

C Create, Enhance, and Preserve Wealth Cohnconnection

Summer 2010 ■ www.jhcohn.com



Summer 2010

HIRE Act and Foreign Financial Institutions

Page 2

Process Improvements Lead to Increased Cash Flow

Page 3

Form 5500 Electronic Filing Requirements Now in Effect

Page 5

Successful Employee Development

Page 6

Succession Planning for Closely Held Businesses

Page 8

SAS 70s Are Changing

Page 9

The Opera Ain't Over 'Til Brünnhilda Sings

Page 11

Business Fraud: It Can Happen to Your Company, Too

Page 13

DEADLINE APPROACHES FOR ACCELERATED FILERS TO COMPLY WITH XBRL MANDATE

by *Kenneth Nielsen Goldmann, CPA, Partner and Capital Markets and SEC Practice Director, J.H. Cohn LLP*

Large accelerated filers who file on a calendar-year basis are required to utilize eXtensible Business Reporting Language—XBRL—to file their financial reports and statements effective with the quarter ended June 30, 2010. Companies must use XBRL—a specially designed, XML-based computer language—within the following documents:

- Annual and quarterly reports filed on Forms 10-K or 10-Q
- Transition reports
- Securities Act registration statements (such as an S-1)
- Reports on Form 8-K and Form 6-K that contain revised or updated financial statements

The largest of the large accelerated filers—companies with a market capitalization in excess of \$5 billion—have been using XBRL for their reports beginning with fiscal periods ending on or after June 15, 2009. All other filers (except accelerated filers as noted above) including smaller reporting companies, and foreign private issuers using International Financial Reporting Standards (IFRS), will be required to use XBRL as of June 30, 2011.

Comparability of Data and Automation Are Important XBRL Goals

On January 30, 2009, the Securities Exchange Commission (SEC) issued a mandate requiring companies to submit their financial statements to the SEC, as well as post documents to their websites, using an XBRL format. The goal of the SEC in mandating the use of XBRL is to “provide investors with quicker access to the data they want in a format that is easily used, searched, and analyzed.”

Similarly, the American Institute of Certified Public Accountants (AICPA) cites some of the benefits as cost savings, greater efficiency, and improved reliability, as well as “the accuracy, clarity, and usability of the information to be audited.” The overarching intent of using XBRL is a common understanding of a company’s financial data among all relevant parties, including investors, analysts, regulatory entities, banks, and other lenders.

Future plans include the expansion of XBRL to include tax reporting and the filing of loan reports and applications.

In addition to the SEC, the XBRL effort is being led by the AICPA and advocacy group XBRL, a national consortium of firms, including users and other interested parties. The idea first came to fruition in 1998 when Charlie Hoffman, CPA, conceived of the idea of a universal language for business reporting.

How XBRL Works

XBRL has been designed specifically for use as a business reporting standard and works in much the same way as a bar code. XBRL consists of electronically readable tags that correspond to standard definitions. These standard definitions, or taxonomies as they are being called, correlate closely to specific elements of U.S. Generally Accepted Accounting Principles (GAAP).

If an already-established taxonomy does not meet a company’s data reporting needs, the company may change it slightly to

 **J.H. COHN** LLP
Accountants and Consultants since 1919

We turn expertise into results.



J.H. Cohn is an independent member of Nexia International

properly reflect its information, hence the flexibility or “extensibility” of the system. This feature is perceived by the AICPA and other regulatory bodies as an important benefit.

Another key characteristic of XBRL is the use of instance documents, which are XML files companies will use to transmit their data in a uniform manner that can be read by all parties.

XBRL requirements will be phased in gradually. During the first year of compliance, companies are only required to tag primary line items in addition to block tagging footnotes and schedules. The following year, detailed tags for financial data in footnotes and schedules must be added.

There are several software packages available that companies can use to help them fulfill

their XBRL reporting requirements. The SEC’s XBRL website (<http://xbrl.sec.gov>) features a list of vendors.

A Few Early Snags

The first wave of companies that have already had to comply with XBRL—approximately 500 large companies—have made a few minor errors.

XBRL recently released a white paper, “Avoiding Common Errors in XBRL Creation” (available online at www.journalofadvocacy.com). Two early mistakes include mis-tagging numerical data as positive instead of negative, and vice versa, as well as omitting some facts required by the taxonomy, among others. Another helpful document containing valuable XBRL observations and best practices has been made public by the SEC on its website in the wake of its recent public education seminar.

As with any new protocol, there will be questions and perhaps a few issues to resolve before XBRL becomes second nature. The SEC, AICPA, and XBRL all have numerous resources on their websites to assist companies and preparers in understanding the philosophy behind the new standard as well as practical logistics and considerations. ■



Kenneth Nielsen Goldmann, CPA, is a J.H. Cohn partner and director, Capital Markets and SEC Practice. He may be reached at kgoldmann@jhcobn.com or 1-877-704-3500.

HIRE ACT IMPOSES REPORTING, COMPLIANCE OBLIGATIONS ON FOREIGN FINANCIAL INSTITUTIONS

by James Wall, JD, LLM, Principal and Director, J.H. Cohn LLP

Though most of the publicity generated by the Hiring Incentives to Restore Employment Act of 2010 (“the HIRE Act”) focused on its intent to create jobs, the bill will have significant tax ramifications as it incorporates provisions of the Foreign Account Tax Compliance Act, which was introduced in Congress last year.

The HIRE Act imposes significant new information reporting and compliance obligations on foreign financial institutions (and some other foreign persons). Perhaps most important, unless foreign financial institutions identify and disclose their U.S. account holders, payments to the institutions of U.S. source investment income and proceeds from certain equity and debt instruments of U.S. issuers will be subject to a new 30 percent withholding tax.

Key tax provisions of the HIRE Act include:

- The addition of a 30 percent withholding tax on any “withholdable payment”

(which includes U.S. source investment income and also certain capital gain income) made to:

- (a) a foreign financial institution unless the foreign financial institution agrees in writing with the IRS to take certain steps to disclose U.S. investors, or
- (b) a “non-financial foreign entity” (e.g., a hedge fund or a private equity fund) unless the nonfinancial foreign entity provides certain disclosures with respect to its U.S. investors (or certifies that it has none) to the IRS.

Generally, these provisions are effective for payments made after December 31, 2012. However, payments on certain obligations will be “grandfathered.”

- The repeal of the portfolio debt exception as it applies to foreign targeted bearer bonds. The HIRE Act did not repeal the portfolio debt exception as it applies to “registered



debt obligations.” Most portfolio debt falls into this latter category. Issuers and holders of portfolio debt obligations would be well advised to review the basis for qualification. This provision applies to obligations issued after March 18, 2012.

