ICPA® EXAM Review

International Certified Professional Accountant®

2018 Edition

IICPA

ICPA®
Exam Review

Part One

Financial Accounting and Reporting,
Management Accounting
External and Internal Auditing,
Internal Control

Part Two

Corporate Finance,
Commercial Banking, Financial Markets,
Economics, Commercial Law,
International Taxation,
Blockchain
A Complete Glossary of Accounting Terms

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ICPA® Exam Review
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ABBREVIATIONS

Used in this text

AAG	Audit and Accounting Guides
AICPA	American Institute of Certified Public Accountants
AIN	Accounting Interpretation
APB	Accounting Principles Board (Opinions)
ARB	Accounting Research Bulletins
DIG	Derivative Implementation Group
EITF	Emerging Issues Task Force
FIN	Interpretations
FPS	Staff Positions
FTP	Technical Bulletins
IAS	International Accounting Standard
IASB	International Accounting Standards Board (London, England)
IICPA	International Institute of Certified Public Accountants Incorporated in the State of Delaware
ASC	Accounting Standards Codification by the Financial Accounting Standards Board
FASB	Financial Accounting Standards Board (Norwalk, Connecticut, United States of America)
IFRS	International Financial Reporting Standards (IASB)
OT	Original Text
QSPE	Qualifying Special Purpose Entity
SEC	Securities and Exchange Commission
SFAC	Statement of Financial Accounting Concepts
SFAS	Statement on Financial Accounting Standards
SOP	Statement of Position
TIS	Technical Inquiry Service

Foreword

The International Certified Professional Accountant®, abbreviated ICPA®, requiring a 4-year bachelor's degree in accounting, finance, economics or related fields, is an entry designation into the international accounting profession.

The Associate Certified Professional Accountant®, abbreviated as ACPA®, requiring a minimum 2-year associate degree, is an intermediate professional accounting designation, a stepping stone for the more rigorous ICPA examination.

Both, the ICPA® and the lighter ACPA®M examinations are based on this text.

Michael Schemmann
January 2018

® signifies registered service mark, USPTO and WIPO.
SM signifies service mark application pending, USPTO / WIPO...

Chapter 1

Accounting Concepts and Standards

Accountancy

Accountancy (UK), or accounting (US), is the production of financial records about an entity. Financial accounting based on historical cost— as opposed to management or cost accounting which should be forward-looking—generally produces financial statements that show in money terms the assets (economic resources) and liabilities under the control of management; selecting information that is relevant and representing it faithfully. Many tedious accounting practices have been simplified with the help of computer software.

Accounting is thousands of years old; the earliest accounting records, which date back more than 7,000 years, were found in Mesopotamia encompassing the land between the Tigris and Euphrates rivers in present day Syria and Iraq.[1] The people of that time relied on primitive accounting methods to record the growth of crops and herds, eg, the number of heads or from Late Latin *capitellum*, diminutive of Latin *caput*, from which the term capital is derived as a measure of wealth.

Early accounts served mainly to assist the memory of the business person, and the audience for the account was the proprietor or record keeper alone. Double-entry bookkeeping first emerged in northern Italy in the 14th century, where trading ventures began to require more capital than a single individual was willing or able to invest. Luca Pacioli's work published in 1494 entitled *"Particularis de computis et scripturis"* ("Details of Computation and Recording") is probably the first published book on double-entry bookkeeping.

During Pacioli's time, accountancy was part of mathematics, perhaps on the rationale that both were conventions finding expression in numbers, although quite distinct in that mathematics is seen as an exact science lending itself to research, while accounting is an art based on convention much like driving on the left hand side of the road. Today, accounting has been made highly complex.

However, the reader should not be alarmed by simplification as complexity is often a device for claiming sophistication, or for evading simple truths, using the phrase coined by John Kenneth Galbraith's (1975) on "Money, Whence It Came, Where It Went,"[2] applying equally to GAAP and to IFRS:

"Much discussion of money involves a heavy overlay of priestly incantation. Some of this is deliberate. Those who talk of money and teach about it and make their living by it gain prestige, esteem and pecuniary return, as does a doctor or a witch doctor, from cultivating the belief that they are in privileged association with the occult – that they have insights that are not available to the ordinary person. Though professionally rewarding and on occasion personally profitable, this too is a well-established form of fraud. There is nothing about money that cannot be understood by the person of reasonable curiosity, diligence and intelligence."

"The study of money, above all other fields in economics, is the one in which complexity is used to disguise truth, not to reveal it. Most things in life – automobiles, mistresses, cancer – are important principally to those who have them. Money, in contrast, is equally important to those who have it and those who don't."

[1] Wikipedia, "Accountancy." Upper Mesopotamia, also known as the Jezirah, is the area between the Euphrates and the Tigris from their sources down to Baghdad. Lower Mesopotamia consists of southern Iraq, Kuwait and parts of western Iran.
[2] John Kenneth Galbraith. 1975. "Money. Whence It Came. Where It Went." Chaper 2, "Money." Boston: Houghton Mifflin

Accounting Concepts

The terminology may vary between the past Accounting Concepts (U.S.'s *Financial Accounting Standards Board* — FASB) and Framework (European *International Accounting Standards Board* — IASB), now uniformly known as "conceptual framework," representing a foundation of underlying beliefs covering the objectives, qualitative characteristics, and definitions of the elements of financial statements, that are not in and by themselves, and cannot override, promulgated standards.

FASB: Concepts Statements[3]

"The FASB Concepts Statements are intended to serve the public interest by setting the objectives, qualitative characteristics, and other concepts that guide selection of economic phenomena to be recognized and measured for financial reporting and their display in financial statements or related means of communicating information to those who are interested. Concepts Statements guide the Board in developing sound accounting principles and provide the Board and its constituents with an understanding of the appropriate content and inherent limitations of financial reporting. A Statement of Financial Accounting Concepts does not establish generally accepted accounting standards."

“The objective of the conceptual framework project is to develop an improved conceptual framework that provides a sound foundation for developing future accounting standards. Such a framework is essential to fulfilling the Board’s goal of developing standards that are principles based, internally consistent, and that lead to financial reporting that provides the information capital providers need to make decisions in their capacity as capital providers. The new FASB framework will build on the existing framework.”

IFRS: Conceptual Framework[4]

"The Conceptual Framework project aims to update and redefine the existing concepts to reflect the changes in markets, business practices and the economic environment that have occurred in the two or more decades since the concepts were first developed.

"Its overall objective is to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally converged. Therefore the IASB and the US FASB (the boards) are undertaking the project jointly."

Summary of Decisions Reached to Date[5]

"At present [4 February 2008], there are differences in the status of the Boards’ existing frameworks. For an entity preparing financial statements under International Financial Reporting Standards (IFRS), the IASB’s *Framework* provides guidance when there is no standard or interpretation that specifically applies to a transaction or other event or condition, or that deals with a similar and related issue. In those situations, the entity’s management is required to consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the *Framework.*

Under US GAAP, the FASB’s Concepts Statements have a much lower status—they are ranked no higher than accounting textbooks, handbooks, and articles, and below widely recognized and prevalent general or industry practices."

