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PEEC Revises Two Ethics Interpretations

The AICPA Professional Ethics Executive Committee (PEEC) recently revised two ethics interpretations, "State and Local Government Client Affiliates" and "Information System Services."

State and Local Government Client Affiliates

PEEC issued revised ethics interpretation, "State and Local Government Client Affiliates," previously titled, "Entities Included in State and Local Government Financial Statements" (ET 1.224.020). It is effective for years beginning after December 15, 2020.

This interpretation applies to state and local government entities that are financial statement attest clients, and helps members identify the entities related to a state or local government (SLG) that are *affiliates* of the SLG for independence purposes. Financial interests in and other relationships between members and affiliates of financial statement attest clients may create threats to a member's compliance with the Independence Rule.

PEEC clarified the circumstances and affiliate relationships that may violate the Independence Rule. Independence applies even if the member (or member's firm) does not provide attest services to the affiliate. The revision also changes the language in the interpretation in numerous places to refer to "financial statement attest client" rather than "state or local government entity."

Information System Services

PEEC issued revised ethics interpretation, "Information Systems Services," previously titled "Information Systems Design, Implementation, or Integration" (ET 1.295.145). It is effective on January 1, 2021.

The revised interpretation addresses the circumstances under which certain threats to independence would or would not be at an acceptable level when a member provides nonattest services related to an attest client's information systems.

Practitioners who provide information systems design, implementation, or

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integration services to an attest client at any time during the period covered by the financial statements or the period of the professional engagement must consider ET 1.295.145.

The revised interpretation provides that certain threats to independence would *not* be at an acceptable level, and independence would be impaired, if the member designs or develops an attest client's financial information system (FIS). Threats to compliance with the Independence Rule could not be reduced to an acceptable level by the safeguards.

However, if the member were performing design, development, or implementation services for an attest client that are not related to a FIS, threats to independence would be at an acceptable level provided the general requirements of ET 1.295, *Nonattest Services*, are met.

Recent Updates to AICPA Technical Q&As

The AICPA periodically issues nonauthoritative Technical Questions and Answers (Q&As) based on selected practice matters identified by the staff of the AICPA's Technical Hotline and various other bodies within the AICPA. Technical Q&As are not approved, disapproved, or otherwise acted upon by any senior committee of the AICPA.

Newly Added

In May 2019, the AICPA issued Technical Q&A 6140.27, *Not-for-Profit Entities, Definition of "Direct Care" of Collection Items*. The nonauthoritative guidance discusses characteristics to consider when determining which costs are considered direct care. This topic arose after the FASB issued, ASU 2019-03, *Not-for-Profit Entities (Topic 958): Updating the Definition of Collections*, which aligns the definition of collections in GAAP with the definition used by the American Alliance of Museums, but doesn't provide a definition of direct care.

Newly Removed

In May 2019, the AICPA also removed the 23 revenue-related Technical Q&As listed below—

