroughly identifying all relevant positions and presenting them transparently. Participants can discuss the balance between transparency and practicality in disclosures, especially for small or private entities.

5. State and local taxes, like Texas's gross receipts tax, may not be classified as "income taxes" but can have similar implications for uncertain tax positions. These require careful analysis of nexus, allocation rules, and state-specific regulations. The group can discuss how to navigate state-specific challenges and whether they've encountered unique state tax issues in their practice.

6. Micro-level evaluation ensures precision but can be time-consuming and resource-intensive. This granular approach minimizes aggregation errors and provides detailed insights into each position. Discussion can center on the practicality of implementing such detailed evaluations and whether technology or automation tools can streamline this process.

7. Historical outcomes provide insights into how tax authorities interpret certain positions, which can inform the likelihood of sustaining similar positions in the future. However, changing regulations or tax authority perspectives may alter this evaluation. Participants can debate how much weight historical outcomes should carry in the assessment process.

8. Excluding uncertain tax positions from tabular reconciliations can lead to incomplete or misleading financial statements, increasing audit risks and undermining stakeholder confidence. The discussion can address how reconciliation enhances transparency and what barriers prevent some organizations from fully complying with this requirement.

PART 2. SMALL BUSINESS

Acts Discreditable

Welcome to the second and final program section on the A&A portion of this month's program. In this session, we'll be looking at the acts discreditable rule.

This rule applies to all members and addresses a wide range of professional and personal behaviors that can impact the integrity and reputation of the accounting profession. During this session, we'll explore some specific acts that are considered discreditable to the profession. We'll discuss their implications and the responsibilities imposed on CPAs. We'll examine some real-world examples, discuss avoidance techniques, and provide actionable insights to ensure compliance with the ethical standards of the profession.

Now let's join Chris Martin, CPA, who will lead us as we delve into this critical topic that safeguards the trust and credibility inherent to the accounting profession.

Mr. Martin

Hi, my name is Chris. Welcome to today's presentation. We're going to be talking about The Acts Discreditable Rule of The Code of Professional Conduct from the AICPA. Now when we start talking about ethics in a broader context, right, we often describe it in terms of doing the right thing and having integrity. The Acts Discreditable Rule of the AICPA Code of Professional Conduct is the shortest and the simplest of all the rules that are out there. And fortunately or unfortunately, it's the only rule that applies to retired or non-working CPAs as well. And we'll be seeing a breakdown of The Code of Professional Conduct into the various parts a little bit later. But again, this is the only one that applies across the board to all members of the AICPA. And it's also the most all-encompassing of all the different AICPA ethics rules as well. So we're going to be delving into that just a little bit more and taking a look at what specifically is allowed and what's prohibited in the code. But then we're going to kind of look outside of the box from that standpoint to see how far this particular rule applies into our lives as CPAs, when we're on the clock and when we're not. So it's a very interesting topic and we'll be delving into all those various items in just a couple of minutes. For right now, you see my bio. I've served many, many years in public accounting. I also served many, many years as a CFO outside of the public accounting sphere, and I've been teaching auditing and accounting related courses for the last 20 years or so. So I've been dealing with The Code of Professional Conduct in many, many different ways and very different roles throughout my entire career. In this particular topic today, The Acts Discreditable Rule, I find it to be very interesting for the reasons that I just described. So let's go ahead and jump into our learning objectives and talk about what we're going to be talking about here together today.

You see your learning objectives coming on. And before I get into those, let's just think through for a moment just overall ethics in general. So CPAs, certified public accounts, have countless ethical responsibilities, and I'm sure that you've taken other ethics related courses over the course of your particular career. Now, the AICPA's Code of Professional Conduct contains descriptions of all the different ways that we as CPAs then can put ourselves in danger of losing our professional licenses and ultimately our careers, right? There are a lot of consequences to breaking the ethics rules and regulations that we all have agreed to follow voluntarily, by the way, right? There's a preamble to the code that basically says that membership in the AICPA and adherence to the code is voluntary. And so you are, by accepting this Code of Professional Conduct, putting yourself into that particular position where you're agreeing to abide by it. Now, one of the advantages today and one of the things that we're going to be talking about is one that encompasses basically a wide range of professional and personal indiscretions, again, called The Acts Discreditable Rule. Now these acts were prohibited in Section 400. We're going to be looking at that here in just a moment. And they define an Acts Discreditable to the accounting profession as unprofessional conduct under the rules that also are then followed by the State Boards of Accountancy. Now we ask ourselves then what kind of acts would bring discredit to the entire profession? Are these limited to our performance of our professional engagements, or can they extend into, let's say, private decisions or private actions that don't directly relate to the services that we provide to our clients?