- The addition of new reporting rules requiring any U.S. individual who holds an interest in a “specified foreign financial asset” to report information about such asset on the individual’s tax return if the aggregate value of such assets is in excess of \$50,000. This reporting requirement also applies to entities formed or used to hold specified foreign financial assets (“SFFAs”). SFFAs include financial accounts maintained by a foreign financial institution and any stock or security issued by a non-U.S. person, any financial instrument or contract held for investment that has a non-U.S. issuer or counterparty, or any interest in a foreign entity. Failure to disclose the required information regarding SFFAs will result in a \$10,000 penalty. These provisions apply to taxable years commencing after March 18, 2010. It seems clear that regulations or some other form of guidance will have to be issued to enable taxpayers to comply with these provisions.
- The addition of a 40 percent penalty for any underpayment attributable to any undisclosed SFFA and the extension of the statute of limitations to six years for any understatement attributable to any undisclosed SFFA. This provision applies to returns filed after March 18, 2010 as well as to previously filed returns where the applicable statute of limitations has not expired.
- An expansion of reporting requirements with respect to passive foreign investment companies. All shareholders of a passive foreign investment company now are required to file an annual report with respect to such investment. This provision is effective as of March 18, 2010 but is premised on such reporting “as the Secretary may require.” Therefore, compliance appears not to be required until regulations or some other form of guidance is issued as to what information must be reported.
- The imposition of a 30 percent withholding tax on certain “dividend equivalent” payments, absent a reduction in rate pursuant to an applicable U.S. tax treaty. This provision applies to certain “swap payments” that are contingent upon, or determined by reference to, the payment of a dividend. This provision is effective for payments made on or after September 14, 2010.
- Increased reporting requirements and penalties with respect to foreign trusts. The effective dates of these provisions are varied but generally are effective as of March 18, 2010.

The HIRE Act contains many other significant provisions that can affect international transactions. ■



James Wall, JD, LLM, is a J.H. Cohn principal and director of the Firm’s International Tax Services Group. He may be reached at jwall@jhcohn.com or 1-877-704-3500.

FOUND GOLD: PROCESS IMPROVEMENTS LEAD TO INCREASED CASH FLOW AT TWO NEW JERSEY DISTRIBUTORS

by Anthony Zecca, CPA, Office Managing Partner, Cohn Consulting Group, a division of J.H. Cohn LLP

COFOs and controllers are challenged every day to uncover new ways to help their businesses improve profitability and cash flow and be more competitive. While many companies have reduced staff, often these reductions were forced by the down economy, rather than achieved by permanently changing the internal business processes to allow the company to operate effectively and efficiently while utilizing fewer resources. By implementing lean business concepts, Cohn Consulting Group’s (CCG) Performance Consulting team, lead by John Macrae, a Lean Six Sigma Green Belt, has helped its clients eliminate waste in their business processes and redefine the way work gets done. This allows its clients to operate with a lower cost structure regardless of the economy’s fluctuations.

Creating a Dashboard

Consider this example: A beverage distributor had experienced significant growth as a result of a substantial investment in developing its brands and its considerable focus on

processes, which resulted in higher inventory levels and increased breakage and returns.

Using data analysis tools from Six Sigma, a methodology that utilizes data and

By implementing lean business concepts, Cohn Consulting Group’s (CCG) Performance Consulting team ... has helped its clients eliminate waste in their business processes and redefine the way work gets done.

strong customer service. Despite the growth, the distributor’s margins were under pressure as a result of manufacturers’ efforts to improve their own profitability by pushing more costs, which they had previously absorbed, down on the distributor. During the growth spurt, margins also deteriorated as the company lost some of its control over several of its business

statistical analysis to measure and improve a company’s operational performance, practices and systems, CCG helped its client better understand what its data was saying about the actual performance of the processes contributing to increased breakage and returns, as well as the capability of those processes if they were improved. While the company recognized

that, in a perfect world, breakage and returns would not be acceptable at any level, it was understood that a zero-defect target from the start would not be realistic. Therefore, the initial objective was to establish reasonable breakage and returns targets that could be achieved based both on past performance, and process improvements that could be implemented without changes to the external environment.

Cross-functional teams from sales, warehousing, delivery, accounting, and IT were organized and trained on the basic tools and technique of Lean to enable them to identify the issues that were contributing to the deteriorating effectiveness and efficiency of the key business processes. The teams identified the root causes for the increase in breakage and returns and developed solutions for reducing them and ultimately improving process performance. The company had previously reduced staff to address the decrease in profitability; management's initial thought, in light of the increased breakage and returns rate, was to rehire the staff in order to help address the issue. Through the work CCG performed with this internal team, it helped the distributor's management team understand how to improve its business processes to accommodate the existing level of business, regardless of decreased staff.

Recommendations were implemented and CCG worked with the teams to develop process performance metrics to measure the improvements' effect and to ensure the processes remained in control. In order to ensure a focus on constant improvement and continually drive for lower levels of breakage and returns, the company is implementing business intelligence (BI or dashboard) technology. This technology allows the distributor to pull performance data from several dissimilar systems—including its accounting system, a separate sales management system, and offline spreadsheets—into one easy-to-use, point-and-click dashboard. The dashboard provides constant communication regarding process performance and allows for timely decision-making to correct issues if process performance slips below the new standard.



Six months into the implementation, average monthly breakage was reduced by approximately 40 percent, which has contributed to a dramatic improvement in the company's profitability. In addition, the company has reduced inventory levels and therefore the working capital it needs to support its business as a result of reducing its inventory levels and the cushion it needed to maintain in order to absorb the fluctuations caused by the prior levels of breakage and returns.

Improving Effectiveness and Efficiency Through BI

Another manufacturing client hired CCG to help improve the effectiveness and efficiency of its accounting and finance function and its inventory costing methodology. Its inventory costing process was inaccurate and required a significant amount of manual adjustment at month-end. While the company was profitable, it experienced increasing inventory levels and slower inventory turns, despite modest growth. The company had a significant amount of cash tied up in working capital and had several more capital projects on the board that required funding. Despite this significant investment in inventory, no one really "owned" the inventory management or purchasing process. The company's accounting and finance department was more concerned with the accuracy of the inventory accounting than with helping the company better manage the investment in inventory.

CCG worked with management to identify historical target inventory levels. Each inventory turnover was equal to more than \$1 million, and the initial target was a two-time improvement in inventory turns for a more than \$2 million cash impact, with a four-time improvement or \$4 million target by year-end.

A team from accounting and finance and IT was gathered to evaluate and improve the inventory costing process and to modify the costing methodology

in its accounting system. Because the company lacked visibility into its inventory performance, CCG recommended a business intelligence solution to allow accounting and finance to track inventory performance at the individual item level.

The company had a disconnected planning process. As sales developed a top-line sales forecast accounting and finance developed an expense budget, but the two were not connected, and everything was developed in Excel spreadsheets. In addition, the purchasing process was disconnected and reactive and lacked the ability to plan based on sales forecasts. CCG worked with the company and made recommendations for improving its budgeting, planning and forecasting processes including improvements to the methodology and the ability to link the sales path, from individual customer forecasts all the way through purchasing.

While CCG's recommendations focused first on developing and improving a manual process, the company is now in the process of evaluating the recommended budgeting, planning, and forecasting tool, which would automate the new manual process. The benefits of such a tool include the elimination of multiple, disconnected Excel spreadsheets and the issues associated with controlling their content and the integrity of formulas, roll-ups, and version control. This investment in budgeting, forecasting, and planning technology and the BI solution utilized were easily funded with a fraction of the cash generated by the reduction in inventory.

