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8-1997

Planner, Volume 12, Number 3, August-September 1997

American Institute of Certified Public Accountants (AICPA)

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August–September 1997

PLANNER

Ideas from leading experts in financial planning

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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Susan Frohlich, CPA, Technical Manager in the AICPA PFP Division summarizes the lessons learned in the concurrent session "Regulatory Issues for New Investment Adviser Registration" presented by Jacqueline H. Hallihan, president CEO and founder of National Regulatory Services, Inc. (Lakeville, CT), a provider of compliance and registration services for investment advisers and broker-dealers.

Mark Spinelli, CPA, Technical Manager with the AICPA Practice Monitoring Team, summarizes the lessons learned at the concurrent session "Emerging Markets" presented by Seth Masters, Chief Investment Officer, Emerging Markets, at Sanford Bernstein & Co., Inc. (New York, NY).

Retirement Planning in the Nineties

by James G. Martin, CPA

James G. Martin, CPA, of Horne CPA Group in Grenada, MS, describes the issues that personal financial planners must address with clients to help them prepare for a financially secure retirement.

Planning for retirement in the 1990s is vastly different than it was three to four generations ago. In the past, people counted on Social Security and company pensions to provide them with a comfortable retirement. Now, however, because of changes in demographics, Social Security, company retirement plans, and spending and saving patterns, people must do most of the planning and saving rather than depend on Social Security and company retirement plans to provide security. The changes make the future less secure for unprepared retirees, but they provide an opportunity for personal financial planners to help people achieve financial security in their retirement.

When the Social Security system was instituted, life expectancy was approximately 65 years. Now, life expectancy is approximately 77 years. Increased funds must be available because of the additional living costs and increased medical costs associated with increased longevity.

Some actuaries predict that the Social Security system will be bankrupt by 2030. The number of so-called baby boomers reaching retirement age, along with increased life expectancy, will accelerate the financial strain on the Social Security system.

Even if the Social Security system survives, future retirees could at some point possibly have no other resources. Many companies have changed retirement plans from defined benefit plans to defined contribution plans, mostly 401(k) plans. Participants in these plans will have only the money saved in their accounts rather than the certain benefit paid by a defined benefit plan as long as they live. Once funds saved in a defined contribution plan are spent, no funds are available.

Americans as a whole are spenders rather than savers. According to the Bureau of Labor Statistics, only about 3 percent of income is saved each year. Individuals who have normally relied upon company defined benefit plans and Social Security rather than personal savings will have difficulty keeping pace with retirement costs.

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TRENDWATCH

One of the biggest needs in developing countries is advice. Newly prosperous consumers in developing countries are overwhelmed by choices, so demand will be great for products that facilitate wise decisions on a variety of matters including personal finances. In response, Time Warner Inc. launched *Time Money* as an insert in *Time* magazine's Southeast Asian edition. It's directed at middle-class Asians, with articles on such topics as supporting aging parents and currency trading. John Naisbett's *Trend Letter,* May 29, 1997, p. 8.

DALBAR, Inc. has instituted a rating system for personal financial advisers. The Boston-based benchmarking and customer-service firm believes that market advantage in the future will hinge on the quality of financial advice rather than financial product quality. The rating sys-

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TRENDWATCH

(continued from page 1)

tem is based on "the most valuable components of advice delivery," which, according to DALBAR, are performance results, trust, satisfaction with services and scope. The ratings are determined by polling the clients of the financial planners and investment advisers to determine how well they have performed in these categories. To qualify for a rating, personal financial advisers must actively service a minimum of 100 clients. The minimum is reduced to fifty if $15 million is managed. The advisers must provide a complete confidential list of active retail clients who will be surveyed with written questionnaires to determine each adviser's or firm's rating. *Excellence in Advice: a Proposal.* To obtain a copy, call DALBAR at 617-723-6400.

