Michigan Association of CPAs

AICPA ISSUE BRIEFINGS
Spring 2009 Legislative Visits – Washington, D.C.

These issues served as basis for MACPA leaders and Legislative Advisory Group meetings with Members of Congress in April 2009.

Four AICPA background papers are attached, covering the following topics:

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CURRENT AND FUTURE REGULATION OF SELECTED FINANCIAL SERVICES INDUSTRY PARTICIPANTS

Introduction

The American Institute of Certified Public Accountants (the "AICPA") has prepared this background paper on the current federal regulation of four types of entities that have played major roles in the American financial services industry in recent years: (1) broker-dealers, (2) hedge funds, (3) investment advisers and (4) hedge fund advisers. The paper also summarizes the audit requirements that currently apply (or, in some cases, do not apply) to such entities. We also describe several recent proposals by members of Congress, the Chairman of the SEC and the Secretary of the Treasury to subject such entities or their auditors to additional federal oversight.

Current Regulation of Key Financial Services Industry Participants

Broker-Dealers: Under the federal securities laws, a "broker" is defined, with certain exceptions, as "any person engaged in the business of effecting transactions in securities for the account of others" and a "dealer" is defined, with certain exceptions, as "any person engaged in the business of buying and selling securities for such person's own account, through a broker or otherwise." The Securities and Exchange Commission (the "SEC") has estimated that there are over 5,000 broker-dealers registered with the SEC. We estimate that only about 10% of these broker-dealers currently either clear or carry customer securities.

Regardless of whether a broker-dealer is publicly or privately owned, all broker-dealers are subject to regulation and oversight by the SEC, as well as by one or more "self-regulatory organizations" ("SROs"), such as the Financial Industry Regulatory Authority ("FINRA"). The SROs perform routine examinations and oversight of their member firms. Broker-dealers are subject to detailed regulations, including (1) financial responsibility rules that impose "net capital" requirements on broker-dealers, (2) customer protection rules intended to safeguard customer securities and cash, (3) books-and-records requirements identifying the records that broker-dealers must create and keep for specified periods, and (4) rules that require all broker-dealers, except for a few specialized types of broker-dealers that engage in limited activities, to file periodic financial statements and annual audit reports with the SEC and each SRO of which the broker-dealer is a member.

Among the customer protection rules applicable to broker-dealers is Rule 17a-13 under the Securities Exchange Act of 1934 (the "1934 Act"), which requires a broker-dealer to perform quarterly reconciliations of its overall positions at a clearing agency to the broker-dealer's records. In addition, Rule 17a-5 under the 1934 Act requires an annual audit of the broker-dealer's practices and procedures to perform such securities counts. Audit reports filed by broker-dealers with the SEC and SROs must also contain statements of financial condition, income and cash flows; changes in stockholders' or partners' or sole proprietor's equity; and changes in liabilities subordinated to claims of general creditors.

Since the adoption of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), auditors of public broker-dealers (*i.e.*, broker-dealers that have issued their own securities to the public and are "issuers" under the federal securities laws) must register with the Public Company Accounting Oversight Board (the "PCAOB"), perform their audits in accordance with PCAOB standards, and submit to the PCAOB's inspection and enforcement authority. Sarbanes-Oxley also requires auditors of privately held (or "non-public") broker-dealers to register with the PCAOB, but the SEC issued a series of exemptive orders beginning in 2003 that suspended this requirement. The last such SEC exemptive order expired on January 1, 2009, however, and has not been renewed. As a result, financial statements of non-public broker-dealers for fiscal years ending after December 31, 2008 must be audited by a PCAOB-registered accounting firm, although the PCAOB has stated that Sarbanes-Oxley does not provide it with inspection or enforcement authority over such firms.

Hedge Funds: While the term "hedge fund" is not defined in the federal securities laws, the SEC has observed that the term is widely used to describe entities that own a "pool" of securities and perhaps other assets, whose interests are not sold in a registered public offering and which are not registered as "investment companies" (*i.e.*, mutual funds) under the Investment Company Act of 1940 (the "1940 Act"). Hedge funds are frequently established as domestic LPs (limited partnerships) or LLCs (limited liability corporations) or as offshore corporations. They employ a variety of different investment and trading strategies with the goal of capital appreciation. With an estimated $1.5 - $2.0 trillion in assets currently under management, hedge funds have attracted considerable attention in recent years.

