University of Mississippi

eGrove

Newsletters

American Institute of Certified Public Accountants (AICPA) Historical Collection

5-2004

Planner, Volume 19, Number 3, May-June 2004

American Institute of Certified Public Accountants (AICPA)

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_news

Part of the Accounting Commons, and the Taxation Commons

PLANNER

MAY/JUNE 2004
VOL. 19, NO. 3

Newsletter of the AICPA
Personal Financial Planning Section

What's Inside

2 **Block Your Calendar**

Read about "The CPAs'/CAs' Role in an Aging Society: An Expanded Vision for Applying Eldercare/PrimePlus Services in Your Practice."

2 **Investment Responsibilities of Your Corporate Clients With 401(k) Plans: What Advisers Should Know**

Clark M. Blackman II examines recent case history in this area and points out areas of concern.

4 **Advising Older Clients: Problems and Solutions**

Working with older clients requires an awareness of special communication strategies to avoid misunderstandings. Richard Ross explains why.

6 **Drawing on Founder's Liquidity: How to Help Clients Take Cash Out of Their Companies—On Their Terms**

Joseph F. Trustey provides some ideas for advising private business clients who want to turn their sweat equity into cash.

6 **Visit the CPA Financial Planner Forum**

Affluent Women and Financial Decisions: A New Study That May Change Your Marketing Strategy

When you think of courting new clients, is it men that first come to mind? If so, a new report by the Spectrem Group may prompt you consider interesting new possibilities. The report indicates a number of important gender differences in both investment style and style of working with financial advisers.

A Fertile Ground for New Clients?

The study found that affluent women who handle the investment decisions for their households use financial advisers to a greater extent than men—and are more satisfied with the advice they receive. While more demanding of their advisers, they also tend to be more loyal to them. While the study found that affluent women's households (those where the woman made the investment decisions for the household) had fewer investable assets than those of affluent men, $1.5 million vs. $2 million, this group still represents a significant pool of potential clients, since, as a whole, the affluent group (defined as those with investable assets of at least $500,000) constitutes about 9.6 percent of all U.S. households. Women are the primary investment decision-makers in about one in every five of these households.

According to Catherine S. McBreen, managing director of the Spectrem Group, "At a time when the financial services industry is struggling to move past the scandals that have badly tainted its reputation, affluent women represent something of a bright, shining light. As a group, they continue to rely upon financial advisers more than men and are substantially less interested in investing on their own. As financial services firms look for friends in this challenging environment, women may well be the answer."

Key Findings

- A full 70% of affluent women said they use professional advisers as their primary financial advisers, compared with 62% of men. More than half (55%) of affluent men like to be actively involved in the day-to-day management of their investments, compared with 40% of women.
- Of those who do not use any adviser, affluent men (28%) far outpaced women (18%).
- Affluent women (67%) were more satisfied with their primary adviser than men (62%). Those women were significantly more satisfied with the quality of service (75%) and the adviser's knowledge of their overall financial situations and needs (69%) than men (66% and 58%, respectively).

Spectrem Group (*www.spectrem.com*) prepared the report from a survey of 3,300 affluent households in the summer of 2003.

Continued on next page

AICPA

PLANNER May/June 2004, Volume 19, Number 3. Publication and editorial office: AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881. Copyright © 2004, American Institute of Certified Public Accountants, Inc. Opinions of authors and the AICPA staff are their own and do not necessarily reflect policies of the Institute or the Personal Financial Planning Team.

Editorial Advisers

David Drucker
Sunset Financial Management, Inc.
Albuquerque, New Mexico

Michael Eisenberg
Michael M. Eisenberg A.C.
Los Angeles, California

Andrew Gluck
Advisor Products Inc.
Syosset, New York

Randi K. Grant
Berkowitz, Dick, Pollack & Brant
CPAs, LLP
Miami, Florida

Monte Kane
Kane and Company, P.A.
Miami, Florida

Nadine Gordon Lee
Prosper Advisors LLC
Armonk, New York

Randy Ryan
AICPA

Margi Jannucci
AICPA

David Handrich
AICPA

Editor

Gerri Chanel, CPA

For questions or assistance with your PFP Section Membership, please contact *pfp@aicpa.org* **or call 1-201-938-3828.**

Continued from page 1

- In terms of selecting an adviser, affluent women were more concerned with knowledge about multiple elements of the wealth management process (86%) than men (77%) and the adviser's ability to resolve problems (81% vs. 72%).

