

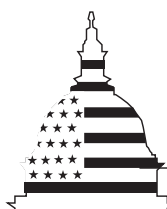
GAO

Report to the Ranking Minority Member,  
Subcommittee on Financial Institutions,  
Committee on Banking, Housing, and  
Urban Affairs, U.S. Senate

June 2001

SECURITIES AND  
EXCHANGE  
COMMISSION

Reviews of  
Accounting Matters  
Related to Public  
Filings



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Accountability \* Integrity \* Reliability





United States General Accounting Office  
Washington, DC 20548

June 14, 2001

The Honorable Robert F. Bennett  
Ranking Minority Member  
Subcommittee on Financial Institutions  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

Dear Senator Bennett:

This report responds to your request that we review how the Securities and Exchange Commission's (SEC) Office of the Chief Accountant (OCA) resolves accounting issues submitted by companies that have or are contemplating publicly traded securities. As agreed, this report describes the (1) number and types of accounting-related inquiries and written submissions that are presented by companies and their auditors and those that are presented through requests for consultation services from SEC's Division of Corporation Finance (DCF), (2) SEC's procedures for reviewing and deciding on accounting issues, including the controls in the SEC's process to ensure consistency when dealing with these accounting issues, and (3) views from SEC registrants, the accounting profession, and SEC officials regarding how well the process is working.

The primary mission of the SEC is to protect investors and maintain the integrity of the securities market. The Securities Act of 1933 requires that, prior to the offering or sale of securities, the issuer must register the securities offering with the SEC by filing a registration statement. The registration statement must contain financial and other material information concerning the securities and the issuer. Following the securities' registration, the Securities Exchange Act of 1934 requires that the issuer make periodic filings disclosing its financial status and changes in condition. For example, issuers must file annual reports containing financial statements, which are required to be prepared in conformity with generally accepted accounting principles (GAAP) and audited by independent public accountants. The SEC reviews selected issuers' filings for compliance with accounting and disclosure requirements. During fiscal year 2000, the SEC received over 14,000 registrants' filings. Also, under the Securities Act of 1934, the SEC has specific authority to establish accounting and reporting standards as part of its mandate to administer and enforce the provisions of federal securities laws.

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As the SEC's principal advisor on accounting and auditing matters, OCA resolves issues arising from the SEC's review of registrants' financial statements and disclosures. OCA also reviews registrants' accounting issues through prefiling inquiries from the registrants themselves.

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## Results in Brief

Registrants submit issues that generally involve unusual, complex, or innovative transactions and, in many instances, for which no clear authoritative guidance exists. During calendar year 2000, OCA received 113 new submissions and carried over 21 submissions from the prior calendar year for a total caseload of 134 written submissions during the year. Of these, OCA closed 116, leaving 18 submissions that were carried over to calendar year 2001. Examples of the type of accounting issues frequently reviewed include business combination issues, such as the application of the pooling versus purchase methods of accounting, and complex issues surrounding revenue recognition and financial instruments.

OCA has published procedures that are publicly available for dealing with the registrants on accounting issues. In December 1999, OCA issued *Protocols for Registrant Submissions to the Office of Chief Accountant*. They address the submission of accounting matters by registrants to OCA for oral and no-name inquiries, written submissions, meetings with SEC staff, and correspondence with SEC staff regarding registrants' understanding of SEC staff's positions. OCA has also documented formal internal procedures for reviewing and resolving registrants' accounting issues. These internal procedures contain key controls, which are designed to help ensure consistency in its process for dealing with registrants' accounting issues.

The representatives from SEC registrants and the accounting profession whom we spoke with conveyed a range of experiences, both positive and negative, with regard to the SEC's handling of accounting issues. Some common concerns were expressed regarding the SEC's decision-making process on accounting issues. Specifically, registrants and their auditors told us that the SEC's process for handling accounting issues and the basis for its positions are not always apparent. Representatives cited the need for additional transparency of the SEC's internal processes. OCA officials explained their internal procedures to us and stated that they would consider providing additional information to registrants and their auditors regarding the SEC's internal process for its review and decision-making on accounting matters.

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In addition, representatives from the registrants and the accounting profession expressed concern about the difficulty in tracking the variety of sources used by the SEC in determining acceptable accounting practices and financial reporting methods for filings. Registrants and their auditors stated that many of these sources are in addition to, and outside of, the private sector standard-setting process and are not subject to due process. OCA officials stated that these sources are available in the Code of Federal Regulations and on their external Internet Web site. OCA also said that private publishing firms, such as Commerce Clearing House, Inc. (CCH) publish documents that contain all SEC rules. With regard to the SEC's issuance of interpretive guidance without due process, the SEC officials stated that all SEC guidance can be tied to existing GAAP and, therefore, does not represent new GAAP. The SEC officials said that the staff's interpretive guidance describes new fact patterns appearing in industry and provides guidance for handling these new types of cases under existing GAAP.

We are making recommendations that focus on information provided by OCA to registrants and the accounting profession. Specifically, we are recommending that the SEC make public additional information that explains its current policies and procedures for reviewing and deciding on accounting issues. Also, because of the differing views, we are recommending that the SEC officials meet with representatives of the registrants and the accounting profession regarding the methods for disseminating the variety of SEC's rules and interpretive guidance and the method for communicating OCA's final position on accounting issues. Increased transparency and open communications are fundamental for an effective working relationship between the registrants, the accounting profession, and the SEC.

In commenting on a draft of this report, the SEC expressed appreciation for the constructive nature of the recommendations and said that it had begun considering ways to implement them. The SEC described its planned actions to create more transparency for SEC processes for making decisions on accounting issues and highlighted the availability of its current guidance and positions on accounting issues. The SEC also pointed out that many of the accounting cases it deals with are unique. The American Institute of Certified Public Accountants (AICPA) said that the recommendations made in our report, if properly implemented, would provide an opportunity to promote improved transparency of the SEC processes and communications among registrants, the accounting profession, and the SEC. The AICPA provided additional suggestions for specific discussion topics related to OCA's procedures and

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communications with registrants. The SEC's and the AICPA's written comments have been reprinted in appendixes I and II, respectively.

