

KBA GROUP LLP AND CARR LLP SPONSOR THE LEADERSHIP SERIES

In early March, KBA Group LLP and CARR LLP were proud to sponsor The Leadership Series at the Park City Club in Dallas. The Leadership Series is an annual executive forum held exclusively for past and present winners of The Dallas 100, an awards competition that recognizes the fastest growing privately-held companies in the Dallas area. This year's event featured keynote speaker, Dallas Mayor Tom Leppert. Prior to his election in June 2007, Mayor Leppert was recognized as a Dallas business and community leader and he served as Chairman and CEO of The Turner Corporation.

Addressing the crowd comprised of CEOs, CFOs and COOs, Mayor Leppert discussed the common challenges leaders face whether they are heading up a city or a corporation. He also discussed his perspective on achieving and sustaining growth in the business community including



his plans for future generations of leaders. One new educational initiative is designed to match our youth with corporations for paid 8 week internships. For more information about becoming involved in this program, please visit www.educationisfreedom.com. For more information about the 2008 Dallas 100, visit <http://www.kbagroupllp.com/news/events.aspx>.

PRIVATE COMPANY RISK ASSESSMENT STANDARDS – CHANGES TO THE FISCAL 2007 AUDIT PROCESS

ADAM TARNOW

In February of 2006, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued eight new Statements on Auditing Standards (SASs) collectively referred to as the Risk Assessment Standards. These new Risk Assessment Standards were developed to fill in gaps in widely used audit methodologies such as the “balance sheet” approach. For more than twenty-five years, auditors have utilized the “balance sheet” approach to perform successful audits which included a thorough testing of all material balance sheet accounts and an analytical review and other specific procedures related to the statement of operations. Additionally, auditors gained an understanding of the business and the control environment and major cycles. Although this method was effective, the perception was that it often led to “cookie cutter” audits and disjointed audit documentation files and potentially did not sufficiently modify audit

procedures based on the financial controls at specific companies. To remedy this, the ASB issued the new Risk Assessment Standards which are effective for audits of financial statements for periods beginning after December 15, 2006. This means that all privately-held businesses will be subject to a process that will include an emphasis on reviewing financial controls for all fiscal year 2007 audits.

Objectives of the New Risk Assessment Standards. The ASB designed the new Risk Assessment Standards with the following three objectives in mind.

- (1) For auditors to obtain a more in-depth understanding of the audited entity and its environment, including internal control;
- (2) For auditors to perform a more rigorous assessment of the risks of where and how financial statements could be materially misstated;

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PRIVATE COMPANY RISK ASSESSMENT STANDARDS

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- (3) For improved linkage (and better documentation of this linkage) between the auditor's assessed risk and the nature, timing and extent of audit procedures performed in response to identified risks.

The standards, which have succeeded in improving the fundamental building blocks of the audit process, also introduce an audit methodology that differs in subtle, yet significant ways from the audit methodology used by a majority of audit firms.

A Better Understanding of the Entity. Auditors are already required to obtain an understanding of the audited entity, so what does the ASB mean by "a more in-depth understanding?" Essentially, auditors are now required to increase the breadth (i.e. what they know) and depth (i.e. how well they know it) of their understanding of the audited entity. For example, while performing the new audit methodology, an auditor should obtain detailed information concerning the entity's capital structure, ownership and governance as well as how certain industry practices and/or government regulations will affect the organization.

A Better Understanding of Internal Control. Arguably, the most significant change brought about by the new standards is the auditor's requirement to understand their client's internal control environment. In the past, auditors invested a minimal amount of time on internal controls. This was due to the fact that very few audit firms placed any reliance on an audited entity's internal controls. This allowed firms to assess control risk at "maximum" and, therefore, perform the audit relying primarily on substantive procedures. Internal control memos in most audit files usually focused on process flow (i.e. how sales are recorded, billed and subsequently collected) and allocated very little time to addressing the controls over each process. Under the new Risk Assessment Standards, auditors are no longer allowed to default to maximum control risk. If an auditor believes control risk for their client should be assessed at maximum, they must now document their justification for this assessment.

