

2005

SEC and PCAOB alert - 2005/06

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AUDIT RISK ALERTS

SEC and PCAOB Alert — 2005/06

*A Roundup of Recent SEC and
PCAOB Issuances and Guidance*

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA[®]

SEC and PCAOB Alert — 2005/06

*A Roundup of Recent SEC and
PCAOB Issuances and Guidance*

Notice to Readers

This publication provides preparers and auditors with a detailed overview of recent developments at the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) with respect to financial reporting and auditing matters. The material in this publication was prepared by AICPA staff and has not been considered or acted upon by senior technical committees of the AICPA or the AICPA Board of Directors and does not represent an official opinion or position of the AICPA. It is provided with the understanding that the author and publisher are not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought. The author and publisher make no representations, warranties, or guarantees as to and assume no responsibility for the content or application of the material contained herein, and expressly disclaim all liability for any damages arising out of the use of, reference to, or reliance on such material.

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SEC and PCAOB Alert—2005/06

Securities and Exchange Commission Developments

The summaries below are for informational purposes only and should not be relied upon as a substitute for a complete reading of the applicable rule. In addition, the information presented below does not encompass all of the recent issuances and activities of the Securities and Exchange Commission (SEC). See the SEC Web site at www.sec.gov for complete information.

SEC Staff Accounting Bulletins

A Staff Accounting Bulletin (SAB) reflects the SEC staff's views regarding accounting and disclosure practices. They represent interpretations and policies followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws. Listed below are two of the most current SABs.

SAB No. 107

SAB No. 107, issued in March 2005, summarizes the views of the staff regarding the interaction between the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, this SAB provides guidance related to the following:

- Share-based payment transactions with nonemployees
- The transition from nonpublic to public entity status
- Valuation methods (including assumptions such as expected volatility and expected term)

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- The accounting for certain redeemable financial instruments issued under share-based payment arrangements
 - The classification of compensation expense
 - Non-GAAP financial measures
 - The first-time adoption of FASB Statement No. 123R, *Share-Based Payment*, in an interim period
 - The capitalization of compensation cost related to share-based payment arrangements
 - The accounting for the income tax effects of share-based payment arrangements upon adoption of FASB Statement No. 123R
 - The modification of employee share options prior to adoption of FASB Statement No. 123R, Disclosures in Management's Discussion and Analysis (MD&A) subsequent to the adoption of FASB Statement No. 123R

Additional Guidance Related to SAB No. 107. Readers may also refer to the SEC's Office of Economic Analysis Memorandum, "Economic Perspective on Employee Option Expensing" for additional guidance at <http://www.sec.gov/interps/account/secoeamemo032905.pdf>. This document answers questions about the possible difficulties in obtaining reliable estimates of the value of employee options under FASB Statement No. 123R that often appear to arise from misconceptions about modern financial economics and valuation methods. The SEC addresses key questions and misconceptions. The conclusions are based on a review of the standard methods of valuation based on financial economics theory and practice, and focus on the following topics:

- Benefits of expensing employee stock options
- Choice of model
- Estimation of model parameters (assumptions, inputs)
- Verification of model and parameters, ex post
- General misconceptions and errors

SAB No. 106

SAB No. 106, Section 4, “Interaction of Statement 143 and the Full Cost Rules,” under “Topic 12-D, Oil and Gas Producing Activities—Application of Full Cost Method of Accounting,” was issued in September 2004. The interpretations in this SAB express the staff’s views regarding the application of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, by oil- and gas-producing companies following the full-cost accounting method. The SAB, which adds Section 4 to Topic 12-D of the SAB series, addresses the impact of FASB Statement No. 143 on the full-cost ceiling test and on the calculation of depreciation, depletion, and amortization.

SEC Final Rules, Exemptive Orders, and Interpretive Releases Issued in 2005

Presented below are certain newly issued SEC rules, exemptive orders, and interpretive releases that are relevant to accounting and auditing. Refer to the SEC Web site at www.sec.gov for a comprehensive list.

Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports of Companies That Are Not Accelerated Filers

The SEC issued Release No. 33-8618 on September 22, 2005, approving a further one-year extension of the Section 404 reporting requirements of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) for *non-accelerated filers* as well as the SEC’s request for comments regarding the implementation of the internal control reporting requirements at <http://www.sec.gov/rules/final/33-8618.pdf>. For purposes of foreign private issuers, this deferral applies only to those that are non-accelerated filers, whereas foreign private issuers that are accelerated filers and that file their annual reports on Form 20-F or Form 40-F will still be held to the compliance date of fiscal years ending on or after July 15, 2006. The compliance date for non-accelerated filers has been deferred to the first fiscal year ended on or after July 15, 2007 (from the previous compliance date of July 15, 2006), and applies to the following internal control reporting requirements:

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- A company must include in their annual reports a report of management on the company's internal control over financial reporting and an accompanying auditor's report.
 - A company must evaluate, as of the end of each fiscal period, any change in the company's internal control over financial reporting that occurred during the period that has materially affected or is reasonably likely to materially affect the company's internal control over financial reporting.
 - Certain representations must be included in the certifications required by the SEC Exchange Act rules 13a-14 and 15d-14, regarding a company's internal control over financial reporting.

The Commission further considered the specific challenges that non-accelerated filers are faced with as well as the ongoing efforts by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to develop an enhanced COSO Framework for smaller public companies in their determination of extending the compliance dates to July 15, 2007. However, companies should not use this extension to delay their Sarbanes-Oxley 404 compliance efforts, but should use this extension towards effective implementation.

Removal From Listing and Registration of Securities Pursuant to Section 12(d) of the Securities Exchange Act of 1934

In July 2005, SEC Release No. 34-052029 adopted amendments to its rules and Form 25 to streamline the procedures for removing from listing, and withdrawing from registration, securities under Section 12(b) of the Securities Exchange Act of 1934 (Exchange Act). The final rules require all issuers and national securities exchanges seeking to delist and/or deregister a security in accordance with the rules of an exchange and the SEC to file the amended Form 25 in an electronic format with the SEC on the EDGAR database. The final rules also provide that Form 25 serves as an exchange's notice to the SEC under Section 19(d) of the Exchange Act. Finally, the final rules exempt, on a permanent basis, standardized options and security futures products traded on a national securities exchange from Section 12(d) of the Ex-

change Act. The amendments serve to reduce regulatory burdens on the exchanges and issuers, and to make the delisting and deregistration process more transparent and efficient in the interests of investors and the public.