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## Background

The primary mission of the SEC is to protect investors and maintain the integrity of the securities market. The Securities Act of 1933 requires that, prior to the offering or sale of securities, the issuer must register the securities offering with the SEC by filing a registration statement.<sup>1</sup> The registration statement must contain financial and other material information concerning the securities and the issuer. Following the securities' registration, the Securities Exchange Act of 1934 requires that the issuer make periodic filings disclosing its financial status and changes in condition. For example, issuers must file annual reports containing financial statements, which must be prepared in conformity with GAAP and audited by independent public accountants. During fiscal year 2000, the SEC received over 14,000 registrants' filings. The SEC reviews selected issuers' filings to ensure compliance with accounting and disclosure requirements. The SEC has enforcement authority under federal securities laws to take legal action against companies that do not comply with the securities laws.

SEC's critical role to protect investors' interests has been made even more challenging with the significant changes in the global economy and capital markets over the past few years. The current business environment is characterized by a globalized, highly competitive economy; explosive growth in the development and use of technology; expansion in the number of public companies; and the unprecedented growth and in some cases subsequent decline in the market value of those securities. Furthermore, growth in equity values has placed tremendous pressure on public companies' management to reach earnings or other performance targets and to meet or exceed the earnings expectations of the security analysts and investors. Missing these targets may cause a significant decline in a security's market value and reduce management's compensation in those cases when it is tied to achieving target earnings and/or stock market prices. Several major instances of misstated earnings have resulted in massive declines in the values of the affected companies. Recently, the SEC has become increasingly concerned with the

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<sup>1</sup>Not all offerings of securities must be registered with the SEC. For example, private offerings to a limited number of persons or institutions, offerings of limited size, intrastate offerings, and securities of state and federal governments are exempted from registration requirements.

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inappropriate use of GAAP and the resulting effect on reported earnings and, in some cases, has required companies to restate their earnings.

The SEC's DCF oversees the disclosure of information, which is required by federal securities laws, to the investing public. DCF's staff routinely reviews the disclosure documents filed by public companies with SEC and consults with OCA to resolve issues arising from the review of registrants' filings. OCA is the SEC's principal advisor on accounting and auditing matters. OCA also reviews registrants' specific accounting treatment of complex issues as a result of pre-filing inquiries from the registrants themselves. OCA encourages registrants to consult on those financial reporting and auditing issues that involve unusual, complex, or innovative transactions for which no clear authoritative guidance exists.

As the SEC's principal advisor on accounting and auditing matters, OCA provides rulemaking and interpretation initiatives that supplement private sector accounting standards and provide implementation guidance for financial disclosure requirements. OCA provides general interpretive and accounting advice through interpretive releases and letters, staff accounting bulletins, responses to telephone inquiries, speeches, and active participation with the standard-setting bodies.

Under the Securities Exchange Act of 1934, the SEC has specific authority to establish accounting and reporting standards as part of its mandate to administer and enforce the provisions of the federal securities laws. Soon after its creation, the SEC decided to rely on accounting standards established in the private sector as long as such standards had substantial authoritative support. Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector that establishes standards for financial accounting and reporting. The SEC officially recognizes GAAP standards established by FASB as authoritative. As such, the SEC requires compliance with GAAP in the presentation of financial statements. FASB's deliberations are open to the public, and its standards are subject to public exposure and comment prior to issuance. The SEC is involved in establishing accounting standards through the oversight of, and close working relationship with FASB, and other professional standard-setting bodies. The SEC is also involved in establishing accounting standards through the adoption of rules and publication of interpretive guidance. Rules and interpretive releases, such as in the Codification of Financial Reporting Policies and

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Regulation S-X<sup>2</sup> of the SEC, have an authority similar to pronouncements by FASB for SEC registrants. The SEC staff issues Staff Accounting Bulletins that represent interpretive guidance and practices followed by DCF and OCA in administering the disclosure requirements of the SEC. The SEC has relied on generally accepted auditing standards (GAAS) promulgated by the AICPA's<sup>3</sup> Auditing Standards Board (ASB) as the standard for independent audits. ASB's deliberations are open to the public, and its standards are subject to public exposure and comment prior to issuance.

The SEC monitors the structure, activity, and decisions of not only FASB, but also FASB's Emerging Issues Task Force (EITF). EITF was formed in 1984 to provide timely financial reporting guidance on emerging issues before divergent practices became widespread and entrenched. Task force members are drawn primarily from public accounting firms but also include representatives of industry. The Chief Accountant of the SEC or his designee attends EITF meetings regularly as an observer and participates in the discussions, but does not have a vote. If the group reaches a consensus<sup>4</sup> on an issue, generally FASB takes this as an indication that no further board action is needed. If no EITF consensus is possible, it may be an indication that action by FASB is necessary. EITF proceedings are documented in *EITF Abstracts*. The SEC staff and FASB and EITF members work together in an ongoing effort to improve the standard-setting process and to respond to various regulatory, legal, and business changes promptly and appropriately.

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<sup>2</sup>Regulation S-X contains the SEC's principal accounting requirements, which govern the form and content of financial statements filed by public companies with the SEC. It addresses those areas in which GAAP standards are not explicit and there is a need for an authoritative source for such requirements.

<sup>3</sup>The AICPA is the national professional organization for certified public accountants (CPA). Its primary mission is to provide members with the resources, information, and leadership to enable them to provide valuable service to the public, employers, and clients. To achieve its mission, the AICPA acts as an advocate for CPAs and establishes rules and standards for the accounting profession.

<sup>4</sup>A consensus of EITF is deemed to exist when not more than 2 of the 13 members disagree with the suggested accounting approach. An EITF consensus is considered to be a GAAP standard under SAS No. 69, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Auditor's Report*, which was issued by the AICPA in 1992. The SEC staff questions registrants' accounting practices that differ from an EITF consensus.



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In carrying out its responsibilities, OCA works with the private sector accounting profession, including the AICPA SEC Practice Section and the AICPA SEC Regulations Committee. The AICPA SEC Practice Section is part of the profession's self-regulatory system, with a goal of protecting the public interest by improving the quality of CPA firms' practice before the SEC. The AICPA SEC Practice Section establishes requirements for member firms and has a program to monitor those requirements. Member requirements include adhering to quality control standards and submitting to a peer review of each firm's accounting and auditing practice every 3 years. The AICPA SEC Regulations Committee is part of the AICPA SEC Practice Section that acts as the primary liaison between the profession and the SEC on technical matters relating to SEC rules and regulations. The AICPA SEC Regulations Committee provides input to the SEC on accounting and auditing matters and communicates important SEC developments to its AICPA members. The AICPA SEC Regulations Committee includes accounting firms that belong to the AICPA SEC Practice Section as well as members from academia and industry.