- Q&A 1200.01, *Disclosure of Revenues of An Agent*.
- Q&A 3400.04, *Accounting for Issuance of Cents Off Coupons*.
- Q&A 5100.01, *Equipment Sales Net of Trade-Ins*.
- Q&A 5100.02, *Rights to Broadcast Time Received for Service*.
- Q&A 5100.04, *Discounts on Prepaid Funeral Arrangement Plans*.
- Q&A 5100.10, *Members of Country Club Assessed for Debt Retirement*.
- Q&A 5100.14, *Recognition of Fees Earned on Construction Mortgage Placements*.
- Q&A 5100.16, *Rental Revenue Based on Percentage of Sales*.
- Q&A 5100.28, *Revenue From Private Label Sales*.
- Q&A 5260.01, *Recognition of Estimated Losses on Uncompleted Contracts*.
- Q&A 6130.04, *Method of Recognizing Revenue From Commissions on Loan Insurance*.
- Q&A 6300.01, *Recognition of Commission Income by Insurance Agency*.
- Q&A 6300.02, *Method of Recognizing Revenue From Commissions on Credit Life Insurance*.
- Q&A 6300.03, *Recognition of Income on Unclaimed Refunds Due Policyholders on Policy Cancellations*.
- Q&A 6400.33, *Accounting for a Joint Operating Agreement*.
- Q&A 6400.43, *Application of FASB ASC 958, "Classification of Distribution From Financially Interrelated Fundraising Foundation (Recipient Entity) to a Health Care Entity Beneficiary."*
- Q&A 6400.47, *Application of Accounting Standards Update No. 2011-07, "Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities," in Consolidated Financial Statements*.
- Q&A 6600.01, *Method of Recognizing Revenue From Commissions by Real Estate Brokerage Firm*.
- Q&A 6600.04, *Method of Recognizing Profit on Sale of Undeveloped Land With a Release Provision*.
- Q&A 6700.01, *Distinction Between Long-Term and Short-Term Construction Contracts*.
- Q&A 6940.01, *Method of Accounting for Sale of Territorial Franchise Rights*.
- Q&A 6940.02, *Revenue Recognition for Franchisors*.
- Q&A 8100.03, *Accounting for a Joint Operating Agreement*.

The PPC Technology Update

by Roman H. Kepczyk, CPA.CITP, CGMA

Path to Advisory Services

Most of the firms we have consulted with in the past two years are experiencing the most successful and profitable years in their history. The majority would say they have never been busier, and they have more "bread and butter" compliance work than they can handle. Does that sound about right? The reality is that many have been lulled into the comfortable position of "doing what they are doing" instead of paying attention to how rapidly the world is changing around them. In my more than three decades of focusing on information production in the accounting profession, I have never seen the evolution of accounting tools and technology and the reduction of traditional compliance work occur as rapidly as has happened in the past two years. (That includes the Dot.com years!) The good news is the profession, media, and major associations are mobilizing around these opportunities and promoting a transition towards more advisory services. But how do you get reluctant firm members started down this path? Below we address eight "stepping stones" that firms should consider when moving towards a future with more advisory services.

1. **Understanding the Trends Driving the Transition.** One of the primary focuses of Daniel Burrus' book, *The Anticipatory Organization*, is the prioritization of "hard" trends that will happen versus "soft" trends that might happen. The economy and gas prices are examples of soft trends that go up and down versus hard trends that only go in one direction. Think about computing power, internet accessibility, and the cost of data storage. Each of these items only gets faster, more available, and less expensive. These hard trends have led to enterprise computing capabilities that are now accessible to all firms in the cloud. This has opened the opportunity for smaller firms to utilize big data, advanced data analytics, robotic process automation, and artificial intelligence, which are the technology drivers rapidly automating the accounting profession today and creating the push towards an advisory focus.
2. **Financial Indicators.** Headlines and financial surveys point to consultative services being the fastest growing and most profitable segment within the accounting profession. As lower level compliance services continue to be automated by software, the adopters of these applications will replace the practitioners that are not automated by producing the work at a significantly lower cost. Is your firm prepared to begin the evolution to advisory services to remain competitive?
3. **Evolution vs. Revolution.** The rate of technological change and adoption of streamlining applications is increasing at a constantly quicker pace, meaning that firms staying with the status quo are falling behind at a quicker pace. Firms have a choice to either evolve with the new tools such as APIs (application program interfaces), RPA (robotic process automation), and data visualization (Tableau, Qlik, Microsoft Power BI) that are standardized, working, and cost-effective today; or to wait until they have a group of personnel that will force the change (or leave the firm). Revolutions are not pretty and usually cause significant financial and emotional pain, so firms should discuss their evolution plan now.
4. **Mindset Challenges.** Firms will need to openly address embedded mindsets to transition resistive personnel to be advisory-focused rather than compliance-focused. First, the majority of firm training has been on following a specific process to do compliance work; advisory work is not clear-cut and usually there is no checklist, so personnel must learn to deal with ambiguity. Second, compliance-focused personnel are used to working towards a specific answer or solution, which is not the case when doing advisory work. Finally,

compliance personnel have most often been trained to bill for hourly work for what is most often seen as commodity type services, compared to advisory services that are billed based on value received by the client, so they will need to learn to bill in new ways.

