SMALL FIRM SOLUTIONS

WINNING STRATEGIES FOR PROFITABLE FIRMS

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IN THIS ISSUE

HOT TOPICS FOR SMALL FIRMS

FROM JAMES METZLER, AICPA VICE PRESIDENT, SMALL FIRM INTERESTS

Welcome to the second issue of Small Firm Solutions, *the AICPA e-newsletter created especially to address the unique needs of members in the smallest firms. Thank you for your meaningful feedback on our first issue. I am pleased to report we had over 60,000 downloads of the newsletter!*

Here's an update on some of the recent developments that will have an impact on small practitioners:

FIN 48 effective date delay. The Financial Accounting Standards Board voted to defer the effective date of a complicated new standard—FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*—for all nonpublic entities for one year, to periods beginning after December 15, 2007. This move was strongly advocated by the Private Company Financial Reporting Committee, which is a joint effort of the AICPA and the FASB. The PCPS Technical Issues Committee, which monitors standard-setting developments from the small firm perspective, had also urged the FASB to take this step.

What it means for small firms. Those who work closely with small businesses were concerned that many non-public companies did not fully understand FIN 48 and how it would affect them. Small practitioners, as well, would benefit from more time to consider how the standard applies to their clients. Many non-public entities and their CPAs have only recently become aware that FIN 48 does apply to pass-through entities, the most common form for small businesses. The deferral will allow both small practitioners and their clients time for appropriate education and make it possible for standard setters and publishers to create more guidance on the standard, particularly as it applies to pass-throughs.

Where to learn more: http://www.aicpa.org/download/info/AICPA_NewsUpdate_Vol.10_No.51.pdf. You can also find out more information about the work of the PCFRC at www.pcfr.org.

Speaking up for small firms. I spend most of my time on the road, listening to the concerns of small practitioners across the country and making sure their voices are heard at the Institute and with other prominent bodies and people. I'm not the only one involved in promoting small firm interests, however. In discussing the delay of the FIN 48 effective date, I mentioned the PCPS Technical Issues Committee. I hope all of you are familiar with the work of this group, which advocates on behalf of small firms before standard setters. TIC meets with groups like the FASB, Auditing Standards Board and Governmental Accounting Standards Board, and writes influential comment letters alerting them to the impact of proposed standards, specifically on small firms and their clients. The committee also publishes the *TIC Alert*, an award-winning newsletter that offers a quick update on new standards and what they mean to small firms and their clients.

Where to learn more: The *TIC Alert* and TIC comment letters can be found at http://pcps.aicpa.org/Resources/Technical+Issues+Committee+and+Communications/.

An important new AICPA/SBA alliance. The AICPA and the U.S. Small Business Administration have signed a strategic alliance agreement that will provide our members with greater access to the SBA's programs and nationwide network. As part of the agreement, we will have access to information on some of the SBA's resource partners, including the Small Business Development Centers, Service Corps of Retired Executives and the Women's Business Centers. We will also have access to SBA pamphlets, brochures and other publications. SBA speakers will participate in AICPA workshops, conferences, seminars and other activities to discuss SBA financing, government contracting and other business topics of value to small practitioners. AICPA members can use a hyperlink on our site to go to the SBA Web site and each organization has assigned a contact person to serve as liaison to the other group. I am that contact person for the AICPA and look forward to a strong and meaningful relationship with the SBA.

Why it's important for small firms: I have found that the SBA continues to create great programs for the benefit of small business clients. The old complaint about the SBA was that they were hard to work with, and thus were not on the radar of CPAs when helping clients. That problem is gone and digging in to the many benefits of the SBA can be very beneficial to clients. America's small businesses account for 99.9% of the nation's businesses, according to data on the SBA site. These companies rely on their CPAs for advice on a wide range of issues. This alliance will make it easier for practitioners to take advantage of SBA resources for their clients and it raises our profile with this important strategic partner.

2007 PCPS Top MAP Issues Survey results released. This respected barometer of trends in the profession found that technical complexity and finding and retaining qualified staff were among the top practice management issues facing CPAs in smaller firms. For the first time this year, PCPS is not issuing one overall Top MAP Issues list because it was determined that averaging the answers from many different types of firms is not an accurate gauge of the concerns of each segment. Instead, PCPS is releasing five separate Top MAP Issues lists that reflect the views of CPAs who are sole practitioners and those in firms with two to five professionals, six to ten professionals, 11 to 20 professionals and more than 21 professionals.