More than half (54%) of affluent women would follow their primary advisers if they switched firms, compared with 47% of men. Three quarters (75%) of affluent men say they will take calculated risks while investing, compared with 60% of women. More than half of the men (52%) say they set aside a portion of their assets for more speculative or high-risk investments, compared with just 43% of women.

Block Your Calendar for "The CPAs'/CAs' Role in an Aging Society"

Mark your calendar for "The CPAs'/CAs' Role in an Aging Society: An Expanded Vision for Applying Eldercare/PrimePlus Services in Your Practice," a conference presented jointly by the AICPA and the Canadian Institute of Chartered Accountants. The conference will be held at Caesar's Palace in Las Vegas October 25-26, 2004, with Pre-Conference Optional Workshops on October 24. The program and curriculum are being finalized by the Conference Steering Committee and the new focus leverages traditional CPA strengths and competencies in cash flowing planning and budgeting, pre- and postretirement planning, business succession planning, insurance reviews, and tax planning. CPAs will learn how to include pre-retirement age clients in their practices and thereby benefit from the greater potential revenue stream for a longer term. More information is available at *https://www.cpa2biz.com/CS2000/Products/CPA2BIZ/Conferences/2004+Eldercare+Conference.htm*

Investment Responsibilities of Your Corporate Clients With 401(k) Plans: What Advisers Should Know

By Clark M. Blackman II

Washington has responded to the Enron collapse and ensuing fallout to participants of its qualified plans with an avalanche of well-intentioned bills. Most proposed changes include provisions for increased education for 401(k) plan participants, which is, of course, a good thing. However, 401(k) plan participant education is only one element of the problem; plan sponsors (their officers and investment committees) as well as many of their investment advisers also need more education, specifically as it relates to their fiduciary responsibilities.

As 2002 ended, one more piece of bad news was handed to the former executives of Enron. The Department of Labor (DOL) filed a "friend of the court" brief in the case involving that company's 401(k) plan and, specifically, Kenneth Lay's personal responsibility for plan losses. Lay had sought a dismissal of the charges against him in the civil case regarding the losses in the 401(k) plan on the grounds that he had no personal liability for the plan's assets. However, the DOL had a different perspective on this issue and stated its position as follows:

- "ERISA's fiduciary obligations are among the 'highest known to the law'; *Bussian v. RJR Nabisco,* 223 F.3d 235, 294 (5th Cir. 2000). They do not permit fiduciaries to ignore grave risks to plan assets, stand idly by while participants' retirement security is destroyed, and then blithely assert that they had no responsibility for the resulting harm.

Continued on next page

- "Corporate officers who appoint fiduciaries must 'ensure that the appointed fiduciary clearly understands his obligations, that he has at his disposal the appropriate tools to perform his duties with integrity and competence, and that he is appropriately using those tools'; *Martin v. Harline,* 15 EBC 1138, 1149 (D. Utah 1992).
- "Section 404(c) plan fiduciaries [encompassing 401(k) plans] are still obligated by ERISA's fiduciary responsibility provisions to prudently select the investment options under the Plan and to monitor their ongoing performance."

Late in 2003, the judge in the case agreed with the DOL that the officers could be tried as fiduciaries to the plan. The court then went on to surprise the custodian named in the case (Northern Trust) by asserting that it would also be considered a fiduciary to the plan.

Personal liability on the part of officers of companies that sponsor 401(k) plans may come as a surprise to many company executives. Many may believe they have insulated themselves from this type of exposure. They should not assume that it is simply a matter of providing an array of choices to participants or hiring an outside third party administrator (TPA). Fiduciaries may believe they have insulated themselves from their fiduciary responsibilities by hiring an outside administrator who will take care of all aspects of the 401(k) plan, including the investment choices. Although firms like Fidelity, CIGNA, or Putman may be willing to provide TPA services at little or no cost in return for providing an array of investment products, this does not relieve the executive or committee member of responsibility for investment performance. Objective, independent oversight and evaluation of investment performance by a "qualified" individual is still necessary. Thus, the solution is to proactively address the issue of meeting one's fiduciary responsibilities. The goal should be to address the exposures that lead to an executive or committee member being held personally liable to plan participants.