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## Scope and Methodology

To fulfill our objectives, we interviewed officials and professional staff members from the SEC's OCA. We reviewed relevant policies and procedures, including the *Protocol for Registrant Submissions to OCA* (effective December 1999) and *OCA's Policies for Handling Registrants Matters* (dated August 2000). We focused on the procedures and controls employed by the SEC for resolving registrants' pre-filing accounting issues and issues on filings in which DCF consults with OCA. To gain an understanding of OCA's procedures and the controls employed by the SEC throughout the process, we reviewed OCA's case files of written submissions from registrants and their auditors. Although we reviewed cases to gain an understanding of the SEC's process and the related issues, we did not perform testing to evaluate whether the SEC properly implemented its procedures throughout its caseload, nor did we evaluate the SEC's final accounting positions on the cases that we reviewed.

We interviewed representatives from the AICPA's SEC Practice Section and SEC Regulations Committee, FASB's EITF, and several CPA firms. We also interviewed representatives from Financial Executives International (FEI) and its Committee on Corporate Reporting. FEI is a professional association of senior financial executives, with many members from SEC registrant companies, which communicates its members' views on emerging issues to standard-setting bodies and legislators. We also interviewed representatives from SEC registrant companies to obtain their views on the SEC's process for handling accounting issues.

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We conducted our work from December 2000 through May 2001, in accordance with generally accepted government auditing standards. We requested comments from the SEC, the AICPA SEC Practice Section, the AICPA SEC Regulations Committee, and FEI. We received written comments and technical comments from the SEC and the AICPA. FEI advised us that they did not have official comments on this report. The SEC's and the AICPA's written comments are discussed in the "Agency Comments and Our Evaluation" section of this report and are reprinted in appendixes I and II. We incorporated the technical comments provided by the SEC and the AICPA throughout this report as appropriate.

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## Accounting-Related Inquires to OCA

OCA receives both prefiling and active filing accounting issues for review through oral inquiries and written submissions from registrants and their auditors and from DCF. Oral inquiries received by OCA involve broad issues that are often not registrant specific. Registrants or their auditors can call OCA to ask prefiling accounting questions. Oral inquiries and OCA's responses are considered informal and therefore not binding for a subsequent filing. Oral inquiries are sometimes done on a "no-name" basis, whereby the registrants or their auditors telephone OCA to ask questions without giving their names. However, OCA encourages registrants or their auditors to put accounting inquiries in writing to ensure a clear understanding of the facts, especially those involving complex, unusual, or innovative transactions for which no clear authoritative guidance exists.

Prefiling written submissions from the registrants and their auditors are registrant specific, and OCA considers its position to be binding for purposes of deciding whether a registration has complied with the SEC's accounting and disclosure requirements. OCA also receives inquiries through consultations with DCF on issues related to filings from registrants. Some of DCF's inquiries are oral and others are considered written inquiries when the issues are substantive and involve extensive OCA's review. Inquiries from DCF include questions relating to (1) accounting issues and auditing matters that involve basic policies of SEC, (2) auditor's independence or qualifications, or (3) new, unusual, or controversial accounting issues relating to a registrant's financial statement presentation.

OCA receives various types of accounting-related inquiries through the processes described above. OCA tracks written submissions but does not track oral inquiries. OCA provided the following caseload information on written submissions and DCF consultations for calendar year 2000: OCA received 113 new submissions during calendar year 2000 and carried over

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21 submissions from 1999 for a total caseload of 134 written submissions for calendar year 2000. Of the 134 cases, OCA reported that it closed 116 cases, leaving 18 cases that were carried over to calendar year 2001. Approximately 38 percent of the 113 written submissions received by OCA came from DCF. The registrants and their auditors submitted the remaining 62 percent of the cases to OCA.

According to OCA, the written submissions it receives involve issues that are complex and involve significant judgment. Examples of the type of accounting issues frequently reviewed include business combination issues, such as the application of the pooling versus purchase methods of accounting and complex issues surrounding revenue recognition and financial instruments. OCA's position on these accounting issues can have a significant impact on a company's reported earnings and financial condition and a correspondingly large impact on the stock value of a company. The following represents the breakdown by type of the 113 submissions received by OCA during calendar year 2000:

- business combinations (29),
- revenue recognition (25),
- financial instruments (19),
- capital accounts (11),
- consolidations and equity method (9),
- stock compensation (4),
- auditor's independence (2),
- deferred income taxes (3),
- foreign reporting issues (2),
- financial statement presentation (3), and
- asset impairment, accounting changes, leasing, earnings per share, contingencies, and interest capitalization (1 each).

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## OCA's Procedures and Controls for Reviewing Accounting Matters

Because of concerns regarding the communications between auditors and the SEC, the AICPA issued a "best practices" guide in 1996 for member firms' communications with SEC staff in order to promote effective, efficient communications among SEC staff, registrants, and their auditors. The AICPA provided this document to the SEC, which in turn issued its *Protocols for Registrant Submissions to the Office of Chief Accountant* in December 1999. The SEC protocols are available to the public on the SEC's Web site and the AICPA's Web site; they set out the formal procedures for registrants' inquiries to the SEC on accounting matters. The protocols cover the following:

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- oral and no-name inquiries,
  - written submissions from registrants on prefiling accounting issues,
  - meetings with SEC staff, and
  - correspondence with SEC staff regarding registrants' understanding of the staff's position on an accounting issue.

The SEC's protocols cover the process for submitting accounting issues to OCA for review, conducting meetings with the SEC, and closing out issues with the SEC. The protocols do not include information about the internal process that SEC uses for its review and decision-making on registrant accounting matters. The protocols also do not provide information on the SEC's procedures for dealing with issues on filings in which DCF consults with OCA on accounting issues.

In December 1999, OCA began to document its internal procedures for its review of registrants' accounting matters and its procedures for dealing with issues on filings in which DCF consults with OCA on accounting issues. Completed in August 2000, these written internal procedures include key steps and controls in the SEC's process for dealing with registrants' accounting issues. These internal procedures have not been made available to registrants or the accounting profession. The following are OCA's key steps and controls as described in the protocols and SEC's current internal procedures.