Why it's important for small firms: Most small practitioners wonder whether their competition is facing the same problems that they are or if firms in other communities are affected by the same trends, but they usually have no way of answering these questions. The PCPS Top MAP Issues Survey provides the information that CPAs need to gain a perspective on where they stand and it breaks down the results so that CPAs in each size segment can find information that applies directly to their firms.

Where to find more information: At the PCPS Firm Practice Center: www.aicpa.org/pcps.

PCPS Risk-Based Auditing Toolkit available. PCPS has created a toolkit to help CPAs understand and implement the AICPA risk assessment standards, Statements on Auditing Standards Nos. 104 through 111. All AICPA members have access to an FAQ document, which offers a thorough but succinct review of the standards, with links to related resources. They can also access "The Risk Assessment Standards: A High Level Overview," an archived version of an online Forum given by AICPA Vice President, Professional Standards, Chuck Landes.

Why it's important for small firms: Both of these free resources offer CPA firm leaders and their staff members a straightforward and efficient way to gain a better perspective on these significant new standards.

Where to find it: http://pcps.aicpa.org/Resources/Keeping+Up+With+Standards/Risk+Assessment+Standards+Implementation+Guidance.htm.

Do you have comments and suggestions on how the Institute can help enhance your professional life? Don't hesitate to contact me to share your ideas and opinions at jmetzler@aicpa.org. ■

James C. Metzler

TAXATION

Does Your Client Owe Taxes in Another State?

How many of your clients do business in multiple states? Once upon a time, this question might only have raised tax concerns if a company had a physical presence in the state. States have become much more aggressive about seeking ways to collect revenue on every possible transaction, however. And, while many local firms have long assumed their small business clients operated outside the state nexus radar screen, that assumption, too, is no longer correct, based on many practitioners' experiences. Here's some advice from CPAs who have seen what happens when clients come under scrutiny in another jurisdiction.

Ask questions about client operations. "Talk to clients about whether they sell products over state lines or maintain a warehouse or have a salesman in another state," advises David McIntee, of McIntee Fusaro & Associates, PLLC, in Hillsborough, North Carolina. The consequences for companies caught unaware can be extensive, he says, citing a case in which a foreign state reviewed 10 years of a client's back returns. If a foreign state does want to revisit many years' worth of returns and there is an income tax liability, "the statute of limitations may prevent the client from obtaining credits and offsets for some of those earlier years on their home state returns," he says.

Beware of questionnaires. CPAs should warn clients to call them if they receive a questionnaire asking about their operations in another state, advises Bill Pirolli of DiSanto, Priest & Co. in Warwick, Rhode Island. States use the information they gather in their tax efforts, so clients should understand the need to consult their CPAs before responding.

Anticipate a challenge. Clients may have little enthusiasm to cooperate when told about new taxes to pay or their recordkeeping may make it difficult to sort out where transactions occurred. McIntee also recommends that CPAs keep an open mind about the types of business that could be affected. A restaurant with one location would seem an unlikely target, for example, unless it is selling products online. He also advises practitioners to expect surprises in the tax rules. "No matter how much you know about state taxes, you'll

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probably be surprised by the unfamiliar laws you'll come across in other states," he says.

Stay connected. There is no central information point covering every state's tax laws. States' web sites do include tax information (for links to them, go to http://www.at-homeworks.com/state_tax.htm), however, and state CPA societies and their state taxation committees can be good sources of information. McIntee also recommends networking whenever possible with other CPAs across the country. One option for small practitioners are the small firm network groups open to members of the AICPA Private Companies Practice Section. To learn more about them, go to http://pcps.aicpa.org/Community/Firm+Size+Network+Groups.htm.

