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The Practicing CPA

SEPTEMBER 1985

An AICPA publication for the local firm

LIABILITY INSURANCE—COVERAGE AND PREMIUMS

According to the insurance industry, worldwide business conditions during 1984 were the worst it has experienced since 1906—the year it was hit by a large number of claims resulting from the earthquake in San Francisco.

A basic principle of insurance is to spread the risk. Plans offering substantial amounts of insurance re-insure portions of their exposure to gain stability. Insurers, typically, respond to a dramatic increase in claims by raising premiums for business they wish to continue to insure and by withdrawing from markets they believe cannot be made profitable. This was the situation in 1984, and, as a result, most insurance programs have been affected and some have even failed. Programs insuring accountants for professional liability were no exception.

The AICPA professional liability insurance plan provides protection for compensatory damages arising from professional services performed for others through

- Neglect, error or omission.
- Misrepresentation, dishonesty or fraud (except if intentional).
- Civil libel, slander or defamation of character (except if committed in bad faith).

The present plan, which currently insures almost 15,000 practice units, has been sponsored by the AICPA since 1974. The objective is to ensure that there is an insurance program available to members that will assist them in defending against negligence suits and underwriting the cost of recovery up to policy limits when such claims are found to be valid.

The plan is offered nationwide to spread the risks and to achieve a substantially stable premium. Due to the severity and number of claims reported in 1984 and the increase in legal expenses required to defend them, the AICPA plan's reinsurers refused to

renew contracts with the underwriters unless the premiums and deductibles were substantially increased. The bad news was that increase in premiums. The good news was that the reinsurers were staying with the plan.

Many small practitioners who have never submitted claims, and don't know anyone who has, believe that it is the large firms that are responsible for these adverse developments, with the small firms asked to bear a good part of the cost of subsequent financial losses.

The AICPA plan, however, is designed to offer insurance only for members practicing with firms of up to 250 staff members in size. In fact, about 85 percent of the policies now in effect are written for firms with 1 to 10 staff members. By the end of last year, firms of that size had incurred over 2,000 claims since the plan began. These claims resulted in losses of \$22.5 million as against the approximate \$20.5 million those firms paid in premiums. In the same period, firms with staff numbering 11 to 25 had over 900 claims. These resulted in losses of \$22 million while the firms paid in the aggregate about \$10 million in premiums. The largest firms in the program have the best experience and most positive (i.e., the lowest) loss rates of any single group.

All losses affect the primary and reinsurance markets. Thus, when reinsurers demand added pre-

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Developing and Implementing a Long-Range Plan

Mauldin & Jenkins is a local firm in a rural area. Albany, Georgia, is an agricultural crossroad, and ours is a general practice. That is what is needed there and at our three other locations in the state. We believe in offering our clients quality services and believe, also, that the outlook for local firms, such as ours, is good if we plan for the future. The need to plan is obvious.

Client and staff development are long-range propositions. So is developing the firm's capabilities. These undertakings must reflect the changing environment of public accounting so that the firm is able to take advantage of opportunities. The secret to success is not firm size, it is creating the capability to perform.

Performance means producing high-quality work, and this, in turn, necessitates maintaining the correct balance between staff and workload. The firm should also have other priorities. These are its bottom line, its practice development activities and the quality of life of its partners and staff. One is as important as the others.

Expectations—clients', staff's and your own—must be met or the firm won't be successful. All must be involved, be part of a team, if they are to perform at higher levels. It is a matter of setting challenging goals and of being able to adjust to opportunities. You must have the goods on the shelf (be they products or people) if you are to respond to opportunities.

The planning cycle

In our firm, we have a series of partner and staff reviews so that we can find out what their expectations are. This is followed by a planning retreat at which the intention is not to reach conclusions or make decisions but to create an environment in which people are free to come up with ideas. We find this type of partners' retreat beneficial because we leave it with the right attitudes for updating our firm's long-range plan.

We believe staff members should have input on

budgeting, so we obtain their suggestions on time allocation and let them know their views are being considered. The budget details include

- The expected growth rate and the firm's attitude toward acquisitions, mergers and expanding services. (These allow us to determine opportunities.)
- Time budgets (established after discussion), rate structure and gross revenue. (These allow us to determine our capabilities.)
- An estimation of annual costs and expenses.
- The annual operating budget.

