



THE IMPORTANCE OF CORPORATE GOVERNANCE FOR THE PRIVATE COMPANY



William McNamara, CPA
Director of Construction Services Group
Cowan, Guteski & Co., P.A.

New Federal laws enacted to stop large public companies from misleading its shareholders are slowly, but steadily trickling down to privately owned businesses. In October of 2002 Congress passed the Sarbanes-Oxley Act. Not since the Stock Market Crash of 1929 has a piece of legislation changed the culture and operations of big business. The Sarbanes-Oxley Act, more commonly referred to as “SOX,” requires management and the board of directors to operate their companies in an open and transparent business forum. SOX requires putting what’s best for the investor first, the company second and its officers and directors last.

While small closely-held businesses may not see direct or immediate benefits, many of the SOX objectives will eventually be introduced into their business practices. It is a natural progression. As the financial reporting requirements for large businesses change; best practices will be established and then copied by other organizations. Where can the closely-held business see a benefit in its relationship with their banker or surety bond company? A company’s character is always a significant factor with both parties and any actions taken to strengthen it can only improve the company’s standing. SOX was created to restore public confidence in big business; emphasizing ethical and practical business sense is good for any size company.

The following are five areas where the new SOX regulations can impact the closely-held business:

1. CORPORATE GOVERNANCE

SOX requires the CEO and CFO to personally endorse the financial results of its company, a responsibility the closely-held business already has. But it also requires the adoption of a company wide code of ethics and conduct. Setting the tone at the top is a key concept in the law. A privately held company that clearly identifies its business practices will enjoy an enhanced reputation with the customers it services and the organizations it does business with.

Having written policies and procedures covering a company’s internal controls, operating practices and reporting responsibilities that are communicated is also covered. Many small businesses receive their corporate book and never hold and document in the form of Board Minutes their major policies and actions. Closely-held businesses that document an annual board of directors meeting that re-affirms the title, compensation and job responsibilities of its officers, validates its actions so that they can be better defended if disputes among family members arise.

2. FINANCIAL REPORTING

The accounting profession has seen the adoption and implementation of many new accounting pronouncements over the past several years. They range from being extremely complex (share based compensation rules) to the involvement of unintended victims (Is my real estate partnership a Variable Interest Entity?). Unfortunately, many of these pronouncements are a direct result of the corporate scandals detailed in the business news. For the small business owner, a well defined financial reporting plan should be developed.

It's a solid recommendation to meet with your accountant and internal accounting staff to discuss the new or pending reporting requirements, as well as how they could impact your company's financial statements. Generally Accepted Accounting Principals (GAAP) dictate the adoption of many of these new pronouncements.

Business owners can also consider changing their reporting method to Other Comprehensive Basis of Accounting (OCBOA). An example of OCBOA is the income tax basis. Under the income tax basis revenue and expenses are recorded in a similar fashion to the way income taxes are reported to the Internal Revenue Service. Many third parties find the income tax basis acceptable and some even claim it is the preferred choice for the privately owned business.

However, since many lending and surety bonding companies still require GAAP reporting, the authoritative Board that promulgates GAAP is studying an alternative commonly referred to as Big GAAP vs. Little GAAP. In this case, when an accounting pronouncement is issued which is intended to address a transaction involving a Fortune 500 company, the privately owned business will be exempted out. This process may spare the smaller company the expense of adopting something with little or no added value to their reporting process.

3. THIRD PARTY LENDERS AND CREDITORS

We must keep in mind that many of the organizations who provide financing and insurance products to the privately owned business are also subject to the provisions of SOX. As these organizations adopt the new rules they will obviously see positive changes within their own organizations. They will then incorporate those provisions into their business model. The old saying of "What's good for the goose is good for the..." well you get the point. So a natural migration of SOX rules will trickle down to the privately owned business.

Here is where a privately owned company can distinguish themselves against the competition and build better character. If they proactively implement SOX requirements and communicate that they voluntarily did so, they will enhance their reputation with their business associates and contacts.

4. RETENTION OF KEY EMPLOYEES

Successful companies have satisfied workforces. This rule will never change. Schoor DePalma, Inc. and Parette Somjen Architects, LLC demonstrate this model to perfection. Both companies are ranked high in employee satisfaction and listed as one on the best places to work in New Jersey (NJBiz 2006). Why? Management has developed a plan and has communicated the importance of each employee's contribution. Employees buy into the plan because they know how important it is to the success of the company. Both of these companies have developed cultures that say this is how we will deliver our services. As a result, customer satisfaction is also very high.

The tone set by management is another cornerstone of SOX. They not only want a company to act ethically, they require a company to specifically address how it will act. Provisions for communication and feedback throughout the chain of command of an organization are required to be developed. This includes employee evaluations, job responsibilities and in cases where problems are identified, a confidential and defined communication process that protects the employee.

5. GROWTH AND NEW OPPORTUNITIES

Many privately owned companies in the construction industry submit bids for public work through local governments. The government is already adding and addressing many of the items in SOX. Bid requirements will eventually be written to include SOX like requirements. Companies that are ahead of the curve will have a competitive advantage over others who are not.

The foundation of the U.S. economy is not the companies garnering the negative headlines of today. They are the closely-held, family owned businesses that roll up their sleeves to get the job done. Opportunities for business expansion, new products or markets find their way to companies who are growing, opportunistic and organized. Is that your company? If not, but you would like it to be, study the new SOX requirements and see what can be implemented into your practices.

As one of the leading accounting and consulting firms for the construction industry, Cowan, Guteski & Co., P.A. understands the importance of the SOX requirements. Contact Bill McNamara, CPA - Director of the Construction Services Group at 732-349-6880 extension 116 or bmcnamara@cowanguteski.com for more information on the Sarbanes-Oxley Act.

About Cowan, Guteski & Company, P.A.

As a diversified certified public accounting firm, Cowan, Guteski & Co., P.A. is committed to being an active partner in their client's growth by delivering value driven accounting and profitability consulting services. Visit www.cowanguteski.com for more information on the services available to meet the unique needs of the construction industry.