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## Key Steps From the SEC's Published Protocols

- OCA requires registrants to submit standard, comprehensive information for written submissions so that OCA can fully understand the issues. The required information is listed in the protocols, and includes the following:
  - a clear description of the accounting, financial reporting, or auditing questions;
  - all facts that may influence a decision as to the proper accounting treatment for the transaction;
  - the accounting treatment proposed by the registrant and the basis for that conclusion, including an analysis of all the relevant accounting literature, as well as all alternatives considered and rejected; and
  - a statement regarding the conclusion of the registrant's auditor on the proposed accounting treatment.
- Upon resolution of an issue, the SEC protocols state that the registrant should prepare and send a letter to the SEC describing the registrant's understanding of the SEC staff's position.

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## Key Steps From the SEC's Internal Procedures Document

- OCA maintains teams of experts specializing in specific accounting issues, and individual issues are referred to the appropriate team of experts.
- OCA's teams of experts are to follow various prescribed steps for resolving each issue, which can include researching the accounting literature, researching the disposition of prior cases, and consulting with internal and external subject matter experts, including representatives from FASB and representatives from the "Big 5" accounting firms.<sup>5</sup>
- If a majority of the team dealing with an issue disagrees with the registrant's proposed accounting treatment, the decision is to be discussed with the team leader and a Deputy Chief Accountant and/or the Chief Accountant before communicating with the registrant.
- All issues that are not clearly answered by the accounting literature or staff precedents or are unusual, novel, or controversial are to be discussed with a Deputy Chief Accountant. A Deputy Chief Accountant discusses issues with the Chief Accountant where deemed appropriate.
- The Chief Accountant is to be notified if previous SEC staff positions are being reversed or if a registrant would be required to restate its financial statements. In such situations, the SEC staff must first obtain the approval of a Deputy Chief Accountant, and then must discuss the case with the Chief Accountant before notifying the registrant of its decision. The Chief Accountant may overturn the decision of the SEC staff if he becomes convinced that it is the best course of action.
- Whenever a team leader discusses the resolution of a matter with a registrant or the registrant's auditor, at least one other team member is required to be present.
- Once a decision is reached, the SEC is to document the decision in a memorandum for its files. The memorandum is to include relevant background information and facts of the case, the question raised, and alternate accounting treatment(s) that were considered but not accepted.
- A registrant may appeal the staff's position to a Deputy Chief Accountant, the Chief Accountant, or the Commission.

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## Views of Registrants, Their Auditors, and the SEC

The representatives from SEC registrants and the accounting profession with whom we spoke with said they had a range of experiences, both positive and negative, with the SEC's handling of accounting issues. Some of the representatives we spoke with expressed common concerns regarding the SEC's process for deciding on accounting issues.

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<sup>5</sup>The "Big 5" accounting firms are Andersen LLP, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP.

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Specifically, we were told that the SEC's process for handling accounting issues and the basis for the SEC's position is not always apparent to the registrants and their auditors, and representatives cited the need for additional transparency in the SEC's internal processes. In addition, the representatives we spoke with expressed concern about the difficulty in tracking the variety of sources used by the SEC in determining acceptable accounting and financial reporting. According to these representatives, many of the sources used by the SEC are in addition to, and outside of, the private sector standard-setting process.

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## Transparency of OCA Policies and Basis for Decisions

Representatives and members of the SEC registrant and accounting profession we spoke with did not identify any specific problems with the SEC protocols issued in 1999. The protocols deal with the process to be followed when submitting accounting issues or questions to the SEC. However, the representatives expressed concern that OCA's process for handling the issues is not clear, and registrants and their auditors are often unsure of how the SEC reached its decisions and on what basis. Representatives suggested that additional transparency regarding the SEC's process would help them to understand how issues are being handled and resolved by OCA.

Representatives of registrants and the accounting profession expressed a need for additional information regarding the following:

- general status information, including time estimates for resolving issues and status of the review;
- how accounting issues are assigned to SEC staff members;
- how OCA consults with standard-setting bodies and other large accounting firms, including how OCA ensures that information presented in these consultations is unbiased and how the results of consultations are used in resolving issues;
- the SEC's approval processes for determining whether registrant restatements are necessary;
- how OCA coordinates with DCF, including how OCA and DCF minimize duplication of information requested from the registrants and auditors; and
- OCA's final position on accounting issues.

The representatives we spoke with also stated that registrants and auditors who have only occasional dealings with OCA would especially benefit from additional transparency regarding SEC's procedures for deciding on registrant-specific accounting issues. The representatives said

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that large corporations and their auditors who are involved in frequent SEC registration filings have over time established effective working relationships with SEC staff and can often obtain information on SEC procedures through their frequent dealings with the SEC. The representatives also said that other registrants and auditors who have not developed ongoing working relationships with the SEC have greater difficulties working through the process, and additional information about OCA's process would be beneficial.

Also, many registrants said they believe that because they do not understand OCA's process, they must rely too heavily on their external auditors, even though the application of accounting methods is ultimately the registrants' responsibility. There is the perception that only the major accounting firms are aware of OCA's process and that it is almost mandatory to have these accounting firms lead the effort for them. While registrants would want to consult with and have the support of external auditors, registrants said that if they better understood OCA's processes, they might be able to take the lead in the process without having to rely so heavily on their external auditors. In addition, many of the representatives from the AICPA, who have considerable experience in dealing with OCA, expressed uncertainty about OCA's process and said they saw a need for additional information.

Representatives said that they are reluctant to appeal OCA's staff decisions to the Chief Accountant, Deputy Chief Accountant, or the Commission for three reasons. First, registrants have the impression that the SEC staff's supervisors have reviewed the matters prior to communicating with registrants and their auditors, and are in support of the staff's positions. Second, registrants have the perception that, in the appeal process, the SEC may open other accounting issues. Finally, the appeal process also adds to the registrants' time and cost. Representatives estimated that it can cost from \$25,000 to \$100,000 for legal and accounting fees to bring an issue to OCA, and appeals would add to this cost. Representatives told us that only a few decisions have been appealed and that the SEC's initial decisions were not changed through the appeal process.