Developing better forecasting and planning processes and systems has helped clients reduce their inventory position and, subsequently, increase their cash flow. Freeing up millions of dollars through inventory improvements, especially in this economy, is akin to found gold. ■



Anthony Zecca, CPA, is office managing partner of Cohn Consulting Group, a division of J.H. Cohn. He may be reached at azecca@jhcohn.com or 1-877-704-3500.

FORM 5500 ELECTRONIC FILING REQUIREMENTS ARE NOW IN EFFECT

by Evan Zuckerman, CPA, Partner and Mathew Krukoski, CPA, Partner, J.H. Cohn LLP

Effective January 1, 2010, all 2009 Form 5500's must be filed electronically using the ERISA Filing Acceptance System II (EFAST2). EFAST2 is a system designed by the Department of Labor (DOL), Internal Revenue Service (IRS), and Pension Benefit Guaranty Corporation to simplify and expedite the submission, receipt, and processing of the Form 5500 and the new Form 5500-SF (or "Short Form").

Any Form 5500s for the 2008 plan year (either delinquent or amended) are still allowed to be filed on paper until October 15, 2010. Form 5500s for plan years prior to 2008 are now only accepted through the EFAST2 system.

Under the all-electronic EFAST2 system, filers may choose between using EFAST2 approved vendor software (e-File) or through a direct-input, web-based filing application using the EFAST2 website (i-File) to prepare and submit the Form 5500 or Form 5500-SF. Most employers will likely utilize the approved vendor software of their tax professional or Plan's third-party administrator. However, employers may consider using the i-File process for smaller plans with less detailed filing information.

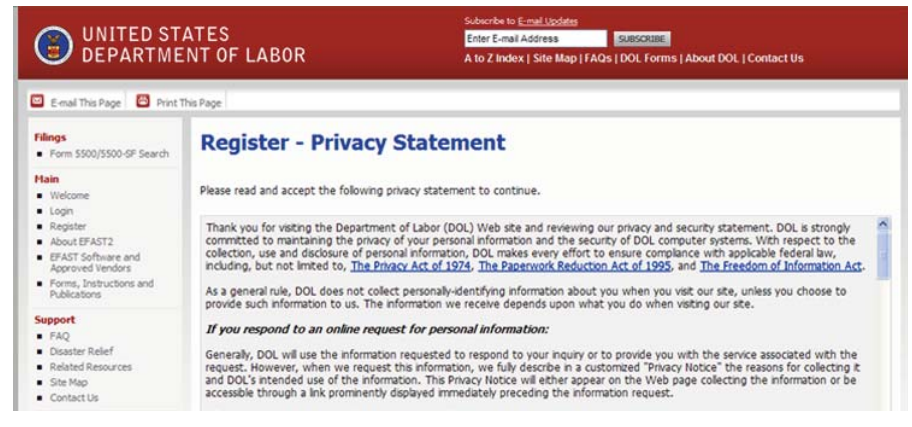
The process for filing an extension for the Form 5500 (i.e., Form 5558) has not changed. It is still filed in paper form with the IRS. However, the new Form 5500 instructions indicate that filers will not be required (or allowed) to attach copies of Form 5558 to their electronic filings using EFAST2. You must, however, keep a copy of the Form 5558 that was filed with the IRS with the plan's records.

Anyone who will be signing a Form 5500 as either a Plan Administrator or Employer must apply for personal "Filing Signer" credentials with the DOL. This process will require Plan Administrators and Plan Sponsors to register with the DOL through the EFAST2 website for Filing Signer credentials. These credentials will

Step 1: Go to the DOL Website: www.efast.dol.gov and click "Register"



Step 2: Review the privacy agreement and check "I have read this agreement" and then click "Accept Agreement"



allow the designated Plan's representative to sign the Form 5500 filing electronically.

Alternately, the DOL will also allow the tax professional that assists with the filing of your return to electronically sign the return for you. This option will require you to sign a written statement stating you have approved the completed return and authorize the tax professional to electronically sign and submit the return. With this option, you will not be required to obtain signing credentials. You may choose to obtain these credentials if you wish to monitor the status of the return on the DOL website.

J.H. Cohn has prepared detailed instructions to assist your organization in applying for Form 5500 signer credentials. If you have not already received a copy of these instructions, or for more information about this and other filing requirements,

including assistance in reviewing plans for compliance, please contact your J.H. Cohn engagement partner at 1-877-704-3500. ■



Evan Zuckerman, CPA, is a J.H. Cohn partner in the Audit and Advisory Services group, where he focuses on employee benefit plans. He may be reached at ezuckerman@jhcohn.com or 1-877-704-3500.



Mathew Krukoski, CPA, is a partner at J.H. Cohn, where he specializes in employee benefit plan audit engagements. He may be reached at mkrkoski@jhcohn.com or 1-860-633-3000.

Financial Managers Learning Forum Concludes Successful Semester, Gears Up for Fall

J.H. Cohn's Financial Managers Learning Forum (FMLF) has concluded another successful semester, introducing programs on such topics as IFRS, healthcare reform, IT internal controls, and employment law to financial decision makers throughout New York, New Jersey, and Connecticut.

FMLF was founded more than 20 years ago to provide financial decision-makers with quality programs that have practical business application and qualify for CPE credits. The programs attract financial decision-makers from a wide variety of business types and industries. Today, through the program's Financial Managers Curriculum (FMC), J.H. Cohn provides clients and friends of the Firm with the opportunity to attend networking and for-credit educational events and receive thought leadership on today's topics of interest. There is no registration fee and each course, which carries no registration fee, qualifies for three CPE credits.

The Fall 2010 course schedule will be available in August and will include courses **for the first time** in Southern California; registered members will receive an email when it is available. If you are not yet a member we invite you to join and take advantage of this complimentary CPE, networking, and knowledge-gathering opportunity by visiting us online at www.jhcohn.com/FMLF. For more information about this program, please contact the program at learn@jhcohn.com.

TIPS AND TECHNIQUES FOR SUCCESSFUL EMPLOYEE DEVELOPMENT

by Chuck Kovach, Director of Learning and Development, J.H. Cohn LLP

Employees, managers, and companies need to share ownership of career development.

In a recovering economy, as organizations work to recapture market share and preserve their customer base while economizing and streamlining operations, enabling employees to learn in a flexible, cost-effective manner is often hugely appealing.

Workforce research has proven that the opportunity to continually enhance professional skills is a major factor in employees' overall job performance and satisfaction. High performers, especially, have been shown to learn the most from on-the-job experiences and coaching, dually supported by the right formal education and training programs.

At J.H. Cohn, we encourage our employees to learn in a variety of ways and in the manner that works best for them. To facilitate this, we host a comprehensive Learning and Development program that delivers comprehensive educational opportunities to help them advance their skill set and broaden their knowledge base in a number of areas. Since establishing this formal program, we've identified a series of "words to live by" that help managers and other supervisors motivate and develop their staff:

- **Help employees find their interest.** People learn best when they're motivated, and a large part of that motivation is the degree of natural interest someone



has in a particular area. To help illustrate this point, at J.H. Cohn we frequently ask employees to identify their most rewarding learning experience and describe what made it so memorable. In discussing these experiences, it becomes clear that the learning experiences people remember most are those in which they have a personal interest.

