

# PUBLIC COMPANY

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## New Guidance Expected to Lower 404 Compliance Costs

The Public Company Accounting Oversight Board recently published guidance to auditors on how to implement its Standard No. 2, "An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements."

The guidance comes in response to concerns raised at an April 2005 roundtable hosted by the Securities and Exchange Commission and attended by the PCAOB. During the roundtable, the PCAOB heard directly from issuers, auditors and investors on the front lines of implementing Section 404 of the Sarbanes-Oxley Act of 2002.

Roundtable participants generally supported the objectives of Section 404. However, many expressed concerns about high compliance costs.

"The guidance makes a lot of sense," says J. Marc Welch, CPA, a principal of Tauber & Balsler, P.C.'s audit department. "When 404 was first released, we were fresh from Enron and Anderson, and Sarbanes-Oxley was new. We were hearing about prison terms and dollars fined, and everyone went way the opposite way. This new guidance brings everything back to center."

### Guidance Discourages "One-Size-Fits-All" Audit Plans

The guidance consists of a Board Policy Statement and a series of staff questions and answers, providing technical guidance to auditors on how to use the provisions and underlying principles of Auditing Standard No. 2 to conduct effective and cost-efficient audits of public companies' internal control over financial reporting.

The PCAOB Policy Statement points out that some auditors have failed to use tailored audit plans and instead used "one-size-fits-all" audit plans driven by standardized checklists that may have little to do with the unique issues and risks of the particular client's financial reporting processes. This is a disappointing development indicative of poor training and audit planning," the Policy Statement says.

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According to the Policy Statement, to properly plan and perform an effective audit under Auditing Standard No. 2, auditors should:

- Integrate audits of internal control with financial statement audits, so that evidence gathered and tests conducted in the context of either audit contribute to completion of both audits;
- Exercise judgment to tailor audit plans to the risks facing individual audit clients, instead of using standardized "checklists" that may not reflect an allocation of audit work weighted toward high-risk areas (and weighted against unnecessary audit focus in low-risk areas);

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# Tips on Conducting an Audit Committee Self-Evaluation

Your audit committee is one of the key components of corporate governance for your organization. An annual self-evaluation will ensure that your audit committee is maximizing its effectiveness in helping the board of directors uphold integrity and accuracy of financial reporting, internal controls and the external audit process.

Consider the following tips as you design your self-evaluation process:

1. **Select a point person.** Identify one person who will coordinate the evaluation process. This might be the chair, a member of the committee, or it could be an outside party, as long as the coordinator remains fair, impartial and is skilled at orchestrating a multitude of players and information.
2. **Set a timeline.** Create a schedule for the evaluation process, which can be built into your corporate calendar of events and adhered to on an annual basis.
3. **Look closely at the members.** Evaluate all of the members of your committee, using 360-degree or similar evaluation tools.
4. **Question impact.** Ask questions about the committee's impact on the organization's financial reporting system and annual audit. Assess the committee's relationships with management and auditors.
5. **Use tools.** There are a number of self-evaluation questionnaires available, including one from the AICPA website, which you can download for \$10: [www.aicpa.org/audcommctr/toolkitscorp/homepage.htm](http://www.aicpa.org/audcommctr/toolkitscorp/homepage.htm).

Through this process, each member is evaluated by all other members of the committee, the chair, and others who interact with the audit committee. Factor in each members' attendance as well as the level of participation. If the members of the committee feel that the chair is not performing well, they should voice their concerns to the board chair, or to the corporate governance committee.

Your commitment to an annual self-evaluation will enhance the effectiveness of your audit committee, and will give members an evolving process for continuous improvement.

## SEMINAR

### REDUCING THE PERSONAL RISK OF RUNNING A PUBLIC COMPANY

Attend this information-packed seminar and learn about...

- The personal risk of joining a board of directors
- The personal liability of ERISA legislation
- D&O and related insurance issues
- Questions board members and audit committees should be asking the company's management and its auditors

Wednesday, September 28, 2005

3:30 - 5:30 pm Program

5:30 - 6:30 pm Reception

Villa Christina – 4000 Summit Boulevard, Atlanta

This seminar is brought to you by  
The Public Company Team of Tauber & Balsler, P.C.

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More information available at [www.tbcpa.com](http://www.tbcpa.com)

# FASB 123(R) Requires Recording Stock Option Expenses in 2005

Beginning this year, the Financial Accounting Standards Board (FASB) requires that public companies filing as small business issuers recognize the cost of share-based payments in company financial statements.