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## The SEC's Response

OCA representatives referred to OCA's written procedures for internal processing in response to the concerns of registrants and their auditors. OCA officials stated that they would consider making public some information regarding their internal procedures for handling registrants' matters, as well as explanations of the key steps and communications that

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should occur between the SEC and the registrants throughout the process. At the same time, SEC officials also stated that certain information relating to the staff's internal policies requested by the registrants and their auditors would not be provided.

OCA officials provided the following responses to the specific issues raised by the representatives of the registrants and the accounting profession whom we spoke with in preparing this report.

- OCA officials stated it would be difficult to provide registrants with an estimate of how long it will take to review and rule on issues because this process is not completely within the SEC's control. The SEC staff often will request additional information from the registrant after receiving an initial written submission. However, registrants do not always respond to these requests for additional information promptly or the registrants' circumstances may change, thereby changing the scope of the issues. Because the SEC's process depends to a certain extent on the nature and timing of responses from the registrants, SEC officials stated that they would be unable to provide definitive time estimates for handling written submissions. The SEC did, however, state that often a sense of urgency or a specific deadline exists with regard to resolving an accounting issue, due to a pending transaction. In those cases, SEC officials said the SEC staff and the registrants work very closely and interactively to resolve the issue based on the timing needs of the registrants.
- Accounting issues are assigned to OCA professional staff members who work in teams in specialized areas. Under OCA procedures, assigned OCA staff generally calls the registrant within 3 days of receiving the issue with follow-up questions or to schedule a conference call involving the registrant and its auditors. Through this communication, the registrant also becomes aware of the specific SEC staff members assigned to its case, and OCA is able to determine whether the registrant has certain timing needs for resolving the issue. Also, the SEC provides a list of staff names by specialized work area at the annual conference sponsored by the AICPA SEC Regulations Committee.
- In researching a specific accounting issue, OCA staff members sometimes consult with standard-setting bodies and the other accounting firms. OCA staff members may prepare a "white paper" detailing the facts of the case. The paper generally summarizes the issue and basic facts that are specific to the registrant and poses the one, key accounting question relevant to the case. The paper does not identify the registrant. An OCA official responded that the registrants and their auditors might be concerned that the facts presented to the standard-setting bodies may be biased by the staff members. However, OCA representatives emphasized that it is the



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responsibility of the Chief Accountant and a Deputy Chief Accountant to ensure that the issues and facts are fairly presented and that OCA does not advocate a certain position.

- The SEC's internal procedures require that the Chief Accountant be notified if a registrant will be required to restate its financial statements. In such situations, the SEC staff must first obtain the approval of a Deputy Chief Accountant and then must discuss the case with the Chief Accountant before notifying the registrant of its decision. The Chief Accountant may overturn the decision of the SEC staff if he becomes convinced that it is the best course of action.
- In reviewing registrants' filings, DCF sometimes requests assistance or consultation services from OCA to resolve difficult accounting issues. Some of DCF's inquiries of OCA are oral and, if the questions are easily resolved, do not involve further interaction with the registrant. According to SEC officials, in cases in which additional information is needed from the registrant, both the DCF staff member reviewing the filing and an OCA staff member are present when the registrant is called for additional information. This internal procedure helps to ensure continuity and prevents or minimizes any duplication of information requests between DCF and OCA. Depending on the issues, OCA staff may also have further follow-up questions on previously submitted information from the registrant if it was unclear.
- After OCA staff members complete their review, OCA provides an oral response to the registrant along with an explanation of the basis for OCA's position and then documents its decision in a memorandum for its files. The SEC asks the registrant to provide a letter documenting the registrant's understanding of OCA's position. This procedure is set forth in the SEC's protocols and is intended to ensure that the registrant clearly understands OCA's position and the basis for its decisions. However, registrants do not always respond to OCA's request, especially when they disagree with SEC decisions. Although the SEC does not provide written responses to registrants' issues, it issues its staff accounting bulletins as a way to communicate broad issues to the registrant community.

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## Sources Used by the SEC to Make Decisions on Accounting Issues

Representatives of the registrants and the accounting profession expressed concerns that the SEC is using a variety of sources in addition to the authoritative standards and interpretations issued by the private sector standard-setting bodies as criteria for making decisions on accounting issues. Representatives expressed concern about the variety of SEC interpretive guidance, which they believe is being used by the SEC in its decisions on accounting issues. Many of the representatives we spoke with stated that it is becoming increasingly difficult to keep track of the

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variety of guidance being issued and used by the SEC, especially for the smaller accounting firms with limited resources. The representatives we spoke with cited the following guidance being used by the SEC as criteria:

- SEC Financial Reporting Releases;
- SEC Accounting and Auditing Enforcement Releases;
- SEC Staff Accounting Bulletins;
- SEC Frequently Asked Questions (FAQ) documents;
- SEC announcements at EITF meetings (such SEC announcements become part of public record, and some believe that this is setting new rules through the announcement process);
- DCF Outline of Current Issues and Rulemaking Projects, which contain pending rulemaking, recent rule adoptions, current disclosure issues on mergers and acquisitions, significant no-action and interpretive letters, and accounting issues;
- speeches by SEC staff members and commissioners;
- letters to the AICPA, EITF, and others to express SEC staff positions, including interpretations of other SEC formal interpretive guidance;
- highlights of joint meetings of SEC staff and AICPA SEC Regulations Committee and International Practices Task Force; and
- comment letters—for example, SEC staff positions are sometimes identified only as comments arise, and the SEC staff position is applied for the first time in a registrant review environment.

Registrants told us that rulemaking is coming from various places—the SEC, FASB, and EITF. The registrants want to know what is expected for fair presentation and disclosure so that they can comply. However, they said that the criteria being used by SEC are sometimes unclear, even to their auditors. The members of the accounting profession we spoke with said that they assist their clients in determining what is acceptable reporting under GAAP, but they too are often uncertain as to what the SEC’s position will be in the matter. Consequently, they often bring such issues to the SEC, not for the purpose of inquiring what is acceptable under GAAP, but for the purpose of determining whether their application of the accounting standards will be acceptable to the SEC.

Representatives of the registrants and the accounting profession express concerns that the SEC staff is using sources other than standards and guidance that have been through due process for determining what is acceptable financial reporting. They believe that the SEC staff defines acceptable accounting and reporting requirements through its interpretive guidance, without going through a formal due process under rulemaking. Due process provides a public forum for affected parties to comment on

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the impact of new standards or rules on particular industries and businesses. Registrants and external auditor representatives expressed concern that this process has resulted in the SEC staff setting GAAP as criteria for determining what is acceptable accounting and financial reporting for purposes of registrants' filings. As stated in the background section of this report, the SEC has specific authority to establish rules governing the financial reports of public companies and to ensure fair financial reporting.