Early on, we encourage employees to seek a number of different types of engagements to help them find the practice area or industry in which they have a genuine interest; we have found that this results in higher motivation, faster learning, and improved performance. In addition, during their first year at the Firm, employee learning plans include core skills in each major practice to not only help make them more well-rounded, but to expose them to what

may be an untapped proficiency. Lastly, the Firm's mentoring program exposes young professionals to different views, types of work, and areas of opportunity.

- **Clearly define required skills.** In *Alice in Wonderland*, the Cheshire Cat wisely tells Alice, "If you don't know where you're going, any road will get you there." As with virtually every other aspect of business, creating a clear roadmap to results is a critical success factor. Employee development is no exception. To help employees define where they're going and how, we've developed specific "competencies" or skills needed to perform various roles, each of which is documented in job descriptions and in J.H. Cohn's online HR performance management system. These competencies provide supervisors and employees with a uniform standard for development, one

that is also flexible and can be changed quickly in response to today's dynamic business environment.

- **Provide for self assessment.** Involving employees in processes that affect them increases motivation and performance and provides the organization with valuable information on how to better manage performance and results. At J.H. Cohn, self-assessment is the first step in our performance management process. This assessment includes a comparison of employee skills to defined competencies. Combined with feedback on the same skills from supervisors, this assessment provides employees with a well-rounded snapshot of where they are skill-wise at any point in time and provides a basis for setting new goals. Areas of personal interest—both new and ongoing—are routinely discussed as part of the employee's career growth plan.

- **Encourage goal-setting in terms of desired skills and business results.** In an organizational setting, both the company and its employees have goals which they pursue. When employees' goals are aligned with those of the organization, performance and job satisfaction increase. Within an organizational setting, one approach for encouraging alignment between company and employee goals is to ask people to include the phrase "so that" in their goal statements to help define what they believe the benefit of accomplishing their goals is to the business and to their own development. For example, an employee's goal might read: "Increase my ability to perform public company audits *so that* that the Firm can improve market share in this area."

The success of this approach depends on employees having accurate information on organizational goals and strategy. At J.H. Cohn, we provide this information in a number of ways, including Firm-wide communication; a robust intranet with timely, relevant information; quarterly town hall meetings; and regular "state-of-the-Firm" sessions

which include a discussion of the Firm's global objectives and strategy. In addition, we encourage frequent group discussions and one-on-one meetings between the employee and their engagement supervisor to discuss department and Firm developments.

- **Prioritize on-the-job development.** A Center for Creative Leadership study, supported by other research and tools from leadership development authorities, found that the biggest factor in developing high performers was the quality of the job experiences they had, supported by feedback and formal training when needed. Among the ways to put this concept into action is to identify "stretch" assignments for employees that enable them to grow while performing their jobs. Action learning is another frequently used technique which combines job assignments, feedback, and formal training in a single activity. In one type of action learning program that we use, employees work in teams to analyze an actual Firm issue and create recommendations to present to senior management. Through their team experience and the feedback they receive on their recommendations, participants gain skill in areas such as strategic thinking and team performance while contributing meaningfully to a solution.
- **Emphasize learning as a continuous pursuit.** Given today's rate of change, it's clear that to remain current, and grow, people need to make a lasting commitment to learning throughout their lives and careers. Within the Firm, we've found that those employees who view learning as a career-long pursuit develop faster. Within the HR field, this valuable quality is referred to as "learning agility." Individuals with a high degree of learning agility actively try to learn things quickly from experience as well as feedback, and importantly, are willing to continually try new things. We communicate this concept in "passage" programs such as campus hire orientation and our courses for new

managers. We also include continuous learning as a specific skill in every skills competency list. Including this skill ensures that there is ongoing goal-setting and feedback throughout the Firm on this ability.

Managers (Together With HR), the Job is Yours

At its core, employee skill development is a two-way street that requires ongoing attention and dialogue among the organization's managers and their employees. At the outset, however, HR management must ensure that there is a consistent message and a clear mandate: employee development is important and every supervisor must play a part.

In the process of creating or strengthening your employee development program, keep the following in mind:

- Supporting development is an ongoing commitment.
- The organization needs to provide direction and tools.
- Structure and flexibility must be balanced.
- Establishing an effective program takes time.

The relationship between competent, fulfilled employees and satisfied customers cannot be overstated—over the years, studies have shown time and again there is a direct correlation between employee satisfaction, excellent service, and customer satisfaction. By embedding these tips and techniques throughout your employee development programs, you are helping to facilitate a team of satisfied, highly-skilled employees, and by extension, increasing your company's chance for overall business success. ■



Chuck Kovach is director of Learning and Development at J.H. Cohn. He may be reached at ckovach@jhcohn.com or 1-877-704-3500.

SUCCESSION PLANNING NEEDS TO BECOME A PRIORITY FOR CLOSELY HELD BUSINESSES

by Charles M. Smith, CPA, CPC, SPHR, Director of Human Capital Consulting, J.H. Cohn LLP

There comes a point in the lifecycle of any family-owned or closely held business when the owners must step back and decide what will happen to that business once they are no longer at the helm. Too often, this fails to happen, putting even the most successful businesses at risk for failure once the founder no longer oversees the company's day-to-day operations.

Statistics confirm the worst. Seventy-three percent of closely held businesses don't execute any type of succession planning. As a result, 70 percent of closely held businesses do not make it to the second generation and 85 to 90 percent don't make it to the third generation. The greater majority—estimated between 95 percent and 97 percent—do not make it to the fourth generation. Considering that an estimated 11 million family businesses employ almost 60 percent of the American work force and are a significant portion of the United States' gross domestic product, the importance of keeping family business strong and smoothly and successfully transitioned among generations is clear.¹

Why the high failure rates? Sometimes the business is tied too closely to the founder to succeed once he or she is out of the picture; other times, despite the owner's natural predilection to assume that the next generation will take control, there is a lack of interest.

Take, for example, this common dilemma: A service business was founded 30 years ago and has since then grown to profitability and \$50 million in annual sales. The owner and founder, now 63 years old, employs his two children, ages 38 and 36, in key sales development and operational roles. Neither has worked elsewhere and because of the personalities at play—Dad has a dominant personality and is a natural risk taker but lacks coaching skills, while his children remain passive and subordinate to their father's whims—there is no clear future leader should the founder be unable to run his business. No plans have been put in motion for either child—nor for any other executive—to succeed him, opening the door for a rough, potentially fatal transition should Dad be unable to continue.



That there is no clear future leader within the owner's bloodline is nobody's fault. After all, it takes a certain personality to found and lead a successful business, and such personality traits are not inherited, but rather inherent, which makes it easier to understand why the majority of companies do not proactively make the cross-generation transition.

