Trust Me, I’m a Skeptic

SPEAKERS
Jonathan Kraftchick, CPA
jkraftchick@cbh.com

Pick a card, any card...
If the confidence of the public in the integrity of the accountants’ report is shaken, their value is gone.
Let’s Start with You

- How skeptical do you think you are compared to other people in this room?
  - Rate yourself on a scale of 1-10, 10 being the most skeptical.

REPORT TO THE NATIONS ON OCCUPATIONAL FRAUD AND ABUSE

2016 GLOBAL FRAUD STUDY
When fraud occurs, the typical organization loses what percentage of its annual revenue due to fraud?

a. 1  
b. 3  
c. 5  
d. 7

Figure 38: Type of Victim Organization—Frequency and Median Loss
We take the existing independence rules quite seriously, and consequently abide by all the existing rules. We are professionals that follow our code of ethics and practice by the highest moral standards. We would never be influenced by our own personal financial well being.

Chairman of the Mgmt of Accounting Practice Committee
During SEC hearing on auditor independence (2000)
What do the standards say?

AU-C 200: Overall Objectives for the Independent Auditor and the Conduct of an Audit in Accordance with GAAS

.17 The auditor should plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated.

What do the standards say?

.A22 Be alert to the following:

- Audit evidence that contradicts other evidence obtained
- Information that brings reliability into question
- Conditions that may indicate possible fraud
- Circumstances that require procedures outside of GAAS

.A26 The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity’s management
What do the standards say?

AU-C 240: Consideration of Fraud in a Financial Statement Audit

.13 If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor should investigate further.

.A9 Maintaining professional skepticism requires an ongoing questioning...particularly...when considering the risks of material misstatement due to fraud.

Skeptikos

› To be reflective and inquisitive of all things:
  ▪ Against every statement its contradiction may be advanced with equal justification
  ▪ The impossibility of knowledge
## Six Ways to Skepticism

1. Suspension of Judgment
2. Search for Knowledge
3. Interpersonal Understanding
4. Questioning Mindset
5. Autonomy
6. Self-Esteem

- Evaluate the evidence
- Evaluate the provider
- Act on the information

### Suspension of Judgment
What percentage of spreadsheets contain errors?

Search for Knowledge
The Broken Machine

Hey boss! The time system is down.

Wait what? Why?

Because a particular server failed.

Why did it fail?

The Broken Machine

Because an obscure subsystem was used in the wrong way.

Why was it used in the wrong way?

The IT pro who used it didn’t know how to use it properly.

Why didn’t he know how to use it properly?
The Broken Machine

Because he was never trained.

Why wasn’t he trained?

My guys are too busy and I just didn’t have time to do it.

Guess you’ll have a lot more time now. Pack your things.

Interpersonal Understanding

- Amicable & Courteous
- Insecure
- Precise & Strategic
- A bit high maintenance
- Feels guilty about something
The Story of Turner’s Ghost Employees

Just the Facts

• Turner was a payroll specialist for a large Florida NFP
• Over 2 years he stole $112,000 to cover medical costs
• Posting of time and attendance (Turner’s job) was separate from adding/deleting employees. A supervisor reviewed all payroll distributions.
White as a Ghost

- Turner stole user ID/password to create ghost employees, prepare fake payroll summary and had paychecks direct deposited into his account.
- Created phony file copies of payroll checks (on white paper). Legitimate checks were on yellow paper.
- Annual audit transaction testing – staff accountant noticed the white paper and started asking questions.

Red Flags

- Infrequent change in passwords
- SS#’s were for dead people
- Employee #’s were higher than typical employees
- None of fake employees had personnel file
- Net payroll expense was lower than funds actually issued because it did not include ghost employees
- Payroll Summaries created were in different type face
- Multiple direct deposits to the same bank account
An audit committee where everybody is happy and likes each other is an audit committee that makes me nervous.

KPMG Audit Committee Institute (2011 survey)
Can you match the line? – Round 1

Barriers & Biases

- Anchoring
- Availability
How old was Gandhi?
Which causes more deaths in the US?

a. Shark attacks

b. Getting hit by falling airplane parts

Which department commits the most fraud?

a. Accounting

b. Executives/Upper Management

c. Operations

d. Sales
A herd of sheep is leaving the stall.

There is no fence, only the gate...
It ain’t what you know that gets you into trouble. It’s what you know for sure that just ain’t so.

*Mark Twain (we think)*

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**Trust Me, I’m a Skeptic**

**SPEAKERS**

Jonathan Kraftchick, CPA

jkraftchick@cbh.com
Building an Effective Team Through Empowerment

Tom Chaby
Threat Landscape
BUILDING A CYBER BALANCE SHEET FOR YOUR BOARD

Presented by:

AGENDA

1. About the Research
2. What is a Cyber Balance Sheet
3. Audience Q&A
A long time ago in a boardroom far, far away...

Cyber Balance Sheet

A NEW HOPE

It is a period of cyber war: CISOs, fighting to prove that their security programs are worth it, struggle to convince skeptical Board members to invest in new security projects.

During the battle, Focal Point and Cyentia released secret plans for the ultimate weapon, the CYBER BALANCE SHEET, a new idea that just might be strong enough to sway an entire Board....

Unsure of what to do next, the CISOs register for webinars in hopes of acquiring these secret plans in time for the upcoming Q2 Board meeting....
THE PROBLEM

EMPEROR PERSPECTIVE

“We have a new enemy...I have no doubt this boy is the offspring of Anakin Skywalker...he could destroy us.”

ADMIRAL PERSPECTIVE

“Evacuate? In our moment of triumph! I think you overestimate their chances.”

Independent Research Study

Combining the perspectives of Corporate Directors & CISOs
- Cyber Balance Sheet Summit in NY @NASDAQ
- 75 Interviews
WHAT WE DID

CISOs + Corporate Directors + Security Experts

What is the primary value of cyber security?
Are you confident your security program is effective?
What factors make it easier or harder to convey value?
How do you assess security posture and set priorities?

WHAT WE HEARD

Balance Point 1
The Value of Cybersecurity

Key Takeaway
CISOs and Boards should have candid, upfront conversations about what a successful security program looks like and what the Board expects in terms of assurances to that end.

What is the primary value of cybersecurity to the business?
Balance Point 2
Conveying Security’s Value

What factors make it easier/harder to convey value?

CISO Perspective
“The main challenge is I could do everything right, and we could still have a loss. I could do everything wrong and nothing may happen.”

Balance Point 3
Assessing Posture & Priorities

Are you confident with the security program’s effectiveness?

How do you assess risk posture and set priorities?
Finding Meaningful Metrics

The quest to align the conversation

Key takeaway

Metrics reported to the Board should be tied to business-level outcomes supported by the security program. All parties should agree on the metrics, establish thresholds and goals, and understand what changes over time signify. Ideally, every metric and movement has meaning that can be used to support management decisions.

Measuring and Expressing Risk

Key takeaway

Ultimately, how risk should be expressed is a product of Board preference and organizational maturity. If yours isn’t ready for quantification, begin by using proper terminology and logic in your qualitative descriptions of risk. Experience shows that Boards fed mostly words about risk will eventually begin asking questions that require numbers, and likely dollars, to adequately answer.
## WHAT WE HEARD

### Balance Point 6

**Communicating with the Board**

<table>
<thead>
<tr>
<th>Tips on communicating with the Board</th>
<th>Board Perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relate to the business</td>
<td>“Develop KPIs for the Board based on business initiatives rather than security products and processes.”</td>
</tr>
<tr>
<td>Build security awareness</td>
<td></td>
</tr>
<tr>
<td>Be credible and candid</td>
<td></td>
</tr>
<tr>
<td>Provide pointed evidence</td>
<td></td>
</tr>
<tr>
<td>Know the audience</td>
<td></td>
</tr>
</tbody>
</table>

*All 10 tips are in the Cyber Balance Sheet Report*

**Board Perspective**

“Security has a seat at the table but has nothing to say. We’re listening, but security mumbles.”

### OK, SO NOW WHAT?

**Talk** to your Board.

Find out what is **important** to them.

Get everyone on the **same page**.
What is it?

Cyber Assets
Assets include anything owned by the company that has value, including the capabilities and controls the company has developed to protect its assets.

Cyber Liabilities
Liabilities convey emerging threats, inadequacies in protection, risk exposure, current/future initiatives, over/underspend, etc.

HOW DOES IT WORK?

CRAWL
Be concise, speak the same language, and work from the same starting point.

WALK
Begin to balance risk in three positions:
- Acceptance
- Mitigation
- Transfer
And talk about cyber risk in terms of materiality.

RUN
Build and keep a Cyber Balance Sheet for your organization.
What should the categories be?

Under what circumstances can assets become liabilities and vice versa?

How should you show risk acceptance, mitigation, and transfer?

BEST PRACTICES

Five Key Lessons to Take Back to your Business

1. Bring everything back to business goals.
3. Follow-up. Prove that you’ve delivered what you promised.
4. Describe risks in terms of their materiality to the Board.
5. Ask your Board members what they’ve seen elsewhere, and what they’d like to see from you.
Your questions

I now will take.

Interested in contributing to next year’s report? Email contribute@cyberbalancesheet.com

THANK YOU
I would like you to participate in an important research study. The purpose of the study is to gain a better understanding of how investment decisions are made, which is of widespread interest to businesses, accounting professionals, and policy-makers.

Your involvement entails completion of a case that requires a hypothetical investment decision, among other judgments, and should take approximately 15 minutes.

Participation is voluntary, and you may choose to terminate participation at any point. I am interested in your judgment and accordingly, ask that you exercise the same care as you would take if you were making an actual investment decision. There are no right or wrong responses. Further, because it is YOUR RESPONSE that we want, please DO NOT CONFER WITH ANYONE ELSE WHO MAY BE COMPLETING THE CASE. You can be assured that your responses are anonymous and your identity will not be disclosed to anyone other than to the members of the research team. All responses will be used in the aggregate and will strictly be used for academic purposes only.

