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## How to Write a Quality MD&A

For the past two years, the SEC's Division of Corporate Finance has told companies that their Management's Discussion and Analysis (MD&A) disclosures were inadequate. In August 2005, the SEC filed a civil fraud suit against the former CEO and CFO of Kmart Corp, alleging that the MD&A in a 2001 quarterly report provided a less than clear and candid disclosure.

The MD&A provides an analysis of a company's business, results of operations and financial condition from the perspective of company management. Its objectives are clear, but often the reports are vague, says SEC staff.

According to an article in the January 2006 *Journal of Accountancy*, public companies are often shy about disclosing information they perceive may give competitors a leg up, even though much of this information is often already known in the industry. The article asserts that this occurs most often when the company is not doing well and resists revealing declining numbers. The SEC lawsuit against Kmart suggests this was the case with the company's quarterly report.

The suit also illuminates that "less-than-forthcoming" disclosures can subject a company to SEC litigation.

### How to Prevent Litigation Trouble

A higher quality MD&A is a more complete and accurate disclosure, which should reduce liability exposure under federal securities laws. The SEC has provided detailed guidance (issued in a December 2003 release) on submitting a quality MD&A disclosure. The SEC release

encourages companies to resist the temptation to use an old MD&A as a template, with new numbers plugged into an otherwise unaltered narrative. This shortcut often leads to inaccurate reports.

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**MD&A disclosures should not be merely a recitation of financial statements in narrative form or an otherwise uninformative series of technical responses to MD&A requirements.**

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The SEC's guidance emphasizes that MD&A disclosures should not be merely a recitation of financial statements in narrative form or an otherwise uninformative series of technical responses to MD&A requirements, neither of which provides the important management perspective called for by MD&A. Instead, the SEC encourages top-level management to be involved in the drafting of MD&A, and the 2003 release provides guidance regarding:

- The overall presentation and focus of MD&A (including thorough executive-level overviews, a focus on the most important information and a reduction of duplicate information);
- Emphasis on analysis of financial information;
- Known material trends and uncertainties;
- Key performance indicators, including non-financial indicators;

# What's Next for Sarbanes-Oxley?

The Securities and Exchange Commission has announced a series of actions it intends to take to improve the implementation of the Section 404 internal control requirements of the Sarbanes-Oxley Act of 2002. These actions are based on extensive analysis and commentary in recent months from investors, companies, auditors and others. The planned actions are:

- **Guidance for Companies** – The SEC has mapped out steps to prepare for the issuance of management guidance, to assist companies in completing its assessment of internal control over financial reporting.
- **Revisions to AS No. 2** – The PCAOB will propose revisions to its Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements. The revisions, subject to SEC approval, would 1) seek to ensure that auditors focus during integrated audits on areas that pose higher risk of fraud or material error; 2) incorporate key concepts contained in the guidance issued by the PCAOB on May 16, 2005; and 3) revisit

and clarify what, if any, role the auditor should play in evaluating the company's process of assessing internal control effectiveness.

- **SEC Oversight of PCAOB Inspection Program** – The SEC will examine whether PCAOB inspections of audit firms have been effective in encouraging implementation of the principles outlined in PCAOB's May 1, 2006 statement, which included guidelines for achieving cost-saving efficiencies, among other concepts.
- **Extension of Compliance for Non-Accelerated Filers** – The SEC expects to issue a short postponement of the effective date of the SEC's rules implementing Section 404 for non-accelerated filers. It is anticipated that any such postponement would nonetheless require all filers to comply with the management assessment required by Section 404(a) of Sarbanes-Oxley for fiscal years beginning on or after December 16, 2006.

To learn more about these planned actions, please visit: [www.sec.gov/news/press/2006/2006-75.htm](http://www.sec.gov/news/press/2006/2006-75.htm).

## GETTING TO KNOW...



### Sheldon Zimmerman

As a former chief financial officer for a national specialty retailer, Sheldon D. Zimmerman, CPA, brings a "real world" perspective to his work as an accountant.

"My clients' comfort level rises when they see that I know firsthand what bankers are looking for and what it's like to negotiate and integrate an acquisition," says Sheldon.

As an audit principal at Tauber & Balsler, P.C., Sheldon has more than 30 years of professional experience, including working with bankruptcy matters, corporate restructurings, lender negotiations and cash flow projections. Additionally, he has significant experience with negotiations and integration issues surrounding corporate acquisitions and dispositions.

Sheldon, who was formerly a partner in a national CPA firm,

places a high degree of emphasis on client service. "I'll give them my home number, my mobile number, whatever it takes to stay in close contact," he says, speaking to his approach of being accessible and responsive.

Sheldon earned his Bachelor of Business Administration from the University of South Florida. He is a member of the Georgia Society of CPAs, the AICPA, the Turnaround Management Association, the Association of Insolvency and Restructuring Advisors, and National Association of Corporate Directors.

He has three children, loves to play golf and recently coached his 7-year-old daughter's softball team to a league championship.

Contact: 404.814.4958 or [szimmerman@tbcpa.com](mailto:szimmerman@tbcpa.com).

# IRS Updates Voluntary Correction Program for Retirement Plans

The Internal Revenue Service has revised the revenue procedure governing its popular voluntary correction program for employee retirement plans – the Employee Plans Compliance Resolution System (EPCRS). The EPCRS can be used to correct certain errors in retirement plans, so that tax benefits are not lost amid ever-changing and increasingly complex tax laws.