The Use of Form S-8, Form 8-K, and Form 20-F by Shell Companies

SEC Release No. 33-8587, issued in July 2005, adopted rules and rule amendments relating to filings by reporting shell companies. These provisions are intended to protect investors by deterring fraud and abuse in the securities markets through the use of reporting shell companies. Significant provisions include:

- Defines a *shell company* as a “registrant with no or nominal operations and either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets;”
- Amends rules to define the terms, *business combination related shell company*, *shell company*, and *succession*.
- Amends Form S-8 to prohibit the use of this form under the Securities Act of 1933 by shell companies.
- Amends Form 8-K under Item 5.06 to require a shell company to disclose the same type of information that it would be required to provide in registering a class of securities under the Securities Act of 1934
- Amends Form 20-F to address the reporting obligations of foreign private issuers that are shell companies.
- Amends Forms 10-Q, 10-QSB, 10-K, 10-KSB, and 20-F, to require a company to indicate by checking a box on those forms whether it is a shell company under the amended definition.

Securities Offering Reform

SEC Release No. 33-8591, issued in July 2005, adopted rules that will modify and advance significantly the registration,

communications, and offering processes under the Securities Act of 1933. The rules will eliminate unnecessary and outmoded restrictions on offerings. In addition, the rules will provide more timely investment information to investors without mandating delays in the offering process. The rules also will continue long-term efforts toward integrating disclosure and processes under the Securities Act and the Securities Exchange Act of 1934. The rules will further these goals by addressing communications related to registered securities offerings, the delivery of information to investors, and procedural aspects of the offering and capital formation processes. Significant provisions:

- Classify issuers based on their reporting history.
- Define ineligible issuers.
- Relax the limits on communications before, during, and after a registered securities offering.
- Streamline the shelf registration process.
- Affect the definition of a shelf registration and the effective date for Section 11 liability.

Technical Amendments to Rules Setting Forth the Method for Determining Market Capitalization and Dollar Value of Average Daily Trading Volume; Application of the Definition of Narrow-Based Security Index

In Release No. 34-52115 (July 2005), the Commodity Futures Trading Commission (CFTC) and the SEC (collectively referred to as the Commissions) adopted technical amendments to certain references in rules under the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 that set forth the method for determining market capitalization and dollar value of average daily trading volume, to reflect new terminology and rule designations that will become effective as a result of the adoption by the SEC of Regulation NMS. Specifically, the phrase “reported securities as defined in § 240.11Ac1-1” will be replaced with the phrase “NMS securities as defined in § 242.600.”

SEC Defers Compliance Dates for FASB Statement No. 123R and Provides Clarification on the Effect on Independent Auditor's Reports

On April 14, 2005, the SEC announced the adoption of a new rule that defers the compliance dates for FASB Statement No. 123R. The new compliance dates were changed to allow companies to implement FASB Statement No. 123R at the beginning of their next fiscal year, instead of the next reporting period that begins after June 15, 2005, or December 15, 2005, for small business issuers. The SEC, in its announcement, provided the following example for further clarification:

The financial statements for a calendar year-end company do not need to comply with FASB Statement No. 123R until the interim financial statements for the first quarter of 2006 are filed with the SEC. The financial statements for a company, other than a small business issuer, with a June 30 year-end, however, must comply with FASB Statement No. 123R when the interim financial statements for the quarter beginning July 1, 2005 are filed with the SEC.

Since the announcement by the SEC of the deferral of FASB Statement No. 123R compliance dates, many questions have been raised in practice regarding what effect the deferral will have on the independent auditor's report in terms of whether the company would be in compliance with generally accepted auditing principles (GAAP) if relying on this deferral, and whether any report modifications would need to be made to the independent auditor's report. The matter was discussed with the SEC staff and the following clarification was obtained:

The SEC deferral of the FASB Statement No. 123R compliance dates will not affect the independent auditor's report and no report modifications would be deemed necessary. The SEC has the authority to make, amend or rescind rules and regulations, including GAAP for issuers, under Section 19a of the Securities Act of 1933 and under Section 13b of the Securities and Exchange Act of 1934.

See the full text of the final rule release by going to the following link: <http://www.sec.gov/rules/final/33-8568.pdf>.

SEC Adopts Amendments That Affect Foreign Private Issuers for First-Time Adoption of International Financial Reporting Standards

In an effort to facilitate the transition of foreign companies to the use of International Financial Reporting Standards (IFRS) and improve the quality and comparability of their financial disclosure, the SEC has adopted certain amendments to Form 20-F. (Form 20-F is the combined registration statement and annual report form for foreign private issuers under the Securities Exchange Act of 1934). The amendments provide a one-time accommodation to foreign private issuers that change their basis of accounting to IFRS. This accommodation applies to foreign private issuers that adopt IFRS prior to or for the first financial year starting on or after January 1, 2007. The accommodation permits eligible foreign private issuers for their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders' equity, and cash flows prepared in accordance with IFRS, with appropriate related disclosure. The accommodation retains current requirements regarding the reconciliation of financial statement items to generally accepted accounting principles as used in the United States (U.S. GAAP).

In addition, the SEC is amending Form 20-F to require certain disclosures of all foreign private issuers that change their basis of accounting to IFRS. The amendments, which were issued by the SEC on April 13, 2005, and became effective on May 20, 2005, can be obtained from the SEC Web site at <http://www.sec.gov/rules/final/33-8567.pdf>.

SEC Adopts Rule to Establish a Voluntary XBRL Program

On February 3, 2005, the SEC adopted a rule to establish a voluntary eXtensible Business Reporting Language (XBRL) program. Under this program, registrants may voluntarily furnish XBRL data in an exhibit to certain EDGAR filings beginning with the 2004 calendar year-end reporting season. XBRL codes or tags individual pieces of business and financial information in a consistent way across industries such that data are entered one time only and can

be easily identified and directed to any number of possible places and users, no matter what type of software is used. XBRL makes business information more usable by allowing companies to publish information in a variety of formats (e.g., SEC filings, earnings announcements, annual reports, and audit committee or management reports). XBRL also helps the user of the information more easily locate specific details for one or multiple companies. Therefore, the user is able to rapidly perform company and industry analyses with a clearer view of relevant information.