If you would like to be included in a drawing for ONE OF TWENTY $100 AMAZON GIFT CARDS, you will be given instructions on how to do so at the end of the case. TWENTY participants will be randomly selected to receive a prize.

To participate, please complete the packet materials enclosed, starting with Case Materials:Part A and continuing by following the directions at the end of the Part A packet; only remove and complete a packet from the envelope when you reach the end of a section and are instructed to so do. Alternatively, if you would like to participate online, please visit: https://tinyurl.com/InvestingStudy. You may participate either by completing the packet and returning it to a conference worker before leaving today OR online at a desktop or laptop computer (no tablets/smart phones please), but not both. Further, if you have already participated in the study and entered the drawing, please do not complete an additional case.

Should you have any questions about the case please feel free to contact Peter Kipp at peter.kipp@unt.edu. Thank you very much for your participation in my research!

Thank you.
Professor Peter Kipp, PhD, CPA
University of South Florida
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SEC update

Agenda

► SEC update
  ► Current political landscape
  ► SEC priorities
  ► SEC rulemaking
  ► Non-GAAP financial measures
  ► Proxy season
  ► SEC enforcement activities
  ► SEC reporting and comment trends

SEC update

Learning objectives

► Discuss how current SEC priorities could affect future financial reporting requirements
► Identify SEC rules and other guidance that may require changes in reporting, disclosure or internal control processes
► Describe key themes in the SEC’s focus on non-GAAP measures
► Discuss whether the accounting topics that most commonly gave rise to restatements and comments in recent years could require action on your part
► Discuss the possible effects of recent PCAOB standard-setting activities
► Identify the effect that the recent EU audit legislation could have on your auditor and other adviser relationships
Current political landscape
Effects on SEC activities

- SEC Commissioners
  - Jay Clayton (R) confirmed as SEC Chair on May 2
  - Other commissioners: Michael Piwowar (R) and Kara Stein (D)
  - Two additional commissioner seats open
- Clayton’s priority: capital formation
  - Wants to encourage IPOs earlier in companies’ growth
  - JOBS Act has made it easier for emerging growth companies to go public
- Recent SEC actions
  - Revisiting conflict mineral rule and CEO pay ratio rule
  - Changes to policies in Division of Enforcement
SEC priorities
Disclosure effectiveness – SEC and FASB overview

**SEC projects**
- Reviews of S-X, S-K, industry guides and proxy disclosures
- Delivery of information

**Framework**
- Board’s decision process
- Entity’s decision process

**FASB projects**
- Fair value measurement
- Defined benefit plans
- Income taxes
- Inventory
- Interim reporting

**Topic-specific**

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**SEC priorities**
Disclosure effectiveness – history

The following outlines the SEC’s activities to date:
- Since Chair White’s speech in 2013 the SEC and its staff have issued a number of concept releases, requests for comment, reports and proposed rules related to the disclosure effectiveness initiative, yet it is far from completion.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>JOBS Act Section 108 - Required the SEC to review S-K’s registration requirements and determine how they can be modernized and simplified.</td>
</tr>
<tr>
<td>2014</td>
<td>Chair White Speech – The Path Forward on Disclosure</td>
</tr>
<tr>
<td>2015</td>
<td>Staff Report – Public Company Disclosures</td>
</tr>
<tr>
<td>2016</td>
<td>Concept Release - Disclosure Requirements in Regulation S-K</td>
</tr>
<tr>
<td>2017</td>
<td>Final Rule – Exhibit Hyperlinks</td>
</tr>
</tbody>
</table>
SEC priorities
Disclosure effectiveness – other items

► The JOBS Act and FAST Act included provisions to help ease the regulatory burden on smaller companies but also progressed the disclosure effectiveness initiative by:
  ► Allowing (all) issuers to include an optional summary of its business and financial information in Form 10-K (Item 16)
  ► Requiring the SEC to study the disclosure requirements of Regulation S-K with a goal to modernize and simplify its requirements. (issued November 2016)
  ► Requiring the SEC to study Regulation S-K and eliminate duplicative, outdated, or unnecessary disclosures for all filers. (DUSTR proposal issued in July 206)
  ► The staff continues to review comment letters received on related to disclosure effectiveness.

SEC priorities
Disclosure effectiveness – DUSTR proposal

► “Disclosure Update and Simplification Proposing Release” (DUSTR)
  ► Proposal would modify or eliminate certain SEC disclosure requirements:
    ► That are redundant or outdated in light of requirements in other Commission rules, US GAAP or IFRS
    ► That overlap with US GAAP (i.e., those requirements that convey reasonably similar information, or information that is not materially incremental and may no longer be useful to investors)
    ► That are outdated or superseded by new accounting, auditing and disclosure requirements, for example:
      ► References to US GAAS would be superseded by “standards of the PCAOB”
      ► References to “extraordinary items” or “pooling of interests” would be removed
Financial reporting that accurately reflects economic and business realities has never been more important.

We talked to 120+ key participants in the financial reporting process, including CFOs, CAOs, controllers and directors of SEC reporting. Participants covered a wide range of sectors including manufacturing, life sciences, health care, pharmaceuticals, electronics, technology, software and services, and professional services. Annual revenues of $5m to $50b.

We know that 74% of responding companies are already taking action to improve their financial reporting disclosures, with still others planning to take action in the near-term.

- 97% have seen improvement in financial communication.
- 78% have seen improvement in process efficiencies.
- 39% have saved or expect to save at least 1–3 days of financial reporting preparation time.

Calls for improvements in financial reporting is coming from the top:

- Biggest reasons companies are making changes: 53% management team and senior-level executive influence, 22% SEC initiatives.

Companies are focused on three key areas related to disclosure effectiveness:

- 80% focusing on disclosing material information and eliminating immaterial information.
- 77% focusing on reducing redundancies, including using more cross-references.
- 70% focusing on eliminating outdated information.

Three areas of the SEC report that companies have improved the most:

- 40% Notes to the financial statements.
- 25% Business items.
- 18% Other.
SEC priorities
SEC Chief Accountant on audit committee effectiveness

► Wes Bricker at University of Tennessee on March 24
► Audit committees play a critical oversight role
► Two responsibilities are especially important right now
  ► Understanding risks of adopting new accounting standards
  ► Support controls over use of Non-GAAP measures
► Other key considerations regarding effectiveness
  ► Understand the business and operating environment and changes
  ► Set positive tone at top regarding ICFR
  ► Balance the audit committee workload; focus on core roles; consider training on current developments, especially new stds
  ► Monitor corporate objectives that could impact external auditors
  ► Consider enhanced voluntary reporting; challenge disclosures
  ► Promote board and audit committee diversity

SEC priorities
New accounting standards

Staff Accounting Bulletin No. 74
► Avoid boilerplate disclosure
► Eliminate redundancies
  ► Financial statement footnotes
    ► Disclose effect of adoption on financial statements
      ► Consider disclosure that addresses magnitude of impact and directional impact if quantification is not available
  ► MD&A disclosure
    ► Future impact of new accounting treatment
      ► Material changes and trends
      ► Financial and non Financial (e.g., covenants)
► SEC staff has requested companies disclose where they are in process if impact is not yet known
SEC priorities
New accounting standards – ASC 606

► Considerations for full retrospective transition
  ► New or amended registration statements

Planning to file registration statement becoming effective after first Form 10-Q filing
Example: File Form S-3 in May 2018, after ASU adopted

Recast all comparative periods in prior annual financial statements, if material
Recast 2015, 2016 and 2017 financial statements

► SEC staff will not object if entities:
  ► Do not recast earliest two years of selected financial data table and ratio of earnings to fixed charges disclosures
  ► Continue to use pre-transition significance test for equity method investees for S-X Rules 3-09 and 4-08(g) for prior periods
► The staff would not consider adoption of ASC 606 a fundamental change

SEC rulemaking
Final rule – ‘Regulation A+’ and ‘Regulation Crowdfunding’

► Expands exempt public offerings
► Generally available only to private domestic companies
► SEC staff issued C&DIs on Regulation Crowdfunding in May 2016

<table>
<thead>
<tr>
<th>Regulation A+</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Regulation crowdfunding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual offering limitations</td>
<td>Up to $20m</td>
<td>Up to $50m</td>
<td>Up to $1m</td>
</tr>
<tr>
<td>Subject to state securities laws?</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Financial statements</td>
<td>Unaudited (US GAAP or PCAOB standards)</td>
<td>Audited</td>
<td>Offering size</td>
</tr>
<tr>
<td>Offering size</td>
<td>&gt; $500k – Audited (Reviewed for first-time issuers)</td>
<td>&gt; $100k ≤ $500k – Reviewed</td>
<td>≤ $100k – Certified by CEO</td>
</tr>
<tr>
<td>Accounting basis</td>
<td>US GAAP – Public Business Entity basis (domestic issuers)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ongoing reporting</td>
<td>None</td>
<td>Annual, semiannual and current reporting</td>
<td>Annual reporting, certified by CEO</td>
</tr>
<tr>
<td>Securities holder counts</td>
<td>Included in 12(g) holder counts</td>
<td>Excluded from 12(g) holder counts</td>
<td></td>
</tr>
</tbody>
</table>
**SEC rulemaking**
Final rule – Fixing America’s Surface Transportation (FAST) Act

- Changes Jumpstart Our Business Startups (JOBS) Act provisions and SEC requirements to facilitate capital formation by smaller companies
- Reduces minimum public filing period from 21 days to 15 days before IPO road show
- Protects emerging growth company (EGC) status during IPO until earlier of (1) IPO date or (2) one year after issuer would have otherwise lost EGC status
- Allows an EGC to omit certain financial statements it reasonably expects will not be required at IPO registration statement effectiveness
- Allows certain smaller reporting companies to forward incorporate by reference subsequent Exchange Act reports in an effective Form S-1
- Allows an issuer to include a brief summary of its business and financial information in Form 10-K

