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PEER REVIEW IS REVISED

The AICPA peer review board (PRB) and its standards task force received approximately 300 comment letters on its proposed revisions to *Standards for Performing and Reporting on Peer Reviews*, issued as an exposure draft last spring (see *The Practicing CPA*, Jul.99, page 3). Those comments were not ignored.

At its October 1999 meeting, the PRB incorporated into the revised peer review standards for firms that do not audit SEC registrants many of the suggestions from smaller firms who had been concerned that the costs associated with their peer reviews would soar. In fact, the wording adopted for several of those standards is quite different from that in the exposure draft. The new standards become effective January 1, 2001.

"I am very pleased with the new standards and the work of the PRB," said Bea L. Nahon, president-elect of the Washington State Society of CPAs and sole owner of a firm in Bellevue, Washington. "I spoke with a number of members who had been concerned that the proposed revisions in the exposure draft would require firms that performed only a few review engagements to have a system review. These firms would have experienced a significant increase in costs," said Nahon. "The final revisions remedy this and many other potential problems in the exposure draft."

The new standards

According to Susan Coffey, AICPA vice-president of self-regulation and the SEC practice section, the revisions to the peer review performance and reporting standards will improve the way peer reviews are conducted and administered. The new standards establish the following three categories of peer review for firms that are enrolled in the AICPA peer review program.

1. **System review.** This review will be required for firms that perform engagements under the SASs and/or examinations of prospective information under the SSAEs. It is essentially the same as the current on-site peer review, with a name change.
2. **Engagement review.** This review is for firms that are not required to have a system review and who are not eligible to have a report review (discussed below). It is similar to the current off-site peer review in that it requires, among other things, a separate report and letter of comments, a technical review, committee acceptance and monitoring actions. However, the objectives of an engagement review will include establishing whether the reviewed firm’s working paper documentation conforms with the requirements of SSARSs and SSAEs that are—in all material respects—applicable to its engagements.

There will be no opinion on the reviewed firm’s system of quality control and, therefore, the reviewer will not express an opinion on the firm’s compliance with its own quality control policies and procedures or with quality control standards. Rather, the reviewers will provide limited assurance that financial statements or information and the related accountant’s report conform with the requirements of professional standards.

3. **Report review.** Firms that perform compilations that omit substantially all disclosures would have a report review. However, if a firm prepares compilations where “selected information is presented and substantially all disclosures required are not included,” it must have an engagement review.

At a minimum, at least a technical review is required and possibly acceptance by the administering entity’s peer review committee (PRC). In addition, the PRC may impose monitoring actions on the firm and/or the reviewer.

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The **PRC** is the Committee appointed by the Board of Directors of the American Institute of Certified Public Accountants. The PRC is responsible for the development and interpretation of auditing standards for the profession. The PRC has the authority to establish and modify rules and procedures for the profession. The PRC also has the authority to establish standards for the profession and to interpret those standards.

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### Welcome changes

“Requiring a technical review of report reviews, and the possibility of review by the PRC, alleviates the concerns of smaller firms that undergo a report review that comprehensively, observations and recommendations by reviewers will be appropriate and in keeping with professional standards,” said Nahon.

Firms that have engagement reviews will have to submit workpapers as required by professional standards; however, according to Nahon, the standards have minimal workpaper requirements. “The workpaper requirement for a review is a representation letter, and there really are no workpaper documentation standards for compilations,” said Nahon.

### More to come

The revised standards contain some additional guidance on handling disagreements between the administering entity and either the reviewer or the reviewed firm. The PRB plans to provide more guidance on this issue.

Committee-appointed review teams (CARTs) and association-formed review teams will still be available to the administering entities. However, in the future, the PRB plans to provide administrative guidance on certain billing issues relating to CART reviews. Administering entities that wish to have CART reviews will be required to follow the PRB’s administrative guidance.