Supervision and control are essential to maintain high work standards and achieve goals. Timely corrections must be made where necessary, and proper control of the following areas is critical for success:

- Productivity.* We get input from partners and staff who have a joint responsibility to achieve the productivity rate (chargeable hours divided by total available hours) set by the firm. Productivity can be controlled through frequent time reports and summaries. Controls should be established by personnel classifications because of the different productivity standards.
- Realization.* Rates are established for each individual, set at the upper limits and written down where necessary. Any variance in realizing the standard billing rate is the subject of a monthly report to the managing partner, and variances in excess of a certain amount are stated in the annual financial report.
- Collectibility.* A front-end fee arrangement and prompt, adequate billing solve some of these problems. At our firm, collections are the responsibility of the partner in charge of work and billings. There is also a review by a second partner, and approval of the managing partner is needed for any charge-offs.

In regard to the collection of fees from our clients, we use a 75-day report, which relates 75 days of production to the total fees, work in process and accounts receivable. The reports of partners whose work in process and accounts receivable exceed the total of the 75 days of production on their clients are

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marked in red. Those showing work in process and accounts receivable to be less than the total of the 75 days of production are marked in black. The reports are issued monthly, by partner, and state the amount by which each exceeds or is short of 75 days' production.

An adequate reporting system is essential. Everyone should be provided with what he or she needs to know—no more. One suggestion is to use the chart of accounts that is presented in section 201.02 of the *AICPA Management of an Accounting Practice Handbook*. We also prepare an annual financial report for the partners. The contents comply with the firm's reporting policies to clients and contain an independence qualification, various financial statements and supplemental data. (See chapter 501 of the *MAP Handbook*.) This provides partners with the information they need—data for preparing proposals and for comparisons with other firms.

The opportunities that can be derived from planning are immense. You can get satisfaction, financial rewards and retirement security. Planning is an endless cycle, however. You evaluate one year, only to begin the next. This can be discouraging to everyone.

If the plan is to gain the support of other firm members, there must first be enthusiastic support of it and commitment to it from the top, that is, from the founding partner, the senior partner and the managing partner. The next step is to recognize where problems exist and to reconcile incompatible goals.

We found that when our partners were exposed to other firms' successful planning experiences, this helped gain support for the plan in our own firm. An easy way to get this exposure is at state society or AICPA MAP conferences.

When we compared our statistics with those of other attendees at a MAP conference in 1971, we found we were not very profitable. Inspired to develop a five-year plan, we did not adequately involve all partners, and our first draft was a failure. It was then that we realized that for a plan to succeed, it must have the total commitment of all members of the firm, it must involve them and meet their expectations, and there must be action taken to make it work.

How to write a plan

Chapter 104 of the *AICPA MAP Handbook* contains many ideas on writing a long-range plan, such as format, delegation of responsibility and the like. The plan should always be written down and communicated to personnel; otherwise everyone in the firm will have different ideas as to policies. Basically, the

plan should contain a philosophy of practice which covers items such as the following:

- Quality of practice.
- Scope of services.
- Ethics of practice.
- Size of practice, including the area of service, the industry specialization and the number of offices.
- Personnel policies.
- Environment.
- Attitudes toward professional and public service.
- Merger philosophy.
- Admission of partners.
- Successors to key positions.
- Profits.

It should also have a section covering firm statistics, ratios and results such as

- Gross fees per partner, per professional staff, per administrative person, per individual, per chargeable hour and per client.
- Chargeable hours per partner, per professional staff, per administrative person and per individual.
- Net income per partner, per individual and per chargeable hour and various related percentages.
- Capital per partner and percent of gross fees and net income to capital.
- Personnel ratios—partners to professional staff, partners to administrative personnel and administrative personnel to total personnel.
- Growth rate—real and inflationary.

In addition, the plan should contain both comparisons based on other firms' data and statistics found in the *MAP Handbook* and a five-year projection.

A long-range plan must be subject to modification. Both opportunities and capabilities change, and firms must adjust to a situation. Some of the reasons for revisions in our plan include the loss of senior partners and the slow development of new ones, and mistakes in judgment. Then there have been unexpected opportunities such as the unusual growth of a new office.

We think continuous planning can offer significant benefits to every practitioner and recommend a definite commitment to planning and control. It means making the necessary decisions and taking the required action, but it also means you can become master of your fate. You have only one life to live, so make it what you want it to be.