For more information, an article in the AICPA Tax Insider describes recent related legal developments. You can find it at http://www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2007/CorpTax/Myths.jsp. ■

SOLE PRACTITIONERS

Balancing Personal and Professional Life in a Solo Practice

How can you maintain a healthy balance between work and personal life when you have no employees to share the workload? Many sole practitioners struggle with that question as they attempt to achieve both personal and professional satisfaction. It's possible to retain an equilibrium, however, based on tips from solo owners we interviewed. Here are their suggestions:

Be choosy about clients. Allen K. Murphy, a sole owner in Springfield, Illinois, looks for warning signs of problem clients in initial interviews and severs relationships with unprofitable ones. By focusing on worthwhile clients, "I work the same number hours I did when I was working for somebody else," says Murphy, who has been in solo practice for 10 years. Cheryl Woods, a sole owner in rural Centerville, Washington, agrees. "When I started my practice, I knew that if I wanted to do a good job, I would have to know when to stop accepting clients."

Share resources. Murphy shares office space with another CPA, whose staff answers his phone. He turns to people in the office when he has technical questions, or networks with other practitioners with whom he has built relationships over the years to get a perspective on technical or practice issues.

Stick close to home. Woods has been operating her practice out of her home since 1979. "The real key to success was the cooperation of my family," says Woods, who lives on a wheat and cattle ranch with her husband and daughter. Woods meets with clients at her dining room table and encourages them to call whenever they need her, so there is definitely overlap between her work and home life. But this overlap also allows her flexibility elsewhere. "My daughter was very active in sports in both grade school and high school, and I never missed anything," she says.

Accept your own limits. Achieving a good equilibrium includes having realistic ideas about how much you should be trying to balance. "For a long time, I struggled with feeling that I had to do everything perfectly and I couldn't slack off anywhere," Woods says. "It took quite a few years before I decided I had to prioritize and do the best I could."

Keep a perspective on the advantages. Running your own show is not a bad thing, sole owners note. While CPAs in larger firms can hand off tasks to other firm members, they also must spend time gaining consensus among partners or supervising staff. "I don't have any partners to answer to and I don't have staff that I have to train and watch over," says Murphy. When he needs help, Murphy does hire an accounting professor part-time who puts in 400 to 500 hours a year.

Scheduling it all "takes a tremendous amount of work, but it's a wonderful life," Woods says. "That's the lure of being a sole practitioner. You're not working for anyone else." ■

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THE NEXT GENERATION

Succession Planning for the Sole Practitioner *By Joel Sinkin*

For most practitioners, the objectives of succession planning are to effectively transition client relationships to the successor firm and to maximize the value of the firm as a result of the transfer. The two are inextricably related. Effectively transitioning your client relationships to a successor firm should also maximize the value of your practice.

The foundation of any succession plan rests on why clients select and stay with you in the first place. Most people assume all CPAs are competent. The primary reason your clients pick and stick with you is not normally because of technical skills. It is because of your personal style and their trust in you. Larger firms have clients that typically are loyal to the brand as well as to individual partners. However, in smaller firms, the loyalty is generally exclusive to the owner (or sometimes key staff). Your staff, location, fee level and services also are important. It's the intangibles in your practice that count with clients.

Recognizing these basic concepts is critical to succession planning. It will help you successfully choose the right successor and jointly develop a plan to transition those relationships to the successor. This in turn will lead to capturing the value of your practice.

How do you choose the right successor? Chemistry between you and the buyer is the single most important aspect in determining the right successor for a sole practitioner. In a small practice, client handholding skills are critical. Start with a basic test. Do you like your potential successor? If you don't, why would your clients like him or her and want to stay with them? Next, ask if the successor firm has a plan for integrating your clients into their practice that is complete and makes sense. The plan should cover which of their firm's partners and staff will be assigned to your clients. Ask about these peoples' current responsibilities and capacity for new work and try to determine how your clients will fit into their schedule. You should be comfortable that they can provide your clients the same level of service they have been accustomed to receiving from you.

If chemistry is foremost, surely next is continuity in the way your clients are served. Your clients like the way you are sailing your ship. Ideally, you will find a firm that will provide stability to your clients. Look for things like the firm's proximity to your current location, fee structure, service offerings, special expertise, if relevant, and client service philosophy. Assuming the basics match up well, the endorsement you provide the successor will also have an important impact on your clients' perception of the new firm.