**SEC rulemaking**
Final rule – CEO pay ratio disclosure

<table>
<thead>
<tr>
<th>Pay ratio</th>
<th>Annual total compensation of principal executive officer (PEO)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median annual total compensation of all other employees except PEO</td>
</tr>
</tbody>
</table>

- Allows some flexibility in determining median employee
  - Use entire population of employees or a statistical sample
  - Determine using any consistently applied compensation measure (e.g., W-2 information), not necessarily total compensation
- Generally calculate median employee every three years and make the determination at any point during the last three months of the fiscal year

Calendar year-end entities provide 2017 pay ratio in 2018 proxy
SEC rulemaking
Final rule – CEO pay ratio disclosure

<table>
<thead>
<tr>
<th>Must include</th>
<th>May exclude</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Employees of parent and consolidated subsidiaries</td>
<td>• Independent contractors if paid by a third party</td>
</tr>
<tr>
<td>• Part-time, seasonal and temporary employees</td>
<td>• De minimis population of non-US employees in individual foreign jurisdictions (&lt;5% of total employees)</td>
</tr>
<tr>
<td></td>
<td>• Employees in foreign jurisdictions with data privacy laws (count towards de minimis exemption)</td>
</tr>
</tbody>
</table>

Disclose the methods and material assumptions used in determining components of the pay ratio

SEC rulemaking
Proposed rules

• Dodd-Frank Act
  • Clawback of excess incentive-based compensation upon an accounting restatement
  • Excessive incentive-based compensation arrangements for covered financial institutions
  • Pay versus performance disclosures: Proposal would mandate disclosing the relationship between executive compensation and total shareholder return
  • Universal proxy and disclosure on hedging policies
  • Inline XBRL
• Amendments to smaller reporting company (SRC) definition would allow more companies to qualify as SRCs if they have either:
  • A public float of less than $250m (up from $75m)
  • No public float and revenue of less than $100m (up from $50m)
SEC rulemaking
Final rule

► Exhibit hyperlinks and HTML format
  ► Registrants will be required to include a hyperlink to each exhibit listed in the exhibit index for required exhibits under S-K Item 601
  ► All such filings will need to filed in HTML format to achieve this
  ► Effective 9/1/17 for accelerated and large accelerated filers
  ► Effective 9/1/18 for smaller reporting companies and non-accelerated filers

SEC rulemaking
Proposed rules – Inline XBRL and IFRS Taxonomy

► Today, companies submit XBRL tagged financial statements as an exhibit to their SEC filings
► Inline XBRL embeds tags directly in the HTML filing and would be required
  ► Currently permitted under a voluntary program
  ► Goal is to increase use of XBRL data by investors
  ► Would not change
    ► Scope of XBRL tagging
    ► Officer certification
    ► Auditor involvement
  ► Four year phase-in after rule is finalized and effective
► SEC published IFRS Taxonomy for FPIs using IFRS as issued by IASB
  ► FPIs must file XBRL tagged financial statements for periods ending after 15 December 2017
Non-GAAP financial measures

► A frequent area of focus in SEC staff reviews of public filings and related comment letters
► Due to concerns on the growing use and prominence of non-GAAP measures
► Applies to both earnings releases and SEC filings

“This area deserves close attention, both to make sure that our current rules are being followed and to ask whether they are sufficiently robust in light of current market practices.”

– SEC Chair Mary Jo White

Non-GAAP financial measures

2016 Compliance & Disclosure Interpretations (C&DIs)

► SEC staff updated and clarified previous interpretations

<table>
<thead>
<tr>
<th>SEC staff views on:</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-GAAP measures that are misleading</td>
<td>► Excluding normal, recurring cash operating expenses</td>
</tr>
<tr>
<td></td>
<td>► Presenting measures inconsistently between periods</td>
</tr>
<tr>
<td></td>
<td>► Excluding non-recurring changes but not gains</td>
</tr>
<tr>
<td>Tailoring recognition and measurement principles</td>
<td>► Accelerating the recognition of deferred revenue that must be recognized ratably under GAAP</td>
</tr>
<tr>
<td>Prominence of non-GAAP measures</td>
<td>► Omitting comparable GAAP measure</td>
</tr>
<tr>
<td></td>
<td>► Using bold or larger font for non-GAAP</td>
</tr>
<tr>
<td></td>
<td>► Volume and order discussing</td>
</tr>
<tr>
<td></td>
<td>► Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure</td>
</tr>
<tr>
<td>Presenting measures per share that appear to be liquidity measures in substance</td>
<td>► EBIT per share and EBITDA per share</td>
</tr>
<tr>
<td></td>
<td>► Other measures on a per-share basis that appear to function as liquidity measures</td>
</tr>
<tr>
<td>Determining the income tax effects of adjustments to non-GAAP measures</td>
<td>► Non-GAAP income tax effects are not determined appropriately based upon non-GAAP profit level</td>
</tr>
<tr>
<td></td>
<td>► Inappropriate use of cash tax for a performance measure</td>
</tr>
</tbody>
</table>
Non-GAAP financial measures

Staff comments

► Staff comments primarily focus on:
  ► Prominence of non-GAAP information
    ► Starting reconciliations with GAAP measure
  ► Whether the disclosures could be considered misleading
    ► Using individually tailored accounting principles
    ► Removing recurring cash operating expenses
  ► Appropriateness of non-GAAP disclosures
    ► Clearly describing the measure and nature of adjustments
    ► Labeling of measures (e.g., nonrecurring)
  ► Clarifying or expanding the description of non-GAAP measures

Non-GAAP financial measures
SEC staff comment on prominence – example

► We note that you present non-GAAP measures in the headline of your press release without also presenting GAAP with equal or greater prominence, as required by Item 10(e)(1)(i)(A) of Regulation S-K. Your presentations appear to give greater prominence to the non-GAAP measures than to the comparable GAAP measures, which is inconsistent with the updated Compliance and Disclosure Interpretations. Please review this guidance when preparing your next earnings release.
Non-GAAP financial measures
Other examples of SEC staff comments

It appears you adjust a GAAP measure to accelerate the recognition of revenue in your presentation of gross operating margin which may be inconsistent with the updated Non-GAAP Compliance and Disclosure Interpretations. Please review this guidance and explain to us whether and how it will impact your disclosures in future filings.

Your disclosure of Adjusted EBITDA per share provides meaningful information regarding your operating performance and cash flows, including your ability to meet future working capital requirements. As such, it appears that you are presenting Adjusted EBITDA as a liquidity measure. Non-GAAP liquidity measures should not be presented on a per share basis.

For each non-GAAP measure presented in future filings, please provide a statement disclosing why management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding your financial condition and results of operations. Please note that each measure should be discussed separately, and that boilerplate disclosure alone is not sufficient.

In future filings, when presenting a forecasted non-GAAP financial measure, please provide a reconciliation of that measure to the most directly comparable GAAP financial measure.

Non-GAAP financial measures
Other factors

<table>
<thead>
<tr>
<th>Common questions</th>
<th>Recent focus areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Confusion about which non-GAAP rules and regulations apply</td>
<td>► Restructuring charges – The staff said it may question, but is unlikely to object, to restructuring adjustments (e.g., if restructuring appears integral to the business)</td>
</tr>
<tr>
<td>► Reconciliation of non-GAAP forecasts</td>
<td>► Operating expenses – The staff continues to challenges adjustments they consider to be recurring cash operating expenses</td>
</tr>
<tr>
<td>► Presentation of changes and revisions to non-GAAP measures</td>
<td>► Naming of measures – The staff reiterated that non-GAAP measures must not have the name as a GAAP measure as they would be misleading</td>
</tr>
<tr>
<td>► Uncertainty over presenting measures on a per-share basis</td>
<td></td>
</tr>
</tbody>
</table>
Non-GAAP financial measures

Next steps

► Revisit use of non-GAAP measures in filings and earnings releases
  ► Consider alternative ways of presenting similar information
► Challenge usefulness and appropriateness of non-GAAP measures
► Present GAAP measure with equal or greater prominence consistent with interpretive guidance
► Consider revising disclosure describing how management uses the non-GAAP measure and how investors could use it
► Consider disclosure controls over non-GAAP measures
► Review compensation performance targets disclosed in the proxy as they may meet the definition of a non-GAAP measure

“Preparers should consider how their disclosure controls and procedures apply to the disclosure of non-GAAP measures.”

— SEC Deputy Chief Accountant Wesley Bricker

Proxy season

Trends for 2017

► Diversity of board composition that evolves over time
  ► Diversity of talent, thought and tenure
  ► Particular focus on gender diversity
► Environmental and social risk
  ► Climate risks as part of strategy and capital decision-making
  ► Board expertise to help with sustainability oversight
► Response to regulatory and legislative uncertainty
► Executive pay incentives
  ► Simplified pay programs that evolve with strategy
► Short-term views in the market
  ► Emphasize long-term strategy, performance targets, capital allocation and environmental, social and governance factors
Proxy season
Reminders for 2017

► Compensation Discussion & Analysis (CD&A)
  ► Requires disclosure of performance targets when they are material elements of compensation policies and decisions
  ► Targets are sometimes based on non-GAAP measures

<table>
<thead>
<tr>
<th>Within CD&amp;A</th>
<th>Outside CD&amp;A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not considered non-GAAP measures</td>
<td>Consider whether they are non-GAAP measures</td>
</tr>
<tr>
<td>Not subject to non-GAAP requirements</td>
<td>Comply with all non-GAAP requirements</td>
</tr>
</tbody>
</table>

► Pay ratio (CEO’s total annual compensation to total annual compensation of their median employee)
  ► Required in 2018 proxies
  ► SEC staff issued guidance in December 2016

SEC enforcement activities
Statistics

► Record number of cases in FY16 led to over $4.0b in recoveries
  ► SEC filed more than 850 cases in FY16
  ► ~7% increase in financial reporting cases from FY15

"The Enforcement Division’s leveraging of data, quantitative analytics … contributed significantly to this year’s very strong results.”