Many investment and commercial banks are increasingly using the Internet to conduct workaday business. Concerns about security are giving way to concerns about reliability and performance. Communication delays of minutes are acceptable for some applications. Retail houses are using the Internet to find new clients by offering a few free services in exchange for names and telephone numbers. Institutional shops use it to distribute research, software and hard-to-aggregate quotes from the fixed-income markets. Banks are hoping to persuade depositors to use electronic storefronts rather than expensive branches. "The New Plumbing on Wall Street," *Investment Dealers' Digest* (June 23, 1997), pages 10–14.

Companies are consolidating 401(k) services. Companies providing 401(k) services are moving toward having a single provider coordinate the administrative tasks of all employee benefits, rather than several different service providers, such as benefits consulting firms and money managers. Consolidating functions can help employers cut costs and create a more professional operation. "Risk Reporter: The Future of 401(k)," *Risk Management* (July 1997), page 8. ◆

Investment Fee Approach: Are Apologies Really Necessary?

By Albert J. Zdenek, Jr., CPA/PFS

"How do you charge for investment services?" is probably one of the questions CPA planners most frequently ask each other when they gather. Of course, we expect answers from our colleagues that range from "I charge on an hourly basis" to ". . . on a commission basis."

Some CPAs hesitate to charge what their services are worth. They almost apologize to the clients for the fees they charge. Because of the learning curve involved, many CPAs struggle for a while to provide adequate investment services profitably. Some eventually determine that they can not make enough money in this field because they can not charge enough to cover their value. Some sell products because they feel that commissions are fairer to clients than fees.

So, some CPAs end up working outrageous hours to provide planning and investment services and look for other work—perhaps providing tax compliance and other accounting services—to support themselves. This may sound rather dramatic but a lot of planners are not being compensated for the work that must be done to do the job properly.

Exploring Options

I am not going to preach about the method you use to earn your money. There are a variety of ways to set fees, and a case can be made for each one. (The sidebar discusses some of the more common methods.) Rather than preach, I am going to encourage you to explore the available options so you will earn what you are worth and what you need to earn to provide the services you want and still achieve your personal and business goals. Allow yourself to be open to all of the great possibilities out there!

What is this leading up to? Some CPAs give away services, especially financial and investment advice. Investment direction is one of the most high profile subjects we discuss with our clients in the planning process. It is also the most probable cause of a lawsuit if the client suffers harm from our advice. So, giving free advice can result in the worst of both worlds: Give expertise away for nothing and get sued for the advice!

Phyllis Bernstein, Director of the AICPA PFP Division, points out that nobody has been successfully sued simply for losing money, provided they followed a prudent process that makes documenting all client contact critical. Why did you recommend what you recommended? Be sure that you can prove that you explored the client's needs and determined the suitability of your recommendations. Such documentation should also serve as evidence to you that what you're giving clients is more than just casual comments off the top of your head. You're providing a valuable service that deserves payment.

The Demands of Advising

Serious planners know that a lot of time and hand holding are needed to properly educate clients about investments. It requires daily reading, research and ongoing dedication to remain current. CPAs may ask, "Don't tax law changes or new FASB's demand significant time?" Sure they do, but investment products were largely absent from CPAs' education and early accounting indoctrination. You

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William Moran
Editor

Phyllis Bernstein, CPA
Director

can be a successful CPA without knowing what a derivative is or the difference between Warren Buffet's method of stock picking and the research on modern portfolio theory, but you'd better know this information and much more if you want to advise clients properly on investments.

The usual methods I have seen CPAs use in charging for investment and financial advisory services are hourly fees, commissions from the sale of products (for example, funds, limited partnerships or insurance), asset management fees or a combination of these. Again, all are appropriate if the earnings results are what you want for your practice, they comply with professional standards and you render quality service to the client.

Some CPAs already charge management fees for investment advisory services, which may include the actual management of a portfolio, money manager searches, or recommendations for a portfolio of mutual funds for the client.