Now these particular types of open questions and the broad contours of the rule indirectly then forces all of us to really evaluate our conduct in all spheres of our life. And we're going to find in just a moment that the AICPA's Code doesn't clearly define what constitutes this Acts Discreditable. It does provide some specific examples of such conduct, most of which are relatively obviously in our baseline ethical violations that relate to work that's performed for our clients or in our professional interactions with the general public. And we're going to be going into all of those various examples here in just a few minutes as we get into the materials for today's presentation. Section 400, though, also specifically identifies some prescribed conduct that doesn't directly relate to our services or our interactions with our clients, governmental bodies, or even the general public. Instead, they involve some personal choices and behaviors that, according to the AICPA, reflect poorly on and therefore, in their opinion, bring discredit upon our entire profession as a whole. Things like, for example, discrimination or sexual harassment, employment practices, failure to file personal tax returns, cheating on the CPA exam. Now when we start looking at these types of examples of things that are outside of our professional lives but yet still bring discredit to our entire profession, we have to stop and pause for just a minute, be like, well what else might be included in those particular items because the AICPA kinda left it open for us. These specified personal transgressions, although they seem like no brainers in terms of exposing us to licensing and maybe ethics trouble, many of our colleagues fear that the problem is the AICPA left the door too wide open for the possibility that other personal conduct might also constitute an act discreditable. And we've also found then that state licensing bodies have shown that they have no problem walking through that particular door. A recent study, as a matter of fact, looked at how these "social crimes," that is, those types of activities that don't directly involve our performance of our professional duties, these crimes are often the basis for disciplinary action. Such acts, as like for example, maybe driving under the influence, nonpayment of child support, drug possession. These violations actually comprised over 10% of the disciplinary actions that were taken by certain Boards of Accountancy in California, Illinois, New York, and Texas that were the subjects of these particular studies. Other state and federal convictions, including things like maybe financial felonies and misdemeanors unrelated to professional engagements, make up over 27% of those disciplinary actions. These included things like, of course, money laundering, drug dealing, immigration fraud, assault. Now, of course, a lot those, you go, wow, if you're doing those, I might question your ethics or your integrity as my CPA if you were laundering money for a particular organization. But again, things like maybe drug dealing or immigration fraud or even assault sometimes—should that impact my professional license, my career? Maybe, maybe not. That's the subject that we want to talk about here today. Something like driving under the influence as a serious transgression as that is. If that brings discredit to the accounting profession, it allows the possibility that other conduct that's equally unrelated to the actual work that we do could be the basis of professional discipline. This makes us think long and hard about our actions even when we're off the clock. Make sure that you expand this knowledge into those particular realms and how that might apply to the types of activities that you get involved with, again, outside of work. Let's take a look at our learning objectives that are on your screen right now. Upon completion of this On-Demand webinar, you should be better able to first of all list and identify the acts considered discreditable to the profession for members in public practice, members in business, and other members. Those are the three parts of The Code of Professional Conduct. Part one, members in public practice, Part two, members in business, Part three, other members, those that are in education, those that are retired, etcetera. We're then going to apply the conceptual framework for activities that aren't specifically listed in the code, but which may then be considered Acts Discreditable to the profession. Again, this is where we start expanding outside of the actual black and white words in the code to be like what other acts or actions might again bring discredit to our profession? What could be interpreted in that particular realm? And again, there's a lot of openness to that, that we have to be really careful in considering the acts that we get involved with. Ultimately, we want to be able to walk away with some avoidance techniques to consider if we happen to be faced with a possible Acts Discreditable matter. So again, that's a pretty good walk away from today's presentation.

Now as I mentioned just a moment ago, we do have the AICPA Code of Professional Conduct and it's broken into those three parts, and I've got the different subcategories listed under each part. And you see there in the highlights, this Acts Discreditable Rule, the 1.400, 2.400, and the 3.400 is the only one that goes across the entire gamut of the various parts of the of The Code of Professional Conduct.

All right, so let's take a look at the rule itself, 1.400, 2.4 and 3.4. It basically states this. Again, remember I mentioned this one of the shortest rules that's in The Code of Professional Conduct and it basically says, you shall not commit an act that's discreditable to the profession. Period. OK, interpret it as you will, right? Again, the argument, the debate of the pros and cons of this particular rule.

So let's take a look at what the AICPA is actually put into the actual verbiage of the rule itself.

They said, hey, here's some examples of things that you can, and you cannot do. The first one we see here is Section .010 and it says basically you would be presumed to have committed an act discreditable to the profession and you're in violation of this Acts Discreditable Rule, if a final determination that's no longer subject to appeal is made by a court or some administrative agency of competent jurisdiction that you have violated any of the antidiscrimination laws of the United States, the state that you're working with, maybe even the municipality that has jurisdiction over your services, including those that are related to sexual and any other forms of harassment. OK, so not only is this potentially a criminal or a civil matter, but it could also impact the license that you hold to practice the career that hopefully you're very proud of and you've worked very hard to come into, right? So, we have to be really careful when we're employing others, right? Make sure that you work with your firm's human resources policies and procedures to make sure that you avoid any kind of discrimination or harassment types of activities because it can have a very far-ranging impact on your entire career.

Now this next one should be kind of a no brainer, right? And we're told that if you solicit or if you knowingly disclose the uniform CPA examination questions or the answers or both without the AICPA's written authorization, OK. And I know that certain firms, certain organizations do get written authorization from the AICPA, for example, you know, a lot of the different CPA review agencies, for example, they have the authority to utilize some of those questions and answers from past exams. But without that, you would be in violation of the Acts Discreditable Rule. Now if you do a real quick Google search, you'll find that a number of firms have recently been in violation of this particular one, even a couple of the big four over the last several years. And I remember one of the big four, I think it they were fined like $100 million or some extraordinary amount like that. And they were basically sanctioned in a lot of different ways by the AICPA because they were giving the questions and answers to their newly formed staff people on the CPA exam and then they were hindering some of the investigation into the allegations that they were doing that. So it can be a really big deal. And just think about it for just a moment, as CPAs, what do we have to offer the, the general public and to our clients? And a lot of times it really is our integrity, right? Take my word for it. In my opinion, these financial statements are free of material misstatement. Well, I know that if you're lying and cheating on your basic exams, for example, right? How good are you going to be at giving me an appropriate opinion that is free of personal bias, right? And in accordance with your code of conduct, OK, I'm going to have some doubts about that. So I think that's why it really becomes an acts discreditable to our entire profession. It damages all of us from that particular standpoint.