The approved taxonomies (classification systems) are for commercial and industrial companies, banking and savings institutions, and insurance companies. The effective date of the rule, which can be accessed at <http://www.sec.gov/rules/final/33-8529.pdf>, is March 16, 2005.

Also, in August 2005, the SEC extended the voluntary program to investment companies. The expansion will allow mutual funds to file exhibits to their annual report to shareholders (N-CSR) and quarterly statement of portfolio holdings (N-Q) in XBRL.

SEC Extends Time for Banks to Comply With Gramm-Leach-Bliley Act Broker Registration Requirements

The SEC issued an order further extending, until September 30, 2006, the compliance dates for banks with respect to certain broker registration requirements contained in the Gramm-Leach-Bliley Act. The SEC does not expect banks to develop compliance systems to meet the terms of the broker exceptions until the SEC amends its rules. Banks have indicated that they will need time to implement systems to ensure compliance with the new statutory requirements regarding the definition of broker. Release No. 34-52405, "Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definition of "Broker" under Section 3(a)(4) of the Securities Exchange Act of 1934" can be viewed at the following link: <http://www.sec.gov/rules/exorders/34-52405.pdf>. For additional information, the press release is available at: <http://www.sec.gov/news/press/2005-130.htm>.

Commission Guidance Regarding Prohibited Conduct in Connection With Initial Public Offerings Allocations

Release No. 33-8565 was issued in April 2005 to provide guidance under Regulation M with respect to the process known as book-building, including the process for allocating shares in initial public offerings (IPOs). It provides guidance with respect to prohibited conduct in connection with securities distributions, particularly with a focus on IPO allocations.

Recent Guidance Provided by the Division of Corporation Finance

The Division of Corporation Finance, among other matters, provides guidance to companies on SEC rules and forms and proposes new and revised rules to the SEC. They recently issued the following guidance.

Current Accounting and Disclosure Issues in the Division of Corporation Finance

Readers should be aware of the document prepared by the staff of the Division of Corporation Finance available at <http://www.sec.gov/divisions/corpfin/acctdis030405.pdf>, which was last updated in March of 2005. The updated document contains references to revised and new items that were recently incorporated into the document. The items recently incorporated as “new” current accounting and disclosure issues are in the following areas:

- Statement of cash flows
- Oil and gas
- Leasing
- Revenue—Buy/sell arrangements
- Investments—Auction rate securities
- Pension, post retirement, and post employment plans—Selection of discount rates under FASB Statements No. 87, *Employers’ Accounting for Pensions*, and No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*

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- Loans and other receivables—Loans held for sale
 - Materiality assessments and the use of sampling

The items incorporated as “revised” current accounting and disclosure issues are in the following areas:

- Asset-backed securities
- Issues associated with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, “Formal Documentation Under Statement 133”
- Issues associated with FASB Statement No. 133, *Financial Statement Presentation and Disclosure*

SEC Issues Accounting Guidance to Certain Registrants

In February 2005, the staff of the SEC Division of Corporation Finance publicly posted sample letters sent to certain registrants in order to promote widespread awareness of certain accounting issues and to provide examples of comments that other registrants should consider as they prepare future SEC filings, as applicable.

Statement of Cash-Flow Presentation. This sample letter communicates the staff’s observations with respect to particular issues encountered by certain registrants related to FASB Statement No. 95, *Statement of Cash Flows*. The letter specifically addressed the presentation of cash receipts from inventory sales in consolidated statements of cash flows. The staff also emphasizes that the appropriate classification and presentation of items in the statement of cash flows is more important than ever, because, in certain instances, the statement is relied upon by analysts and investors as much as if not more than the statement of income. The staff therefore encourages companies to put more time and effort into ensuring that the statement of cash flows, and related disclosure in the financial statement footnotes and in MD&A, is meaningful and useful to users of the financial statements. The full text of the staff’s observations and the related sample letter can be obtained on the SEC Web site at http://www.sec.gov/divisions/corpfin/acctdis030405.htm#P384_52979.

Sample Letter Sent to Participants in the Oil and Gas Industry.

A sample letter was sent in February 2005 by the Division of Corporation Finance to registrants identified as being engaged in oil and gas operations. The SEC recently addressed several accounting and disclosure issues that may apply to oil and gas or other operations. The following areas are addressed in the sample letter:

- Buy/sell arrangements
- Accounting for suspended exploratory wells
- Accounting for goodwill by a full-cost company disposing of a portion of a property

Readers should be aware that the staff stated in the sample letter that their observations and disclosure guidance related to “buy-sell transactions are based on experience with transactions utilized in the petroleum industry, but may have application to nonpetroleum products and other industries. The full text of the staff’s observations and the related sample letter can be obtained on the SEC Web site at <http://www.sec.gov/divisions/corpfin/guidance/oilgas021105.htm>.

International Reporting and Disclosure Issues in the Division of Corporation Finance

Readers should be aware of the document prepared by members of the staff of the Division of Corporation Finance available at <http://www.sec.gov/divisions/corpfin/internatl/cfirdissues1104.htm>.

Frequently Asked Questions and Staff Statements

SEC Issues Questions and Answers on Securities Offering Reform Transition

The Division of Corporation Finance staff of the SEC has published questions and answers representing the staff’s views on questions it has received regarding issuers’ transition to compliance with the new rules and forms adopted by the SEC in the “Securities Offering Reform” rulemaking. The fourteen questions and answers cover the following topics:

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- Effective date of the new rules
 - Use of new communications rules
 - Inclusion of new undertakings
 - Automatic shelf registration statements
 - Other shelf issues

The questions and answers can be found at <http://www.sec.gov/divisions/corpfin/transitionfaq.htm>.