---

[3] FASB online at http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156317989 and Project Update May 15, 2017.
[4] IFRS online at http://www.ifrs.org/Current+Projects/IASB+Projects/conceptual+Framework/ Conceptual+Framework.htm. Page last updated 29 July 2010.
[5] FASB/IASB latest update as of 4 February 2008 and Project Update May 17, 2017,

Chapter 14

Management Accounting

Management Accounting, sometimes confused with **Managerial Accounting**[44], is the modern course at schools of business for what was up to about the 1980s simply "Cost Accounting". [Cost, *verb transitive:* cost, *past tense, past participle;* costing, *ppr.* Middle English, *costen*; Old French, *coster*; Low or Late Latin, *costare*, contr. of Latin, *constare*, to stand together, stand at, cost; *con-*, together, and *stare*, to stand. 1. To require to be given or expended in barter or purchase; to be bought for; as, the book *cost* a dollar. – Webster's]

Basic terms used in managerial accounting.

- **Cost accounting** today includes (1) managerial accounting providing internal entity reports for use in planning, control and non-routine decision-making, and (2) financial accounting to the extent that its product costing function satisfies external reporting requirements to shareholders and the interested public at large. (Gleim, Part 3, p. 25)
- **Cost** is defined in the Institute of Management Accountants in Montvale, NJ, USA (IMA), in its Statement on Management Accounting (SMA) No 2A: "(1) In management accounting, a measurement in monetary terms of the amount of resources used for some purpose. The term by itself is not operational. It becomes operational when modified by a term that defines the purpose, such as acquisition cost, incremental cost, or fixed cost. (2) In financial accounting, the sacrifice measure by the price paid or required to be paid to acquire goods or services. The term 'cost' is often used when referring to the valuation of a good or service acquired. When "cost' is used in this sense, a cost is an asset. When the benefits of the acquisition (the goods or services expire), the cost becomes an expense or loss [of the period – author]."
- **Cost of goods manufactured** equals all manufacturing costs incurred during the period, plus beginning work-in-process, less ending work-in-process. Work-in-process was once called "semi-finished goods", a term that is quite descriptive.
- **Cost of goods sold** are calculated by adding to all manufacturing costs and purchases the beginning inventory, resulting in "goods available for sale", and deducting that part of goods available for sale that has not been sold in the accounting period and is captured in ending finished goods inventory.
- **Direct cost** can be specifically associated with a single cost object. **Direct (or variable) cost** varies directly and proportionately with activity, e.g., in manufacturing.
- **Direct labor costs** are wages paid that can be specifically identified in connection with the production process.
- **Direct materials costs** are, for example, materials included in finished goods that can be traced to those goods.
- **Fixed costs** remain fixed or unchanged for a given period of time (within a relative range of activity), e.g. monthly rent expense or executives' fixed monthly salary.
- **Work-in-process** in manufacturing (once descriptively called "semi-finished goods") is an account that captures the costs of goods used in production that has not been completed.
- **Job-Order Cost Accounting**

Job-order costing accumulates and allocates costs to specific jobs, e.g., houses, airplanes, an aircraft carrier. Data taken from ABC Company's accounts are as follows:

[44] Managerial Accounting is primarily concerned with the planning and control of organizational operations, considers non-quantitative information, and is usually less precise than cost accounting. (Gleim, Irvin, and Dale L. Flesher. 2004. *CMA/CFM Review. Management Reporting, Analysis, & Behavioral Issues.* 11/e. Gainesville, FL: Gleim Publications, Inc., p. 27

	January 1 Beginning Inventory	**December 31 Ending Inventory**
Inventories		
Raw materials	20,000	10,000
Work in process	25,000	30,000
Finished goods	15,000	25,000
Costs incurred		
Purchase of raw material		150,000
Direct labor		100,000
Factory rent		50,000
Factory utilities		10,000
Indirect materials		12,000
Indirect labor		9,000
Selling expenses		20,000
Administrative expenses		17,000

Schedule of direct material used in production

Beginning balance raw material inventory	20,000
Raw materials purchased	150,000
Raw materials available	170,000
Ending balance raw materials inventory	10,000
Raw materials used in production	**160,000**

Amount of manufacturing overhead incurred during the year

Factory rent	50,000
Factory utilities	10,000
Indirect materials	12,000
Indirect labor	9,000
Manufacturing overhead incurred	**81,000**

Based on the above information, we can prepare (1) a Schedule of **Cost of Goods Manufactured** and a **Cost of Goods Sold** section for the Income Statement of ABC Company:

ABC Company
Schedule of Cost of Goods Manufactured
For the year ending December 31, 2XXX

Beginning balance work in process			25,000
Add:			
Current manufacturing costs			
Beginning balance raw material inventory	20,000		
Raw material purchased	150,000		
Raw materials available	170,000		
Ending balance raw materials inventory	10,000		
Raw materials used in production		160,000	
Direct labor		100,000	
Manufacturing overhead			
Factory rent	50,000		
Factory utilities	10,000		
Indirect materials	12,000		
Indirect labor	9,000		
Manufacturing overhead incurred		81,000	341,000
Total			366,000
Less: Ending balance work in process			30,000
Cost of goods manufactured			**336,000**

Cost of Goods Sold section for the Income Statement:

Beginning balance finished goods	15,000
Add: Cost of goods manufactured	336,000
Cost of goods available for sale	381,000
Less: Ending balance of finished goods	25,000
Cost of goods sold	**356,000**

Process Costing

Process costing is a system of averaging used in the production of homogenous items passing through two or more departments adding (1) labor and (2) overhead both together referred to a "conversion costs" accumulated in a separate departmental Work in Process (WIP) account. The costs transferred from one department to another are "transferred-in cost" and "transferred-out cost". The format and an example are as follows:

PRODUCTION COST REPORT	**Units**	**Materials**	**Labor**	**Mfg O/H**
Units in beginning inventory	6,000	$ 60,000	$ 40,000	$ 10,000
Units started in the period	52,000			
Units completed & transferred	45,000			
Units in ending inventory	13,000			
Costs added during the period		$ 300,000	$ 500,000	$ 150,000
Percentage of completion		80.00%	60.00%	60.00%
Unit Reconciliation				
Units in beginning WIP	6,000			
Units started during period	52,000			
Units to account for	58,000			
Units comp. & trsf'd during period	45,000			
Units in ending WIP	13,000			
Units accounted for	58,000			

Cost per EU Calculation				
Cost	**Material**	**Labor**	**Mfg O/H**	**Total**
Beginning WIP	$ 60,000	$ 40,000	$ 10,000	$ 110,000
Cost incurred during period	$ 300,000	$ 500,000	$ 150,000	$ 950,000
Total	$ 360,000	$ 540,000	$ 160,000	**$ 1,060,000**
Units				
Units completed	45,000	45,000	45,000	
EU, Ending WIP	10,400			
Total	55,400	52,800	52,800	
Cost per EU	$6.50	$10.23	$3.03	$19.76
Cost Reconciliation				
Cost of completed units	45,000	$19.76		$889,010
Cost of Ending WIP:				
Materials	10,400	$6.50	$67,581	
Labor	7,800	$10.23	$79,773	
Manufacturing Overhead	7,800	$3.03	$23,636	$170,990
Total Cost Accounted For				**$1,060,000.00**

