

3-2008


# The Changing Components of the Corporate Annual Report: An Update

Deborah S. Archambeault  
*University of Dayton, darchambeault1@udayton.edu*

John G. Fulmer Jr.  
*University of Tennessee, Chattanooga*

Richard A. Turpin  
*University of Tennessee, Chattanooga*

Follow this and additional works at: [https://ecommons.udayton.edu/acc\\_fac\\_pub](https://ecommons.udayton.edu/acc_fac_pub)

 Part of the [Accounting Commons](#), [Business Administration, Management, and Operations Commons](#), [Business Law, Public Responsibility, and Ethics Commons](#), [Corporate Finance Commons](#), and the [Nonprofit Administration and Management Commons](#)

---

## eCommons Citation

Archambeault, Deborah S.; Fulmer, John G. Jr.; and Turpin, Richard A., "The Changing Components of the Corporate Annual Report: An Update" (2008). *Accounting Faculty Publications*. 46.  
[https://ecommons.udayton.edu/acc\\_fac\\_pub/46](https://ecommons.udayton.edu/acc_fac_pub/46)

This Article is brought to you for free and open access by the Department of Accounting at eCommons. It has been accepted for inclusion in Accounting Faculty Publications by an authorized administrator of eCommons. For more information, please contact [frice1@udayton.edu](mailto:frice1@udayton.edu), [mschlange1@udayton.edu](mailto:mschlange1@udayton.edu).

# The Changing Components of the Corporate Annual Report: An Update

By Deborah Archambeault, John G. Fulmer, Jr. and Richard A. Turpin

An update on reporting on internal controls.

Recent regulatory changes affect not only the content of annual reports but also the population of companies that are required to comply with these reporting regulations. Lenders need to stay abreast of the information provided in corporate reporting packages. This article provides an update on regulatory changes and discusses how these changes affect the information that can be found in corporate annual reports.

## A Brief Recap

Changes to the corporate annual report since 2002 have focused on the reporting company's internal controls over financial reporting. As a result of concerns about the reliability of financial reporting and the need for more confidence in the financial reporting process, additional reporting requirements were brought about by the Sarbanes-Oxley Act of 2002 (SOX), the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC). As a result of these changes, a company's management and its independent auditor are required to assess and report on the effectiveness of these controls.<sup>1</sup>

Public companies classified as accelerated filers (companies with a market capitalization of \$75 million or more) have been subject to these SOX-404 reporting requirements since fiscal years ending on or after November 15, 2004. Because the costs of compliance with these requirements were deemed to be particularly burdensome for smaller public companies, and because smaller companies needed additional guidance in implementation, the SEC granted several extensions of the compliance date for so-called nonaccelerated filers (companies with market capitalization less than \$75 million). As a result of these extensions, nonaccelerated filers have not

yet been required to include any reports on internal controls in their annual reports. However, as discussed below, nonaccelerated filers will be required to comply by the end of 2007. Therefore, lenders who deal primarily with smaller public firms will soon be able to take advantage of the availability of this internal control information in the annual report.

## Recent Developments and Regulatory Changes

Since the inception of the internal control reporting requirements, the primary source of guidance for the auditor's attestation has been PCAOB Auditing Standard No. 2 (AS-2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*). Because there was no corresponding guidance for management, much of management's assessment was also driven by AS-2. Roundtable discussions among the PCAOB, the SEC, auditors and user groups have led to two important conclusions:

First, the audit of internal controls over financial reporting has produced significant benefits, including an enhanced focus on corporate governance and controls and higher quality financial reporting. Second, these benefits have come at

---

*Deborah Archambeault is Assistant Professor of Accounting at the University of Tennessee, Chattanooga. Contact her at [debbie-archambeault@utc.edu](mailto:debbie-archambeault@utc.edu).*

*John G. Fulmer, Jr. is First Tennessee Professor of Finance at the University of Tennessee, Chattanooga. Contact him at [John-Fulmer@utc.edu](mailto:John-Fulmer@utc.edu).*

*Richard A. Turpin is UC Foundation Associate Professor of Accounting at the University of Tennessee, Chattanooga. Contact him at [rick-turpin@utc.edu](mailto:rick-turpin@utc.edu).*

a significant cost. Costs have been greater than expected and, at times, the related effort has appeared greater than necessary to conduct an effective audit of internal control over financial reporting. (PCAOB Rel. No. 2007-0005A, p. 2.)

In an attempt to preserve the benefits of internal control reporting while keeping costs under control, the PCAOB, SEC and other interest groups have set out to streamline and improve the process for evaluating and reporting on internal controls. New guidance designed specifically for managers, as well as new guidance aimed at helping small business implementation, has been released.<sup>2</sup> In addition, the PCAOB revisited the guidance provided in AS-2 and superseded that guidance with a new standard, AS-5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.<sup>3</sup> Some of the most notable changes arising from the new standard involve eliminating unnecessary procedures, making the audit more clearly scalable for smaller and less complex companies and making the standard easier to understand. Further, whereas under AS-2 the auditor was responsible for providing two opinions (an opinion on management’s assessment of controls as well as an opinion on the effectiveness of the controls), under AS-5 the auditor is only responsible for reporting on the effectiveness of controls.

In addition, on August 9, 2006, the SEC granted what may be the final extension of the SOX-404 compliance deadline for smaller companies. Under this most recent extension, nonaccelerated filers have been given until fiscal years ending on or after December 15, 2007, to provide a report of management’s assessment of in-

ternal controls and until fiscal years ending on or after December 15, 2008, to provide an auditor’s attestation on the effectiveness of internal controls. The SEC has stated that it will consider future postponements if the SEC has not issued guidance for management on how to complete its internal control assessment or if the PCAOB has not revised AS-2. However, since both of these events have already taken place, as discussed above, a need for future postponement is not likely.

