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AMERICAN INSTITUTE
CERTIFIED PUBLIC ACCOUNTANT

**Activities
of the
Private Companies
Practice Section**

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NEW YORK, N. Y. 10036

PCPS

Reporter

Published by and for the Members of the Private Companies Practice Section of the AICPA Division for CPA Firms

Editor: **John R. Mitchell**

Promotion Activity

The public information program outlined in the October *Reporter* is continuing on schedule. More materials have been developed for use by the Division's spokespersons, including a lively slide show that can be used either with a synchronized audio tape or with a script. The slides themselves take less than ten minutes and are designed to be used as part of a longer presentation.

WSJ AD WELL RECEIVED, MORE COMING

The Division's advertisement promoting CPAs' commitment to professional excellence appeared nationally in the December 21 *Wall Street Journal*. A week earlier reproducible copies were distributed to member firms with suggestions for forwarding them to clients, staff, and community contacts.

The ad stresses CPAs' traditional dedication to independence, integrity, objectivity and quality. It briefly describes the Division and its membership requirements, and cites the importance of peer review.

Members' comments have been favorable. Some would have preferred more aggressive wording, but most applauded the overall approach and message.

The Rhode Island Society of CPAs placed the same ad, with the Society's own tag line, in the business section of the *Providence Sunday Journal*. This is being reported to other state societies to encourage them to do the same. The Division plans four placements, during February and March, in the *American Banker*, a daily publication that commercial bankers read carefully.

VARIOUS LEAFLETS AVAILABLE

The *Why You Should Join the PCPS* leaflet has been completely revised and updated. The new edition stresses benefits that are particularly important to smaller firms. Copies were mailed to partners in many small firms.

For a sample of the leaflet, or a supply to distribute to other CPAs, write the PCPS in care of the AICPA. Be sure to say how many copies you want.

Two other Division leaflets are available in quantity from the AICPA Order Department. The earliest, *What Is the Division for CPA Firms* (Product 338547) was originally developed to help firms explain the significance of their Division membership. It overemphasizes sanctions, but is still useful. However, the more recent *What Is Peer Review* (Product 887162) is generally considered a more effective promotion piece, now that most member firms have been reviewed at least once.

REMINDER. In late 1983 the Division developed a peer review communication kit, with a suggested press release and letter announcing a firm's peer review, and

hints on how to use them. Clippings from local papers across the country show that many firms are using the materials. For a copy of the kit write the PCPS in care of the AICPA. □

TIC Conducts Deferred Tax Survey—High Response from Membership

Last fall the Technical Issues Committee sent a questionnaire on accounting for income taxes to each of the Section's 1,624 member firms. The fact that there were 821 responses—an unusually high proportion—leads to two important conclusions:

- PCPS firms consider accounting for income taxes a major issue.
- Member firms support the TIC's advocacy activities.

Forty-seven percent of the respondents favored retaining the present "comprehensive allocation" method, while 42% preferred no allocation. Another 11% preferred partial allocation, or recording the tax effects of some but not all timing differences. These percentages demonstrate why writing standards that are widely supported is so difficult a task.

Assuming that comprehensive allocation continues to be required, 59% favored (and 41% opposed) a no allocation method option for small private companies, or "differential measurement." (For related information see the Technical Issues Activity article.)

The questionnaire asked respondents to choose from three methods for accounting for the tax effects of timing differences. Fifty-six percent preferred the deferred method, which is used now. Thirty-five percent selected the liability method, which some accountants think would be simpler, while 9% preferred the net-of-tax method.

On a less controversial issue, 71% indicated that measurement of the tax effects of timing differences should be based on current tax rates (as at present). Nineteen percent favored arbitrary rates established by the FASB, and 10% preferred using the expected rates for the reversal period. Fifty-six percent would recognize in income the tax benefits of a net operating loss carry-forward when that benefit is realized in the tax return. Most others preferred recognizing the benefit when realization is assured beyond a reasonable doubt, but 9% would do so when realization is probable.

Both the TIC and the Executive Committee appreciate the membership's strong support, as evident from the response ratio. For a detailed tabulation of the replies, write to the Private Companies Practice Section at the AICPA. □

It's So Good to Hear From You

Member firms frequently write to Division staff members, sometimes pointing out things that should be improved and sometimes telling us about some good things that have happened. Here are excerpts from a couple of recent letters.