FASB Statement 123(R) was made final in December 2004, to be effective as of the first interim or annual reporting period that begins after June 15, 2005, or December 15, 2005 for small business issuers. The Securities and Exchange Commission has since amended the compliance dates, requiring companies to implement Statement No. 123(R) at the beginning of their next fiscal year after the dates specified above.

The Statement covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans.

Prior to Statement No. 123(R), the focus of FASB's rules were largely on the difference between those subject to fixed and variable accounting. The most significant change Statement No. 123(R) offers is that issuers now must attribute a value to these awards and recognize that expense over the vesting period.

In valuing share options and similar instruments (such as SARs), the Statement guidance says that if observable market prices are not available, fair value is determined using an option-pricing model. Statement No. 123(R) does not recommend a particular model, but does describe the requirements for such a model.

The two types of models discussed in Statement No. 123(R) are commonly used to provide reasonable estimates of value and they meet the criteria specified in the Statement. These models are (1) the Closed-Form Model, of which the most widely known is the Black-Scholes-Merton option-pricing model; and (2) the Lattice Model.

For your company, use the pricing model that produces the best estimate of fair value, which may require performing pricing using more than one method and then evaluating which produces the best result. Once the best method is selected, it is important to use the same pricing model consistently.

The new ruling has been highly criticized as a measure that could impede job creation and slow economic growth. Read the full text of the Statement at: [www.fasb.org/pdf/fas123r.pdf](http://www.fasb.org/pdf/fas123r.pdf).

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- Use a top-down approach that begins with company-level controls, to identify for further testing only those accounts and processes that are, in fact, relevant to internal control over financial reporting, and use the risk assessment required by the standard to eliminate from further consideration those accounts that have only a remote likelihood of containing a material misstatement;
- Take advantage of the significant flexibility that the standard allows to use the work of others; and
- Engage in direct and timely communication

with audit clients when those clients seek auditors' views on accounting or internal control issues before those clients make their own decisions on such issues, implement internal control processes under consideration or finalize financial reports.

The PCAOB will continue to study the implementation of Auditing Standard No. 2. To review the guidance, go to [www.pcaobus.org](http://www.pcaobus.org) and click on "Standards" and then "Staff Q&A."

To learn more about Tauber & Balsler, P.C.'s audit practice, please contact Marc Welch, CPA, at (404) 814-4990 or [mwelch@tbcpa.com](mailto:mwelch@tbcpa.com).

## TAX TIP

**Executive Compensation and Deduction Limitations.** The IRS is placing more attention on the deduction limit under IRC Section 162(m), which establishes a \$1,000,000 cap on deductible compensation for CEOs or one of the other four highest paid officers in public companies. Compensation strategies to avoid this limit include:

1. Deferred compensation, which is counted in the year received
2. Contributions to qualified pension and profit sharing plans and benefits paid under health and welfare plans
3. Commission-based compensation
4. Qualified performance based compensation

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# Proposed New Standard for Business Combinations

In their first major joint project, the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) have published, for public comment, an Exposure Draft containing joint proposals to improve and align the accounting for business combinations.

The goal is to develop a single high-quality standard for accounting for business combinations to be used for domestic and cross-border financial reporting. The proposed standard would replace the existing requirements of the IASB's IFRS 3, *Business Combinations*, and the FASB's Statement No. 141, *Business Combinations*.

The proposals in the Exposure Draft retains the fundamental requirement of IFRS 3 and Statement No. 141 to account for all business combinations using a single method – where one party is always identified as acquiring the other.

The proposed changes include a requirement to measure the business acquired at fair value and to recognize the goodwill attributable to any noncontrolling interests (previously referred to as minority interests) rather than just the portion attributable to the acquirer. The proposals would also result in fewer exceptions to the principle of measuring assets acquired and liabilities assumed in a business combination at fair value. Additionally, the proposals would result in payments to third parties for consulting, legal, audit and similar services associated with an acquisition being recognized generally as expenses when incurred rather than capitalized as part of the business combination.

The Exposure Draft is available at [www.fasb.org](http://www.fasb.org) and [www.iasb.org](http://www.iasb.org). The comment period ends October 28, 2005, and the Boards will hold public roundtable meetings to gather additional input on the proposals.

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