

Working with the Division of Corporation Finance

Introduction

On September 3, 2008, members of the Audit Committee Leadership Network met with representatives of the Securities and Exchange Commission's (SEC's) Division of Corporation Finance (Corp Fin) at SEC headquarters in Washington, DC.

The meeting followed from a previous dialogue between the Audit Committee Leadership Network and John White, director of Corp Fin, that was held on September 5, 2007.¹ At that meeting, Mr. White recommended that companies develop a relationship with one of the 11 assistant directors in Corp Fin who have responsibility for the filing review process for registrants in particular industries. As a first step, members agreed to meet with Mr. White's direct reports who oversee the work of the assistant directors. The meeting covered:

- **Feedback on Corp Fin's filing review process**
- **Accounting complexity**

SEC staff from Corp Fin participating in the discussion included:

- Paul Belvin, Associate Director, Disclosure Operations
- Lillian Brown, Senior Special Counsel to the Director
- Wayne Carnall, Associate Director, Chief Accountant
- James Daly, Associate Director, Disclosure Operations
- Shelley Parratt, Deputy Director, Disclosure Operations
- Barry Summer, Associate Director, Disclosure Operations
- John White, Director

Audit committee chairs who participated in the meeting attended in a personal capacity. They were:

- Denny Beresford
- Laban Jackson
- Mike Losh
- Oscar Munoz
- Sir Ian Prosser
- Sandy Warner

ViewPoints reflects the network's use of a modified version of the Chatham House Rule whereby names of participants at the meeting are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. The views expressed by individual SEC staff members are their own and do not necessarily represent the views of the Commission or any other member of the staff. For further information about the Audit Committee Leadership Network, see "About this document," on page 7.

¹ More details of this meeting can be found in Audit Committee Leadership Network, "Regulatory balance: a dialogue with John White," *ViewPoints*, October 19, 2007, which is available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Oct07_View17.pdf.

Executive summary

Corp Fin's mission, according to the SEC website, is "to see that investors are provided with material information in order to make informed investment decisions – both when a company initially offers its stock to the public and on a regular basis as it continues to give information to the marketplace. The Division also provides interpretive assistance to companies on SEC rules and forms and proposes new and revised rules to the Commission."²

During the meeting between Corp Fin's senior staff and audit committee chairs, the following topics, summarized below, were discussed. Further detail is available on the pages noted:

- **Feedback on Corp Fin's filing review process** (*Page 2*)

Corp Fin staff set out some of the changes that have been made in the past five to six years to the filing review process that Corp Fin uses for periodic reviews of every listed company's major filings. In particular, the SEC now asks more questions of issuers rather than simply providing detailed comments. Audit chairs were generally positive about the impact of the changes, particularly the ability to seek reconsideration of issues, but they also expressed some concern that the review takes longer now. They also suggested that Corp Fin consider issuing "no comment" letters after reviews that result in no inquiries of a company. Several audit chairs proposed that SEC staff should develop relationships with senior executives at the largest registrants.

- **Accounting complexity** (*Page 6*)

Accounting complexity frustrates issuers and the SEC alike, but Corp Fin does not see itself as a source of that complexity. Mr. White supported several recommendations from the Advisory Committee on Improvements to Financial Reporting (CIFiR), including the recommendation that the Financial Accounting Standards Board (FASB) should produce simpler accounting rules.

Feedback on Corp Fin's filing review process

The Division of Corporation Finance "selectively reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934 to monitor and enhance compliance with the applicable disclosure and accounting requirements. In its filing reviews, the Division concentrates its resources on critical disclosures that appear to conflict with Commission rules or the applicable accounting standards or on disclosure that appears to be materially deficient in explanation or clarity."³

In recent years, Corp Fin has gained more resources for meeting its regulatory obligation. Notably, in 2003, the U.S. Congress approved \$841 million to add additional lawyers and accountants to the SEC to fulfill the requirements of the Sarbanes-Oxley Act (SOX).⁴

² For further information, see <http://www.sec.gov/divisions/corpfin.shtml>.

³ Division of Corporation Finance, "Filing Review Process," November 11, 2008. Available at <http://www.sec.gov/divisions/corpfin/cffilingreview.htm>.