Those companies that are led by the right person, at the right time, are most fortunate. In some cases, such as the one detailed above, to continue its success a company needs an entirely different leadership and management style than what its current owner possesses. Often, given the enormity of the task, these challenges lead to no one addressing succession planning.

One may be born with strong leadership skills, or they may be learned over time through observation and hands-on coaching and leadership development, but one thing that many experts agree on is that the most successful business leaders have five core competencies.

When the leadership transition also involves a change of ownership, there are numerous tax, wealth transfer, and operational considerations to undertake, including:

- The role of comprehensive financial planning to create increased business value
- Degree of financial interdependence (family/business overlap)
- Potential schisms between active and inactive family members
- Methods of ownership transfer – gifting, equity compensation, or selling the owner's interest?
- Timing—Will the transfer take place before the owner's death (which speaks to the owner's confidence in the new leadership) or after?
- Funding the transfer—Split-dollar insurance, owner financing, or deferred compensation model?
- Estate planning for the owner—Determining the role of life insurance trusts, family limited partnerships, Grantor Retained Annuity Trusts (GRATs), and Self-Cancelling Installment Notes (SCINs)
- Contingency planning—What happens if the new leadership fails to meet expectations?

¹ Connecticut CPA Quarterly Fall 2006, Pamela Weaver, citation sources: 70%, 85% - 90%, and 95% - 97% (Aronoff - 1999); 11 million, 60% (Astrachen & Schanker, 2003)

- *Goal Achievement*—the ability to set, pursue, and attain achievable personal, professional, and team goals regardless of obstacles or circumstances.
- *Influencing Others*—the ability to personally affect others' actions, decisions, opinions, or thinking.
- *Interpersonal Skills*—the ability to interact with others in a positive manner.
- *Personal Accountability*—the ability to answer for personal actions.
- *Self Management*—the ability to prioritize and complete tasks in order to deliver within allotted time frames; the ability to control oneself under stress.

When considering succession planning, family business leaders and their advisors tend to focus on the operational transfer of power, wealth transfer, and tax issues, as well as the relationship issues between the parent and the successor (see sidebar for more on this). Yet once the transition is complete, the mere support of the founder or training in the mechanics of the business is insufficient to achieve success if the new leader does not have the necessary leadership skills to maintain the performance of the business. The development of leadership skills takes time, practice, and commitment from both the existing leader and the future leader.

Pre-planning is key. Ideally, future planning should happen five to seven years in advance of the anticipated transition. While many business owners will get a

greater sense of satisfaction when the company continues to thrive into the next generation, realistically, this is not always possible. Early discussions about expectations on both sides can help to plan the transition, or make it clear that that is not possible. Transitioning to the next generation is the goal for many businesses, and realistic expectations and sound business principles will only serve to enhance the process. ■



Charles M. Smith, CPA, CPC, SPHR, is director of Human Capital Consulting at J.H. Cohn, where he offers leadership development and other organizational development services. He can be reached at cmsmith@jbcohn.com or 1-860-633-3000.

SAS 70s ARE CHANGING

Where Are We Now and What Can We Expect Before the End of the Calendar Year?

by Kelly A. O'Callaghan, CPA, Partner, and Bruce H. Nearon, CPA, Director, J.H. Cohn LLP

Statement on Standards for Attestation Engagements No.16, *Reporting on Controls at a Service Organization* ("AT 16"), issued by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) in April 2010, and auditing standard *Audit Considerations Relating to an Entity Using a Service Organization*, will supersede the previous guidance in SAS 70, whose reports serve as a "report card" on service organizations and provide information on factors an independent auditor should consider when auditing the financial statements of an entity that uses service providers to process transactions (For more information on these reports, read J.H. Cohn's previous article "Have You Asked Your Auditor About SAS 70?").

Changes to the Standard

The SAS 70 standard was recently replaced with two new standards that separate auditing guidance relevant to the two different types of organizations. The AICPA has indicated that the SAS 70 standard has changed to address concerns

regarding the clarity, length, and complexity in existing U.S. auditing standards. In addition, the changes were made to converge U.S. auditing standards with those of the International Auditing and Assurance Standards Board ("IAASB").

The first, AT 16, is effective for periods ending on or after June 15, 2011 and includes guidance for service auditors. It will require some changes by services organizations; these, however, are not a drastic departure from the original SAS 70. The key changes include:

1. Management of the service organization is required to provide the service auditor with a written assertion about (1) the fairness of the presentation of the description of the system, (2) the suitability of the design of the controls, and in a Type 2 engagement, (3) the operating effectiveness of those controls. In the original SAS 70 this would have been included in management's representation letter provided to

the auditor at the conclusion of the engagement.

2. The description of *controls* is referred to as a description of the system.
3. The description of *the system* is prepared using suitable criteria, such as objectivity, measurability, completeness, and relevance.
4. The description of the system is not limited to controls as they relate to user entities' financial reporting; however, including a description of a system that is not related to financial reporting is optional based on the needs of the service organization and their user organizations.
5. Distribution of a Type 2 report is limited to customers of the service organization during the period covered by the report. For Type 1 reports distribution is limited to customers of the service organization as of the date of the report.

AT 16 also prompts changes for services auditors, including:

1. Service auditors will attest to management's assertion.
2. Although AT 16 addresses controls at service organizations that are likely to be relevant to user entities' controls over financial reporting, the service auditor may use the guidance in it when performing engagements under AT 101 Attest Engagement to report on controls at a service organization other than those relevant to user entities' internal control over financial reporting.
3. Type 2 opinions on fairness of the presentation of the description and the suitability of the design of controls covers a period rather than a specified date.
4. The service auditor is required when obtaining an understanding of the service organization's system to identify risks that the description of the system

is not fairly presented or that the control objectives are not achieved due to intentional acts by service organization personnel.

5. The service auditor should investigate the nature and cause of any deviations identified, including considering whether the deviations may be the result of intentional acts by service organization personnel.
6. The results of prior year tests cannot be used as a basis to reduce current year testing when performing a Type 2 engagement.

The second standard effects CPAs auditing the financial statements of an entity that uses a service organization.

Conclusion

SAS 70s are changing and the changes will affect service organization, service auditors, user entities, and user auditors. The good news is that the changes result

in clearer and less complex standards that do not require significant additional efforts to implement. For service organizations with international customers reports prepared under AT 16 should be acceptable to user auditors in other countries since the standard converges with International Standards on Auditing. ■



Kelly A. O'Callaghan, CPA, partner, is a member of J.H. Cohn's Information Technology Audit team. She can be reached at kocallaghan@jhcohn.com or 1-877-704-3500.



Bruce Nearon, CPA, is the national director of the Firm's Information Technology Audit Team. He can be reached at bnearon@jhcohn.com or 1-877-704-3500.

GATEWAY TO INTERNATIONAL TRADE CONFERENCE FOCUSED ON GLOBAL BUSINESS OPPORTUNITIES

J.H. Cohn LLP and Citibank's Commercial Banking Group, a leading provider of commercial loans to small- and medium-sized businesses, in affiliation with Nexia International, recently presented the *Gateway to International Trade* conference at the New York Marriott Marquis. More than 450 people, including business owners and executives, attended the conference.