The investment committee is held to a standard equal to that of an experienced, qualified investment consultant and is responsible for performance review and evaluation of all aspects of the investments provided. Information and performance reviews provided by a TPA who simultaneously manages any of the funds used by the plan would typically not qualify as an independent, objective review.

Do you and your clients know who is an investment fiduciary in a particular situation? Fiduciaries include, but are not limited to, company retirement plan sponsors (their officers and investment committee members), foundations and endowments, trustees, and any other persons having direct and immediate responsibility for someone else's assets.

In May of 2003, the AICPA and the Foundation for Fiduciary Studies published a handbook for investment fiduciaries entitled "Prudent Investment Practices." It outlines 27 "practices" that should be followed by an investment fiduciary to ensure compliance with the various directives provided by ERISA, Department of Labor, the Securities and Exchange Commission, and case law that have evolved in this area over the past 30 years.

The handbook is a compendium of investment practices that all fiduciaries need to be aware of, and is available at $30 a copy to the public at large (with a $10 discount to AICPA members) through the Foundation for Fiduciary Studies (*www.ffstudies.com*). AICPA PFP Section Members can access the guide without cost at *https://www.cpa2biz.com/ResourceCenters/Personal+Financial+Planning/default.htm* ●

"Do you and your clients know who is an investment fiduciary in a particular situation?"

To Learn More:

An in-depth article entitled "Fiduciary Focus: Providing Advice to 401(k) Plans" is available at

https://www.cpa2biz.com/Resource Centers/Investment+Advisory+Service/Fiduciary+Focus+Providing+Advice+to+401k+Plans.htm.

Clark M. Blackman, CPA*/PFS, CFA, CIMA is managing director and chief investment officer for Investec Advisory Group, L.P., Houston. (*Investec Advisory Group is an investment consulting firm and is not a licensed CPA firm). He is a member of the American Institute of Certified Public Accountants Center for Investment Advisory Services Resource Panel and was the leader of the task force charged with editing the "Prudent Investment Practices" handbook. He may be contacted at 1-713-622-9111 with questions regarding fiduciary responsibility or the Handbook.

Advising Older Clients: Problems and Solutions

By Richard B. Ross

CPAs providing personal financial services to older clients are confronted with a situation that is only going to become more difficult in the years ahead:

- Older adults have more difficulty comprehending and remembering complex information.
- Older clients generally have more assets. If they are wealthy, they have more complex affairs to manage.
- Members of the huge baby boom generation are reaching the age when they have significant accumulated wealth, perhaps more complex financial affairs than their parents because they have lived more complex lives, and a diminishing ability to comprehend and remember complex financial, legal, and tax discussions.

The essence of the role of a CPA providing personal financial services is delivering advice, not just financial products. But how do you effectively deliver advice to clients who, because of the aging process, may have difficulty comprehending it?

Aging is a biological process that inevitably causes a decline in our capacity to hear, see, and process information. The extent of the decline varies with the individual. Just as there are 80-year-olds who still play tennis well, there are 80-year-old clients who are capable of comprehending everything you tell them. But it would be a mistake to believe that either the tennis player or your client is as good at it today as they were 20 or 30 years ago.

Does intelligence in general decline with age? That depends on the "type" of intelligence. There are two types: "fluid intelligence," which peaks at about age 25 and declines from that point on, and "crystal intelligence," which peaks at about age 25 but stays level throughout life.

The Decline of Fluid Intelligence

Fluid intelligence is our ability to process information accurately, completely, and quickly. Unfortunately for CPAs in general and those offering personal financial services in particular, everything else being equal, we need high levels of fluid intelligence to process tax, legal, and financial information. That means many of your older clients do not fully comprehend what you tell them. Worse, it means that a potentially large number *actively misunderstand* what you tell them: they do not accurately or completely process the information you convey.

