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Members in Small·Local Accounting Firms

November 1998

AICPA

Understanding the New Confidentiality Privilege

By Dan L. Mendelson, CPA, J.D., LL.M., Donald L. Herskovitz, J.D., LL.M., and Alan R. Einhorn, CPA, J.D.

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On the Alert

Under the Internal Revenue Service Restructuring and Reform Act of 1998, the privilege of confidentiality in noncriminal federal tax matters, formerly available only for certain communications between attorneys and clients, was partially extended to CPAs and other federally authorized tax practitioners (FATPs). Section 3411(a) of the act added Sec. 7525, which extends the common-law attorney-client confidentiality privilege to tax advice furnished to a taxpayer-client (or potential taxpayer-client) by any individual authorized under federal law to practice before the IRS. While similar to the attorney-client privilege, the confidentiality privilege is limited to certain tax advice. Sec. 7525 does not modify or expand the attorney-client privilege of confidentiality, other than to extend it to CPAs and other FATPs. In addition, the new privilege does not apply to written communications regarding corporate tax shelters.

Major Features

Here are some of the key points of the new law:

1. Both oral and written tax advice given by a CPA to a taxpayer-client can be protected.
2. Tax advice on state and local tax matters is not covered, but may be protected under state CPA-client confidentiality law.
3. The confidentiality privilege does not extend to criminal tax matters, which should be referred to an experienced criminal tax attorney. A *Kovel* letter, which provides that the CPA is employed by an attorney, protects CPA-client communications.

4. Separate engagement letters, billing statements and files are essential to preserve the confidentiality privilege for tax advice communications, including tax advice documents.

5. Engagement letters should address the confidentiality privilege, but it is the client's responsibility to establish and assert the privilege. The engagement letter should include an indemnity clause to reimburse the CPA for defending the client's rights under the confidentiality privilege.

6. The CPA's notes to the client file, mental impressions and thought processes may be protected under the confidentiality privilege.

7. If a CPA does not communicate a tax advice document to the taxpayer-client, but retains it in his or her file, and if the document is closely related in time and material to the tax discussion, under *Swidler* it may qualify for the confidentiality privilege.

8. If the tax advice document is not communicated to the taxpayer-client, and is remote in time or materiality to the tax discussion, the document may still be protected by the work-product doctrine if prepared "in anticipation of litigation" or pursuant to employment by an attorney under a *Kovel* letter.

9. The confidentiality privilege may be waived if a CPA communicates a tax advice document to the taxpayer-client and sends a copy to the latter's banker or financial adviser; the disclosure to a third party may cause the privilege to be waived.

10. Attorneys employed by CPA firms are FATPs who may qualify under the confidentiality privilege.

11. Attorneys in law firms have a stake in the reasonableness of regulations under new

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Sec. 7525, because unduly narrow definitions of privileged tax advice communications may affect the IRS's view of the scope of the attorney-client privilege in tax matters.

Dan L. Mendelson, CPA, J.D., LL.M., a member of the AICPA Tax Division's Responsibilities in Tax Practice Committee, is National Director, Tax Professional Responsibility, Washington National Tax Group, at Deloitte & Touche LLP, Washington, D.C. He chairs the AICPA Executive Committee Working Group on Parity in Tax Practice Before the IRS, and serves on the Financial Status

Audit Task Force. Donald L. Herskovitz, J.D., LL.M., Senior Technical Adviser, Washington National Tax Group, Deloitte & Touche LLP, Washington, D.C., is a member of the AICPA Tax Division's Corporations & Shareholders Taxation Committee. Alan R. Einhorn, CPA, J.D., Director, Washington National Tax Group, Deloitte & Touche LLP, Washington, D.C., is a member of the AICPA Tax Division's Tax Practice Management Committee.

This article was adapted from an article in the Oct. 1998 issue of *The Tax Adviser*.

