



# Leaders' Edge

The newsletter of The Michigan Association of Certified Public Accountants

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### **Accountancy Reform Enacted: New Laws Strengthen and Protect Integrity of the CPA**

Michigan CPAs collaborated on a legislative effort that culminated on December 19 with the adoption of new laws that strengthen the role of CPAs and protect the public. A significant provision within a package of legislation signed last month by Governor Jennifer Granholm provides whistleblower protection to licensed CPAs and individuals employed by licensed CPAs, allowing full disclosure of information that was previously protected under "client confidentiality."

### **Circular 230: An In-Depth Look at the New Regs and Their Impact on CPAs**

The final regulations amending Circular 230 are attracting considerable attention, mostly because of their potential scope. Author Raymond Rowe examines how the regulations may impose new content and disclosure requirements on an expanded variety of tax advice and opinions, including e-mail and other electronic communications. He provides suggestions implementing the guidelines and best practices for any firm with more than one CPA – and says it should be done sooner, rather than later.

## From the Chair of the Board

### **Imagine If ... We Had No Voice in Lansing**

The MACPA [Legislative Advisory Group](#), government relations staff, lobbyist, grassroots involvement and our [Political Action Committee](#) are all working hard behind the scenes to ensure a favorable working environment for CPAs and accounting professionals. Their work continues to ensure reform detrimental to CPAs and accounting professionals doesn't come to pass. Likewise, these groups are also working to pass legislation that assists in advancing the integrity of the CPA - such as the accountancy reform. Read of such scenarios in this week's Chair's Message.

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## Top Stories

### **Accountancy Reform Enacted *New Laws Strengthen and Protect Integrity of the CPA***

Michigan CPAs collaborated on a legislative effort that culminated on December 19 with the adoption of new laws that strengthen the role of CPAs and protect the public.

A significant provision within a package of legislation signed last month by Governor Jennifer Granholm provides whistleblower protection to licensed CPAs and individuals employed by licensed CPAs, allowing full disclosure of information that was previously protected under "client confidentiality." Under this new law, protected information can be disclosed to law enforcement or government agencies if the individual has knowledge of violation of federal, state or local law.

Other key aspects of the legislative package, which includes *PA 277*, *PA 278* and *PA 279*, contain the following provisions:

- Mandatory enrollment in a peer review program for any firm performing attest services.
- Increased enforcement of unlicensed activity or "copycat CPAs," including raising the offense to a felony and beefing up fines and prison terms.

The new laws stem from the Michigan State Board of Accountancy, which was required to examine *Sarbanes-Oxley* provisions to determine if any should apply to privately held businesses and to the CPAs who provide services to those businesses.

"The Michigan State Board of Accountancy worked diligently for 18 months to examine detailed provisions of the federal *Sarbanes-Oxley Act of 2002*, which mandated a review of our state accountancy laws," said Michigan State Board of Accountancy (MSBA) Chair Beth Bialy, CPA. "Throughout the process, we relied extensively on input from CPAs and business leaders to develop legislative recommendations that first and foremost protect the public interest."

#### **Peer Review**

Peer review has been a condition of AICPA membership for licensed CPA firms or sole practitioners – but has not been required as a condition of MACPA membership or licensure. The mandatory peer review enrollment provision for licensure of Michigan CPA firms performing attest services will take effect March 2007. Of the 54 licensing jurisdictions, 42 have or soon will have some sort of peer review requirement as a condition of licensure.

"The profession has always been committed to practice monitoring programs; this legislation is just taking one more step by making it mandatory," said Dennis M. Echelbarger, CPA, a member of the MACPA Legislative Advisory Group.

#### **Copycat CPAs**

The "copycat CPA" provision provides for vigorous enforcement against individuals who falsely represent themselves as licensed CPAs. Under this provision, the copycat offense is now a felony, punishable by up to five years in prison and/or \$25,000 fine. It also gives authority to the MSBA to levy an additional administrative fine up to \$10,000.

Previously, violations were considered a one-year/\$5,000 misdemeanor – and as such, not on prosecutors' hot lists. By upping the ante, and by providing the MSBA with additional resources for enforcement, copycat CPAs can be more effectively identified and prosecuted.

Additional changes enacted in the legislative package include the following:

- **MSBA make-up** – Mandate that one member of the MSBA, either professional or public, is an accounting educator because the Board frequently addresses issues related to accounting curricula.
- **Record retention** – Amend record retention rules, by reference to standards of the AICPA, the Public Company Accounting Oversight Board (PCAOB), Government Accountability Office (GAO), Department of Labor, etc.
- **National standards** – Incorporate, by reference, standards developed by the PCAOB and other appropriate national standard-setting bodies and specify that any violation of the standards be a violation of the Michigan Occupational Code. Currently, the Administrative Rules are not specific and contain no provision for automatic updating of standards.
- **Self-reporting** – Mandate CPAs to self-report criminal convictions and disciplinary action and raise the civil fine limit to \$25,000 per violation. Violations that must be reported include final determinations or judgment by a federal or state agency or court in which dishonesty, fraud or negligence is an element.
- **Fee increases** – Increase fees for individual licensing and registration; and earmark those funds for administrative and enforcement activities of the MSBA.
- **Ethics requirements** – Require Michigan Department of Labor & Economic Growth approval of the form and content of ethics courses, and require reporting of all courses (not just hours).

"The MACPA strongly believes the MSBA took a reasoned approach to this legislative effort," Echelbarger said. "In line with the MSBA's efforts, the MACPA's mission is to promote high standards of quality, objectivity and integrity and advocate responsibility and accountability within the profession."

With the exception of the peer review requirement, the provisions of this new law have taken immediate effect. As previously mentioned, the peer review requirement will take effect in March 2007.

Additional details regarding the legislation, including a Q&A, are published on the [MACPA web site](#).

## Top Stories

### Circular 230: An In-Depth Look at the New Regs and Their Impact on CPAs

By Raymond T. Rowe

Mainly as a result of the actions of the IRS against a number of large CPA and law firms regarding tax shelters, Circular 230 was most recently amended, effective June 21, 2005, to cover the issuance of tax opinions and to establish an "aspirational" set of "best practices."

The IRS became concerned with tax opinions since clients used them to justify aggressive tax positions in order to pay the least tax possible. The concern was that many of these tax opinions did not arrive at logical conclusions based upon the fact situation, law, regulations, rulings and case law. In what has been described as "overkill," the IRS reaction was to impose standards on all written communications.

Circular 230 is the set of regulations governing how CPAs, attorneys, enrolled agents and others practice before the Internal Revenue Service. A portion of the Circular 230 rules parallel to a great extent the *AICPA Code of Professional Conduct* and the Standards of Tax Practice.

#### Written Communications

If the newly written communication rules were only restricted to the tax opinion letter or memorandum, they might only affect CPAs who issue tax opinions. However, the newly written communication rules impose restrictions on tax opinions *as well* as other written communications.

The definition is expansive. It covers any communication in writing, including letters, memos, e-mails and faxes. Whenever a client has requested that the CPA notify him in writing about a tax matter, this writing is potentially a covered written communication unless there is a specific exception. A simple letter discussing whether or not a client should file a joint return or file as married filing separate becomes a written communication subject to the new Circular 230 rules. The new requirements can also cover comments on the tax consequences of estate planning, partnership, LLC or S corporations and other routine communications.

Written communications are divided into three classifications: a covered opinion; a limited scope opinion; and other written advice.

A **covered opinion** includes any written advice on a transaction identified by the IRS as a listed transaction that the IRS has determined is a tax avoidance transaction. These so-called listed transactions are identified under Reg. Sec. 1.6011-4(b)(2). A covered opinion also includes any written advice concerning any entity, plan or arrangement in which the principal purpose is the avoidance or evasion of tax. In addition, if the opinion is a reliance opinion, marketed opinion, subject to a condition of confidentiality or subject to contractual protection, rather than a principal purpose, it is sufficient if there is a significant purpose to avoid or evade tax. A covered opinion can fall within more than one of these classifications.

A principal purpose is one that is more significant than any other purpose. Circular 230 does not provide guidance on what constitutes a principal or significant purpose of avoiding tax. It does state that if the opinion is relying upon exclusions or deductions that are specifically provided for in the Internal Revenue Code that these opinions are exempt. Thus, it appears you can state such things as "the standard deduction for 2006 is \_\_\_\_\_" or similar statements. However as mentioned before, the letter regarding the filing of a joint return may have a tax avoidance motive.

There is a safe harbor from the principal purpose test, but it is in name only. It appears the current IRS

interpretation requires that the taxpayer must ultimately prevail in his position for the safe harbor to be met.

Circular 230 says a federal tax issue is any issue that concerns the federal tax treatment of income, gain, loss, a deduction, a credit, the existence or absence of a taxable transfer or the value of property. Thus, almost any writing that has anything to do with a federal tax matter is considered to be a covered opinion.

**The danger to the CPA** is that if the Circular 230 rules are not followed, the CPA can be subject to censure, fines, suspension or disbarment from practice before the IRS. Any or all of these penalties can be imposed for willful violation of the Circular 230 rules, reckless or incompetent violation of the standards for advising clients on tax positions, failing to meet the covered opinion requirements or any of the requirements for other written advice.