Let's take a look at a real quick example scenario. So we've got Claire, and Claire is a CPA, and she's been so busy with her company's initial public offering that she failed to file her personal income tax returns for the last two years. What do you think? Has she committed an act discreditable to our profession? Right. Well, I mean, that's a really big phrase to use for the fact that she didn't file her own personal income tax returns for two years. Do you think the answer is yes or no? Her failure to file her personal tax returns doesn't really affect the professional services that she performs for her employer. So some of us would go, well, gosh, you know what, definitely if she was not turning in the tax returns for her employer, right? But what about her personal stuff? And so we actually learned that the answer here is yes. Yes, she has. A member has the responsibility to comply with the applicable federal, state, or local laws regarding the timely filing of personal tax returns. So in this particular case, Claire is potentially in violation of the Acts Discreditable Rule as supported by the rule that's called Failure to File a Tax Return or pay a type of Tax Liability interpretation.

Here it is on your screen right now. Now notice bullet point #2 there, OK. We also have the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to the profession as well. So for those of you who might be a member in business, say you're a controller, a CFO, accounting manager, etcetera. If you have all of those different payroll taxes that you've collected for your entity, right, and you're not timely remitting those to those taxing authorities, you can also be in violation not only of necessarily of criminal or civil penalties, but also the Acts Discreditable Rule to the entire profession, right? So make sure you get those payroll taxes, and your personal taxes filed on a timely basis. All right.

Now this next one should be somewhat of a no brainer as well, right? And this particular rule, OK, .040 tells us that we would be considered in violation of the Acts Discreditable Rule if we, by virtue of our negligence, do any of the following. We make or permit or direct another to make any kind of materially false or misleading entries in the financial statements or records of an entity. OK? We failed to correct an entity's financial statements that are materially false and misleading when we have the authority to record those particular entries. Or we sign, or we permit, or we direct another to sign, a document that contains materially false and misleading information. And we've seen a lot of instances of this in the news over the last several years as well, right, where firms actually have been discredited and actually prohibited from practicing because they were materially misstating financial statements of various organizations that are out there. One that comes to mind fairly immediately is a firm called The Borger Firm. B o r g e r. You can Google that after the presentation to kind of read up a little bit more of that. But that's one of the more recent firms that has been completely disbanded and prohibited from practicing at least before the SEC and the PCAOB because they negligently reported financial information that wasn't true. OK. So we have to be really careful when we're doing that. Now, of course, this one seems like a real hallmark of our entire profession. So this one's easy to see, but it could easily bring, you know, a bad vibe onto the entire profession, again, discrediting all of the work that we do together as colleagues.

The next one here a little bit easier and applies a little bit more to those of you who might get involved and let's say governmental work or governmental audits, etcetera, or those of you that work with regulatory types of agencies. So I'm just going to read it right from the screen because this rule is pretty cut and dry and in black and white. It just says that basically many governmental bodies, commissions, or other regulatory agencies have established certain requirements, things like standards, audit standards, guides, rules, regulations that we then are required to follow in the preparation of financial statements or related information, or in performing a test or similar services for entities that are subject to their jurisdiction. We must then, if we accept one of those types of engagements, agree to follow the requirements of those organizations in addition to the applicable financial reporting framework. So we're agreeing that we're going to abide by those various rules and regulations as well. If we have a material departure then from those particular requirements, we would be considered to be in violation of the Acts Discreditable Rule unless we are able to disclose that those requirements were not followed and the applicable reasons for that. So if you had a really good reason that this particular rule or this regulation, for example, would have introduced some misleading information into the set of financial statements or whatever it is that you happen to be compiling or creating from a review or an audit standpoint for this particular engagement, then you would be in violation of those particular items.

Now, in governmental audits, certain engagements as you see there on the screen, require compliance with government auditing standards, guides, procedures, statutes, rules, regulations, in addition to generally accepted auditing standards. So for example, if you're auditing a governmental agency, you have to follow the GASB rules, right? If you accept one of these engagements, you're obligated to follow those particular requirements as well. Failure to do so, as you see in bullet point #3, is considered a violation of the Acts Discreditable Rule. Again, unless you disclose in your report that such requirements weren't followed and the applicable reasons for not following those particular requirements. Now, personally, I've never been in a situation where I did have to disclose this type of an item. But I'm sure because it's there that there are situations and circumstances that do arise where in your professional judgment you believe again that one of these particular rules or regulations would create misleading information. So therefore, you simply disclose that in order to remain in compliance with the Acts Discreditable Rule as well as other ethical rules and principles as well. So for example, like the General Standards Rule, the Accounting Principles Rule, etcetera. We happen to cover all of those other rules and other ethics trainings that we offer here through Checkpoint Learning as well. So make sure that you check your account and sign up for those other learning opportunities in the other ethics types of practices that we get involved with.

