

The Report



CONDLEY AND COMPANY, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS
AND BUSINESS ADVISORS
www.condley.com



The Sarbanes-Oxley Act Implications for Companies & Organizations Not Publicly Traded

By Jeff Graham, CPA, CBA, CFE, Audit Partner

The Sarbanes-Oxley Act has received an enormous amount of press and attention in the corporate world. Sarbanes was implemented in response to the well-publicized corporate scandals that occurred prior to implementation of the Act; and in essence to help restore the public's trust and confidence in the system. The bill was primarily focused on publicly traded companies, but two of the provisions – document destruction and whistleblower protection - apply to all corporate entities (including nonprofit organizations).

INDEPENDENT AND COMPETENT AUDIT COMMITTEE

Publicly Traded Corporations: Requirements for publicly traded corporations:

- Audit committee members must be Board members and be independent.
- Disclose whether a “financial expert” is serving on the audit committee.

Implications for Other Entities: While an audit may not be the appropriate solution or provide benefit to all entities, those that are performing an audit should consider creating an oversight committee (audit committee) to oversee the function of the audit. The committee would be the most effective if all members were in fact independent of the management and financial function of the entity; financial expertise should also be considered.

AUDITOR RESPONSIBILITIES

Publicly Traded Corporations:

- Rotation of the lead and reviewing partner of the external auditing firm every five years (this requirement does not directly insinuate that the auditing firm itself be changed, but does require the lead partner to rotate).
- Prohibits the auditing firm from providing certain non-audit services.
- Auditing firms must also report critical accounting policies and practices being used, discussed with management, and represent the preferred way management wants these policies and practices treated.

Implications for Other Entities: Non-audit services should always be closely monitored by the audit committee or board of an organization and, in some instances, approved by such bodies. The accounting profession itself (outside of Sarbanes-Oxley) has implemented independence rules (Interpretation 101-3) that would preclude an auditing firm from providing certain functions without the appropriate disclosure.

Some non-audit services have in effect been determined through Interpretation 101-3 to impair an auditing firm's independence and in fact cannot be performed by the same firm undertaking the audit function. The most effective approach may be to know and understand the various services being provided by the auditing firm and approve completion of those procedures.

Inside this issue:

The Sarbanes-Oxley Act Implications for Companies & Organizations Not Publicly Traded continued - page 2

*Texas Margin Tax- page 3
Tax Increase Prevention and Reconciliation Act - page 4*

An Independently Owned Member of the McGladrey networks worldwide Service Through RSM International



Effective oversight would also suggest that the audit committee or board be informed of and understand the critical accounting policies and practices being used. Statement on Auditing Standards No. 61 (SAS 61) requires that certain communications be made when an entity has an audit or oversight committee and this document can contain some important information to the entity, not only in the area of accounting policies, but other critical areas/concerns as a result of the audit process.

CERTIFIED FINANCIAL STATEMENTS

Publicly Traded Organizations

- Financial statements must be certified by the CEO and CFO.

Implications for Other Entities

There are no legal requirements for other entities to have the CEO and CFO certify financial statements. Nevertheless, the CEO and CFO should fully understand the financial statements being provided to potential third parties; the board, as a matter of fiduciary responsibility, should be familiar with the financial statements as well. Audited financial statements are in effect the Company's financial representations and every effort should be made to ensure the accuracy.

INSIDER TRANSACTIONS AND CONFLICTS OF INTEREST

Publicly Traded Organizations

- Loans to any directors or executives of the company are basically prohibited.

Implications for Other Entities

While other entities are not expressly prohibited, if such loans are provided, they should be formally

approved by the board. Some industries (such as the financial institution industry) have further regulatory restrictions on insider transactions and entities should be cognizant of those rules as well. A conflict of interest policy is also a good procedural control for any entity to clearly establish expectations and requirements.

DISCLOSURE

Publicly Traded Organizations

- Requires disclosures including information on internal control mechanisms, corrections to past financial statements, material off-balance sheet transactions, and material changes in operations or financial situation.

Implications for Other Entities

The majority of these newly required disclosures will not apply to other entities; however, entities should strive to provide an accurate picture for internal and third party users.

WHISTLE-BLOWER PROTECTION

All Entities

Whistle-blower protection applies to all entities and in summary makes it illegal for a corporate entity to punish a whistle-blower in any manner. This brings to light the importance of a corporate culture which does not tolerate fraudulent or inappropriate activities – both procedural and in reality. The best protection for an entity is to have well written policies that include dealing with complaints and that prevent any retaliation. Any complaints need to be taken seriously, properly investigated and followed-up on if considered necessary.

DOCUMENT DESTRUCTION

All Entities

Sarbanes-Oxley specifically addresses destruction of litigation-related documents, but all entities should consider a written, mandatory document retention and destruction policy. Certain records – such as financial records, contracts, real estate, employment files – may need to be archived. Each entity's policy regarding archival of documents should be clearly stated, as well as back-up procedures. If an official investigation is underway or suspected, the entity should stop any document purging in order to avoid possible criminal obstruction charges.

It's important to keep in mind that each entity will vary as to their document retention and destruction policies. The appropriate level of research and consultation may need to be obtained in some instances in order to establish appropriate guidelines.

