

COMPLIANCE WEEK

Investors Inured to Restatements; No SOX Relief; More

By Tammy Whitehouse — November 6, 2007

There's some new evidence that the stigma of restating financial results may be easing in the post-Sarbanes-Oxley world.

Economists at the Public Company Accounting Oversight Board say the average net loss in market capitalization for companies announcing plans to restate has declined \$207 million per restatement announcement since Sarbanes-Oxley took effect, compared with similar events prior to Sarbanes-Oxley. That amounts to a total decline in market cap loss of \$74 billion in the post-SOX period compared with pre-SOX days, according to the authors.

According to the research, the average volatility in the stock price is lower following the market's initial reaction to the restatement announcement. The authors say the findings suggest that under Sarbanes-Oxley, investors behave as if they believe restatement announcements convey more timely and higher-quality information, leaving them with less uncertainty about companies that are restating their financial statements.

Jana Hranaiova, senior financial economist, and Steven Byers, chief economist at the PCAOB, detail their findings in a working research paper titled "Changes in Market Responses to Financial Statement Restatement Announcements in the Sarbanes-Oxley Era." They shared the research at a recent gathering of the PCAOB's Standing Advisory Group and plan to present it for publishing in an academic journal.

Byers tells Compliance Week that the PCAOB is interested in gauging market reaction to restatements because it may provide some cost-benefit analysis for the impact of Sarbanes-Oxley on capital markets and it may serve as a possible indicator of improvements in auditing of financial statements.

"We would expect there to be fewer restatements going forward if the quality of auditing of financial statements was better and these errors were caught prior to statements being filed the first time," he says.

The pair of economists fielded some criticism from the PCAOB's advisory panel—some focused on the research method or presentation of findings, while others criticized the findings themselves. Hranaiova says the suggestions may result in some minor revisions to the presentation of the data, but not the conclusions. "People may be defensive about the results, but these are the facts," she says. "This is what the data shows [sic]."




Michael Cangemi, president of Financial Executives International, says the PCAOB research is consistent with what FEI found in a recent survey of CFOs. Some 60 percent said they agreed there is less stigma attached to issuing a financial restatement than there was five years ago.

Cangemi says investor inurement to restatements may be a reflection of an increase in the number of restatements that have been issued in recent years. "When you get that much volume, there's so much noise it's hard to attach much significance to it," he says.

It could also be driven by investor realization that auditors are taking a more conservative approach to auditing under Sarbanes-Oxley, in part to protect themselves from liability claims. "Something that might not have been a restatement five years ago is now," he said. "Auditors feel better disclosing and restating because they think it protects them."

RELATED RESOURCES

 [PCAOB Working Paper: Restatements and SOX \(Oct. 18, 2007\)](#)

 [Financial Executives International Summary \(2007\)](#)

Congress Not Moving on SOX Relief for Smaller Companies

Smaller public companies waiting for Congress to swoop down with an 11th hour rescue from Sarbanes-Oxley compliance may be disappointed to learn no such measure is rushing through legislative channels.

Bob Benoit, president and director of SOX research at Lord & Benoit, says only one bill specifically calling for a delay in Section 404 compliance requirements for smaller public companies has been introduced into the House of Representatives, but so far, it has received no action. The bill was introduced in June.

RELATED RESOURCES

 [HR 2829 F.S. Gov't. & Appropriations Act \(2008\)](#)

 [Small Business SOX Compliance Act](#)



Benoit

A separate bill farther through the legislative process is being described in some circles as a measure that would delay Section 404 requirements for smaller companies, but in fact it restricts funding to enforce compliance, notes Benoit.

The House passed a budget bill (HR 2829 *Financial Services and General Government Appropriations Act, 2008*) with an amendment to prohibit the Securities and Exchange Commission from using its funds to enforce the current Section 404 effective date for smaller companies. Currently, smaller companies are required to report on the effectiveness of their internal controls over financial reporting with their 2007 reporting cycle, but they aren't required to get an independent auditor's certification over such reports until the following year.

Mary MacLean, press secretary for Rep. Scott Garrett, R-NJ, who sponsored the amendment to the appropriations bill, says the intention is to "prevent the SEC from forcing small-cap companies to comply with 404 for fiscal year 2008."