Other revisions to the peer review standards are as follows:

- The CPA who actually performs an engagement or report review is designated as the reviewer. The reviewer, or in unusual circumstances, any additional reviewers, must be approved by the entity administering the peer review.
- If a firm’s most recent review was a report review, the firm’s members are not eligible to perform peer reviews. A firm’s members are eligible to be engagement-and-report reviewers if, on its last peer review, the firm had an unqualified/unmodified report on its system of quality control, engagement review or off-site.
WHO THE REVISIONS AFFECT

Most firms in the AICPA peer review program perform reviews and/or compilations as their highest level of service.

<table>
<thead>
<tr>
<th>Engagement review firms</th>
<th></th>
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<tbody>
<tr>
<td>Reviews only</td>
<td>388</td>
</tr>
<tr>
<td>Reviews and full disclosure compilations only</td>
<td>462</td>
</tr>
<tr>
<td>Reviews and omit disclosure compilations only</td>
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</tr>
<tr>
<td>Reviews and full &amp; omit compilations only</td>
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<td>2,640</td>
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<tr>
<td><strong>Total</strong></td>
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<table>
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<tbody>
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<td>Omit disclosure compilations only</td>
<td>7,353</td>
</tr>
<tr>
<td><strong>Total</strong></td>
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</tr>
</tbody>
</table>

*This does not include firms performing engagements under SASs and/or examinations of prospective information under the SSAEs.

peer review (until the off-site review is phased out), and the peer reviewer must have the same type of engagements as the reviewed firm.

- If a firm's most recent review was a report review, the firm's members are not eligible to be charged with the responsibility for acceptance of any reviews. A committee member charged with the responsibility for acceptance of reviews must, at the very least, have received an unqualified/unmodified report on his or her firm's system of quality control, engagement review or off-site peer review (until phased out).

- All peer reviews are subject to oversight by the AICPA and the administering entity.

A job well done

"The PRB should be complimented for taking a fresh look at the off-site program and going through the process of improving peer review," said Nahon. "There were a lot of comments in response to the exposure draft, which speaks well of the members of our profession. Most important, the PRB made an effort to really listen and to make changes—a great example of self-regulation." ✅

NONCOMPETE AGREEMENTS

A n employee who leaves a CPA firm—taking clients and proprietary or confidential information with him or her—can cause it to suffer significant losses in income, or other damages. How can a firm protect itself from such loss? One solution, while not foolproof, is to require its staff to sign a "noncompetition" ("noncompete") contract that says they agree not to compete with the firm for a specified period of time following their termination or resignation.

What the agreements cover

Typically, noncompetition agreements require employees to agree to the following:

- During the term of their employment with the firm, to fully devote their time, services, attention and effort to the performance of their duties and to the promotion of the business and the interests of the firm.

- During the term of their employment and for a specified period thereafter (typically 1 to 3 years):
  - Not to serve as employees, officers, directors, managers, members, partners or joint venturers in, or as proprietors of, a business that is similar to the business engaged in by the firm.
  - Not to solicit any clients of the firm.
  - Not to solicit or hire any employees of the firm.
  - Not to use, or disclose to any third party (including any new firm), any proprietary or confidential information (including processes and know-how), whether it relates to the firm and its business or to its clients and their respective businesses, and to return to the firm, at the end of their employment, all documents and computer files containing any such proprietary or confidential information.

Noncompetition agreements sometimes require employees to refrain, following their termination or resignation, from any disparagement of the firm or its partners or employees.

Reasonableness of terms

In general, the more reasonable noncompete agreements are, the more likely they are to be enforced by the courts. Courts generally consider three issues when determining if a noncompete agreement is reasonable:

1. The length of the postemployment, noncompetition period.
2. The geographical area in which the employee is prohibited from competing.
3. Whether the restrictions are reasonably necessary to protect the legitimate business interests of the firm.

continued on page 4
The enforceability of noncompete agreements varies from state to state. Because of this, CPAs should not require an employee to sign such an agreement without first consulting with an attorney who practices in the state(s) where the firm does business.