Staff Statement on Management's Report on Internal Control Over Financial Reporting

The SEC staff has provided guidance to help address questions regarding internal control reporting. In general, this statement addresses the following areas:

- The purpose of internal control over financial reporting
- Reasonable assurance, risk-based approach, and scope of testing and assessment
- Evaluating internal control deficiencies
- Disclosures about material weaknesses
- Information technology issues
- Communications with auditors
- Issues related to small business and foreign private issuers

An overarching principle of this guidance is the responsibility of management to determine the form and level of controls appropriate for each organization and to scope their assessment and testing accordingly. One size does not fit all, and control effectiveness is affected by many factors. The statement provides the staff's views on certain issues raised in the implementation of Section 404 of Sarbanes-Oxley. Readers should go to <http://www.sec.gov/info/accountants/stafficreporting.pdf> to refer to the complete document.

Exemptive Order on Management's Report on Internal Control Over Financial Reporting and Related Auditor Report Frequently Asked Questions

Since the Commission's November 2004 publication of Release No. 34-50754, *Exemptive Order Under Section 36 of the Securities Exchange Act of 1934 Granting an Exemption from Specified Provisions of Exchange Act Rules 13a-1 and 15d-1* (Exemptive Order), the SEC has received a number of questions regarding the implementation and interpretation of the Exemptive Order. In response, on January 21, 2005, the SEC issued ten frequently asked questions (FAQs), which address questions such as how the exemptive order will affect the certification of officers' responsibility for establishing and maintaining internal controls; the filing of auditor consents; the ability for a company to still be eligible to use Form S-8 or to file a new registration statement on Form S-2 or S-3; and the amended Form 10-K. The full text of the staff FAQs can be found at <http://www.sec.gov/divisions/corpfin/faq012105.htm>.

Current Report on Form 8-K Frequently Asked Questions

Since its publication of Release No. 34-49424, *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, the SEC has received a number of questions regarding the implementation and interpretation of the new Form 8-K items. The SEC's responses to some of these frequently asked questions can be found at <http://www.sec.gov/divisions/corpfin/form8kfaq.htm>.

Registrants and their counsel are reminded that one of the principal purposes of the revisions to Form 8-K is to increase the number of unquestionably or presumptively material events that must be disclosed currently, in accordance with the goals of Section 409 of Sarbanes-Oxley. Registrants also should ensure that they have implemented appropriate disclosure controls and procedures in accordance with Exchange Act Rules 13a-14 and 15d-14 in order to ensure that information required to be disclosed by Form 8-K is brought to the attention of management and disclosed within the time frames contemplated by Form 8-K. Unless otherwise indicated, references to Regulation S-K also apply to the corresponding provisions of Regulation S-B.

Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports Frequently Asked Questions (Revised October 6, 2004)

Since the adoption of the SEC's *Rules on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports* (Release No. 34-47986, June 5, 2003), the SEC has received questions regarding the implementation and interpretation of the rules. The SEC staff continues to entertain these questions, and where appropriate, will continue to answer publicly the more frequently asked questions. These FAQs can be found at <http://www.sec.gov/info/accountants/controlfaq1004.htm>.

SEC Issues XBRL Voluntary Filing Program FAQs

The SEC has published FAQs regarding the XBRL voluntary filing program. Topics addressed in the FAQ document are segment functionality, validation, external references, namespace names, and supported XBRL taxonomies. The complete FAQs can be accessed by going to the following link: <http://www.sec.gov/info/edgar/xbrlfaq032105.htm>.

Independence Guidance

Application of the SEC's Rules on Auditor Independence Frequently Asked Questions

In response to the many questions received by the SEC staff regarding the implementation and interpretation of the SEC's Rules on *Auditor Independence*, most recently relating to the SEC's Rules on *Strengthening the Commission's Requirements Regarding Auditor Independence*, FAQs have been issued by the SEC staff and can be found at <http://www.sec.gov/info/accountants/ocafaqaudind121304.htm>. The document was last updated December 13, 2004, and includes the following topics:

- Partner rotation transition questions
- Audit partner and partner rotation
- Prohibited and non-audit services

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- Audit committee pre-approval
 - Audit committee communications
 - Fee disclosures
 - “Cooling-off” period
 - Broker-dealer and investment advisers

Hurricane Katrina Assistance

Hurricane Katrina made landfall along the Gulf Coast on August 29, 2005, causing catastrophic damage to parts of Alabama, Louisiana, and Mississippi. The storm and subsequent flooding displaced individuals and businesses, and disrupted communications across the Gulf Coast region. The SEC issued the guidance discussed below to address the needs of companies and individuals located within the areas affected by Hurricane Katrina that must comply with the requirements of the federal securities laws.

SEC Grants Exemptions to Filers Affected by Hurricane Katrina

On September 15, 2005, SEC Release No. 52444, the SEC issued an exemptive order under Section 17A and Section 36 of the Securities Exchange Act of 1934, and an exemptive order under Section 6(C) and Section 38(A) of the Investment Company Act of 1940, that are intended to provide relief from filing requirements under the Acts to registrants, transfer agents, and registered investment management companies affected by Hurricane Katrina. For additional information, readers should go to <http://www.sec.gov/rules/exorders/34-52444.pdf>.

To assist investors and regulated entities in the aftermath of Hurricane Katrina, the SEC has established the following telephone and e-mail hotlines:

Investors: 1-800-SEC-0330 or Help@sec.gov

Registrants: (202) 551-3300 or cfhotline@sec.gov

New Help to Facilitate Payments to Victims of Hurricanes Katrina and Rita

The SEC has issued new regulatory relief designed to help ensure that insurers have the capital and liquidity to pay Hurricane Katrina and Rita victims.

The Division of Corporation Finance has taken the following actions to enable insurers for victims of Katrina and Rita to take advantage of short-form registration statements on Form S-3, and to speed the processing of new registration statements:

- For insurance and reinsurance companies with existing shelf registrations pursuant to Rule 415(a)(1)(x), the SEC staff will permit the extended use of the SEC's brief "notice" registration of additional securities under Rule 462(b). Under this extension, the staff will permit use of those procedures, including notice by fax and immediate effectiveness, to register additional securities in an amount up to 20 percent of the dollar amount of securities originally registered on that shelf registration statement (rather than the amount remaining on that registration statement).
- The Division of Corporation Finance will process Securities Act filings by reporting insurance and reinsurance companies within not more than five business days of their receipt.