The next one here again, pretty cut and dry, and it's talking about indemnification plans and limitation of liability provisions, and typically in our engagement letters that we might sign with certain organizations. So as we see here, certain governmental bodies, commissions, or other regulatory agencies, OK, have established requirements through various laws, regulations, or published interpretations that sometimes they prohibit entities that are subject to their regulation from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by those regulators, or you provide, or they provide that the existence of those provisions would disqualify you from rendering such services to these entities. So if we then enter into or we direct or we knowingly permit another individual to enter into a contract for the performance of audit or other attest services that are subject to these requirements, then we should not include or knowingly permit or direct another individual to include an indemnification or a limitation of liability provision that would cause that regulated entity or the member themselves to be in violation of those requirements or disqualify a member from providing those services to the regulated entity. A member who enters into or directs or knowingly permits another individual to enter into an agreement for the performance of audit or other attest services would be considered in violation of the Acts Discreditable Rule. So that's a pretty easy one, right? If you're not allowed to include indemnification or limitation of liability provisions, then just don't do that and don't allow it to kind of sneak in by maybe permitting someone else to actually do that.

Let's take a look at another example scenario. This one is pretty interesting. It actually is based on a real case that exists out there as well. So we've got John, who is a partner at a large national firm, and John provided confidential client information to a close friend. That friend then initiated the stock transaction and thanked John for this information by giving him $50,000 in cash and a Rolex watch, right? So John made out pretty well here by just giving them this little snippet of information. What do you think? Did John commit an act discreditable to our profession? Now we can back up really quickly and say, hey, you know what? That was probably insider trading information. That's a criminal act. It's maybe even a civil liability act as well. But does it bring discredit to the accounting profession? OK. So as we take a look and we think about the answer that might be here, we have to remember that under the AICPA's rules, we are prohibited from disclosing or using confidential information for the benefit of ourselves or of others without the specific consent of the client. The SEC rules also address insider trading as buying or selling a security while in possession of material nonpublic information about a particular security. Now, insider trading violations also include things like tipping, OK, such information like we see here that John was doing by giving that information that was tipped certain pieces of information that they then utilize to go and either buy or sell those securities, OK. So they take advantage of that confidential information about that employer or that particular client. Now, tipping includes providing confidential information of employer or a client to our family, to our business associates, even to our friends. Now, an insider trading case again occurred at one of the big four firms when a partner leaked confidential information about two particular audit clients, OK, to a close friend. And again, as you see there on the screen, receive cash and a fancy watch in return. This act ultimately was considered discreditable to the profession, OK. And because this act also violated the independence rules, the audit reports on both of these clients had to be withdrawn by the firm, OK. So it goes pretty deeply into some of the things that we are prohibited from doing. So a lot of times if we have an act discreditable, it's probably also going to violate other ethics rules and ethics principles as well.

So let's talk a little bit more about this confidential information that we have. So confidential information again that we obtain either from our employment or from volunteer activities as well. So you don't have to be a true employee of this particular organization. So we see here you are considered in violation of the Acts Discreditable Rule if you disclose or if you use any confidential, and this could be former as well, right, employer information acquired as a result of your employment or volunteer relationships without the proper authority or specific consent of that either former or current employer or organization for whom you might work either in a volunteer capacity, unless there is a legal or professional responsibility to use or to disclose that information. So, for example, maybe you're a volunteer or you're working for a particular organization, and you know that fraud is going on, right? And you're like, gosh, I should probably report that fraud. But I also have the duty to keep that information confidential. What do I do? I'm between a rock and a hard place when it comes to the ethics of my profession. Well, oftentimes, if we know of particular illegal acts, right, then we are required to disclose those to the appropriate authority or authorities. Otherwise, it could be considered an act discreditable to our profession.

Now, let's take a look at that rule just a little bit more. When are we permitted or when are we required to disclose that confidential employer information? So luckily, the code gets into this just a little bit more to allow us a little bit more guidance in these particular situations where, again, we're kind of caught between that rock and the hard place when it comes to the ethics of our profession as well. So we see here, anytime that it's permitted by law and authorized by the employer, OK. Where it's required by law, let's say, for example, to comply with a validly issued and enforceable subpoena or summons or inform the appropriate public authorities of violations of law that have been discovered. Permitted on behalf of the employer to obtain things like financing with lenders, to communicate with vendors, to communicate with clients and customers, or to communicate with the employer's external accountant, attorneys, regulators, and other business professionals. So if you're that controller, right, then you have an obligation to your external accountant, who may be your auditor, for example. You can provide them that information and not be outside of this particular rule, OK. There is a professional responsibility or a right to disclose information when not prohibited by law, to initiate a complaint with or to respond to any inquiry that's made by the Professional Ethics Division or trial board of the AICPA or some duly constituted investigative or disciplinary body of, let's say, a state CPA society, a board of accountancy, or other regulatory body. Also protect the members professional interest in legal proceedings, comply with professional standards and other ethics requirements, or to report potential concerns regarding questionable accounting, auditing, or other matters to that employer's confidential complaint hotline or to those charged with governance if that's the body that you report to in those particular instances, OK. So again, I'm glad that the rules included these particular pieces have got us to allow us to then be better at communicating that information when it is most appropriate to do so.