The consequences of such misunderstanding should not be underemphasized, since:

- Clients may choose not to follow your recommendations because they don't really understand them or the rationale for them.
- You may have to spend time and effort correcting problems after clients have followed misunderstood recommendations.
- Unhappy clients may leave.
- Those unhappy enough may even complain to regulators.

The Need to Use Crystallized Intelligence

The second type of intelligence is "crystallized intelligence." Crystallized intelligence is our ability to use what we already know. It is our experience, both in life generally and with respect to the subject matter. It is also the solution to many communication problems.

Here is an easy way to see the difference between fluid and crystallized intelligence. You know what the answer to 2 times 2 is. It is burned into your brain; it is part of your existing knowledge. On the other hand, do you know the answer to 343 times 962? You can work out the answer using your fluid intelligence but you don't know it in the same way as you do 2 times 2. (Your knowledge of the *rules* for working out the answer is crystallized intelligence.)

As people age, they not only are able to use what they know as well as ever, but *they know more.* So, by substituting crystallized intelligence for fluid intelligence they compensate for decline of the latter. But you need to help clients over age 50 use their crystallized intelligence. Without help, they may not be able to find the trigger to their experience or they may use experience that is not relevant or even wrong.

Today, many older clients remain afraid to invest in equities because the experience they are using to evaluate the market is the 2001-2002 bear market. They should be evaluating the market in terms of market performance over a much

Continued on next page

longer period. They may not do that, however, unless you lead them to it.

Practical Solutions to Communication Problems

There are a variety of measures you can take to help older clients access their crystallized intelligence and significantly increase comprehension. The measures are simple to implement. Because they are simple, they are sometimes seen as unimportant—but they are not. They are critical if you really want to improve the ability of your older clients to meaningfully understand what you tell them.

Meet in the morning.* Older adults are at peak performance mentally in the morning. As the day wears on, the capability to process information slips, as does the ability to accurately remember past events. There is evidence that by late in the day 65-year-olds function at about the same level as an 18-year-old who has consumed four or more beers. In general, follow the rule that the older the client, the more urgent it is to meet as early in the morning as is practical for him or her.

Directly access experience. Help older clients remember relevant experience. Use "remember when?" For example, "Remember when the market crashed in 1987 and the Dow lost 20% in one day and then went down again the next day? What happened after that?"

Eliminate stress from your office.* Many offices are stressful places for older clients. They are difficult to get to and once there, stressors are everywhere. There are loose rugs, low levels of lighting, chairs difficult to get into or out of, vents blowing air that is too hot or too cold, and so on. Not being able to handle everyday stress is part of the biological definition of aging. Stress interferes with memory formation and recall. It causes inattention and fatigue.

Rely less on numbers. Numbers are processed using fluid intelligence. Every number you use makes it more difficult for an older client to really comprehend what you are talking about. Some numbers are essential. Many are not. Focus on the essential ones.

Use analogies.* Analogies are the easiest way for most people to comprehend something new or different. By saying "this is similar to that," when the client already knows what "that" is, you have moved him or her a long way toward understanding what "this" is. Example: "Asset allocation is like a flower garden. If you plant just one type of flower, it will bloom and then die. But if you plant flowers that bloom at different times, your garden will look good all year round."

Even though older adults may have experience with tax, legal, and financial matters, that doesn't mean they understand the specifics of what you tell them. If you present new concepts or information without sufficient regard for limitations inherent in aging, you are likely to find they haven't understood you as well as you would like—or as well as they need to.

Notes

*Adapted from Ross, Richard B. and Michael P. Sullivan, *101 Easy Ways to Increase Business with Boomerplus Clients,* 2003, 50-Plus Communications Consulting.

> **"A potentially large number of your older clients *actively misunderstand* what you tell them: they do not accurately or completely process the information you convey."**

Richard B. Ross is a sales, marketing, and research consultant specializing in the psychology and financial behavior of "baby boomers" and older consumers. He is a principal in 50-Plus Communications Consulting, whose professional services include sales training, seminar development, marketing consulting and research, sales and marketing communications services, and conducting sales meeting presentations.