—by Charles W. Jenkins, CPA
Albany, Georgia

Auditing and the New Technology— A New and Brighter Future

Notwithstanding all that has been said and written in recent years about the need to expand management consulting capabilities, auditing and accounting services remain the primary source of revenue for most CPA firms. The market for these two services is certainly changing, however, particularly for audits that clients may need but for which they are increasingly unwilling to pay more each year.

On the other hand, a most exciting and expanding area for many CPA firms has to do with computer consulting. As our firm's microcomputer expertise grew, it became apparent to us that the way to improve our auditing process, so that we could conduct an audit as efficiently as possible, was to apply the new technology to it.

Our first thought was to look at what was avail-

Meet-A-Client

Clients sometimes produce goods and services that other clients can use to help improve their business operations. To facilitate such transactions, Doty, Jarrow & Co., a Chicago, Illinois, CPA firm, often runs an item in its client newsletter describing the product and offering to introduce interested parties.

A few months ago, for example, a client of the firm introduced an "electronic imager," a device that, apparently, can convert the telephone system into a closed-circuit television network, and transmit video images anywhere in the country. As well as describing the equipment and how it works, the article suggested some possible uses that other clients might find appealing.

Another issue of the firm's newsletter told of the specialized, results-oriented services provided by a small management consulting organization. Believing that some of these services are in areas where contacting a management consultant would not occur to clients, Doty, Jarrow offered to make the introductions.

Cross-referrals are a great way to strengthen client relationships. A short article under that title in the December 1984 *Practicing CPA* contains some other ideas on helping clients expand their businesses through contact and dealings with each other.

able. Naively, we assumed that there would be dozens of software programs from which to select. To our amazement, we found only three at that time and not one that really satisfied our need to make fieldwork more efficient. In the end, we realized we would have to write our own software program, and with the combined efforts of staff in both our auditing and management consulting departments, that's exactly what we did.

In designing a program that would aid the accountant in the field and make the audit process easier, more efficient and a good deal more interesting, our staff realized that we needed to develop software that would be flexible and easy to use. We wanted a system that could be used on a portable microcomputer at a client's office. We also wanted a system that would eliminate the time-consuming, manual tasks of posting journal entries to a trial balance, footing and cross-footing the trial balance, combining accounts on the trial balance and preparing the financial statements. Our creation, which we titled "RBG Fieldwork," does this and more.

Once the original chart of accounts is entered, the program requests the prior year's balance and the current unadjusted balance for each account. The user then enters the combination number for each account, which is used to accumulate totals for the financial statements and supporting schedules.

Journal entries are logged directly into the computer and result in an adjusted balance for each account. (One of the features of this system is that it will not accept an out-of-balance journal entry.) The user can print or display the working trial balance in the traditional format of a 14-column workpaper at any time, or display the workpaper index for any account on the working trial balance directly on the computer. Moreover, the reviewer's initials can be entered alongside any account of the working trial balance. If an account is subsequently changed, the reviewer's initials are then automatically removed.

"RBG Fieldwork" has features that allow the user to perform analytical reviews by obtaining comparative financial statements (dollars and percentages) and common-size financial statements. The program is not designed for use in auditing specific account balances such as receivables and inventory. However, integration with other software, such as Lotus 1-2-3, is presently being tested.

Experience indicates a moderate reduction in time related to the preparation of trial balances, etc., the first year the program is used and even more the second year. There is no procedural difference in reviewing computer-based trial balances

as opposed to manually prepared ones. So, apart from being able to initial accounts electronically, review time is not saved to any appreciable degree. However, the trial balances and adjusting entries are much easier to read.

Although our firm has grown over the years, we have never lost our small-firm orientation. Our frustration with other programs we tested before embarking on this project was with the fact that they all seemed to be designed for large audits. We concluded that they could not be used effectively for the majority of audits conducted by our firm. One of our primary goals, therefore, was to design the software to be cost-effective for a small or medium-size CPA firm.

There is only one major prerequisite for using this software, and that is the proper hardware. "RBG Fieldwork" performs on an IBM PC or PC-compatible microcomputer with 128k memory, such as Compaq, Panasonic and Columbia. Its menus and automatic file backup make it very easy to use, and we find auditors only need a two-hour training session. The cost of training is, therefore, very reasonable.