As mentioned previously, at this time the “best practices” rules are aspirational and thus these penalties will not be imposed for willful failure to follow this portion of the rules. In addition, under the *American Jobs Creation Act of 2004*, the IRS can also impose significant fines based upon the gross income derived from tax shelter opinions. It is for these reasons most tax practitioners are taking a very conservative approach to Circular 230 and are including disclaimers as a general rule on all communications not meant to be formal covered opinions.

A **reliance opinion** is a covered opinion that arrives at a conclusion on a more-likely-than-not standard that one or more significant federal tax issues will be resolved in favor of the taxpayer. More-likely-than-not is a greater than 50 percent likelihood that the taxpayer will prevail. There is no “acting in good faith” exception to these requirements. However, the CPA can protect himself by including a prominent disclaimer disclosure.

The term significant federal tax issue includes any issue to which the IRS has a reasonable basis to challenge a resolution favorable to a taxpayer who is receiving the written advice if it could have a significant impact on the taxpayer’s overall federal tax treatment of the transaction covered by the opinion. If the opinion states there is only a reasonable basis for concluding the taxpayer will prevail, something less than a more-likely-than-not conclusion, it is not a reliance opinion. A Circular 230 disclaimer, described below, will eliminate the necessity to follow the covered opinion rules.

A **marketed opinion** is a covered opinion involving a significant purpose in which the tax practitioner knows or has reason to know that it will be used for marketing, promoting or recommending an investment or arrangement to one or more taxpayers by someone other than the opinion writer or a member of his firm.

These opinions can be excluded from the covered opinion rules by including not only the normal Circular 230 disclaimer, but additional disclosures stating the opinion was written to support the promotion or marketing of a transaction and the taxpayer should seek separate advice from his or her own independent tax advisor. The disclaimer will not be sufficient if the matter discussed is a listed transaction. The marketing requirement is met even if the opinion is given only to recommend a particular transaction to a client and members of that client’s family.

The final two types of covered opinions are those subject to conditions of **confidentiality** and those subject to **contractual protection**. Both of these also only require a significant tax avoidance purpose rather than a principal purpose to be classified as covered opinions. The requirements of the first type are met if the practitioner imposes a restriction on the disclosure of either the tax treatment or the structure of the transaction to protect the confidentiality of the practitioner’s tax strategies. These types of restrictions were often used in some tax shelter opinions.

The **contractual protection** type of an opinion would provide that the fees could be fully or partially refunded if the intended tax results are not obtained. In the alternative, the practitioner could not collect fees unless a favorable result was reached. The IRS has made it clear the practitioner cannot avoid this type of

transaction by classifying something as not being a fee when the IRS determines that it is a fee.

### **Covered Opinion Requirements**

A covered opinion must comply with four specific requirements, each with its own conditions. The first of these is the *identification of factual assumptions*. These must be individually identified in a separate section so the reader can determine what facts the practitioner relied upon and may be relevant to the taxpayer. The factual assumptions cannot be unreasonable. For this requirement there is a known or should-have-known standard.

Statement No. 3 of the Statements on Standards for Tax Services provides that a CPA can rely, without verification, on information supplied by the taxpayer or third parties. This Standard also requires reasonable inquiries if the information appears incorrect, incomplete or inconsistent. The Circular 230 standard does not allow the practitioner to rely upon unreasonable factual representations, statements or findings of others. It makes no reference to reasonable inquiries if the information appears unreliable. Thus, the practitioner issuing a covered opinion may be at risk if he cannot confirm all factual assumptions.

The next requirement is that the opinion must *relate the applicable law to the facts*. Applicable law includes "potentially applicable judicial doctrines." It is generally understood these doctrines will include the substance over form doctrine, the business purpose doctrine, the step transaction doctrine and the reciprocal trust or reciprocal transfer doctrine.

In arriving at an opinion, the practitioner can assume a favorable resolution of any significant tax issue only where the opinion is a limited scope opinion or the practitioner is relying on the opinion of another practitioner who is competent to give advice on the issue presented. There is also a requirement that the opinion not contain any internally inconsistent legal analyses or conclusions.

The next requirement is the opinion must *evaluate all significant federal tax issues*. It must analyze each issue and come to a conclusion as to whether the taxpayer will prevail on each issue. Again, the limited scope opinion and reliance on the opinion of others exceptions may apply.

The opinion must *arrive at an overall conclusion* as to the likelihood that the federal tax treatment of the transaction is proper and state the reasons for this conclusion. As stated earlier, when the opinion is a marketed opinion, the conclusion must be a more-likely-than-not conclusion.

### **Limited Scope Opinions and Other Written Advice**

Sec. 10.35(C)(3)(v) allows a written opinion to be a limited scope opinion and thus meet less stringent standards. The CPA and the taxpayer must agree the scope of the opinion is limited, and the reliance on the opinion for penalty avoidance is also limited. This form of opinion will need to include a Circular 230 disclaimer. It cannot involve a listed transaction and it cannot be a marketed opinion.

The best way to establish these limits is in the engagement letter.

This form of opinion is a good alternative when the tax issues are difficult and the transaction has a significant tax avoidance purpose. In this form of an opinion, the CPA can make reasonable assumptions regarding favorable resolution of certain tax issues for the purpose of arriving at an opinion on the remaining issues. If these favorable assumptions are used, the CPA must identify each of them in a separate section of the opinion.

Other written advice includes preliminary advice when it is understood that a subsequent opinion will be issued, advice concerning the qualification of a qualified plan, bond opinions and opinions in SEC filed documents. Advice given as to the tax benefits of a transaction is also allowed after the tax return containing the transaction has already been filed. A CPA may also give written advice to his or her employer as to

matters relating to the employer's tax liability. Initially, it was not possible to issue a negative opinion that the matter would not be resolved in the taxpayer's favor. In Treasury Decision 9201 issued on May 18, 2005, this was overturned and the CPA can now issue a negative opinion.

### **Circular 230 Disclaimers**

As mentioned earlier, the CPA should institute a standard to include a disclaimer on anything relating to federal taxes given to a client or potential client unless the CPA intends to issue a covered opinion. Failure to do so, and a subsequent determination by the IRS that the "writing" constitutes a covered opinion and does not meet the required standards, could result in sanctions.

*Thus, the "best practice" is to include the disclaimer.*

Initially it was proposed the "prominent disclosure" of the disclaimer meant it must be in a typeface larger than any portion of the writing. This was subsequently changed so it only needs to be in the same size as the largest text in the writing.

If you do a web search on "Circular 230 Disclaimers" you will find a wide range of wording. Some are extensive and some are very brief such as, "This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed upon the taxpayer."

Some firms use different disclaimers for different purposes including using a disclaimer in an engagement letter. One concern of the CPA is the client's perception of the disclaimer, especially when they are reading it in light of the invoice they just received for the work that included the disclaimer.

After reviewing a number of disclaimers, you should determine what best suits the firm for its various purposes. Remember the necessity to include such a disclaimer on e-mail and faxes.

Recently, members of a Detroit-area CPA firm indicated they often send out handwritten notes along with tax returns or other correspondence. Firms who utilize a similar technique in their practices might want to consider a rubber stamp with a disclaimer for these notes along with admonition to those using them to print small. One example of a disclaimer is as follows:

*Circular 230 Disclosure: The following disclosure is required pursuant to Circular 230 which sets forth best practices for tax advisors.*

*To the extent the above contains an opinion on one or more federal tax issues such opinion was not written to be used and cannot be used for the purpose of avoiding penalties. If you would like a written opinion on one or more federal tax issues addressed above upon which you can rely for the purpose of avoiding penalties please contact me.*

### **Sanctions for Circular 230 Violations**

The IRS Office of Professional Liability can impose fines, censure, suspension or disbarment from practice before the IRS for a number of reasons. One reason is for the willful violation of any of the Circular 230 rules other than the "best practices" rules, since those are considered aspirational.

In addition, sanctions can be imposed upon a tax practitioner for recklessly, or through gross incompetence, violating other Circular 230 provisions including (10.34) advising with respect to tax return positions and for preparing or signing of tax returns; (10.35) the requirements for covered opinions; (10.36) the procedures to ensure compliance with covered opinion rules; and (10.37) the requirements for written advice other than covered opinions. Prior to June 21, 2005, these sanctions applied to willful violations, the Sec. 10.34 requirements and

tax shelter opinions.

Complaints can be filed both by IRS employees, the public or other tax practitioners. Similar to an MACPA ethics complaint, if the referral appears to have merit, the Office of Professional Responsibility notifies the tax practitioner in writing and requests a response. The tax practitioner can also request a conference prior to the evaluation of the case.

Subsequent to the evaluation, the matter is either dismissed, the parties agree to the form of sanction or if no agreement is reached the matter is turned over for an administrative hearing. Sanctions are published in the *Internal Revenue Bulletin* and published on the [IRS web site](#). In addition the IRS may notify the accountancy board or other state licensing agency of the sanctions. The Office of Professional Responsibility is seeking legislative changes making disciplinary hearings public.

### **Guidance on Firm Tax Policy**

Traditionally, Circular 230 involved practitioner-oriented requirements and sanctions. This has now been expanded. Section 10.36 requires those practitioners "who have or share principal authority and responsibility for overseeing a firm's practice of providing advice concerning federal tax issues must take steps to ensure that the firm has adequate procedures in effect for all members, associates and employee for purposes of complying" with the covered opinion requirements of Circular 230. As previously noted, sanctions can be imposed not just at the individual level but also against the firm for failing to have adequate procedures in place.