Equivalent units of production (EU) take into account the number of partially completed units in work in process in terms of an equivalent number of whole units:

$$\text{Costs per equivalent units} = \frac{\text{Costs in beginning WIP + Costs incurred current period}}{\text{Units completed + Equivalent units in ending WIP}}$$

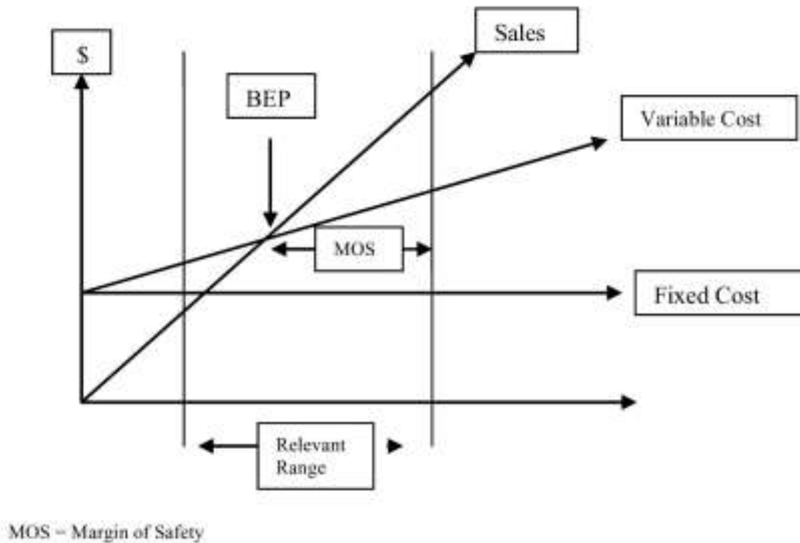
Cost per equivalent unit calculation

Cost	Material	Labor	Overhead	Total
Beginning WIP	$ 10,000	$ 15,000	$ 20,000	$ 35,000
Current period cost	100,000	200,000	250,000	550,000
Total cost	**110,000**	**215,000**	**270,000**	**885,000**
Units				
Units completed*	#40,000	#40,000	#40,000	-
Equivalent units, ending WIP	40,000	24,000	24,000	-
Total units	**#80,000**	**#64,000**	**#64,000**	-
Cost per equivalent unit**	**$1.38**	**$3.36**	**$4.22**	**$8.96**

* Material 100% complete, as to labor and overhead 60% complete
** Cost per equivalent unit (total $ cost ./. total # units)

Cost-Volume-Profit Analysis

CVP or Break-Even-Point Analysis measures how costs and profit change when production volume changes assisting managers in planning, control, and decision-making assuming straight-line relationship with stepped-up fixed cost, if any.



Formula:

Variable Cost + Fixed Cost = Total Cost

Limitations:

- A supply side costs only analysis, saying nothing about the performance of actual prices.
- Assumes fixed cost (FC) are constant, or stepped-up from a certain volume of production onward.
- Assume average variable costs are constant per unit of production (straight-line behavior).
- Assumes quantity produced equals quantity sold (no inventory).
- In multi-product company, CVP assumes relative proportions of each product sold and produced are constant.

Chapter 17

Internal Control

Definition of internal control in ISA 315:

> 4. (c) Internal control. — The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.
>
> International Standards of Accounting (ISA) 315, *Risks*: *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environments.*

Objective of internal control:

The SEC, concerned with financial reporting to the public, defines the objective of internal control as follows:

> The objective of internal control over financial reporting ("ICFR") is to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles ("GAAP").
>
> See "SEC Guidance on Internal Control over Financial Reporting" below.[52]

Under the COSO Framework (Committee of Sponsoring Organizations of the Treadway Commission)[53], internal control is broadly defined as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following internal control categories:
- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with laws and regulations.

"The first category addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of resources.

The second relates to the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements, such as earnings releases, reported publicly.

The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs." (COSO, "Internal Control — Integrated Framework")

COSO defines internal control as having five components:
1. Control Environment-sets the tone for the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control.

[52] 17 CFR PART 241 [RELEASE NOS. 33-8810; 34-55929; FR-77; File No. S7-24-06]
[53] COSO "Internal Control – Integrated Framework". Online at http://www.coso.org/IC-IntegratedFramework-summary.htm Retrieved 2010-10-21.

2. Risk Assessment-the identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed
3. Information and Communication-systems or processes that support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities
4. Control Activities-the policies and procedures that help ensure management directives are carried out.
5. Monitoring-processes used to assess the quality of internal control performance over time.

SEC Guidance on Internal Control over Financial Reporting

Effective 27 June 2007[54] — Excerpts, edited by the author:

I. Introduction

Management is responsible for maintaining a System of Internal Control over Financial Reporting ("ICFR") that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The rules we adopted in June 2003 to implement Section 404 of the *Sarbanes-Oxley Act* of 2002 ("Sarbanes-Oxley") require management to annually evaluate whether ICFR is effective at providing reasonable assurance and to disclose its assessment to investors. Management is responsible for maintaining evidential matter, including documentation, to provide reasonable support for its assessment. This evidence will also allow a third party, such as the company's external auditor, to consider the work performed by management.

ICFR cannot provide absolute assurance due to its inherent limitations. The "reasonable assurance" referred to in the Commission's implementing rules relates to similar language in the *Foreign Corrupt Practices Act* of 1977 ("FCPA").

Exchange Act Section 13(b)(7) defines "reasonable assurance" and "reasonable detail" as "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." The Commission has long held that "reasonableness" is not an "absolute standard of exactitude for corporate records." In addition, the Commission recognizes that while "reasonableness" is an objective standard, there is a range of judgments that an issuer might make as to what is "reasonable" in implementing Section 404 and the Commission's rules. Thus, the terms "reasonable," "reasonably," and "reasonableness" in the context of Section 404 implementation do not imply a single conclusion or methodology, but encompass the full range of appropriate potential conduct, conclusions or methodologies upon which an issuer may reasonably base its decisions.

The Interpretive Guidance is organized around two broad principles.

1. [M]anagement should evaluate whether it has implemented controls that adequately address the risk that a material misstatement of the financial statements would not be prevented or detected in a timely manner.

2. [M]anagement's evaluation of evidence about the operation of its controls should be based on its assessment of risk. The guidance provides an approach for making risk-based judgments about the evidence needed for the evaluation.

II. Interpretive Guidance – Evaluation and Assessment of Internal Control Over Financial Reporting

A. The Evaluation Process

[54] Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 – 17 CFR PART 241 [RELEASE NOS. 33-8810; 34-55929; FR-77; File No. S7-24-06]

The objective of internal control over financial reporting ("ICFR") is to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles ("GAAP"). The purpose of the evaluation of ICFR is to provide management with a reasonable basis for its annual assessment as to whether any material weaknesses in ICFR exist as of the end of the fiscal year. To accomplish this, management identifies the risks to reliable financial reporting, evaluates whether controls exist to address those risks, and evaluates evidence about the operation of the controls included in the evaluation based on its assessment of risk. [Emphasis added.]