Now, I remember when I was a young CPA in the state of Florida, which just happens to be where I was licensed. And I'm not sure if it's, it's still a rule there. But I remember when we would go out to do a proposal for a particular audit engagement, let's say, and we were competing against various different firms. We weren't allowed in those proposals to tell this potential new client how much we were going to charge because they didn't want it to be a bidding war where the client or the potential client was just going to hire the cheapest firm that was out there. So you basically couldn't talk about your fees. You had to talk about your competency, talk about some of the resources, some of the things that you're going to be doing as part of that to your engagement. So they would buy it based on that quality, not on the price itself. And so sometimes that was a real hindrance because a lot of times if we knew who we were going up against, for example, we would underbid a lot of those various jobs in order to get them. So I think a lot of discussions with the Florida Board of Accountancy ensued to try to say, hey, you know, we need some relief from this particular rule because it's making it harder for us to get the appropriate business and once we actually got those clients to be able to service them properly. So here's what the Acts Discreditable Rule says when it comes to false, misleading, or deceptive acts in promoting or marketing our professional services. So you would be considered in violation of the Acts Discreditable Rule if you promote or you market your abilities to provide professional services or you make claims about your experience or qualifications in a manner that's considered false, misleading, or deceptive. OK. So sometimes for example, holding yourself out as a CPA when you're not a CPA, that would be very deceptive from that standpoint, right. And even though you're not a member of the AICPA, because you're not licensed as a CPA, you're also though still considered in violation of this Acts Discreditable Rule to the entire profession. We see here in bullet point #2 these promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This would include any representation, again, about CPA licensure or any other professional certification or accreditation that's not in compliance with the requirements of that relevant licensing authority or designating body. So you hold yourself out or you let people think that maybe you're a certified fraud examiner as well, or you mislead them and they think that, hey, you're a CPA, but you're also a certified information systems auditor based on the types of questions that maybe you're asking or the conversations that you get involved with, right? People feel misled by that. So you have to be really careful when we're communicating a lot of our experience and other things that maybe we're interested in as we pursue various professional engagements as well.

Now, here's a little bit more about the use of that CPA credential. And you know every state is going to be a little bit different. And again, I'm licensed in the state of Florida, I know what the Florida licensing rules are. But as you see here in bullet point number one, you need to refer to your applicable state agency laws and your board of accountancy rules and regulations for any guidance regarding the use of your CPA credentials. So you would need to look in the various states that you hold a license. OK, I currently live in Massachusetts, and I did not transfer my license to Massachusetts, so I'm still held to the Florida rules. However, the state of Massachusetts has certain rules and regulations within their board of accountancy that says if you're an out of state CPA, here's what you're allowed to do and here's what you're not allowed to do as far as holding yourself out as a CPA. So, for example, I am required to do certain continuing education hours in the state of Massachusetts as well as in the state of Florida. We see here in bullet point #2 then failure to follow those accountancy laws, those rules, regulations on the use of that credential in any of those jurisdictions in which we would practice would be considered to have used that CPA credential in a manner that is false, misleading, or deceptive, and again then in violation of the Acts Discreditable Rule.

Here's a real quick example scenario. How about records requests? So let's say that a statute exists in your particular state that allows you to place a lien on a client's records in the event of unpaid fees. OK, so you didn't pay me, so I'm not returning those books and records that you gave me to do your tax return or to do your audit or your review, for example. So given these facts, are you obligated to return the client's records? No, not until they pay the fees they owe. Or two, yes, these records should be provided upon request. And we see here a law exists in our state that allows us to place a lien on them. But what does the AICPA require us to do? OK, so here's the answer. So if your client has fully paid all fees, OK, then you have a duty to give them back all of their documents that were elements of that particular engagement other than your working papers. OK. Working papers are documents that reflect your thought process and your analysis, OK. So the answer here is number one is not correct. You can't not return those particular client’s records. Remember that the Code requires actions above and beyond the law itself. The laws of your state do not change our profession's ethical standard, which is to return all client provided records in all circumstances. Remember, it was the client's property to begin with, not yours to withhold. You can, however, withhold documents that you prepared for the client, for example, tax returns, financial statements, etcetera, if they don't pay your fees. And you're not obligated to give them your working papers. But if those were their invoices, their reports, their check copies, their bank statements, etcetera, they belong to the client and you give those back to them no matter what. OK, so B or #2 here, yes, these records should be provided upon request. The Code does require the return of client [provided] records under all circumstances.

Here's the rule itself. Comply with the rules and regulations of authoritative regulatory bodies such as your State Board of Accountancy when you perform services for a client and are subject to the rules and regulations of such regulatory bodies. We make client prepared records available to the person or the entity that provided the records to us. The client provided records may not be withheld for nonpayment of fees. You should make available member-prepared records, the things that you prepared, related to a completed and issued work product. However, such records may be withheld if fees are due to you for that specific work product, the work is incomplete for purposes of complying with professional standards, or threatened or outstanding litigation exists concerning the engagement or your work. So here are the times when you can withhold your particular records related to this completed and issued work product. Remember, as you see there in the last bullet point, working papers are considered your property and you're not required to make that information available. However, keep in mind that certain state and federal statutes and regulations and contractual agreements could impose additional requirements. So if you happen to have these particular situations arise, you may want to, you know, at least discuss this with your legal counsel to make sure that you are not breaking the regulations and ultimately the law as well. All right.