The AICPA Tax Executive Committee has issued [Proposed Statement of Standards for Tax Services, Quality Control](#), dated Dec. 30, 2005. There is a comment period until Aug. 31, 2006. The final Statement is expected to become effective June 30, 2007. This Proposed Statement recommends both CPA firms and CPAs in industry establish quality control standards to insure member compliance with the *AICPA Code of Professional Conduct* in the performance of tax services, and that an adequate monitoring and documentation system be established for this purpose.

The Proposed Statement goes beyond the Circular 230 requirements, but the June 30, 2007 effective date requires that a CPA firm at a minimum adopt an interim policy to deal with Circular 230. In adopting the interim policy, the CPA firm should consider reviewing the proposed AICPA requirements and attempt to include them within the interim policy.

It is highly recommended that the CPA firm not wait until June 30, 2007 to put a policy into place. Even though the best practices requirements are aspirational, Sec. 10.36 in referring to best practices, states "tax professionals are expected to observe these practices to preserve public confidence in the tax system." Thus, it is recommended even an interim policy make reference to following both the *Code of Professional Conduct* and the Statements on Standards for Tax Services as part of the CPA firm's best practices.

### **Overall Conclusion as to Circular 230**

The effective date was June 21, 2005, but the rules are still evolving and are not clear. Practising Law Institute, an arm of Thompson, was slated to publish a Circular 230 Manual. Due to publishing difficulties, it has been delayed twice. This is indicative of the problems practitioners are having with these new rules and requirements.

CPAs should immediately begin using disclaimers and explaining to their clients why they are using them. CPA firms should institute policies on written opinions in order to protect themselves. They should also make sure the policies are followed. They should also consider what range of fees they will need to charge to issue

a covered opinion.

Over the next year or so, we should see more definitive information regarding Circular 230. Both the AICPA and the Tax Section of the American Bar Association are very active in communicating these problems with the IRS, and can be expected to continue to do so. The AICPA and others including malpractice insurance carriers will be also providing additional guidance on including Circular 230 issues in engagement letters.

***About the Author***

*[Raymond T. Rowe](#) is licensed to practice law in the State of Michigan and is registered as a Certified Public Accountant. He frequently lectures at MACPA events and serves both on the Board of Directors and a number of task forces including Ethics.*

***This article has been written to provide general information to the readers thereof and does not create a client relationship with the author. The information also is not intended or written to be used nor may it be relied upon to avoid any penalties that may be imposed under the Internal Revenue Code on the reader.***

## Message from the Chair of the Board

### Imagine If ... We Had No Voice in Lansing



Peggy Haw Jury  
2005-2006 MACPA  
Chair of the Board

The laws under which a CPA's professional livelihood exists are created by the 148 state legislators in Lansing and enforced by multiple state agencies. Positive relationships and open channels of communication at this level are imperative to the effective protection and advancement of the integrity of the CPA designation. Case in point: the recent adoption of accounting reform legislation (see [Accountancy Reform Enacted](#)).

The MACPA [Legislative Advisory Group](#) and other member volunteers played a critical role in the passage of this significant accountancy reform. Our top priority was ensuring the ultimate results embodied the interests of the CPA profession and of the public. Key provisions of this initiative drastically increase the enforcement of unlicensed practice laws, require peer review as a condition of licensure, provide whistleblower protection for CPAs and help to align Michigan with other licensing jurisdictions.

The next step is for the State of Michigan to amend the administrative rules regulating CPAs to align them with the new laws. Again, through our established relationships and lines of communications, the MACPA will be at the table. Just like we were in recent years with the successful passage of the major tort-reform initiative, Privity, and enacting LLP and LLC laws, to name a few.

It's important for members to realize that not all of the results of our government affairs efforts are so visible and tangible. Sometimes, as a result of the work by our legislative team – our [Legislative Advisory Group](#), government relations staff, lobbyist, grassroots involvement and our [Political Action Committee](#) – it's the things that *don't* happen that are important.

Imagine...

... a situation in Michigan where provisions of the *Sarbanes-Oxley Act*, such as scope of services restrictions, are no longer limited to publicly held companies. Imagine the impact on both firms and private companies in Michigan if you could no longer provide any other services to audit clients. No such regulation has even been introduced in Michigan, in part due to the fact that MACPA's legislative team ensures the profession has a seat at the table when the discussions turn to accounting reform.

... a situation in Michigan where the state sales tax is expanded to include professional services. Given the state's budget scenarios over recent years, this idea has been contemplated on countless occasions. No such proposal has gotten "traction" in Michigan – and as you know, it is the MACPA legislative team ensures the profession has a seat at the table when discussions turn to tax reform.

Legislation was introduced in Michigan this session to return to the old "reasonable foreseeability" standard in regards to professional liability for CPAs. This legislation didn't make it very far, thanks to the MACPA legislative team who works to represent you at the table when discussions turn to professional liability.

Your involvement and support of our advocacy is critical – both to uphold the integrity of our profession and to protect the public interest. While this message isn't meant to be a PAC appeal, your [contributions](#) do help strengthen our "voice" for appropriate legislation in Lansing by putting our money behind our words.

Any time you have a question or concern about our advocacy efforts, or if you want to get more involved, please feel free to e-mail [me](#) or CEO [Peggy Dzierzawski](#).

## Financial Literacy

### Volunteers Needed for Tax Program Assisting Low-Income Families

Reach out to those in need – share your financial expertise by volunteering for the Tax Assistance Program!

The MACPA, in conjunction with its Communications Task Force, is once again hosting a site for the [Accounting Aid Society's Tax Assistance Program](#). The MACPA is adopting Focus:HOPE in Detroit on two Saturdays – Feb. 11 and Feb. 18, 2006. At this event, you can provide tax assistance to low income families and individuals who would not otherwise be able to afford the valuable advice of a CPA.

Volunteers must attend a [training session](#) that explains the software used, typical client situations and tax updates. Experienced tax professionals may attend an abbreviated session lasting from two to four hours. Complimentary CPE credit will be offered for volunteers attending these training sessions.

We'd like you to be a part of this wonderful community service program – so [e-mail](#) or call the MACPA Communications Department at 248.267.3717 and sign up for a training session or to volunteer!

*Accounting Aid Society's Tax Assistance Program is among the nation's largest free tax assistance programs serving people in poverty. More than 6,700 families living in poverty received income tax refunds and tax credits through the Tax Assistance Program this year. **More than \$6.4 million was returned directly to low-income residents in Wayne, Oakland and Macomb counties.***

## Tax Tidbits

### Tax Talk Today Covers 2005 Tax Law Changes Affecting Individual Returns

On the December 13 webcast of *Tax Talk Today*, a panel of IRS officials and tax professionals covered the tax law changes and other issues that will impact the 2005 federal returns of most individual taxpayers.

The panel focused on the new definition of a qualifying child as the change that will have the biggest effect on individual returns in the coming filing season. Changes to the definition of a qualifying child can affect five different tax benefits, including head of household filing status, dependency exemptions, the child tax credit, the child and dependent care credit and the earned income credit. Tax practitioners should assist their clients in examining each benefit to identify unique differences and requirements affected by the change.

According to the *Tax Talk Today* panel, there are now four tests to identify a qualifying child:

1. Relationship test – is the child the taxpayer's child, sibling or a descendent of the taxpayer's child or sibling?
2. Residency test – did the child live with the taxpayer for more than half of the tax year?
3. Age test – is the child younger than 19 years of age, or younger than 24 years if a student, or permanently and totally disabled?
4. Support test – did the child provide no more than half of his or her own support?

The panel advised tax practitioners to pay close attention to the far-reaching impact of this change to the definition of a qualifying child.

In additional news regarding Hurricane Katrina provisions, a new and potentially far-reaching deduction – the Exemption Amount for Taxpayers Housing Individuals Displaced by Hurricane Katrina (Form 8914) – is available for taxpayers that housed individuals for at least 60 consecutive days who were displaced by the hurricane.

This \$500 exemption amount is for up to four individuals for a maximum total of \$2,000 and will be available in 2005 and in 2006 – but the exemption can only be claimed one time per individual, and the \$2,000 maximum is for both years combined.

The panel also advised that tax practitioners stay on the alert regarding charitable contributions made after August 27, 2005. The taxpayer may elect to treat most cash contributions made after the date as qualified contributions, which are not subject to the 50 percent of adjusted gross income limit or the overall limit on itemized deductions for high income taxpayers. Taxpayers can also claim charitable mileage rates for Hurricane Katrina, depending on the dates of the charitable driving: 14 cents per mile before Aug. 25, 2005; 29 cents per mile from Aug. 25, 2005 to Aug. 31, 2005; and 34 cents per mile from Sept. 1, 2005 through Dec. 31, 2005.

Effective Jan. 1, 2005, new rules govern the charitable donation of a motor vehicle with a claimed value of more than \$500. First, the donor must attach to his or her return a written acknowledgement of the donation (either new Form 1098C or the donee's own acknowledgment). The donee must furnish it within 30 days of either the donation or the sale of the vehicle. Second, the taxpayer may need to use gross proceeds instead of fair market value to determine the amount of the deduction.