Under the Commission's rules, management's annual assessment of the effectiveness of ICFR must be made in accordance with a suitable control framework's definition of effective internal control. Therefore, management's evaluation process includes not only controls involving particular areas of financial reporting, but also the entity-wide and other pervasive elements of internal control defined by its selected control framework. This guidance is not intended to replace the elements of an effective system of internal control as defined within a control framework.

1. Identifying Financial Reporting Risks and Controls

The evaluation begins with the identification and assessment of the risks to reliable financial reporting (that is, materially accurate financial statements), including changes in those risks. Management then evaluates whether it has controls placed in operation (that is, in use) that are designed to adequately address those risks. Management ordinarily would consider the company's entity-level controls in both its assessment of risks and in identifying which controls adequately address the risks.

These controls are then subject to procedures to evaluate evidence of their operating effectiveness, as determined pursuant to Section II.A.2 below.

a. Identifying Financial Reporting Risks

Management should identify those risks of misstatement that could, individually or in combination with others, result in a material misstatement of the financial statements ("financial reporting risks"). Ordinarily, the identification of financial reporting risks begins with evaluating how the requirements of GAAP apply to the company's business, operations and transactions. Management must provide investors with financial statements that fairly present the company's financial position, results of operations and cash flows in accordance with GAAP. A lack of fair presentation arises when one or more financial statement amounts or disclosures ("financial reporting elements") contain misstatements (including omissions) that are material.

Management's evaluation of the risk of misstatement should include consideration of the vulnerability of the entity to fraudulent activity (for example, fraudulent financial reporting, misappropriation of assets and corruption), and whether any such exposure could result in a material misstatement of the financial statements. The extent of activities required for the evaluation of fraud risks is commensurate with the size and complexity of the company's operations and financial reporting environment.

Management should recognize that the risk of material misstatement due to fraud ordinarily exists in any organization, regardless of size or type, and it may vary by specific location or segment and by individual financial reporting element. For example, one type of fraud risk that has resulted in fraudulent financial reporting in companies of all sizes and types is the risk of improper override of internal controls in the financial reporting process. While the identification of a fraud risk is not necessarily an indication that a fraud has occurred, the absence of an identified fraud is not an indication that no fraud risks exist. Rather, these risk assessments are used in evaluating whether adequate controls have been implemented.

b. Identifying Controls that Adequately Address Financial Reporting Risks

Chapter 24

International Taxation

Introduction

International taxation is the study or determination of tax on a person or business subject to the tax laws of different countries or the international aspects of an individual country's tax laws as the case may be. Governments usually limit the scope of their income taxation in some manner territorial or provide for offsets to taxation relating to extraterritorial income. The manner of limitation generally takes the form of a territorial, residence-based, or exclusionary system. Some governments have attempted to mitigate the differing limitations of each of these three broad systems by enacting a hybrid system with characteristics of two or more.

Many governments tax individuals and/or enterprises on income. Such systems of taxation vary widely, and there are no broad general rules. These variations create the potential for double taxation (where the same income is taxed by different countries) and no taxation (where income is not taxed by any country). Income tax systems may impose tax on local income only or on worldwide income. Generally, where worldwide income is taxed, reduction of tax or foreign credits are provided for taxes paid to other jurisdictions. Limits are almost universally imposed on such credits. Multinational corporations usually employ international tax specialists, a specialty among both lawyers and accountants, to decrease their worldwide tax liabilities.

With any system of taxation, it is possible to shift or re-characterize income in a manner that reduces taxation. Jurisdictions often impose rules relating to shifting income among commonly controlled parties, often referred to as transfer pricing rules (see below “Allocation of Income, Deductions, Credits or Allowances”). Residency-based systems are subject to taxpayer attempts to defer recognition of income through use of related parties. A few jurisdictions impose rules limiting such deferral ("anti-deferral" regimes). Deferral is also specifically authorized by some governments for particular social purposes or other grounds. Agreements among governments (treaties) often attempt to determine who should be entitled to tax what. Most tax treaties provide for at least a skeleton mechanism for resolution of disputes between the parties.

The United States taxes nonresident alien individuals and foreign corporations on their

(1) effectively connected income, i.e., income that is effectively connected with a trade or business conducted within the United States, with an allowance for expenses incurred in the production of such income, taxed in the same manner as U.S. citizens and domestic corporations at graduated tax rates, and

(2) U.S. source fixed and determinable, annual or periodic income from sources within the United States (without regard to the form received or paid), which is not effectively connect with the conduct of a U.S. trade or business, at a flat 30% tax rate, or lower treaty rate, of the gross income without any allowance for expenses incurred in the generation of such income (IRC Sec. 1441(a), Regs. §§1.871-7(b)(1), 1441-1, 1441-2(a), 1.1441-2(b) as amended by T.D. 8734). Excluded from the 30% withholding tax for nonresident aliens are winnings from blackjack, roulette, baccarat, craps and big six wheel. (CCH¶2425)

Fixed or determinable, annual or periodical income ("FDAP"). Fixed or determinable, annual or periodical income includes interest (but some types of interest ("interest on deposit" and "portfolio investment interest" are excluded), dividends, rents, salaries, salaries, wages,

premiums, annuities, compensations, remunerations and emoluments, and timber, coal and iron ore royalties gains, profits, and income.

Annuities. Generally, the earnings and accretions of a qualified plan are sourced according to the situs of the trust, except for certain amounts received by a nonresident alien as an annuity for services rendered outside the U.S. Not included in FDAP are amounts received as an annuity under a qualified plan: (1) received by a nonresident alien individual for services rendered outside the U.S. or based on personal services for a foreign employer performed within the U.S. (described in IRC Sec. 864(b)(1)); and (2), where at the time the first payment is made 90 percent or more of the persons covered under the plan are citizens or residents of the U.S. If the recipient's country of residence grants reciprocity, or is a developing country under Title V of the Trade Act of 1974 (19 U.S.C. 2461), requirement (2) need not be met

Social security benefits. 85 percent of the gross amount of Social Security and Railroad Retirement benefits (defined in IRC Sec. 86(d)) received by nonresident aliens are subject to the 30% tax, resulting in an effective rate of 25.5% (under IRC Sec. 871(a)(3)) or lower treaty rate which prevail if there is a conflict with domestic U.S. law (see Art. 18(2) of the U.S. Model and recent Treaties, "Pensions, Social Security, Annuities,

Original issue discount obligations. IRC Sec. 871(a) and 881(a) apply to not effectively connected OID imposing a 30% tax, except on obligations payable 183 days or less from its date of original issue or on any tax-exempt obligation (CCH¶2431).

Interest on deposit excluded. To encourage foreign persons to do business with U.S. banks, Congress has established exemptions for certain categories of noneffectively connected interest on deposits, e.g. time deposits, certificates and other amounts held by a person engaged in the banking business).

Portfolio investment interest excluded. Generally, no withholding tax applies to two types of portfolio interest: (1) on any obligation that is not in registered form if (i) arrangements exist that are reasonably designed to ensure they are to be sold or resold only to non-U.S. persons, (ii) the interest is payable only outside the U.S., and (iii) on the face of the obligation is a statement that any U.S. person holding the obligation will be subject to U.S. taxation; (2) on registered obligations where the withholding agent of the interest has received a statement stating that the beneficial owner is not a U.S. person.

