

Working with CPAs

As part of your team of professionals that you work with to help you improve your business, a CPA is a valuable resource for you and your business. It is important to know how someone attains that CPA designation, the guidelines they follow, and the various levels of service that they can provide.

Choosing a CPA

There are various factors to consider when choosing a CPA to work with you and your business. One factor to consider is the reputation of the CPA and/or the accounting firm. You want to align your business with a CPA with a good reputation in the community, as well as someone that you trust. Does the CPA have knowledge of your industry, or have the resources and willingness to learn about your industry? It's an important factor to consider so that you are both on the same page and they understand the issues that your business has to deal with on a daily basis. Getting referrals from other businesses and talking to them is a great way to get a feel for a CPA and how they operate and how they assist others that may be in the same industry. Also, checking to see if they use Linked-In and who they may be connected to can give you possible connections on who you can contact to get more information on the CPA/firm.

Check to see if the CPA is active in the accounting industry and in the community by asking if they are members of the accounting associations (AICPA and WICPA). Do they belong to any other networking groups or any of the local chambers of commerce in the community?

Fee structure is another factor that needs to be considered as well. As you know, not all firms bill in the same manner, so it's important to review what the hourly rate is, how often billing is done, and how available the CPA or staff are if you have questions regarding certain situations. The highest fee doesn't necessarily mean you are getting the best service, and the lowest fee doesn't mean you're getting the least amount of service either. Finally, make a request for the firm's most recent peer review report to see if there were any issues that were discovered in the firm's work. A peer review is done every three years and all CPAs need to comply with the standards established by the accounting industry.

Licensing of CPAs

In Wisconsin, CPAs get their license through the Department of Regulation and Licensing. But before they can get their license there are several requirements that they need to attain before they can hold themselves out to be a CPA. First, they need to have 150 credits when they graduate from college, typically 30 credits more than the normal 120 credits for most degrees. These additional credits are usually taken in the form of upper level accounting and tax classes that are more advanced than the normal business classes. Secondly, the applicant must pass a four-part exam that covers (a) tax law and business law, (b) auditing, (c) accounting principles, and (d) information technology, economics, and business environment. All four parts need to be passed within 18 months of passing the first part.

Additionally, one must have adequate experience either in the private or public sector before they can get their CPA license. In Wisconsin, you need one year of experience. And finally, there is an ethics test that you must take before you can get your CPA license and hold yourself out to be a CPA.

Once you have your license, there is annual continuing education that is also required in order to maintain your status with the state and AICPA. Over a three-year period at least 120 hours of continuing education must be taken in areas that increase or enhance your knowledge in areas of accounting, tax, or other areas related to accounting.

Code of Professional Conduct

As with many industries in the personal services sector, CPAs have a code of professional conduct that they adhere to. Below are the main areas of the code of professional conduct that CPAs follow.

Responsibilities - As CPAs, we have a responsibility to maintain the public's confidence in the profession because trust between a client and the CPA is such an important part of the relationship. It is also our responsibility to continue to strive to improve the art of accounting by enhancing standards and improving the quality of the work that we do.

The accounting profession is unique in that it is a self-governed industry. Accounting boards set the standards and they are enforced by accountants as well. On an annual basis CPA firms conduct internal inspections in order to verify that they are following the rules of the industry. And every third year, an outside CPA reviews the accountants' files to make sure that they are in compliance with the standards as well. The results of that outside inspection are what are found in the peer review report mentioned earlier.

Public Interest - As CPAs, we not only have to keep our client's interest in mind but also others in the public that rely on the information produced by the CPA. Some of the other members of society that rely on the information would be banks, government agencies, investors, and the business community at large. Banks and investors want to know that a CPA has prepared the financial statements that are produced and that they can be relied on. The level of service that the CPA has provided will be detailed in the report. The various levels of service will be described later. The government is relying on the CPA to follow the tax code and properly report the correct amount of income tax.

Integrity - CPAs should also have integrity and be honest and candid with not only their clients but all others in the public that rely on their reports. They are to adhere to both the form and the spirit of the standards in the accounting industry.

Objectivity and independence - One of the most important standards is that the CPA remains objective and be independent when performing certain functions while working with a client. Independence must be both independence in fact and appearance. Sometimes you are independent but it may not seem that way from someone from the outside looking in. That is where the independence in appearance comes into play. You must not only actually be independent; you must appear to be independent as well. It is important to avoid any conflicts of interest between yourself and your client, or potentially between two clients in the same industry, or possibly family members that may have different circumstances that may or may not benefit from the outcomes of transactions. There are instances where you can still perform work for the client even if you are not independent; it just needs to be disclosed to the reader in the report that you are not independent. This will be discussed in more detail later on.

Due Care – The final standard is that the CPA exercise due care when performing their duties. By this, the CPA needs to be competent and diligent when performing their work. This may mean that they bring in outside professionals in certain situations if they do not have the adequate knowledge in a certain area. It also means that the work must be adequately planned and supervised by all those in the employment of the accountant.