In addition, under the new standards, an auditor must now obtain an understanding of each company's entity level controls (i.e. management's control over the entity as a whole) as well as their activity level controls (specific controls over revenue/receivables, purchases/payables, inventory/cost of sales, etc). Each auditor must obtain a sufficient understanding of controls to be able to determine if each control is properly designed and appropriately implemented. How will this information be obtained? The new standards give three options: (1) inquiry, (2) observation and (3) re-performance. Inquiry alone, however, is no longer sufficient. No longer will an auditor simply ask management about topics such as their attitude towards financial reporting, their operating philosophy or their commitment to competence. Auditors are now required to corroborate management's responses by either observation or re-performance.

A More Rigorous Assessment of the Risk of Material Misstatement. Under the new standards, the planning meeting has been emphasized and because of the new risk assessment

standards, is one of the most important steps in the new audit methodology and is a high priority for all team members.

As the audit team increases the breadth and depth of their understanding of the audited entity and its internal control environment, the audit team then uses this information to make a better determination of where the risks of material misstatements are most likely to reside. While each team member is gathering information about the entity's environment, conducting interviews with personnel about the process and controls over significant cycles, and observing or re-performing certain key controls, they must also be on the lookout for "what could go wrong."

The new standards assume that if the process of gathering information about an entity's environment and internal controls over key cycles is done to the extent now required, then the audit team will be better equipped to assess the areas of highest risk for each entity. It is during the planning meeting that the audit team synthesizes their information and assesses the areas of highest risk.

Improved Linkage Between Assessed Risk and Audit Procedures Performed. Finally, after the audit team has successfully determined "what could go wrong" and assessed risk, the last step in the process is to determine exactly what audit procedures will be performed in response to all identified risks. Traditionally, most audit firms have used pre-packaged audit programs with few, if any, modifications. If an audit program step was not considered necessary, it was not typically removed from the program. Instead, it was annotated as "not considered necessary" or "not applicable" and there was rarely a clear link between why certain audit procedures were performed or were not performed. Now, under the new standards, there is a direct and well documented link between assessed risk and the audit procedures performed.

Noticeable Changes to the Fiscal 2007 Audit Process. What changes will be most noticeable to privately-held companies during their upcoming fiscal 2007 audit? First and foremost, their auditor will appear to be more curious about their business. Although most firms have a good understanding of each of their clients, the new standards require auditors to more thoroughly and systematically document information about a wide range of topics that affect the entity's environment. As a result, many clients will probably spend a significant amount of time with their auditors discussing items such as management's philosophy and operating style, how current economic conditions are affecting the entity and whether or not the entity plans to implement any significant new marketing programs during the next year.

Secondly, auditors will be asking more detailed and specific questions about processes and internal controls over significant accounting cycles. Fortunately, these new standards do not require auditors to test controls over every accounting cycle. But, for those cycles that are deemed to be significant, clients should expect to discuss them in detail with their auditor. It is also possible that their auditor will test certain controls over those cycles.

Finally, each client can expect an auditor who better understands the unique aspects of their business.

KBA GROUP LLP ANNOUNCES THE PROMOTION OF TERRY LOVELACE TO PRINCIPAL, TAX SERVICES



KBA Group LLP is pleased to announce the promotion of Terry Lovelace to Principal, Tax Services. Terry has over 25 years of experience providing tax planning and compliance guidance to a wide range of businesses and individuals. He has extensive experience assisting high net worth individuals with their complex income and estate tax planning issues. In addition, Terry has co-authored several tax planning books that are currently in print and used daily by thousands of tax advisors. He is a significant contributor to the success we have enjoyed at KBA Group and we congratulate him on his promotion.

In his new role as a Tax Principal in the Firm, Terry will continue to provide excellent service to clients in a variety of industries including, but not limited to, oil and gas, real estate, construction, manufacturing, retail, hospitality, and service.

A graduate of Northwestern Oklahoma State University, Terry is involved in several professional organizations including the American Institute of Certified Public Accountants (AICPA) and the Texas Society of Certified Public Accountants (TSCPA).

WHAT'S A HAIR BALL ANALYSISSM ANYWAY?

DAVID McCULLY

Once in a while, we come up with cheeky expressions to describe a service, or a group of services, that we provide to our clients. In this case, the phrase we have coined is "Hair Ball AnalysisSM". While this service does not exactly sound like one that a certified public accounting firm would routinely provide, it is a service that KBA Group's Transaction Advisory Service practice provides as a part of its buy-side due diligence engagements. If we have sufficiently stirred up your curiosity, then here is some more detailed information about our Hair Ball AnalysisSM.