“There could be a lot of pressure on charities to really get a good price for the vehicle,” said Bob Erickson,

senior technical advisor, Tax Forms and Publications, IRS.

Other changes reviewed by the panel included the implementation of an automatic six-month extension using only Form 4868; the IRS' decision to accept conditionally those electronically filed returns with reject codes 501 and 504 (related to dependents); changing addresses for IRS processing centers, for which updates are posted on the

[IRS web site](#); significant changes to elective salary deferrals; energy tax incentives, including alternative motor vehicle credits for hybrid cars and the 2006 energy tax incentives for home improvements; and credit card payments.

"We also have the credit card option, and we've expanded that somewhat," said Pamela Walker, chief of IMF Policy & Procedures Branch of Wage and Investment, Submission Processing, IRS. "Balances due on any 1040 returns, even delinquent balances due, can be paid up to five years in arrears."

Access a [full transcript](#) of this webcast – titled "Get Ready for Filing Season 2006 (Part 1 - Individuals)."

## Tax Tidbits

### Quick Links to Michigan Tax Info

#### 2005 Tax Forms Now Available Online

Most of the 2005 tax forms for business and individual taxes are now available on Treasury's web site (remaining forms will be added shortly). [Search for forms](#) by tax type or year or form number, or access forms from this [web page](#).

#### New Income Tax Developments for 2005

##### Now Available Online

Review [new developments](#).

#### Improved Tax Preparer Information

Tax preparers can [access quick links](#) to information on the Treasury web site, and you can keep a copy of the [PDF file](#) on your desktop. The links on this document will make it easy to access online information about a variety of topics such as Streamlined Sales Tax, Interstate Tax Commission and Treasury's Revenue Administrative Bulletins.

#### More Information

Here are quick links to information most requested by taxpayers who contact Treasury's Customer Service number for assistance:

[Property Tax Credit](#)

[Information for Seniors and Retirees](#)

[Military Personnel](#)

[College & University Students](#)

[Michigan Income Tax](#)

[Michigan Business Tax](#)

## Tax Tidbits

### Perspective on Michigan E-file A Record Breaking Program – Thanks to MACPA

By Terry Stanton, Public Information Officer, Michigan Department of Treasury

Michigan's accounting professionals and the MACPA are fundamental partners with the Department of Treasury and play a key role in efforts to ensure compliance with the state's Tax Code and maintain the accuracy and fairness of our tax reporting and collection systems.

The Michigan Department of Treasury is committed to utilizing technology whenever possible to improve the efficiency of its systems. For the 2004 tax season, Treasury instituted a new e-file policy, designed to offer budget savings to the state and provide significant benefits to MACPA members, their practices and their clients.

Today, Treasury's e-file program has been a resounding, record-breaking success, with much of the thanks owed to MACPA members who have supported it. Thanks to tax professionals around the state, Treasury processed a record number – 2.75 million – of e-filed income tax returns last year, ranking Michigan third in the nation.

Treasury's e-file policy will continue during the upcoming tax season: all tax professionals who prepare and file more than 200 State of Michigan income tax returns are expected to file those returns electronically.

#### New This Year

Treasury officials believe e-filing continues to present an outstanding opportunity for the state to improve its tax processing efficiencies. New e-file programs for Single Business Tax filers are added this year. Following is an outline of the new programs.

#### Federal/State 1120 E-file

Tax preparers and transmitters, accepted in the IRS 1120 e-file program, may participate in the Fed/State 1120 e-file program. This allows both federal and state returns to be filed together electronically, through one transmission to the IRS. The IRS will acknowledge acceptance of the federal return and receipt of state data, which will then be made available to the Department of Treasury, for acknowledgment and processing.

#### State Stand-Alone 1120 E-file

Tax preparers and transmitters accepted in the IRS e-file program may also participate in the State Stand-Alone 1120 e-file Program, if it is supported by their software. Preparers will have to indicate, in their software, that it is a State Stand-Alone filing.

#### E-file Advantages

*E-filing establishes a tax practice as progressive and consumer-oriented.*

#### ***E-filing is safe.***

- Tax information is encrypted and submitted via secure, telephone lines.
- The possibility of theft or compromise of a return is virtually eliminated.
- Preparers receive electronic confirmation that the return has been accepted.

#### ***E-file is fast.***

- 95 percent of all Michigan income tax returns can be filed electronically.
- Clients receive refunds on error-free returns much faster than paper.

The IRS will validate the account number against the name, and issue a receipt notification that the state submission was received. If the return passes validation, the state data will be made available to the Department of Treasury for acknowledgment and processing. The transmitter should receive the Michigan acknowledgment within three business days from the date the return is successfully transmitted to the IRS. The Electronic Transmitter Identification Number (ETIN) must be entered correctly in the software in order to receive acknowledgments. Copies of federal and Michigan returns and schedules should not be mailed to Treasury unless requested.

### **Who Can E-file**

Software developers are required to support e-file for all SBT returns that are included in their tax preparation software. If preparers use computer software to prepare SBT returns, they must e-file all eligible returns that are supported by the software.

The following 2005 forms are eligible for 1120 e-file:

C-8000	SBT Annual Return
C-8000C	SBT Credit for Small Business and Contribution Credits
C-8000D	SBT Capital Acquisition Adjustment
C-8000H	SBT Apportionment Formula
C-8000ITC	SBT Investment Tax Credit
C-8000KC	SBT Schedule of Shareholders and Officers
C-8000S	SBT Reductions to Adjusted Tax Base
C-8009	SBT Allocation of Statutory Exemption, Standard Small Business Credit and Alternate Tax for Member of Controlled Groups
C-8010AGR	SBT Adjusted Gross Receipts for Controlled Groups
C-8020	SBT Penalty and Interest Computation for Underpaid Estimated Tax
C-8030	SBT Notice of No SBT Return Required
C-8043	SBT Statutory Exemption Schedule
C-8044	SBT Simplified Return
3307	SBT Loss Adjustment Worksheet for the Small Business Credit

The following outlines Michigan's current SBT Direct E-file program.

### **SBT Direct E-file**

Preparers purchase and install tax preparation software on their computer and use Internet access to e-file. Returns can be transmitted directly to Treasury, or the software provider may also be able to transmit return, sometimes for an additional fee. Software companies can explain which transmission capabilities are offered.

Returns will be signed using an electronic signature composed of the following shared secrets:

- Business Account Number (FEIN or Treasury-assigned TR number)
- Gross receipts or adjusted gross receipts from the most recently filed original SBT return (not an

- amended return or a return as corrected by Treasury)
- Treasury-assigned CSN.

Note: If the return is signed using shared secrets and the return is rejected because the shared secrets do not match, the taxpayer/preparer may correct the shared secrets information and retransmit. There is no limit on how many times a return can be retransmitted in this circumstance.

In the past, Treasury has provided active SBT taxpayers who have filed form C-8000, C-8030 (filed by registered taxpayers) or C-8044 in the last two years with their Customer Service Number, which must be supplied as part of the electronic signature when e-filing a return. The CSN is eight digits comprised of one alpha character and seven numbers. The CSN is case sensitive and the letters "I" and "O" are not used.

Beginning with tax year 2005, Treasury will no longer mail CSN letters to eligible SBT filers in January. Therefore, if a taxpayer is filing their second return with Treasury within the last two years, they will need to obtain their CSN from Treasury's web site self-service.

Taxpayers should keep their CSN on file, as they will use the same number for future filings of e-filed SBT returns. If a CSN has been misplaced, it can be obtained through Treasury's web site self-service. If Internet access is not available, call 517.636.4700 and request a letter containing the CSN to be mailed to the taxpayer.

#### SBT E-File Advantages

- **Fast.** Single Business Tax (SBT) e-file returns will be processed much faster than paper returns. Paper-filed returns will take considerably longer to process.
- **Convenient.** No more paper returns to mail. Prepare and transmit SBT returns using software that has been approved by the Michigan Department of Treasury.
- **Accurate.** Treasury processes the same data that is entered into the computer. The computer program checks for math errors before the return is accepted. E-file returns have significantly less chance of error compared to paper returns.
- **Secure.** Only the preparers and their clients see the returns. Confidential information is protected by Secure Socket Layer (SSL) 128-bit encryption.
- **Customer Service.** Receive electronic proof from both the IRS and Michigan that returns were received.

## Accounting & Auditing

### Independence and Compilations: Your Input Is Needed

Due to the evolving complexity of the Independence Standards as codified in the *AICPA Code of Professional Conduct*, the Accounting and Review Services Committee (ARSC) is seeking the input of CPAs, clients and third-party users of compiled financial statements as to the need for independence when performing compilation engagements.

Through an electronic [survey](#) entitled "Need for Independence in Compilation Engagements," the ARSC would like to receive comments before it further considers the independence requirements related to compilation engagements.

The ARSC welcomes responses and comments to the survey from all interested parties **until May 19, 2006**.

The ARSC requests that practitioners ask their colleagues and clients to consider filling out the survey and advise known third-party users of the compiled financial statements about the survey.

After consideration of comments received, the ARSC plans to address the issue at a public meeting to decide whether it should revisit the need for independence when performing a compilation engagement and, if required, consider how the impairment of a practitioner's independence should best be communicated in the compilation report.

Access the [online survey](#).

