5-2003

Planner, Volume 18, Number 1, May-June 2003

American Institute of Certified Public Accountants (AICPA)

PLANNER

May/June 2003
Vol. 18, No. 1

Newsletter of the AICPA
Personal Financial Planning Section

What's Inside

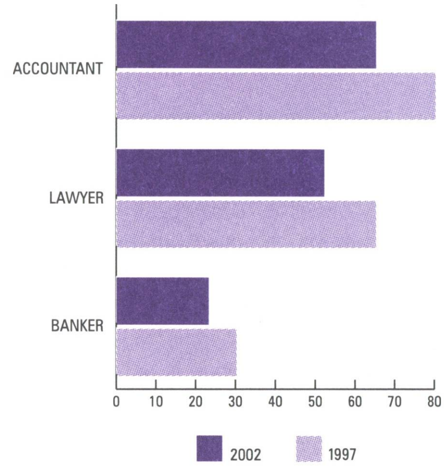
WINNER 2002 APEX® AWARDS FOR PUBLICATION EXCELLENCE

The Face of Family Business

A survey highlights the issues faced by American family businesses

For family businesses, outside advisers play significant roles in business, estate, and succession planning. Although trust levels for all outside advisers to family businesses have dropped, accountants remain the "most trusted" of these advisers. This was the finding of the 2002 *MassMutual Financial Group/Raymond Institute American Family Business Survey*.

Top Three Most Trusted Advisers



Asked whom they consider their "most trusted business adviser," 34.6% of respondents indicated their accountant, and 17.1% indicated their lawyer. Most respondents (69%) however, place their accountants among the top three most trusted advisers. Lawyers followed accountants in the one-through-three rankings at 54.2%. Bankers were selected by 21.6%, and business peers by 19.7% as among their top-three advisers.

When asked to select the advisers most instrumental in succession and estate planning, respondents ranked accountants (40.7%) and lawyers (38%) almost equally.

Trust obviously is very important for building and sustaining CPA consultant-client relationships. The survey's findings suggest, however, that trust is crucial if CPAs are to respond to the many opportunities to work with their family business clients to address the issues they face if they are to enhance their profitability and ensure their continuity as a family business. The report presents a picture of a thriving segment of the American economy, but it is also a segment that must meet complex challenges.

Changing Hands

Survey results indicate that the leadership of almost 40% of family businesses will change within the next five years. More than a quarter of respondents (27.4%) expect that, within five years, the current CEO will retire, and another 12% expect the CEO to semi-retire. More than half of respondents (55.7%) expect the CEO to retire within 10 years. This is a dramatic shift in leadership in that CEO tenure at family businesses is as much as six times longer than at a typical nonfamily public company. Of the CEOs planning to retire within five years, 58% have chosen a successor; 42% have not.

Continued on page 3

AICPA

TRENDWATCH

Hedge funds grow in popularity while the SEC takes a look. Worried that unsophisticated retail investors may lack the protections they need, the Securities and Exchange Commission has been examining hedge funds since last May and, in a recent speech, SEC Chief William Donaldson signaled that hedge-fund regulation may soon be tightened.

Three years of falling stock markets have made hedge funds seem more attractive to investors. Last year, hedge funds generated an average return of just 0.2%, but this was far better than the 22.4% decline posted by the average diversified equity mutual fund in America. Over three years, hedge funds have turned in an average return of 11.2% a year, while mutual funds have fallen by 11.7% a year. In this same three-year time frame, investors have poured $200 billion into hedge funds, according to the *Wall Street Journal*, April 9, 2003.

There are now around 6,000 hedge funds — double the number of five years ago — managing $600 billion between them. Regulators fret that hedge funds' superior performance is not all it appears, and that investors do not fully understand all the risks. Once the preserve of the super-rich, hedge funds are now marketed more widely. A new vehicle, called a "fund of hedge funds," requires a minimum investment of just $25,000, against an old requirement of $1 million or more. Just as the industry is opening up, however, an increasing number of fraud cases are coming to light. The SEC brought charges against 12 hedge funds last year, up from just five in 2001.