CONCLUSION

The majority of the provisions of the Act apply to publicly traded organizations and there are no legal requirements for other entities. Nevertheless, the costs vs. benefits of implementing the provisions of the Act should be considered by all entities. The ultimate goal is to better protect the assets of an entity – whether it be through enhanced internal controls, an external audit, implementing an internal audit function, or other methods – and for a formal board to ensure that they have complied with their fiduciary responsibilities. A proactive approach in most instances will prove to be a valuable tool.



Texas Margin Tax

By Leroy Bolt, Managing Partner

Recently, Gov. Rick Perry signed the new Texas Margin Tax into law effective January 1, 2008, which will replace the old Franchise Tax. The first returns for the new margin tax will be due May, 2008. Under the old law, only corporations and limited liability companies were subject to taxation, however, the new law covers all businesses that receive any limited liability protection under Texas law, with a few exceptions. Therefore, limited partnerships and limited liability partnerships will now be subject to the Margin Tax.

Following is a short recap of the new Margin Tax:

Exempt Entities

- Sole Proprietorship
- General Partnership
- Grantor Trust
- Passive Entity (special requirements necessary to fall under this category)
- An Entity whose gross revenue is less than or equal to \$300,000 or owes less than \$1,000 for taxes. (Must still file a short information report.)

Calculation of Margin Tax... In very general terms the Margin Tax is calculated by subtracting the larger of either Cost of Goods Sold or Compensation from Total Revenue and multiplying the result by the percentage of revenue apportioned to Texas and then apply 1% for most businesses or .5% for retailers and wholesalers.

- Total **Revenue** generally includes gross receipts (less returns and allowance), dividends, interest, rents, royalties capital gain and other income.

- **Cost of Goods Sold** only includes costs required to produce or acquire a "good." These goods must also be owned by the business. Therefore, businesses that only provide services will not be able to deduct Cost of Goods Sold.
- **Compensation** refers to the amount of wages and benefits paid to employees. Wages are capped at \$300,000 per employee, but benefits are not capped under the new law.
- Once the **taxable margin** is calculated it will then be apportioned to Texas based on Texas gross receipts as a percentage of total gross receipts.

Your business is not bound in later years by which item you choose to deduct. Each year you may choose whether to deduct Cost of Goods Sold or Compensation based on which is larger.

- There is an **alternate method** which uses 70% of the revenue as the taxable margin. The calculated margin is taxed at the same 1% or .5% as applicable.

Planning... The new margin tax will be more complicated and inclusive than the current franchise tax. It is not too early to begin planning for the new Margin Tax. For instance, you may choose to hire those individuals that are contract laborers or temporary workers as employees in order to boost your compensation deduction. We anticipate that the Texas Legislature will have revisions and changes before the effective date of January 2008, due to the complexity of the Margin Tax. For more information on the new Margin Tax or for planning advice please contact our office.

*** **CONGRATULATIONS TO OUR NEWEST CPA, LAUREN MORGAN** ***

Lauren is a Staff Assistant in Tax/Accounting Services, a native of Abilene, received Master's degree in December 2005 from ACU majoring in accounting. She and husband Matthew attend Southern Hills Church of Christ.

Just A Note:

New Employees: Joining the firm of Condley and Company...

Leah Andrews - Auditor

Alexis Barron - Staff Assistant, Audit

Jeff Blanks - Staff Assistant, Audit

Ryan Gibson - Staff Assistant, Audit

*Beverly Helmer - Para-Professional,
Tax/Accounting Services*

*Lori Lynn Keller - Staff Assistant, Tax/
Accounting Services*

*Brenda Mills - Para-Professional, Trust
and Estate Services*

Tie Lasater - Audit Intern

Kristina Mayer - Tax/Accounting Intern



Check out Condley and Company's new web-site, www.condley.com



Tax Increase Prevention and Reconciliation Act

By Mary Lee Brooks, Tax Partner



On May 17, 2006 President George Bush signed the Tax Reconciliation Act into law which will impact a diverse set of taxpayers. The following are brief highlights of the bill and its impact:

- Alternative Minimum Tax (AMT) exemption amounts are increased for individuals for 2006 only. \$62,550 for married taxpayers filing jointly and \$42,500 for single taxpayers. If Congress does nothing for 2007, 15 million taxpayers will be subject to AMT.
- Dividend and Capital gains tax will continue to be taxed @ 15% through 2010. The lower rates were set to expire in 2008. Most

lawmakers believe that after 2010 this tax will revert back to 20% because of the budget deficit.

- Enhanced Expensing under Sec. 179 for small business is extended through 2009. Small businesses may expense, for 2006, up to \$108,000 of qualified property purchased and reduced by any amount of property purchased that exceeds \$430,000.
- Elimination of the \$100,000 ceiling to convert traditional IRAs to Roth IRAs for tax years after 2009. The transfer will be treated as a taxable distribution, but no penalty for early withdrawal will be imposed. Taxpayers may recognize all

income in 2010 or spread it over 2011 and 2012.

- The Kiddie Tax states that children under 14 must include their unearned income on their parent's return. The age has been increased from 14 to 18 beginning in 2006.
- The credit for qualified production activities has been limited to 50% of all wages in the past. However, the new law states that it will now be limited to 50% of wages that are deducted in arriving at qualified production activities income.
- Tax-exempt entities that are parties to tax shelter transactions may be subject to penalties.

Founded on Principle. Focused on Service.

PRSRPT STD
U.S. POSTAGE
PAID
Permit #1060
Abilene, TX

CONDLEY AND COMPANY, L.L.P.
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS
P.O. Box 2993 • Abilene, Texas 79604-2993
Returned Service Requested