## Of Interest

### CPAs Are the Real Pit Bosses: Accounting and Auditing for Gaming

By Dr. Craig Foltin

*This article has been adapted from one that originally appeared in the October 2005 CPA Journal and is used with permission.*

#### Gaming on the Rise Across America and Michigan

Just a little over a decade ago, casino gaming only existed in Nevada and Atlantic City. While Hawaii and Utah have no form of gambling at all (i.e. casinos, race tracks, lottery), 34 states allow casino gambling. These numbers continue to climb as casinos pop up in and around major cities such as Tampa, Chicago, Milwaukee, St. Louis and Seattle and in the back woods of Oregon and Minnesota.

Michigan is no exception. With three land-based casinos in Detroit and 17 tribal casinos spread across the state, Michiganders have a wide variety of gambling options to choose from.

#### Exhibit 1

[Types of Gaming by State](#)

This growth is not only providing entertainment for people, but creating jobs for accountants. Gaming creates unique accounting, auditing, and consulting opportunities ripe for the picking for an aggressive CPA firm. Just in Michigan, millions of dollars of gaming transactions occur daily, requiring complex accounting and auditing systems along with specialized financial reporting.

The role of CPAs in gaming organizations is paramount, as they guide and influence the entire gambling operation. Combine that with the growth of gaming across the state, CPAs can strike it rich at Michigan's casinos without wagering a dime.

#### Economic Impact on Michigan

Gaming is making a substantial impact throughout the United States (see exhibit 2). Now more than ever, state and local governments find themselves in financial trouble. Gaming is one way to raise revenue without raising taxes, which is why many state and local governments are supporting gaming.

Michigan and particularly Detroit are perfect examples. Detroit is now the sixth largest casino market in the country. If Indian gaming were included, Michigan as a total market would be fourth. See the list of the top 10 markets in Exhibit 2. Three Detroit casinos boast 225,000 square feet of gaming space, 9,400 gaming positions. They employ 7,500 people and attract 30,000 people each day.

#### Exhibit 2

[Top Ten Casino Markets](#)

The three Detroit casinos generated nearly \$1.2 billion in gaming revenue for calendar year 2004. Michigan, with one of the highest tax rates on gross gaming revenue in the country at 24 percent, snags 12.1 percent while the remaining 11.9 percent goes to the city. Gaming taxes paid in 2004 on just gambling revenue by these three casinos totaled approximately \$280 million. Income taxes from workers (gross wages totaled \$366 million in 2004) and other taxes are excluded from this figure.

The three Detroit casinos were originally deemed temporary because the original licenses stipulate non-gaming amenities such as hotel rooms. However, because of court challenges, this has not yet occurred.

However, in November of 2005, the Michigan Gaming Control Board approved plans for a permanent Greektown facility scheduled to open in 2008.

Michigan's extensive Native American gaming market includes 17 tribal casinos, which generated approximately \$868 million in gaming revenue in 2004. Eleven are located in the Upper Peninsula. The largest and most influential of the Indian casinos is the Soaring Eagle in Mt. Pleasant with more than 500 hotel rooms, 4,700 slots and entertainment facilities.

Because of state tribal gaming compacts, the taxes paid to state and local governments is approximately \$86 million, substantially less than the rates of the Detroit commercial casinos. Although tribal owned, Greektown in Detroit falls under the commercial gaming laws of Michigan.

### **Industry Guidance**

The AICPA is the primary source of casino accounting information. [Casinos – AICPA Audit and Accounting Guide](#)

is the principal source of casino accounting and auditing direction.

**Internal Controls** may be the most important area to consider because of the high risk associated with casino gaming. The AICPA says that risk is heightened because of the following reasons:

1. It is not practical to record all individual table game transactions.
2. Cash receipts or equivalents are not recorded until they are removed from the drop boxes and counted.
3. The revenues produced are not from the sale of products or services that are readily measurable.

This is why it is important for both management and the auditor to pay extra attention to internal controls.

The process involving all paper controls should be reviewed thoroughly. All chip and cash exchanges and chip inventories require fill slips or credit slips. Statistical benchmarks based on average win/loss percentages are also essential to evaluate and can indicate fraud or errors in a system.

Physical safeguards take on a new dimension with gaming. Unique aspects include table drop boxes, safes, vaults, count room equipment, control over access to gaming equipment and supplies, keys, slot meters, and particularly electronic surveillance. Sometimes thousands of cameras are in place. The auditor must review this monitoring system and the people who are responsible.

Internal control testing for casinos requires extraordinary emphasis and strong personal knowledge unique to gaming. Use of flowcharts, questionnaires, decision tables and much personal observation are required beyond the ordinary inspection of documents, reports and electronic devices.

**Analytical Procedures** become even more critical to an audit. Numerous statistics such as win percentages provide key information. Although this data may fluctuate in the short term, win/loss percentages for each game are fairly precise over the long run. Differences from the norm would be a big red flag, unless casino policy has changed.

**Financial Reporting** closely approximates that of the private sector. Accrual basis is used and revenue is considered as net win (money gambled less payouts). Actually financial statements are fairly straightforward, due to the use of only the basic accounts.

One balance sheet account that may depart a bit from the norm is accounts receivable due to a casino's credit

or IOU policy. Other areas that may uniquely impact the financial statements and should be covered in the notes include: complimentary offers, promotions, jackpots and customer deposits.

**The Audit** requires extra special planning and supervision due to the distinctive aspects discussed above. The auditor should be familiar with the general operations of a casino before starting fieldwork; additional background in hotel and food service is a plus.

Planning becomes even more important for gaming. Documentation is always a key to every audit and this is especially true in this instance. Copies of casino policies and manuals, configurations (both physical layout and computer programs), schedules, statistics, personnel policies and interviews are all a must.

SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*) takes on increased value to the auditor due to the higher potential for fraud. Special attention should be given to cash balances and revenue cutoff. Cash and cash equivalents are all about in a casino and in many different forms. They exist in casino cages, drop boxes, gaming devices, safes, etc. They take the form of currency, coins, house chips, personal checks, travelers checks, customer deposits, chips from other casinos, table chips and credits.

Since casinos operate 24 hours a day and it is infeasible to record every gambling transaction, cut-off procedures must be well documented. Customer wagers should be recorded when the win for each table, machine, etc. is counted and determined. This may vary for each table and machine and the official count could be hours after a particular table, slot, etc. is closed.

Fiscal year ends on calendar year poses additional headaches because New Year's Eve is one of the busiest gaming days of the year. In summation, the auditor should ensure that a sound and consistent plan is in place to count and recognize revenue.

It is important to note that this guide may receive a major overhaul, though a timeline is not yet determined. The AICPA Accounting Standards Executive Committee (ASEC) appointed a special task force in the second quarter of 2003 to revamp this authoritative manual. The last time ASEC met on this matter was December of 2004, with no plan to issue an exposure draft at that time. Tentative conclusions reached at the December meeting are reviewed in Exhibit 3.

**Exhibit 3**  
[Potential Changes to  
AICPA Audit Guidelines](#)

Clearly, there is tremendous work for accountants in the gaming area, as management, casino employee, consultant or auditor. The AICPA's audit guide should be the first place to go for those interested. Background information and illustrations are also included in the [Casinos – AICPA Audit and Accounting Guide](#), which can be purchased through the AICPA for \$43.30.

### **Supplementary Resources**

A leader representing the commercial casino industry is the [American Gaming Association](#). Their organization addresses federal and state legislative, regulatory and tax issues affecting organizations and customers. They perform a lot of research and serve as the nation's first gaming information clearinghouse, providing much data and many statistics. Just a few of the topics include accounting issues, legal issues, economic impact, revenue by state and gaming demographics. Several publications are also available through this organization. An overview study can be accessed at their web site for years 2004 and 2005 entitled *State of the States: The AGA Survey of Casino Entertainment*.

For tax services, the [IRS](#) provides an abundance of accounting opportunities by requiring 18 forms. Required reporting ranges from simple issuances to reporting gambling winners, monthly income and annual filings. In

addition, casinos must separately report each transaction of currency in or out of more than \$10,000. This covers everything from chip purchases to safekeeping deposits, even if multiple transactions add up to \$10,000 in a single day.

Also, most casino and card clubs are subject to Title 31, the *Bank Secrecy Act*. This *Act* deals with suspicious transactions, illegal activity, money laundering and tax evasion. All require a great deal of specialized expertise and entail the implementation of a detailed written plan encompassing considerable amounts of complexity.

To add to the difficulty, the IRS requires some unique and specialized reporting for tribal gaming. The IRS is currently working with a volunteer group of tribal representatives to create an IRS/Tribal consultation policy.

For additional information on Indian gaming, the [National Indian Gaming Association](#) operates as a clearinghouse and is an educational, legislative and public policy resource for tribal policymakers and the public on Indian gaming issues. In addition, when dealing with tribal gambling it is important to know that it is governed by the *Indian Gaming Regulatory Act*, enacted in 1988. Congress also created the [National Indian Gaming Commission](#) to help regulate tribal gaming.

Marketing, training, supervision, general procedures, surveillance, internal controls, management contracts, leasing, public relations and compliance offer even more possibilities for CPA know-how. One of the most experienced full-service accounting and consulting firms is [McGhie Consulting](#). They have a vast array of experience and service top casinos all over Nevada and the world. McGhie group offers everything from start up plans to the final reporting and auditing services. They serve as an excellent model for CPA firms who might wish to enter this growing area.