⁴ Pamela Barnett, "SEC chief applauds budget increase, promises to beef up staff," *Government Executive.com*, March 14, 2003. Available at <http://www.govexec.com/dailyfed/0303/031403cdam2.htm>.

As a result, as of 2008:

The Division performs its primary review responsibilities through eleven offices staffed with approximately 80 percent of the Division's employees. The members of these eleven offices have specialized industry, accounting, and disclosure expertise. The Division assigns filings by companies in a particular industry to one of ... eleven Assistant Director Offices ... The Division has staffed each office with 25 to 35 professionals, primarily accountants and lawyers.⁵

At the meeting, audit chairs heard that the Division *“went from 250 people to 500 people⁶ post-SOX.”* One SEC staffer added, *“It was a transition for us to go from a small division where we knew everyone's name to a larger division.”*

Despite this growth, the SEC staff member pointed out that *“there is not much turnover at associate director and assistant director levels – and that is a source of continuity for a company ... Most [of the senior staff] started as first-line examiners and have more than 20 years' tenure at the SEC. We are organized by industry.”* One senior staffer told audit chairs, *“Audit committees should read our letters and review the response from their company. The [assistant director] group is looking at everyone else in your industry and then commenting on your company. If I were on an audit committee, I'd really care what our industry experts are saying.”*

Corp Fin is undertaking an internal change program to improve its customer service: *“There has been a change in our comment letters over the last five to six years. We now ask more questions ... A lot of these questions get answered, and we're done.”* Another SEC staffer said, *“We have our own internal task force to look at how we interact with the public, what types of inquiries we get, and how we deal with them. We want a unified way for the public to interact with us.”* One audit chair, commenting on the new “Q&A” approach to reviews, said, *“The outcome has been terrific,”* to which an SEC staffer responded, *“It helps to have outside encouragement.”*

Building relationships with Corp Fin staff

In an August 2008 speech, Mr. White noted Corp Fin's “commitment to transparency, responsiveness, and service in our interactions with the public ... as we seek to fulfill our mission of investor protection.”⁷ The issue of how to improve the dialogue between public companies and Corp Fin, which had first been raised at the September 2007 meeting between network members and Mr. White, was taken up again at the September 2008 meeting. One audit chair commented, *“[When you look at] the Federal Reserve as a principal regulator, the CEO, CFO, auditors, and [others inside and outside the company] have direct, personal relationships with key contacts at the Fed to talk about issues with neither party being surprised ... I don't see that with the SEC. I am delighted to see the continuity in [staffing in the Division] – that should lend itself to relationships with issuers.”*

⁵ Division of Corporation Finance, “Filing Review Process.”

⁶ These numbers include staff in parts of the Division other than Disclosure Operations.

⁷ John W. White, “Corporation Finance in 2008 – A Year of Progress.” Speech to the American Bar Association, Section of Business Law Committee on Federal Regulation of Securities, New York, August 11, 2008. Available at <http://www.sec.gov/news/speech/2008/spch081108jww.htm>.

An SEC staffer responded: *“The Fed relationship is different. There are a small number of regulatees. SEC has to oversee all public companies ... [The notion of a personal relationship] seems to me to be a good idea; it should work, and it should be happening, particularly with big companies [that we] review more frequently, close to every year. It often makes sense to have ongoing conversations ahead of disclosure events, or as they happen, rather than [afterwards].”*

One member of the SEC staff told audit chairs, *“When I was an assistant director, we had a lot of contact with counsel. We knew who represented each company. We have 1,200 companies to oversee [through our assistant director groups], so we respond to those who contact us. It is usually counsel from the big New York law firms. We might know some controllers, and they could feel comfortable contacting us. I did not speak to a CEO. It just doesn’t happen.”* Another added, *“The CEO would want to talk to [SEC chairman] Chris Cox or John White, not an assistant director. They are looking for a peer relationship.”*

Several audit chairs said senior executives at their companies had been advised by their lawyers and accountants not to meet with SEC staff. One staff member commented, *“Relationships are built with lawyers or accountants who know people here and may have worked here. As a [former] lawyer in private practice, we’d go as far as we could without meeting the SEC, unless we knew what the answer would be – so as not to close down any options.”*

Despite having relatively little contact with corporate executives, the Division does meet regularly with some who represent issuers. A staff member stated, *“It is a more fruitful conversation.”* In addition to meeting with corporate and external counsel, the SEC meets regularly with representatives from accounting firms, associations, and trade groups. It also collects information through wider consultation, e.g., concept releases and roundtables.

