Private companies prepare for more regulation and audits

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Private companies are bracing for their version of the Sarbanes-Oxley Act, which appears to be on the way. That 2002 law requires accountants to take a closer look at public companies' financial statements and, for the first time, examine systems and controls they use in preparing those statements. The change for public company audits started with their 2004 business. Sarbanes-Oxley does not cover private companies. Rules issued this year and in 2006 by the American Institute of Certified Public Accountants (AICPA) require accountants to conduct similar expanded audits for private companies, starting with audits for 2007 business. Those audits will be more expensive - probably by at least 20 percent - and take more time. But they will help auditors in their bottom line of "finding a fraud, if there is one," said Mark Fromberg, a partner in Miami-based accounting firm Rachlin Cohen & Holtz. More importantly for most clients, the new rules will help auditors gain a better understanding of clients and their businesses, Fromberg said. That will help auditors in making suggestions that can improve operations and profits, he said. A study by Chicago-based law firm Foley & Lardner shows the costs of audits for U.S. public companies rose by averages of 67 percent for 2004, 3 percent for 2005 and 5 percent for 2006. The first year's high increases were attributed due to new reviews under Sarbanes-Oxley. Fromberg expects costs for South Florida private companies could rise between 20 percent and 40 percent on audits conducted in 2008 (for 2007 business). He expects increases will be much smaller in following years, because auditors will put new testing systems in place in 2008. Fromberg would not disclose his firm's fees, but said most South Florida private companies spend less than $100,000 a year on audits. Fromberg; Candido Fernandez, a partner in Miami-based accounting firm Kane & Co.; and David Brieto, a partner in Miami-based accounting firm Morrison, Brown, Argiz & Farra, all said many audits should take about 20 percent longer. "I realize it will cost extra time and money," said David Tenner, comptroller at Miami Lakes-based Isaco International, a Rachlin Cohen & Holtz audit client. "But they will gain a better understanding of how we run our business, and I hope they will find ways to help us streamline our processes." Isaco is an importer and distributor of men's boxer shorts, sleepwear, socks and other apparel. "There could be some hardships on companies like ours, because we might have to hire someone who knows the financial reporting world," Tenner said. He focuses on his company's finances and operations, not on financial statements and the rules that govern them. "Most public company CFOs have staff who understand GAAP [generally accepted accounting principles] and have one or more individuals in charge of financial reporting," Fromberg said. At many private companies, the CFO or comptroller "is not up to date with new accounting standards." "This is like Section 404 of Sarbanes-Oxley for private companies," he said of the new rules. Rachlin Cohen & Holtz, Kane & Co. and Morrison, Brown, Argiz & Farra are holding seminars on the new rules for their clients. "They are saying the expected increase in costs is too high," Fernandez said. "We are telling them it will increase the efficiency of audits." New requirements for audits of private companies * Auditors are required to understand a client's system of controls, or how it accumulates data and compiles it for inclusion in financial statements. Auditors must analyze the effectiveness of controls to identify potentially material errors. * Auditors must test cash flows, accounts receivable and allowances for loan losses. "A company can no longer say it is basing its calculations on historical assumptions," said Mark Fromberg, a partner at Rachlin Cohen & Holtz. * If auditors find what their rules define as deficiencies or weaknesses in controls, they must send the client a letter with details. The company must make the letter available to its board of directors. If lenders ask the company for any communications on deficiencies from auditors, they must provide such letters.