In comparison with mutual funds, which are regulated under the 1940 Act, hedge funds typically rely on two statutory exemptions to avoid regulation as investment companies. The first such exemption is Section 3(c)(1) of the 1940 Act, which excludes from the definition of an "investment company" any entity whose outstanding securities (other than short-term commercial paper) are beneficially owned by not more than 100 investors and which is not making or

planning to make a public offering of its securities. The second exemption is found in Section 3(c)(7) of the 1940 Act, which excludes from the definition of an "investment company" any entity whose outstanding securities are owned exclusively by "qualified purchasers" (typically, individual or institutional investors that already own substantial investments) and which is not making or planning to make a public offering of its securities. Because hedge funds are exempt under the 1940 Act, they are not subject to the 1940 Act's stringent requirements, which include obligations to calculate a fund's "net asset value" on a daily basis, redeem a fund's shares upon an investor's request, and establish a board of directors whose responsibilities include monitoring the fund's contractual arrangements with its manager and other third-party service providers.

In addition, hedge funds typically have no more than 499 investors, in order to avoid registration and periodic reporting requirements under the 1934 Act. Accordingly, hedge funds are exempt from both the 1940 Act's substantive requirements and the 1934 Act's registration and annual reporting requirements. Hedge funds (and their managers and advisers) are subject, however, to the anti-fraud and anti-manipulation provisions of the Securities Act of 1933 (the "1933 Act"), the 1934 Act, and the Investment Advisers Act of 1940 (the "Advisers Act"). In addition, depending on their investments, hedge funds may be required to report certain of their securities holdings or trading positions to the SEC and/or the Commodity Futures Trading Commission (the "CFTC").

There is currently no requirement under the federal securities laws that hedge funds retain independent public accountants to conduct annual independent audits. Many hedge funds do so on a voluntary basis, however, to meet investors' expectations. In addition, as described in the "Hedge Fund Advisers" section, investment advisers to some hedge funds arrange for those funds to be audited annually under a provision of the Advisers Act that dispenses with certain account statement delivery requirements if annual audits have been performed.

Investment Advisers: Under the Advisers Act, an "investment adviser" is defined as one who "for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." Investment advisers with $30 million or more in assets under management are required to register with the SEC, and are thereafter subject to inspection by the SEC's Office of Compliance Inspections and Examinations, unless they qualify for an exemption. In comparison, smaller investment advisers with less than $25 million in "assets under management" are regulated by state authorities, rather than by the SEC. Registration with the SEC, rather than with a state securities regulator, is optional for investment advisers with between $25 and $30 million of assets under management.

In addition, some investment advisers rely upon the "private adviser exemption" from registration set forth in Section 203(b)(3) of the Advisers Act. This section exempts from registration with the SEC "any investment adviser who during the course of the preceding [12] months has had had fewer than [15] clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the [1940 Act]." Investment advisers that rely on this exemption from registration remain, however, subject to the statute's anti-fraud provisions.

With limited exceptions, investments advisers currently are not required under the Advisers Act to obtain independent audits or to file audited financial statements with the SEC, even if they have discretion over client accounts. It is possible, of course, that an investment advisory firm may also be an "issuer" (i.e., a public company that has issued its own securities to the public). In those circumstances, the 1934 Act would require the investment adviser to file financial statements with the Commission audited by a PCAOB-registered accounting firm.

Recent events, such as the Madoff scandal, have focused particular attention on investment advisers' custodial arrangements. In general, investment advisers do not have actual custody (*i.e.*, physical possession) of client funds or securities, and current rules generally prohibit such arrangements. Advisers may be deemed to have constructive custody of client assets, however, in a variety of scenarios, including:

- Arrangements (including a general power of attorney under which an adviser is authorized or permitted to withdraw client funds or securities maintained with a custodian upon the adviser's instructions to the custodian; and

- Situations where an adviser acts in any capacity that gives the adviser legal ownership of, or access to, client funds or securities (such as when an adviser serves as the general partner of a limited partnership, managing member of a limited liability company or in a comparable position for another type of pooled investment vehicle, or as trustee of a trust).

In many of these situations, an adviser also will have discretionary trading authority for a client. Where an adviser has constructive custody of client assets, it must comply with Rule 206(4)-2 under the Advisers Act (the "Custody Rule"), which requires the adviser to maintain those assets with a "qualified custodian" (generally, any U.S. bank, U.S. broker-dealer, futures commission merchant for the limited purpose of effecting futures transactions or, in some instances, a foreign financial institution). An investment adviser is referred to as having "self-custody" of client funds or securities when, for example, the adviser is "dually registered" as a broker-dealer and, therefore, can be a "qualified custodian." In other situations, a broker-dealer or bank affiliated

with an investment adviser serves as the "qualified custodian." When an investment adviser has "self-custody" or uses an affiliated custodian, the SEC expects there to be functional separation between the entity's advisory and broker-dealer functions.