Web Sites Worth Watching

Here is a handy list of Web sites of interest to CPAs. If you have other sites to share, send them to the Editor (see below for contact information):

Accounting and Finance Salary Survey by Source Finance
www.sourcesvc.com

AICPA
www.aicpa.org

Barrons
www.barrons.com

Bureau of Labor Statistics
www.bls.gov

Business Cycle Indicators
www.globalexposure.com

Business Finance Magazine (formerly Controller Magazine)
www.businessfinancemag.com

CPA Exam Information
www.aicpa.org

CPA Vision Project
www.cpavision.org

CPA WebTrust
www.cpawebtrust.org

Fast Company
www.fastcompany.com

Federal Reserve
www.bog.frb.fed.us

Fedstats
www.fedstats.gov

Financial Accounting Standards Board
www.fasb.org

Fortune
www.fortune.com

Government Accounting Office
www.gao.gov

Governmental Accounting Standards Board
www.gasb.org

Harvard Business Review
www.hbsp.harvard.edu

Industry Week
www.industryweek.com

InformationWeek
www.informationweek.com

InfoWorld
www.infoworld.com

Institute of Internal Auditors
www.theiia.org

Institute of Management Accountants
www.imanet.org

Internal Revenue Service
www.irs.ustreas.gov

National Association of Colleges and Employers
www.jobweb.org

National Association of State Boards of Accountancy
www.nasba.org

The New York Times
www.nytimes.com

PCWeek
www.pcweek.com

Robert Half and Accountemps Salary Guide
www.roberthalf.com

Securities and Exchange Commission
www.sec.gov

U.S. Census Bureau
www.census.gov

The Wall Street Journal
www.wsj.com

Managed Care Issues into the Next Century— What the CPA Needs to Know

This CPE course gives you a complete and insightful guide to capitation, integrated delivery systems and many other complex issues arising as a result of rapid changes in the health care market. Developed for CPAs who must be ready to work with physicians, HMOs or hospital clients facing rapidly emerging issues in managed care, the course highlights include:

- Integrated delivery system models and processes.
- Capitation and other risk-based payment methods.

- Federal fraud and abuse issues.
- Tax aspects of managed care.
- Antitrust issues for managed care.
- Retirement plans and other ERISA issues in consolidations and combinations.
- Management information systems contracting.

The price for this intermediate-level course (No. 730080CLC11) is \$119 for members and \$149 for non-members. To order, contact the Member Satisfaction Center:



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Published for AICPA members in small firms. Opinions expressed in this supplement do not necessarily reflect policy of the AICPA.

Anita Dennis, supplement editor
973/763-2608; fax 973/763-7036; e-mail: adennis20@aol.com

Ellen J. Goldstein, CPA Letter editor
212/596-6112; egoldstein@aicpa.org

Getting Out the Word About Y2K

By Sandi Smith

A large component of any y2k project should be communications planning and actions. Just about everyone with any relationship to the company will be involved in some way with communications.

One of the first steps should be to make sure employees know what's going on. In 1997, when I was writing the book *Solving the Year 2000 Dilemma*, I interviewed a number of employees and had to define y2k for many of them. Needless to say, it doesn't make your company look very smart if a reporter, customer or shareholder calls to ask about the subject and your employee says, "What's y2k?" Employee training is essential, and I recommend including every employee, from boardroom to mailroom, in y2k training. The training should answer questions such as:

- What is y2k?
- Will the employee's job change because of it?
- Will there be new responsibilities?
- Is the company handling the problem?
- If calls are received, to whom should they be forwarded?
- If the employee has questions, whom can he or she call?

Executives should be trained, too, but on different points, such as economic and strategic impacts, the company's risk areas, how to manage the project and how to keep up with current events.

Client Concerns

Internal training is just the start of y2k communications. Clients must be notified next. A letter sent to all clients should state that the problem is real and outline steps they need to follow to repair their systems. Think of the potential consequences if you don't send this letter. Will you receive calls on 1/1/00 saying, "Why didn't you tell me?" What about your revenue stream? It is estimated that a small but significant percentage of businesses will face bankruptcy because of y2k issues, according to expert Capers Jones. I am keeping tabs on my major clients and encouraging them to keep up with their y2k project efforts.

