Insights

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Auditing

Proposed Amendment to AU Section 722

Many nonissuers prepare quarterly financial information in a manner similar to public companies based on contractual, indenture, or other third-party requirements. Private equity exchanges, for example, may require listed companies to prepare interim condensed financial information that is "substantially similar" to the information that an issuer includes in a quarterly report on Form 10-Q and also expect the listed companies to have the interim financial statements reviewed by an independent accountant. Independent accountants may also be requested to perform a review of interim financial information for a nonissuer in other situations, including (a) an exempt offering (including Rule 144A offerings) that includes interim financial information or (b) a review of interim financial information prepared in accordance with the provisions of an indenture agreement.

Currently, AU Section 722 does not apply to reviews of financial information of nonpublic entities except in specific limited situations (i.e., when a nonissuer makes a filing with a specified regulatory agency in preparation for a public offering or listing). The AICPA Auditing Standards Board has issued an exposure draft of a proposed Statement on Auditing Standards (SAS), Interim Financial Information, which, if finalized, would amend AU Section 722, Interim Financial Information, to accommodate reviews of interim financial information of nonissuers, including companies offering securities pursuant to SEC Rule 144A or participating in private equity exchanges. This statement would apply when the interim financial information of a nonissuer is intended to provide a periodic update to year-end reporting (for example, interim financial reporting in accordance with Article 10 of SEC Regulation S-X) and the accountant has either (a) audited the entity's latest annual financial statements or (b) is auditing the current-year financial statements and the entity's latest annual financial statements were audited by another auditor. The proposed statement clarifies that if these conditions are not met, reviews of interim financial information of nonissuers should be performed in accordance with Statements on Standards for Accounting and Review Services. The proposed SAS also removes the guidance for reviews of the interim financial information of issuers since such guidance resides in the auditing standards of the Public Company Accounting Oversight Board.

If finalized, the proposed statement would be effective for interim periods within fiscal years beginning after December 15, 2008. Early application would be permitted.

The exposure draft is available for comment until November 3, 2008 at http://www.aicpa.org/download/auditstd/ED_Interim_Financial_Information.pdf.

Public Sector

GASB Proposes to Transfer Guidance from AICPA Auditing Literature

Currently, preparers of state and local government financial statements must look to the American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SASs) for guidance on certain accounting and financial reporting issues, such as related-party transactions, subsequent events, and going concern considerations. As such, the Governmental Accounting Standards Board (GASB) has issued the following Exposure

Drafts, which propose to transfer such guidance into the GASB's accounting and reporting literature:

Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards; and

The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.

The GASB proposes to move the relevant parts of the SASs to its literature without substantive changes. The Exposure Drafts are available for comment until October 30, 2008 at http://www.gasb.org/exp/index.html.

SEC

Qualifying for Smaller Reporting Company Status

Effective February 4, 2008, the SEC adopted a new system of disclosure rules for a "smaller reporting company" filing periodic reports and registration statements with the SEC. Under the new rules, a company qualifies as a "smaller reporting company," and therefore for scaled disclosure, if it (1) had a common equity public float of less than $75 million or (2) is unable to calculate its public float and has annual revenue of $50 million or less, upon entering the system. For purposes of determining this eligibility, public float is calculated as of the last business day of the second fiscal quarter. Most SEC reporting companies already calculate this number to determine whether they need to file annual and quarterly reports with the SEC as accelerated filers. A company must look to the definitions of "smaller reporting company" and "accelerated filer" to determine if it qualifies as a smaller reporting company and non-accelerated filer for each year.

Due to the application of the transition rules for accelerated filers, a company can be both an accelerated filer and a smaller reporting company at the same time. For example, a company with a fiscal year ended December 31 that is an accelerated filer and had public float that had dropped to $60 million as of June 30, 2007 qualified as a smaller reporting company for filings due in 2008 because fiscal year 2007 was the initial determination year for the company to qualify for smaller reporting company status, and it had less than $75 million in public float on the last business day of its second fiscal quarter. However, since the company was an accelerated filer with respect to prior filings, it would be required to have less than $50 million in public float on the last business day of its second fiscal quarter in 2007 to exit accelerated filer status in 2008. In this example, the company had a public float of $60 million on the last business day of its second fiscal quarter of 2007, and therefore is unable to transition to non-accelerated filer status. Such a company may use the scaled disclosure rules for smaller reporting companies in its annual report on Form 10-K, but the report would be due 75 days after the end of its fiscal year and must include the auditor attestation report required by Section 404 of the Sarbanes-Oxley Act. A reporting company that newly qualifies as a smaller reporting company is permitted to provide scaled disclosure as soon as it wishes to do so — even in the next quarterly report on Form 10-Q it files covering the second fiscal quarter in which the company made its new eligibility determination.