You should expect, of course, that the successor firm will perform due diligence on your practice. You should also perform due diligence on them. In addition to the basic things like a financial and legal review, do some homework to determine their track record on key indicators. Has your potential successor done a deal like yours before? If so, how did it work? What is their retention rate for their existing clients? If they can't keep their clients why would they be good at keeping yours? What is their reputation and image in the community? Have they had any legal or professional ethics problems? These determinations will help you evaluate their suitability.

Should the deal for your succession be contingent on client retention? The extent to which deals are contingent on client retention varies considerably among transactions. When considering this element of a deal, look at it from the other side's point of view. You might be willing to buy a practice with no adjustment for clients that leave soon after closing, but the risk that might happen would probably cause you to offer significantly less compensation for the practice. Normally, client retention can be maximized if you choose the right successor and the transition is handled properly. Many deals are done with little or no subsequent client attrition other than what occurs naturally, especially when the seller stays involved after closing. Rather than accept a lower value for your practice, you may be better off doing the deal with a firm that is committed and capable of maximizing your value.

What is an appropriate transition plan? Even if you have picked the perfect successor firm, client retention also depends on executing a transition plan. This starts with how you communicate the change to your clients. Present the transition in the most positive light by emphasizing what the clients are gaining from the new firm, not what they are losing of yours. Announcement letters should point out the things that are key to clients, such as the fact that you are staying on, even if it's in an of-counsel role; the fee structure is remaining intact; the practice remains conveniently located; and critical staff are part of the newly combined team. To ensure the letter is read, send the announcement letter in your envelope written on the new firm's stationery.

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Consider in advance how the phone will be answered and whether clients will recognize the new firm's name. You and your successor should consider using a generic greeting during the transition period, such as "accounting office" if a more descriptive name is too cumbersome. Decide who will receive a letter announcing the affiliation and who will be told in person or by phone. Some firms send announcement letters to annual clients with tax organizers just before tax season, even if the deal was finalized in October, to avoid a long delay between the announcement and their next service event. You know your clients best and you should have a strong influence in structure and execution of the transition plan, especially if you bear the risk of client retention risk under the terms of the deal.

One unique method of transitioning clients is to affiliate with your successor prior to your retirement (see the *Journal of Accountancy* article "Two-Stage Deals;" March 2006, http://aicpa.org/pubs/jofa/mar2006/sinkin.htm). Under this technique, you work alongside and as a part of your successor firm for a specified period so that clients can become comfortable with the newly combined practice and the successor can take the necessary time to get to know the client base and their expectations while you are still around to help.

Critical steps. An effective succession plan, and maximizing value, depend on choosing the right successor, focusing on what will maximize client retention and executing a proper transition plan.

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PRODUCTIVITY BOOSTERS

External Hard Drives *By Roman Kepczyk, CPA. CITP*

Tape backups make it easy to archive firm information and move it offsite, but they can be inconvenient for the quick restoration of a file, particularly as yesterday's tapes may not be in the office. In addition, most tape drive programs are somewhat complex and require an IT person to run the software and restore a file. Enter today's external drive solutions that can back up all client data files in small to medium-size firms, making it easy for staff to find the files and restore the data themselves.

External hard drives attach to individual workstations or to the server. They back up data either by individually copying files or doing a "one-touch" backup that will copy all designated information to the drive. They can also synchronize data drives so they only back up changed or new files. Many also include data encryption to protect the data from unauthorized access. The price of these devices has come down significantly, with 500 Gb (gigabyte) drives selling for under $200 from companies such as LaCie, Iomega, Western Digital and Seagate. In addition, the backup speeds have been improved significantly by using USB 2.0, eSATA and Firewire connections.

While tape drives will still be around for backing up the entire network infrastructure and storing it safely offsite, today's external hard drives provide an opportunity for smaller firms and sole practitioners to protect and get easy access to client files.

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PRACTICE MANAGEMENT

A Privacy Checklist for CPA Firms

What are your firm's privacy procedures? Small firms are not immune from the privacy risks that should be taken into account when handling internal and client data. Following sound privacy guidelines is good business practice in firms of any size. This checklist created by the AICPA Privacy Task Force provides CPA firms with practical illustrations of selected generally accepted privacy principles (GAPP) that can help them maintain privacy best practices within their organizations. Not all recommendations will apply to all firms, but they can be adapted to individual needs. For additional information on GAPP and its principles, criteria and illustrations that CPA firms should consider, refer to www.aicpa.org/privacy. You can access more privacy resources at http://infotech.aicpa.org/Resources/Privacy/Tools+and+Checklists/Checklists+and+Worksheets/.