Compliance letters have become a frustrating component of y2k for many people. These letters may be sent by vendors, landlords and suppliers to ask whether a part, system or the entire company is ready for the Year 2000. No doubt you have had clients asking you how to fill out y2k compliance letters from their customers. Some clients may turn to their CPA firms for help when vendors ask whether the client's company will be compliant. I do not give advice on these letters. As a matter of fact, I run from them. Lawyers who are informed about y2k matters can handle this subject better than accountants can, I believe, and I can give you several recommendations if you need them.

It's a good idea to send these letters yourself, and for clients to send them. The letters and their responses should be tracked in a log. If a reply is not received the first time, send as many as three rounds of letters to get the information you need. Replies should be analyzed and compared with information gathered in phone calls and from Web visits to help determine the best option for a particular system. Letters should be kept short to improve the chances of a response, asking simply whether an item is compliant. If not, ask if

there is an upgrade or substitute, and if so, what the cost will be.

Checking Connections

When working with business partners that interface electronically with the company, communications are critical to plan, execute and test the compliance of the interfaces. This relationship can start with a letter or phone call but should end up with a team member from each company coordinating the detailed tasks that are involved in y2k remediation.

The y2k project team will need a way to communicate with the executive steering committee, and the project status report and periodic meetings are good ways to accomplish this. The meeting and the report are essential elements to ensure the project is progressing on schedule. If it is not, then communications to clear hurdles and obstacles and possibly hire more team members should be put in place. A good executive sponsor should be in touch with the project manager at least daily.

During Jan. and throughout critical times in 2000, an emergency communications plan may be needed. The project team should be able to reach executives quickly, via beeper or cell phone, when decisions must be made on the spot. Extra staff might be needed on help lines in Jan. and Mar. (when leap year arrives). This communications planning should be part of the crisis or contingency plan for the y2k project.

A good communications plan is another key building block in a well-managed y2k project. Pass the word on to your y2k team.

Sandi Smith, CPA, MBA, CMA, CDP, is based in Dallas, and offers technology consulting and training to businesses around the globe. A frequent speaker around the country, she has authored books, videos, computer-based training courses, television segments, articles and instructor-led courses on the year 2000 topic. Check out her new y2k practice aid designed to quick-start CPAs who wish to consult on y2k at www.sandismith.com.

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Competing in a Changing Marketplace

What can you do to position your firm to thrive in a changing business environment? **Profession in**

Transition: The AICPA Forum on Competing in a Changing Marketplace has the answers. This program brings together in one innovative forum:

- Major players in the first wave of CPA firm acquisitions.
- Regulators.
- Leaders of the profession and managing partners who are developing strategies for competing in a rapidly changing marketplace.

Don't miss this dynamic and exciting gathering to be held on Jan. 14-15 at the Sheraton San Diego.

Prices vary based on group and early-bird registration and on whether an attendee is a member of the AICPA and of PCPS. To register:



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2000

Recently Issued Auditing Standards and Interpretations

Keeping current on the latest auditing pronouncements may be difficult at times; following is a list of recently issued auditing standards and interpretations that may be helpful. More standards will be listed in our next issue.

Statements on Auditing Standards (SAS)

- SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (No. 060675CLC11). Effective for periods ending on or after Dec. 15, 1997.
- SAS No. 83, *Establishing an Understanding with the Client* (No. 060678CLC11). Effective for engagements for periods ending on or after June 15, 1998.
- SSAE No. 7, *Establishing an Understanding with the Client* (No. 023025CLC11). Effective for engagements for periods ending on or after June 15, 1998.
- SAS No. 84, *Communications Between Predecessor and Successor Auditors* (No. 060683CLC11). Effective for engagements accepted after Mar. 31, 1998.
- SAS No. 85, *Management Representations* (No. 060687CLC11). Effective for audits of financial statements for periods ending on or after June 30, 1998.
- SAS No. 86, *Amendment to SAS No. 72, Letters for Underwriters and Certain Other Requesting Parties* (No. 060688CLC11). Effective for comfort letters issued on or after June 30, 1998.
- SSAE No. 8, *Management's Discussion*

and Analysis (No. 023026CLC11). Effective upon issuance, Mar. 1998.

