The Evolution of Transparency—Corporate America Comes Through the Looking Glass

By: John P. Bennecke, Managing Director
True Partners Consulting LLC

As the calendar year of corporate America enters into the fourth quarter with more financial uncertainty on the horizon, there is one thing which is known for sure: The financial world in which we all live and hopefully prosper provides a much more transparent view into the financial health of a company's operations. To many of you this evolution may have seemed to take an eternity; the long hours, increased professional fees, and scrutiny over every minute detail associated with your corporate governance, internal controls, and financial reporting have been flowcharted, documented, and memorialized in volumes of text. To others this may be just the beginning, and you may soon feel much like Alice as she embarks on her incredible journey on the other side of the looking glass. No matter which side of the mirror you are on, transparency will certainly be the overriding theme.

Corporate transparency has evolved over the last several years having its roots founded in the well-publicized business failures of the early 2000s. In the current business environment it is critical that companies do all they can to ensure investor confidence in the financial markets, and one of the ways to do this requires a clearer view into a corporation at all levels. As a result, today we must deal with the byproduct of these failures in the form of increased regulations, increased public and private company oversight, and more regulatory requirements than ever before.

The Sarbanes-Oxley Act of 2002, also known as the Public Company Accounting Reform and Investor Protection Act of 2002, commonly referred to as "SOX," was enacted on the heels of several corporate scandals. This Act brought with it numerous regulatory requirements, increased board of director responsibility, and perhaps most notably, criminal penalties for those who choose to willfully violate the Act. To date, debate continues to challenge the effectiveness of this Act, and many have said that all that was created is a new set of rules to be broken. No matter where you stand in terms of your own personal belief on the Act's effectiveness, if you conduct business in the public company arena you will certainly be required to comply with SOX.

SOX spawned a quasi-public agency known as the Public Company Accounting Oversight Board or "PCAOB," and tasked them with the responsibility of policing the public accounting firms. The PCAOB is charged with the authority to oversee, regulate, inspect, and discipline the public

accounting firms in their roles as auditors and service providers of public companies. As a result of increased scrutiny over auditor independence, many companies have chosen or have been required by their boards and/or audit committees to spread the work and services traditionally provided by their audit firm, to firms which are independent of their auditors.

Many view the resulting sensitivity to independence as having yielded both positive and negative results. In certain cases it has significantly increased the complexity of the audit process, resulting in increased professional time and extended deadlines. Additionally, many audit firms have used SOX as leverage to provide additional fees at premium rates, under the premise that the firms were faced with limited professional resources and limited time in which companies were required to comply. The laws of supply and demand were certainly in favor of the large audit firms in the early days of Sarbanes Oxley.

At the other end of the spectrum, SOX has provided a launching pad for the next generation of professional service firms. This new breed of professional service is extremely focused and diverse in their respective areas of expertise, focusing in areas such as Tax, Due Diligence, and Forensic Accounting, to name of few. As a result, companies now have a choice beyond the traditional firms when looking for experts to assist them in navigating the complex world of financial reporting in a transparent environment.

The theme of transparency is not limited to the corporate governance and internal controls environment. The Securities and Exchange Commission ("SEC"), Financial Accounting Standards Board ("FASB"), and the Internal Revenue Service have all followed suit with their own initiatives to enforce transparency in reporting.

The SEC now operates under a fair disclosure regime also know as the Regulation FD, which requires public companies to disclose information to the public at the same time information is provided to the financial reporting marketplace. The intent was to mitigate the once common practice of providing select information to the financial professionals prior to information being made available to the public.

As recently as September 2009, Mary Schapiro, head of the SEC, has reiterated the need for increased reporting and increased transparency disclosure in corporate financial statements. While many of you will insist that the current transparency in financial statements is adequate and may even be overkill, it is interesting to see the thought leaders of various governing bodies still seeking a drive to increased transparency.

FASB—not to be outdone by the SEC—has also embarked on an initiative of increased transparency in financial reporting. Areas such as business combinations and accounting for income taxes have come to the forefront of increased disclosure for corporations who prepare their financial statements in accordance with GAAP. It should be no surprise that FASB has

focused its efforts in the areas material to the financial statements, which at times have been viewed as the playground for aggressive and abusive transactions and earnings management.

Finally, the Internal Revenue Service has quickly adapted their internal and external practices and has hired resources to deal with the rapidly changing environment. No longer desiring to be viewed as an antiquated and slow to adapt change, the IRS has asserted itself as an early adopter of the transparency initiative. This is evident in the evolution of the corporate tax reporting environment. The new reporting requirements imposed on corporations, provide a more direct reconciliation between the worlds of financial reporting and tax reporting. As a result, taxpayers are seeing a much more focused approach to IRS exam activity, which is clearly in line with the SEC and FASB initiatives. Additionally, the IRS has made tremendous efforts to streamline and standardize the tax reporting of corporations in an effort to ensure the transparency in tax reporting in a manner consistent with the rest of the financial reporting world. This is evidenced in the requirements of electronic filing (eFiling) for certain corporate taxpayers, and the increased requirement of corporate taxpayers to report and reconcile their tax returns to the audited financial statements.

No matter which side of the looking glass you are on, it is certain that you will be required to ensure the transparency of information provided to all stakeholders inside and outside of your organization. As we look into the future, history will guide, the business environment will continue to change, and transparency in all areas of business is here to stay.

This communication is for informational purposes only and is not intended to be an analysis or recommendation based on a particular reader's or entity's specific facts and circumstances. True Partners Consulting LLC does not assume any responsibility with respect to assessing or advising the reader as to tax, legal, or other consequences arising from the reader's particular situation. You should consult with your professional tax advisor to discuss the potential application of this subject matter to your particular facts and circumstances. The information contained herein is based on our understanding of the current tax laws and published tax authorities in effect as of the date of publishing, all of which are subject to change. True Partners Consulting LLC assumes no obligation to update this communication for any future changes in tax law, regulations, or other interpretations.

We are required by regulation to inform you that any tax advice contained in this communication (or in any attachment) is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of: (i) avoiding U.S. federal, state, or local tax penalties or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed in this communication (or any attachment).

©2009 True Partners Consulting LLC. All rights reserved. Printed in the U.S.A.