Under the Custody Rule, an adviser with custody of client assets must notify its clients of the qualified custodian's name and address and have a reasonable basis to believe that the custodian is sending an account statement at least quarterly to each of the adviser's clients. Alternatively, an adviser may send quarterly account statements directly to its custodial clients. In that situation, however, the adviser must arrange for an independent public accountant to conduct a "surprise examination" to verify all of the custodial funds and securities by actual examination. The independent accountant must file a certificate with the SEC within 30 days of the completion of its examination, describing its procedures, and also notify the SEC within one business day if it finds any material discrepancies during the course of its examination. In practice, such "surprise examinations" under the Custody Rule are relatively infrequent, because advisers tend to prefer alternative methods to satisfy the rule's requirements.

Hedge Fund Advisers: Many hedge fund managers rely upon the "private adviser exemption" under the Advisers Act to avoid registration with the SEC, as they have fewer than 15 "clients." For these purposes, each hedge fund is treated as a single client. In 2004, the SEC adopted a rule intended to require hedge fund managers to "look through" a fund and count each fund investor as a separate "client." Following the adoption of this rule, many hedge fund managers registered with the SEC as investment advisers. In 2006, however, the U.S. Court of Appeals for the District of Columbia Circuit overturned the SEC's rule, concluding that the agency's interpretation of the Advisers Act was "counterintuitive" and "arbitrary."

Some hedge fund managers are currently registered with the SEC as investment advisers. In particular, some hedge fund managers both have over $30 million in assets under management and cannot rely upon the private adviser exemption (because they have 15 or more clients). In addition, some hedge fund managers registered as investment advisers with the SEC after the 2004 rule was adopted and did not withdraw their registrations after the D. C. Circuit overturned the SEC's rule.

The "Custody Rule" (described above in the "Investment Adviser" section) contains a specific provision that addresses a situation where a registered investment adviser manages a hedge fund and is deemed to have custody of client funds or securities. In that scenario, the fund manager is not required to deliver (or ensure the delivery of) a quarterly account statement, if the adviser arranges to have the fund audited at least annually by an independent public accountant and distributes the fund's audited financial statements to the fund's limited partners or other

beneficial owners within 120 days after the end of the fund's fiscal year (or, in the case of a "fund of funds," within 180 days of the end of the fund's fiscal year). This rule does not apply, however, to hedge fund managers that are not registered with the SEC.

Recent Legislative and Administration Proposals

Approximately a dozen bills have been introduced proposing enhancements to the regulation of the financial sector in response to the Madoff and other recent scandals, as well as in response to the current financial crisis. In this section of the paper, we summarize two such legislative proposals, as well as potential changes to current laws identified by the Chairman of the SEC and the Secretary of the Treasury.

S. 344 (The Grassley-Levin Bill): Senators Chuck Grassley and Carl Levin co-introduced S. 344, the "Hedge Fund Transparency Act of 2009," on January 29, 2009. The legislation would revise the 1940 Act by repealing the two current exceptions from the definition of an "investment company" that hedge funds typically rely upon to avoid SEC registration and regulation under the 1940 Act. These exceptions are set forth in Sections 3(c)(1) and 3(c)(7) of the 1940 Act and were discussed above in the "Hedge Funds" section. Instead, these exceptions would be recast as "exemptions" under Section 6 of the 1940 Act, and hedge funds would be allowed to rely on them only if they satisfied certain criteria.

Specifically, smaller hedge funds that previously had relied on the Section 3(c)(1) or 3(c)(7) exemptions would now fall within the definition of an "investment company," but would remain exempt from the 1940 Act's requirements. In comparison, hedge funds with $50 million or more in assets that satisfy the current criteria under Section 3(c)(1) or 3(c)(7) would remain exempt only if they (1) registered with the SEC; (2) filed an annual information form with the SEC that included information on, among other things, the fund's beneficial owners, its affiliations with other financial institutions, the fund's "primary accountant and broker," and the current value of the fund's assets and assets under management; (3) maintained such books and records as required by the SEC; and (4) cooperated with any request for information or examination by the SEC. The legislation does not specifically address whether the funds would be required to file audited financial information with the SEC and, if so, whether their auditors would need to be registered with the PCAOB.

H.R. 1212 (the Kanjorski Bill): Congressman Paul E. Kanjorski introduced H.R. 1212 on February 26, 2009. In introducing the legislation, Congressman Kanjorski publicly stated that its goal is to prevent the recurrence of the situation that arose in the Madoff scandal, where Bernard L. Madoff Investment Securities LLC (a dually registered broker-dealer and investment

adviser) was audited by a small accounting firm that was not registered with the PCAOB and had represented to the AICPA that it was not performing audits.