Foreign corporations generally are treated the same as non-resident aliens with regard to portfolio interest (IRC Sec. 881(c)(1) and (4)); except (i) when received by a 10-percent shareholder, (ii) a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business, or (iii) received by a controlled foreign corporation from a related person.

Contingent interest. The portfolio interest exemption does not apply to contingent interest received after 1993, except on fixed-term debt issued before April 7, 1993 or thereafter if pursuant to a binding contract in effect April 7, 1993.

Certain interest and dividend income. Interest on bank deposits that are not effectively connected with a U.S. trade or business are exempt from U.S. tax, including income from a foreign central bank of issue from bankers' acceptances and a percentage of any dividend paid by a domestic corporation that meets the 80-percent-foreign business requirement.

Effectively connected rules. Periodical income is effectively connected with a U.S. business if: (1) the income is derived from assets used in, or held for use in, the conduct of a U.S. business, and (2) the activities of the U.S. business were a material factor in the realization of the income. Due regard is given to whether or not the asset or income was separately accounted for on the books kept for the U.S. business, although this in itself is not a controlling factor.

Benefits granted with respect to certain types of income connected to a trade or business below, in particular definition there of trade or business and *"Derived in connection with"*

requirement as discussed by the Treasury Department in its "Technical Explanation to the U.S. Model Treaty".

Resident and non--resident alien defined. An alien is a person who is not a U.S. citizen. An alien is considered to be a U.S. resident for income tax purposes if he (1) is a lawful permanent resident of the US. at any time during the calendar year , (2) meets the requirements of the "substantial presence test, or makes the first-year election to be treated as a resident. An alien not coming within any of these texts will be treated as a nonresident alien for income tax purposes, with special rules determining when residency begins and when it ends, and determining nonresident alien status under income tax treaties.

Foreign corporation defined. A foreign corporation is not organized under the laws of the United States or its territories but in a foreign jurisdiction.

Residence defined. As a general matter only residents of the Contracting States may claim treaty benefits (U.S. Model Treaty Art.4) if he qualifies under Art. 22 (Art. 28 in the German treaty) ("Limitation on Benefits").

As a general matter, a person who under those laws is a resident of one contracting state and not of the other need look no further (Technical Explanation Art. 4). Tie-breaker rules apply where the person is a resident in both contracting states under their respective tax laws in order to assign a single state of residence, e.g. where is his center of vital interests, habitual abode, citizenship, or the competent authorities settle by mutual agreement (Art. 4(2)).

An alien must be classified as a U.S. resident if he (1) is a lawfully admitted resident (greencard holder), (2) demonstrates a substantial presence test, or (3) makes a first year election.

The determination of residence for treaty purposes looks first to a person's liability to tax as a resident under the respective taxation laws of the contracting states, e.g. by reason of domicile, residence, citizenship, place of management, place of incorporation or any other similar criterion. Thus residents of the United States include aliens who are considered U.S. residents. (Technical Explanation Art. 4(1)). Even entities subject to tax who rarely pay tax would generally be accorded treaty benefits, e.g. RICs (Regulated Investment Company), REITs (Real Estate Investment Trust) and REMICs (Real Estate Mortgage Investment Conduit). But subparagraph 1(a) of Art. 4 makes clarifies that a person is not a resident only because he is liable to income from sources in that state. For example, a consular officer deriving taxable U.S. source investment income will not be considered a U.S. resident under the U.S. Model Treaty, neither will a foreign enterprise with a permanent establishment in the U.S. which is taxable only with respect to its U.S. effectively connected income but not its worldwide income (Technical Explanation Art. 4(1)).

Fiscally transparent entities. The income derived through "fiscally transparent entities" (also known as "conduits") of a contracting state such as partnerships and certain estates and trusts that are not subject to tax at the entity level will be considered to be derived by a resident of the contracting state. Entities falling under this description in the United States would include partnerships, common investment trusts, and grantor trusts, and LLCs (Limited Liability Companies) that are treated as partnerships for U.S. tax purposes. For example, if a U.S. corporation distributes a dividend to an entity that is treated as fiscally transparent in the other State, the dividend will be considered to be derived by a resident of that State. In the case of a partnership this normally would include the partners of the entity that are residents of that other contracting state. Where income is derived through an entity organized in a third state that has owners resident in one of the contracting states, the characterization of the entity in that third state is irrelevant for purposes of determining whether the resident is entitled to treaty benefits with

respect to income derived by the entity. This rule applies to trusts to the extent that they are fiscally transparent in their beneficial owner's state of residence. For example, if X, a resident of the other contracting state, creates a revocable trust and names persons resident in a third country as the beneficiaries of the trust, X would be treated as the beneficial owner of income derived from the United States under the rules of IRC Secs. 671 through 671. (Technical Explanation of the U.S. Model Treaty, Art. 4(1))

Corporate dual residency issue. A corporate dual residency issue may arise where a company is a resident of one contracting state but is treated as a resident of the other contracting state where it is either incorporated or managed. Under the tie-breaker rule of Art. 4(3) of the U.S. Model Treaty, residence of such a company will be in that contracting state in which it was created or organized.

Associated enterprises. Art. 9 of the U.S. Model and recent Treaties incorporates into the Treaty the arm's-length principle reflected in the U.S. domestic transfer pricing provisions, particularly IRC Sec. 482. It provides that when related enterprises engage in a transaction on terms that not arm's-length, the contracting states may make appropriate adjustments to the taxable income and tax liability of such related enterprises to reflect what the income and tax of these enterprises with respect to the transaction would have been had there been an arm's-length relationship between them by modifying the terms of the arrangement or recharacterizing the transaction to reflect its substance. (Technical Explanation of Art. 9 of the U.S. Model Treaty. See also separate Chapter "Special or Technical Areas", "Allocation of Income IRC (Section 482).

The necessary element in these relationships is effective control, which is also the standard for purposes of IRC Sec. 482. Thus, the Treaty Article applies if an enterprise of one state participates directly or indirectly in the management, control, or capital of the enterprise of the other state, or if any third person or persons participate directly or indirectly in the management, control, or capital of enterprises of different states. All types of control are included, i.e. whether or not legally enforceable and however exercised or exercisable. (Technical Explanation of Art. 9(1)).

The fact that a transaction is entered into between such related enterprises does not, in and of itself, mean that a contracting state may adjust the income (or loss) of one or both of the enterprises. If the conditions of the transactions are consistent with those that would be made between independent persons, there should be no adjustment under Art. 9. Similarly, const share arrangements or general service agreements are not in itself an indication of non-arm's-length transactions giving rise to adjustment under Art. 9(1) of a Treaty. Both, related and unrelated parties enter into such arrangements (e.g. joint venturers may share some development costs).