The Division of Corporation Finance has been instructed to continue these administrative steps through Dec. 1, 2005. The complete release can be viewed by going to the following link: <http://www.sec.gov/news/press/2005-142.htm>.

SEC Studies

SEC Issues Final Study Mandated by the Sarbanes-Oxley Act of 2002 on Off-Balance Sheet Arrangements, Special Purpose Entities, and Transparency of Filings by Issuers

Section 401(c) of Sarbanes-Oxley mandated the SEC to conduct a study of issuer filings and issue a report with recommendations addressing the extent of off-balance sheet arrangements, including the use of special-purpose entities, and whether current finan-

cial statements of issuers transparently reflect the economics of off-balance sheet arrangements.

The SEC Chief Accountant said:

The report identifies improvements that have occurred in financial reporting since passage of the Sarbanes-Oxley Act and, importantly, it offers recommendations for further improvements designed to increase both the transparency and usefulness of the balance sheet. Greater transparency can be achieved in some areas simply by reducing accounting choices and complexity. Since the events leading to passage of the Sarbanes-Oxley Act, we have made progress in improving financial reporting to investors, but more can still be done. I'm hopeful that this report will help focus efforts on further ways to improve transparency.

The study has been completed and the report has been posted to the SEC's Web site at www.sec.gov. The full text of the report can be viewed directly by going to <http://www.sec.gov/news/studies/soxoffbalancerpt.pdf>.

SEC Releases Staff Report Describing Findings From Examinations of Select Pension Consultants

The SEC's Office of Compliance Inspections and Examinations has published the "Staff Report Concerning Examinations of Select Pension Consultants" (the Report). The Report, part of the SEC's program to identify and investigate risks in the securities industry, examined the practices of pension consultants and specifically focused on any conflicts of interest in their operations. The Report contains recommendations to enhance pension consultants' compliance programs to help ensure that the adviser is fulfilling its fiduciary obligations to its advisory clients.

The Report also raises important issues for plan fiduciaries who often rely on the advice and recommendations of pension consultants in operating their plans. The full text of the plan can be viewed at <http://www.sec.gov/news/studies/pensionexamstudy.pdf>.

As a result of the questions raised by the Report, the U.S. Department of Labor and the SEC published tips to assist fiduciaries of employee benefit plans in reviewing conflicts of interest of

pension consultants. The guidance is entitled “Selecting and Monitoring Pension Consultants—Tips for Plan Fiduciaries.” The tips provide relevant questions plan fiduciaries should ask to encourage better disclosure and information relating to potential areas of conflicts of interest by pension consultants. The tips can be viewed at <http://www.sec.gov/investor/pubs/sponsortips.htm>.

Office of the Chief Accountant: Staff Letters to Industry

Readers should be aware of the following staff letters to industry which provide helpful guidance and clarification regarding the SEC staff’s interpretation of certain accounting issues and their application under GAAP:

- *Letter from Deputy Chief Accountant to Deloitte Touche Tohmatsu on the separation of various legal practices from their respective Deloitte Touche Tohmatsu member firms (June 7, 2005).* This letter provides guidance regarding independence issues.
- *Letter to Robert J. Kueppers, Chairman, Center for Public Company Audit Firms, from Donald T. Nicolaisen (February 7, 2005).* This letter focuses on specific concerns regarding the appropriate accounting for operating leases; restatements resulting from the correction of errors that deviate from the lease accounting standards; and clear and concise disclosures of both operating and capital leases.
- *Letter from the Deputy Chief Accountant to Deloitte Touche Tohmatsu on the disposition of its member firm’s Spanish consulting practice, GMS Management Solutions, S.L. (January 18, 2005).* This letter provides guidance regarding independence issues.

Readers can find these staff letters to industry, along with others, at <http://www.sec.gov/info/accountants/staffletters.shtml>.

SEC Issues Annual Report Reminders Alert

On March 4, 2005, the SEC’s Division of Corporation Finance issued a staff alert about annual report reminders in response to

issues and observations that have arisen repeatedly. The alert is intended to be for companies that are in the process of completing their Forms 10-K and 10-KSB and highlight existing requirements, staff positions, and key points on the following topics:

- Disclosures of previously unreported Form 8-K events
- Correct version of the certifications required by Rules 13a-14(a) and 15d-14(a)
- Placement of the internal control reports
- Auditor consents

The full text of this alert can be accessed directly at <http://www.sec.gov/divisions/corpfin/cfalerts/cfalert030405.htm>.

SEC Issues Staff Progress Reports on Market Approaches to Valuing Employee Stock Options Under FASB Statement No. 123R

The SEC Chairman has announced that the SEC Office of Economic Analysis has issued an informal staff progress report on the ongoing SEC evaluation of proposals to value employee stock options for financial reporting purposes in accordance with FASB Statement No. 123R, which requires companies to recognize compensation paid in the form of employee stock options as a cost in their financial statements. The SEC press release can be viewed at <http://www.sec.gov/news/press/2005-129.htm>. There were two documents included in the SEC's issuance of this staff progress report as follows:

1. Speech by SEC Staff, "Statement Regarding Use of Market Instruments in Valuing Employee Stock Options, an overview by the SEC Chief Accountant," which can be accessed at <http://www.sec.gov/news/speech/spch090905dtn.htm>.
2. "Economic Evaluation of Alternative Market Instrument Designs: Toward a Market-Based Approach to Estimating the Fair Value of Employee Stock Options," a memorandum by the SEC Office of Economic Analysis, which can be accessed at <http://www.sec.gov/news/extra/memo083105.htm>.

Division of Investment Management Issues Staff Guidance

The SEC's Division of Investment Management regulates investment companies, such as mutual funds, closed-end funds, unit investment trusts (UITs), exchange-traded funds (ETFs), and interval funds, including variable insurance products, federally registered investment advisers, and public utility holding companies. It has recently issued the guidance summarized in the following sections.