The program has been successfully field-tested for over a year by our own staff as well as by a select number of other CPA firms. Its reliability is excellent. Software support is basically contained in the self-explanatory documentation, but our staff in the office is also available for phone calls regarding the use of the system.

No special client characteristics are needed to make the software cost-effective. It can be used at any company that has a chart of accounts and, in fact, is used at both large and small companies with excellent results.

Perhaps the best result we have witnessed is the renewed enthusiasm in our audit department. Not only is efficiency improving, but the staff as a whole is taking a great interest in honing its computer skills.

The excitement generated has been such that it was only a matter of time before the inevitable occurred. The firm has embarked on enhancements to "RBG Fieldwork" and the development of new programs to deal with other aspects of accounting that all local CPA firms face each day. What used to be the more mundane side of accounting has now become the more exciting. By taking advantage of the electronic revolution, auditing has now taken its place as part of the state of the art. ☑

—by James G. Castellano, CPA
and Bernard Sirkin, CPA
St. Louis, Missouri

Compensation Trends of Outside Directors

Based on a study of 600 of the 1,000 largest U.S. companies, Korn/Ferry International reports that the average earnings for all outside directors were \$18,800 in 1984, up 29 percent from the comparable earnings in 1980. The chart below breaks down the statistics as follows:

<u>Type of Company</u>	<u>1984</u>	<u>1980</u>	<u>Increase</u>
Industrials			
\$400–\$600 million	\$15,200	\$10,800	41%
\$1–\$3 billion	20,300	18,200	12
\$5 billion and over	26,300	22,100	19
Banks and other			
financial institutions	17,500	12,000	46
Retailers	21,400	13,200	62
Service companies	18,900	—	—
Average	\$18,800	\$14,600	29%

Other findings of the study show that in 1984 the average compensation ranged from \$14,100 for outside directors of industrial companies in the \$200–\$400 million revenue category to \$36,100 for directors of \$5 billion-and-over companies. The average compensation for directors in the upper quartile was \$27,100. ☑

The White House Conference on Small Business

More than 1,800 delegates are expected to attend the conference on small business at the White House next August, and more than 30,000 delegates are expected to participate in the 55 scheduled prior state conferences. All the sessions are designed to let small business leaders discuss issues and make specific and comprehensive recommendations for the future of small business.

Conferences will be held in all 50 states (in some, at two sites), the District of Columbia and Puerto Rico. They began in Richmond, Virginia, on August 9, and will end May 22, 1986, in Syracuse, New York. The complete schedule and conference information, such as delegate registration details, is available by contacting the White House Conference on Small Business, 1801 K Street, N.W., Suite 1101, Washington, D.C.: (202) 653-9550. ☑

Insurance (continued from page 1)

miums, the premium for the basic part of the policy must increase.

Some practitioners believe that the premium increase should be more closely directed to those practitioners causing payout, for example, to those who offer services that present a higher risk of loss. They also suggest that a lower premium should be charged to firms that have not required any payout in the previous five-year period.

The vast majority of claims with the AICPA plan are from firms that have never previously been sued. Up until now, however, the AICPA professional liability plan committee, which is responsible for monitoring the plan, has not been able to develop an application that would with any certainty identify a firm that is more likely to be sued than others. The committee is, however, attempting to develop a pricing structure that would accommodate the average local practice offering a standard mix of services at a basic premium. Firms would have an option to purchase coverage on unusual or known high-risk services at additional premiums. The committee is also conducting an intensive evaluation of claims and attempting to profile firms that create unusual risks. Since the beginning of November 1984, such firms have been denied participation in the plan.