— SEC Chair Mary Jo White
**SEC enforcement activities**

**Targets and tools**

- Emphasis on holding gatekeepers accountable (e.g., accountants, lawyers, audit committee chairs, broker dealers)
- Financial Reporting and Auditing (FRAud) Group
  - Revenue recognition
  - Valuation and impairment issues
  - Earnings management
  - Missing or insufficient disclosures
  - Internal accounting controls
  - Corporate Issuer Risk Assessment
- Whistleblower program
  - Protects and rewards whistleblowers
  - 3,923 tips in fiscal 2015

**SEC enforcement activities**

**Select accounting cases**

- Magnum Hunter Resources Corporation – ICFR environment and the failure to appropriately assess the severity of control deficiencies
- General Motors Company – ICFR failed to timely identify and evaluate loss contingencies
- American Realty Capital Properties – Material misstatement of non-GAAP measures
- MDC Partners – Failure to comply with non-GAAP rules relating to prominence
- FMC Technologies – Segment controller and subordinate recorded a series of accrual adjustments and error corrections in the wrong period to inflate earnings
- Orthofix International – Largest segment improperly recorded revenue that had contingencies, product that could not be sold and recognized discounts as expenses
SEC reporting trends and comments
Restatement themes

<table>
<thead>
<tr>
<th>Top three topics – 2015</th>
<th>%</th>
<th>Top three topics – 2014</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxes</td>
<td>14</td>
<td>Income taxes</td>
<td>17</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>8</td>
<td>Revenue recognition</td>
<td>13</td>
</tr>
<tr>
<td>Liabilities, depreciable assets</td>
<td>6</td>
<td>Statement of cash flows</td>
<td>6</td>
</tr>
<tr>
<td>expense recognition</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In order to avoid errors/restatements, entities should:

- Identify and account for key contractual terms
- Focus on changes in business and effects on estimates on a timely basis
- Entities should correct identified errors as soon as practicable to avoid restatement due to an accumulation of individually immaterial errors

SEC reporting trends and comments
SEC’s filing review process

- Reviews by Division of Corporation Finance
- Required by Sarbanes-Oxley every three years
  - Many registrants are reviewed more frequently
- IPOs, Forms 8-K (Items 2.02, 4.01 and 4.02), merger proxies

SEC reporting trends and comments
SEC’s filing review process

Companies receiving comment letters by size

Public float:
- <$75m, 24%
- $75 to $700m, 20%
- >$700m, 56%

Number of SEC comment letters by year

<table>
<thead>
<tr>
<th>Year</th>
<th>Comment Letters</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>7,610</td>
</tr>
<tr>
<td>2012</td>
<td>5,916</td>
</tr>
<tr>
<td>2013</td>
<td>5,352</td>
</tr>
<tr>
<td>2014</td>
<td>4,683</td>
</tr>
<tr>
<td>2015</td>
<td>3,741</td>
</tr>
<tr>
<td>2016*</td>
<td>2,905</td>
</tr>
</tbody>
</table>

Number of SEC comment letters issued to complete review

<table>
<thead>
<tr>
<th>Number of Comment Letter Rounds</th>
<th>% of SEC Staff Reviews</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 letter</td>
<td>75%</td>
</tr>
<tr>
<td>2 letters</td>
<td>19%</td>
</tr>
<tr>
<td>3 letters</td>
<td>5%</td>
</tr>
<tr>
<td>4 letters or more</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: Audit Analytics – Comment letters related to Forms 10-K posted to EDGAR during the 12-month period ended 30 June 2016.
## SEC reporting trends and comments

### Areas of frequent comment

<table>
<thead>
<tr>
<th>Comment letter topic</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s discussion and analysis (MD&amp;A)</td>
<td>1-1</td>
</tr>
<tr>
<td>Non-GAAP financial measures</td>
<td>2-4</td>
</tr>
<tr>
<td>Fair value measurements</td>
<td>3-2</td>
</tr>
<tr>
<td>Revenue recognition</td>
<td>4-3</td>
</tr>
<tr>
<td>Segment reporting</td>
<td>5-7</td>
</tr>
<tr>
<td>Income taxes</td>
<td>6-6</td>
</tr>
<tr>
<td>Intangible assets and goodwill</td>
<td>7-8</td>
</tr>
<tr>
<td>Acquisitions and business combinations</td>
<td>8-9</td>
</tr>
<tr>
<td>Signatures, exhibits and agreements</td>
<td>9-5</td>
</tr>
<tr>
<td>Commitments and contingencies</td>
<td>10-13</td>
</tr>
</tbody>
</table>

Source: Audit Analytics – Comment letter taxonomy for SEC staff comment letters issued to registrants related to Forms 10-K from 1 July 2014 to 30 June 2016.

### SEC reporting trends and comments

#### Areas of frequent comment – MD&A

- **Results of operations**
  - Identify and quantify specific business drivers of results
  - Disclose key metrics and how they correlate with material changes in the results of operations
  - Discuss significant components (disaggregation) of costs of sales and operating expenses at consolidated and segment levels

- **Critical accounting estimates**
  - Provide a more robust analysis than that included in the notes to the financial statements (e.g., goodwill impairment)
## SEC reporting trends and comments
### Areas of frequent comment – revenue

<table>
<thead>
<tr>
<th>ASC 605</th>
<th>ASC 606 (implementation disclosures)</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Gross versus net – requests for additional information relating to</td>
<td>▶ Staff expects disclosure on status of adoption, including:</td>
</tr>
<tr>
<td>specific arrangements to understand the analysis performed</td>
<td>▶ Matters not yet addressed (open items)</td>
</tr>
<tr>
<td>▶ Sales incentives – questions when incentives are recorded as an</td>
<td>▶ Quantitative estimates based on best available information</td>
</tr>
<tr>
<td>expense rather than a reduction to revenue</td>
<td>▶ Subsequent changes aren’t necessarily control deficiency</td>
</tr>
<tr>
<td>▶ Multiple element arrangements – requests as to if the guidance is</td>
<td>▶ Disclose that amounts are preliminary (if applicable)</td>
</tr>
<tr>
<td>applicable for certain transactions</td>
<td>▶ May disclose information for a subset of revenue streams</td>
</tr>
<tr>
<td></td>
<td>▶ Disclosures need to evolve</td>
</tr>
</tbody>
</table>

### SEC reporting trends and comments
### Areas of frequent comment – segments

- Identification of chief operating decision maker (CODM)
  - Registrants shouldn’t default to CEO
  - CODM does not need to have ultimate decision-making authority
- Identification of operating segments
  - Neither reports provided to CODM nor organizational structure are determinative
  - Emphasis on how the business is managed
- Aggregation of operating segments to reporting segments
  - Consider both qualitative and quantitative factors
  - Similar economic characteristics and all qualitative criteria
    - No bright lines on similar economic characteristics; future doesn’t trump past
    - Similarity viewed from the perspective of a reasonable investor
- Don’t forget about the enterprise-wide disclosures
**SEC reporting trends and comments**

**Areas of frequent comment – segments**

- Tell us the title and describe to us the role of each of the individuals who report to the Chief Operating Decision Maker (CODM).
- Please identify and describe to us the role of each of your segment managers.
- Describe to us the information regularly provided to the CODM and how frequently it is prepared. Similarly, describe to us the financial information provided to the Board and how frequently it is prepared.
- Explain to us how budgets are prepared, who approves the budget at each step of the process and describe the level of detail discussed at each step.
- Tell us how often the CODM meets with his staff to discuss variances between actual and budgeted results.
- Describe the level of detail communicated to the CODM when actual results differ from budgets and clarify who is involved in meetings with the CODM to discuss budget variances.
- Describe the basis for determining segment manager compensation.

**SEC reporting trends and comments**

**Areas of frequent comment – taxes**

- Foreign earnings
  - Support for indefinite reinvestment assertions
    - Disclosures other than in the audited financial statements may contradict assumptions in asserting indefinite reinvestment
  - Effect of foreign earnings on effective tax rate
    - Disproportionate income generated in low-tax jurisdictions
- Realizability of deferred tax assets
  - Weighting of positive and negative evidence
    - Consideration of how objectively verifiable the evidence is
  - Significant estimates and assumptions used in analysis
  - Consistency with assumptions used elsewhere (e.g., goodwill impairment)
- MD&A disclosures
  - Should include a complete story about tax positions
    - Reasons for historical changes in the effective tax rate and discussion of reconciling items
    - Insight into the extent to which past income tax rates are indicative of future tax rates
    - Trends and uncertainties related to changes in unrecognized tax benefits
    - Differences between trends in income tax expenses and cash taxes paid
SEC reporting trends and comments
Areas of frequent comment – commitments and contingencies

► Measurement and disclosure of loss contingencies
  ▶ Undertake sufficient procedures before concluding that a range of loss cannot be estimated
  ▶ Failure to disclose losses that are reasonably possible of being in excess of the amount accrued
  ▶ Evaluate and update disclosures each reporting period

► Balance sheet presentation
  ▶ Criteria for offsetting loss contingencies and insurance recoveries (ASC 210) (i.e., gross versus net presentation)

SEC reporting trends and comments
Other comments – internal control

► Internal control over financial reporting (ICFR)
► Focus on timely evaluation of whether control deficiencies are material weaknesses
  ▶ Does not require an actual material misstatement
  ▶ Evaluation when there are immaterial error corrections
    ▶ Similar comments when other indications of deficiencies exist
  ▶ Consideration of both quantitative and qualitative factors in the evaluation of the severity of a control deficiency
► Disclosure of material changes in ICFR
► Consistency of conclusions on disclosure controls and procedures with ICFR conclusion
Lessons Learned from Implementing the New Revenue Standard
Brad Hale & Phil Pace
May 18, 2017

Speaker

BRAD HALE, CPA
Managing Director, CBIZ MHM, LLC
MHM’s Professional Standards Group

Brad began his career in public accounting with Deloitte and most recently served as the Director of Accounting and Risk Management for Bloomin’ Brands Inc., where he was an integral part of completing their IPO. He focuses on building MHM’s attest footprint through relationships with companies facing complex technical accounting matters and growing the Accounting Advisory practice, particularly through Topic 606 advisory engagements.