Ross is a frequent public speaker and has authored articles appearing in The Wall Street Journal and other publications.

He previously served as a senior executive for major research and consulting firms. He directed the research program for the President's Commission on Pension Policy in the early 1980s and served as executive director of the Center for the Study of Investor Behavior.

Ross may be reached at *dickross@graymoney.biz.*

Drawing on Founder's Liquidity: How to Help Clients Take Cash Out of Their Companies—On Their Terms

By Joseph F. Trustey

Sooner or later, your small private business clients will face the difficult decision of how to turn years of sweat equity into cash. They will likely approach you, as their CPA, for advice and guidance. Once you know the hows and whys of founder's liquidity, you can help clients make the right decisions, thereby expanding your role as a trusted adviser.

Founders of successful, later-stage businesses can use one of several ways to take a portion or all of their money out of the company. However, some options—including going public or completing a strategic sale—may require owners to step down before they are ready to turn over the reins or, alternatively, may require them to stay with the company for longer than they would like. Another solution, bank debt, can provide them with instant cash but not without exposing them to new financial obligations.

Armed with the right information, you can help your clients understand both the advantages and disadvantages of these common liquidity options and present them with the alternative of private equity. Often overlooked, private equity can provide substantial liquidity for founders while leaving them in control. Moreover, it enables them to grow the business toward a final liquidity event down the road that will deliver an additional substantial return on all those years of hard work and commitment.

Why Clients Need Founder's Liquidity

There are many reasons why you or your client may broach the subject of liquidity. For example, you may recommend it in order to take advantage of the Jobs and Growth Tax Relief and Reconciliation Act of 2003, which reduces the long-term capital gains tax from 20% to 15% until the end of 2008. Entrepreneurs who sell a small portion of their businesses for cash—and then achieve an initial public offering (IPO) or strategic sale later—have the chance to benefit twice from this lower tax rate.

Another important reason for liquidity is wealth diversification. Many owners have a disproportionate amount of personal wealth tied up in their company. Turning some of that equity into cash and then spreading it across multiple investments reduces their exposure to economic fluctuations. It also enables them to take disciplined risks that are critical for growing their business without sacrificing personal wealth.

In addition, your client may seek liquidity to purchase a second home, add to an art collection, or begin to enjoy extended travel.

The decision to take cash out of the company could be driven by any of or a combination of these reasons.

Alternatively, your client may also want cash to invest back into the business itself.

Alternative Options: IPOs, Mergers, and Bank Debt

Three common options for gaining additional liquidity are an IPO, a merger or strategic sale, and bank debt.

IPOs are more realistically an option for founders of larger and more mature companies. Today's Wall Street underwriters tend to favor businesses with a market cap of at least $150 million. These IPO candidates must also comply with stringent accounting and reporting regulations imposed by the Sarbanes-Oxley Act. Larger companies have the resources to overhaul their financial systems to meet compliance requirements, whereas smaller companies often do not.

Another road to liquidity is via a merger or strategic sale. The advantage of this strategy is an immediate payoff—with the business owner realizing 100% of the company's current value. On the other hand, your client will have to give up some or complete control and work with new management team members who may or may not see things the same way. Moreover, if the company goes through a subsequent final liquidity event, your client will not benefit from it because he or she will have already sold his or her interest in the business.

A third liquidity option, bank debt, works like a typical bank loan. The company founder can use either personal assets such as real estate or the business itself as collateral. The downside is that the loan must be repaid; if for any reason the borrower can't repay the loan, the bank will foreclose. Furthermore, bank loans can be expensive. There are closing costs associated with processing the loan as well as interest to be paid on the principal.

Continued on next page

Liquidity With Less Sacrifice

Owners who need liquidity yet want to stay in control of and continue to build their businesses should consider an important alternative to an IPO, merger, or bank debt, that is, a private equity investment. In essence, this alternative entails the sale of a portion of the company to a private equity firm. There is no need to give up control. In fact, many private equity firms insist that owners stay in place.

Furthermore, private equity is extremely flexible. Owners can sell as much of their holdings as they want, depending on how much equity they want to divest. In addition, the private equity partner will help the management team continue to grow the company, so a future liquidity event will net a larger payoff.

