

PUBLIC COMPANY

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Smaller Companies May Get a Break on SOX 404

Smaller businesses may get some relief from complying with Sarbanes-Oxley Section 404. The Securities and Exchange Commission's Advisory Committee on Smaller Public Companies has recommended that smaller companies be excused from assessing their internal controls over financial reporting and from having their auditors certify those controls.

Chartered on March 23, 2005, the Advisory Committee's objective is to assess the current regulatory system for smaller companies under the securities laws of the United States, and make recommendations for changes.

The Committee's preliminary report, published March 3, 2006, in the *Federal Register*, includes a series of non-binding recommendations, the first of which concerns the establishment of a new system of scaled or proportional securities regulations for smaller public companies based on separating smaller public companies into two groups: microcap and smallcap companies. Microcap companies would include businesses whose common stock (or equivalent) comprises the lowest 1% of total U.S. equity market capitalization, and smallcap companies

would include those whose common stock (or equivalent) comprises the next lowest 5% of total U.S. equity market capitalization.

Therefore, smaller public companies – consisting of both microcap and smallcap companies – would amount to the lowest 6% of total U.S. equity market capitalization. While they account for only a small percentage of total U.S. equity market capitalization, these companies represent nearly eighty percent of all U.S. public companies, as shown in Table 1.

Have the Recommendations Gone Too Far?

Supporters of these recommendations have argued that Section 404 compliance is very expensive and places a burden on small companies. However, dissenting opinions emphasize that, while it is a good idea to find a way to help small companies, it is a bad idea to release small companies from compliance.

Former SEC chairman Arthur Levit recently commented on the Advisory Committee's

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Table 1	Market Capitalization Cutoff (million)	Percentage of Total U.S. Equity Market Capitalization	Percentage of all U.S. Public Companies
Microcap Companies	\$128	1	52.6
Smallcap Companies	\$128-\$787	5	25.9
Smaller Public Companies*	< \$787	6	78.5
Larger Public Companies	> \$787	94	21.5

*Includes both microcap and smallcap companies

Overcome Tax-Related Material Weaknesses

A study by Audit Analytics reports that nearly one-third of the public filers that have received adverse opinions on internal controls had tax accounting listed as a contributing factor.

Reasons cited for this include: short supply of tax professionals; Sarbanes-Oxley has imposed a higher demand for precision on tax-accounting procedures; and many companies had not previously documented internal control procedures for tax because tax departments have generally operated independently from audit departments.

A significant number of the adverse opinions issued to date can be attributed to greater scrutiny of the tax function stemming from the application of FAS 109, which governs the accounting for income taxes.

Often, firms that report material weaknesses in tax accounting lose stock value after the announcement.

Material weaknesses are defined as a significant deficiency, or combination of signifi-

cant deficiencies, that results in more than a remote likelihood that a material misstatement of the financials will not be prevented or detected.

Six strategies to overcome tax-related material weaknesses include:

1. Assign a tax representative to the company's financial disclosure committee.
2. Perform and document a formal review of standard tax calculation templates.
3. Prepare and retain documentation on tax positions and assumptions in a format that may be viewed by third parties.
4. Develop tax-focused technical training.
5. Include tax risk management as an annual agenda topic for the Audit Committee.
6. Establish stronger lines of communication between internal and external staff.

To learn how Tauber & Balser, P.C., can help you strengthen your tax-related internal control process, contact Barbara D. Catherall, CPA, at bcatherall@tbcpa.com.

GETTING TO KNOW...



Marc Welch

J. Marc Welch, CPA, has turned his lifelong enthusiasm for working with numbers into a solid career in accounting spanning more than 20 years to date, with a concentration in assurance and attestation services.

As an audit principal at Tauber & Balser, P.C., Marc consults with public companies on the application of Generally Accepted Accounting Principles and other reporting requirements of the Securities and Exchange Commission, and has experience in many industries, including technology, publishing, manufacturing and wholesale distribution industries.

"When you are working with a public company, you know you are working at the highest level and with more complex accounting issues and reporting requirements," says Marc.

During his tenure in the profession, Marc has seen dynamic

changes in accounting standards and compliance requirements for public companies. "It's definitely more expensive to be a public company now," he says.

Marc's personal philosophy centers on being responsive to clients, being knowledgeable and giving first-rate advice regarding proper reporting. "It's always best to do what it takes to get it right the first time," says Marc. "If you have to come back and make corrections after the fact, you have trouble."

