

# Standing Up to SOX

## Building a Stronger Board of Directors

By Thomas A. Basilo, CPA, Shareholder; CEO and Chairman, WithumSmith+Brown Global Assurance



In the post-Enron, Sarbanes-Oxley (SOX) era, the role of the board of directors has moved from “friendly” advisors to corporate overseers. In public companies, directors and officers are being held more accountable for their companies’ actions. And the ripple effect of SOX is being felt by private firms and not-for-profits. Customers, lenders, investors, suppliers and potential purchasers are putting increasing pressure on private entities to adopt SOX-like policies and procedures, which often start with creating the proper tone at the top.

# WithumSmith+Brown The Journal



Here are some recommendations on ensuring that your board is doing an effective job of guiding the future of your organization, while keeping a vigilant eye on its corporate behavior.

**Consider appointing outside directors.** Many privately-held companies have an internal board consisting of owners, family members and company officers—but no independent outside board members. Although public companies are now required under SOX to have independent directors, private companies have been slow to adopt this policy. The major reason is the cost involved. Outside board members command (and deserve) some compensation, including a cash stipend and stock options. In addition, the cost of directors and officers liability insurance policies (“D&O”) has increased significantly, and outside directors demand strong coverage, including “Side A” coverage that fully protects them. (For further information on D&O insurance, please see the whitepaper, *Protections of D&O Insurance*, at [www.wsbga.com/knowledge.htm](http://www.wsbga.com/knowledge.htm)).

**Choose outside directors with appropriate business and industry skills.** Independent board members should be competent, possess specialized skills and understand the issues the company is facing. Anyone who has even a remote connection with the company and its owners should be excluded. There is no hard and fast formula, but successful outside directors generally have good business sense, a collegial attitude, high energy and the time to do the job at hand.

*(continued, overleaf)*

- WS+B Global Assurance, a firm affiliate, provides SOX compliance services to corporations.

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# SOX Compliance

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**Finding good outside board members**, however, is challenging. Big-name board members may carry some cachet—but overcommitted individuals are not a wise choice. *The Record*, a Bergen County newspaper, published an article in June 2006 about former New Jersey Governor Thomas Kean and how he sat on six boards, while working full-time as president of Drew University. His annual fees exceeded \$400,000, plus stock options. Guidelines established by The National Association of Corporate Directors recommend no more than four boards for a working professional. Be sure the outside directors you appoint can devote the time needed to fulfill their fiduciary duties to your company.

**A board should reflect a company's future.** Look for outside directors with the knowledge and experience to take the company in the direction you want to go. A non-competitor in a closely related industry often can be a very valuable person to have on the board.

**The board should focus more on policy and direction** than on daily operations. Strong consideration should be given to having subcommittees, such as audit and compensation committees (such committees are required for listing on certain stock exchanges). If you have subcommittees, the board members assigned should have the appropriate knowledge and experience to carry out their responsibilities. For example, an independent audit committee member should have financial expertise and a good understanding of financial statements. The same is true for compensation committees, as far as expertise. Executive compensation is today's highest profile issue, and having competent, experienced and independent board members deciding on compensation relays an excellent message to shareholders and other parties of interest on the tone at the top.

**Keep the board informed and be transparent.** To be effective, your board must be kept up-to-date about what's going on at your company. The board should meet no less than quarterly. Many boards meet on a monthly basis. Many private company boards are becoming much more formal. Their inquiries often center on "What is our policy?" The SOX governance process is bringing many issues to light—and making companies and shareholders much more aware of what's going on in companies than ever before.

**Being transparent means having everything laid out for all eyes to see.**

Corporate boards should document their fiduciary duties, know about best practices in corporate governance and exhibit due care in the discharge of their duties. Minutes reflecting discussions of all meetings should be carefully kept.

*For more information on issues related to SOX compliance, please contact WithumSmith + Brown Global Assurance at 609.734.9090.*

## For Potential Board Members

If you're invited to serve on the board of a corporation, you'll want to limit your personal liability for corporate malfeasance. Before accepting board membership, ask the following of management:

1. What is the company's financial position?
2. How have you determined that no material weaknesses in internal controls exist?
3. Do company bylaws provide for reimbursement to directors and officers for personal liability costs?
4. Do you have a directors & officers (D&O) liability policy?
5. What are the policy limits and deductibles?
6. Does the coverage exclude wrongful acts; under what circumstances?
7. Is there a severability clause?
8. Who signed the D&O policy?
9. Does the company have Side A coverage?
10. Does the company have a stand-alone policy for employment compliance?