SEC Issues Guidance on Auditing Standards for Financial Statements of Insurance Company Depositors of Variable Insurance Products

The Division of Investment Management staff has issued letters to four different groups regarding auditing standards for financial statements of insurance company depositors of variable insurance products. These letters can be accessed at http://www.sec.gov/divisions/investment/letters_audit.htm. The Chief Accountant of the Division of Investment Management noted in the letters that, for certain insurance company depositor or sponsor financial statements included in the registration statements of variable annuity and variable life insurance contracts, the staff will not object to audit opinions on financial statement audits conducted in accordance with either the standards of the Public Company Accounting Oversight Board (PCAOB) or generally accepted auditing standards (GAAS) issued by the AICPA, until further notice. However, the staff is currently considering whether the audits of these types of financial statements are required to be audited in accordance with PCAOB standards. During this period of consideration, the staff will accept auditor's reports prepared in accordance with either PCAOB standards or GAAS.

Staff Responses to Questions About Amended Custody Rule

Questions about the amended rule 206(4)-2, the custody rule under the Investment Advisers Act of 1940, was updated on January 10, 2005. Specifically, questions VI.7 and VI.8 were revised and VI.9 was added under section VI, "Pooled Investment Vehicles."

To view the changes, go to http://www.sec.gov/divisions/investment/custody_faq.htm#VI.7.

SEC Proposed Rules

Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports

The SEC voted to propose amendments to the periodic report filing deadlines and the Exchange Act Rule 12b-2 definition of an accelerated filer. The proposals would:

- Create a new category of companies called “large accelerated filers.”
- Adjust the definition of “accelerated filers.”
- Cause large accelerated filers to become subject to a 60-day Form 10-K annual report deadline and a 40-day Form 10-Q quarterly report deadline next year and in subsequent years.
- Maintain the current 75-day Form 10-K annual report deadline and 40-day Form 10-Q quarterly report deadline for accelerated filers next year and in subsequent years.
- Amend the definition of accelerated filer to ease restrictions on the process for exiting accelerated filer status.

Large Accelerated Filers and Accelerated Filers. The proposed amendments would create a new category of filers, namely, *large accelerated filers*, for companies that have a public float of \$700 million or more and meet the same other conditions that apply to accelerated filers. The proposed amendments also would redefine *accelerated filers* as companies that have at least \$75 million but less than \$700 million in public float.

Amendments to the Accelerated Filer Definition. The proposed amendments would modify the procedures by which accelerated filers can exit accelerated filer status by permitting an accelerated filer whose public float has dropped below \$25 million to file an annual report on a non-accelerated basis for the same fiscal year that the determination of public float is made. The proposed amendments similarly would permit a large accelerated filer to

exit large accelerated filer status once its public float has dropped below \$75 million.

The full text of the detailed release can be viewed by going to <http://www.sec.gov/rules/proposed/33-8617.pdf>.

Proposed Interpretive Guidance Regarding Client Commissions

The SEC voted to publish for comment interpretive guidance on money managers' use of client commissions to pay for brokerage and research services under Section 28(e) of the Securities Exchange Act of 1934. Section 28(e) creates a "safe harbor" by providing that a person who exercises investment discretion with respect to an account shall not be deemed to have acted unlawfully or to have breached a fiduciary duty under state or federal law solely by reason of having caused an account to pay more than the lowest available commission if that person determines in good faith that the amount of the commission is reasonable in relation to the value of the "brokerage and research services" received.

The proposed interpretive guidance would clarify that the scope of the Section 28(e) safe harbor is limited to brokerage and research services that:

- Satisfy the eligibility criteria in the statute.
- Provide lawful and appropriate assistance to the money manager in carrying out his decision-making responsibilities.
- Satisfy the requirement that the money manager make a good faith determination that commissions paid are reasonable in relation to the value of the products and services provided by broker-dealers in connection with his responsibilities to the advisory accounts for which he exercises investment discretion.

The SEC also voted to publish for comment guidance on commission-sharing arrangements. At the time this alert was published, the full text of the release had not been posted to the SEC Web site. The press release can be viewed by going to <http://www.sec.gov/news/press/2005-134.htm>.

Advisory Committee on Smaller Public Companies

The SEC has established the SEC Advisory Committee on Smaller Public Companies to assess the current regulatory system for smaller companies under the securities laws, including the impact of Sarbanes-Oxley. The individuals appointed and serving on the advisory committee are from a broad range of market participants, including individuals from diverse industries, geographical areas, professions, and categories of smaller companies and investors. The advisory committee is structured around four subcommittees that have all undertaken various sectors to research that will result in a proposal of recommendations. The four subcommittees are:

1. Governance and Disclosure
2. Internal Control over Financial Reporting
3. Accounting Standards
4. Capital Formation

In August 2005, comment letters were received regarding the following key issues associated with compliance for “smaller” public companies:

- Cost of initial implementation (consultants)
- Ongoing cost to maintain new processes and systems
- Increased audit and legal fees
- Increased directors’ compensation
- Ongoing cost of increased SEC reporting requirements
- Increased burden and liability on CEO and CFO
- Opportunity costs

Some of the recommendations the Committee might make in its final report to the SEC were discussed at the third meeting in August 2005. They include that newly proposed definitions for size of company will consist of the following categories:

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- Any company that ranks within the bottom 6 percent of the total U.S. public market capitalization should qualify as a *smaller public company*.
 - Any company that ranks within the bottom 1 percent of the total U.S. public market capitalization should qualify as a *micro-cap smaller public company*.
 - All other companies greater than 6 percent of the total U.S. public market capitalization should qualify as *large public companies*.
 - The scrapping of accelerated periodic filing deadlines for smaller public companies. That accelerated filer deadlines for public companies should be permanently extended and not be subject to the faster filing deadlines under the Securities Exchange Act of 1934 (i.e., stay at 40/75 as opposed to moving to 35/60).

The Advisory Committee has been charged with making recommendations for changes in the system by April 2006. For additional information go to <http://www.sec.gov/info/smallbus/acspc.shtml>.

SEC's Roundtable on Implementation of Internal Control Reporting Provisions

The Roundtable on Implementation of Internal Control Reporting Provisions (the Roundtable), hosted by the SEC and attended by the PCAOB on April 13, 2005, gathered registrants and accounting firms to share their experiences in implementing the new reporting requirements under Section 404 of Sarbanes-Oxley. The Roundtable included representatives of the PCAOB, issuers, auditors, investors, and other interested parties.