Specifically, the Kanjorski bill would require all audits of broker-dealers registered with the SEC, including non-public broker-dealers, to be performed by PCAOB-registered firms. In addition, the legislation would amend Sarbanes-Oxley to provide the PCAOB with explicit inspection and enforcement authority over auditors of all registered broker-dealers. As discussed previously, the PCAOB interprets Sarbanes-Oxley as requiring the registration of accounting firms that audit registered non-public broker-dealers, without providing the PCAOB with the ability to inspect such firms or investigate them for possible violations of professional standards or applicable laws.

Testimony of SEC Chairman: SEC Chairman Mary L. Schapiro testified before the Senate Banking Committee on “Enhancing Investor Protection and Regulation of the Securities Markets” on March 29, 2009. During her testimony, Chairman Shapiro observed that “some of our rules regulating financial intermediaries need to be modernized” and that the SEC is currently evaluating legislative recommendations to Congress.

Chairman Shapiro noted that the SEC is considering asking for legislation that would require investment advisers that manage hedge funds, and possibly hedge funds themselves, to register with the SEC. She also stated that the SEC is evaluating whether investment advisers and broker-dealers should be subject to uniform regulatory standards, rather than different regulatory regimes, since “the services they provide often are virtually identical from the investor’s perspective.”

Chairman Shapiro also testified that the SEC is reviewing the need for enhancements to the current rules governing custodians of client funds and securities. Specifically, she stated that the SEC Staff has been directed to draft rules that would, if adopted:

- Require *all* investment advisers with custody of client assets to undergo an annual “surprise” third-party examination to confirm the safekeeping of those assets;

- Require certain investment advisers to obtain periodic third-party compliance audits to review their compliance with applicable laws; and

- Require a senior officer from each broker-dealer or investment adviser with custody of client funds or securities to attest to the sufficiency of the controls in place to protect client assets, and publish the list of the firms that had provided such certifications (together with the names of their auditors).

Testimony of Treasury Secretary: Treasury Secretary Timothy Geithner outlined the Treasury Department's "Framework for Regulatory Reform" before the House Financial Services Committee on March 26, 2009 and presented a set of recommendations intended to address systemic risk within the financial markets. One set of recommendations related specifically to hedge funds and their managers. In particular, Secretary Geithner proposed that:

- All advisers to hedge funds (and other private pools of capital, including private equity and venture capital funds) with assets under management exceeding a not-yet-determined threshold should be required to register with the SEC;

- All funds advised by an SEC-registered investment adviser should be subject to counterparty disclosure requirements and regulatory reporting requirements;

- The regulatory reporting requirements for such funds should require the confidential reporting of information necessary to assess whether the fund (or family of funds) is so large or highly leveraged that it poses a threat to financial stability; and

- The SEC should share the reports that it receives from the funds with a "systemic risk regulator," which would then determine whether any hedge funds could pose a systemic threat and should be subjected to heightened "prudential standards" that take into account the risk that the distress or failure of such an entity could impose on the financial system and the economy.

Secretary Geithner further indicated that the Treasury Department would be presenting additional proposals to Congress in coming weeks addressing other components of regulatory reform, including proposals to protect consumers and investors, eliminate current gaps in the existing regulatory structure and foster international coordination.

The Trusted Advisor: CPAs Step Up to Help America through Economic Crisis

The United States is in the midst of extremely challenging economic times and the need for solid financial guidance has never been greater. Consistent with the profession's commitment to the public interest, certified public accountants (CPAs) are fulfilling their mission of being the country's most trusted business advisors by providing citizens and businesses, both large and small, with sound, objective financial advice.

CPAs don't need hard times to be essential. The profession has more than a 100-year tradition of providing high-quality counsel to individuals and businesses across America each day. In today's tumultuous economic climate, the discipline and competence they bring to navigating complex financial information with integrity and without bias is critical and unsurpassed.

As the national, membership organization for the CPA profession, the American Institute of Certified Public Accountants (AICPA) is committed to providing its members with the latest information and tools to help them educate both businesses and individuals about surviving these times. In January 2009, the AICPA launched the Economic Crisis Resource Center (www.aicpa.org/economy) providing CPAs in every practice area, from business and industry to government to small firms, with the information they need to help their employers and clients minimize the effects of the recession. The Center contains tools, such as webcasts, articles, podcasts, blogs and CPE courses on strategic planning, budgeting, fraud detection and maintaining the public trust. The site is continually updated with the latest events and information, including government actions and court rulings.

What follows is a summary of ways that CPAs are supporting employers, clients and the public through the greatest economic crisis since the Great Depression.

Making Main Street Sustainable

The economic downturn is affecting businesses of all sizes. As the engine of America's economy, small businesses are particularly vulnerable. Not only are many CPA firms small businesses themselves, but they provide other small businesses with the necessary knowledge and tools to survive the recession. The AICPA is committed to supporting these firms in their efforts to position their small business clients for success.