## Effects of Regulatory Changes on the Corporate Annual Report

The regulatory changes discussed above will result in two primary changes to corporate annual reports. First, the number of companies that will be required to comply with the internal control reporting requirements is about to increase significantly. The accelerated filers who have been providing management reports on internal controls will soon be joined by their nonaccelerated filer counterparts for fiscal years ending on or after December 15, 2007. That means that lenders can expect to see the management report on internal controls in all annual reports released in early 2008. The auditor attestation on internal controls for these nonaccelerated filers should appear in annual reports in early 2009. Second, the content of the auditor’s attestation on internal controls will change slightly. Whereas in the past the auditor’s attestation has provided two separate opinions (one opinion on management’s assessment and a separate opinion on the effectiveness of the controls), auditor attestations

continued on page 48

*Exhibit 1. Summary of Changes to Internal Control Reports Included in the Corporate Annual Report*

<b>Report</b>	<b>Compliance Date for Accelerated Filers (fiscal years ending on or after)</b>	<b>Scheduled Compliance Date for Nonaccelerated Filers (fiscal years ending on or after)</b>	<b>Source of Reporting Requirement</b>
Management Assessment of Internal Control Over Financial Reporting	November 15, 2004	December 15, 2007	SOX-404(a) and Item 308(a) of Regs. S-K and S-B
Auditor’s Attestation on Internal Control Over Financial Reporting*			SOX-404(b) and Item 308(b) of Regs. S-K and S-B
• <i>Opinion on management’s assessment</i>	November 15, 2004; not required after December 15, 2007	Not required	PCAOB AS-2
• <i>Opinion on effectiveness of internal controls</i>	November 15, 2004	December 15, 2008	PCAOB AS-2 and AS-5

\* May be issued as a separate report or may be combined with the Report of the Independent Auditor on Audited Financial Statements.

## Financial Reporting

continued from page 28

included in annual reports issued in early 2008 for fiscal years ending on or after December 15, 2007, will include only an opinion on the effectiveness of internal controls. Exhibit 1 summarizes these changes.

### Conclusion

In response to numerous high-profile corporate scandals (for example, Enron and WorldCom), and concerns over the reliability of financial reporting, reporting requirements for public companies continue to be refined. The latest changes to these rules subject smaller public companies to internal control reporting requirements, allowing lenders to obtain significant new information about smaller companies. Lenders can refer to *How to Use the Changing Components of the Corporate An-*

*nual Report* for examples of the use of the new SOX-required reports.<sup>4</sup>

### Endnotes

- <sup>1</sup> SOX-404(a) and Item 308(a) of Regulations S-K and S-B require management's assessment and report on internal controls. SOX-404(b) and Item 308(b) of Regulations S-K and S-B require the independent auditor's attestation on internal controls.
- <sup>2</sup> The SEC issued *Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting* in Release Nos. 33-8810 and 34-55929, effective June 27, 2007. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) published guidance on the use of its framework to address the needs of smaller businesses on July 11, 2006.
- <sup>3</sup> AS-5 was adopted by the PCAOB on June 12, 2007, and was approved by the SEC on July 25, 2007.
- <sup>4</sup> Deborah S. Archambeault, John G. Fulmer Jr. and Richard A. Turpin, *How to Use the Changing Components of the Corporate Annual Report*, *COMMERCIAL LENDING REV.*, May-June 2006, at 33.

## Announcing ... GAAP Financial Statements Disclosures Manual

GAAP FINANCIAL STATEMENTS DISCLOSURES MANUAL provides a complete, quick and valuable reference source for financial statement disclosures. The MANUAL contains more than 900 examples of realistic sample footnote disclosures to assist in the preparation of financial statements for an audit, review or compilation engagement. It facilitates compliance with authoritative pronouncements by integrating, in each chapter, the specific disclosure requirements with the sample footnotes. The MANUAL is current through the issuance of the following pronouncements:

- FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans An Amendment of FASB Statements No. 87, 88, 106, and 132R*
- FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*
- FASB Technical Bulletin 01-1, *Effective Date for Certain Financial Institutions of Certain Provisions of Statement 140 Related to the Isolation of Transferred Financial Assets*
- SOP 06-1, *Reporting Pursuant to the Global Investment Performance Standards*
- EITF Issue No. 06-9, *Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee*
- FASB Staff Position No. EITF 00-19-2, *Accounting for Registration Payment Arrangements*
- FASB Staff Position No. FAS 123(R)-6, *Technical Corrections of FASB Statement No. 123(R)*

The MANUAL provides sample disclosures that are technically sound, understandable and comprehensive and that cover a variety of scenarios, from the most common to the most unusual. It is designed for ease of use. Information can be located based either on the disclosure topic or on the disclosure's location in the financial statement. In addition, each chapter is structured as a standalone chapter, providing all of the information you need for a specific topic. Each chapter consists of an executive summary; a listing of relevant authoritative literature; a listing of disclosure requirements mandated by GAAP; and specific examples of disclosures.

GAAP FINANCIAL STATEMENTS DISCLOSURES MANUAL will be available from CCH INCORPORATED, 4025 W. Peterson Avenue, Chicago, Illinois 60646-6085. To order by phone, call 1-800-248-3248, book #0-5273-400.