**Postemployment agreements**

Agreements that prohibit a former employee from competing with the employer within a limited area (such as a city, county or state), for a period of one year following the termination of his or her employment, are more likely to be enforced. Agreements that prohibit an employee from competing with the firm for longer periods of time and anywhere in the world are much less likely to be enforced. The employer must prove that the time period during which the employee is prohibited from competing and the geographical area in which he or she is prohibited from competing are necessary to protect the business interests of the firm.

Obviously, the time period will vary from firm to firm and from employee to employee, depending on the geographical area in which an employee performed services and developed client relationships for a firm and on how long it may reasonably take until the firm will no longer be significantly damaged by the competitive activities of the former employee.

Some employees (depending on their position in the firm) can do more damage to a firm than others; therefore, the terms of a postemployment, noncompete agreement can vary.

**Necessary restrictions**

According to the courts, employers can use noncompete agreements to protect their business interests, including client relationships and confidential and proprietary information, and they can prevent employees from using employer-provided training and information to compete with them.

However, the most complicated issue relating to the enforcement of such agreements is not whether an agreement protects the firm or is related to a reasonable geographical area. Rather, the noncompete agreement must not place undue hardship on the employee. An agreement that prevents an employee from working following his or her termination or resignation is unlikely to be enforced by the courts. In light of this, not only must the time period and geographical area be carefully tailored to the firm’s legitimate business needs, but also the description of the businesses for which the employee cannot work, and with which the employee cannot be associated, should be as narrow as possible, while still adequately protecting the firm’s legitimate business needs.

**Requirement for new employees**

Hiring a new employee is generally considered by U.S. courts to be sufficient reason to require him or her to sign a noncompete agreement. However, firms should particularly consider noncompete agreements for their professional staff—who are the most likely to pose a competitive threat following their termination or resignation.

All employees, regardless of their position, should sign a confidentiality agreement in which they agree not to use for their own purposes, or disclose to any third party, proprietary or confidential information. Both noncompete and confidentiality agreements can be standalone documents or included in an employment contract.

**Requirement for current staff**

Noncompete agreements entered into with existing employees are enforceable only if they are signed and the employee receives a benefit, such as a raise in salary, a promotion or other favorable change in employment status. Raises an employee would have received anyway are not sufficient consideration to support a noncompete agreement entered into with an existing employee.

Check with your attorney to determine what constitutes “adequate consideration” in your state for the purpose of supporting a noncompete agreement for existing staff.

**Not a panacea**

Noncompete agreements are important tools for employers and may prevent significant damage to a firm’s business. As a general rule noncompete agreements are enforceable, but must be limited in time and geographical area and must be tailored to a firm’s legitimate business needs. The burden, however, is on the firm to seek an injunction to prevent the employee from competing, and this, of course, involves substantial time and expense. The firm must be prepared to take legal action quickly if it finds a former employee is engaging in competitive activity, for the longer it waits, the less likely the court will enforce the noncompetition agreement.

— By **Eileen R. Sisca**, an attorney in the corporate department of Eckert Seamans Cherin & Mellott, Pittsburgh, Pennsylvania. Phone: 412-566-6993; e-mail: ers@escm.com.
Clarification

The October 1999 Practicing CPA contained a “Case in Point” discussion of a CPA who allowed a client (taxpayer) to deduct the decrease in value of two undeveloped land parcels on an S corporation return (with the corresponding losses passed through to the individual shareholder) on the grounds that holding a number of lots of almost identical size for resale should allow the use of a lower-of-cost-or-market (LCM) inventory method. The CPA concluded there was substantial support for this position. Nonetheless, he had the taxpayer attach voluminous disclosure documentation to his individual return. The IRS, upheld by the Tax Court, found that no inventory method (including LCM) applies to real property and disallowed the losses.