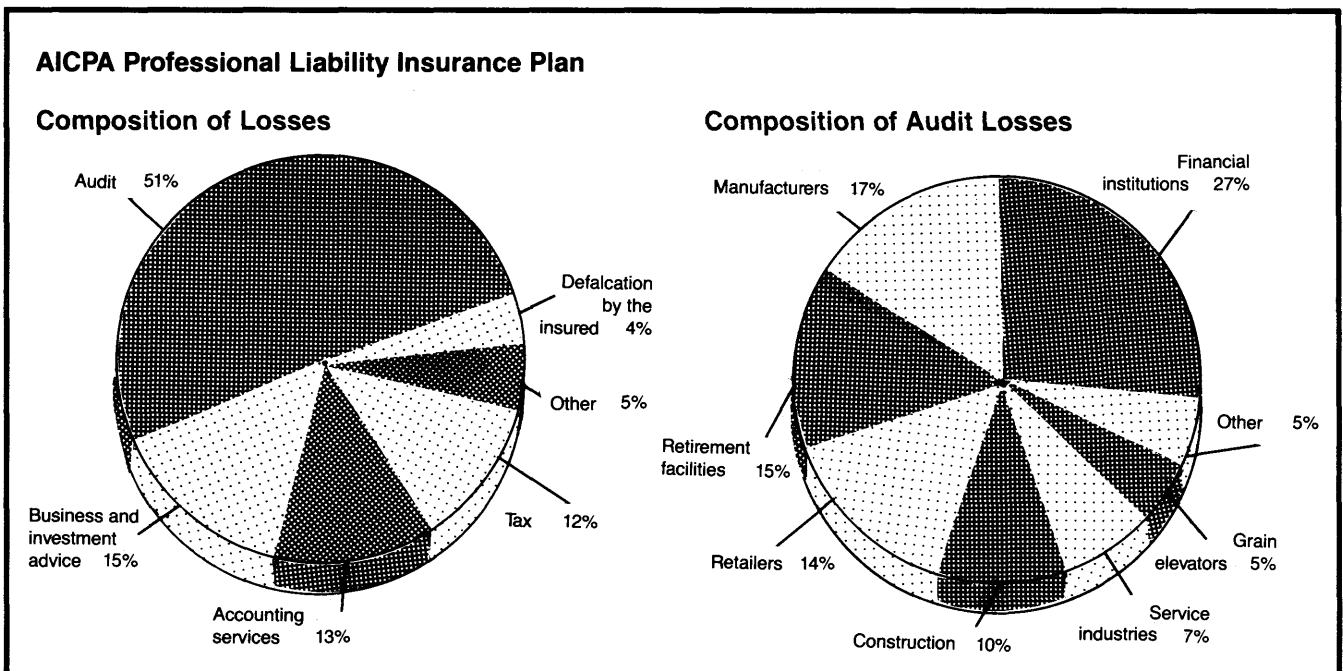
Some practitioners think that those who do not have the exposure associated with an SEC practice should have a different coverage from those who do. The committee points out that the plan offers a broad policy form with minimal exclusions. Incidental or small amounts of work that fall under the SEC classification are covered at no additional

charge. Significant SEC exposure results in a premium surcharge because of perceived added risk. An analysis shows that, from the plan's inception, major losses attributable to audit engagements amounted to 57.23 percent of total losses, and losses attributable to SEC, blue sky and similar registration exposures amounted to 1.51 percent. The most recent analyses of losses in the plan are summarized in the charts below.

Most of the criticism over the year-end increase came from insured parties who had been members of the plan for many years. They had become used to the stability of both plan and premiums. Some programs that went out of business in the second part of last year were, in fact, charging more for coverage than the AICPA plan. This suggests that the AICPA plan may have been underpriced and kept together by its large size and minimal administrative costs.

The plan committee advises members not to practice without liability insurance coverage even when premiums seem high. That they are high is a reflection of the higher risk, particularly where the practice is more sophisticated than most.

The AICPA professional liability insurance plan has demonstrated its stability, and the committee encourages participants to remain with it and good risks to join. Because conditions mandate greater underwriting selectivity than in the past, not every new applicant can be accommodated and participating members who leave the plan cannot be assured reentry. A commitment to quality is essential. Nevertheless, the committee desires to continue to offer a solid, broadly gauged program to the maximum number of local firms.



Microcomputer Maintenance, or the Art of Avoiding Constant Servicing Expense

Sorbus, the computer-maintenance company, has published a booklet listing several dozen ways to protect microcomputers from damage in use. Sorbus's preventive-maintenance suggestions may not only be useful to a firm's own personnel but could be worth passing along to clients as well. Their tips include the following:

- Install equipment in an area where there is minimal traffic, to avoid having it banged into. Put it on a sturdy table or desk rather than a rolling cart. Once you've placed it where you want it, leave it there.
- Locate equipment out of the direct sunlight, away from heating vents, radiators or open windows. Ideal conditions include a temperature of about 75 degrees and a relative humidity of 50 percent.
- Don't smoke around the equipment. Dust and tar can gum up the works. No eating or drinking, either, because of the danger of crumbs or spills. If a spill *should* occur, take the affected unit to a service center at once for a professional cleaning.