The contracting states preserve their rights to apply internal law provisions relating to adjustments between related parties. They also reserve the right to make adjustments in case involving **tax evasion** or **fraud**. Such adjustments .. the distribution, apportionment, or allocation of income, deductions, credits or allowances .. are permitted even if they are different from, or go beyond, those authorized by Art. 9(1) of the U.S. Model and recent Treaties, as long as they accord with the general principles of Art. 9(1), i.e. that the adjustment reflect what would have transpired had the related parties been acting at arm's-length. For example, while paragraph 1 of Art. 9 explicitly allows adjustments of deductions in computing taxable income, it does not deal with adjustments to tax credits. It does not, however, preclude such adjustments if they can be made under internal law. (The OECD Model reaches the same result.) (Technical Explanation of Art. 9 of the U.S. Model Treaty.)

Art. 9 permits tax authorities to deal with thin capitalization issues. They may, in the context of Art. 9, scrutinize more than the rate of interest charged on a loan between related persons. They also may examine the capital structure of an enterprise, whether a payment in respect of that loan should be treated as interest, and, if it is treated as interest, under what circumstances interest deductions should be allowed to the payor. (Technical Explanation of Art. 9 of the U.S. Model Treaty.)

When a contracting state has made an adjustment and the other contracting state agrees to it, that other state is obligated to make a correlative adjustment (or corresponding adjustment) to the tax liability of the related person in that contracting state. When an adjustment under Art. 9 has been made, one of the parties will have in its possession funds that it would not have had at arm's-length. In the U.S., the general practice is to treat such funds as a dividend or contribution to capital (secondary adjustment), applying the provisions of Art. 10 (Dividends) and the imposition of a 5% withholding tax on the dividend, depending on the relationship between the parties. Under certain circumstances, the parties may be permitted to restore the funds to the party that would have the funds at arm's-length, and to establish an account payable pending restoration of the funds.

Election to be treated as a resident. An individual who is an alien may elect to be treated as a U.S. resident if (1) he did not qualify as a resident for the calendar year immediately preceding the election year, (2) must meet the substantial presence test in the year following the election, (3) must be present in the U.S. for at least 31 consecutive days in the election year, (4) and must be present in the U.S. for at least 75% of the number of days in the period beginning with the first of the 31-day presence and ending with the last day of the election year.

An election to be treated as a resident is also available to nonresidents married to a U.S. citizen when both spouses agree to it.

The OECD Model Tax Treaty

The OECD *Model Convention with respect to Taxes on Income and on Capital* provides the basis for the negotiation and interpretation of more than 3000 tax treaties that make up a network that co-ordinate the income and corporate tax systems of most countries with the objective of removing tax barriers to cross-border trade and investment. (www.oecd-ilibrary.org/taxation/ retrieved 2017-12-02)

Allocation of Income, Deductions, Credits or Allowances (U.S. IRC Sec. 482)

In general, while the taxpayer is presumed to have complete power and control over the structure and conduct of his business affairs to minimize the tax burden, the IRS, at its discretion (which must not be abused), is authorized in Internal Revenue Code Section 482, to allocate credits or allowances, as well as gross income and deductions, between related organizations, trades or business, whether or not incorporated, in order to prevent the evasion of taxes (accomplished through "income shifting") or to clearly reflect the income of such trades or businesses.

IRS has no power to create income. The IRS' powers of reallocation are broad and belong to the IRS alone; the taxpayer cannot require the IRS to reallocate income or deductions (Reg. §1.482-1(a)(3)). But the IRS does not have the power under IRC Sec. 482 to create or impute income where non existed. (*Tennessee-Arkansas Gravel Co.*, 40-2 USTC ¶9512; *Smith-Bridgman and Co.*, Dec. 18,087 (Acq.); *Latham Park Manor, Inc.,* Dec. 34,733)

Chapter 25

Blockchain

A blockchain, originally block chain, is a continuously growing list of records, called *blocks*, which are linked and secured using cryptography. Each block typically contains a hash[145] pointer as a link to a previous block, a timestamp and transaction data. By design, blockchains are inherently resistant to modification of the data. The *Harvard Business Review* describes it as "an open, distributed ledger that can record transactions between two parties efficiently and in a verifiable and permanent way".[146] For use as a distributed ledger, a blockchain is typically managed by a peer-to-peer network collectively adhering to a protocol for validating new blocks. Once recorded, the data in any given block cannot be altered retroactively without the alteration of all subsequent blocks, which requires collusion of the network majority. (Wikipedia, "Blockchain.")

Blockchains are secure by design and are an example of a distributed computing system with high Byzantine fault tolerance.[147] Decentralized consensus has therefore been achieved with a blockchain. This makes blockchains potentially suitable for the recording of events, medical records, and other records management activities, such as identity management, transaction processing, documenting provenance, food traceability or voting.

The first blockchain was conceptualized in 2008 by an anonymous person or group known as Satoshi Nakamoto and implemented in 2009 as a core component of bitcoin

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145 A cryptographic hash function is a special class of hash function that has certain properties which make it suitable for use in cryptography. It is a mathematical alogorythm that maps data of arbitrary size to a bit string of a fixed size (a hash) which is designed to also be a one-way function, that is, a function which is infeasible to invert. The only way to recreate the input data from an ideal cryptographic hash function's output is to attempt a brute-force search of possible inputs to see if they produce a match, or use a rainbow table of matched hashes. Bruce Schneider has called one-way hash functions "the workhorses of modern cryptography". The input data is often called the *message*, and the output (the *hash value* or *hash*) is often called the *message digest* or simply the *digest*.

146 Marco Iansiti and Karim R. Lakhani, "The Truth About Blockchain," *Harvard Business Review*, January 2017.

147 In fault-tolerance computer systems, and in particular distributed computing systems, Byzantine fault tolerance (BFT) is the characteristic of a system that tolerates the class of failures known as the Byzantine General's Problem which is a generalized version of the Two General's Problem – for which there is an unsolvability proof. Byzantine failures are considered the most general and most difficult class of failures among the failure modes. The so-called fail-stop failure mode occupies the simplest end of the spectrum. Whereas fail-stop failure model simply means that the only way to fail is a node crash, detected by other nodes, Byzantine failures imply no restrictions, which means that the failed node can generate arbitrary data, pretending to be a correct one. Thus, Byzantine failures can confuse failure detection systems, which makes fault tolerance difficult.

where it serves as the public ledger for all transactions.[148] The invention of the blockchain for bitcoin made it the first digital currency to solve the double spending problem without the need of a trusted authority or central server. The bitcoin design has been the inspiration for other applications. In August 2014, the bitcoin blockchain file size, containing records of all transactions that have occurred on the network, reached 20GB (gigabytes).[149] In January 2015, the size had grown to almost 30GB, and from January 2016 to January 2017, the bitcoin blockchain grew from 50GB to 100GB in size. The words *block* and *chain* were used separately in Satoshi Nakamoto's original paper, but were eventually popularized as a single word, *blockchain,* by 2016.

According to Nolan Bauerle,[150] "blockchain technology is not a new technology but rather a combination of proven technologies applied in a new way. It was the particular orchestration of three technologies (the Internet, private key cryptography and a protocol governing incentivization) that made bitcoin creator Satoshi Nakamoto's idea so useful. The result is a system for digital interactions that does not need a trusted third party. The work of securing digital relationships is implicit — supplied by the elegant, simple, yet robust network architecture of blockchain technology itself."