The international trade conference afforded U.S.-based businesses with plans to expand internationally, as well as foreign-based enterprises importing goods or services into the U.S., the opportunity to speak with international business experts from J.H. Cohn, its associates from Nexia member firms, and Citibank Commercial Bankers, as well as foreign trade consultants, about global expansion and the unique aspects of doing business in each country.

"This is an unprecedented time for global business, and as international business and accounting standards continue to shift, it is paramount that corporate executives stay abreast of how they will be impacted and the opportunities that exist in a global economy," said Roy W. Hoffman, CPA, a J.H. Cohn International Services partner. "Attendees expressed that this event was an exceptional opportunity to network and share information with others involved in international trade."

Seth Pinsky, president of the New York City Economic Development Corporation, presented at the general session about New York City's role in the nation's international trade programs. John Ahern, Global Head of Trade within Citi's Global Transaction Services business, presented on trends in global trade, the value of trade finance for internationally focused businesses, and Citi's leadership in these areas.

Gateway to International Trade was supported by the Manhattan Chamber of Commerce in conjunction with World Trade Week NYC, as well as by the chambers of commerce of many of the countries represented at the event. The conference serves as an unofficial kick-off to Manhattan's World Trade Week, which began Monday, May 17, 2010 and for which Hoffman served as chairman for the fifth time. ■



THE OPERA AIN'T OVER 'TIL BRÜNNHILDA SINGS

by Patrick O'Keefe, Director of Economic Research, J.H. Cohn LLP

A May 26 Quinnipiac poll found that 74 percent of all Americans thought that the economy was still in the grips of the "Great Recession."¹ Yet data through May suggest that total output of goods and services—Gross Domestic Product (GDP)—exceeds its pre-recession peak and the economy has recovered.

What explains the discrepancy?

While GDP is estimated quarterly, there are reliable monthly data on its components. An index of these data, the National Activity Index prepared by the Chicago Federal Reserve Bank², has reached its highest level since February 2007, nine months before the recession began and suggests that economic activity is near its long term trend.

So, at the time of the Quinnipiac poll, the economy was not just retracing lost ground, it was making new highs. The U.S. economy was producing more goods and providing more services than when the contraction began at the end of 2007.

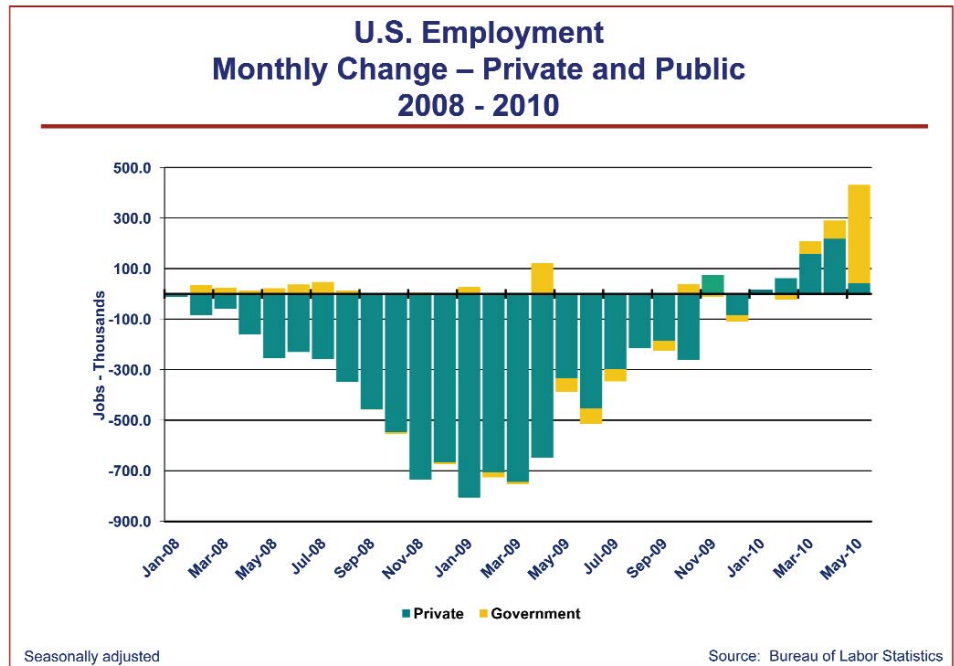
Why, then, did three-quarters of American households think the economy was still in recession? Primarily because what is obvious on the stat sheet is not yet apparent on Main Street.

GDP may have fully recovered its 3.7 percent peak-to-trough decline, but employment was 5.3 percent below its pre-recession high. On Main Street, where GDP is just another number, jobs count.

Employment has increased at an accelerating rate since the beginning of the year. Employers report adding 982,000 jobs in the first five months of 2010. Those gains were widespread, with 38 states reporting increases in the most recent month.

But on Main Street America, the jobs picture appears less fulsome for three reasons.

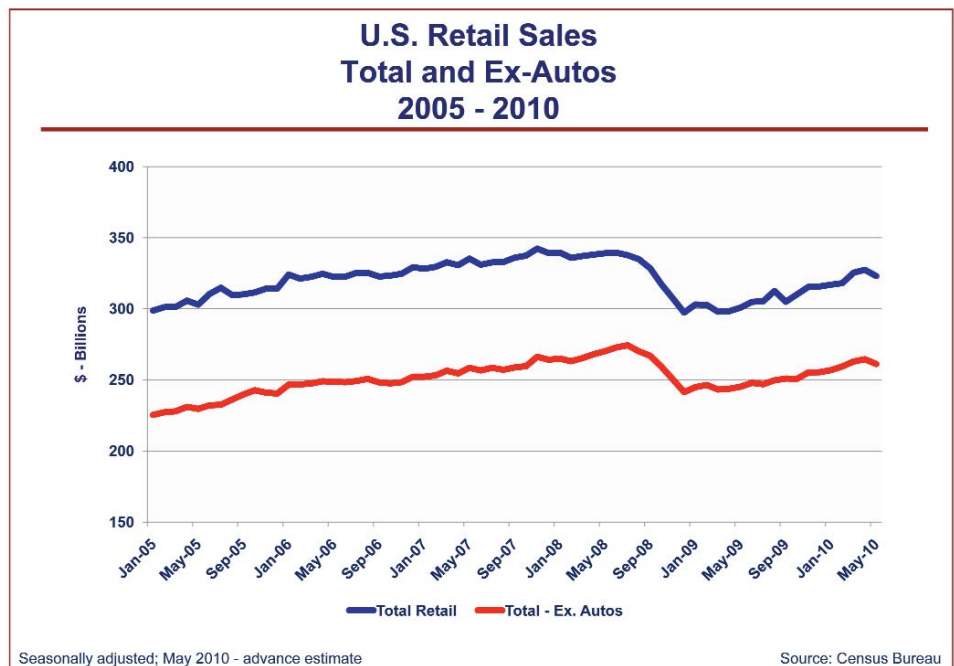
First, some three-quarters of 2010's new jobs are temporary. Since the beginning



of the year, the Census Bureau filled 550,000 temporary jobs, the bulk in May. Concurrently, temporary help firms added 175,000 jobs.