Dust a major menace

- Vacuum the printer periodically. Wipe the printer surface with a mild cleaner. Use the dustcovers that come with the equipment. Never oil any part of the system; sealed bearings operate without external lubrication, and oil will only collect dust and cause clogging. Unplug equipment before cleaning.
- Once you turn it on, let your micro run continuously as long as there is a likelihood of your using it. Turning it on and off causes thermal expansion and contraction that puts stress on various elements. Be sure your power supply is adequate. Don't use a power line that is shared with other equipment big enough to cause voltage variations. If voltage variations are unavoidable, talk to an expert about installing a line filter to protect against surges.
- Avoid the etching of a stationary image onto the inner surface of the cathode ray tube screen. This is done by keeping the brightness level very low when the unit is on but not being used. Once the screen has been etched in this manner it cannot be repaired but must be replaced.
- Use antistatic mats to protect against memory loss or other mishaps. In the absence of mats use antistatic spray on carpets and clothing. Static avoidance is the reason that 50 percent humidity is important.

The 1985 MAS Conference

Given the impact of current conditions on traditional services, many local practitioners believe it is imperative to develop other practice areas such as management advisory services. The eleventh annual AICPA MAS conference on September 9-10 at the Westin Hotel in Chicago is designed with this in mind; that is, to help practitioners provide the business advice and assistance that small-business owners need.

Presented in conjunction with the Illinois CPA Foundation's Midwest Accounting Show, the conference offers sessions on MAS marketing and MAS practice administration and on such services as personal financial planning, business valuation engagements and assisting clients with mergers, sales and acquisitions and with office automation.

Time is short, but you might still be able to register for the conference. Just call the Institute's meetings department at (212) 575-6451.

Do unto your diskettes...

- Treat diskettes gently, or they may develop alignment problems. Don't subject them to temperature extremes, by leaving them for example, in a parked automobile (true also of other EDP equipment and supplies). Never touch the diskette surface. Store diskettes in their protective covers.
- If a problem occurs, use the owner's manual to determine, if you can, which part of the system is not operating properly, so you can describe it over the telephone to your dealer or qualified service company. Don't take anything apart yourself.
- Don't skimp on quality when buying computer supplies—especially printer ribbons and diskettes. Not only could you wind up with poor print quality, but you might also experience jams, a frequent need for replacements and loss of data.

Finally, Sorbus tells us which parts of a system normally require most frequent servicing: first, printers, then disk drives, next keyboards and finally the microcomputers themselves. If your experience differs from that, they suggest, it may be the way you are applying and using the equipment rather than defects in the manufacture.

Questions for the Speaker

A participant at an AICPA MAP conference asks, "How can you give sufficient priority to staff development with all of the other pressures of running a practice?" Richard A. Berenson, a New York City practitioner, responding to this question, says, "One of our goals is to perpetuate our practice. Staff development has a high priority in our firm because, without it, we will never achieve that goal."

H. W. Martin, a retired Georgia CPA agrees. He says that failure to devote adequate time to staff development assures a firm of a limited future, or even of an unwanted merger with another firm.

Mr. Martin suggests that time schedules be set and maintained for staff development, just as they are for delivering tax returns. He thinks administrative deadlines should be met even if doing so results in partner overtime. He says that clients and employees respect a firm that is operated in a businesslike manner, just as they respect high-quality work. Mr. Martin believes that if a CPA firm cannot run its own operations in such a manner, it can hardly expect others to believe it can successfully counsel them in the handling of their affairs.

Help Reduce Computer Abuse

The Institute is participating in an effort being made by the Small Business Administration (SBA) to help small businesses protect themselves against computer crime. In response to the requirements of the Small Business Computer Security and Education Act of 1984, the SBA appointed a nine-person advisory council, including a member of the Institute staff, Donald L. Adams, vice-president of finance and administration, to direct this project.

One of the tasks assigned to the council is to gather "data on computer security and crime," particularly as it has impacted small businesses. To help in this project, readers are asked to supply information about cases of computer abuse involving small businesses. Such information should be based on firsthand knowledge.

Those who submit information are asked to be as detailed as possible. The name of the victim of the abuse does not have to be disclosed, and the person who submits the information may remain anonymous. Your cooperation in helping the council assess the impact of computer abuse will be greatly appreciated. Information should be sent to Donald L. Adams, CPA, at the Institute.

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