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## The SEC's Response

OCA officials provided the following responses to the specific issues raised by the representatives of the registrants and the accounting profession whom we spoke with in preparing this report.

OCA officials acknowledged that, in its review of accounting and disclosure issues, the SEC staff uses a variety of sources, including SEC Financial Reporting Releases, SEC Accounting and Auditing Enforcement Releases, SEC Regulation S-X, Staff Accounting Bulletins, answers to FAQs, speeches, and letters. As stated in the AICPA's Statement on Auditing Standards, No. 69, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles in the Independent Auditor's Report"*, the SEC's rules and interpretive releases have an authority similar to pronouncements of FASB for SEC registrants. SEC rules, communicated through issuance of SEC Financial Reporting Releases, are approved through the Commission. Staff Accounting Bulletins, answers to FAQs, speeches, and letters are staff positions that act as interpretations of existing GAAP. Most registrants and their auditors have found them to be useful sources in their filings to the SEC.

OCA officials stated that SEC has made these materials readily available. Commercial publishers, such as Commerce Clearing House, Inc., publish a loose-leaf document covering federal securities laws that contain the Codification of Financial Reporting and Policies, Regulation S-X, and the Staff Accounting Bulletins. The SEC's rules and releases are included in the Code of Federal Regulations by topic index and are published weekly in the SEC Docket. In addition, the Staff Accounting Bulletins, answers to FAQs, speeches, and letters are posted on the SEC's Web site. The SEC officials also stated that the SEC began posting speeches and letters on its Web site after members of the accounting profession requested that they be published to aid the registrants and their auditors in understanding the SEC's positions for administering SEC disclosure requirements.

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With regard to the concern from the registrants that the SEC is using interpretive guidance, such as Staff Accounting Bulletins, to set GAAP without due process, the SEC officials stated that Staff Accounting Bulletins are interpretive guidance and do not represent new GAAP. SEC staff, through speeches, describes new fact patterns appearing in industry and provides guidance for handling these new types of cases under existing GAAP. Also, the SEC published answers to FAQs as a guide to registrants and their auditors in submitting filings to the SEC. The Staff Accounting Bulletins and speeches can be tied back to existing accounting literature and are meant to be communicated to everyone. If an issue is unclear, OCA will send the issue to EITF for resolution. The SEC officials believe that, since the interpretive guidance is not new GAAP, it is not subject to due process.

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## Current Relations Between the SEC and the Accounting Profession and Registrants

The Panel on Audit Effectiveness<sup>6</sup> reported that the relationships between the SEC and the accounting profession are stressed. The strained relationships were described in *The Panel on Audit Effectiveness Report and Recommendations*, August 31, 2000, as follows:

“While one would expect occasional tensions, the current relationship between the profession and the SEC seems under unusual stress. The Panel views this situation as counterproductive to continued improvement in financial reporting, which is a shared goal of both the profession and the SEC. The Panel believes that this important relationship must be restored to its historic level of candor, trust, and respect.”

Many of the comments we heard from the registrants’ representatives, representatives from the accounting profession, and SEC officials over the course of our work are consistent with the conclusions of the Panel on Audit Effectiveness regarding the stressed relationships between the registrants, their auditors, and the SEC. In fact, representatives from the accounting profession and registrants stated that they believe that tensions between registrants, the accounting profession, and the SEC have been higher during the past few years than during any recent period.

An OCA official stated that the relationship between the industry and the SEC has ebbed and flowed throughout the years depending on economic

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<sup>6</sup>The Panel on Audit Effectiveness was formed at the request of the SEC to comprehensively review the conduct of the audits and the governance of the profession. The Public Oversight Board appointed an eight-member panel of leaders from the accounting profession.

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and business events and the related issues with the Commission. He stated that tension should exist between the SEC and the companies it regulates, but it is a “constructive tension,” which has evolved and has made the U.S. markets work well. He also stated that FEI has been conducting a study on the quality of financial reporting. In this study, there have been a large number of restatements in recent years, some were a result of the SEC’s actions, but most were from registrants, and auditors’ actions. He stated that the impact of financial reporting is greater today than ever before.

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## Conclusions and Recommendations

An effective working relationship between the registrants, the accounting profession, and the SEC is important for ensuring that investors are protected and that the integrity of the securities market is maintained. This working relationship would benefit from increased transparency of OCA procedures in resolving accounting matters, especially for those registrants and auditors who have infrequent dealings with OCA. Due to the common concerns expressed by representatives of registrants and the accounting profession and SEC’s recognition that additional information would be beneficial, we recommend that the Chairman of the SEC direct the Chief Accountant to implement procedures to improve the availability of information to registrants regarding OCA’s process for deciding on accounting issues. Such procedures would include expanding the protocols or issuing additional public information to explain the SEC’s current policies and procedures for handling registrant’s matters, including

- general communications to registrants and auditors about the status of the reviews,
- assignment of accounting issues to SEC staff members,
- how the SEC conducts its consultations with other accounting firms and FASB, and how the results of such consultations are considered in its decisions,
- the SEC’s approval process for determining when registrant restatements are necessary,
- coordination between DCF and OCA, and
- when decisions are considered to be final.

We found differences in views between SEC officials and representatives of the registrants and accounting profession regarding the accessibility of the variety of SEC rules and interpretive guidance, and methods of communicating OCA’s positions on accounting issues. Therefore, we recommend that the Chairman of the SEC direct the Chief Accountant to

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- meet with representatives from the accounting profession and registrants to determine how best to disseminate information on rules and interpretive guidance and
  - meet with representatives from the accounting profession and registrants to determine how the SEC could provide additional written information on the reasons for its decisions, especially when they involve complex and unusual accounting issues.

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## Agency Comments and Our Evaluation

We requested comments from the SEC, the AICPA, and FEI. We received written comments from SEC's Chief Accountant on behalf of the SEC's OCA, and the Chair of the AICPA SEC Practice Section on behalf of the AICPA's SEC Practice Section and the AICPA's SEC Regulations Committee. FEI advised us that they did not have official comments on this report. The SEC's and the AICPA's written comments are discussed below and reprinted in appendixes I and II, respectively. We also received technical comments from both the SEC and the AICPA that we incorporated throughout this report as appropriate.