What about in the situation where, you know, our firm sells, or we acquire another firm, or maybe we discontinued or we acquired a particular practice? Here's what the rule says here about the transfer of those particular files and return of these client records. So let's say that we have a sale or a transfer of our practice. And I know this is happening in our profession all the time. Any time this happens, as you see here, we're going to submit a request to each client requesting consent to transfer the files to the successor firm, and we allow 90 days for them to reply. We don't transfer any client files until the consent has been obtained or that 90-day consent period has lapsed. We then return any client records as set forth in the Records Request interpretation unless otherwise agreed. And we just took a look at that Records Request interpretation just a moment ago. If there's a discontinuation of the practice, so you're retiring, you're just kind of getting out of the business, we would then notify each client of this discontinuation. We again would return any client records as set forth in that previous discussion unless otherwise agreed. And if we're unable to contact the client, we have to retain those in accordance with our firm's record retention policy or as required by the applicable legal or regulatory requirements, whichever happens to be longer. Ultimately, if we're acquiring a practice, then, we have to be satisfied that all of the clients of that predecessor firm have consented to that continuation of professional services and the retention of any client files or records that the successor then retained. So again, it's all about getting your client’s consent and just being very transparent with the transfer of that information. Otherwise, you're out of compliance with the Acts Discreditable to the Profession Rule.

Let's take a look at a real quick example scenario here. So we've got Sima, and Sima is a manager of the public accounting firm of Sharma and Sharma CPAs. She recently left that firm to join Davey Jones & Company, which happens to be another public accounting firm. Well, prior to leaving, she turned in all the firm manuals, the computer files, all the other supplies that had ultimately been issued to her. And she also informed the clients that she'd been servicing of her planned move to this new firm. Some of the clients actually advised her that they might transfer their work to this new firm in the future. So prior to her final departure from her current CPA firm, she copied the files of those clients who had informed her that they might transfer their work at a future date. And when she started working at the new firm, she gave these files to one of the new partners. Has she committed an act discreditable? OK. And at face value, yeah, I think she probably has, right? So Sima in this particular case has likely committed an act discreditable in that she failed to follow proper procedures that we should adhere to when resigning, OK, such as maybe informing and submitting, informing our employer, OK, prior to leaving and then submitting all of the company's property, including documents that contain the client's information to that employer. The code states that a member who discloses or again uses any confidential information without the employer's consent and approval shall be found to be in violation of the Acts Discreditable Rule. So in this case, her actions can be considered to be discreditable to the profession as she did not obtain consent from the employer or from the client before using that client's information.

OK, finally, here we have removing client files or proprietary information from your firm, a member whose employment relationship is terminated, so you've left for whatever reason, we would be considered in violation of the Acts Discreditable Rule if we take or retain originals or copies in any format from the firm's client files or proprietary information without that firm's permission unless we have a contractual arrangement within the firm that allows such action. A firm's ownership agreement would govern the ownership of those client files and proprietary information. Accordingly, this interpretation would not apply to the owners of those firms. So if you happen to be a partner, for example, you're considered the owner of the firm. So if you happen to be leaving, you would have some kind of a contractual arrangement hopefully in your partnership agreement that would determine which clients are yours, which clients are the firms, etcetera. And so that particular agreement or contract would rule in those particular situations.

Finally here, if we happen to disclose confidential information obtained from a prospective client or a non-client without consent, so this might be in the situation where we're doing a proposal for example, and we're learning pieces of information about a prospective client, we still have to hold that in confidence, right? Otherwise, as we see here, if we were to disclose that without consent, then we would be in violation of the Acts Discreditable Rule.

So we see here that there's a lot of different things in the Acts Discreditable Rule that we have to make sure that we're in compliance with. I've got it listed out for you in this particular table over this in the next couple of slides. OK, so these are the different subtopics that we covered here in today's presentation.

But remember, outside of these, we also have to think through, am I getting involved with something that could ultimately be considered an act discreditable to the profession, particularly if it's something that's going to break a particular regulatory item or a particular law, even when it doesn't pertain to the profession itself and the professional types of activities that we perform in conjunction with our professional engagements with our clients. OK.

That being said, I hope you're now able to identify and list some of those acts that are considered discreditable to the profession. Again, there's not that many. They're very easy to remember. And anytime any question comes up about any of the items that we covered here in this particular presentation, just raise a red flag, go to the Acts Discreditable Rule. Look it up. There's an AICPA hotline that you can call if you need more information as well. Just go to the AICPA's website, which is aicpa.org. That information would be available there for you to get some consultation on particular scenarios. Again, if you need some additional guidance, we can also now apply this conceptual framework for activities that aren't specifically listed in the code, but which may ultimately then be considered an act discreditable to the profession. And I hope you feel a little bit more comfortable now walking away with some avoidance techniques and some mindset shifts that would allow us then to avoid these particular issues that could be considered an act discreditable to our profession.

OK, I want to say thank you so much for being here. Before I get there, notice that my LinkedIn link is here. I would love for you to join me on LinkedIn. That way if you have any questions about today's topic, or any other topic that we teach you in Checkpoint Learning, I'll be happy to engage with you there and answer any particular questions that you might have. So please utilize that and thank you so much for being here. I appreciate your time and your attention.