THE DIRECTORY REALLY HELPED

Last month we submitted an audit proposal to a local company. This company also solicited proposals from a large national accounting firm that had done the auditing for the former owners. This potential client in [the Midwest] was totally dependent upon a New York bank for its financing.

While the client was interested in doing business with a local accountant and, in particular, with us, they had some reservations as to our acceptability by the New York bank. When the President of the company contacted the banker in New York to see if we would be acceptable, the New York banker responded, "Wait a minute while I check this directory." Needless to say, our name was listed in the Division for CPA Firms Directory, and we were found to be acceptable to the banker.

The story has a happy ending for us because we were successful in winning the audit . . .

ACCOLADES TO A PEER REVIEWER

Dear Mr. Lipay:

The field work for our second peer review was completed on October 5th, and we would like to share with you some of our feelings concerning Thomas J. Westgate, CPA, who conducted the review for the AICPA.

Tom truly exemplifies the "professional" man. His attitude, enthusiasm, industrious ways, and fairness were great example setting characteristics from which our entire staff learned a great deal and for which we are very appreciative.

During the review, Tom offered us many suggestions and freely commented about the strengths of our firm and those qualities which he felt were exceptional. He was a teacher by example, both in how he approached the review and the hard work he put into its completion. He shared with us many experiences he has encountered over the years which will be beneficial to the continuing development of our firm. From the beginning, a very easy flowing dialogue developed between Tom and our entire professional staff. He possesses the unique ability of building confidence for himself, the profession as a whole, and our staff; yet, maintained a firm set of standards no matter what the circumstances.

We feel indeed fortunate to have had Tom critique our firm because his professional attitude has allowed us, once again, to learn from a peer review and has increased our attitude concerning the profession and the interaction of all its members. Our compliments to you and especially to Tom Westgate.

Thank you.

Sincerely,
LENKOWSKI, LONERGAN & Co.
/s/ Robert A. Lenkowski

Mr. Westgate is a partner in Murphy & Company, Providence, RI.

Peer Review Statistics Demonstrate Gains In Quality

The number one objective that AICPA's governing Council set for the PCPS, back in 1977, was to "improve the quality of services by CPA firms to private companies. . . ." Most firms that have had their peer reviews will agree that this objective is being met—that regardless of how good they were beforehand they are better firms today because of their reviews.

Peer review statistics strongly reinforce this impression by showing that firms fare significantly better on their second (or subsequent) reviews than they did the first time around:

Peer Review Reports Accepted Through December 1984

	Percent of Total	
	First Reviews	Subsequent
Unqualified	87%	94%
Qualified or Adverse	<u>13</u>	<u>6</u>
	<u>100%</u>	<u>100%</u>

For subsequent reviews the proportion of "problem" reports is less than half that for initial reviews—indicating that firms are improving their quality controls and that the system really works!

Barrows Appointed to Executive Committee

Jon A. Barrows has been appointed to serve the remaining portion of the term of an Executive Committee member who resigned when his firm merged. Barrows is a veteran in PCPS committee service, having already served three years on the Peer Review Committee. He is a partner in Bolan, Vassar & Barrows, of Phoenix.

Conference Reminder

Mark your calendar now for the Seventh Annual PCPS Conference, scheduled for May 19-21, in Fort Worth. It opens Sunday evening with a reception for members and their spouses.

Fourteen CPE hours are recommended for the technical program, to be presented Monday and Tuesday. On Wednesday May 22 the CPE Division, in cooperation with the Division for CPA Firms, will present the full-day course, A Guide for Conducting Peer Reviews.

Technical Issues Activity

In the last year or so there has been an important change in the Technical Issues Committee's approach to its mission. As its recognition and prestige grow, the TIC is writing fewer formal letters of comment. Instead, the committee is meeting directly with the standard-setters when there are differences of opinion to discuss possible solutions that all concerned will welcome. In most cases the standard-setters, recognizing the need to consider all points of view, have initiated the meetings. While this approach may be less dramatic than dispatching strong letters, a cooperative effort probably serves all segments of the profession better, now that the PCPS advocacy role is so well accepted.

For example, last autumn the TIC, the Executive Committee, or both met in open sessions with the Financial Accounting Standards Board; with the chairmen and other representatives of the Accounting Standards Executive Committee, the Auditing Standards Board and the MAS Executive Committee; and with a representative of the Accounting and Review Services Committee.