Carol Angel, CPA, ChFC, of Angel & Phinney PC, CPAs, Portland, Oregon, just started charging an asset management fee as part of their continuing planning program. She decided to charge this way because it means she is being paid properly to spend the time to do the work properly. Carol spends a large amount of time on investments for the good of all clients not just one. So how do you charge for this time? The asset management fee allows her to be fair to everyone while she spends her time learning and staying current for everyone.

Having tried all the standard fee methods, I decided long ago to charge an asset management fee and I don't sell products. The asset management fee is separate from the planning fee, and it is billed quarterly, in advance, to the client. This method fosters the relationship between me and my clients that I want, and it supports our view that portfolio management and financial planning are two distinct services.

Being involved deeply in the investment area is time consuming, but greatly needed by clients. It also happens to be a lot of fun. When clients see the integrity in your recommendations the fee you charge will not remain a primary issue for them and they will come to appreciate the value of your services. Just make sure the method you choose works for you.

By explaining your fees up front, your clients will never say to you "If I'm paying a mutual fund manager and a discount broker, why do I also need to pay you?" Our services add value to the success of their plans. It is hard to have to explain constantly to clients why they need us. The chief reason many CPAs avoid this discussion is they are afraid to say they add value. But there is no need to apologize for that! ◆

TYPICAL FEE ARRANGEMENTS

It is important to explain to clients the details of how you do business and all of the costs involved. Follow up this explanation with a written engagement letter that summarizes what you do and the costs. Have the client sign it and return a copy for your records.

Here are typical fee arrangements:

■ ***Hourly fees.*** Some CPA financial planners do not manage assets or sell products and charge an hourly fee for the time spent with clients. When you charge hourly fees, be sure to charge for the actual hours it takes to provide the service. The problem with hourly fees is that if clients are not prepared to pay for the amount of time you think necessary, they may go elsewhere or nowhere. By disclosing fee estimates, you're also qualifying clients.

■ ***Commissions on sales of products.*** Some planners choose not to receive a commission from load funds or other commission compensation because they believe it could result in putting their interests ahead of those of their clients. Planners should remember that charging annual fees on top of commissions could result in the client paying twice: once for advice and once for the product.

Planners who decide to charge commissions should be aware of their state's rules on commissions. The AICPA makes available to members a list of "State Rules on Commissions and Contingent Fees" through its 24-hour Fax Hotline. Dial 201-938-3787. The document number is 604.

■ ***Asset management fees.*** Some CPA planners charge an annual management fee based on clients' assets. Fees depend upon the amount of money under management. Money managers and mutual fund managers are compensated this way.

■ ***Flat fees.*** Some planners charge an annual retainer for all planning work. An annual fee is set in subsequent years based largely on the amount of assets under management, their complexity and other factors.

■ ***Fee-offset.*** Some planners charge a fee that is offset with commissions when they are forced to use a product structured with a commission.

Other fee methods exist that are generally combinations of those described above. They include fee plus commission, fee caps and hourly or fixed fees plus asset-based fees.

Deciding how to charge fees is largely up to the planner. It is important to remember, however, that asset-based fees could be considered contingent fees in some situations and therefore it is advisable to check with your state accountancy laws or regulations for guidelines.

Whatever fees you charge, it is important to fully disclose the method and amount of your fees. The disclosure should contain, in addition to the planner's fees, the fees charged by the mutual funds and the discount broker who executes the transactions and maintains custody of the funds.

—Phyllis Bernstein, CPA

Director, PFP Division

Retirement Planning in the Nineties

Continued from page 1

What do these Changes Mean For Your Clients?

Because of these changes, in the future, your clients will depend more on their personal savings for retirement income. To assist clients in meeting the challenge of achieving financial security during retirement years, you can help them understand that three things must happen in relation to these savings:

1. The rate of return on their savings must outpace inflation.

2. They must begin saving at an earlier age.

3. Their savings must be invested in a diversified manner.

What Can You Do?