The Economist, March 27, 2003

Health insurance costs continue to increase. According to a recent survey, most employers plan to pass some of these cost hikes on to workers; and many small businesses are considering dropping coverage entirely. In a nationwide survey of 600 large and small businesses, 92 percent say they are likely to increase the amount their employees pay for health insurance premiums next year. The study was part of a report for Cover the Uninsured Week, and was released by several business and labor groups and the Robert Wood Johnson Foundation. The survey found that companies of all sizes expect health insurance costs to jump an additional 18 percent during the next year. The survey also found that for this year (and the next five years), employees will be expected to pay more of their health-insurance premiums, as well as larger deductibles and co-pays. Other survey findings include:

- To cope with surging health-insurance premiums, 45 percent of employers say they will reduce employee health benefits during the next five years.
- Just 4 percent of businesses say they are likely to drop employee health care coverage entirely next year. If faced with rising costs for the next five years, however, businesses are increasingly likely to drop coverage, particularly small business that have fewer than 50 employees.
- These small employers said they expect an average premium increase of about 20 percent per year for the next five years.

Stephen Taub, *CFO.com*, March 18, 2003

Parents underestimate college costs, while hoping to contribute to those costs. As many parents struggle under the burden of student loan debt, they are also working to make sure their kids do not face the same fate. However, many parents misjudge the amount of money it will take to reach that goal, according to the fourth quarter 2002 Principal Financial Well-Being Index, a quarterly study that identifies and tracks trends in consumer financial well-being, retirement planning, employee benefits, and workplace trends. The study is conducted by Harris Interactive and commissioned by the Principal Financial Group.

The results indicated that parents do expect their kids to pitch in somewhat for the cost of their degrees; 76% of respondents said children should take partial responsibility for college costs. However, 67% say they want to finance the majority (51 percent or more) of their children's education, and over one-third (36 percent) of parents plan to pay 75 percent or more of college costs.

However, the parents surveyed do not appear to have an accurate view of college costs. More than half of those surveyed overestimated the current cost of earning a four-year degree from a public university, with one out of every six parents (17 percent) estimating the costs to be over $100,000. On the other hand, nearly one-third underestimated the current price tag of a college education. Only 15 percent of those surveyed accurately estimated the cost to be in the $40,000 to $49,000 range.

www.principal.com/about/news/collegedebt031303.htm

PLANNER, May–June 2003, Volume 18, Number 1. Publication and editorial office: AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

Gerri Chanel, CPA
Editor

For questions or assistance with your PFP Section Membership, please contact *pfp@aicpa.org* **or call 1-212-596-6211.**

Continued from page 1

Succession Risks

Older CEOs looking to retirement are less likely to have chosen a successor. Of CEOs 61 years of age and older, 55% haven't selected a successor. More than a quarter (28%) of CEOs between 56 and 60 years of age who are expected to retire within five years haven't chosen a successor, and almost half (45.3%) of the same age group expected to retire within 10 years haven't chosen one either. Furthermore, 13.4% of respondents say they will "never" retire.

This is a risk factor for future problems. The potential for disruption is great in companies in which transition is not prepared for and actively managed.

Keeping It in the Family

Of respondents who had chosen a successor, 84.5% selected a family member. The successor is typically 40 years of age. More than one-third of family businesses (38%) with succession policies require at least three years of outside work experience to be full-time employees of the business. Still, most family businesses seem to risk the firm's continuity with less stringent policies. One quarter of chosen successors had no full-time work experience outside the family business. Most family businesses (71.7%) had no policy concerning qualifications family members must have to be full-time employees.

In coming years, women are likely to play a larger role in family businesses. More than 34% of respondents say the next CEO may be a woman. As would be expected, few family businesses (13.6%) have hired someone outside the family for the CEO position. However, of those with nonfamily CEOs, 31% rate the experience as "extremely successful" and 40% rate it as "very successful." The remaining 29% rate the experiences as "somewhat," "slightly," or "not successful."

Keeping Control

Most respondents (87.8%) expect the same family or families to remain in control of the business in five years. Sources of stress, however, can threaten successful ownership transition. About two-fifths (38.7%) of family businesses have had a family member leave within the past five years. Divorce was the cause for leaving in 21% of the cases. Few (9.7%) married family members have prenuptial agreements. A strong relationship exists between the number of buyouts in the last five years and an increase in the number of divorces during the same period. This would suggest the desirability of using mechanisms, such as buy-sell agreements, prenuptial agreements, and liquidity policies, to help protect the business and the family

Buyouts of family members occurred in 35.7% of surveyed companies in the past 10 years. Although such buyouts often are desirable and amicable, they can also be stressful for the family.

More than one-third (37.8%) allow ownership outside the family. Although such arrangements help to build employee loyalty and motivation, they also pose a risk to family ownership continuity.