Second, under-employment remains at historically high levels. Among all workers,

6.3 percent hold part-time jobs for economic reasons, almost double the pre-recession under-employment rate of 3.2 percent. Third, largely as a consequence of the first two, average weekly earnings are lower than a year ago.



¹ <http://www.quinnipiac.edu/x271.xml>

² The Chicago Fed National Activity Index is a composite of 85 indicators of output, employment, income, consumption, and housing. It compares current conditions to historic trend and indicates whether the economy is expanding or contracting.

Temporary and part-time jobs are better than unemployment, but they do not instill the same confidence nor yield the same income as permanent, full-time positions. And that may well explain why 75 percent of the respondents told the Quinnipiac pollsters that the Great Recession had yet to end.

Yet even though households say the recession continues, their outlook has brightened. For example, consumer confidence is higher than at any time since the credit crisis began in mid-2007. It is a tenuous improvement, however. May's retail sales, which slipped 1.4 percent after seven consecutive monthly increases, demonstrated that households remain cautious. Despite the pull back, however, retail sales are up 8.6 percent since bottoming at the end of 2008.

Over that period, even as households increased spending, they reduced their short term debts—including their credit card balances. In other words, consumers are both spending more and spending differently.

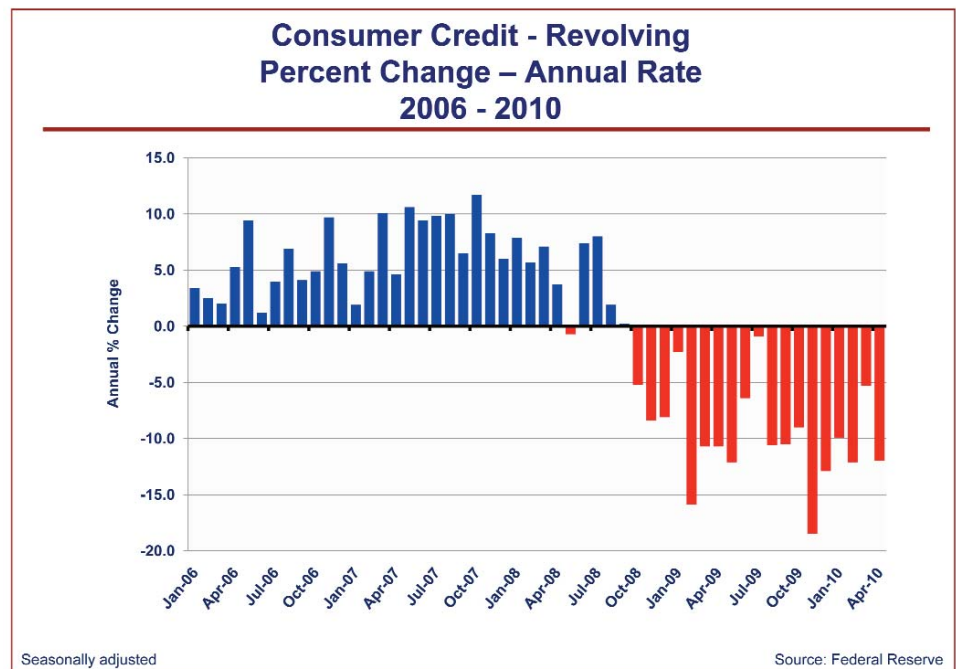
Coincidentally, the savings rate—which jumped as households increased their precautionary savings during the Panic of '08—moved lower. While this suggests that households may feel somewhat more optimistic about the future, it is also to be noted that the savings rate has not fallen to pre-panic levels.

Looking forward, the household sector's more confident, but still cautious, outlook should sustain consumer spending into next year. If jobs and incomes grow more robustly, consumer spending will accelerate the rate of expansion. A cautious optimism prevails.

Similarly, the business sector—where the signs of the turnaround first appeared—is fueling growth as it invests in equipment, updates software, and restocks shelves. This is expected to continue in both the manufacturing and service sectors according to the Institute for Supply Management's surveys.

With the exception of the anemic construction sector—particularly nonresidential construction—private investment looks to expand through mid-2011.

Based on conditions in the household and business sectors (and assuming no seismic



shocks), the economy's low-trajectory, self-sustaining expansion should carry well into 2011, perhaps beyond.

During that time employment, incomes and profits should increase steadily—although only gradually.

This outlook has a relatively short shelf-life. And Brunnhilda ain't singing.

The turbulence that began in 2007 has been contained, but its underlying causes have yet to be resolved. Indeed, the monetary and fiscal policies that successfully stabilized the financial system and restored economic growth—both globally and domestically—were hair-of-the-dog remedies (looser money, larger deficits) that unavoidably fed the mongrel to calm it.

Now, *Orthrus* needs de-fanging or, at the very least, muzzling. Only when that is accomplished will Brunnhilda start singing.

Doing so (i.e., adopting financial and fiscal restraints) will inevitably impinge on economic growth. But not doing so risks a reprise of the Panic of '08 and, therefore, policymakers will eventually act. Although as happened during the Panic of '08, they may well stall until markets compel action, as occurred prior to the adoption of the Troubled Asset Relief Program (TARP).

The inevitable implications for Main Street are: credit will contract (i.e., less

available, tighter standards, higher rates) and costs will rise (viz., higher taxes and fees).

The changes may not occur abruptly, but some are already moving forward (e.g., financial reform, state and local budget cuts). Others (e.g., the impending hikes in taxes on various types of investment income) will occur if action is not taken.

The precise magnitude, distribution, and timing of their economic impacts will depend on details that remain to be settled. While projecting how those details will be resolved is entirely speculative, one thing is certain: they will have a substantial, pervasive and disruptive effect on every element of the economy, including your business and household.

Rather than speculating about the details of impending policies, it would be more beneficial to plan for how you will adapt to their inevitable consequence: a credit-constrained, higher-taxed economy.

That's Brunnhilda's aria...and she's about to start singing. ■



Patrick J. O'Keefe is director of economic research at J.H.Cohn. He can be reached at pokeefe@jhcohn.com or 1-877-704-3500. For more insight from Mr. O'Keefe, please visit our website, www.jhcohn.com.

BUSINESS FRAUD: IT CAN HAPPEN TO YOUR COMPANY, TOO

by Sharon Bromberg, CPA, CIRA, CFF, Partner, J.H. Cohn LLP

No matter what your industry, the size of your company, or how well you “know” your colleagues or employees, the potential for fraud is real and ever-present. That potential becomes even greater during difficult economic periods. According to a 2009 survey conducted by Kroll, Inc.¹, 30 percent of survey respondents said that the global financial crisis has increased the levels of fraud at their organizations, while 85 percent said that their company has suffered at least one fraud in the last three years. Lower profits heighten the risk of fraud. One in six companies responding said that they saw greater vulnerability to fraud from the reduction in internal controls, while one in seven said that increased fraud was the result of salary freezes.