To prepare for retirement, clients first need to determine what level of income they want for retirement, taking inflation and their current level of assets into account. Once an estimated amount of funds needed is determined, the planner computes the amount of additional investments required each month or year to fund this goal. Then, the planner helps the client to develop an investment plan, which is the key to the success of a secure retirement. The investment plan should be reviewed annually to determine if adjustments are needed.

Considerations In Developing Investment Plans

Since the investment plan is the key to having sufficient income for retirement, four factors affecting investments must be considered.

1. ***Inflation.*** The rate of inflation changed from 1 percent in the 1950s to a high of approximately 13 percent in 1981. The current inflation rate is approximately 4 percent. Inflation has devastating effects on purchasing power. Based upon the 1967 consumer price index (which pegs the purchasing power of a dollar at a dollar), the approximate value of a dollar today is only about twenty cents. If an investment does not outpace inflation, an individual actually has less money in terms of purchasing power at the end of each year.

A comparison of salary levels also illustrates the effect of inflation. A salary of approximately $23,000 in 1970 would have to increase to more than $80,000 in today's dollars to have the same purchasing power.

2. ***Real rate of return.*** An investor must choose investments that earn more than inflation and taxes. The following chart indicates that treasury bills yield about ½ percent above the inflation rate. History shows that to achieve any appreciable level of return above inflation, an investor must invest in common stocks.

1926-1995 Real Returns (Inflation adjusted)

Series	Geometric Mean Return
I. Small stocks	9.1
II. Common stocks	7.2
III. Long-term corporate bonds	2.5
IV. Long-term government bonds	2.1
VI. Treasury bills	0.6
VII. Inflation	0.0

Source: Ibbotson Associates, *Bonds, Bills, and Inflation–1996 Yearbook.* Chicago, Ill,: Ibbotson Associates, 1996.

3. ***Early start.*** The earlier the client starts the investment process the better. The compounding of interest increases the returns on investment, so the longer the funds are invested the higher the returns should be. This principle is illustrated with IRAs. If an individual contributes $2,000 annually to an IRA beginning at age 25, after forty years at a 10 percent annual rate of return, the value will be approximately $970,000. If the same individual had begun contributing at age 21, an additional $8,000 would have been contributed to the IRA. At the same rate of return of 10 percent, the individual would earn approximately $1,435,000, an increase of about $465,000 despite the relatively small difference in the initial investment.

4. ***Diversification of assets.*** Several studies have shown that approximately 92 percent of the return from investments results from sound asset allocation or diversification decisions rather than the selection of particular investments. Asset allocation means that investments are distributed among three basic asset categories, rather than concentrated in one. The three categories are: cash and cash equivalents; fixed income investments; and stocks and real estate.

An individual investor must use different asset categories to achieve the best overall investment returns, coupled with the lowest possible risk. Even though equity investments carry more risk than such cash equivalents as certificates of deposit, performance data indicates that the long-term rate of return of stocks is substantially higher than that of CDs and other types of investments. Therefore, it is critical to financial well-being to use a diversified investment approach.

To help clients reach their retirement goals, personal financial planners can help them to be more responsible for their own future financial well-being. Our clients' financial futures are in their own hands, and we planners must guide them in taking the responsibility to meet the increasing challenges. ◆

Mark Your Calendar

January 12–14, 1998

1998 AICPA PFP Technical Conference

Hilton Walt Disney World, Orlando, Florida

More details in October/November *Planner*

Build Your Practice: Become Accredited as a Personal Financial Specialist

The PFS examination is scheduled for November 7, 1997. Personal financial planners can give themselves an edge up over competitors by earning this designation. Here's some of the benefits you'll gain by doing so.

Several factors have generated a need for CPAs to establish themselves as specialists in certain disciplines associated with the accounting profession. The business environment changes rapidly and continuously. Computer technology advances, changing how people work and eliminating the need for performing certain tasks and activities. Others factors include increasingly complex accounting and auditing standards and new tax laws and government regulations. Perhaps, the most significant change affecting CPAs is increased public expectations.

Are You Viewed as an Expert?