However, SEC staff would like to see better relationships developed with large issuers: *“We need to hear what registrants are concerned about, hear their questions, and answer them as best we can. Just putting a face to a name. Throwing an issue over the transom to get a view ... With respect to the largest companies, we need to do this – it’s harder to do it for everyone. We have a responsibility to [the larger companies] in particular because of their impact on the economy,”* and because, as one audit chair noted, *“They are going to have most of the issues.”* However, another audit chair observed, *“We can’t waste your time, and we need to be conscious of that.”*

Seeking reconsideration

At the 2007 meeting, one issue that concerned audit chairs was how to escalate issues for reconsideration within the Division. At that time, *ViewPoints* reported, *“Mr. White advised ... ‘My prior approach [in private practice] was not to go around people but to go through people. If you don’t like the answer, ask to invite the [next most senior] person up the chain to the meeting. The [assistant director] relationship is an important thing to develop.’* However, one member observed, *“The staff become more defensive as you*

escalate,’ and described how ‘a phone call with three people becomes a meeting with 17 people. We need more dialogue before things become difficult. There need to be steps to build rapport.’”⁸

Within this context, the SEC has been seeking to encourage companies to seek reconsideration of the SEC’s opinion, if they feel it is justified. In its document on the filing review process, Corp Fin notes:

Division staff members, at all levels, are available to discuss disclosure and financial statement presentation matters with a company and its legal, accounting, and other advisors. A company should not hesitate to request that the staff reconsider a comment it has issued or reconsider a staff member’s view of the company’s response to a comment at any point in the filing review process.⁹

One member had positive feedback about seeking reconsideration: *“At the last meeting, John said, ‘Call us or call your assistant directors, if you want.’ We scoffed. The lawyers and external auditors wouldn’t recommend it. In two instances, we called, and it worked beautifully. The message that [Corp Fin is] open to communication is important, and you need the lawyers and accountants to understand that.”*

Improving the timeliness of reviews

Despite some positive feedback on the new approach to filing reviews, one audit chair said, *“On timeliness, the ‘Q&A’ process is different and welcome, but it takes longer than it did. There are multiple rounds of questions ... It is taking longer each time there’s a review.”*

One SEC staff member observed, *“You are damned if you do and damned if you don’t. The Q&A process is to answer the questions first. The answers might raise another question. If the ultimate outcome is no change to the disclosure, you will be happy with the outcome, not the time it took to get there.”* However, *“If you have a comment sitting here for four months, that’s not right. We have tried to go faster and be more responsive.”* Another staff member added, *“We don’t want to stand between you and the markets.”*

SEC staff said any delays were not due to lack of resources: *“With our mandate and internal goals and a constant effort to focus on material issues, I think we are adequately staffed. But if we had to review more companies, or more quickly, we would need more resources.”*

Any issues around timeliness are more likely due to volume: *“We can’t review all the 10-Qs within 30 days of filing, as mostly they come in on the same day.”* One SEC staffer added, *“We have an internal policy of not issuing comments after the end of the fiscal year, so we have March 31 to December 31 to review a large percentage of companies. That is our only window. We have to comment before you submit the next one ... We monitor how much time we spend and how long the ball is in the company’s court on a filing review. We work hard to keep ourselves [under control] ... Time slips are often on the company side.”*

Getting closure

At the September 2008 meeting, audit chairs also expressed a desire to know when the SEC had completed a filing review, even if that review ended with no comments. One SEC staff member noted, *“When a*

⁸ Audit Committee Leadership Network, “Regulatory balance: a dialogue with John White,” 4.