Marc earned his Bachelor of Business Administration at the University of Georgia. He is a member of the Georgia Society of CPAs, the AICPA, and National Association of Corporate Directors. Marc enjoys playing golf and is an avid Georgia Bulldogs football fan.

Contact Marc: 404.814.4990 or mwelch@tbcpa.com

SEC's Voluntary Filing Program Promotes Use of Interactive Data

Companies participating in a voluntary program to test the use of interactive data will receive expedited reviews of registration statements and annual reports, according to a January 2006 announcement by the Securities and Exchange Commission.

Interactive data holds the promise of transforming the static, text-only documents that companies file with the SEC into dynamic financial reports that can be quickly and easily accessed and analyzed.

"The best way for filers to understand how interactive data works is to participate in the voluntary program," said SEC Chairman Christopher Cox. "The filers will have an opportunity to share with the SEC their individual experiences with preparing, making and analyzing their interactive filings. They will also better understand how interactive data can help streamline their financial reporting process."

The Language of XBRL

The Voluntary Filing program is part of the SEC's process for assessing eXtensible Business Reporting Language (XBRL). XBRL is designed to help companies, markets and investors benefit from improving the timeliness and accuracy of corporate reporting and simplifying analysis of SEC filings.

XBRL works as a tagging system for information, so data within an XBRL document is searchable and can be easily extracted. This

means that analysts and investors won't have to dig through reams of financial reports to collate large quantities of information.

The benefit to filing companies is the transparency provided by XBRL documents. XBRL is expected to play a role in increasing transparency in business information – business reporting requirements have become more complex and have increased the costs of processing and analyzing report information, which has led many analysts to reduce the number of companies they follow. That means less information is available for investors.

With regulatory agencies expressing more interest in XBRL for business filings, demand for XBRL functionality in financial software packages is increasing.

The SEC has not promoted the idea of a regulatory mandate for companies to adopt XBRL, but is using incentives that reward early adopters who join the voluntary filing program, in an effort to broaden the user base.

Once the XBRL standard is accepted, management, investors, regulatory agencies and others are expected to reap significant benefits, whether sharing information within a single organization or trading documents across company lines.

For more information about the XBRL Voluntary Filing Program, visit: www.sec.gov/info/edgar/xbrlfaq032105.htm.

TAX TIP

Deduction for Domestic Production Activities Income. On October 22, 2004, President Bush signed into law the American Jobs Creation Act, which includes a tax deduction relating to income from certain domestic production activities, effective for taxable years beginning after December 31, 2004 (IRC Section 199). For taxable years beginning in 2005 and 2006, the deduction equals 3% of the lesser of

- (a) qualified production activities income or
- (b) taxable income for the taxable year.

The deduction is limited to 50% of W-2 wages paid by the taxpayer during the year.

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recommendation in an editorial opinion piece in the *Wall Street Journal*. Levit said, "The debate until now has centered on who should be exempted, not on how to ensure that companies have the internal controls needed to prepare reliable financial statements. This focus is unproductive since it is clear from a reading of SOX that Congress wanted all public companies to assess internal controls and have an outside auditor test them. Instead of defying Congress

and provoking costly litigation, we need to work within the law to find ways to make compliance easier and less expensive for small businesses."

The Advisory Committee's final recommendations are due to be released in late April. Read the full report in the *Federal Register*, Vol. 71, No. 42 (March 3, 2006): www.gpoaccess.gov/fr. Comments are due by April 3, 2006.

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SEC Proposing Overhaul of Pay Disclosure Rules

The Securities and Exchange Commission published proposed rules in February 2006 that would amend disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters, and security ownership of officers and directors. The proposed rules affect disclosure in proxy statements, annual reports and registration statements. The proposal includes a requirement that disclosure under the amended items generally be provided in "plain English."

The proposed amendments are intended to make proxy statements, reports and registration statements easier to understand. They are also intended to provide investors with a clearer and more complete picture of the compensation earned by a company's chief executive officer, chief financial officer and highest paid executive officers and members of its board of directors. In

addition, the proposed rules are intended to provide better information about key financial relationships among companies and their executive officers, directors, significant shareholders and their respective immediate family members.

The new rules would organize executive compensation disclosure into three broad categories:

- Compensation over the last three years;
- Holdings of outstanding equity-related interests received as compensation that are the source of future gains; and
- Retirement plans and other post-employment payments and benefits.

The full text is published in the *Federal Register*, Vol. 71, No. 26 (Feb. 8, 2006): www.gpoaccess.gov/fr. Comments are due by April 10, 2006.

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