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## SEC Comments

The SEC's Chief Accountant, commenting on behalf of the SEC's OCA expressed appreciation for the constructive nature of our recommendations and stated that actions are being planned by the SEC to implement our recommendations. Regarding our recommendation to improve the availability of information to registrants about the OCA's processes for decisions on accounting issues, OCA plans to publish its internal procedures, with minor modifications. In addition, the OCA plans to publish an article, which will describe how accounting issues typically flow through the SEC's OCA. Regarding our recommendations that OCA meet with representatives of the registrants and accounting profession to determine (1) how best to disseminate information on rules and interpretive guidance and (2) how the SEC could provide additional written information on the reasons for its decisions, the SEC agreed that discussions would be helpful and appropriate. OCA anticipates either adding these issues to the periodic meetings with the AICPA's SEC Regulations Committee and other appropriate committees, or convening a special meeting to discuss these two issues.

The SEC's OCA also provided additional details on planned modifications to its internal procedures for decisions on accounting matters, and its outreach programs that inform the public of OCA's decisions and positions on accounting issues. In its comments, the SEC's OCA also provided information on the size of OCA's staff and the scope of its workload. These

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additional details can be found in OCA's written comments, which have been reprinted in appendix I.

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### Comments From the AICPA SEC Practice Section and the AICPA SEC Regulations Committee

In its written comments, the AICPA noted the critical role SEC plays to individual investors who place their trust in the capital markets. The AICPA also recognized that the SEC staff executes its critical mission under difficult and challenging circumstances, including pressures that result from market timing and limited resources. The AICPA stated that if our recommendations were properly implemented, they could provide an opportunity to promote improved transparency of the SEC processes and communications among registrants, the accounting profession, and the SEC. Related to our recommendations, the AICPA provided additional suggestions for specific discussion topics regarding the SEC's communications with registrants about its procedures and its process. The AICPA's suggestions deal with the following areas:

- the SEC's "white papers" used in its consultation process;
- timing of SEC responses;
- the SEC's referrals of matters to the standard-setting bodies;
- the SEC's approving official for restatements; and
- codification of SEC staff positions.

We believe that discussions between the SEC and the accounting profession on the above issues would be constructive as part of the meetings between the SEC, registrants, and the accounting profession. Additional details can be found in AICPA's written comments, which have been reprinted in appendix II.

We are also sending copies of this report to the Acting Chairman of the Securities and Exchange Commission, the Director of the American Institute of Certified Public Accountants' Professional Standards and Services, and the President and Chief Executive Officer of Financial Executives International.

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If you have any questions, please call me at (202) 512-2600 or Jeanette Franzel, Acting Director, at (202) 512-9471 or contact her via e-mail at *franzelj@gao.gov*. Key contributors to this report were Darryl Chang, Charles Ego, Peggy Smith, and Meg Mills.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Jeffrey C. Steinhoff". The signature is fluid and cursive, with the first name "Jeffrey" being the most prominent part.

Jeffrey C. Steinhoff  
Managing Director  
Financial Management and Assurance



# Appendix I: Comments From the Securities and Exchange Commission



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

May 30, 2001

Ms. Jeanette Franzel  
Acting Director  
Financial Management and Assurance  
United States General Accounting Office  
441 G Street, NW  
Washington, DC 20548

Dear Ms. Franzel:

Thank you for your May 16, 2001 letter to Acting Chairman Unger and the opportunity to comment on the draft report being prepared by the General Accounting Office ("GAO") on the Securities and Exchange Commission's Reviews of Accounting Matters Related to Public Offerings ("draft report").

As you know, during the preparation of the draft report, staff from the Securities and Exchange Commission's ("Commission" or "SEC") Office of the Chief Accountant ("OCA") provided background materials to GAO, and staff from OCA and the Division of Corporation Finance ("DCF") on several occasions met with GAO staff and participated in telephone conversations with members of your office to discuss the issues presented in the draft report. We appreciate the professionalism with which the members of the GAO staff conducted their review.

OCA is the primary adviser to the Commission on accounting, auditing, and auditor independence issues arising under the federal securities laws. Our office has 25 professional staff, including the Chief Accountant, two Deputy Chief Accountants, ten permanent staff certified public accountants, eight Professional Accounting Fellows who serve on the staff for two years before returning to the private sector, one Academic Fellow serving a one-year appointment, one staff accountant, one lawyer, and one computer specialist.

Although OCA's staff is smaller than a typical national office of a major accounting firm, OCA is involved in a wide range of programs and activities. For example, OCA assists in the review and comment on financial statements included in filings by over 15,000 Commission registrants, participates in the preparation of Commission rules and the issuance of Commission and staff interpretive guidance, reviews all recommendations to the Commission from the Division of Enforcement involving accounting or auditing issues and, when appropriate, assists in enforcement or disciplinary actions against accountants. In addition, OCA oversees and works closely

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with private sector standard setting and regulatory bodies, such as the Financial Accounting Standards Board (“FASB”), FASB’s Emerging Issues Task Force (“EITF”), the Derivatives Implementation Group, the Financial Accounting Standards Advisory Council (“FASAC”), the Public Oversight Board (“POB”), and the American Institute of Certified Public Accountants’ (“AICPA”) Auditing Standards Board, Accounting Standards Executive Committee, SEC Practice Section, and SEC Regulations Committee. We also oversee various organizations that impact international accounting standards, such as the International Accounting Standards Committee, the International Accounting Standards Board, the Standards Advisory Council, and the Standing Interpretations Committee. In addition, a Deputy Chief Accountant chairs the International Organization of Securities Commission’s Standing Committee No. 1 on Multinational Disclosure and Accounting, which currently is evaluating international auditing standards to identify areas for improvement.

OCA has considered the two recommendations included in the draft report to improve OCA’s procedures regarding its reviews of accounting matters. We appreciate the constructive nature of the recommendations, and we already have begun to identify alternatives to implement them. Each recommendation is summarized below, followed by OCA’s comments on that recommendation.