Shareholder Agreements

More than half (54.4%) of family businesses have buy-sell agreements among shareholders. A little more than one-third (37.7%) have a formal redemption liquidity plan. Only 26.6% conduct a formal valuation every year, and 32.5% do so every other year. This suggests that many do not have adequate information on the business's value for estate-tax and buy-sell purposes.

Almost 29% of respondents planned to divide ownership equally among members of the next generation. Some respondents (22.3%), however, recognized differing family member interests by planning to allocate greater ownership in recognition of greater contributions to the business: 10.1% plan to give less ownership to inactive children; 6% plan to pass over inactive children. However, 24.9% are undecided about dividing ownership. Almost 8% plan to sell the business outside the family.

Advisory Boards

An outside advisory board helps ensure a family business's continuity and increase its value. This was the conclusion of Robert Pulliam, CPA, speaking at the AICPA Business

Continued on page 6

> **"Helping family-owned businesses to survive requires planners to address the many issues they face with respect to both business success and family harmony. Opportunities abound for CPA planners to provide assistance to family business clients in facing these many issues."**

AICPA conference

REGISTER TODAY!

2003 AICPA Advanced Investment Management Conference

June 23-24, 2003

The Seaport Hotel and World Trade Center Boston, MA

Preconference Workshop on Sunday June 22

Recommended CPE: 16 hours (main), up to 7 (optional)

Acquire the practical guidance, technical expertise, and management skills necessary to add this niche to strengthen your advisory services.

This conference is designed for investment advisers. You will learn the advanced principles of portfolio construction, diversification tactics, the latest investing trends, and insights on alternative investments. Plus you'll discover new products and services that can help your practice grow.

Conference highlights include:

- Innovative investment strategies and techniques
- Best practices in investment advisory services
- Building value in your practice
- Technology tools for investment advisers

Hear from top speakers in the industry:

- Bill Bachrach, the industry's leading resource for helping financial professionals become trusted advisers
- Dr. Robert Goodman, senior economic adviser and managing director of Putnam Investments
- Richard Pell, senior vice president and chief investment officer at Julius Baer

For an introduction into the world of investment advisory services, come a day early for the preconference workshop, "Fundamentals of Investment Planning," to be held Sunday, June 22.

The Seaport Hotel and World Trade Center Boston are right on Boston's historic waterfront. They are close to the train station and a short ferry ride from the airport, too.

CALL (888) 777-7077 or visit us at www.cpa2biz.com/conferences or more information and to register today!

Conference Agenda

SUNDAY, JUNE 22 — Preconference Optional Session

9:00 AM – 4:30 PM	*How to Set Up and Run an Investment Advisory Practice*

MONDAY, JUNE 23 — MAIN CONFERENCE — DAY ONE

7:00 AM – 8:00 AM	**Continental Breakfast**
8:10 AM – 9:00 AM	**Welcome and Introduction**
8:10 AM – 9:00 AM	**General Session** Global Investment Opportunities
9:00 AM – 9:50 AM	Trends and Recent Developments in the Advisory World
9:50 AM – 10:30 AM	**Refreshment Break and Vendor Display**
10:30 AM – 11:45 AM	**Concurrent Sessions *(Select One)*** Back Office: Buy or Build? Best Practices in Investment Advisory Services Fundamentals of Investing in Real Estate
11:45 AM – 12:30 PM	**Lunch**
12:30 – 1:45 PM	**Concurrent Sessions *(Select One)*** Maximizing After Tax Returns Back Office: Buy or Build? *(Repeat of Session #3)* Fundamentals of Investing in Real Estate *(Repeat of Session #5)*
1:45 PM – 3:00 PM	**Concurrent Sessions *(Select One)*** Investment Policy Statement Handling Your Business and Regulatory Risk One Woman's Junk Is Another's Fortune: The Case for High-Yield Bonds in a Diversified Asset Allocation Model
3:00 PM – 3:45 PM	**Refreshment Break and Vendor Display**
3:45 PM – 5:15 PM	**General Session** Building Value in Your Practice
5:15PM – 6:30 PM	**Reception and Vendor Display**