The [Government Accountability Office](#) (GAO) has also tackled some gaming issues. What may be their most relevant gaming research is an April 2000 study entitled, *Impact of Gambling, Economic Effects More Measurable Than Social Effects*.

The GAO found gambling was on the rise, citing that 86 percent of Americans have gambled at least once in their lifetime, up nearly 20 percent since 1976. Their study reviewed the effect of gambling on economic items such as job trends, welfare caseload, unemployment, tax revenue and community investment. They also examined social issues such as domestic violence, child abuse, divorce, homelessness and crime. They found significant evidence of positive economic impacts of gambling, but no support of negative social impact on gambling. They did qualify their lack of social impact findings by saying the quality of relevant research in that area is extremely limited and there was a lack of data on causes of the above-mentioned social actions. This report incorporated and reviewed a June 1999 study by the National Gambling Impact Commission.

Other pertinent gaming research done by the GAO includes: *Indian Issues, Improvements Needed in Tribal Recognition Process; Internet Gambling, An Overview of the Issues; Campaign Finance, Contributions From Gambling Interests have Increased; and Indian Gaming, Federal Controls Did Not Detect Compact Approval Violation*.

Sources specific to Michigan include the [Michigan Gaming Control Board](#), and [The Michigan Gaming Law](#) web site. This site offers the basics of the law, the history and updates on gaming in the state. The legal group also offers services on regulatory reporting, compliance management services, licensing, etc.

Without a doubt, gambling is emerging as a major industry in the U.S. The economic impact is growing and it represents a significant revenue and job source for state and local governments. Gaming has become an acceptable entertainment alternative and is on the rise. Gambling has also taken hold in Michigan. Growing amounts of accounting guidance are becoming available for those CPA firms aspiring to take advantage of the

abundant accounting and tax opportunities. Now may be the right time for your firm to bet on gaming accounting as part of your service mix and become the pit boss of accounting.

***About the Author***

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**Related Links**

<a href="#">American Gaming Association</a>	<a href="#">Michigan Gaming Law</a>
<a href="#">AICPA</a>	<a href="#">Michigan Gaming Control Board</a>
<a href="#">MACPA</a>	<a href="#">Harrah's Entertainment</a>
<a href="#">IRS</a>	<a href="#">Greektown Casino</a>
<a href="#">Governmental Accountability Office</a>	<a href="#">MGM Grand Detroit</a>
<a href="#">McGhie Consulting, CPAs</a>	<a href="#">Motor City Casino</a>
<a href="#">National Indian Gaming Association</a>	<a href="#">Soaring Eagle Casino, MI</a>
<a href="#">National Indian Gaming Commission</a>	<a href="#">Casino Windsor</a>
	<a href="#">Noble Savage Media</a>
	<a href="#">Gambling News Magazine</a>

## Of Interest

### Your Clients Need a Financial Check-Up Once a Year: How to Give it to Them

By Brian Hamilton

The best business people I know are always ahead of the financial data they possess; that is, they possess an inherent understanding that good management decisions are always based upon what is going to happen rather than on what has already happened.

Historically, accountants report on past and current results – working in the here-and-now. Conversely, clients live in the what-might-become. While the best business decisions might be based upon a careful review of future conditions, not on past conditions, business people also need to understand the past in order to be able to make their futures happen. Oftentimes, business people cannot develop a good framework for future decisions because they don't know what is happening now.

CPAs can connect what has happened (the results from financial statements) to what business people want to happen in the future.

I once worked for a CEO who said it best: financial statement data is a vital strategic weapon that can be deployed as a real asset in the marketplace.

***Financial statement information is vital information, but it is also massively under-used by both accountants and the clients they serve.*** Why? There are four major reasons:

1. Business people are so busy making ends meet they don't have the time to sit down and look at and analyze financial data.
2. Business people are intimidated by accounting (and accountants) and they don't know how to read their financial statements. This is a HUGE part of the client engagement process and we need to be fully aware of this. Nobody wants to feel stupid, so people are afraid to ask the questions they should ask.
3. Accountants are so busy making ends meet they don't have time to sit with clients to look at and analyze financial data. Many are focused on simply getting work done.
4. Accountants are intimidated to admit they may not always know the intricacies of interpreting financial statements. We were trained to do accounting, not necessarily to "use" the information we produce. Financial analysis, and indeed finance, is quite different from accounting.

### **How To Conduct a 30-Minute Financial Check-Up**

By sitting down with clients at least once a year to review financial statements, accountants can build a bridge from the past to the future. While a 30-minuted financial check-up is not time consuming, it is highly productive. At a minimum, it will deepen the relationships you have with clients. It may also generate additional fees, as clients will learn you are more than a tax preparer/compliance professional.

***Here are some basic things to include in your 30-minute check-ups:***

1. Explain the financial statements in plain and easy-to-understand language. Make sure it's not a one-way communication – no lectures – and the client understands the issues being discussed. Numbers from a Balance Sheet or Income Statement don't mean anything to the average and highly intelligent

- business client. Break things down and make sense of the financial numbers. This point is vital.
2. Develop some understanding of margin management. Most business people don't understand the importance of margins. In large part, either the gross margin or the net margin drives the business in most companies. (Gross margin is Sales less Cost of Sales divided by Sales. Net Margin is Net Profit divided by Sales.) Many good business people think the key to success is increasing sales volume. They don't have an appreciation for how volume increases both cash and profit. Many times, increases in sales may decrease profits or cash or both.
  3. Point out some very simple areas the client can work on. The vast majority of businesses are driven by three or four key pieces of data. If these are managed well, the business does well. If they are not managed well, the business does not do well. It is important to identify these before the session.

The sessions should be informal and brief. If the session goes well, the client will view you as a true strategic partner, a friend and ally. If it does not go well, then at least the client will know you care. In all likelihood, your clients will be surprised and impressed that you took the time to help them. And, you may also generate additional fees from these sessions since they oftentimes lead to further questions, challenges and work.

### ***About the Author***

*[Brian Hamilton](#) is the chief executive officer of Sageworks, Inc., which develops ProfitCents, an application that aids accountants in communicating with clients.*

## Of Interest

### 2005 Supply/Demand Report Shows Continued Increase in Accounting Graduates, Employment Up

The report on *The Supply of Accounting Graduates and the Demand for Public Accounting Recruits* is prepared for anyone interested in the demographics of the accounting profession. The following information from the 2005 edition (for the 2003-2004 academic year) is based on a survey conducted of U.S. colleges and universities that offer accounting degrees at the Baccalaureate, Master's or PhD level and a survey of public accounting firms and sole practitioners affiliated with the AICPA.

Here are some of the highlights of this year's report:

- Enrollments in accounting programs continue to climb. For the four-year period 2000 to 2004, enrollments are up 19 percent (to 171,000 in 2004.)
- Since 2000, accounting graduates are also up 19 percent.
- The increase in enrollments from 2003 to 2004 was 1.5 percent.
- The number of bachelor's degree recipients (40,400) increased 9 percent compared to 2003.
- The number of master's degrees awarded in 2004 (13,350) increased 5.4 percent for the same period.
- In 2004, 55 percent of accounting bachelor's and master's graduates were female.
- Ethnic minorities accounted for 23 percent of bachelor's graduates, 21 percent of master's graduates and 38 percent of PhDs.
- In 2004, there was a 17 percent increase in the number of new accounting graduate hires by the firms compared to 2003. The number of bachelor's hired increased 13 percent (to 15,000) and master's hires increased 33 percent (to 4,700).
- Females accounted for 53 percent of accounting graduates hired by the firms.
- Twenty-three percent of the firm hires in 2004 were ethnic minorities.

Regarding firms' hiring trends, estimates of percentage changes from actual in 2004 to predicted for 2005, 2007 and 2009 are optimistic across all firm sizes.

[Download](#) the complete report from the AICPA's Accounting Education Center.

## Legislative & Regulatory

### Member Perceptions of the Peer Review Program *Is Peer Review Ready for Transparency?*

Peer review is truly part of the fabric of our profession, something that has touched almost anyone connected with the world of CPAs. As accounting processes undergo scrutiny and change to become more transparent – the peer review process is naturally part of that effort.

When peer review was born, its focus was remedial. The promise of confidentiality of results clearly induced many members to vote in favor of mandatory peer review. Over the years however, things have changed dramatically. Tens of thousands of CPA firms – for a number of different reasons – make peer review results available beyond the reviewed and the reviewer.

Based on the changing business environment, the AICPA Council passed a resolution in May 2004 that supports the need for increased transparency of the AICPA Peer Review Program and directed the Peer Review Board and the staff to assist members in meeting their regulatory reporting obligations.

In addition, demand for access to the results of peer reviews is at an all time high. Emblematic of that demand are calls from officials of the National Association of State Board of Accountancy for their member boards to have “unfettered access” to peer review results.

Peer review as experienced by most CPA firms remains a key piece of our profession’s self-regulatory system, along with the AICPA’s *Code of Professional Conduct* and the Uniform CPA Examination. It is evident that the current system must become more transparent for all peer-reviewed firms if any self-regulatory aspect is to be maintained. The regulators have made this crystal clear.