Personal financial planning is a burgeoning industry. The so-called baby boom generation has reached a point where they need—and seek—advice about the wealth they're inheriting and accumulating. Apprehensive about their future security, they're looking to experts to help them secure a future in which they'll live as comfortably as they are now.

Will they see you as a CPA they can turn to for advice? Will they see you as the expert? Here's your opportunity to increase your visibility as an expert specialist? As a PFS, you provide assurance to prospective clients that you're a competent provider of PFP services. You reinforce that assurance by improving your PFP skills and expertise.

Gain Marketing Support

By becoming a PFS, you enhance your marketability. The AICPA supports you in your marketing efforts by providing you with:

- ***Listing on the exclusive PFS list***. Your name and telephone number will be included in a geographic listing supplied to potential clients who call the AICPA for the name of CPA financial planners. National publicity of the PFS designation results in daily requests for names of financial planners. The list will also be posted to the AICPA website.
- ***Promotional materials.*** Once you obtain the PFS designation, you receive:

  —A marketing and media kit, including specific tangible tools to help you attract clients. The kit includes camera-ready advertisements, a radio script, Yellow Page advertisements, a speech and a press release, sample client letters and advice on using the media to promote your practice.

  —A unique high impact logo developed for the exclusive use of PFS practitioners.

  —A six-page brochure explaining to clients the value of the PFS designation. You can imprint your firm's name on the back panel. The first twenty-five copies are free.

  —A distinctive certificate and pin to identify you as a CPA•PFS.
- ***Public awareness program.*** The AICPA's ongoing media relations campaign heightens the awareness of PFS among consumers, the financial community and the press. The designation has been featured in such publications as *The Wall Street Journal, Fortune, Inc.,* and *Kiplinger's Personal Finance Magazine,* and in regional newspapers through syndication.

Are You Qualified to Become A PFS?

To qualify for the PFS designation, you must—

1. Be a member in good standing of the AICPA.

2. Hold a valid and unrevoked CPA certificate issued by a legally constituted state authority.

3. Have at least 250 hours of experience per year in personal financial planning activities for the three years immediately preceding the application. This experience must be in each of the following areas:

- Personal financial planning process
- Personal income-tax planning
- Risk-management planning
- Investment planning
- Retirement planning
- Estate planning

4. Agree to comply with all the requirements for reaccreditation.

5. Pass the PFS examination;

6. After notification of successful completion of the examination, submit six references to substantiate working experience in personal financial planning.

When and Where To Take the Examination

The PFS examination is offered twice annually, typically in June and November at 250 sites nationwide. The next examination is scheduled for November 7, 1997. The registration deadline is October 10, 1997

How to Get More Information

To get more information about the PFS program and examination, **call the AICPA Order Department at 800-862-4272, option no. 1 and ask for the "Personal Financial Specialist Candidates' Handbook," product no. G00055.** The Handbook provides more detail about PFP experience requirements, examination content, format and procedures, resources for preparing for the examination and reaccreditation requirements.

New AICPA Products for Planners

CPA's Personal Finance & Investing Alert
by Jonathon Pond, CPA

Let nationally-recognized investment strategist Jonathon Pond, seen by millions on Public Broadcasting television, share his ideas with you through this exclusive AICPA subscription series designed for the CPA. Each cassette runs approximately 90-100 minutes, covering three to four major topics in depth and two or more additional brief topics. Here's a sampling of the type of topics you can expect: Family limited partnerships, new tax rules for the small business, estate planning for the affluent client, the disability insurance crisis, sensible investment allocation, asset protection strategies, the changes in the investment climate in the new century, and much more!

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Lessons Learned at the 1997 AICPA Investment Planning Conference

The Future of Investment Planning

As Foretold by Leading Experts

In opening the 1997 AICPA Investment Planning Conference at the Grand Hyatt in New York City, Robert Clarfeld, CPA/PFS, of Clarfeld & Company, PC, in New York City predicted that the conference would provide participants the content and context that will add to their competence and confidence as financial planners. The conference speakers certainly delivered the content, helping participants to understand the dynamics of the current investment planning marketplace and predicting the future of the world they'll be making planning decisions in.