Brad is a member of MHM’s Professional Standards Group where he performs internal consultations on complex private or public company engagements, as well as focuses on the firm’s SEC audit methodology. He serves the PSG as a subject matter expert in revenue recognition, leasing, business combinations, share-based compensation, debt vs. equity treatment, complex financial instruments, goodwill, and consolidations & VIEs.

727.572.1400 • bhale@cbiz.com
Can you give us a quick refresher on Topic 606 and dates of adoption?
Entities can elect to early adopt on January 1, 2018. Public Business Entities must adopt on December 31, 2019. All other entities must adopt by January 1, 2020.

5-Step Process:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfied a performance obligation
Where did you start?

- Got up-to-speed on the standard
- Assembled a cross-functional team
- Developed a timeline
- Conducted in-depth scoping analysis at the trial balance level
Account handle | GS Account | Account purpose | Rev Non-Contract/Portfolio |
--- | --- | --- | --- |
40000010 | Food Sales-Restaurant | This consists of food sales in the restaurant. | Dine-in meal |
40000020 | Beverage Sales-Non Alcoholic | This consists of non-alcoholic beverage sales in the restaurant. | Dine-in meal |
40010010 | Liquor Sales | This consists of liquor sales in the restaurant. | Dine-in meal |
40010020 | Beer Sales | This consists of beer sales in the restaurant. | Dine-in meal |
40010030 | Wine Sales | This consists of wine sales in the restaurant. | Dine-in meal |
40010040 | Pre-opening Liquor/Beer/Wine Sales | This consists of liquor, beer or wine sales prior to the restaurant opening for business to the general public. | Dine-in meal |
40020010 | Service Payout | | |
40020020 | Service Charge | This consists of the 10% surcharge fee charged to all guests in Hong Kong. The surcharge stays at the restaurant and is offset in Employee Benefits (via staff appreciation lunches). | Dine-in meal |
40020030 | Loyalty Revenue Deferral | This consists of deferred revenue related to loyalty programs both domestically as well as internationally. For the domestic program, a portion of the revenue for qualifying visits is deferred until the redemption period that the award can be redeemed. For the Hong Kong program, the value of the loyalty card is amortized over the 24 month life of the card. See Summary tab for the amounts for the respective programs. | |
40030000 | Gift Card Breakage Revenue | This consists of breakage for gift cards that have been sold but not yet redeemed. Breakage is considered if a gift card has a balance 36 months after being sold. | |

Where did you start?

What resources from the organization were devoted to the project?

How did you achieve cross-functional involvement?
What resources from the organization were devoted to the project?

- Technical Accounting/Financial Reporting
- Gift Card/Loyalty Accounting and Processing
- International Accounting
- Corporate Finance
- Tax
- Investor Relations
- Marketing
- Other possibilities
  - Human resources
  - Legal
  - Treasury

How did you achieve cross-functional involvement?

- Importance of buy-in from senior leadership to understand the potential impact to the organization as a whole
- Discussion with Audit Committee naturally elevates importance
- Accounting shouldn’t carry the entire burden
Did you collaborate with others in the industry?

- Darden and other restaurant companies
- Hilton
- National Restaurant Association and other restaurant-company conferences
- Controllers Executive Board forums
- CEB Accounting & Reporting Leadership Council Retail Revenue Recognition cohort
  - Dick’s Sporting Goods, Inc.
  - Under Armour, Inc.
  - The Kroger Co.
  - Central Garden & Pet
What are some examples of the way that Bloomin’ is impacted by the standard?

- Gift card breakage
- Franchise fees
- Franchise marketing reimbursements
- Loyalty programs
- Marketing promotions
What are some examples of the way Bloomin’ is impacted by the standard?

In May 2014, the FASB issued ASU No. 2014-09 “Revenue Recognition (Topic 606). Revenue from Contracts with Customers” (“ASU No. 2014-09”). ASU No. 2014-09 provides a single source of guidance for revenue arising from contracts with customers and supersedes current revenue recognition standards. Under ASU No. 2014-09, revenue is recognized in an amount that reflects the consideration an entity expects to receive for the transfer of goods and services. ASU No. 2014-09, as amended, will be effective for the Company in fiscal year 2018 and is applied retrospectively to each period presented or as a cumulative effect adjustment at the date of adoption.

While the Company continues to assess all potential impacts of the standard, it currently believes the most significant impact relates to accounting for breakage and advertising fees charged to franchisees. Under the new standard, the Company expects to recognize breakage proportional to actual gift card redemptions. Advertising fees charged to franchisees, which are currently recorded as a reduction to Other restaurant operating expenses, will be recognized as Other revenue. In addition, initial franchise fees will be recognized over the term of the franchise agreement, which is not expected to have a material impact on the Consolidated Financial Statements.

What are the two transition methods and how did you select one?
What are the two transition methods and how did you select one?

- **Retrospective:**

  Financial Statements  
  Year ended December 31, 2018, 2017 and 2016

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported</td>
<td>Topic 606</td>
<td>Topic 606*</td>
<td>Topic 606*¹</td>
</tr>
</tbody>
</table>

*Disclosure of changes under Topic 606 is required
¹ Adjust opening retained earnings

- **Modified Retrospective:**

  Financial Statements  
  Year ended December 31, 2018, 2017 and 2016

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported</td>
<td>Topic 606*¹</td>
<td>Topic 605</td>
<td>Topic 605</td>
</tr>
</tbody>
</table>

*Disclosure of difference from Topic 605 is required
² Adjust opening retained earnings

What internal controls did you consider with respect to the adoption itself?
What internal controls did you consider with respect to the adoption itself?

- Entity-level control considerations
  - Commitment to competence
  - Identifies risk to the organization
  - Gathers the appropriate information to make judgments and satisfy disclosures
  - Retains data for reliable restatement

- Activity-level control considerations (Financial Reporting Cycle)
  - Look to control currently in place with respect to adoption of new accounting standards
  - Ensure proper layers of review are in place
  - Validate controls around completeness of the revenue population
At what point did you feel comfortable involving your audit firm?

What can I expect from my audit firm?

- Early in the process
  - Buy-in on project plan
  - Shared perspective on expected areas of impact
  - Show mutual commitment to Audit Committee

- Project check points
  - Documentation process alignment after completion of one revenue stream
  - Refreshes on expected control activities prior to turning over deliverables
What can I expect from my audit firm?

- Private vs. Public companies
- A focus on the controls and process taken by management to arrive at its conclusions
- If controls around the process are weak, you can expect large sample sizes to test the adoption
- A possible shift from transaction-level testing to contract-level testing
- Fee discussions

Were any system changes or other third-party tracking changes required?
Were any system changes or other third-party tracking changes required?

- SAP configuration for amortization of franchise fees
- Loyalty program third-party reports were designed on the front end with knowledge of the 606 requirements
  - Use of 3rd party provider to track outstanding points and usage
- Deep dive on breakage data and model
- SSAE 16 (SAS 70) considerations

What were the most challenging parts?
What were the most challenging parts?

- Resource allocation
- Surprise factor
- Pressure placed on transition
- Time spent on small parts of our business
- Heavy documentation expectations

How long is the typical implementation project?
How long is the typical implementation project?

- 3 phases
  - Planning and Scoping (1 week)
  - Contract deep dive (varies based on contract volume or number of revenue streams; average 3 – 4 weeks)
  - Disclosure and transition method (varies based on level of impact; average 3 – 4 weeks)

What are some common pitfalls that you are seeing in implementations?
What are some common pitfalls that you are seeing in implementations?

- Getting started
- Wanting an answer before seeing through the process
- Scoping the project
- Calculating contingent revenue
- Treatment of contract costs
- Underestimating level of documentation
- Understanding impact downstream (i.e. controls, contracts, etc.)
- Bias

QUESTIONS
Fraud and Internal Controls

Seminar Outline

- Fraud Update – ACFE 2016 Report to the Nation
- What is a CFE?
- Fraud and Abuse
- Fraud Triangle
- Whistleblower Hotline
- Risk Assessment
  - Employee Red Flags
  - Management Red Flags
- Fraud Examples
ACFE 2016 Report to the Nation on Occupation Fraud and Abuse

- Estimated Typical Organization Loses 5% of Revenues each Year due to Fraud
- (Applied to 2013 estimated Gross World Product - $3.7 trillion)
- How much is $3.7 trillion?
  - MORE THAN 16 TIMES the net worth of the world’s 3 wealthiest people combined
  - 22 DAYS WORTH OF TRADING on the New York Stock Exchange
  - In stacked nickels, it would reach the MOON AND BACK 187 TIMES

- Total loss caused in 2016 study exceeded $6.3 billion

ACFE 2016 Report to the Nation on Occupation Fraud and Abuse

- 2410 Cases of Occupational Fraud in Study
  - 1038 Cases - USA (48.8% of cases)
  - 285 Cases - Sub-Saharan Africa
  - 221 Cases - Asia-Pacific
- Investigated between January 2014 and October 2015
- Frauds took place in 114 different countries throughout the world
ACFE 2016 Report to the Nation on Occupation Fraud and Abuse – cont’d

- Estimated Typical Organization Loses 5% of Revenues each year due to Fraud
- Total loss caused by cases in study exceeded $6.3 billion
- Average loss per case $2.7 million
- Median loss for all cases $150,000 with 23.2% cases causing losses of $1 million or more
- Asset misappropriation most common – 83% (median loss $125k)
- Financial statement fraud occurring less than 10% of cases (median loss $975k)
- Corruption 35.4% of cases (median loss $200k)

Longer fraud lasted, greater the financial damage
- Median length stayed at 18 months
- Schemes that lasted more than 5 years caused median loss of $850,000

Tips continue to be key in detecting fraud
- More than 39.1% of cases detected by tips (2014 – 40%)
- Organizations with hotlines – 47.3%
- Organizations without hotlines – 28.2%
- Majority from employees of victim organization

94.5% of cases, perpetrator made efforts to conceal fraud
- Most common method – creating and altering physical documents
ACFE 2016 Report to the Nation on Occupation Fraud and Abuse – cont’d

- Occupational Fraud is Global Problem
  - Most trends in fraud schemes, perpetrator characteristics and anti-fraud controls are similar global
- High Level Perpetrators do Most Damage
  - Median Loss Owners/Executives $703k (up from $500k in 2014)
  - Median Loss Managers $173K (up from $130k in 2014)
  - Median Loss Other Employees $65k (down from $75k in 20014)
- Small Businesses Face Increased Risk
  - Check tampering, skimming, payroll and cash larceny schemes

www.acfe.com

What is a CFE?