TUESDAY, JUNE 24 — MAIN CONFERENCE — DAY TWO

7:00 AM – 8:00 AM	**Continental Breakfast and Vendor Display**
7:00 AM – 7:50 AM	**Breakfast Roundtable** Center for Investment Advisory Services
8:00AM – 9:45 AM	**General Session** Becoming Your Clients' Trusted Adviser
9:45 AM – 10:30 AM	**Refreshment Break and Vendor Display**
10:30 AM – 11:30 AM	**General Session** State of the Economy
11:30 AM – 12:30 PM	**Lunch**
12:30 PM – 1:45 PM	**Concurrent Sessions *(Select One)*** Mutual Funds: The Secret Weapon for Better Performance An In-Depth Look at Becoming a Trusted Adviser Technology Trends for Investment Advisers
1:45 PM – 2:00 PM	**Refreshment Break and Vendor Display**
2:00 PM – 3:15 PM	**Concurrent Sessions *(Select One)*** Identifying Investment Manager Skill Best Practices in Investment Advisory Services *(Repeat of Session #4)* Optimal Portfolio Construction Using Mutual Funds, ETFs, and Separate Accounts
3:15 PM – 4:30 PM	**Concurrent Sessions *(Select One)*** Alternative Investments for the Non-High Net Worth Individual Practical Tools for Investment Advisory Efficiency Identifying Investment Manager Skill *(Repeat of Session #20)*
4:30 PM	**Conference Adjourns**

REGISTER TODAY!

Continued from page 3

Valuation Conference in New Orleans, November 17–19, 2002. Pulliam is managing director of Pulliam Financial Group, Winston-Salem, North Carolina. He presented the first of a two-part session entitled "Keeping Family and Business Together During Succession." Although Pulliam was speaking to an audience of valuation analysts, he focused much of his presentation on guidance that would help all CPAs assist clients to create more value in their family businesses. More than half of the survey respondents rated their boards as strong and positive components of their companies: 22% rated the board's contribution as "good;" and 36% rated it as "outstanding." A significant percentage of respondents, however, reported weak board performance: 25% cited "no contribution," 2% rated it as "poor," and 15% rated it as "fair."

> **"Nothing is more important than planning."**

Probably, the negative or lukewarm assessment can be explained by the fact that 49.3% of the boards met only once or twice a year and 13.4% did not meet at all. Only 19.2% met three or four times yearly, and 10.1% met five or more times a year. Most (61%) did not compensate board members. Compensated boards typically were paid modestly.

Boards tend to be small: 87% have three or four members. Most (90.6%) have at least two family members.

Strategic Planning

A company's board of directors typically contributes to developing business strategy. However, since family businesses tend to underuse their boards, most (60.4%) lack an adequate written strategic plan.

Nothing is more important than planning, Pulliam said in his presentation. He cited statistics showing that of the family businesses with formal business plans, 91% have seen a significant increase in revenues; 81% experience a significant change in profits; and 67% enjoy at least a threefold increase in profits.

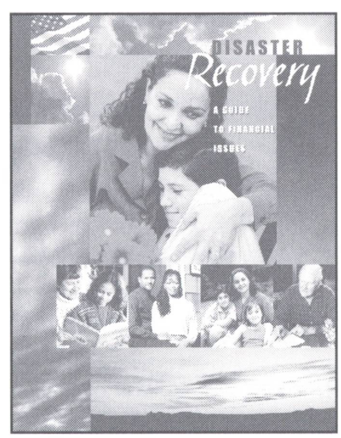
The survey report summarizes planning's importance, saying, "The research shows significant correlations between the existence of a written strategic plan and a variety of other planning and actions necessary for family-business survival. For example, they are more likely to have buy-sell agreements, a formal redemption plan, and formal valuations of company share value. They hold board of directors meetings more frequently and rate the contribution of their boards more positively. They also have more employees, tend to have qualification policies for employing family members and are more likely to have selected a successor. In addition, they have higher sales revenues and greater international sales."

Furthermore, the report concludes, "Family-owned businesses show a fierce desire to survive. To do so will require constructively addressing the many issues they face in the interest of both business success and family harmony." Opportunities abound for CPA planners to provide constructive assistance to family business clients in facing these many issues.

New Guide Offers Financial Planning Assistance to People Affected by Disaster

The AICPA has teamed with the American Red Cross and the National Endowment for Financial Education (NEFE) to produce and distribute a new, broad-based guide to help people affected by natural and man-made disasters recover from financial loss. The booklet, *Disaster Recovery: A Guide to Financial Issues* is written to help individuals struck by natural disasters regain a sense of financial balance by offering suggestions on what initial and subsequent steps should be taken and how to begin planning again for the future. The Guide is offered as a public service by the AICPA, NEFE and the American Red Cross.