**Practical  
Accountant**

**WS+B Receives 2006  
Practice Innovation Award**

*Practical Accountant*, a national business and accounting magazine, has named WithumSmith+Brown a 2006 Practice Innovation Award recipient. The award, now in its seventh year, recognizes accounting firms that take the lead in developing new or improved services and promoting efficiency in the public accounting industry.

The firm received this honor for two innovations: a client portal offering WS+B clients secure, 24-hour access to financial information and the formation of a new firm affiliate, WithumSmith+Brown Global Assurance, offering SOX compliance services to business clients.

## Business Agreements

# A Hasty Agreement Can Lead to Litigation

By Randall M. Paulikens, CPA/ABV, DABFA, Shareholder



*Randy is a shareholder in the firm's Red Bank office.*

Commercial litigation, in its many forms, is the essence of a disagreement. Two or more parties have differing opinions on the same issue and cannot reach a resolution on their own. Because a disagreement contains many intricacies, settling the issue is never simple.

A key way of avoiding an extensive litigation process is to have a clearly-drafted agreement prepared when the relationship between the individuals begins. The agreement must be thorough and cover every aspect of the situation, because vague documents can have varied interpretations.

**The process of negotiation** can take many months, and there is a natural inclination of the parties to want to get the deal done quickly. Due to this hasty conclusion, it is possible for one party to believe that a particular section means one thing, while the other side believes that the same section means something completely different. In fact, it is possible that a dozen different people will have a dozen different interpretations. But because everyone is in a hurry to get the deal done, some aspects are left undefined. A huge mistake is made when everyone agrees verbally that if there are problems in the future, "we will work it out."

**If everything goes well**, then usually there is no reason to go back to the documents. Everyone is happy. If, however, everything goes really bad, there still may not be much need to go back to the documents because the results, or lack thereof, may not change the reality each party now faces.

**Surprisingly, it is when things go somewhere in the middle** (not great, but also not really bad) that the table is set for disagreement because one party may blame the other and seek a better benefit of the bargain. This results in costly litigation and the hiring of additional attorneys and experts, while consuming the resources of all parties involved. Suddenly, those sections that "we will work out" are now the focus of litigation.

**Early review of agreements by a skilled professional** and feedback during the drafting stage are essential to avoid such issues. By virtue of an expert's experience, he or she can suggest solutions for potential issues that may arise in the future and ensure they are unambiguous. Now is the best time to have an expert review your agreement. Tomorrow, after the ink is dry, may be too late.

*If you would like to discuss a matter related to an agreement, please contact your WS+B litigation advisor.*





# As the Gap Grows

## The Differences Between Tax and GAAP

By Nina M. LoConte, CPA, Semi-Senior Accountant

In today's business environment, the differences between tax and financial statement accounting are continually growing. Virtually every public company is forced to keep two sets of books: one for tax purposes and the other for shareholders and creditors.

**The reason this schism exists** is that the rules governing tax and financial statement accounting are based on two completely different sets of objectives. Tax rules are created by legislatures to either generate governmental revenue or to promote economic goals. For instance, the threshold for a dollar-for-dollar deduction of new machinery and equipment purchased nearly quadrupled in 2003 in order to encourage small businesses to expand.

**Generally Accepted Accounting Principles (GAAP)**, in comparison, are standards created by governmental regulators and accounting industry overseers, with the goal of regulating the transparency of financial statements by promoting full disclosure, consistency and some degree of uniformity. In the wake of the recent accounting scandals, even more standards have been published that differ from tax regulations. Accordingly, current rules require companies that share common ownership to consolidate when a financial statement is issued.

### GAAP vs. Tax Reporting

#### A Case Study

A company bought a \$100,000 asset in early 2000.