The AICPA's Private Company Practice Section (PCPS) has taken the lead in its response to the economic crisis. It continually develops new content and tools to ensure that CPAs can help their small business clients thrive, even in challenging times. Recently developed resources include:

- **Small Business Stimulus Plan Client Communication**: Information for CPAs to provide to clients on the impact of President Obama's small business initiatives.
- **American Recovery and Reinvestment Act of 2009 Client Brochures**: Materials that provide a clear overview of the key tax provisions of the new Act.

- **Required Employer COBRA Payment Communication**: A client overview of the requirements under recent changes in COBRA and the "Making Work Pay" tax credit.

Economic Podcast Series

The PCPS Economic Podcast Series was developed to enable CPA firms to help their clients and their own firms get through this economic crisis. Each podcast features CPAs speaking about a specific topic that has affected their firms and their firms' responses. Topics include:

- Targeted Marketing
- Staff Expectations and Concerns
- Watch the Numbers, Not the News
- Reducing Debt
- Revisiting Term Loans
- Timing of Major Expenses

Resources:

- PCPS Firm Practice Center: pcps.aicpa.org/
- PCPS Economic Podcast Series: pcps.aicpa.org/Resources/Economic+Podcast+Series/
- PCPS Resources on Obama's Recovery Act and Small Business Plan: pcps.aicpa.org/Obama+Recovery+Act+and+Small+Business+Plan.htm
  - Client Communication: pcps.aicpa.org/Small+Business+Stimulus+Plan+Client+Communication.htm
  - Required Employer COBRA Payments: economy.aicpa.org/2009/03/payroll-and-cobra-provisions-of-the-economic-stimulus-plan.html

Navigating Corporations through the Economic Crisis

In recent months, economic turmoil has affected businesses from Wall Street to Main Street. New regulations are bringing increasing complexity to day-to-day business operations. The financial issues are challenging in and of themselves, but the issues of managing staff and meeting customers' real-time needs also make it difficult for businesses to stay focused and productive. As American businesses navigate through these difficult economic times, they look for guidance from their financial advisors, controllers and CFOs — CPAs who remain on the frontlines focused on company bottom lines and on the cutting edge of the issues most affecting business and industry.

For the past several years the AICPA has surveyed CPA decision-makers in executive functions about their views on the economy. In 2007, the AICPA announced its partnership with the University of North Carolina Kenan-Flagler Business School on the quarterly Economic Outlook Survey. Respondents include CPAs in public and private companies, government and organizations, including not-for-profit organizations. Usually over half the respondents are either CFOs or CEOs of their organization. The survey acts as a bellwether for the outlook of key decision-makers in our economy. Survey results of late have pointed to continued pessimism among financial executives; however we expect

future survey responses will show beginning signs of recovery across the various industries. The results of the surveys get broad distribution through national and business media outlets.

To help American businesses weather the current maelstrom, the AICPA has prepared a vast array of resources posted to the Economic Crisis Resource Center.

- ***Navigating the Current Economic Crisis: What It Means for Business*****:** This new presentation resource helps CPAs in business and industry to educate employees, management and boards of directors about critical issues during difficult economic times. It discusses key concerns such as fraud prevention, pension plans, risk management, internal controls and processes and liquidity — all issues in which staff and management have a vested interest as they work together to keep businesses and industries afloat. The slides and their corresponding notes provide a concise and effective way for financial executives to communicate to stakeholders and their employees the issues their companies are facing.

- **Business Briefs:** Businesses today are concerned with maintaining cash flow, meeting budget projects, avoiding layoffs, retaining employees and preventing fraud, among other very important issues. To help CPAs in business and industry tackle the day-to-day management issues they face during this economic crisis, the AICPA has launched a series of Business Briefs, consisting of biweekly articles on topics such as:

    - Succession planning
    - Risk management
    - CPA leadership
    - Business fundamentals

- **"CPA Straight Talk" Podcast Series:** The "CPA Straight Talk" podcast series provides strategies on the key financial and non-financial issues businesses are facing during this difficult economic time and helps CPAs keep their organizations looking forward. In each podcast, experts share their thoughts and insight, assisting CPAs, their employers, clients and families as they seek sounder fiscal footing. Topics include fraud detection and prevention, impairment, engagement management and safeguarding assets during a recession. "CPA Straight Talk" podcasts are available online at the AICPA Economic Crisis Resource Center at economy.aicpa.org/podcasts/index.html.

The AICPA also is focusing on the role of audit committees. Achieving financial statement integrity and reliability depends on CPAs to balance the needs of multiple stakeholders, including management, regulators, investors and the public interest.