Three of the speakers at the general sessions offered their insights about why the investment planning marketplace is as it is now and described the implications of certain events and conditions for the future of that marketplace. Leading off, Richard F. Hokenson, chief economist of Donaldson, Lufkin & Jenrette, told participants that fundamentally they were all in the right business. Hokenson told participants that "the most important conclusion" to take from this marketplace was "This is a world of low and declining interest rates and nominal returns."

Future Challenge: Low Returns

The fundamental challenge of the future, Hokensen said, would be the low returns on investments. In explaining the reasons for the change, Hokenson cited the radical change in the growth dynamics of developed countries in the 1990s, which he attributed to the drop in numbers of those 20 to 29 years old. This cohort drives consumption. He also cited Japan's current position as a country with a rapidly aging population as the reason for its economic decline in the 1990s. The U.S. is experiencing a similar rapid growth in the aging population. Consequently, in fifteen to twenty years it can be in a position similar to Japan

How should the challenge be addressed? Hokenson advised participants to focus on identifying superior companies with superior returns because average returns will not be good enough.

Investment Advising: A Growth Business

The aging of the so-called baby boomers is one of the forces of change in the investment planning marketplace cited by Geoffrey H. Bobroff, president of Bobroff Consulting, East Greenwich, RI, the luncheon speaker on the first day of the conference. Focusing primarily on the mutual fund marketplace, Bobroff described where the marketplace is and where it is heading. He believes that the "advice side of our

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Strategic Asset Allocation

by Phyllis Bernstein, CPA

Between 80 percent and 90 percent of investment returns depend on getting the right asset allocation—determining what asset classes to include and how much (weight) of each asset class should be selected for the long term. Strategic asset allocation is the key decision. Strategic asset allocation accounts for 92 percent of a portfolio's performance, while market timing or tactical asset allocation and security selection account for the rest, according to the August 1991 study by Brinson, Brain, Singer and Beebower of large pension plans results for a ten-year period.

Good asset allocation methods have two goals: risk reduction and risk control. It is important also for the portfolio to fit with the client's demographics and risk profile. Lummer advises that to reduce risk it is better to build portfolios with asset classes with low correlation to each other. His "everyman" allocation model for a long-term investor comprises 60 percent equities (30 percent large cap, 10 percent small cap or under $1 billion, and 20 percent international) and 40 percent fixed (30 percent short-term bonds with one to three years maturities and 10 percent international bonds). For more risk, he recommends 75 percent equities and 25 percent fixed income.

Historical returns over the last seventy years show that small cap stocks outperform large cap stocks. Lummer's comment on small caps is worth noting: Small caps on average outperform large caps, but not in all cycles. We are not cycle-proof and can't predict when the cycles can reverse for large caps. Small caps are not followed as closely as large caps because large institutions avoid them. These are the "great unwashed" stocks. They are not watched unlike "the stars" that everyone watches. Small caps are often undervalued. The stars are overpriced because analysts overreact to news. Lummer suggests a balance between value and growth in selecting small cap stocks. His tilt is to value more than growth—2/3 to 1/3.

Lummer's following conclusions about and forecasts for the next twenty years are based on actual data:

- Short-term bonds are preferable to cash.
- Inflation linked bonds offer extra return protection as opposed to hard assets.
- The correlation of stocks' performance with inflation is zero. Stocks react negatively to inflation. Stocks are a good forecaster of economic cycles. ◆

Lessons Learned at the 1997 AICPA Investment Planning Conference

Continued from page 5

business is a growth business." Despite a prevailing attitude that investors should not pay commissions, two-thirds of purchasers want advice and guidance and are willing to pay for it. But they don't want to pay for it in the "old fashioned way." Thus Bobroff predicts that the future will see a shift from transaction-based fees to ongoing asset-based fees.

