

CORPORATE

Avoiding Conflicts Under FAS 109

The closing paragraph of a recent article in *The Tax Adviser*, the journal of the American Institute of Certified Public Accounts, states the issue succinctly: “An auditor’s use of the ‘tax specialist’ for tax matters is more important than ever before,” author Katherine D. Morris, CPA, writes in the May 2005 issue. “Clear guidance on tax services is needed to satisfy audit firms, CEOs, CFOs and audit committees.”

Prompting Morris’ avowal regarding the need for audit firms to tap the expertise of tax specialists is the accounting industry’s ongoing discussion regarding the impact of the Sarbanes-Oxley Act of 2002 on audit firms’ responsibilities under Financial Accounting Standards Board Statement (FAS) No. 109 and the potential conflicts of interest it can create for both auditing firms and their clients.

A Closer Look at FAS 109

Issued in February 1992, FAS 109’s stated purpose is to recognize the amount of taxes payable or refundable for the current year and the deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a corporation’s financial statements or tax returns. In short, FAS 109 requires public companies to disclose a reconciliation of the reported amount of income tax expense that would result from applying domestic federal statutory rates to pretax financial income.

The focus of FAS 109, which applies only to publicly owned companies, is the treatment of deferred tax assets and liabilities, which arise when the tax treatment of an item is temporarily or permanently different from its financial accounting treatment. For example, generally accepted accounting principles (GAAP) might allow a \$20,000 expense for a particular item where the Internal Revenue Code allows just a \$9,000 deduction. The temporary difference arises if the Code also allows for the remaining \$11,000 to be deducted in subsequent years.

Sarbanes-Oxley Brings FAS 109 Into Focus

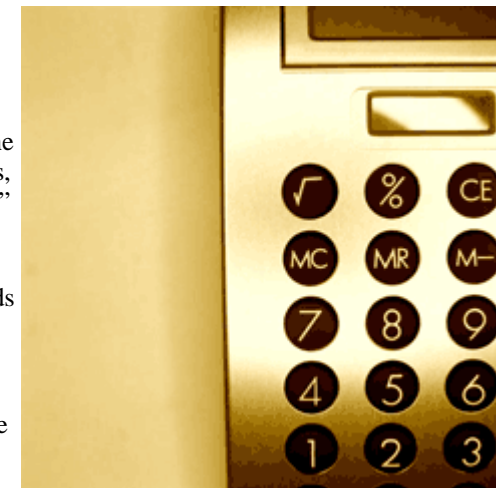
With the passage of Sarbanes-Oxley three years ago, FAS 109 went from being a thorny and sometimes subjective accounting issue to one that also involves issues of corporate ethics, accountability and potential conflicts of interest. A key question concerns which types of tax services auditing firms can provide to public clients without compromising their independence and, as a result, the viability of those companies’ audit statements.

The lack of a “bright line” rule governing tax planning and advice has been a source of concern to many audit firms, but proposed guidance identifying tax services that pose and do not pose unacceptable threats to auditor independence may help clarify the situation. In December 2004, the Public Company Accounting Oversight Board (PCAOB) voted unanimously to propose rules that would prohibit registered public accounting firms from providing certain tax services to public company audit clients, providing any tax services to officers in a financial reporting oversight position, and receiving contingent fees for such tax services from public company audit clients.

Ensuring Accuracy

The issue of verifiable auditor independence is particularly important as it relates to FAS 109 because deferred tax liabilities can offer significant advantages to companies. A big one is the time-value of money that results from a deferral in paying taxes. Sarbanes-Oxley requires public companies to have adequate, auditable internal controls in place for accounting decisions of this type, and it requires auditors to attest to the accuracy of those reports. Since the PCAOB standards clearly indicate that an audit firm cannot function as part of a client company’s system of internal controls, there is increasing demand for the services of independent tax specialists such as Geller & Company to perform various services including FAS 109 accounting.

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