- **Audit Committee Effectiveness Center:** The AICPA's Audit Committee Effectiveness Center (www.aicpa.org/audcommctr/homepage.htm) provides the guidance, tools, publications and resources to make audit committee best practices actionable as the committees discharge their fiduciary responsibilities. A recent addition is the *Report on the Current State of Enterprise Risk Oversight* by Mark S. Beasley, Deloitte professor of enterprise risk management and director of the ERM Initiative at North Carolina State University. This report aims to help boards of directors and senior executives adequately manage risks and preserve stakeholder value for the organizations they serve. Other helpful resources the AICPA supplies audit committees with are:
  - *Audit Committee Briefs:* Published monthly, Audit Committee Briefs provide practical guidance on timely topics for audit committees.
  - *Audit Committee Tool Kits:* Contains ready-to-use tools, forms and best practices for audit committees of public companies, private companies, not-for-profit organizations and government entities.
  - *Audit Committee Matching System:* Matches qualified candidates with needy audit committees and boards of directors.

Resources:
- CPA Letter Daily Signup: www.smartbrief.com/cpa
- Economic Crisis Resources Center: www.aicpa.org/economy
- Audit Committee Effectiveness Center: www.aicpa.org/audcommctr/homepage.htm
- *Report on the Current State of Enterprise Risk Oversight:* www.aicpa.org/audcommctr
- "CPA Straight Talk" Podcast Series: economy.aicpa.org/podcasts/index.html

As you can see, CPAs are the trusted advisors who enable people and organizations to shape their future. These initiatives are just a few of the many ways CPAs provide essential services to individuals and businesses every day. As the leading national professional organization for CPAs, with more than 350,000 members, we're proud of the invaluable contribution CPAs make to the public good and remain committed to supporting them as they help others through this uncertain time and all its challenges and opportunities.

Educating Americans on the Importance of Personal Financial Accountability

The CPA profession is passionate about and committed to helping Americans and the United States through this economic crisis. As the U.S.'s most trusted financial advisor, CPAs are in a unique position not only to explain why financial literacy is important, but to design and implement programs that are widely available to the public.

CPAs believe that this current economic crisis is an opportunity to be a calming, rational voice to promote the importance of sound financial planning and to advocate for

Americans to be personally accountable for their financial future. CPAs are striving to empower Americans with the information and tools they need to survive the current recession. Behavioral changes made during these fiscally challenging times will help Americans not only thrive once the U.S. comes through the recession but also possibly change their financial destiny and that of future generations.

2009 Harris Poll Reveals Almost Universal Concern About Economy

A 2009 Harris Interactive Poll conducted on the behalf of the AICPA shows how the current economic slowdown has impacted Americans' behaviors and attitudes.

- Half (51%) of those employed full or part-time feel at least slightly concerned about losing their job soon. In fact, four percent of those employed indicate they either expect or know they will lose their job soon. While four percent may not seem like much, extrapolated to the full U.S. population this represents approximately more than 5.5 million Americans.
- Half (49%) of Americans feel pessimistic about the U.S. economy over the next year.
- Fully two-thirds (67%) of adult Americans indicate they have reduced spending either *somewhat* (38%) or *significantly* (29%).
- Financial concerns are influenced by age. Retirees have three top concerns: *rising energy and home heating costs* (19%), *retirement* (12%) and *uninsured medical expenses* (12%). Those under the age of 55 are most concerned with *losing their job* (14%), their *child's education* (13%) or *lack of savings for financial emergencies* (12%). The top concern for those under the age of 35 is *paying for their own or their spouse's student loans* (17%).

Helping Steer Americans to Sounder Financial Management

During the economic downturn, the profession's award-winning 360 Degrees of Financial Literacy and Feed the Pig efforts have shifted to focus on helping Americans manage through economic crisis.

The AICPA's award-wining financial literacy Web site (www.360financialliteracy.org) is the centerpiece of this effort. To ensure consumers have relevant information to weather the current financial storm, new resources are added to the 360 Web site on a weekly basis. Since August 2008, tips on "Spending Less on Groceries and Eating Out" and "Staying Sane in a Crazy Market" to articles on "Protecting Brokerage Accounts" and "Rethinking Retirement," are helping Americans of all ages take control of their finances.

New sections, "Recessionary Survival" and "Investor Education," index the many new and existing resources on these topics available on 360 to help Americans find information quickly. Topics in the Recessionary Survival section include information on coping with job loss, paying for college, saving, investing, planning for retirement, home buying and foreclosure. The Investor Education section addresses the steps Americans should take to ensure their investments are safe.

Thousands of CPAs are counseling clients, colleagues and staff, as well as communities and families, during these trying times. To support them in these efforts, two new mobilization kits, "Recessionary Survival" and "Investor Education," which include articles and presentations with speaker notes, complement the new consumer resources.