But, there’s a lot of confusion and concern about how a “more transparent” peer review process would work. Through an online open-ended survey, the AICPA gathered member feedback.

It was apparent that member views are quite logically shaped by their particular experiences with the peer review process. Some members provided recommendations for changes to improve the program. Many members responding to the survey expressed opinions that were contradictory to other members’ perceptions. It was also evident that members’ perceptions about the peer review program had an effect on their willingness to embrace a system of greater transparency of peer review results.

Simply put, there is a disparity in how individual members perceive the peer program. And, there is a lot of confusion and concern about how a “more transparent” peer review process would work.

A brief review of some of the basics about peer review may help clarify what it is ... and what it is not.

#### **A Definition**

The AICPA Peer Review Program is dedicated to enhancing the quality of accounting, auditing and attestation services performed by AICPA members in public practice. The program was put in place to establish a layer of public protection and to improve firms’ accounting and auditing practices. It does so by identifying CPA firms that have inadequate systems of quality control, detecting non-performance in accordance with

The first article in this peer review transparency series – [The March Toward Public Disclosure of Peer Review](#) – appeared in the November/December issue of *Leaders’ Edge*.

professional standards in all material respects and imposing corrective action to rectify deficiencies.

## **Oversight**

The peer review process includes rigorous checks and balances to help assure that peer reviews are appropriately and consistently performed through the administration and oversight of the process. Peer reviews are administered and reported on in accordance with the *Standards for Performing and Reporting on Peer Reviews* and other guidance adopted by the AICPA Peer Review Board (PRB).

The Program is administered by 41 administering entities (primarily state CPA societies) and is overseen by the PRB and its staff to ensure consistent application of the peer review standards and guidance throughout the nation. The PRB's oversight program requires that each administering entity have its own formal oversight process. Visitation of each of the 41 administering entities, which often includes recommendations for improvements in administering peer reviews, must occur every other year.

Some administering entities also fall under oversight by a state board of accountancy. This, combined with the PRB's oversight, is an effective means of ensuring the program is being administered in accordance with Standards.

## **Discipline**

A disciplinary process is incorporated within the peer review program for any firm that refuses to cooperate, fails to correct material deficiencies, or is found to be so seriously deficient in its performance that corrective actions are not adequate. The PRB may decide, pursuant to due process procedures, to appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated or whether other actions should be taken. The public is notified of terminated firms via *The CPA Letter* and the AICPA web site. State boards are notified of a firm's termination from the program via direct notification.

A separate disciplinary process exists for peer reviewers and administering entities in the event performance issues arise at that level.

## **Evolution of Change in the Process**

In February of 2005, the AICPA established a board-level task force to review the feedback from the online member poll, reflect on the current market and regulatory environment as well as the recent enhancements to the program, and determine if further changes to the peer review program should be recommended.

The task force has identified a number of key issues based on members' comments in response to the online poll:

- Since its inception, the current peer review model has been primarily remedial and educational. Does this remain the appropriate model or should it move toward being more disciplinary and punitive?
- If the results of peer review are to be made available to the public, users and potential users of that information must not only be able to understand the information, but the process behind it. What changes are needed to accomplish this?
- The current peer review reporting process is difficult to understand, and potentially contains information that may be misunderstood or unintentionally or intentionally misused by third parties, including use in litigation. What can be done to address these issues?
- Are there changes to the oversight process that can address the performance of reviewers and their qualifications on specific reviews as well as inconsistencies in the performance among peer reviewers and administering entities?
- Should changes to the services covered by peer review be made?

The task force's efforts, findings and recommendations will be further discussed by the AICPA Board of Directors, the Peer Review Board, and the CCAF Peer Review Committee at meetings through the early

months of 2006.

Through a combination of the willingness of reviewed firms to improve, the professionalism and expertise of the reviewers, the quality of the standards and guidance issued by the PRB and the effectiveness of the oversight process, peer review has been effective in meeting its goal of improving the quality of practice.

At the same time, the AICPA recognizes the need to constantly examine and improve the process and understands that members have: 1) expressed legitimate concerns about the process in the context of transparency, and 2) do not have a shared understanding about all aspects of peer review.

*Future articles in this series will illustrate in greater detail the effectiveness of peer review, while sharing the recommendations of the task force on how peer review can be improved.*

## Legislative & Regulatory

### Tough Times for the CPA Exam *Firms Need to Play a Stronger Role*

*Providing support and encouragement to CPA exam candidates is vital to the success of all CPA firms and the future of the profession. Everyone plays an important role in the process. In view of the declining number of new exam takers, firm leaders must not lose sight of how they set the pace for potential CPAs within their firms.*

Competence. Reliability. A commitment to excellence. These are the traits you expect from the recent accounting graduates you hire. Such traits also include ambition.

Unfortunately, many of your newer hires are taking longer to fulfill their ambition to become CPAs. Though the number of bachelor's degree recipients in accounting rose six percent in 2002-03, the number of CPA Exam candidates has slowly slid from its 1991 high of some 143,000. Last year, that slide turned into a nosedive.

According to a task force report from AICPA, Prometric and NASBA, the candidate numbers plunged from about 82,000 in 2003 to 52,000 in 2004 (the first year of computer-based testing). **That's a decline of nearly 37 percent.** *The #1 reason given by candidates for not taking the exam is they're too busy and lack time to prepare.*

While an exact calendar year comparison of Michigan statistics is not available, Michigan's numbers reflect the downturn. In 2003, 2,282 candidates took the final paper-and-pencil exams. From April 2004 through February 2005 (the first full year of the computerized exam), 1,969 candidates took the exam.

The bottom line of this is your bottom line. If you don't have accountants who are CPAs, your ability to maintain and grow your practice begins to deteriorate, as does the pool of qualified staff to succeed you and keep the practice going.

### Some Practical Ideas to Implement Now

Of course, there are solutions to help you send or re-emphasize the message that becoming a CPA as soon as possible is a core value of your firm's culture. These solutions, used by numerous major CPA firms, include the following:

- Faster advancement after successful exam completion, along with reimbursement for registration, review courses, study materials, even mileage, and/or passing bonuses to cover some of these costs.
- A tracking system to follow employee progress in preparing for and taking the exam. This system could show who has tested, who has passed, etc., and could be used as part of the annual review process, including the threat of demotion, pay decreases or even layoffs for those who do not pass within their first 12 to 15 months at your firm.
- "Window" policies in which new employees are expected to take the exam only at certain times within the year, with a window of only perhaps two to four dates.
- Vacation time to study; permission to study on the job, especially during the off-season; permission to not use personal leave for the day the exam is taken.
- Communication of your firm's CPA Exam policy through HR to new hires. This communication could come, for instance, as part of the employee handbook. Also, education of HR on its role in encouraging employees to make becoming a CPA their top priority.

- Promote the benefits of taking the CPA exam by posting [Top 10 Reasons to Take the CPA Exam](#) in your staff lounge and e-mailing it to your entry-level accountants.

For more information on this vital issue or to access samples of these tools, visit the [PCPS CPA Exam web page](#) or contact the PCPS Team at 800.272.3476 or [pcps@aicpa.org](mailto:pcps@aicpa.org), or visit [www.cpa-exam.org](http://www.cpa-exam.org).

## Legislative & Regulatory

### Maintain the Integrity of the CPA through Political Involvement

Is your name on this list? If you're serious about the integrity of the CPA profession, it should be. View a list of all contributors to the MACPA Political Action Committee, as well as MACPA PAC Capitol Club members – those that contributed \$100 or more.

The MACPA PAC Board of Directors would like to again thank all 2005 contributors – your commitment to the advancement and protection of the CPA profession is admirable.

Please expect your 2006 Donor Renewal Form later this month – please make your contribution right away. Your continued support ensures the unified CPA voice is heard loudly in Lansing. Of course, you can always [contribute online](#).

If you did not contribute in 2005, this is a new year, and you will also be receiving information on the MACPA PAC later this month. Please take the time to review the form and contribute right away.

If you ever have any questions regarding the goals and objectives of the MACPA PAC, contact the MACPA Government Relations Department at (248) 267-3700 or [legislation@michcpa.org](mailto:legislation@michcpa.org).

## Continuing Education

### **"Budgeting" No Longer Part of Business Vocabulary?**

#### ***Course Reveals Radical Changes in Corporate Financial Planning***

Corporate financial planning has undergone such radical changes over the last five years that many business writers are advocating that the word "budgeting" be completely eliminated from our business vocabulary. At an upcoming course, learn how the disciplines of benchmarking, performance measurement, activity-based costing and a German technique called grenzplankostenrechnung are all changing the face of financial planning.

[Trends in Corporate Financial Planning: Beyond Traditional Budgeting](#) addresses how fixed-dollar allocations are quickly disappearing in favor of metrics-driven methods of business performance management. After leaving this course, you will understand emerging trends in corporate financial planning, alternatives to fixed-dollar allocation budgets and the role of performance metrics in corporate financial planning.

The course will be held on February 16 at the VisTaTech Center at Schoolcraft College in Livonia and offers eight general credits. Register [online](#) today.

## Continuing Education

### Winter Accounting & Auditing Conference Features Two Special Presentations, Excellent Breakout Sessions

MACPA members, wait no longer! The most anticipated accounting and auditing event of the season is coming on February 9, 2006, at the MSU Management Education Center in Troy.