In these uncertain times, acquirers of businesses and their capital partners are approaching deals with a renewed sense of caution. With all the talk about recession and the reality of a tight credit market, it is more critical now than ever to gain a solid pre-acquisition understanding of the target business – beyond what traditional financial due diligence provides. Let's face it, nobody wants to make a bad investment.

With this said, due diligence is not something to be overlooked. The due diligence phase of each deal should be viewed as a one-time opportunity to take an in-depth look at the target business and confirm the validity of the investment opportunity. Depending on the structure, industry and process-maturity of the target, an in-depth look into the people, processes and procedures involved in the business can add value in a number of ways. Two must do items include a solid quality of earnings

assessment and a verification of the productive assets of the business. A tax position evaluation is also a must in a stock deal. There is just no substitute for these basic financial due diligence analyses. However, KBA Group's Transaction Advisory Service professionals encourage clients to dig even deeper on the front end of the transaction. This is where the Hair Ball AnalysisSM comes into play.

KBA Group's Hair Ball AnalysisSM typically requires about one day, requires our team to gain an understanding of the intended deal from the buyer's perspective and requires that we have a receptive audience with key management personnel of the target company. The process generally involves an analysis of deal documents, historical financial and operating data and a series of carefully thought out "stupid" questions intended to identify the weaknesses and risks associated with the business. Following are some of the "hair ball" items to consider:

- ▶ In a strategic buy or when adding to a platform investment, what are the expected synergies and how long will it take to realize them?
- ▶ If the target is a carve-out of a larger entity, can you be sure that core costs and processes have not historically been supported by another part of the seller's business?
- ▶ How solid are information and productive equipment systems within the target? Do they suffer from deferred maintenance that may require a substantial future investment to repair?
- ▶ Is the target's management capable of implementing your plans to integrate the business, or will they need additional resources?

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WANT TO GO ELECTRONIC?

Would you prefer to receive our newsletter via email? Send your email address to our Marketing Director, Aimee Glass, at aglass@kbagroupllp.com. Be sure to include "KBA Focus" in the subject line.

HAIR BALL ANALYSISSM

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- ▶ Are the processes for key business cycles documented, or is the day-to-day business at risk if certain key people terminated their employment?
- ▶ Cash and working capital are key. What are the future working capital requirements and seasonal cycles going into the future?
- ▶ Is the company in compliance with permits and licenses required to conduct business?

This list of questions is not intended to be comprehensive, but it is meant to give you a rough idea of what the “hair ball” may look like. Depending on the deal, obtaining straight answers to many other questions may also be appropriate.

What is the Final Outcome of KBA Group’s Hair Ball AnalysisSM?

The Hair Ball AnalysisSM generates a short list of the key financial and operational areas of concern. Most quality acquisition targets end up having three to five critical risk areas, or ones that require a better understanding. From the buyer’s perspective, the identification of any more than five critical risk areas should be cause for concern.

With this list in hand, KBA Group’s Transaction Advisory Service professionals can prepare a targeted project plan with meaningful cost estimates. Moreover, our client can make a decision on which areas require further analysis and who on the deal team should cover those items.

In closing, we want to leave you with a formal definition for our newly coined term.

Hair Ball AnalysisSM {hâr bôl ə-nāl’ī-sīs} - *noun* – A Hair Ball AnalysisSM is defined as a wise investment made at the beginning of a deal that has the ability to steer the deal’s evaluation towards its risks and has the effect of providing a road map to a targeted, cost effective evaluation of the investment opportunity.

Whether it’s analyzing a potential merger or acquisition, preparing information for a sale or financing, or minimizing the tax implications of a purchase or sale, finding the right financial professional to assist with the transaction can be a difficult task. For more information, contact David McCully, Principal, Transaction Advisory Services, at 469.341.0786 or via email at dmccully@kbagroupllp.com.

KBA GROUP LLP ANNOUNCES THE ADDITION OF TERRY PIERCE, DIRECTOR OF RECRUITING AND TRAINING



KBA Group LLP is pleased to announce the addition of Terry Pierce as Director of Recruiting and Training. Terry has over 10 years of experience in human resource and recruiting roles. He actually began his career providing assurance and business advisory services with an international accounting firm. Terry then made the transition to human resources and recruiting, yet remained in the accounting industry. Most recently, he served as the Assistant Director for the Office of Minority Recruiting at Ernst & Young. We are excited to add him to the KBA team, and look forward to his future contributions to the success of the Firm.