⁹ Division of Corporation Finance, “Filing Review Process.”

company is selected for review, we do a first review, and if we have no questions, you never know. However, once you get a letter starting a review [by asking questions], you will get [another letter] closing the review.” The staff member added, *“SOX requires us to review every company every three years ... We get credit for [opening] a review, not for closing them.”* One audit chair responded, *“That’s my point. When I ask the company what’s happening, they say ‘we haven’t heard anything for four months, so we assume it’s OK.”*

Audit chairs suggested that the Division should also send no-comment letters acknowledging the fact that there has been a first review and officially closing it. One audit chair remarked, *“It gives comfort that you had no issues with the document ... It would also help you [in Corp Fin] manage companies to have a balanced view of how you do things.”* Another audit chair agreed: *“Audit committee chairs would like to know you’d reviewed the company.”* However, Corp Fin staff were not enthusiastic about the idea as they believe it provides false comfort for a company as it would not preclude a further review.

Investor input on the filing review process

Audit chairs were also interested in knowing if the Division had *“some process to see what investors are using or really require – either by industry or generally.”* One SEC staff member responded, *“We get fewer visits from investors’ groups, whether investor groups or activist investors, [than from companies]. The meetings we do have tend to focus on single issues. We have lots more interaction with companies than investors, except at roundtables.”*

One audit chair was surprised that no process existed: *“After we put out the 10-Q and 10-K and you make comments, you don’t talk to investors? That’s your customer. How do you know what you are doing is helpful to them?”* An SEC staff member responded, *“We don’t determine the disclosure requirements based on talking to investors – there are specific disclosure requirements in the federal securities laws. These are what the examiner must consider when reviewing a document.”* Another staffer pointed out, *“We solicit public comments on rule proposals, and groups do respond, and their input is highly valued. Many of these groups have different objectives and recommendations that can contribute to disclosure overload.”*

Accounting complexity

At the meeting, one audit chair noted, *“Complexity has increased dramatically – on hedge accounting, for instance.”* Corp Fin staff agreed: *“Accounting has become overly complex. We see it firsthand. It is easier to find fault with the process or the results than come up with a solution. We share the frustration over complexity, but there is no easy solution.”*

In July 2007, the SEC chartered the Advisory Committee on Improvements to Financial Reporting (CIFiR). In August 2008, in its final report, CIFiR differentiated the role of the FASB in providing authoritative guidance from that of the SEC, which provides non-authoritative guidance. The report stated:

We believe that there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance of general significance. The FASB should perform this function for U.S. GAAP [Generally Accepted Accounting Principles], while the SEC should focus on

registrant-specific guidance ... If the SEC staff identifies accounting issues of relatively broad significance in the process of reviewing filings by registrants, the SEC staff should refer such issues to the FASB.¹⁰

Chairman Cox said, “I commend the Advisory Committee and Chairman Pozen for their work to make financial reporting less complex and more useful to investors. I have asked the Commission staff to immediately begin analyzing these recommendations, and to prepare regulatory actions based on them wherever appropriate.”¹¹ A Corp Fin staffer commented, “*There is a CIFIIR [recommendation] aimed at the FASB and the SEC on how we set accounting rules. If indeed we were in the business of setting GAAP here, we should have that process move over to the FASB. The [CIFIIR recommendation] is for FASB to provide simple rules. We are not where complexity comes from.*”

Conclusion

The meeting between audit committee chairs drawn from some of the world’s leading companies and senior leaders of the SEC’s Division of Corporation Finance covered a number of topics of interest to the financial reporting community. These included improvements to the filing review process at the heart of Corp Fin’s work and the issue of accounting complexity. The determination of all the meeting participants to improve the relationship between the regulator and the largest regulated companies – and to do so in order to improve financial reporting for investors – was reflected in a desire to continue to discuss these and other issues in more depth.

About this document

The Audit Committee Leadership Network is a select group of audit committee chairs from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* may share it with those in their own network. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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¹⁰ Advisory Committee on Improvements to Financial Reporting, *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (Washington, DC: ACIFR, 2008), 6. Available at <http://www.sec.gov/about/offices/oca/acif/acif-finalreport.pdf>.

¹¹ U.S. Securities and Exchange Commission, “SEC Advisory Committee Makes Recommendations to Improve Financial Reporting for Investors,” press release, August 1, 2008. Available at <http://www.sec.gov/news/press/2008/2008-166.htm>.