Interpretations

Interpretations are effective on publication in the *Journal of Accountancy* and are available on the AICPA Web site (www.aicpa.org).

- Interpretation of SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*, titled, "Applying Agreed-Upon Procedures to All, or Substantially All, of the Elements, Accounts, or Items of a Financial Statement." This interpretation was published in Nov. 1997.
- Interpretation of SAS No. 62, *Special Reports*, titled, "Evaluating the Adequacy of Disclosure in Financial Statements Prepared on the Cash, Modified Cash, or Income Tax Basis of Accounting." This interpretation was published in Jan. 1998.
- Interpretation of AU Section 311, *Planning and Supervision*, titled, "Audit Considerations for the Year 2000 Issue." This interpretation was published in Jan. 1998.
- Interpretation of SAS No. 73, *Using the Work of a Specialist*, titled, "The Use of Legal Interpretations As Evidential Matter to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraph 9(a) of Statement of Financial Accounting Standards No. 125." Effective for auditing procedures related to transactions required to be accounted for under SFAS 125 that are entered into

on or after Jan. 1, 1998. This interpretation was published in Feb. 1998.

- Interpretation of SAS No. 70, *Reports on the Processing of Transactions by Service Organizations*, titled, "Responsibilities of Service Organizations and Service Auditors With Respect to Information About the Year 2000 Issue in a Service Organization's Description of Controls." This interpretation was published in Mar. 1998.
- Interpretation of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, titled, "Effect of the Year 2000 Issue on the Auditor's Consideration of an Entity's Ability to Continue as a Going Concern." This interpretation was published in Mar. 1998.
- Interpretation of SAS No. 31, *Evidential Matter*, titled, "Applying Auditing Procedures to Segment Disclosures in Financial Statements." This interpretation was published in Aug. 1998.
- Interpretation of SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties*, titled, "Commenting in a Comfort Letter on Quantitative Disclosures About Market Risk Made in Accordance with Item 305 of Regulation S-K." This interpretation was published in Aug. 1998.

To order SASs and SSAEs, contact the AICPA Member Satisfaction Center:



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On the Alert

The AICPA's audit risk alerts are valuable, nonauthoritative practice aids designed to be used as engagement planning tools. The risk alert series consists of the *General Audit Risk Alert*

1998/99 (No. 022223CLC11), *Compilation and Review Alert* 1998/99 (No. 022222CLC11) and 11 industry-specific risk alerts. The *General* and *Compilation and Review Alerts* are \$14 each for members and \$20 for non-members. The *Industry Alerts* are \$12.95 each for members and \$18.50 for non-members.

This year's industry-specific alerts are:

- Auto Dealerships 1998/99 (No. 022228CLC11)
- Construction Contractors 1998/99 (No. 022230CLC11; available mid-Nov.)
- Common Interest Realty Associations 1998/99 (No.

022221CLC11; available late Nov.)

- Depository and Lending Institutions 1998/99 (No. 022224CLC11)
- Health Care 1998/99 (No. 022225CLC11)
- High-Technology 1998/99 (No. 022216CLC11; available late Nov.)
- Insurance 1998/99 (No. 022226CLC11; available mid-Nov.)
- Investment Companies 1998/99 (No. 022217CLC11)
- Real Estate 1998/99 (No. 022218CLC11; available mid-Nov.)
- Retail Enterprises 1998/99 (No. 022219CLC11; available mid-Nov.)
- Securities Industry 1998/99 (No. 022220CLC11; available mid-Nov.)

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