In his new role as Director of Recruiting and Training, Terry will manage the Firm’s recruiting process, handle new hire activities, and oversee the mentoring program. He will also manage the Firm’s training process.

A graduate of Langston University, Terry is involved in several professional organizations including the National Association of Black Accountants and the Association of Latino Professionals in Finance and Accounting.

KBA IN THE COMMUNITY

- ▶ KBA Audit Senior, **Adam Tarnow**, recently developed and presented a continuing professional education course to the Dallas office of Tatum, a nationwide executive services and consulting firm. The course was entitled “The AICPA’s New Risk Assessment Standards and the Subsequent Changes to the Audit Process.” His presentation was so well received that he most recently made a scaled down version of the presentation at a local AeA meeting. AeA is a nationwide non-profit trade association that represents all segments of the technology industry. See Adam’s article entitled “Private Company Risk Assessment Standards” in this issue of KBA Focus.
- ▶ KBA Tax Partner, **Bill Griffin**, recently served as a panelist for businessKillers, an educational workshop presented by Women In Film.Dallas. **Camille Irvin**, KBA Group’s Business Development Director and a member of WIF.D, was also in attendance at this event. The workshop covered the six mistakes that consistently cause businesses to fail. Bill participated in the discussion surrounding two of the six mistakes including “I know what my business is worth” and “You can’t beat Uncle Sam.” Representatives from HFG Advisors, Dallas Audio Post, and Sabina C. Bramlett, P.C. also served on the panel discussion which took place at TM Television.

FOCUS ON SERVICES

AUDIT SERVICES

- ▶ Audits, reviews and compilations of private companies
- ▶ Audits of SEC registrants and related filings
- ▶ Audits of 401(k) & other benefit plans
- ▶ Financial due diligence in connection with acquisitions and other transactions
- ▶ Forensic accounting/ fraud investigation

TAX SERVICES

- ▶ Federal and state tax preparation for:
 - ▶ Partnerships
 - ▶ Corporations
 - ▶ Limited liability companies
 - ▶ Individuals
 - ▶ Estates, gifts and trusts
 - ▶ Non-profits
- ▶ Representation before federal and state tax authorities
- ▶ Federal and state tax minimization strategies
- ▶ Entity selection
- ▶ Entity conversions
- ▶ Tax research
- ▶ Transaction strategies
- ▶ Compensation planning
- ▶ Asset protection
- ▶ Succession planning
- ▶ Estate and gift planning
- ▶ Multi-state planning
- ▶ Sales tax consulting
- ▶ Sales tax audit defense
- ▶ Reverse sales tax refunds
- ▶ Accounts payable refund analysis

RISK ADVISORY SERVICES

- ▶ Sarbanes-Oxley Section 404 Services
- ▶ Internal Audit Services including: outsourcing, assessments, testing and consulting
- ▶ SAS 70 Reports for service organizations
- ▶ Audit Committee Advisory Services

OTHER VALUE ADDED SERVICES

- ▶ Transaction Advisory
- ▶ Business Services
- ▶ Profit Enhancement
- ▶ SBIC Regulatory Consulting & Compliance
- ▶ Family Owned Business

▶ www.kbagroupllp.com

DALLAS 100™ CLIENT WINNERS CONTINUED FROM PAGE 5

The statistics* for the 100 winning companies are a factual testament to the important role entrepreneurs play in our economy. Together, the Dallas 100:

- ▶ Generated more than \$7.9 billion in sales during the past three years.
- ▶ Grew the number of employees from 24,215 in 2004 to 50,516 in 2006.
- ▶ Generated sales in 2006 of \$3.6 billion.
- ▶ Grew average sales from 2004 to 2006 by 190%.

Applications for the 2008 Dallas 100 are now being accepted. To qualify, a company must meet certain requirements including legal status, location, sales history, credit history, character and the like. If you would like to learn more, contact Camille Irvin at 972.788.0330.

**Statistics are gathered from data submitted on applications. Each year's application gathers the data for the previous three year period. For 2007, the application required data for 2004, 2005 and 2006.*

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