- Certified Fraud Examiner (CFE)
- Specialist in the detection and/or deterrence of a wide variety of fraudulent activity
“Association of Certified Fraud Examiners (ACFE) is a member-based global association dedicated to providing anti-fraud education and training. Together with its members, the ACFE is reducing business fraud worldwide and inspiring public confidence in the integrity and objectivity of our profession”

www.acfe.com

- Established in 1988 and headquartered in Austin, TX, the ACFE has grown from:
  - 1992 – 5,500 members
  - 2004 – 29,000 members
  - 2007 – 40,000 members
  - 2016 – 75,000 members
- Membership represents 150 chapters in over 150 countries worldwide
- 94 Chapters in USA – 7 Florida Chapters include: Ft. Myers, Jacksonville, Miami, Orlando, Pensacola, Tallahassee and Tampa
- Tampa Bay Chapter named “Chapter of the Year” in 2009 and 2017
- Membership requires CFE adhere to strict code of professional conduct and ethics
West Virginia University Model Curriculum*
ACCOUNTING

Internal and External Auditing
- Planning
- Risk Assessment
- Internal Controls
- Audit Evidence Reporting

Forensic Accounting
- Litigation Matters & Investigations

Fraud
- Prevention and Deterrence
- Detection
- Investigation
- Remediation


What is Fraud & Abuse?
Fraud & Abuse

- Fraud
  “Any crime for gain, which uses deception as its principle mode of operation”

- Occupational Fraud (abuse)
  “The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets”

What is Forensic Accounting?

- Forensic accounting is the integration of accounting, auditing and investigation skills
- “Forensic” according to Webster’s Dictionary means “Belonging to, used in or suitable to courts of judicature or to public discussion and debate”
- Not dead person
In Other Words……

- Forensic accounting is the action of identifying, recording, settling, extracting, sorting, reporting, and verifying past financial data or other accounting activities for settling current or prospective legal disputes, or using such past financial data for projecting future financial data to settle legal disputes

*The Value Examiner, March/April 2007

Forensic Accounting

- Provides an accounting analysis that is suitable to the court which will form the basis for discussion, debate and ultimately dispute resolution.

- Encompasses both:
  - Litigation Support and
  - Investigation Accounting
Fraud Happens

- Fraud happens as honest mistakes
- What happens when an employee makes a mistake and does not get caught?
- It does not take a genius to steal
- Many fraudulent situations are relatively easy to understand and easy to perpetrate schemes

How is Internal Theft Discovered?

2016 - United States

- 42.2% - Tips from co-worker or complaints 37.0%
- 16% Management Review 14.3%
- 17.7% - Audits 18.1%
  - internal 14.7% 14.1%;
  - external 3% 4%
- 6.8% - By accident 7.2%

2018 Report to the Nations on Occupational Fraud and Abuse. Copyright 2014 by the Association of Certified Fraud Examiners, Inc.
Fraud Triangle

Opportunity

Incentives/Pressures  Rationalization/Attitudes

Opportunity

- Poor controls/lack of segregation of duties
- Poor supervision
- Too much trust
- Poor communication within organization or Board
- Poor financial controls
- No checks and balances
Incentives / Pressures

Financial pressures
  • Work related pressures

Personal pressures
  • Vice/Addictions

Incentives/pressures

- Financial pressures
  - Meeting investor/analyst expectations
  - Meeting debt covenant requirements
  - Credit cards and bills
  - Sickness of unfortunate circumstances

- Vice pressures
  - Addictions
  - Drugs, gambling
Incentives/pressures (continued)

- Work related pressures
  - Fear of losing job
  - Being overlooked for a promotion
  - Feeling underpaid
  - Get even with employer
- Other pressures
  - Satisfy greed with high lifestyle
  - Imposed by self, spouse or others

Rationalization / Attitudes

- I deserve it
- The organization can turn it around if we can just comply with debt covenants one more time
- It’s not hurting anyone (investors, lenders, general public)
Rationalization / Attitudes (continued)

- “I’m only borrowing it and I’ll pay it back”
- “I need it more than my boss”
- “The “Government” or the “Company” can afford it”
- “It’s for a good purpose”

Whistleblower Hotline

- Tips and complaints #1 way fraud uncovered
- 48.7% from employees
- Other parties such as customers and vendors
- Should consider all factors when establishing a whistleblower policy
- And the reporting mechanism
- 47% hotline calls overnight or on the weekends
Major Methods of Perpetration

- Override of internal controls
- Contrived or non-substance transactions
- Fictitious and unrecorded transactions
- Collusion
- Forgery or fake documents

Primary Internal Control Weakness Observed by CFEs

©2014 Association of Certified Fraud Examiners, Inc.
Characteristics of a Fraud Examiner

- Patient
- Skeptic
- Investigative mind
- Organized
- Detail oriented
- Present data (charts and graphs)
- Tell the story with facts

Risk Assessment

- Employee red flags
- Management red flags
- Other red flags
Employee Red Flags

- Employees’ lifestyle changes
- Expenses, cars, jewelry, homes, clothes
- Significant personal debt and credit problems
- Behavioral changes: drugs, gambling
- High employee turnover
- Refusal to take vacation or sick leave
- Lack of segregation of duties in a vulnerable area

Management Red Flags

- Reluctance to provide information
- Excessive number of checking accounts
- Frequent changes in auditors
- Excessive number of year-end transactions
- High employee turnover rate
- Unexpected overdrafts or declines in cash balance
- Financial transactions that do not make sense, common or business
- Photocopies or missing documents
Other Red Flags

- Poor segregation of duties
- Lack of management oversight
- Excess credit memos and other credit adjustments
- Customer complaints and discrepancies
- Missing or altered source documents
- Inadequate record-keeping
- Lack of independent review
- Lack of cash flow from operating activities
- Excess “no sales” or other non sale transactions
- Drop in gross profit margin

Examples of Documentation “Red Flags”

Checks

- Payable to “cash” or “petty cash”
- Made out in even amounts for sums over $500 or $1,000
- Unusual check endorsements
- Made out to vendors and cashed (not deposited)
- Non-payroll checks endorsed by hand
Examples of Documentation “Red Flags”

Checks (continued)
- Missing checks or checks out of sequence
- Excessive number of voided checks
- Large, unexplained reconciling items in the bank reconciliation
- Bank account not reconciled on a timely basis
- Bank statements that do not include canceled checks
- Abnormal number of expense items or supplies reimbursements by employee

Examples of Documentation “Red Flags”

Invoices
- Only a post office box number, no physical address
- Typed rather than printed
- Heading that is rubber-stamped rather than printed
- No telephone number
- Not vendor’s ordinary goods or services
Examples of Documentation “Red Flags”

Invoices (continued)

- Disbursements are unsupported by invoices or other documentation
- Payments to vendors not on the approved list
- Vendor’s invoice without invoice numbers
- Vendor’s address that match employee address
- Purchases that by-pass the normal procedures
- High volume of purchases from new vendors shortly after they obtain vendor status

Fraud Examples
Example #1 Fictitious Expenses

- Investigation involved
  - Unauthorized bonuses
  - Unauthorized PTO Hours
  - Unauthorized Paid Time Cashed
  - Insurance Premiums
  - Expense Reimbursements
  - Payments made to family members

Investigation results $211,871
- Unauthorized bonuses $81,209
- Unauthorized PTO Hours $0
- Unauthorized Paid Time Cashed $55,832
- Questionable insurance premiums $40,110
- Questionable expense reimbursements $7,242
- Questionable payments made to family members $27,478
Rita Crundwell, Age 59 Embezzled $54 Million

America’s Queen of Municipal Embezzlement

- City of Dixon, Illinois
- 16,000 residents
- Annual Budget - < $10 Million
- Comptroller and Treasurer - annual salary $80,000
- With the City for 30 years
- Charged with single count of wire fraud
- Arrested April 17, 2012
- Sentenced to 19 years 7 months
Crundwell – Secret Bank Account

- Over a 20 year period, Crundwell diverted money to an account she set up for personal use, spending it on luxury homes, jewelry, vehicles and a horse-breeding operation.
- She was accused of transferring city revenue into it, including incoming sales taxes and other money from the state, before it got to the city’s books.
- Found she also transferred $100,000 from the Police and Fire Pension Funds to pay city bills.
- Transferred money to general fund over the past few years and later put back into pension funds.

Crundwell – Controls?