CPAs can order copies of the guide for a small fee (to cover the printing expenses) at *http://www.cpa2biz.com/store* or by calling 1-888-777-7077 or sending a fax to 1-800-362-5066 and referencing product number 017231. A downloadable version is available at *https://www.cpa2biz.com/ResourceCenters/Personal+Financial+Planning/PFP+Disaster+Recovery+Guide.htm*. This site will also give you access to a package of materials developed to help CPAs take the first steps toward getting involved in the program, including a streaming video, fact sheet, FAQs and talking points. Additional information on the guide is available at *http://www.aicpa.org/info/committees/2003assistance.asp.*



Continued from page 3

The Face of Family Business

Putting the Next Generation at Risk

Although survey respondents indicated that the senior generation of most family businesses has a "good" understanding of estate taxes, their confidence and accuracy are questionable. For example, fewer than half of the respondents conduct regular formal valuation of company share value.

Other survey responses suggest that a significant percentage are missing out on estate-planning and tax-reduction opportunities:

Survey Responses Concerning Estate Planning Issues

	1997	2002
The senior generation understands the amount of estate tax due upon their deaths:		
Good understanding	76%	68%
Some understanding	21%	26%
Not at all	2%	4%
Estate planning is not completed *(other than a will)*	23%	19%
Other generations know/share transfer intentions	76%	62%
Life insurance will cover estate taxes	67%	48%
Firm has buy-sell agreement defining ownership	57%	63%
Company has formal redemption/liquidity plans	36%	44%
Owners have used all or most of the $1 million gift exemption	28%	22%
Owners regularly use $10,000 annual gift exclusion	57%	50%
Do not regularly use $10,000 exclusion	43%	43%
Owners have never paid gift taxes	81%	64%

About the Survey

The 2002 *MassMutual Financial Group/Raymond Institute American Family Business Survey* was designed and conducted by the MassMutual Financial Group and the George and Robin Raymond Family Business Institute. Survey respondents numbered 1,143 companies. The survey was supported by Loyola University Chicago Family Business Center, The Cox Family Enterprise Center at Kennesaw State University, and Babson College. A similar survey was conducted in 1997.

PrimePlus Marketing Toolkit Information

In the March/April *Planner*, the correct email address for obtaining further information is *bkaestner@aicpa.org*

CPA primeplus[SM] SERVICES
Resources • Strategies • Solutions

AICPA's ElderCare/PrimePlus Competency Model and Self-Assessment Tool

The AICPA has released its ElderCare/PrimePlus Competency Model, one of the models offered in the AICPA Competency Self-Assessment Tool (CAT). The first of its kind, this Web-based tool is designed to assist CPAs in creating and assessing personal and career development plans.

The ElderCare/PrimePlus Competency Model is organized into four main competency categories: personal attributes, leadership qualities, broad business perspective, and functional specialty.

- **Personal attributes:** The characteristics that enable the ElderCare/PrimePlus professional to advise others to well-reasoned and logical points of view and to effectively communicate with others.
- **Leadership qualities:** The skills that allow the CPA to assume a position of influence by assembling and leveraging a variety of resources that address problems and opportunities throughout an organization.
- **Broad business perspective:** The body of knowledge that encompasses an understanding of the organization, ElderCare/PrimePlus practice, and the applicability of alternatives.
- **Functional specialty:** The technical skills necessary to provide a functional service. Technical skills are the core of the CPA ElderCare/PrimePlus training and the foundation that enables the CPA to assume larger roles.

CPA ElderCare/PrimePlus Competency Model allows CPAs to anonymously access the Web-based tool at *www.cpa2biz.com/CPEConferences*. Users then select from a list of position profiles that is similar to their position within their firm, organization, or business, and their level of experience or one that they aspire to in providing ElderCare/PrimePlus services. Users then respond to a series of questions designed to assess their skills based on the selected position profile. Once complete, users receive a personalized and detailed competency assessment report that includes recommended learning opportunities for future development.

The AICPA extends its appreciation to Jay Kaplan, chairperson of the AICPA's ElderCare/PrimePlus Competency Model Task Force, and the volunteer members who contributed their time and knowledge to the development of the ElderCare/PrimePlus Competency Model and Position Profiles.

For more information on the AICPA Competency Self-Assessment Tool (CAT), contact Kayla Briggs at (212) 596-6125 or e-mail the AICPA at *comptool@aicpa.org*.

AICPA
American Institute of Certified Public Accountants
Personal Financial Planning Section
1211 Avenue of the Americas
New York, NY 10036–8775
ADDRESS SERVICE REQUESTED