> *Defining digital trust*
>
> Trust is a risk judgement between different parties, and in the digital world, determining trust often boils down to proving identity (authentication) and proving permissions (authorization). Put more simply, we want to know, 'Are you who you say you are?' and 'Should you be able to do what you are trying to do?'
>
> In the case of blockchain technology, private key cryptography provides a powerful ownership tool that fulfills authentication requirements. Possession of a private key is ownership. It also spares a person from having to share more personal information than they would need to for an exchange, leaving them exposed to hackers.
>
> Authentication is not enough. Authorization – having enough money, broadcasting the correct transaction type, etc – needs a distributed, peer-to-peer network as a starting point. A distributed network reduces the risk of centralized corruption or failure.
>
> This distributed network must also be committed to the transaction network's recordkeeping and security. Authorizing transactions is a result of the entire network applying the rules upon which it was designed (the blockchain's protocol).

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148 Economist Staff, "Blockchains: The great chain of being sure about things," *The Economist*, 31 October 2015.

149 Nian, Lam Pak; Chuen, David Lee Kuo. 2015. "A Light Touch of Regulation for Virtual Currencies". In Chuen, David Lee Kuo. "Handbook of Digital Currency: Bitcoin, Innovation, Financial Instruments, and Big Data." Academic Press. p. 319

150 Nolan Bauerle, "What is Blockchain Technology?" coindesk.com retrieved 2018-01-10.

Authentication and authorization supplied in this way allow for interactions in the digital world without relying on (expensive) trust. Today, entrepreneurs in industries around the world have woken up to the implications of this development – unimagined, new and powerful digital relationshionships are possible. Blockchain technology is often described as the backbone for a transaction layer for the Internet, the foundation of the Internet of Value.

In fact, the idea that cryptographic keys and shared ledgers can incentivize users to secure and formalize digital relationships has imaginations running wild. Everyone from governments to IT firms to banks is seeking to build this transaction layer. Authentication and authorization, vital to digital transactions, are established as a result of the configuration of blockchain technology. The idea can be applied to any need for a trustworthy system of record.

Blockchain and the future of accountancy

Excerpts from an article by ICAEW, the Institute of Chartered Accountants of England and Wales, 2017

Blockchain is fundamentally and accounting technology. The key features of blockchain are that:

- New transactions originate with one user but **propagate** to a network of identical ledgers, without a central controller;
- all transactions and records are **permanent**; unable to be tampered with or removed;
- many blockchains are **programmable**, allowing for automation of new transactions and controls via ‘smart contracts’.

Blockchain is not a single technology, but rather a protocol – a way of doing things – for recording transactions. Unlike the internet, in which data is shared, in a blockchain ownership can be transferred from one party to another. Blockchain is a desirable model for several reasons. For example, in a market with many transacting parties, it could remove the need to reconcile disparate ledgers. Being distributed between all users also eliminates outages and removes the cost of having to pay a central authority to maintain the accuracy of the ledger. Any participant in the ledger can trace all previous transactions, allowing for increased transparency and the blockchain to ‘self-audit’.

The Impact of Blockchain Methods

Blockchain is a replacement for bookkeeping and reconciliation work. This could threaten the work of accountants in those area. Furthermore, the potential for self-executing smart contracts allows for a programmable ledger that could fundamentally alter how all contracts operate. Assuming that all the technological barriers could be overcome, blockchain has huge potential.

- Give developers the flexibility to learn and develop in their preferred environment with an open and modern toolset.

A business owner can develop his use case with help from IBM's deep bench of industry and blockchain experts who come together in the IBM Blockchain Garage to harness the full power of the IBM Blockchain Platform.

A developer can quickly and easily align business requirements and accelerate blockchain application development for free with a cloud sandbox and interactive playground that turns any programmer into a blockchain developer. These tools are designed to turn business rules into code in your preferred environment:

- Explore online
  Leverage Hyperledger Composer, which is an open source development tool to learn key blockchain concepts, to create network definitions, and to leverage reusable industry models and smart contract libraries.

- Install locally
  Leverage IBM certified images of Hyperledger Fabric and Composer, which is an open source framework for building a business network, to develop and test directly on your laptop.

- Collaborate in a cloud environment
  Free and fee options to develop and share your code with others.

Once the business network has been developed, one can deploy it to a live network running on the IBM Blockchain Platform with this recipe.[152]

Recipe

Create a file in the using your favorite editor and name it connection.json. You can use the following as a code template for your connection.json file:

```
{
   "name": "bmx-hlfv1",
   "description": "A description for a V1 Profile",
   "type": "hlfv1",
   "orderers": [
      {
         "url": "grpcs://abca.4.secure.blockchain.ibm.com:12345"
      }
   ],
   "ca": {
      "url": "https://abc.4.secure.blockchain.ibm.com:98765",
```

[152] See “Deploying Hyperledger Composer Business Network to IBM Blockchain Platform Enterprise Plan on IBM Cloud” at https://ibm-blockchain.github.io/platform-deployment/

```
      "name": "PeerOrg1CA"
   },
   "peers": [
      {
         "requestURL": "grpcs://abcd.4.secure.blockchain.ibm.com:22222",
         "eventURL": "grpcs://abcd.4.secure.blockchain.ibm.com:33333"
      }
   ],
   "channel": "mychannel",
   "mspID": "PeerOrg1",
   "globalCert": "-----BEGIN CERTIFICATE-----\r\n...LotsOfStuff\r\n-----END
CERTIFICATE-----\r\n-----BEGIN CERTIFICATE-----\r\nMorestuff\r\n-----END
CERTIFICATE-----\r\n",
   "timeout": 300
}
```

We will refer to this `connection.json` file as `<YOUR_CONNECTION_PROFILE_FILE>` in various commands later.

You will populate the newly created connection.json file with attributes that are provided via your IBM Blockchain Platform dashboard. From your Platform dashboard on IBM Cloud, select **Overview** from the navigation menu on the left panel. Then click on the **Service Credentials** button to display the endpoint and certificate information for the members of the channel where you want to deploy your business network archive.

Orderers

Now we can start to modify the template with the information provided by the Service Credentials, starting with the orderers. While you have multiple orderers in your Service Credentials only one is required for your `connection.json` file replace the orderer url values in the template:

```
"url": "grpcs://abca.4.secure.blockchain.ibm.com:12345"
```

With the "url" value for the first orderer found in your service credentials. Modify this value with your information.

CA (Certificate Authority)

Modify the ca value in your connection.json with both the **url** and the **caName** from either of the entries in the **certificateAuthorities** section.

Peers

Now we need to set the url for each Peer **requestURL** and **eventURL**. Modify the connection.json file and replace the **url** attribute with the **url** value found in your Service Credentials. Replace the **eventURL** attribute with the **eventUrl**

APPENDIX

The Complete Glossary of Accounting Terms

Paragraphs cited refer to the FASB's Accounting Standards Codification [154]

Letter A

- ABC Agreement

An ABC agreement is an agreement between a brokerage entity and one of its employees spelling out the entity's rights when it purchases a New York Stock Exchange membership for the employee. Only individuals can be members of the New York Stock Exchange, and it is common practice for an entity to finance the purchase of a membership, or seat, by one of its employees. The New York Stock Exchange approved ABC agreement contains all of the following provisions regarding the future disposition of the seat:

a. The employee may retain the membership and buy another seat for an individual designated by the entity.
b. The employee may sell the seat and give the proceeds to the entity.
c. The employee may transfer the seat to another employee of the entity.