Through grassroots outreach, state CPA society efforts, national and local media coverage, consumer newsletters, weekly savings tips, podcasts, tweets and social networking sites, each month millions of Americans receive free, impartial, reliable advice from the CPA profession to act now for a better financial future.

Resources:

- 360 Degrees of Financial Literacy Consumer Web Site: www.360financialliteracy.org
    - Recessionary Survival
    - Investor Education
    - Consumer Newsletter Sign Up
    - In Your State provides links to local events
- Feed the Pig Web Site: www.feedthepig.org
    - Weekly Savings Tip Sign Up
    - Links to podcasts, Twitter and Social Networking Sites
- CPA Financial Literacy Resource Center: www.aicpa.org/financialliteracy
    - Recessionary Survival Toolkit
    - Investor Education Toolkit

TAX STRATEGY PATENTS

The AICPA and our members have extensive experience in rendering advice to taxpayers on matters of tax planning and compliance. From this unique vantage point, we have considered the broad impact of tax planning method patents on taxpayers, professional tax advisers, and the public interest.

Background

The patentability of tax strategies is a growing concern among tax practitioners and taxpayers. In 1998, the U.S. Federal Circuit Court of Appeals, in *State Street Bank & Trust v. Signature Financial Group, Inc.*, held that business methods could be patented. Since then, over 75 patents for tax strategies have been granted and over 120 patent applications for tax planning methods are pending.

Patents for tax planning methods have already been granted in a variety of areas, including the use of financial products, charitable giving, estate and gift tax, pension plans, tax-deferred exchanges, and deferred compensation. One patent granted is for the process of computing and disclosing the federal income tax consequences involved in the conversion from a standard Individual Retirement Account – IRA – to a Roth IRA. We expect many more tax planning method patents to be issued, directly targeting average taxpayers in a host of areas including: (1) income tax minimization; (2) alternative minimum tax (AMT) minimization; and (3) income tax itemized deduction maximization.

AICPA Position

AICPA believes that patents granted for tax planning methods:

- Limit the ability of taxpayers to utilize fully interpretations of tax law intended by Congress;
- May cause some taxpayers to pay more tax than Congress intended and may cause other taxpayers to pay more tax than others similarly situated;
- Complicate the provision of tax advice by professionals;
- Hinder compliance by taxpayers;
- Mislead taxpayers into believing that a patented strategy is valid under the tax law; and
- Preclude tax professionals from challenging the validity of tax strategy patents.

The AICPA believes that patents for tax planning methods undermine the integrity, fairness, and administration of the tax system and are contrary to sound public policy.

Recent Legislative Action and Prospects

This congress, the AICPA is well poised to see action on its legislative efforts to ban tax strategy patents. AICPA staff is currently working with champions in both the House (Congressmen Rick Boucher and Bob Goodlatte) and in the Senate (Senators Max

Baucus and Charles Grassley) to introduce freestanding legislation on this issue, in the near term. We are also strategizing on ways to ensure that our legislative language makes its way into any comprehensive patent reform legislation that might move this Congress.

Last year, incredible progress was made on the issue. In the House, Representatives Boucher and Goodlatte introduced freestanding legislation that garnered 38 additional co-sponsors. They were also successful in getting a tax strategy patent provision put into the larger patent reform bill, which ultimately passed the House, by a vote of 220-175.

In the Senate, the Senate Judiciary Committee approved its own patent reform legislation in July that did not include tax patents. That comprehensive reform measure did not receive full consideration by the full Senate. Senators Baucus and Grassley, however, did introduce their own freestanding bill, which ended the session with a total of 30 co-sponsors, including then-Senator Barack Obama.

This momentum was the result of targeted and aggressive lobbying on the part of the AICPA congressional affairs team and our allies. Two Key Person Alerts were sent on this issue. The first was to Key Persons for House Judiciary Committee Members; the second was for the Key Persons for all Senators. The AICPA also met with nearly all 100 Senate offices on this issue, and initiated a coordinated grassroots campaign with state societies in 6 targeted states to try to help with the co-sponsorship drive. Having passed the House once; with nearly a third of the Senate already previously signed onto the bill; and, the President a former Senate co-sponsor, the proposal's prospect are even brighter in the session ahead.

Once new legislation is introduced in the 111th Congress, the AICPA will begin a new co-sponsorship drive, and will work with the House and Senate champions to find a legislative vehicle to try to move the proposal. We will also be reaching out to the Obama Administration to enlist their support.

For more information on this issue, see http://tax.aicpa.org/Resources/Tax+Patents.