The Roundtable was structured around six panels made up of eight or nine individuals per panel which covered the following topics:

- First-year efforts
- Reporting to the public
- Planning and design

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- Documentation and testing of internal control over financial reporting
 - The use of judgment in communications and conclusions
 - Next steps

For more information on the Roundtable, including access to the archived Webcast, go to the spotlight section on the SEC's Web site at www.sec.gov.

Public Company Accounting Oversight Board Developments

Guidance Issued on PCAOB Auditing Standards No. 1 and No. 2

The PCAOB has issued additional staff guidance on PCAOB Auditing Standards No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, PCAOB Standards and Related Rules); and No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (AICPA, PCAOB Standards and Related Rules, AU sec. 320), in the form of questions and answers (Q&As) documents:

- Staff Questions and Answers: Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the PCAOB
- Staff Questions and Answers: Auditing Internal Control Over Financial Reporting (These questions and answers consist of five separate sets, namely, questions 1-26, questions 27-29, questions 30-36, question 37 (January 2005); and questions 38-55 (May 2005). The topics addressed in the latest 18 additional staff Q&As include top-down approach, risk assessment, integrated audit, evaluating management's assessment, and using the work of others.)

These staff questions and answers documents can be obtained at http://www.pcaob.org/Standards/Staff_Questions_and_Answers/index.aspx.

PCAOB Policy Statement on Implementing PCAOB Auditing Standard No. 2

As a result of the PCAOB's response to questions and concerns raised at the April 13, 2005 Roundtable on Implementation of Internal Control Reporting Provisions, additional guidance was issued to help auditors with the implementation process of PCAOB Auditing Standard No. 2. The additional guidance issued consists of a "Board Policy Statement Regarding Implementation of Auditing Standard No. 2." (See complete document at http://www.pcaobus.org/Rules/Docket_008/2005-05-16_Release_2005-009.pdf.) The PCAOB's Policy Statement amplifies some of the themes in the staff questions and answers and articulates the PCAOB's policy on how it intends to administer PCAOB Auditing Standard No. 2 in its oversight of the registered public accounting firms that audit public companies. Some significant provisions of the board policy statement include:

- Administration of certain aspects of PCAOB Auditing Standard No. 2
- Amplifies important themes from staff Q&As
- Describes how the auditor can provide timely advice on accounting and internal control over financial reporting issues to client management
- Outlines the PCAOB's inspections approach to PCAOB Auditing Standard No. 2

The complete PCAOB announcement of the issuance of additional guidance on PCAOB Auditing Standard No. 2 can be accessed by going to http://www.pcaobus.org/News_and_Events/News/2005/05-16.asp.

Inspection Concerns

Following are some concerns noted during recent accounting firm inspections conducted by the PCAOB. Consider reviewing this brief list as a help in determining whether similar issues could exist on your engagements:

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- Fair value accounting
 - Identification of related parties
 - Reverse-merger activity and principal auditor
 - Revenue recognition
 - Expense recognition and classification
 - Tax accounts
 - Independence
 - Adequacy of documentation
 - Understanding contractual arrangements and substance
 - Overreliance on management representations
 - Reliance on the work of another or predecessor auditor

PCAOB Issues FAQs to Provide Guidance for Attest Engagements Regarding XBRL

On May 25, 2005, the PCAOB issued guidance to auditors related to attest engagements regarding XBRL data furnished under the SEC's XBRL Voluntary Financial Reporting Program on the EDGAR System. The guidance was in the form of FAQs and provides the independent auditor with performance and reporting guidance for engagements whereby the auditor must report on whether the voluntarily filed XBRL data accurately reflects the corresponding information in the official EDGAR filings.

The SEC XBRL voluntary filing program does *not* require a public company to obtain auditor's attestation on the XBRL data. However, if the public company does choose to obtain that attestation from the auditor voluntarily, the PCAOB FAQs provide the guidance for doing so. The PCAOB guidance can be accessed directly by going to http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2005/05-25%20.pdf.

PCAOB Adopts Rules on Auditor Independence and Tax Services

On July 26, 2005, the PCAOB adopted *Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees*. This rule is not final and effective until it has been approved by the SEC. The entire release can be accessed by going to http://www.pcaobus.org/Rules/Docket_017/Form_19b-4_Tax_Services.pdf.

PCAOB Adopts Auditing Standard No. 4

On July 26, 2005, the PCAOB adopted PCAOB Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist*. This PCAOB standard is not final and effective until it has been exposed and approved by the SEC.

The proposed standard is based on the framework of PCAOB Auditing Standard No. 2. However, it is intentionally narrower in scope, and establishes requirements and provides the direction that applies when an auditor is engaged to report on whether a previously reported material weakness in internal control over financial reporting continues to exist as of a date specified by management.

Although this new voluntary engagement would be an additional elected method that a company can choose in order to inform the investing public of whether a material weakness in internal control over financial reporting continues to exist, the PCAOB did not adopt this standard with the intent that it should be perceived as a de facto required auditing service. The PCAOB has historically explained that there are currently a number of other ways that a company can communicate that they have corrected a material weakness in internal control such as through their quarterly disclosures and certifications as to changes in internal control over financial reporting under Section 302 of Sarbanes-Oxley. In fact, the PCAOB indicated that although this option will be made available if the standard is approved by the SEC, the hope is that it would be used sparingly and only if it is cost effective to the company. The entire release can be accessed by going to http://www.pcaobus.org/Rules/Docket_018/2005-07-26_Release_2005-015.pdf.

Other Related Developments

Matrix on Appropriate Type of Audit Opinion Approved by SEC

The AICPA SEC Regulations Committee met with the SEC staff and discussed the clarification of PCAOB registration requirements and reports to which PCAOB Standard No. 1 applies. Based on that discussion, the SEC Regulations Committee developed the following schedule.