After outlining the impact on the marketplace of such forces as the growth of defined contribution plans and technology, Bobroff cited some of the challenges faced by investment planners. One challenge is to develop "an end-game strategy." Planners will need to build long-term relationships so that they don't have to rebuild their client base. They will need to assist the baby boomers to invest more aggressively than they thought they would need to because otherwise they won't have the money they need to continue their lifestyles during retirement. Planners will also have to focus on other components of the investment planning process, such as portfolio insurance and products designed to give investors a greater sense of security.

Key to The Bull Market

Long lasting economic expansion has been key to the current bull market. So said Abby Joseph Cohen, managing director and co-chair of the investment policy committee of Goldman Sachs & Co. (Cohen, considered a giant on Wall Street, has been correctly bullish since 1990 and has remained so through all the recent "noise.") Since early 1991, cumulative growth in profits and prices has been slow, but long lasting. Cohen attributed the growth to more responsible behavior by consumers, corporations and government. During the 1980s the U.S. was saddled with too much debt and was uncompetitive in the global marketplace. That has changed 180 degrees: Better economic decision making is occurring in three critical areas:

1. ***Government.*** During the 1980s, the budget deficit quadrupled to become 6 percent of the GNP. Today, the deficit is at $70 billion, which represents 1 percent of the GNP.

2. ***Corporate America.*** During the 1980s, many wrote the U.S. off in the global race as uncompetitive. Today, we are clearly the leader. Corporate profit margins have doubled and return on quality is the highest in history.

3. ***Consumers.*** In the 1970s and 1980s, consumers, in a buying frenzy, loaded up with debt. Today, the "boomers" are older and more financially secure.

The better economic decision making in these three areas has produced a wonderful cycle, which Cohen believes will continue through 1998. However, since the market is more fully valued, she believes some normal volatility, absent in the previous two years, will return to test everyone's will. Key to the growth is low inflation expectations. Cohen expects the bull market to continue through 1998.

One expanding sector of the economy is financial services. This expansion is driven by the needs of the baby boomers, who have contributed to an "explosion" in money market mutual funds and the growth of equity mutual funds. Cohen said that growth opportunities in the financial services sector are still possible because small and

Complying With SEC Regulations

by Susan Frohlich, CPA

Jacqueline H. Hallihan's session, *Regulatory Issues for New Investment Adviser Registration,* covered many topics of interest to new or soon-to-be registered investment advisers (RIAs), including the SEC's current concerns and what examiners are looking for in audits. She discussed the areas of current concern to the SEC, including soft dollar arrangements, personal securities trading and performance advertising.

The SEC's concern about soft dollar arrangements and personal securities trading is that these practices are not being disclosed in Form ADV and in disclosures to the clients. In a soft dollar arrangement, an RIA receives investment research products or services from a broker-dealer, the costs of which are defrayed by the RIA through directing brokerage commissions generated by client transactions. The personal securities trading issue relates to RIAs trading in the same securities as their clients.

Concerning performance advertising, the SEC is finding cases of RIAs reporting inaccurate performance data in advertisements. Ms. Hallihan noted that both the SEC and the state regulatory agencies are looking into this issue. She recommends that RIAs follow the standards set by the Association for Investment Management and Research (AIMR) to avoid potential problems when providing performance results.

Ms. Hallihan's list of things examiners are looking for and finding include many items that can easily be corrected. They include inadequate disclosure on Form ADV and inconsistencies among sales literature, contracts and Form ADV, as well as failing to perform the following activities:

- Implement and enforce firm procedures
- Include all required information on order tickets
- Maintain information on personal trades or review that information to ensure that there are no inappropriate trades
- Maintain a copy of the disclosure document and record the date given or offered to clients ◆

mid-cap stocks have not performed well in the current expanding economy

Will the Bull Market Continue?