5. **Understanding the Nuances.** To get personnel to think about the differences between compliance work and advisory services, Edi Osborne in her Trusted Business Advisor Academy suggests asking staff if the work being done is seasonal vs. non-seasonal, focused on the past or is future-oriented, commodity work or worthy of higher realization; if the firm delivers a product or facilitates a process; and if they are viewed as an historian or a business coach. These subtle nuances force individuals to draw a line between what they have been doing and what they could be doing from an advisory perspective, which also helps in having discussions with clients.

6. **Identifying Existing Expertise.** Compliance focused personnel may have a difficult time knowing where to start the transition to providing advisory work. More often than not, they have already done special projects or have extensive niche/industry segment experience, which are the most logical places to begin looking. Reviewing projects that have helped one client or identifying highly profitable work for another client can often be applied to similar clients just by asking them.

7. **Skilling Up.** As mentioned in the introduction, the entire accounting profession is mobilizing a concerted effort to transition towards providing advisory services so there is more content and training available than ever before. In addition to accounting media content, I would recommend Edi Osborne's *Firm Forward* and Alan Weiss' *Million Dollar Consulting*. There are also a significant number of advisory training courses available through the CPA firm associations and professional consultants, including the Succession Institute, Mentor Plus, Upstream Academy, Convergence Coaching, Boomer Consulting, The Growth Partnership, and Rootworks.

8. **Famous Person Concept.** Finally, one of the most useful approaches utilized by individuals to successfully transition towards advisory services is to be recognized as one of the top three "famous" persons within a specific niche, as this will provide continual opportunities to propose on advisory projects. While some firms buy external consulting practices or hire the famous person from another organization to quickly acquire expertise, individuals can also be developed internally with a proactive effort to showcase their knowledge and expertise through writing, speaking, and surveying. Writing articles for niche publications or contributing knowledge via blogs or podcasts are some of the easiest ways to showcase knowledge. The mere act of summarizing a concept helps "crystalize" the advisor's knowledge so the individual is viewed as an expert. Speaking is also an effective way to become known in a specific niche. Many advisors begin by participating on panels, facilitating forums, or sharing short videos, which can lead to giving seminars and presentations. A final thought on developing advisory expertise is to facilitate surveys to help provide direct insight into current and evolving trends.

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FASB Issues Additional Improvements for Credit Losses

Last month's article, "FASB Issues Improvements for Financial Instruments," focused on the hedging and financial instrument recognition and measurement aspects of ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, which was issued by the FASB in April 2019. This month's article provides a summary of the ASU's amendments applicable to credit losses and the additional transition relief guidance provided in ASU 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*.

ASU 2019-04

ASU 2019-04 provides the following Codification improvements for the credit loss guidance in FASB ASC 326:

- The amendments to FASB ASC 326-20, *Financial Instruments—Credit Losses—Measured at Amortized Cost*, allow an entity to—
  - Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets.
  - Make accounting policy elections: (1) to not measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollectible accrued interest receivable balance in a timely manner and makes certain disclosures, (2) to write off accrued interest amounts by reversing interest income or recognizing credit loss expense, or a combination of both, and (3) to present accrued interest receivable balances and the related allowance for credit losses separately from the associated financial assets on the balance sheet.
  - Elect a practical expedient to disclose separately the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements.
- When transferring loans or debt securities between classifications (e.g., held-for-sale and not-held-for-sale), an entity should reverse, from earnings, any allowance for credit losses or valuation allowance previously measured; reclassify and transfer the loan or debt security to the new classification; and measure the loan or debt security using the new classification's measurement guidance.
- Expected recoveries of amounts previously written off and expected to be written off should be included in the valuation account and shouldn't exceed the aggregate of amounts previously written off and expected to be written off. Also, an entity should include recoveries when estimating the allowance for credit losses.
- Clarifies the equity method losses allocation guidance in FASB ASC 323-10-35-24 and FASB ASC 323-10-35-26 by adding references to FASB ASC Subtopics 326-20 and FASB ASC 326-30 *Financial Instruments—Credit Losses—Available-for-Sale Debt Securities*, for the subsequent measurement of loans and available-for-sale debt securities.
- Clarifies that reinsurance recoverables measured on a net present value basis in accordance with FASB ASC 944, *Financial Services—Insurance*, along with all other recoverables within the scope of FASB ASC 944, are also within the scope of FASB ASC 326-20.
- Removes the prohibition of using projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments. Also, entities utilizing such interest rate projections, should—
  - Use the same assumptions in determining the effective interest rate used to discount those expected cash flows.
  - Adjust the effective interest rate to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments.
- Permits an entity to make an accounting policy election to adjust the effective interest rate used to discount expected future cash flows for expected prepayments on financial assets measure at amortized cost and on available-for-sale debt securities.
- Clarifies that when foreclosure is probable and the lender uses the fair value of collateral to estimate expected credit losses on a financial asset, the lender is required to consider the undiscounted estimated costs to sell the collateral if it intends to sell the collateral rather than operate the collateral.
- Within the vintage disclosure table, an entity should present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column.
- In determining the contractual term of a financial asset, an entity should consider extension or renewal options (not accounted for as derivative instruments) that are included in the original or modified contract at the reporting date and aren't unconditionally cancellable by the entity.

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The ASU 2019-04 amendments related to credit losses are effective as follows:

- For entities that have yet to adopt ASU 2016-13, the effective dates and transition requirements are the same as those for ASU 2016-13.
- For entities that have already adopted ASU 2016-13, the effective date is for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For such entities, early adoption is permitted in any interim period after the issuance of the ASU. The amendments should be applied on a modified-retrospective basis through a cumulative-effect adjustment to opening retained earnings as of the date an entity adopted ASU 2019-04.

Practical Consideration:

For nonpublic entities, ASU 2016-13 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. The amendments should generally be applied through a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period the entity adopts ASU 2016-13. For the full ASU 2016-13 transition requirements, see FASB ASC 326-10-65-1. The ASU is available at **www.fasb.org** and on Checkpoint at **checkpoint.riag.com**.

ASU 2019-05

ASU 2019-05 was issued by the FASB in May 2019 to add an optional election to the transition guidance for ASU 2016-13. When adopting ASU 2016-13, an entity may elect to apply the fair value option to certain financial assets previously measured at amortized cost. The election is irrevocable, made on an instrument-by-instrument basis, and generally permitted for certain financial instruments that—

- Are measured at amortized cost under FASB ASC 326,
- Qualify for the fair value option in FASB ASC 825-10, *Financial Instruments—Overall*, and
- Aren't classified as a held-to-maturity debt security.

ASU 2019-04 and ASU 2019-05 have the same effective dates and early adoption requirements. ASU 2019-05 generally has the same transition method as ASU 2016-13; that is, ASU 2019-05 must be applied on a modified-retrospective basis. In making the election to apply the fair value option, the initial adjustment from amortized cost to fair value is recorded as a cumulative-effect adjustment to opening retained earnings as of the beginning of the first reporting period that ASU 2016-13 was adopted.

Practical Consideration:

For the full ASU 2019-04 and 2019-05 transition requirements applicable to credit losses, see FASB ASC 326-10-65-2 and FASB ASC 326-10-65-3, respectively. The ASUs are available at **www.fasb.org** and on Checkpoint at **checkpoint.riag.com**.