- Crundwell was able to open a bank account without anyone knowing (because she picked up all the mail).
- Bank Account named RSCDA (Reserve Sewer Capital Development Account).
- She was the only signor on the account.
- Money would be deposited into the Capital Development Fund Account.
- She created false invoices, and would write checks payable to “Treasurer”.
- Deposit them into the RSCDA account.
**Crundwell – Controls?**

- Bank statements sent to PO Box
- One person was able to write checks without anyone else approving or signing off on them
- Created fake invoices from the State of Illinois to show city auditors – slow pay
- A relative performed her job any time she was out of the office

**Crundwell – Who’s to Blame?**

- The City of Dixon filed a civil complaint against its auditors for not catching any of the alleged $53 million dollar embezzlement
- City stated the two accounting firms it hired to audit the books over the past five years, failed to catch the embezzlement
- Complaint stated the auditors were “negligent”
- City also named two banks.
"When you put these (invoices) in comparison to one another the discrepancies are obvious and should have been obvious for over 20 years" to auditors – Attorney Devon Bruce told reporters.

• To justify the payment of city funds to the secret bank account, Crundwell created almost 180 invoices over two decades to make it appear the state was billing the city for work it had done in Dixon, Bruce said.
• The auditors, though, failed to notice that Crundwell’s phony invoices contained misspellings and were not on state letterhead, he said.
• He also said the auditors didn’t try to verify the projects by calling the state, checking with a city engineer or personally examining the projects.
Who is to Blame?

- For at least two decades, the same auditors reviewing Dixon’s finances were also preparing Crundwell’s personal tax returns, but
- They failed to be alarmed by the hundreds of thousands of dollars she claimed in income a year on her returns even though she had no documentation, according to Attorney.

Crundwell – Trusted Her

- They simply trusted her
- She was well-liked
- “She’s always had work-ethic, up early, up late,“
- Very generous with her money, donating to and sponsoring several horse shows
Who is to Blame? (continued)

- Attorney Bruce also faulted the bank for violating banking standards by allowing Crundwell to open a city account in 1990 without proper documentation, even if employees knew she worked for the city.
- The bank also accepted checks from the city's Capital Development Fund account simply made out to "Treasurer" he said.

"That could be treasurer of the petunia festival in the city of Dixon, that could be the treasure of the Lions Club in the city of Dixon," Bruce said.

"That check made simply payable to 'Treasurer' should never be allowed to be negotiated."
Who is to Blame? (continued)

In addition, the bank should have been monitoring the account and investigating charges to a city account for jewelry, spas and trips, Attorney Bruce said. When preparing a list of accounts for the annual audit, he said it is also the bank’s responsibility to disclose all accounts. But Crundwell's secret account was not included on the reports until 2010. Even then, auditors did not question its appearance.

"It’s absolutely a red flag in the accounting industry, and they should have investigated that and they did not," Bruce said.

Crundwell - Background

- The attractive Crundwell became the best in the American Quarter horse Association by 2011 having won “best owner and exhibitor” eight years in a row
- To feed her ever more expensive habit, she had a Florida vacation home and apparently $300,000-plus in jewelry paid for by the city
- She even stole $3 million from the city in just the six months during the investigation
- The city had to refinance $6 million in debt
- For three years, city employees did not get a raise
Arrested April 17, 2012

Where the City of Dixon’s money went for the five months ending February 2012:

- $192,000 Public affairs
- $241,000 Public works and property, building, traffic
- $263,000 Streets
- $560,000 Fire
- $589,000 Accounts and Finance
- $1.1 million Police
- $3.2 million Crundwell’s pocket*

*According to FBI allegations. Spending amounts are from the fiscal year 2011-12 budget restated by the City of Dixon in September; they assume that budgeted amounts were in fact spent and prorate them over the five-month period.
SOURCES: Federal Bureau of Investigation, City of Dixon, Chicago estimates

Crundwell - Uncovered

- When on vacation a relative would pick up the mail, however
- While Rita was away on vacation last year, city clerk filled in and discovered the secret account
- She and the mayor took the evidence to the FBI and kept their secret for six months while the FBI investigated —and Rita continued her thievery
- The city manager of neighboring city said he noticed negative fund balances in Dixon and raised red flags with unnamed Dixon officials
Crundwell - Sentenced

- Feb 14, 2013 sentenced 19 years 7 months for $53.7M fraud. Serving in federal prison in Waseca Minnesota. and is scheduled for release on March 5, 2030. She will be 77 when released.

Crundwell

- As Dixon’s own Ronald Reagan said so famously:

  "Trust, but verify."

September 25, 2013

“Dixon City Council approved a $40-million settlement with auditors and Fifth Third Bank at a special meeting today. The out-of-court settlement was reached on Friday with the companies the city blames for allowing former comptroller Rita Crundwell to embezzle $54-million over twenty years.”

City of Dixon - Recovery

- The City of Dixon was able to recover over $40-million dollars through settlements with a bank and former auditors for not catching Crundwell’s embezzlement.
- The deal was worked out in a 17-hour meeting in Chicago. Former auditor CliftonLarsonAllen to pay $35-million, former auditor Sam Card to pay $1-million, and Fifth Third Bank to pay nearly $3.85-million.
The city also received approximately $10-million from the auction of Crundwell's possessions: (that amount just about covered the city's attorney and forensic fees).

Government also seized bank accounts, insurance policy refunds, retirement fund reimbursements ($90k) and loans owed to her. Assets include various pieces of artwork and about 700 trophies.

See wanted to keep the trophies. Those who purchased horses (including one stallion for $775k) were interested in the trophies connected to them.

"Allowing Ms. Crundwell to keep these particular assets because they have more sentimental than tangible value is allowing Ms. Crundwell to benefit to her crime"...according to the feds....."these awards represent the primary motivation of her massive fraud"

Sold sealed bid auction $5,560 – Dec 1, 2015
Questions?

Contact Information

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Lbrock@kbgrp.com

Offices in Tampa, Sarasota and Lakewood Ranch
Setting the stage
A look at the 115th Congress

Deadlines will dominate

**2017**

- **Jan. 3**: 115th Convened
- **Jan. 20**: Inauguration
- **Feb. 6**: President’s FY18 budget due (in theory)
- **Mar. 16**: Debt limit reinstated
- **Apr. 15**: Congress adopts FY18 budget (in theory)
- **Apr. 28-29**: First 100 Days
- **Jul. 31**: FY17 CR Expires
- **Aug. Recess**
- **Aug. 4**: Debt limit reinstated
- **Sep. 4**: FY2017 Ends
- **Sep. 28-30**: August Recess

The November elections – a recap

Democrats picked up seats in both chambers, but remain in minority

- **House** Republicans beat expectations, losing (on net) only six seats
  - 115th Congress balance of power*: 238 Republicans, 193 Democrats
  - Paul Ryan gets another term as Speaker
  - 218 votes needed to pass legislation without Democratic support (~35 member House Freedom Caucus not shy about exerting influence

- **Senate** Republicans lost only two seats and held on to majority
  - 115th Congress balance of power: 52 Republicans, 48 Democrats
  - Sen. Chuck Schumer succeeds Sen. Harry Reid as minority leader, expands leadership team
  - Tough outlook for Democrats – defending 25 seats in 2018 (10 of which were carried by Trump), to only 8 for Republicans

*As of April 18, 2017, at which time four House seats were vacant as a result of cabinet appointments (Price, Mulvaney, and Zinke) and a departure for state office (Becerra)
The deficit reprieve is over
After 2018, budget deficits to stage inexorable ascent

Note: Assumes current law remains unchanged (e.g., remaining tax extenders expire as scheduled, sequester cuts are allowed to transpire as scheduled, etc.).
Source: Congressional Budget Office, The Budget and Economic Outlook: 2017 to 2027 (Jan. 2017); $9.4T cumulative deficit spans the current 10-year budget window (2018-2027)

The American Health Care Act
Passed the House – but what comes next?

- The AHCA would repeal major health coverage- and tax-related provisions of the Affordable Care Act, including those noted below. In its place, the bill would liberalize HSA rules and put in place less generous, age-adjusted refundable tax credits to assist low- and middle-income individuals afford coverage.
- In total, the bill would repeal tax provisions totaling nearly $1 trillion over the next decade.

| Premium assistance tax credit (effective 2020) | 3.8% Net Investment Income Tax (effective 2017) | Additional 0.9% Medicare payroll tax on high-income taxpayers (effective 2023) |
| Medicaid expansion (new enrollment frozen in 2020) | Medical Device Excise Tax (effective 2017) | Annual fee on health insurance providers (effective 2017) |
| Penalties for not carrying/providing adequate coverage, i.e., the “mandates” (effective 2016) | Higher AGI floor for itemized medical expense deduction (effective 2017) | Limit on contributions to health FSAs in cafeteria plans (effective 2017) |
| “Cadillac” tax on high-cost employer-sponsored coverage (postponed effective date to 2026) | Annual fee on manufacturers and importers of branded drugs (effective 2017) | Codification of economic substance doctrine (NOT REPEALED) |
Budget Reconciliation

**GOP control raises specter of “budget reconciliation”**
How does it work?

- **House and Senate must agree on a budget resolution that includes the reconciliation instructions**
  (that alone could pose challenges)

- **Reconciliation instructions cannot be prescriptive – may only specify:**
  - The Committee(s) charged with reporting legislation
  - The budget impact of legislation to be reported (spending ↑↓, revenues ↑↓, or “deficit reduction”)
  - May also be used to raise the statutory debt limit
  - Date by which Committee(s) must report conforming legislation

- **Limited debate** – legislation moved under reconciliation cannot be filibustered in the Senate (may pass with 51 votes)

**Tax reform through reconciliation**

Is it really an option?

- The **“Byrd Rule” can set up 60-vote hurdles in the Senate**, including with respect to:
  - Provisions that would increase the deficit in any year beyond the period covered by the budget resolution, unless offset by other changes in the same title (recall the expiring 2001/2003 tax cuts)
  - Provisions that have no budgetary effect or whose budget effect is “merely incidental” to the policy

- **Committee(s) must meet their instructions; if not, the bill can be filibustered**
  - Example from FY2017 budget (ostensibly targeted at ACA repeal/replace):

  SEC. 2001. RECONCILIATION IN THE SENATE.
  (a) COMMITTEE ON FINANCE.—The Committee on Finance of the Senate shall report changes in laws within its jurisdiction to reduce the deficit by not less than $1,000,000,000 for the period of fiscal years 2017 through 2026.