The focus of the article was not on the substantive correctness of the CPA’s advice, but on the fact it had been communicated orally only, and not in writing. However, one sentence in the article was misleading and requires clarification. It stated that the CPA firm, although recognizing the LCM position was very aggressive, nevertheless concluded “there was substantial support for it, assuming there were adequate disclosures in the return.” That wording was incorrect. Disclosure never, by itself, provides substantial support or substantial authority. What the article should have said was that if there was substantial authority for making the claim, proper disclosure would have shielded both the taxpayer and the preparer from a substantial understatement or negligence penalty.

In the absence of substantial authority (an issue the Tax Court did not deal with), disclosure would not, per se, have allowed the taxpayer to avoid a penalty (although the taxpayer could have argued against it on the grounds that he reasonably relied on the advice of his CPA).

“Case in Point” articles are not written to take sides on substantive issues that may result in a liability claim against a CPA. Rather, they are intended to convey professional liability risk-management recommendations, using actual claims from the files of the AICPA Professional Liability Insurance Program.

The discussion in the October article was not intended to show there was substantial authority for the LCM advice but, rather, how a practitioner could better protect himself or herself against the risks inherent in giving aggressive tax advice—in this case, by having the recommendation in writing to the client with an acknowledgement by the client of the risks being assumed.

John von Brachel

NEW TAX LAW: A POTENTIAL TRAP FOR CPAS

A bill signed by President Clinton in December disallows installment sales reporting of the sale of an asset for taxpayers who are on the accrual method of accounting for federal income tax purposes. Section 536 of HR 1180 is effective for sales or dispositions on or after December 17, 1999.

Because the installment method of accounting is not available for most sales of inventory, this change is most likely to affect business dispositions. For example, a taxpayer selling its assets, may finance the sale by taking back a note from the purchaser. Before the change in the law, a taxpayer could defer at least a portion of the tax by reporting the gain from the sale in installments, recognizing the gain as the note was collected. This resulted in a deferral of the income tax and was consistent with the cash collected from the sale.

Under the new law, the gain will be immediately recognized. This is a potential trap for any CPA who advises an accrual method client on the installment sale of an asset using the old law—there will be immediate recognition of gain and tax liability, with deferred receipt of cash with which to pay the tax. The tax liability from the sale could exceed the cash generated by several times in the first year, severely distressing the business and its owners, and resulting in a claim against the CPA.

When selling a business, cash-method owners can continue to take advantage of installment reporting of the gain if they sell their underlying stock in the business rather than having an accrual-method business sell the assets (cash-method taxpayers are not restricted by the new law). This may be more difficult than selling the underlying business assets, and it is generally not available when a business is continuing.

The new law does not apply to the trade or business of farming, or to the sale of time-share interests or residential lots where the taxpayer elects to pay interest on the deferred tax.

Three other provisions in HR 1180 are of interest to CPAs:
1. The rise in the estimated tax “safe harbor” to 108.6% of prior year’s taxes for those with an AGI over $150,000.
2. The extension through 2001 of minimum tax relief for individuals—allowing them to use non-refundable personal credits to offset the minimum tax. Many middle income taxpayers with education, child and other personal credits may thus avoid a minimum tax situation.
3. The extension of the research credit until June 30, 2004. However, in an unusual twist, research credits

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attributable to the period beginning July 1, 1999 and ending September 30, 2000 can only be claimed after October 1, 2000. Thus, most calendar-year taxpayers who were entitled to the research credit in 1999 will have to file their 1999 tax return without the benefit of the research credit—they must file the refund claim after October 1, 2000 to realize the benefit of the 1999 credit.

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**TAX ON CAPITOL HILL**

Following is a status report of other tax legislation important to CPAs.

**Corporate tax shelters.** On November 9, 1999, the Senate narrowly defeated an amendment that would have limited corporate tax shelters. Congress plans to revisit corporate tax shelters in 2000.

**Workplace retirement planning.** A provision that would allow employers to offer retirement-planning assistance to employees as a *de minimis* fringe benefit without the cost of those services being taxable to the employee was included in the GOP's vetoed tax cut package (H.R. 2488) and is among the tax provisions attached to both the House and Senate minimum wage bills.

