

SEC Regulations Committee
April 9, 2008 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

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Discussion Document B

Topic: Application of new accounting standards with different transition provisions for public and nonpublic companies in connection with an initial public offering

Question: Is a nonpublic company that undertakes an IPO required to apply new accounting standards as if the company had always been a public company?

Background: New accounting standards oftentimes contain different transition provisions for public and nonpublic companies (e.g., FAS 123R, FAS 150, FAS 158, and FIN 48). The different transition provisions generally provide nonpublic companies with additional time (as compared to public companies) before they are required to apply the new standard. Additionally, accounting standards may use different definitions of public/non-public.

At the April 2004 meeting between the SEC staff and SEC Regulations Committee, the staff expressed its view with respect to FAS 150 (in Discussion Document G) that:

" An entity is generally no longer eligible for the nonpublic company treatment alternatives when it is in the process of becoming a public entity. Such entities must comply with public company treatment alternatives in the standard as of the date that all public companies were required to adopt the standard, even if that requires a company that is in the process of filing an IPO to restate prior period financial statements."

The SEC staff's view was reaffirmed at the April 2007 meeting with respect to FAS 158 (in Discussion Document B).

Committee Recommendation: Even though the SEC staff's views described above were expressed in the context of individual new standards (i.e., FAS 150 and FAS 158), the Committee believes the principle expressed should be applied broadly, *to wit*: when a nonpublic company files with the SEC for purposes of becoming a public company, unless the SEC staff issues specific guidance (e.g., the staff's guidance in SAB Topic 14B on share based payments), it should apply all accounting standards (including new standards) as if it had always been a public company. This is true even for standards which prohibit retrospective application.

Consider the following example:

- Company A, a calendar year-end nonpublic company, intends to file a Form S-1 in June 2008 for the purposes of registering the offer and sale of its common stock in an IPO.
- The Form S-1 will include audited financial statements as of December 31, 2007, and 2006 and for each of the three years in the period ended December 31, 2007 and unaudited financial statements as of March 31, 2008 and for the three-month periods ended March 31, 2008 and 2007.
- As a nonpublic company, Company A would not be required to adopt FAS XYZ, a recently issued FASB pronouncement, until its fiscal year ending December 31, 2009. The effective date of FAS XYZ for public companies was interim and annual periods beginning after December 15, 2006 (i.e., January 1, 2007 for calendar year-end companies). FAS XYZ's transition provisions prohibit retrospective application.
- Company A previously provided its 2007 quarterly and annual financial statements to its bank. Those financial statements did not reflect the adoption/application of FAS XYZ (in reliance on the nonpublic company transition provisions).

Application of the principle: Absent guidance from the SEC or its staff that would suggest otherwise, Company A should prepare its financial statements included in its Form S-1 as if it had always been a public company. Accordingly, Company A's 2007 financial statements (interim and annual) should be retrospectively revised to reflect the adoption/application of FAS XYZ as of January 1, 2007. This is true even though Company A had previously provided those financial statements to its bank. It is also true even though FAS XYZ prohibits retrospective application. Company A must apply this principle to pre-existing guidance as well (e.g., ASR 268). In contrast, if the separate financial statements of a nonpublic company are provided in the Form S-1 to comply with Rules 3-05, 3-09 or 3-14, then those financial statements should be prepared in accordance with the transition provisions as set forth in the relevant standard for nonpublic companies.

SEC Staff Response:

The staff agrees with the Committee Recommendation.