Acts Discreditable

by Chris Martin, CPA

There are no supplemental materials for this segment. Proceed to the next page for discussion questions.

GROUP STUDY MATERIALS

A. Discussion Questions

1. Why is the Acts Discreditable Rule considered one of the broadest and most encompassing rules in the AICPA Code of Professional Conduct?

2. How do personal actions, such as driving under the influence or failure to pay child support, constitute acts discreditable to the accounting profession?

3. Do you agree with the AICPA's decision to include personal misconduct, such as discrimination or failure to file personal tax returns, under the Acts Discreditable Rule? Why or why not?

4. The Acts Discreditable Rule often involves subjective interpretation. Should there be clearer guidelines on what constitutes a discreditable act?

5. In the case study about Claire, who failed to file her personal tax returns, was the AICPA justified in viewing this as an act discreditable? What lessons does this teach about compliance?

6. How does insider trading or the misuse of confidential information, as discussed in the case of John, erode public trust in CPAs?

7. Should CPAs be obligated to return client records even if the client has unpaid fees, as required by the Acts Discreditable Rule?

8. What practical steps can CPAs take to avoid committing acts discreditable to the profession, particularly in ambiguous situations?

B. Suggested Answers to Discussion Questions

1. The Acts Discreditable Rule applies to all members of the AICPA, including those who are retired or not practicing. Unlike other rules that pertain to specific professional contexts, it governs personal and professional behavior that could reflect poorly on the accounting profession as a whole. This breadth invites discussions about the boundaries of professional responsibility, the overlap of personal conduct, and how far-reaching ethical obligations should be.

2. Personal actions like these can bring discredit to the profession by undermining the public's trust in the CPA's integrity. While they do not directly relate to professional engagements, they reflect on the ethical character of the individual and, by extension, the profession. Discussing this challenges the group to consider whether the profession's standards are too invasive or necessary to maintain credibility.

3. Including personal misconduct under the rule ensures that CPAs maintain a standard of behavior that upholds the profession's integrity. However, some may argue it blurs the line between personal freedom and professional obligation. Group discussions could explore the balance between personal accountability and professional oversight.

4. While the current flexibility allows the rule to cover unforeseen behaviors, it also creates uncertainty and potential misuse. Clearer guidelines could help CPAs navigate ethical dilemmas confidently, but they may limit adaptability. This question encourages debate on whether a principles-based or rules-based approach is more effective for ethical regulation.

5. The AICPA's stance underscores the CPA's duty to adhere to laws personally and professionally. It demonstrates that failing to comply with tax obligations can reflect poorly on one's professional judgment and responsibility. This question can spark discussions on how personal accountability impacts professional credibility.

6. Insider trading exploits privileged information, compromising the CPA's role as a trusted professional. It not only damages the individual's reputation but also discredits the profession. This opens a discussion on the importance of safeguarding confidential information and the ethical implications of such violations.

7. The rule prioritizes the client's ownership of their records over financial disputes, reinforcing the profession's ethical standards. However, this can be viewed as unfair to CPAs who might struggle to recover unpaid fees. Discussions could explore alternative ways to balance ethical obligations with business realities.

8. CPAs can use avoidance techniques such as adhering to firm policies, consulting the AICPA's resources, maintaining transparency, and seeking legal or ethical advice when in doubt. These proactive measures foster ethical decision-making and ensure compliance. The group could brainstorm other strategies or share personal experiences of navigating ethical challenges.

GLOSSARY

AICPA—American Institute of Certified Public Accountant

Acts Discreditable Rule—A member shall not commit an act discreditable to the profession.

Confidential Client Information—Any information obtained from the client that is not available to the public.

Client Records—Accounting or other records belonging to the client that were provided to the member, by or on behalf of, the client, including hardcopy or electronic reproductions of such records.

Conceptual Framework—The underlying philosophy and the boundaries for judgment that will guide standard setting bodies in resolving accounting and financial reporting issues brought before the board. Being able to refer readily to the conceptual framework is a great benefit to high-quality standards-setting.

Deferred Tax Asset—The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. SFAS 109

Deferred Tax Liability—A deferred tax liability is the deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law. SFAS 109

Effective Tax Rate—Tax rate calculated as the income tax expense or benefit divided by pretax operating income as reported on the primary income statement.

Ethics—Standards of professional conduct and business practices adhered to by professionals in order to enhance their profession and maximize idealism, justice and fairness when dealing with the public, clients and other members of their profession.

GAAP—Generally Accepted Accounting Principles

GASB—Governmental Accounting Standards Board

Independence—To be independent is to be free from conflicts of interest and bias, to be self-governing, to be impartial, to not be subject to control by others, to not require or rely on something else, to not be contingent, and to act with integrity and objectivity (i.e., with judgment that is unimpaired and without bias or prejudice).

Integrity—An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.

IRS—Internal Revenue Service

Member—In its broadest sense, "member" is a term used to describe a member, associate member, or international associate of the AICPA. All members must adhere to the AICPA's Code of Professional Conduct. For the purposes of applying the independence rules, the term "member" identifies the people in a CPA firm and their spouses, dependents, and cohabitants who are subject to the independence requirements.

More-Likely-Than-Not Standard—

Nexus—The connection necessary to impose taxes is called nexus, meaning "connection." A state must have nexus over a business in order to subject that business to taxation. States have been adopting expanded versions of economic nexus.