**GST tax.** A provision in the House (not the Senate) minimum wage bill would give the IRS authority to grant relief to taxpayers for late allocations for the generation-skipping transfer (GST) tax exemption and rules would be modified to substantially alleviate its complexity.

**Marriage penalty.** When President Clinton vetoed H.R. 2488, he defeated a provision to alleviate the marriage penalty. Support remains strong in Congress to ease the marriage penalty, and it is a campaign issue in the presidential race.

**Capital gains.** Individual capital gains rates would have been reduced and capital gains tax brackets would have been indexed for inflation for investors who had paid taxes on their gains up to that point under H.R. 2488. Congress did not take up the capital gains issue again last fall.

**Estate tax.** Congress voted to phase out estate taxes in the vetoed H.R. 2488 and has included language reducing estate taxes in both minimum wage bills.

**Health insurance deductibility.** Language to accelerate to 100% the tax deduction for the cost of health insurance for the self-employed is included in the bills the House and Senate passed to reform the managed health care system. Lawmakers are expected to work out a compromise bill when they return in 2000.

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**A Note From the Executive Committee**

As we move forward into 2000, it is important to look back and take note of what the PCPS executive committee was able to achieve in 1999. To help prepare CPA firms for the changes that lie ahead, the committee issued the *PCPS Millenium Report*. The report included a survey by the Gallup Organization of the current state of the profession and a separate study of more than 1,000 PCPS member firms on the current state of CPA services. The report identified new business opportunities for CPAs and provided ideas on how firms can expand their core services.

In addition, PCPS launched an advertising campaign—targeted to the banking profession—to help build awareness of the AICPA/PCPS peer review process and the PCPS public file. The campaign directs bankers to the PCPS public file and member directory so they can locate a PCPS-member firm in their area. The ads have appeared in *American Banker, ABA Banking Journal* and *Community Banking Quarterly*. They will continue to run in 2000.

Several of our committee members wrote articles, which appeared in professional publications across the country, that highlighted the state of the profession and how CPAs can succeed in this dynamic market.

Looking ahead, the committee expects to offer PCPS members even more. We will intensify our advocacy efforts on behalf of small firms with the appropriate organizations and standard setters. This is one of our most important—but least visible—activities. We will expand the PCPS Web site in 2000 to ensure it continues to offer member firms valuable information.

Other 2000 initiatives include:

* The strategic review. PCPS plans in 2000 to introduce to its members the new "strategic review." The proposed one-day strategic review will assess and evaluate a firm's strategic plan and make recommendations about the direction and the focus of the firm's planning process. It will also enable a firm to identify new client services.

* Peer review certificates. Many PCPS member firms have informed the committee that their clients don't understand how the peer review process works and how it benefits them. Based on this feedback, PCPS will begin issuing certificates for "unmodified" peer reviews that can be framed and hung in your office. Now, your clients will be able to see PCPS's recognition of your hard work and effort to maintain quality standards.
• **Practitioners symposium.** This year’s symposium. June 4–5 in Las Vegas, Nevada, is guaranteed to be informative and fun. We’re preparing, among other things, a course designed to help firms develop and sell new services. PCPS members will receive discounts on the conference and will be invited to a private reception. If you missed last year’s event, don’t make the same mistake twice.

• **Audit efficiency report.** PCPS is preparing a report that will offer readers “best-practices” case studies on not-for-profit audits. This report will serve as a user-friendly guide to help firms implement processes that have worked well for other firms.

These are but a few examples of our 2000 initiatives. We will continue to support, and advocate on behalf of, PCPS’ local and regional member firms, and we welcome any feedback you may have. Here’s to a profitable 2000!

—By Harold Monk, chairman of PCPS Executive Committee. To contact the PCPS committee, call Barbara Vigilante at 201-938-3457, or e-mail her at bvigilante@aicpa.org.