Notice

The firm provides notice about its privacy policies and procedures and identifies the purposes for which personal information is collected, used, retained and disclosed.

- ☐ *CPA Firm Privacy Statement.* Although CPA firms are no longer subject to the notice requirements of the Gramm-Leach-Bliley Act, the AICPA's GAPP and good business practice recommends that firms publish their privacy statement. The privacy statement may use the standard statements required by GLBA.

Security

The firm protects personal information against unauthorized access (both physical and logical).

- ☐ *Employee information.* Personal information about employees, which can include their Social Security numbers; bank account information; medical and benefit details, should be kept secure and restricted only to those individuals with a business reason to have access.
- ☐ *Client tax information.* Clients' tax returns containing personal information should be secured and restricted only to individuals with a business reason to see them. To prevent unauthorized access to tax return information, password-protect all electronic files that contain it. Keep hard-copy tax return documentation secured in a location where visitors do not have access.
- ☐ *Transmitting client data.* E-mails and/or attachments containing client personal information should be encrypted and password protected. A common password system uses the last four digits of the taxpayer's Social Security number, which restricts access to those who know the number. If the information is sent via fax, verify with the intended recipient that the fax number is correct and the fax machine is in a secure location. Use a cover sheet with the appropriate disclosures regarding IRS Circular 230. Mailed documents should be sent either by certified mail or by a carrier that will require a signature from the receiving party.
- ☐ *Computer security.* All computers should be password protected. Each user should sign-in with a unique ID and password. Passwords should be a minimum of eight characters made up of numbers, letters and characters. Passwords should be changed regularly and at least every 60 days. Laptop files containing personal client or employee information should be encrypted, and protected with passwords similar in complexity to those used to secure the computer device on which they reside. Some hard drives now feature built-in encryption.
- ☐ *Servers.* In addition to their regular user ID, server administrators should have a separate and unique administrative ID and password for use only when performing system administration. System default IDs and passwords should be changed immediately. The administrative password should be longer than the regular user passwords, with a minimum of 12 digits.
- ☐ *Computers connected to the Internet.* Security steps should include firewalls, up-to-date anti-virus software, current software security patches and spyware.
- ☐ *Wireless transmissions.* Wireless access points should be password-protected so that no one can log into the network and access firm data. If the office has a hard-wired network, the access point should be outside the network so no one can hack into the servers.
- ☐ *Remote access.* Develop policies for employees who telecommute. For example, consider whether or how employees should be allowed to keep or access client data at home. Also, require employees who use personal computers to store or access client data to use protections against viruses, spyware and other unauthorized intrusions.
- ☐ *Credit card information.* This information should be kept secure to prevent unauthorized access and should not be retained longer than needed.
- ☐ *Computer backups.* Computer backups containing personal information should be kept secure and, if appropriate, encrypted. A copy of the backup also should be kept in a secure off-site location.

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Management
The firm defines, documents, communicates and assigns accountability for its privacy policies and procedures.

- *Employee training.* All employees should be educated on the importance of keeping personal information secure in and out of the office.

Disclosure to Third Parties
The firm discloses personal information to third parties only for the purposes identified in the notice and with implicit or explicit consent of the individual.

Use and Retention
The firm limits the use of personal information to the purposes identified in the notice and for which the individual has provided implicit or explicit consent. The firm retains personal information for only as long as necessary to fulfill the stated purposes.

File Retention/Destruction Policy
Firms should establish a policy on how long to retain client information. At the end of the retention period, the information should either be returned to the client or properly destroyed. Paper documents should be shredded. For electronic data, ensure client information is deleted and written over to make it unrecoverable.

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SMALL FIRM SOLUTIONS *is a quarterly e-newsletter designed to help AICPA members in the smallest firms make the most of their opportunities and keep track of important developments in the profession. It offers news updates as well as articles with practical solutions to common practice challenges.*

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