Fraud drains American companies of an average seven percent of their revenues annually, according to a 2008 survey conducted by the Association of Certified Fraud Examiners (ACFE), a major trade group representing fraud investigators and forensic accountants; others put that estimate closer to five percent annually. Either way, the annual cost of business fraud to the American economy ranges between \$700 billion and \$1 trillion, based on the approximately \$14 trillion value of the U.S. Gross Domestic Product in 2009. The losses to the bottom line are equally damaging.

While business-related fraud is widespread and many executives recognize this reality, they often act as if “it can’t happen to us.” They typically trust their own employees as being honest and ethical individuals, and may furthermore believe that their organization is already well-protected against the potentials risks of fraud. As a result, such executives may not be as pro-active against these risks as is warranted, and they may fail to properly assess their risks and vulnerabilities to fraudulent activity.

The truth is that American businesses are at significant risk of falling victim to the relatively few dishonest managers and



employees, and that a large number of companies do not have effective systems in place to prevent the occurrence of fraud.

The Fraud Triangle: Explaining the Occurrence of Fraud

The Fraud Triangle, developed decades ago by criminologist Dr. Donald Cressey, explains that fraud typically occurs when three factors are simultaneously present: pressure or incentive to commit a fraud; opportunity; and rationalization.

- The incentive to commit a fraud can be triggered by a variety of factors, including an individual’s real or perceived need for additional cash (e.g., to repay debts, living beyond their means, to pay for medical emergencies, etc.); the belief that additional income will reduce personal stress; or to raise their reputation or status within their social setting. A weak economy provides a further compelling reason to commit fraud. For example, since raises or bonuses may be reduced or eliminated during such a period, or job mobility will be more limited, the individual may look to illegitimate means to raise his or her income.
- Opportunity occurs when there is an opening or gap in the company’s current financial or operating system that can be exploited (for example, gaps in internal controls).

- Rationalization enables an individual to feel justified in committing the fraud, e.g., “everyone is doing it,” “the company owes me,” or “the lawyers said it was okay.”

The Need for Effective Internal Controls

Quite often, the opportunity to commit fraud arises because there is too much trust placed in certain managers and employees, without any effective system of checks and balances or internal controls to prevent them from manipulating the financial accounts, misappropriating the company’s assets, or participating in corruption or bribery.

When an individual has sole responsibility or sole access to financial information, bank accounts, information about receivables, and other critical company data, this should be a signal to senior management, CFOs, controllers, and the audit committee that internal financial controls need to be tightened.

Indeed, the most important factors that enable fraud schemes to succeed are: (1) lack of internal controls; (2) lack of management review and oversight; and (3) the ability of certain individuals to override existing controls, according to the 2008 ACFE survey. Other significant factors include lack of the following: competent oversight; independent checks and audits; clear lines of authority; employee fraud education; a fraud reporting mechanism.

¹ Global Fraud Report, Annual Edition 2009/2010, Kroll Inc

What to Do If You Suspect Fraud

When fraud is suspected in an organization, most business owners are unsure what to do first. Of course, general or outside counsel should immediately be contacted. Simultaneously, contact the company's internal auditors to discuss the implementation of additional controls and changes to existing processes to prevent any suspected fraud from continuing or reoccurring. While it's important not to accuse anyone at this time, procedural changes can help. For instance, if asset misappropriation is suspected, add another approver to the sign-off process for expenses. Companies should note that any interim actions do not replace the need for strong internal controls.

In addition, the Company should consider engaging the services of an independent forensic accountant, who will investigate the suspected fraud and provide answers to such questions as:

- How did the fraud occur?
- Who perpetrated it?
- Was it a sole individual or was there collusion among employees or third parties?
- What was the dollar impact of the fraud?
- Is the fraud still occurring?
- Is this fraud/theft occurring in other areas of the company?

The independent forensic accountant will issue a formal report on the findings.

If the independent forensic accountant concludes that fraud has occurred, the resulting report on findings can be used in a number of ways. In cases of sizeable frauds, the report is often used as a basis to pursue legal action. Other times, the reports are given to the State Attorney General. In lower-profile situations, or in situations in which the company does not wish to raise awareness of the perpetuated fraud, the report may be used as a basis for employee termination.

About 90 percent of corporate fraud involves asset misappropriation, such as billing schemes, check tampering, check reimbursements, payroll schemes, and cash register disbursements, according to the ACFE survey. Also included in this category are non-cash misappropriations, which involve the theft or misuse of physical assets, such as inventory or equipment, or the misappropriation of proprietary information.

For the purposes of developing effective internal controls, the focus is on deterring financial misstatements—which includes frauds in such areas as revenue recognition, expense capitalization, misstatement of inventories, overstatement of receivables,

and manipulation of intercompany transactions.

It is impossible to overstate the need for every company to develop a fraud risk program that encompasses fraud risk assessment, disclosure of conflicts, violation-reporting procedures and whistleblower protection, among other components. At J.H. Cohn, through our Corporate Governance Services Group, we remain committed to assisting our clients in developing such a comprehensive risk management function. Protecting your company from financially damaging fraudulent activities is essential to the long-term success of your business.

In addition, should you suspect the occurrence of fraud or other irregularities, J.H. Cohn's Business Investigation Services Group has the expertise and resources to help you investigate the facts related to the suspected fraud and/or violations of company policies. ■



Sharon Bromberg, CPA, CIRA, CFF, is a partner with J.H. Cohn's Business Investigation Services Group and serves as the Firm's Mergers & Acquisitions Co-Practice Director. She can be reached at sbromberg@jhcobn.com or 1-866-688-0700.

California

Los Angeles

11755 Wilshire Boulevard
17th Floor
Los Angeles, CA 90025
310-477-3722

San Diego

4180 Ruffin Road
Suite 235
San Diego, CA 92123
858-535-2000

Warner Center

21700 Oxnard Street
7th Floor
Woodland Hills, CA 91367
818-205-2600

Cayman Islands

P.O. Box 1748 GT
27 Hospital Road
George Town, Grand Cayman
877-704-3500 x7839

Connecticut

Glastonbury

180 Glastonbury Blvd.
Glastonbury, CT 06033
860-633-3000

New Jersey

Roseland

4 Becker Farm Road
Roseland, NJ 07068
973-228-3500

Eatontown

27 Christopher Way
Eatontown, NJ 07724
732-578-0700

Lawrenceville

997 Lenox Drive
Lawrenceville, NJ 08648
609-896-1221

Metro Park

333 Thornall Street
Edison, NJ 08837
732-549-0700

New York

Manhattan

1212 Avenue of the Americas
Suite 1200
New York, NY 10036
212-297-0400

Charles Brucia & Co.,
A Division of J.H. Cohn LLP
1212 Avenue of the Americas
New York, NY 10036
212-682-2459

Frederic Kantor & Company,
A Division of J.H. Cohn LLP
1212 Avenue of the Americas
New York, NY 10036
212-727-2300

Long Island

100 Jericho Quadrangle
Suite 223
Jericho, NY 11753
516-482-4200

White Plains

1311 Mamaroneck Avenue
White Plains, NY 10605
914-684-2700