Smaller reporting companies that qualify will maintain that status until the year after the next calculation date (the end of its second fiscal quarter). Any reporting company that can calculate its public float and did not qualify as a smaller reporting company initially at transition will not qualify as a smaller reporting company in the future unless its public float falls below $50 million on the last business day of its second fiscal quarter. This follows the rule for exiting accelerated filer status. Companies that cannot calculate their public float would need to fall below $40 million in annual revenues to qualify as smaller reporting companies in the future. A smaller reporting company that is no longer eligible for scaled disclosure may finish reporting as a smaller reporting company for the rest of the fiscal year, including in its annual report on Form 10-K. The company must provide the non-scaled, larger-company disclosures in the first quarterly report for the new fiscal year following the eligibility determination date.

The following chart summarizes a few different transitional scenarios for a calendar-year-end company:

	Company A	Company B	Company C	Company D
Prior to new rules Public float as of June 30, 2006	$80 million	$80 million	$60 million	$60 million
Filing status as of December 31, 2006	accelerated filer	accelerated filer	accelerated filer*	accelerated filer*
At transition Public float as of June 30, 2007	$60 million	$80 million	$60 million	$60 million
Filing status as of December 31, 2007	accelerated filer & smaller reporting company	accelerated filer	accelerated filer & smaller reporting company	accelerated filer & smaller reporting company
Later years Public float as of June 30, 2008	$40 million	$60 million	$60 million	$80 million
Filing status as of December 31, 2008	non-accelerated filer & smaller reporting company	accelerated filer	accelerated filer & smaller reporting company	accelerated filer & smaller reporting company
Filing status as of March 31, 2009	non-accelerated filer & smaller reporting company	accelerated filer	accelerated filer & smaller reporting company	accelerated filer

*The company previously had a public float in excess of $75 million and therefore qualified as an accelerated filer.

International

Focusing on Differences Between IFRS and U.S. GAAP: Is this the Right Approach?

This article is the fourth in a series of articles that takes our readers on a journey through International Financial Reporting Standards (IFRS) with a special focus on the standards' quintessential feature: they are principles-based. This article takes a short excursion into the pros and cons of an approach to IFRS and U.S. generally accepted accounting principles (GAAP) based on the knowledge of one of the two sets of standards and bridging to the other by purely focusing on the differences between them.

If we ask a U.S. tax specialist what the differences are between the U.S. tax system and the U.K. tax system, a likely response is that it is almost impossible to reply to such a question. The quantity of literature to be compared is too extensive. Even where basic concepts might be similar, very few aspects of the details are likely to be identical. Indeed, because of the two different systems, even if we compare two paragraphs that are worded almost identically, it cannot be concluded that they could be similarly applied. Ultimately, it is unlikely that a U.S. tax specialist would try to apply U.K. tax laws by starting with U.S. tax laws and bridging the differences.

The same conclusion can be broadly applied when approaching IFRS vs. U.S. GAAP. One cannot apply IFRS by simply starting with U.S. GAAP and bridging the differences. This does not mean that focusing on differences is worthless. Certainly it is an important tool in becoming introduced to IFRS, and possibly a necessary preliminary step to becoming familiar with IFRS. However, we should be aware that, in general, this might be the only goal that this strategy can reasonably achieve.

Knowing a different set of standards is valuable when approaching IFRS, and to be acquainted with U.S. GAAP represents an enviable and privileged starting point. What is valuable about understanding U.S. GAAP is the professional knowledge, experience, and background with the most developed and comprehensive set of standards ever written, which, if well used, can dramatically facilitate the bridge to IFRS. After all, we are still comparing accounting standards - not things as different as chalk and cheese.

It takes a long time, sometimes an entire professional life, to become proficient with one set of standards, let alone two sets of standards. At first blush, focusing on differences may seem to be the most efficient way to approach IFRS. Intuitively, if we are familiar with U.S. GAAP, we just need to focus on the differences and consequently save time and effort in becoming familiar with IFRS. This approach might give the misleading impression that if we use the "U.S. GAAP + Differences" approach, we do not have to start from scratch. This perception is misleading because if we approach IFRS directly, we are not requested to forget the U.S. GAAP knowledge we already have. On the contrary, as already highlighted, such knowledge will be a terrific ally that, if used properly, will pave the road to IFRS.

One of the main issues when comparing IFRS and U.S. GAAP is that under U.S. GAAP in numerous cases, for the sake of clarity, we end up with rules that try to set "bright lines"; the same cannot be said about IFRS. Given a specific topic, once we have identified the U.S. GAAP accounting treatment, it is quite common that under IFRS we conclude that the treatment is similar, but it depends on the specific characteristics of the uniquely identified transaction and its economic substance. It is at this level that U.S. GAAP in many cases sets a rule, while IFRS relies on the flexibility of principles. Indeed, at this level of detail, a "U.S. GAAP + Differences" approach is unlikely to provide the right answer because it focuses on U.S. GAAP when instead we would need to redirect our attention and analysis to the core of IFRS principles.

Possibly, in those cases, the only way to approach differences between IFRS and U.S. GAAP is to apply U.S. GAAP, then apply IFRS, compare the outcomes, and see if a difference emerges. In other words, in those cases, there is no substitute for understanding and applying IFRS in full. A "clean-sheet" approach is recommended because, as noted above, "U.S. GAAP + Differences" does not necessarily result in IFRS.

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