- Absolute Priority Doctrine

A doctrine that provides that if an impaired class does not vote in favor of a plan, the court may nevertheless confirm the plan under the cram-down provisions of the Bankruptcy Code. The absolute priority doctrine is triggered when the cram-down provisions apply. The doctrine states that all members of the senior class of creditors and equity interests must be satisfied in full before the members of the second senior class of creditors can receive anything, and the full satisfaction of that class must occur before the third senior class of creditors may be satisfied, and so on.

- Accounting Change

A change in an accounting principle, an accounting estimate, or the reporting entity. The correction of an error in previously issued financial statements is not an accounting change.

- Accretable Yield

The excess of a loan's cash flows expected to be collected over the investor's initial investment in the loan.

- Accretion Expense

An amount recognized as an expense classified as an operating item in the statement of income resulting from the increase in the carrying amount of the liability associated with the asset retirement obligation.

- Accumulated Benefit Obligation

The actuarial present value of benefits (whether vested or nonvested) attributed, generally by the pension benefit formula, to employee service rendered before a specified date and based on employee service and compensation (if applicable) before that date. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.

- Accumulated Eligibility Credits

Plan participants may qualify for a benefit in which eligibility credits or hours accumulate and result in the plan covering payment of insurance premiums or benefits for a period of time for those participants who have accumulated a sufficient number of such credits or hours to be eligible for the credits. Eligible participants are provided with insurance coverage during periods of unemployment, when Previously published, "The Complete Glossary of Accounting Terms American employer contributions to the plan would not otherwise provide coverage or benefits. The accumulated eligibility credits are sometimes referred to as bank of hours.

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[154] Paragraphs cited in the text without further reference refer to the *Accounting Standards Codification* (ASC) of the Financial Accounting Standards Board (FASB), effective July 2009.

- Accumulated Plan Benefits

Future benefit payments that are attributable under the provisions of a pension plan to employees' service rendered to the benefit information date. Accumulated plan benefits comprise benefits expected to be paid to any of the following:

a. Retired or terminated employees or their beneficiaries
b. Beneficiaries of deceased employees
c. Present employees or their beneficiaries.

- Accumulated Postretirement Benefit Obligation

The actuarial present value as of a particular date of all future benefits attributed to an employee's service rendered to that date assuming the plan continues in effect and that all assumptions about future events are fulfilled. The accumulated postretirement benefit obligation generally reflects a ratable allocation of expected future benefits to employee service already rendered in the attribution period. Before an employee's full eligibility date, the accumulated postretirement benefit obligation as of a particular date for an employee is the portion of the expected postretirement benefit obligation attributed to that employee's service rendered to that date; on and after the full eligibility date, the accumulated and expected postretirement benefit obligations for an employee are the same.

- Accumulation Phase

The period during an annuity contract before annuitization. An insurance entity may call an annuity having an accumulation phase a deferred annuity.

- Acquiree

Note: The following definition is Pending Content; see Transition Guidance in 805-10-65-1. The business or businesses that the acquirer obtains control of in a business combination.

- Acquirer

The entity that obtains control of the acquiree. However, in a business combination in which a variable interest entity (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

- Acquisition Costs

Costs incurred in the acquisition of new and renewal insurance contracts. Acquisition costs include those costs that vary with and are primarily related to the acquisition of insurance contracts.

- Acquisition Date

The date on which the acquirer obtains control of the acquiree.

- Acquisition of Properties (SEC)

See paragraph 932-10-S99-1, Regulation S-X Rule 4-10(a)(14), for the definition of acquisition of properties as used within that Rule.

- ADC Arrangements

See Acquisition, Development, and Construction Arrangements.

- Acquisition, Development, and Construction Arrangements

Acquisition, development, or construction arrangements, in which a lender, usually a financial institution, participates in expected residual profit from the sale or refinancing of property.

- Active Market

An active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

- Active Plan Participant

Any active employee who has rendered service during the credited service period and is expected to receive benefits, including benefits to or for any beneficiaries and covered dependents, under the postretirement benefit plan. See Plan Participant.

- Active Use of the Property

The use of the property by the seller-lessee during the lease term in the seller-lessee's trade or business, provided that subleasing of the leased-back property is minor.
Active use of the property may involve the providing of services where the occupancy of the property is generally transient or short-term and is integral to the ancillary services being provided. Those ancillary services include, but are not limited to, the following:

a. Housekeeping
b. Inventory control
c. Entertainment
d. Bookkeeping
e. Food services.

- Activities

The term activities is to be construed broadly. It encompasses physical construction of the asset. In addition, it includes all the steps required to prepare the asset for its intended use. For example, it includes administrative and technical activities during the preconstruction stage, such as the development of plans or the process of obtaining permits from governmental authorities. It also includes activities undertaken after construction has begun in order to overcome unforeseen obstacles, such as technical problems, labor disputes, or litigation.

- Activities

Activities are efforts to accomplish specific objectives. Some activities include producing and distributing materials. For example, if a not-for-profit entity (NFP) undertakes a mass mailing that includes a letter and a pamphlet, producing and distributing the letter and pamphlet are part of the activity. Other activities may include no materials, such as an annual dinner or a radio commercial.

- Actual Return on Plan Assets (Component of Net Periodic Postretirement Benefit Cost)

The change in the fair value of the plan's assets for a period including the decrease due to expenses incurred during the period (such as income tax expense incurred by the fund, if applicable), adjusted for contributions and benefit payments during the period. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets (see paragraph 715-60-35-107) at the beginning and end of the period, adjusted for contributions and benefit payments. If the fund holding the plan assets is a taxable entity, the actual return on plan assets shall reflect the tax expense or benefit for the period determined in accordance with generally accepted accounting principles (GAAP). Otherwise, no provision for taxes shall be included in the actual return on plan assets.

- Actual Return on Plan Assets (Component of Net Periodic Pension Cost)

For a funded plan, the actual return on plan assets is determined as the difference between the fair value of plan assets at the end of the period and the fair value at the beginning of the period, adjusted for contributions and payments of benefits during the period.

- Actual-Income-Available Method

A method to calculate distributions to shareholders from net investment income in which actual net investment income that has been allocated to each class (as recorded on the books) is divided by the record date shares for each class to derive the dividend payable per share.

- Actuarial Asset Value

A value assigned by an actuary to the assets of a plan generally for use in conjunction with an actuarial cost method.

- Actuarial Calculation

The periodic expected changes in the net closed block liability (on the basis of generally accepted accounting principles [GAAP]), which is after the elimination of the effect of applicable items of other comprehensive income. The amortization of deferred acquisition costs is not a component of the actuarial calculation because deferred acquisition costs are not a closed block asset.

- Actuarial Calculation Date

The date as of which the actuarial calculation is performed, which is as of the date of demutualization or formation of a mutual insurance holding entity.

- Actuarial Cost Method

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