MOBILE WORKFORCE BILL

Background

- Businesses, including small businesses and family businesses that operate interstate, are subject to a significant regulatory burden with regard to compliance with nonresident state income tax withholding laws. These burdens translate into an administrative burden on these entities that takes resources from operating their business. Also, the cost must be passed on to the entity's customers and clients. Having a uniform national standard for state nonresident income tax withholding would significantly ameliorate these burdens. And concomitant with this is the need for a de minimis exemption from the multi-state assessment of state nonresident income tax.

- Accounting firms, including small firms, do a great deal of business across state lines. Many clients have facilities in nearby states that require an on-site inspection during the conduct of an audit. Additionally, consulting, tax or other non audit services that CPAs deliver may be provided to clients in other states, or to facilities of local clients that are located in other states. Many small business clients of CPAs also have multi-state activities. All of these small businesses, accounting firms and their clients are affected by nonresident income tax withholding laws.

- There are 41 states that impose a personal income tax on wages and partnership income, and there are many differing tax requirements regarding the withholding for income tax of nonresidents among those 41 states. A number of states have a de minimis threshold, or exemption for nonresidents working in the state before taxes must be withheld and paid. Others have a de minimis exemption based on the amount of the wages earned, either in dollars or as a percent of total income, while in the state. The rest of the states that impose personal income taxes on nonresident income earned in the state require only a work appearance in the state. Further complicating the issue is that a number of these states have reciprocity agreements with other, usually adjoining, states that specify that they will not require state income tax withholding for residents of the other states that have signed the reciprocity pact.

- It is not difficult to understand that the recordkeeping, especially if business travel to multiple states occurs, can be voluminous. And the recordkeeping and withholding a state requires can be for as little as one day's work in another state. Additionally, the amount of research that goes into determining what each state law requires is expensive and time consuming, especially for a small firm or small business that does not have a great amount of resources. A small firm or business will often be required to engage outside counsel to research the laws of the other states. And this research needs to be updated yearly to make sure that the state law has not changed.

- The economic changes that have occurred as our country has gone from local economies to a national economy are huge. Where businesses once tended to be local, they now have a national reach. This has caused the operations of even small businesses to move to an interstate basis. Because of the interstate operations of these companies, many providers of services to these companies, such as CPAs, find that they are also operating, to some extent, on an interstate basis. And with the ease of communication through the internet, and the ease of travel, the ability to provide some services far from home is not an issue, as it once was. What once were local taxation issues have now become national in scope, and burdens must be eased in order to promote this interstate commerce and insure it runs efficiently.

- Many smaller firms and businesses use third party payroll services instead of performing that function in house. A number of third party payroll service providers are unable to handle multi-state reporting. They often limit, for example, reporting to two states, the state of residence and the state of employment. Additionally, third party payroll service providers generally report on a pay period basis (e.g., twice per month, bi-weekly, etc.) as opposed to daily, which can be a necessity when interstate work is performed. These reporting issues require employers to track and manually adjust the reporting and withholding to comply with various state requirements. The alternative is to pay for a much more expensive payroll service.

- A reasonable de minimus period would ensure that the interstate work for which an exemption from withholding is granted does not become a means of avoiding being taxed or shifting income tax liability to a state with a lower rate. Instead, it insures that the primary place(s) of business for an employee are where that employee pays state income taxes.

- Introduced in the last Congress, H.R. 3359, the Mobile Workforce State Income Tax Fairness and Simplification Act of 2007, would have created a uniform national standard and limited state or local taxation of the compensation of any employee who performs duties in more than one state or locality to: (1) the state or locality of the employee's residence; and (2) the state or locality in which the employee is physically present performing duties for more than 60 days.

- Bill sponsor Rep. Hank Johnson (D-GA) held a hearing in the House Judiciary Commercial and Administrative Law Subcommittee on November 1, 2007 on the bill. The AICPA submitted written testimony for the record of the hearing. As a result of the hearing, the State tax administrators on the one hand, and the coalition of businesses on the other began to negotiate the terms of an agreement. Their negotiations were successful, and an acceptable compromise has been reached. Essentially, the period an employee must work in a host state before having to pay withholding was reduced from 60 days to 30 days.

- Congressman Johnson has secured 4 co sponsors for the legislation and is expected to introduce a bill into this Congress imminently.

AICPA Position

- Having a uniform national standard would eliminate the burden of having to research.
- In addition to uniformity, there needs to be a de minimis exemption.
- Congressman Johnson has reached a balance of the interest of states in taxing work being done within their borders and the needs of business, and especially small business, to be able to operate efficiently, especially in this trying economic climate.

AICPA Legislative Recommendation

- Congressman Johnson's bill on compliance with nonresident state income tax withholding laws, which is expected to incorporate a 30 day de minimus exemption, and nationwide uniformity, should be supported.