General Guidelines

<i>Entities for which audit report on the financial statements is included in document filed with SEC:</i>	<i>Auditor's report on financial statements in current filing must be issued by a public accounting firm registered with the PCAOB? (1)</i>	<i>Auditor's report on financial statements must refer to PCAOB standards? (2)</i>
Issuer (3)	Yes	Yes
Entity that has filed a registration statement in an IPO	No (4)	Yes
Non-issuer subsidiary, division, or segment of issuer for which other auditor's report is included in an SEC filing due to reference by principal auditor to other auditor(s)	(5)	Yes (6)
Non-issuer entity whose financial statements are filed to satisfy S-X Rule 3-05 or 3-14	No	No
Non-issuer entity whose financial statements are included in proxy or Form S-4/F-4 as target	No	No
Non-issuer entity whose financial statements are filed to satisfy S-X Rule 3-09 or 3-16		
• No reference to other auditor's report by issuer's auditor	(5)	No (7)
• Reference to other auditor's report by issuer's auditor	(5)	Yes (6)

<i>Entities for which audit report on the financial statements is included in document filed with SEC:</i>	<i>Auditor's report on financial statements in current filing must be issued by a public accounting firm registered with the PCAOB? (1)</i>	<i>Auditor's report on financial statements must refer to PCAOB standards? (2)</i>
Subsidiary-guarantor whose separate financial statements are filed to satisfy S-X Rule 3-10	Yes (8)	Yes
Employee benefit plan filing on Form 11-K	Yes (8)	Yes

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- (1) This guidance is applicable to audit reports issued or dual dated with latest date after 10/21/03 (or 7/18/04 for foreign auditors).
 - (2) This guidance is applicable to audit reports issued or reissued on or after May 24, 2004.
 - (3) The term *issuer* means an issuer (as defined in Section 3 of the Exchange Act), the securities of which are registered under Section 12 of that Act, or that is required to file reports under Section 15(d) of that Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933. See Section 2(a)(7) of the Sarbanes-Oxley Act and PCAOB Rule 1001.
 - (4) The financial statements that are filed with an initial registration statement need not be audited by a registered firm. Once the company has filed a registration statement, however, it is an *issuer* and any subsequent or restated financial statements must be audited by a registered firm.
 - (5) The auditor of the financial statements of the non-issuer entity must be registered if, in performing the audit, the auditor played a *substantial role* in the audit of the issuer, as that term is defined in PCAOB Rule 1001(p)(ii). If the “substantial role” test is not met, the firm is not required to be registered.
 - (6) Rule 2-02 of Regulation S-X requires that the auditor’s report state whether the audit was conducted in accordance with GAAS. In Release No. 34-49708, the SEC stated that “references in Commission rules...to GAAS or to specific standards under GAAS, *as they relate to issuers*, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission” (emphasis added). In the situation identified in the chart above, the view of the SEC staff is that the reference to GAAS in Rule 2-02, as applied to the other auditor’s report, does “relate to an issuer” for purposes of Release No. 34-49708 and that, therefore, the other auditor’s report must refer to the standards of the PCAOB.
 - (7) Even though the other auditor’s report is not required to refer to the standards of the PCAOB, if the issuer’s auditor uses the work of the other auditor, that audit work must be performed in accordance with the standards of the PCAOB.
 - (8) The entity is itself an issuer and so must comply with issuer rules.

The matrix is available at http://www.aicpa.org/download/belt/2004_0615_highlights.pdf

Sarbanes-Oxley Section 404: Responding to an Adverse Report— A Checklist for the Audit Committee

The AICPA has developed a tool to educate the audit committee of a company that has received an adverse report on the effectiveness of its internal control over financial reporting. The first half of the tool educates the audit committee about the internal control evaluation requirements; the second half includes steps the audit committee should take if faced with this situation. The complete document can be downloaded by going to http://www.aicpa.org/audcommctr/download/Adverse_on_404_Tool.doc.

New Interpretation on Reviews of Nonissuers Owned or Controlled By an Issuer

The AICPA Accounting and Review Services Committee (ARSC) has issued Interpretation No. 27 of AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2), “Applicability of SSARSs to Reviews of Nonissuers Who Are Owned By or Controlled By an Issuer.” SSARS Interpretation No. 27 provides guidance on what authoritative standards an accountant should follow when engaged to review the separate financial statements of a subsidiary, which itself is not an issuer.¹ The Interpretation states that in the situation in which an accountant is engaged to review the financial statements of a subsidiary, corporate joint venture, or other entity that is not itself an issuer, and the review report and reviewed financial statements are not being filed with the SEC, the accountant should perform the review in accordance with SSARSs since the review engagement is not being performed in the context of the

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1. The term *issuer* means an issuer (as defined in section 3 of the Securities and Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 781), or that is required to file reports under section 15 (d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

issuer meeting its reporting obligations as a result of conditions (a) or (b) of the nonpublic entity definition within AR Section 100.04.² On the other hand, if a subsidiary is being reviewed at an interim period as part of an entity's filing of its consolidated interim financial statements with the SEC, then the review should be performed in accordance with PCAOB standards and SSARSs is not applicable because the review is in the context of the issuer meeting its reporting obligations as a result of conditions (a) or (b) within AR Section 100.04.

GAO Issues Guidance for Audits Subject to Both Government Auditing Standards and PCAOB Auditing Standards

On May 4, 2005, the Government Accountability Office (GAO) issued guidance on internal control reporting for audits of certain SEC issuers that are subject to both the *Government Auditing Standards* (GAS, also referred to as the Yellow Book) and the auditing standards of the PCAOB. An example of such an audit would be a lending institution that participates in federally sponsored loan programs such as housing and education. The GAO guidance may be accessed directly by going to <http://www.gao.gov/govaud/ybpcacb.pdf>.

The GAO issued this guidance in order to facilitate reporting of internal control deficiencies identified during audits conducted under both PCAOB and generally accepted government auditing standards (GAGAS) standards, to ensure the consistency of information included in the GAGAS report on internal control, and to assist auditors in complying with GAGAS.

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2. SSARS No. 1 [AR Section 100.04] defines a *nonpublic entity* as:

Any entity other than (a) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally; (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market; or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b).

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The *SEC and PCAOB Alert—2005/06* will be published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's Alert, please feel free to share them with us. Any other comments that you have about the Alert would be appreciated. You may e-mail these comments to lwest@aicpa.org or write to:

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