Disclosure Requirements

When issuing financial statements, Generally Accepted Accounting Principles require that certain items be disclosed to make the financial statements more meaningful to the reader. You can choose to not make the financial statement disclosures, but then the accountants report has to be revised to state that the required disclosures are not included in the financial statements. The decision to include or not include the disclosures is all or nothing – you either disclose everything, or you disclose nothing. Required disclosures which are typically found in financial statements include: significant accounting policies (which will include basis of accounting, cash policies, revenue recognition, assets and depreciation and income taxes), mortgage and loan terms, related party transactions, contingencies, employee benefit plans, leases and subsequent events. When preparing financial statements with disclosures, CPAs will typically utilize a disclosure checklist to ensure that all required disclosures are presented.

Compilations/Reviews/Audits

Accounting standards prescribe several different reporting levels for issuers of financial statements. These include compilations, reviews and audits. An accountants report is required to be attached to the financial statements which will identify the level of service performed, and the level of assurance that the accountant is providing with regards to the financial statements. Regardless of the level of service provided, management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for designing, implementing and maintaining internal controls relevant to the preparation and presentation of the financial statements.

Compilations – When issuing compiled financial statements, the accountant assists management in presenting financial information in the form of financial statements. The accountant does not obtain or provide any assurance that there are no material modifications that should be made to the financial statements. The engagement and the accountants report must comply with Statements on Standards for Accounting and Review Services (SSARS) issued by the AICPA and the accountant is required to have an understanding of the client and the client's industry, must read the financial statements, and consider whether the financial statements appear appropriate in form and free from obvious material errors. The accountant does not have to be independent of the client, but must disclose in the report if they are not.

Reviews – When issuing reviewed financial statements, the accountant performs procedures that will provide a reasonable basis for obtaining limited assurance that no material modifications should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The engagement is performed in accordance with SSARS issued by the AICPA, and the procedures consist primarily of applying analytical procedures to management's financial data and making inquiries of company management. The accountant must be independent of the client to issue reviewed financial statements.

Audits – When issuing audited financial statements, the accountant obtains a high, but not absolute level of assurance that no material modifications are needed to the financial statements in order for them to be in

conformity with generally accepted accounting principles. In the auditors report, an opinion is provided as to whether the financial statements present fairly, in all material respects, the company's financial position, results of operations and cash flows. Audit procedures include inquiry, physical inspection, observation, third-party confirmation, analytical and other procedures. The accountant must be independent of the client to perform an audit.

Tax Planning and Compliance Services

In addition to financial statement services, accountants can also provide tax planning and tax preparation services for your company. Often, tax services will be provided for both the company and the business owner's individual return as this provides for more efficient and flexible tax planning opportunities. The type and timing of tax planning also depends on the type of tax return that the entity files. There are several different types of entity choices and each has different tax aspects.

Corporation/Personal Service Corporation – A business that is formed as a Corporation is required to file a tax return for the business (Form 1120) and pays income tax on the net taxable income reported by the business. If the corporation meets several requirements, it will be taxed as a Personal Service Corporation. Law firms with services substantially performed by employee-owners generally would fall into this designation. A personal service corporation pays tax at a flat 35% rate on all income, as it does not qualify to use the graduated tax rates used for other corporations. Employee-owners are paid a salary which is reported to them on Form W-2.

S Corporation – A corporation may file a special election to be taxed as an S Corporation. With an S Corporation, all income flows through to the shareholders and the tax is paid with the shareholder's individual income tax return. The business does not pay a separate income tax. Owners must be paid a reasonable salary which is reported on Form W-2. Additional profits can be paid as an S distribution which currently is not subject to employment taxes.

Partnership/LLC – With a business taxed as a partnership, all income flows through to the partners/members and the tax is paid with the partners/members individual income tax return. The business does not pay a separate income tax. Partners/members are paid through a guaranteed payment as opposed to a salary. Because the income is related to services provided, it is subject to self-employment taxes. It is very important to have a signed, written partnership or operating agreement which details how the partnership/LLC will operate.

Single Member LLC – While considered a separate entity for legal purposes, a single member LLC is a disregarded entity for income tax purposes. This means that all of the activity for the business is reported on Schedule C which is included with the owner's individual income tax return. This income is subject to self-employment taxes.

In addition to income tax return preparation for businesses and individuals, accountants will also provide tax planning services. This is very important when your business is taxed as a flow through entity (S Corporation, Partnership, LLC) as quarterly estimated tax payments may be needed to pay in the taxes generated by the business. With a Personal Service Corporation, there is generally tax planning done at year end in order to minimize the amount of income that is taxed at the flat rate of 35%.

Other Services

Bookkeeping - In addition to compiling financial statements for your business, your accountant may also provide bookkeeping services. These services can be provided in real time utilizing online software which allow the accountant and the client to both access the accounting data at the same time, or after the fact, which is the more traditional way of providing bookkeeping services. If your accountant does the bookkeeping, they cannot also provide audited or reviewed financial statements as independence will be impaired. If the accountant issues compiled financial statements, the lack of independence must be noted in the compilation report.

Consulting - Consulting services can be provided in many areas of your business. These may include payroll and human resources, financial projections, business planning or succession planning.

In summary, choosing and working with your CPA is a very important part of your business. Having accurate, timely financial information is crucial to making business decisions, and we all know how important it is to file timely, accurate income tax returns. In the event you do receive a communication from a taxing authority, you want to have someone you trust to help you through the process of communicating with the taxing agency that sent the notice. So be certain that your CPA is someone you trust and know you can rely on.