  SEC. 2002. RECONCILIATION IN THE HOUSE OF REPRESENTATIVES.
  (b) COMMITTEE ON WAYS AND MEANS.—The Committee on Ways and Means of the House of Representatives shall submit changes in laws within its jurisdiction to reduce the deficit by not less than $1,000,000,000 for the period of fiscal years 2017 through 2026.

- **Reconciliation has become an inherently partisan exercise – no buy-in from minority party raises risk of later repeal if balance of power shifts**

---

A look at the House GOP “Blueprint”, Trump tax platform
### Remembering H.R. 1, the Tax Reform Act of 2014

**High-level overview and lessons learned**

- Lowered top rates on corporations and individuals to 25%, and transitioned to a territorial system, while maintaining revenue- and distributional-neutrality over the 10-year budget window.

- Deemed to boost GDP by between 0.1% and 1.6%, resulting in additional "dynamic" revenue of $50 - $700 billion.

- Included dozens of politically painful base-broadeners (e.g., amortizing R&D and advertising expenses; repealing MACRS, LIFO, §1031 exchanges, §199 deduction; limiting the mortgage interest/charitable deductions), plus a broad-based 10% surtax that lifted the top effective rate on individuals.

- Phased-in corporate rate reduction, timing shifts (e.g., repealing MACRS, expanding Roth accounts), and one-time revenues (e.g., deemed repatriation) could indicate plan would have lost revenue beyond the 10-year budget window.

### House GOP tax reform blueprint gets a second look

**"Destination-based cash-flow tax"**

<table>
<thead>
<tr>
<th><strong>House GOP Tax Reform Blueprint</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business</strong></td>
</tr>
<tr>
<td>Corporate Rate</td>
</tr>
<tr>
<td>Pass-through Rate</td>
</tr>
<tr>
<td>Full Expensing</td>
</tr>
<tr>
<td>Interest Deduction</td>
</tr>
<tr>
<td>Alternative Minimum Tax</td>
</tr>
<tr>
<td>§199 Deduction</td>
</tr>
<tr>
<td>Net Operating Losses</td>
</tr>
<tr>
<td>International</td>
</tr>
<tr>
<td>Border Adjusted Tax Base</td>
</tr>
<tr>
<td><strong>Individual</strong></td>
</tr>
<tr>
<td>Top Individual Rate</td>
</tr>
<tr>
<td>Capital Gains and Dividends</td>
</tr>
<tr>
<td>Itemized Deductions</td>
</tr>
<tr>
<td>Standard Deduction</td>
</tr>
<tr>
<td>Health Care</td>
</tr>
<tr>
<td>Estate Tax</td>
</tr>
<tr>
<td><strong>10-Year Revenue Effect</strong></td>
</tr>
</tbody>
</table>

* Items marked with an asterisk were included in the House GOP health care reform blueprint, which was released separately from the tax reform blueprint.
**House GOP 'Blueprint' and border-adjustments**

Can't have one without the other?

<table>
<thead>
<tr>
<th>Revenue Estimate (Tax Policy Center) 2016 - 2026</th>
<th>$ billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consolidate/reduce individual tax rates, repeal individual AMT, increase standard deduction, other individual tax cuts</td>
<td>- $2,657</td>
</tr>
<tr>
<td>Reduce corporate rate to 20%, repeal corporate AMT, reduce top passthrough business rate to 25%, transition to territorial system</td>
<td>- $2,345</td>
</tr>
<tr>
<td>Expensing, net of interest deduction limit</td>
<td>- $1,085</td>
</tr>
<tr>
<td>Repeal ACA taxes, estate tax</td>
<td>- $990</td>
</tr>
<tr>
<td>Reduce effective rate on capital income</td>
<td>- $498</td>
</tr>
<tr>
<td>Repeal itemized deductions, other than mortgage and charitable</td>
<td>+ $1,908</td>
</tr>
<tr>
<td>Repeal personal/dependent exemptions</td>
<td>+ $1,654</td>
</tr>
<tr>
<td>Border adjusted tax base</td>
<td>+ $1,180</td>
</tr>
<tr>
<td>All other revenue raisers</td>
<td>+ $734</td>
</tr>
<tr>
<td>Net revenue effect (under conventional scoring)</td>
<td>- $3,101</td>
</tr>
</tbody>
</table>

**If no border adjustments, what base erosion protections would accompany the proposed territorial system?**

**Will the dollar adjust? How much? Impact on American investments abroad / dollar-denominated debts in EMs?**

**Impact on net importers (e.g., retail, oil refining) – will exceptions be made?**

**Impact on net exporters / tax-driven M&A?**

**How would the WTO view this regime? Our trading partners?**

---

**President Trump’s tax platform – an evolution of ideas**

**Business provisions**

<table>
<thead>
<tr>
<th></th>
<th>Sept. 2015 Campaign Plan</th>
<th>Sept. 2016 Campaign Plan</th>
<th>April 2017 One-Pager</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Rate</strong></td>
<td>15%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td><strong>Pass-through Rate</strong>&lt;br&gt;(on business income)</td>
<td>15%</td>
<td>May elect to be taxed as a C corp to benefit from 15% rate; however, all but “small” pass-throughs (undefined) would face second-layer tax on distributions to owners</td>
<td>“15% business tax rate”</td>
</tr>
<tr>
<td><strong>Alternative Minimum Tax</strong></td>
<td>Repeal</td>
<td>Repeal</td>
<td>Repeal</td>
</tr>
<tr>
<td><strong>Full Expensing?</strong></td>
<td>No</td>
<td>Yes, electable for US manufacturers</td>
<td>Silent</td>
</tr>
<tr>
<td><strong>Interest Deduction</strong></td>
<td>Phase-in a “reasonable cap” on the deductibility of business interest</td>
<td>Eliminated for firms that elect full expensing</td>
<td>Silent</td>
</tr>
<tr>
<td><strong>Carried Interest</strong></td>
<td>Tax as ordinary income</td>
<td>Tax as ordinary income</td>
<td>Silent</td>
</tr>
<tr>
<td><strong>Financial Products and Institutions</strong></td>
<td>Phase-out deferral of inside build-up on life insurance contracts for “high-income earners”</td>
<td>Silent</td>
<td>Silent</td>
</tr>
<tr>
<td><strong>International</strong></td>
<td>Repeal deferral</td>
<td>Silent</td>
<td>Territorial</td>
</tr>
<tr>
<td><strong>Deemed Repatriation</strong></td>
<td>Yes (10% rate)</td>
<td>Yes (10% rate)</td>
<td>Yes (rate not specified)</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>Reduce or repeal “special interest” provisions and deductions made “unnecessary or redundant” by the 15% rate</td>
<td>Reduce or repeal most corporate tax expenditures, but specifically calls for retention of the R&amp;D credit</td>
<td>Eliminate “special interest” tax breaks; no mention of retaining R&amp;D credit</td>
</tr>
</tbody>
</table>
### President Trump’s tax platform – an evolution of ideas

#### Individual provisions

<table>
<thead>
<tr>
<th></th>
<th>Sept. 2015 Campaign Plan</th>
<th>Sept. 2016 Campaign Plan</th>
<th>April 2017 One-Pager</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rate Structure</strong></td>
<td>0% / 10% / 20% / 25%</td>
<td>12% / 25% / 33%</td>
<td>10% / 25% / 35%</td>
</tr>
<tr>
<td></td>
<td>(top rate would begin at $300k of joint income)</td>
<td>(top rate would begin at $225k of joint income)</td>
<td>(dollar thresholds unspecified)</td>
</tr>
<tr>
<td><strong>Capital Gains and Dividends</strong></td>
<td>20% top rate</td>
<td>20% top rate</td>
<td>20% top rate</td>
</tr>
<tr>
<td><strong>Alternative Minimum Tax</strong></td>
<td>Repeal</td>
<td>Repeal</td>
<td>Repeal</td>
</tr>
<tr>
<td><strong>Itemized Deductions</strong></td>
<td>Charitable and mortgage interest deductions would be “unchanged for all taxpayers”; however, Pease limitation would be tightened</td>
<td>Dollar cap on total itemized deductions ($200k for joint filers, $100k for single filers)</td>
<td>“Protect” the charitable and mortgage interest deductions</td>
</tr>
<tr>
<td><strong>Standard Deduction</strong></td>
<td>Does not specify parameters, but plan indicates 10% bracket would not apply until single/joint income exceeds $250k/$50k</td>
<td>$15,000 (single) / $30,000 (joint), indexed</td>
<td>“Double the standard deduction”</td>
</tr>
<tr>
<td><strong>Personal Exemptions / Filing Status</strong></td>
<td>Personal Exemption Phase-out would be tightened</td>
<td>Repeal personal and dependent exemptions; eliminate Head of Household filing status</td>
<td>Silent</td>
</tr>
<tr>
<td><strong>Estate and Gift Tax</strong></td>
<td>Repeal</td>
<td>Repeal, but tax capital gains at death in excess of $10 million</td>
<td>“Repeal the death tax”</td>
</tr>
<tr>
<td><strong>New Tax Benefits</strong></td>
<td>None specified</td>
<td>New above-the-line deduction for child care costs + new Dependent Care Savings Accounts</td>
<td>“Tax relief for families with child and dependent care expenses”</td>
</tr>
<tr>
<td><strong>10-Year Revenue Impact</strong></td>
<td>Loses $9.5 trillion</td>
<td>Loses $6.2 trillion</td>
<td>Not available</td>
</tr>
</tbody>
</table>

---

**Questions?**

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