In revising Revenue Procedure 2006-27, the IRS incorporated comments from the retirement plans community by adding flexibility and increasing correction methods. Two challenging issues, in particular, were addressed in the update: 1) excluded employees, particularly in 401(k) plans, and 2) bad loans.

“In this revenue procedure, we have added what we believe are workable solutions. We believe these improvements will advance our goal of increased plan participation,” said Carol Gold, director of IRS’s Employee Plans Division.

EPCRS includes three programs:

1. **The Self-Correction Program (SCP)** permits a plan sponsor to correct “insignificant operational failures” in certain simple plans, such as 403(b) plans, SEPs or SIMPLE IRA plans. These corrections can be made without having to notify the IRS and without paying any fee or sanction.
2. **The Voluntary Correction Program (VCP)** allows a plan sponsor, at any time

before an audit, to pay a limited fee and receive the IRS’s approval for a correction of a qualified plan, a 403(b) plan, SEP or SIMPLE IRA plan.

3. **The Correction on Audit Program (Audit CAP)** allows a sponsor to correct a failure or an error that has been identified on audit and pay a sanction based on the nature, extent and severity of the failure being corrected.

The IRS noted that plan sponsors who fail to take advantage EPCRS will not receive the favorable tax treatment available in EPCRS programs if the problems are discovered upon examination.

The revised revenue procedure also makes it clear that EPCRS remains unavailable in cases where either the plan or the plan sponsor has been a party to an abusive tax avoidance transaction and the plan failure is directly or indirectly related to the abusive tax avoidance transaction.

“EPCRS is a valuable program for plan sponsors who need to make corrections that result from inadvertent errors,” said Gold. “It is definitely not available to those who deliberately engage in abusive tax transactions that jeopardize the integrity of the plan and take advantage of the participants.”

To learn more about EPCRS and its governing Revenue Procedures 2006-27, please visit: [www.irs.gov](http://www.irs.gov).

## TAX TIP

**Section 382 Limitation.** An integral element regarding the acquisition of a corporation is the survival and subsequent use of net operating loss (NOL) carryovers. Code Section 382 imposes restrictions on the use of a corporation’s net operating losses and other carryovers after an ownership change occurs. An ownership change is a greater than 50 percentage point increase by 5 percent shareholders. If an ownership change does take place, Section 382 places an annual limit on the amount of taxable income that may be offset by the loss corporation’s net operating loss carryovers.

**MD&A** continued from page 1

- Liquidity and capital resources; and
- Critical accounting estimates.

The SEC guideline emphasizes preparing MD&A with a strong focus on the most important information, provided in a manner intended to address the objectives of MD&A. In particular, consider: using a tabular presentation of relevant financial or other information;

adding headings to improve the flow of information; including an introductory section or overview; and using a layered approach.

For a copy of the guideline, visit [www.sec.gov](http://www.sec.gov) and search for press release number 2003-179. To learn how Tauber & Balsler, P.C., can help you avoid SEC litigation by drafting a high-quality MD&A, contact Marc Welch at 404.814.4990 or [mwelch@tbcpa.com](mailto:mwelch@tbcpa.com).

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To subscribe:  
 404.261.7200 or  
 online at [www.tbcpa.com](http://www.tbcpa.com)

**PUBLIC COMPANY  
 TEAM LEADERS:**

Warren S. Binderman, CPA  
[wbinderman@tbcpa.com](mailto:wbinderman@tbcpa.com)

J. Marc Welch, CPA  
[mwelch@tbcpa.com](mailto:mwelch@tbcpa.com)

Sheldon D. Zimmerman, CPA  
[szimmerman@tbcpa.com](mailto:szimmerman@tbcpa.com)

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## The Push Toward Interactive Data

Four months after offering significant incentives for companies to furnish their financial information in a computer-readable interactive data format, the Securities and Exchange Commission has announced that the list of participating firms has grown to 20. Participants include blue-chip companies such as 3M Company, Bristol-Meyers Squibb, Dow Chemical Company, General Electric, Microsoft, PepsiCo, Xerox Corporation and XM Satellite Radio Holdings.

These early-adopter companies will receive expedited reviews of their SEC registration statements and annual reports. For their part, the companies will furnish the financial data in their periodic reports to the SEC using the XBRL data-tagging format informally known as "interactive data" and will provide feedback to the SEC on their experience with the new technology.

Interactive data permits individual investors and analysts to quickly search for individual

items of information from financial reports, such as net income, executive compensation or mutual fund expenses. It also enables them to download selected information directly into financial software. In the near future, it is hoped that popular Internet applications will permit automatic, real-time delivery of SEC financial data direct to anyone's desktop.

"Interactive data has the potential to slash hours of waste, cost and inefficiency," said SEC Chairman Christopher Cox. "Not just for the users of financial data, but for the companies that prepare it as well."

The SEC held the first in a series of interactive data roundtable discussions in Washington, DC, on June 12, 2006. Topics included discussions of what information is most helpful to investors, how to accelerate the use of new software that disseminates interactive financial data, and how to best design the SEC's disclosure requirements to take maximum advantage of the potential of interactive data.

**TAUBER & BALSER** P.C.  
 Accountants and Consultants

1155 Perimeter Center West, Suite 600  
 Atlanta, Georgia 30338-5416

Address service requested

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