It's important, however, to help your client understand that the benefits of a private equity investment go well beyond a cash infusion, but that no solution is without a downside. In addition, founders gain a strategic business partner who offers objective advice and high-level guidance to accelerate growth, enhance management practices, and prepare the company for a final liquidity event down the road. Partners from the private equity firm will participate on your client's board of directors and will offer connections to other prospective members with deep board experience. They will help fill key management positions with proven executives who have moved similar companies to market leadership. They will help your client develop the fiscal discipline and public company reporting systems that are critical to engaging potential buyers and underwriters.

Private equity firms are also well connected to Wall Street and thus can lay the groundwork for successful liquidity events. If your client's company grows closer to an IPO, for instance, private equity firms will provide careful road show preparation, counsel on IPO pricing and timing, and important introductions to investment bankers.

Identifying a Candidate for Private Equity

As a company owner's CPA, you are in a prime position to ask if the company is a good candidate for a private equity investment. You know the owner; you know the financials. Moreover, your client will share confidential information with you that he or she may be reluctant to share with others. Is the company financially stable? Does it have a strong balance sheet, and is it self-funding? Self-funding is a particularly important criterion since it demonstrates discipline and sound business practices, which are important factors over the long term. The private equity firm will conduct its own due diligence but these are the initial qualifications it will expect your client's company to meet.

Finding the Right Private Equity Firm

If you and your client decide private equity is a viable liquidity option to pursue, you'll be ready for the next step, to identify an appropriate private equity firm.

Again, you can play a critical role by researching firms, drawing up a short list, and then serving as a financial liaison during the process. After all, the private equity firm will need a good deal of information and much of it will come through you. It is also important for you to stay involved throughout so you can continue to represent your client's business and personal financial goals.

Here are the main criteria for qualifying private equity firms. They should be at least 10 years old. Then you'll know they are stable and have experience in both bull and bear markets. Make sure there is little or no turnover at the partner level and they have proven experience in your client's industry. Ask for specific case stories and listen for a willingness to be candid and forthright about the details. A good private equity firm will also be very clear about its role and your client's role after an investment is completed.

As a CPA, you're the professional best positioned to align your clients' personal wealth goals with their business goals. By helping them understand the options available and then taking the lead, you will continue to build your own value and role as a trusted adviser. ●

Joseph T. Trustey is a Managing Partner of Summit Partners, a leading global private equity and venture capital firm with offices in Boston, Palo Alto, and London. Trustey is based in Boston. Summit Partners has published a white paper, "Alternatives to Selling Your Company Outright: Options for Achieving Partial Liquidity While Staying Firmly in Charge." For a free copy of the white paper, please contact Summit Partners at *financing@summitpartners.com*.

> **"There are many reasons why you or your client may broach the subject of liquidity, including:**
>
> - **to take advantage of capital gains tax rates**
> - **for wealth diversification**
> - **for cash for other purchases"**

Visit the CPA Financial Planner Forum

Have you paid a visit to the new CPA Financial Planner forum? If not, we encourage you to visit *www.aicpa.org/pfp*. After you sign in to the Members-only area for the PFP Membership Section, look for the hyperlink entitled "PFP Discussion Forum" near the top of the Web page. PFS credential holders can access the forum through the PFS-only area.

Once you are in the forum take a look around, but don't forget to register so you can participate in the discussions. After you have successfully registered, you can post and respond to messages, set up buddy lists, and send e-mail to other registered users. You can even send private and instant messages.

This is your place—to share ideas, discuss technical issues, seek advice, post a question, and network with your colleagues. The forum is a great way for you to learn something new or help out a fellow CPA. It has never been a better time to become a part of the community of CPA financial planners.

Visit the Forum today and join in on the discussion!

AICPA
American Institute of Certified Public Accountants
Personal Financial Planning Section
Harborside Financial Center
201 Plaza Three
Jersey City, NJ 07311-3881
ADDRESS SERVICE REQUESTED

First-Class Mail
U.S. Postage Paid
Riverdale, MD
Permit No. 5165