	Financial Reporting	Tax Reporting
Asset Life	3 Years	3 Years
Depreciation Rate	Straight Line	MACRS: 33.3%, 44.45% 14.81%, 7.41%

#### Schedule of Depreciation

Year	Financial Reporting Depreciation	Tax Reporting Depreciation	Accumulated Difference End of Year
2000	33,333	33,333	0
2001	33,333	44,450	11,117
2002	33,334	14,810	(18,524)
2003	—	<u>7,407</u>	<u>7,407</u>
	100,000	100,000	0

#### Some of the most common GAAP and tax differences include:

expenses, such as depreciation expense, where the tax and GAAP calculation of the annual deduction differ; expenditures, which are not tax deductible altogether, such as federal income tax payments; half of meals and entertainment costs; and officers' life insurance premiums. In addition, GAAP and tax rules also differ for inventory valuations, the reporting of installment transactions, pension expenses and deferred employee compensation.

**Identifying and understanding these differences** can create many business planning opportunities by minimizing income taxes and maximizing the financial statement position. Management, often trapped between the two goals, has resorted to using even a third set of numbers, a hybrid between tax and financial statement accounting, to provide meaningful internal information for their organizations. As the gap grows, it is increasingly important to understand and track these differences in order to continue to make wise business decisions for both financial statement and tax purposes.

*To learn more about the differences between tax and GAAP, please contact your local WS+B advisor.*



# Fraud Prevention

## Ways to Identify and Prevent Fraud

By Joseph J. Perez, CPA, Senior Manager



Joe is a senior manager in the firm's New Brunswick office.

Business owners and managers of nonprofit organizations should be aware of the types of activities that are used to defraud companies. Check tampering, skimming and billing schemes are the most common employee frauds that occur.

**Check tampering is most likely to occur** when a trusted individual has access to the company checkbook and is also responsible for recording disbursements and reconciling the bank account. This lack of segregation of duties gives the employee an opportunity to steal and cover it up by modifying a payee in the ledger and discarding the cancelled check. You can help prevent the fraud by having bank statements mailed directly to a member

of management, who can review cancelled checks before reconciliations are prepared.

**Skimming happens most often** in a business that has significant cash sales. The ability of a trusted employee to handle cash creates an opportunity for that employee to record only part or none of the sale and keep the cash. In order to give a customer change, the employee may have to open the register, which should cause a no sale on the register or require the employee to process a void sale. Warning signs include excessive inventory shrinkage, excessive register voids and/or register discrepancies. You can help deter the fraud by implementing surveillance equipment, using spotters/secret shoppers and monitoring register activity at the end of every shift.

**Billing schemes are most common** when an employee can create vendors without review and approval, and that employee is also responsible for coding and approving vendor invoices. This combination of duties creates the opportunity for an employee to commit a fraud by adding a vendor who provides vaguely defined services, such as consulting, and approving the invoice for an amount that is below the organization's policy for higher level of authorization. You can help avoid such a fraud by periodically reviewing approved vendor lists, scrutinizing vendors with initials as their names and randomly scrutinizing payments that are below the company policy for such detail review.

**A little common sense goes a long way to deter fraud.** It is important to identify changes in employees' behavior or attitudes that might make them willing to commit a fraud. Take notice of your employees' lifestyle changes, such as driving better automobiles, wearing expensive jewelry and appearing to live beyond their means. Also, try and get to know your employees' feelings about the organization. A disgruntled employee is more likely to rationalize aberrant behavior than a happy one. The strongest deterrent to fraud is demonstrating that inappropriate behavior will be caught and dealt with appropriately.

*To learn more more about preventing fraud, please contact your local WS+B advisor.*

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## Jim Bourke, WS+B Shareholder, Installed as President of NJSCPA

In early May, James C. Bourke, CPA.CITP, was installed as the 85th president of the New Jersey Society of Certified Public Accountants (NJSCPA). Jim has served in many leadership positions in the organization since joining in 1989. Founded in 1898, the NJSCPA is one of the largest and oldest CPA societies in the nation and is comprised of more than 14,500 CPAs. WS+B wishes Jim much success in continuing the NJSCPA tradition of excellence.



## Sheryl Martin Joins WS+B as Executive Director of Firm Operations

WS+B welcomes Sheryl Martin, CPA, to the firm as executive director of firm operations. Sheryl began her career at Coopers & Lybrand (now PricewaterhouseCoopers), where she was eventually promoted to senior audit manager. Since 1994, she has worked at the American Institute of Certified Public Accountants (AICPA); for the past five years, she was the AICPA's director of firm practice management. WS+B is very pleased to have Sheryl join its management team.