**MAP Agenda 2000: Reaching Out to Smaller Firms**

The PCPS management of an accounting practice (MAP) committee recently was reorganized to broaden its scope to do more for smaller practice units. Members of the small firm advocacy committee were asked to merge with the MAP committee and to form a standing sub-committee of MAP. This gives the MAP committee equal representation from sole practitioners, and small, midsize and large practices. The MAP committee plans to increase its efforts onto meeting the needs of smaller practice units.

Other activities for the new year include the following:

• A meeting of state society MAP chairs and their respective state association committee liaisons and representatives from firm associations and special interest groups will be held in May. This meeting will focus on trends in the profession, as well as suggested MAP agendas for the states and committee organizational issues.

• The small firm advocacy subcommittee assisted in preparing the agenda for the practitioners symposium, ensuring small firm issues will be covered. Participants of the 1999 symposium gave it the highest rating ever. We plan to build on last year’s success and offer an even better program in 2000.

• The MAP forum series will return in October to Las Vegas. The two previous forums on consolidation and staffing were very successful. This year’s forum will address competition in the industry, as well as continued on page 8

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**BizSites**

**Useful Web sites for the practicing CPA**

**Measuring Performance**

CPAs often need to compare a company’s performance with that of others in the same industry. The Internet offers many resources on trend and transaction analysis.

**EDGAR**

The SEC’s EDGAR database provides information on more than 15,000 publicly traded companies. A number of sites—some free and some fee based—offer access to the EDGAR data.

**Free sites**

SEC  [www.sec.gov](http://www.sec.gov)

FreeEdgar  [www.freedgar.com](http://www.freedgar.com)

EdgarScan  [bamboo.tc.pw.com](http://www.bamboo.tc.pw.com)

EdgarOnline  [www.edgar-online.com](http://www.edgar-online.com)

10K Wizard  [www.tenkwizard.com](http://www.tenkwizard.com)

**Fee-based sites**

LIVEDGAR  [www.gsionline.com](http://www.gsionline.com)


**Other resources**

[www.boovers.com](http://www.boovers.com)

This site provides extensive information on public companies in easy-to-use format. The database contains information on more than 12,000 companies. Access to company capsules is free, but profiles, in-depth financials and investor tools are available only to subscribers.

[www.justquotes.com](http://www.justquotes.com)

JustQuotes is a financial data search engine. Enter a company name or stock symbol, and you will see quotes, financial data and links to related Web sites.

[www.moneycentral.msn.com](http://www.moneycentral.msn.com)

Microsoft has its own user-friendly site for analysis of company performance. MoneyCentral provides users with quick profiles, real-time quotes, charts, analyst information, financial results and news updates.

—Compiled by Eva M. Lang, chief operating officer, Financial Consulting Group, Memphis, Tennessee. E-mail: lemay_lang@csi.com.

AICPA/PCPS does not endorse Web sites that appear in BizSites.
new services, strategic alliances, new competitors, strategic planning and much more.

New MAP initiatives for 2000

In December of 1999, MAP launched the midsize CPA firm network in Dallas. We assisted in establishing national groups of midsize firms that meet twice a year to share and discuss practice management issues.

The AICPA Management of an Accounting Practice Handbook also will be available on CD-ROM and online. Much of the content currently is being updated and expanded.

All minutes from the MAP committee meetings will be shared with state society MAP committees electronically.

Every MAP committee meeting will be followed by a town hall discussion in the respective city where the meeting occurs. We will invite all local CPAs to attend in order to find out what is on their minds and determine how the AICPA and the MAP committee can meet their needs.

Lastly, we plan to provide more information and articles on small-firm issues to The Practicing CPA and the Journal of Accountancy.

As always, we would like to hear from you as to how we are doing and what else we should have on our agenda to assist you and your firm.

— By Gary S. Shamis, chairman of the MAP committee. To contact the MAP committee, call David Handrich at 201-938-3034, or e-mail him at dhandrich@aicpa.org.

LETTERS TO THE EDITOR

The Practicing CPA encourages its readers to write letters on practice management issues and on published articles. Please remember to include your name and your telephone and fax numbers. Send your letters by e-mail to pcpa@aicpa.org.