Benoit says a careful reading of the amendment would suggest it doesn't seem to have the effect of stalling smaller company compliance another year. "There is nothing about an extension of time, and there is no legal connection between an extension of time and funding," adds Benoit. The bill passed the House in July and was placed on the Senate legislative calendar, but so far has received no action.

Trent Gazzaway, managing partner of corporate governance for Grant Thornton, says smaller companies seem to be making little progress in working to comply with Section 404. "They're still hoping it will all go away," he said. "A lot of companies are going to sign assertions without any more support for the assertion than they had when 404 went into effect."

Gazzaway said smaller companies sticking their heads in the sand are missing a rare opportunity offered by the SEC to go through their first year of SOX compliance without the audit requirement. That gives companies some "running room," he says, to get their controls in order without worrying about how the auditor will view controls.

Companies delaying the process are setting themselves up for greater costs, according to Gazzaway, because they'll be rushing to get controls in order in 2008 and will be competing for professional resources in the process. "It's almost a self-fulfilling prophecy," he says. "It's going to be expensive, because they're all going to wait until the fourth quarter of 2008; then it will be a crisis."

PCAOB Reshuffles 2008 Standing Advisory Group

The Public Company Accounting Oversight Board has appointed a new slate of advisers to its Standing Advisory Group for 2008, inviting 11 new members aboard.

The SAG retains 16 members from its 2007 panel and reappoints nine others. The board received some 90 nominations and re-nominations when it opened the nomination process in May. In selecting a new panel, the board was looking for expertise in a variety of areas, including accounting, auditing, corporate finance, corporate governance, and investing.

RELATED RESOURCES

 [PCAOB Standing Advisory Group](#)

 [2008 Standing Advisory](#)

The PCAOB convenes its advisory group about three times a year to solicit input and feedback

on public company auditing issues and standard-setting priorities.

Group List (2008)

ASB to Redraft Auditing Standards to Achieve Greater Clarity


The Auditing Standards Board of the American Institute of Certified Public Accountants recently announced that it has commenced a large-scale project to achieve greater clarity in financial reporting by revising its auditing standards.

The goal is to make the standards easier to read and understand so that they can be more easily implemented.

The most significant changes include making requirements more prominent by separating them from the surrounding text; adding objectives throughout the guidance to help the auditor understand the purpose; and setting a sufficiently far-off implementation date to allow auditors to update their practices.

The ASB will also consider eliminating unnecessary differences between its standards and the auditing standards issued by the International Federation of Accountants and the International Auditing and Assurance Standards Board. The ASB estimates the project will take two to three years to complete.

RELATED RESOURCES

 [Auditing Stds. Board Redrafting Standards \(Oct. 11, 2007\)](#)


IAASB Issues Drafts on External Confirmations, Work of an Audit Expert

The International Auditing and Assurance Standards Board recently issued an exposure draft addressing concerns about the use and reliability of external confirmations as audit evidence. External confirmations are written responses to the auditor from a third party.

“Confirmations have sometimes proved to be less reliable than expected, and the proposals are intended to assist in making them effective when an auditor decides to use them,” said IAASB Chairman John Kellas. “In a more complex world, especially where fair values feature in financial reporting, the auditor may have more need of the assistance of experts in other disciplines for the purposes of the audit.”

RELATED RESOURCES

 [ISA 505, External Confirmations](#)

 [ISA 620, Using the Work of an Auditor's Expert \(Oct. 19, 2007\)](#)



Kellas

According to the IAASB, the auditor's decision about whether to use external confirmation procedures is based upon the identification and assessment of risks of material misstatement in accordance with other International Standards on Auditing. Proposed ISA 505, *External Confirmations*, is directed at the effective performance of external confirmation procedures when the auditor determines that such procedures are an appropriate response to an assessed risk of material misstatement.

A second exposure draft was also released, which proposes stricter requirements when an auditor uses an expert to obtain audit evidence. Proposed ISA 620, *Using the Work of an Auditor's Expert*, deals with the auditor's use of the work of a person or organization possessing expertise in a field other than accounting or auditing, employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence. It places particular emphasis on the need for the auditor to evaluate the expert's objectivity and to establish a proper understanding with the expert of the expert's responsibilities for the purposes of the audit.

Comments on the exposure drafts are requested by February 15, 2008.

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