Pass-Through Entity—An entity such as a partnership or S corporation that serves as a conduit or passageway for specific tax consequences to flow to partners or shareholders for use on an individual basis. Income and loss items attributable to the entity are passed through to be used in the computation of personal tax liability.

SEC—Securities and Exchange Commission

Tipping—Providing non-public, material information to others for their benefit, often associated with insider trading violations

Topic 740—ASC 740, Income Taxes, addresses how companies should account for and report the effects of taxes based on income.

Uncertain Tax Position—In accounting, a situation in which a taxpayer believes its interpretation of earnings recognition is less strong than what the interpretation of the IRS is likely to be. While the FASB does not allow companies to report uncertain tax positions on financial reports, they may take these positions on their tax returns in hope that the IRS will not conduct audits.

Workpapers—Workpapers belong to the CPA, are generally prepared by the CPA and do not include any records provided by the client. Workpapers include, but are not limited to, documentation of the work done and conclusions reached by the auditor, showing procedures applied, tests performed, information obtained, and pertinent conclusions reached (AU Sec. 339). The quantity, form, and content of workpapers will vary depending on the circumstance. They should, however, be sufficient to show that the accounting records agree, or reconcile, with the financial statements.

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Choose the best response and record your answer in the space provided on the answer sheet.

1. What is the primary standard used to determine if an uncertain tax position should be recognized?

   A. More-likely-than-not.
   B. Probable and estimable.
   C. Significant influence.
   D. Weighted-average probability.

2. What is a critical component of evaluating uncertain tax positions?

   A. Avoiding tax basis disclosures.
   B. Netting tax positions.
   C. Preparing consolidated financial statements.
   D. Rigorous assessment and proper documentation.

3. To which type of financial statement engagement does the requirement to evaluate uncertain tax positions apply?

   A. All GAAP financial statements.
   B. Audit engagements only.
   C. Nonprofit financial statements.
   D. Tax basis financial statements.

4. What is the required level of documentation for uncertain tax positions?

   A. Detailed evaluation and basis for conclusion.
   B. Including summaries of tax organizer data.
   C. Retaining client communications only.
   D. Summarizing conclusions only.

5. What should be assumed when evaluating uncertain tax positions?

   A. Examinations are based on net tax positions.
   B. An audit will likely not occur.
   C. An audit or examination will occur.
   D. All tax positions meet more-likely-than-not criteria.

Continued on next page

6. What documentation is required for tax positions not considered an issue?

   A. Tax organizer summary.
   B. No documentation is required.
   C. Footnote disclosures.
   D. Documentation with rationale provided.

7. How should transactions between entities in a consolidated group be evaluated?

   A. Considered only if they meet nexus thresholds.
   B. Evaluated individually and then as a group.
   C. Evaluated together.
   D. Ignored for consolidated filings.

8. What must be done if a tax position does not meet the more-likely-than-not threshold?

   A. The position is excluded entirely.
   B. The position is disclosed only.
   C. A liability is recognized.
   D. A deferred tax asset is created.

9. What action is required when a CPA accepts an engagement for an entity subject to specific governmental or regulatory requirements?

   A. Adhere to the specific governmental or regulatory standards.
   B. Avoid engagements with extensive regulatory obligations.
   C. Choose a standard based on client preference.
   D. Perform the engagement using general accounting standards.

10. Under what circumstances can a CPA disclose confidential employer or client information?

    A. When it benefits the CPA's professional growth.
    B. When required by law.
    C. When the client has not fulfilled payment obligations.
    D. When the information is already public knowledge.

Continued on next page

11. What is the consequence of negligently permitting false entries in financial records according to the AICPA Code?

    A. It is acceptable if unrelated to client engagements.
    B. It is allowed if approved by a superior.
    C. It is considered a violation of the Acts Discreditable Rule.
    D. It requires immediate correction to avoid penalties.

12. Which specific acts are explicitly prohibited under the Acts Discreditable Rule for a CPA?

    A. Disclosing CPA exam questions with AICPA approval.
    B. Soliciting CPA exam questions without AICPA authorization.
    C. Submitting overdue personal taxes.
    D. Using AICPA resources for personal financial gain.

13. What does the Acts Discreditable Rule require in engagements involving regulatory agency standards?

    A. Adhering to both the agency's rules and applicable frameworks.
    B. Following the client's preferences over regulatory rules.
    C. Ignoring discrepancies in agency standards.
    D. Notifying the agency of deviations in a separate report.

14. What obligation does a CPA have regarding payroll taxes collected for an organization?

    A. Delay remittance for up to a fiscal quarter.
    B. Retain taxes until the organization's financial audit.
    C. Seek approval from stakeholders before remittance.
    D. Timely remittance of payroll taxes to avoid professional violations.

15. Which situation constitutes a violation of the Acts Discreditable Rule regarding client confidentiality?

    A. Disclosing client details to a third party without authorization.
    B. Discussing general accounting principles used by a client at a conference.
    C. Sharing client information with consent.
    D. Using client data to prepare tax returns for the client.

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Bi-Monthly Accounting Alert	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Acts Discreditable	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|

Which segments of the December 2024 issue of **CPE Network® A&A Report** did you like the most, and why?

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Once Again, Thank You…

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