COMMENT LETTERS

There will, of course, always be times when written communication is preferable, as in providing detailed recommendations on specific passages of an exposure draft. The TIC's October letter commenting on a proposed statement and guide for prospective financial statements presented several such suggestions, along with more extensive comments on the concept of association with financial statements. This was, incidentally, the sixth formal PCPS letter commenting on one or another aspect of CPAs' services with respect to prospective financial information.

A January TIC letter generally welcomed a proposed guide on audits of service-center-produced records, and made half a dozen specific recommendations for improvement. Underlying most of the recommendations was the TIC's conclusion that the proposed publication should present more clearly and cohesively the guidance for situations when the auditor chooses not to rely on internal control to restrict his substantive testing.

ACCOUNTING STANDARDS OVERLOAD

In November the Executive Committee expressed its concern about the continuing accounting standards overload, and recommended that the Institute develop guidance on the income tax basis of accounting. In January the TIC endorsed this recommendation and added another—that guidance also be provided on another comprehensive basis of accounting suitable for private companies.

Both recommendations have been conveyed to the AICPA's Accounting Standards Overload Task Force, which was already considering whether and how the Institute should provide tax basis guidance. This blue ribbon task force, which consists of CPAs who have been especially prominent over the years in AICPA service, was set up to monitor the response to the 1983 report of the Special Committee on Accounting Standards Overload.

The PCPS recommendations were prompted by strong indications, from Financial Accounting Standards Board representatives, that it is not likely that the FASB will authorize differential measurement alternatives, within GAAP, for small or private companies. FASB representatives have also indicated that they would not object to more widespread use by private companies of bases of accounting other than GAAP, in appropriate circumstances.

The TIC recognized that guidance on the income tax basis could be helpful to very small companies, but concluded that many other private companies, and their CPAs, also need relief. The TIC suggests developing a new comprehensive basis of accounting, using existing GAAP as a starting point and then designating specific requirements that would be excluded from the new basis. These exclusions would be identified by simply citing the relevant pronouncement or paragraph number. This approach would not add to the overload because there would be nothing really new for CPAs to learn.

Commenting on the extent to which such a basis might differ from GAAP, a TIC member observed that two fairly recent studies published by the AICPA identified, between them, just five of GAAP's measurement requirements that are considered particularly troublesome—deferred income taxes, accounting for leases, interest capitalization, imputed interest, and compensated absences.

Congressional Hearings Expected to Open Soon

AICPA representatives may testify at hearings to be held in late February by the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce. The hearings are expected to focus on independence and scope of services; audit quality and effectiveness; standard setting; and regulation of the profession. The January 28 *CPA Letter* will contain general information about the Institute's position.

The hearings could generate a significant amount of publicity. If so, member firm personnel may get questions and comments from clients, reporters, or others in their communities. As the hearings approach, member firms will receive information that should be helpful in responding.

Draft of "Attestation Standards" Expected Soon

For more than a year the Technical Issues Committee has been following the progress of a proposal to establish a set of attestation standards, designed to provide a general framework to accommodate and set boundaries around the attest function. An exposure draft will probably be issued soon. These standards could have a profound (though probably gradual) effect on CPA practice. The TIC therefore urges all PCPS members to study the proposal carefully, and to submit their thoughtful comments.

Briefly, an attest engagement is one where the CPA expresses in writing a conclusion on the reliability of one party's assertion for use by a third party. Clearly, audits are attest engagements. Increasingly, however, CPAs have been providing assurance on representations other than financial statements. The proposed standards could bring some degree of coherence and symmetry to the many different types of attestation services that the profession now provides or will offer in future years.

The task force that developed the proposed standards has identified about a dozen significant types of attest

engagements that go beyond the services contemplated by the ten generally accepted auditing standards—GAAS—that have guided the profession since the late 1940s. These include reviews of financial statements, reports on applying agreed upon procedures to elements of financial statements, reports on compliance with contractual or regulatory requirements, reports on internal accounting control, and even reports on computer software.

A task force of the Auditing Standards Board originally developed the proposals. Early drafts were reworked and revised, partly on the basis of extensive discussions with other senior technical committees and the TIC. The proposed standards and their interpretive commentary are expected to be exposed for comment this winter and spring, after balloting by the Auditing Standards Board and the Accounting and Review Services Committee, which will jointly issue the draft.

In informal discussions the TIC has tentatively concurred with the profession's need for this type of guidance, and with the proposed standards' overall approach. In the coming months it will be reviewing the published proposals in considerable detail. It needs and wants PCPS members' input, and urges members also to respond directly to those who propose the standards. □

PCPS Reporter

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