The [Winter Accounting & Auditing Conference](#), offering eight credit hours – including both accounting and auditing and ethics credits – features two special presentations plus a variety of breakout sessions, including:

John Hall of Hall Consulting, Inc., will present ***15 Reasons Internal Controls Break Down...And What to Do About It!*** which addresses how “soft control” failures contribute to internal breakdowns. Specific examples and suggestions auditors, managers and key control employees can use to reduce future problems, including fraud, will be featured.

A principal of Deming PLLC, Stuart Deming, will discuss ***International Financial Reporting Standards and Convergence with U.S. GAAP: An Overview of the Implications for Practitioners and U.S. Business.*** His presentation focuses on the increasing attention U.S. companies, financial institutions, investors and their accountants must pay to International Financial Reporting Standards, and their implications, on a wide range of issues.

This program is designed for the accounting professional working in industry or public practice. Register [online](#).

## **Continuing Education**

### **Industry Members: Get Comprehensive Review of Current Accounting Standards Impacting You**

On February 22 in Troy, industry CPAs will hear a review of current accounting standards specific to them.

[Surgent McCoy's Review of Accounting Standards for Industry](#) is designed specifically for industry professionals, covering recent auditing pronouncements and related developments affecting CPAs and accounting professionals.

Gain a practical guide to impairment; get an overview of accounting standard setting; discuss revenue recognition, stock-based compensation, pensions and post-employment benefits; and more.

Earn eight accounting and auditing credits at this industry event. Register [online](#).

## **Continuing Education**

### **Unique Needs of the Controller Met at Tax Course**

The [AICPA's Tax Update for Controllers](#) course was developed after sifting through a laundry list of issues of most importance to controllers.

Recent tax legislation, regulations, cases and rulings will be presented from the controller's perspective at this event. This course also helps controllers stay on top of those hard-to-handle issues – including reasonable compensation for shareholders, payroll taxes and workers classification and depreciation, UNICAP rules and travel and entertainment.

The course is slated for February 23 at the MSU Management Education Center in Troy. Participants earn eight general credits. Register [online](#).

## Association Briefs

### Market to CPAs through the MACPA

Do you have a product or service that benefits CPAs or accountants?

The MACPA – the premier association for CPAs and accounting professionals in Michigan – has several means for you to reach your target audience. Through a corporate sponsorship package, á la carte marketing options or an exhibitor booth at an MACPA conference, you can put your company front and center in the CPA market.

With corporate sponsorship or á la carte options, you will reach MACPA members through print and/or electronic publications, classified advertising, event sponsorships or by exhibiting. Check out the [Marketing & Exhibitor Prospectus](#) to find out the many ways you can market your products and services.

The newly added á la carte option offers an excellent way for companies to pick and choose specific marketing vehicles. Additionally, corporate sponsorship packages may also be customized – so they can be tailored to suit the marketing needs of your business.

Consider [exhibiting](#) at a MACPA conference to reach a large group of people and have one-on-one contact with potential customers. Exhibiting options are available at the Spring and Summer Management Information Shows, the Small Practitioners Conference and the Personal Financial Planning Conference.

The Marketing & Exhibitor Prospectus provides further details on all the marketing opportunities available to you through the MACPA. You'll find an [exhibitor registration](#) form on the last page of the brochure. Access the [corporate sponsorship application](#) to apply as a sponsor. Contact the MACPA at 248.267.3700 for further information on these opportunities.

## Association Briefs

### High School Leaders Conferences Get Students Excited About Accounting

This season's High School Leaders Conferences are underway and going strong. Since its inception only three years ago, the MACPA High School Leaders Conference has grown from two events to a series of five, which were launched for the 2005-06 school year. High demand from schools to attend this program, coupled with a need to expand geographically, have contributed to the conferences' astounding success.

The first 2005-06 Conferences kicked off on November 30 at Eastern Michigan University in Ypsilanti. Gina Lundquist, a teacher at Summit Academy High School who attended the event, noted the event was a wonderful opportunity for students interested in accounting or business as a career.

"This conference was extremely helpful for me to more completely understand the different types of careers in accounting; and now I am seriously considering a career in accounting," said a student from Airport High School who attended on November 30.

The event features presentations and activities throughout the day, including *Who Done It? The Fascinating World of Fraud*; *Show Me the Money*; *Accounting Gives You an Edge*; a luncheon with college students and more.

"The conference was a great experience...it taught me more about accounting and what I need to do to get ready for a career," said a Warren Woods Tower High School student who also attended on November 30.

Visit the MACPA web site for details on the remaining High School Leaders Conferences – at [Michigan State University](#) on January 31, at [Oakland University](#) on February 7, at [Aquinas College](#) on February 22 and at [Wayne State University](#) on February 28.

## Association Briefs

### MACPA, CareerBank.com Make Your Job/Employee Search Simple

MACPA's partnership with CareerBank.com provides members with access to career-related resources, including resumes and job postings via a nationwide network of more than 650,000 accounting, finance and banking professionals. Post a resume today to get your name out to thousands of firms that may be looking for a professional with your qualifications. For employers, be sure to post your open position for thousands of potential candidates to view.



Also take advantage of CareerBank.com's free resources available on the MACPA web site:

- [Polls](#) - CareerBank runs monthly polls. View an archive of previously run polls or participate in the latest.
- [Links](#) - Take advantage of handpicked links section for finding a wealth of resources on the web.
- [Articles](#) - CareerBank publishes unique articles designed to help anyone from the job seeker to the employer.
- [Salary Wizard](#) - Access free salary data on thousands of job titles and locations.
- [Salary Survey Results](#) - View CareerBank.com salary survey results.
- [Resume Help](#) - Get a free resume critique – e-mail your resume to [careerbank@career-resumes.com](mailto:careerbank@career-resumes.com) or call Career Resumes at 800.800.1220.
- [Testimonials](#) - Find out what clients think of CareerBank services.
- [News](#) - Current information regarding CareerBank.com.
- [Education Center](#)
- [TradePub](#) - Free accounting, finance, banking and insurance-related magazine subscriptions.

## Association Briefs

### **MACPA Accounting Blitzes are a Big Hit with Students**

Throughout October, November and December, 144 MACPA members visited various schools in Detroit, Grand Rapids and Traverse City to teach students basic business concepts. In the process, students also learned about the vast career opportunities in accounting.

The Fall MACPA Accounting Blitz, held in conjunction in Junior Achievement (JA), made it possible for nearly 2,500 students to benefit from the experience and knowledge of the volunteers who visited them. Students learned critical thinking and problem-solving skills through the various lessons presented by volunteers as well as through hands-on educational activities related to the lessons.

Volunteers for the Blitz were equipped with a toolkit from JA that contained kid-friendly lesson plans and activities covering various business-minded topics. Volunteers also attended a training session to learn how to effectively teach in the classroom and how to utilize the plans and activities provided.

The MACPA conducts the Accounting Blitz in the fall and spring each year. If you're interested in more information regarding the Spring Blitz, or if you'd like to volunteer, visit the [MACPA web site](#) or contact [Michelle Mohan](#).

## Association Briefs

### **Children Received Money-Minded Gifts from MACPA During the Holiday Season**

For the second consecutive year, the MACPA New Professionals Task Force brought smiles to children's faces across Michigan.

The New Professionals Task Force participated in the U.S. Marines Toys for Tots program, which puts toys in the hands of less fortunate children. The MACPA put a special twist on their toy collections by asking members and staff to donate money-minded gifts. The response was excellent and children were presented with toys including, math board games, toy banks and lots more.

The top two firms collecting toys for the MACPA were Jenkins, Magnus, Volk & Carroll and BDO Seidman, with donations of more than 100 toys each.

Task Force Vice Chair Dana DePalma, Jennkins, Magnus, Volk & Carroll, was joined by Christine Gonyea, BDO Seidman, and MACPA Member Services Specialist Nicole Shepard and Vice President of Communications and Member Services Cynthia D'Amour as they delivered the toys to Oakland Mall on Tuesday, November 29, 2005. As part of the toy delivery, DePalma was interviewed by Jim Harper from Magic 105.1 FM, who acknowledged and thanked the CPA profession for their participation in this worthy cause.

The Toys for Tots program is just one of many service programs the MACPA and its task forces participate in. This year alone, the New Professionals group collected approximately 8,000 books to donate to Detroit public school children on behalf Terry Murphy, husband of AICPA Chair and MACPA member Leslie Murphy. The group also made a donation to the Ronald McDonald House and volunteered with Habitat for Humanity. Coming up on June 10, the Task Force is spearheading participation in the Komen Detroit Race for the Cure (watch for more information in upcoming MACPA publications on this event.)

The Communications Task Force is taking part in the Accounting Aid Society's [Tax Assistance Program](#) for the second year this February.

To read more about various volunteer efforts of MACPA members, read the November/December 2005 *Leaders' Edge* [Chair's Message](#).

## **Association Briefs**

### **In Memoriam**

We sincerely regret the loss of our fellow members and extend deepest sympathies to their families and friends.

F. Scott Dawe

*Ada*

Bruce R. Mayhew

*Draper, Utah*

Robert H. Rosenau

*Brighton*

Dennis G. Stout

*Shelby Township*

Joseph Trocino

*Mount Clemens*