Inflation will occur, Cohen predicted, but it will not be a problem. There will be no dramatic tightening of monetary policy, but the Federal Reserve will be "preemptive" in its efforts to keep the economy from declining. Cohen said that current market fluctuations demonstrate that volatility has increased in the short-term, but this is a "normal" phenomenon.

Signs of Change

What will alert us to a change in the future? Cohen said the signs to look for were changes in inflation and developments in the labor market. In addition, there were some wild cards that could beat the economy's winning hand. The wild cards would come from outside the U.S. They include the exportation of the currently sluggish economies of Japan and Germany and adverse policy changes resulting from recent elections in the United Kingdom and France ◆

Investing in Emerging Markets

by Mark Spinelli, CPA

On a trip to the Philippines a few years ago I observed that certain companies controlled the manufacturing and distribution of certain products. My egalitarian side said: Why don't they have laws against monopolies? However, my capitalist side took over and said: Don't worry. Just find out how to buy the stock. It seems like a no-lose opportunity. Seth Masters in the session on "Emerging Markets" confirmed my exuberance—and naivetè— and provided me with some very valuable insights.

Masters pointed out that the average return on an emerging markets index portfolio outperformed the best historical ten-year average return produced by the S&P 500 by 6 percent per year! However, the ride was not smooth for investors. The average volatility rate for the emerging markets index was 30 percent, double that of the S&P 500.

Emerging market countries contain the largest share of the world's population, the fastest economic growth rate over the last ten years and the smallest market capitalization. If investors are willing to supply the capital for expansion, then it seems that superior returns will continue for a long time.

Masters covered the basic criteria for investing in an emerging market country. The criteria include: Does the political system in the country protect the financial interests of foreign minority shareholders and what recourse do they have? Are there enough companies on the stock market to find a good value? What is the average spread between the bid and ask price for a stock? (In some countries it is as high as 40 percent.) How long does a trade take to settle? Do you become the owner of record and will you be entitled to dividends? (A lot of regulations in the United States to protect investors are not common to all emerging markets.)

By the end of the presentation I reached the following conclusions about investing in emerging markets:

- Mutual funds represent the best investment vehicle.
- As a long-term investment, emerging markets will improve the investor's chance of beating the S&P 500.
- No more than 5 percent to 10 percent of a portfolio should be in emerging markets.
- The investor must read the prospectus carefully because not all mutual funds meet the basic investment criteria covered by Masters. ◆

Book Review

Firm Retreats: A Step-by-Step Guide for CPA Firms. Dale D. Freidig, CMC, CPA. New York: AICPA, 1997. Paperback. 101 pages. Product no. 090428. $19.95—AICPA members; $25.00—nonmembers.

Some firms conduct retreats annually, some less frequently, and some have never conducted one at all. Whatever category your firm fits into, it should benefit from Dale Freidig's *Firm Retreats*. Freidig's book is of interest to firm partners who are responsible for the success of firm retreats, but it can also help retreat participants gain a clearer understanding of the purpose of retreats and their role in contributing to achieving that purpose.

Freidig covers a range of topics from determining the purpose of a retreat to conducting post-retreat activities. After defining what a retreat is and describing what it can help the firm accomplish, Freidig discusses extensively the purpose of a retreat. He advises, "Whether you retreat once a year, or use retreats routinely throughout the year, the best place to start is to clarify where you want to end up when the retreat is over. . . . Begin by knowing what you want to accomplish."

Freidig follows that advice with a list of eleven "valid reasons for conducting a retreat." However valid the purpose of the retreat, success comes only if the retreat organizers carefully manage several other elements.

Firm Retreats also advises about retreat mechanics and covers the ground rules and the stages of a retreat. Receiving considerable coverage are post-retreat activities—using documentation to motivate staff, communicating the retreat results to staff, and measuring the return on the retreat investment.

Firm Retreats is intended primarily to help guide retreats conducted in CPA firms. The ideas and guidance offered, however, can be adapted by CPAs to use in client firms. Freidig recognizes this opportunity and devotes the final chapter of the book to a discussion of how CPAs might do this. ◆

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