***Information Regarding Processes for Decisions on Accounting Issues***

The draft report recommends that OCA implement procedures to improve the availability of information to registrants regarding its processes for decisions on accounting issues, and that such procedures should include:

“(1) general communications to registrants and auditors about the status of the review, (2) assignment of accounting issues to SEC staff members, (3) how SEC conducts its consultation with other accounting firms and FASB, and how the results of consultation are considered in its decisions, (4) SEC’s approval process for determining when registrant restatements are necessary, (5) coordination between DCF and OCA, and (6) when decisions are considered to be final.”

As noted in the draft report, significant guidance already exists regarding communications with OCA on accounting issues. In December 1999, OCA published its “Protocols for Registrant Submissions to the Office of the Chief Accountant.” Previously, OCA worked with representatives of the accounting profession on a “best practices” guide for accounting firms’ communications with the SEC staff. These documents are available on the web sites of the SEC <[www.sec.gov/info/accountants/acproreg.htm](http://www.sec.gov/info/accountants/acproreg.htm)> and the AICPA <[www.aicpa.org/members/div/secps/lit/best/comsec.htm](http://www.aicpa.org/members/div/secps/lit/best/comsec.htm)>.

During your review, you were given copies of an additional internal protocol entitled “Registrant Matters,” which includes two sections: “Office of the Chief Accountant’s Policies for Handling Registrant Matters” and “Office of the Chief Accountant’s Policies for Handling Division of Corporation Finance Referrals.” We

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believe that publication of this protocol, with minor modifications, would satisfy your recommendation. The proposed modifications that would address the six areas mentioned in your recommendation are noted below.

*Status of Review.* The additional protocol currently does not provide guidelines for communications regarding the status of the staff's review. The need to formalize communication procedures through such a protocol has not been considered necessary because generally there are ongoing conversations between OCA staff and the registrant or its accountants, and any major decision by the staff has been expeditiously communicated to the registrant. The longest delays tend to result from registrants not providing the staff with requested information to supplement information provided in the initial inquiry and, therefore, are known to, and within the control of, the registrant. Further, when a registrant indicates that timing is of the essence, the staff historically has gone to extraordinary lengths to meet the registrant's timing, including working late into the night and on weekends to avoid a registrant missing a filing deadline or a "market window."

Nonetheless, we believe that the recommendation to address communications regarding the status of accounting issues is well-founded, and we anticipate discussing how registrants may inquire about the status of accounting issues in the article discussed below.

*Assigned Staff.* The protocol refers to the list of OCA personnel assignments that generally is disseminated widely at the AICPA's annual conference on SEC Developments, and through other means. This list identifies the OCA "team" assigned to each major accounting, auditing, or auditor independence issue. For example, if a registrant submits an issue regarding the accounting for business combinations, the registrant can identify the staff assigned to such issues by referring to the list. OCA is in the process of providing the list of personnel assignments to the Commission staff who operate the SEC's web site.

We also are in the process of amending the protocol to state that upon receipt of a written submission the OCA "team leader" assigned to the issue will inform the registrant that he or she will be the point of contact for all discussions with OCA, including inquiries about the status of the staff's deliberations.

*Consultations.* The additional protocol notes that OCA staff might consult with FASB staff, other accounting firms, and others, regarding an accounting issue submitted by a registrant. During such consultations, the name and identifying characteristics of the company are not provided to the FASB or firms. The information received by the staff becomes one element in OCA's decision-making process that is considered in connection with other research and the facts and circumstances for the particular registrant. We are in the process of amending the protocol to clarify this element in the process.

*Restatements.* We also are considering the recommendation that the protocol include a discussion of when restatements are necessary. In the course of its review of a

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registrant's periodic reports and registration statements, DCF may find that, in its view, the registrant's accounting does not comply with GAAP or the Commission's rules, and that a restatement of the registrant's financial statements is necessary. In those cases, as well as at any other time, registrants may seek a review of DCF's position by OCA. OCA encourages registrants who desire to have a decision by DCF reviewed by OCA to notify DCF and OCA at the earliest possible date so that the issue may be reviewed expeditiously and the filing may be processed in a timely manner.

A restatement of a registrant's financial statements significantly impacts the registrant and its investors. OCA, therefore, already has several procedures built into its existing protocol that must be met before OCA requests a restatement. In such cases, the Chief Accountant must concur in the restatement. Such decisions, however, tend to be based on the facts and circumstances in each case and generalized statements are difficult. We also note that preliminary research by Financial Executives International, which should be published shortly, indicates that out of 156 restatements in calendar year 2000, the SEC staff requested only 21 and the remainder were made on the initiative of registrants and accounting firms. Any application of our protocol should not interfere with the private sector's actions in this area.

*DCF and OCA Coordination.* The second section of the additional protocol should address the coordination efforts between DCF and OCA. We are in the process of adding a procedure, however, to notify registrants expeditiously when DCF has asked OCA for substantive assistance regarding an accounting matter.<sup>1</sup> As a general matter, registrants and accounting firms are notified of OCA and DCF coordination when staff from both offices participate in phone calls with the registrant.

*Final Decisions.* Under the protocol currently on the SEC's web site, a decision is considered final when a registrant writes a final letter to the OCA staff stating the facts, the accounting issue, and its resolution. We added this requirement because we agree that closure of such issues is important. In those situations where a registrant is uncertain of the final staff decision, it is because the protocol has not been followed. We will continue to encourage compliance with this procedure.<sup>2</sup>

In addition to publishing the additional protocol, we are authoring an article for publication, which will describe how accounting issues typically flow through the

<sup>1</sup> On page 10 of the draft report, and elsewhere, reference is made to the number of accounting issues referred to OCA by DCF. It should be noted, however, that these numbers do not include technical consultations regarding accounting literature or consultations where DCF has remained the primary contact with the registrant. In addition, the chart on page 11 of the draft report does not include auditor independence issues submitted as a result of enforcement or other disciplinary proceedings.

<sup>2</sup> The draft report suggests anecdotally that it can cost between \$25,000 and \$100,000 for legal and accounting fees to bring an issue to OCA. We have not independently assessed these figures, but they seem high. Consultation with OCA on novel accounting issues is generally an inherent part of the review and comment process.

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Commission. Such an article could be written in a much more informal style than our Protocols and procedures. The article could address many of the points raised in your recommendations.

Finally, it must be noted that decisions on registrant issues, and to a certain degree the processes used to resolve those issues, may vary based on the facts and circumstances presented by a particular registrant. As noted below, our decisions often are made where there is no clear or governing accounting literature, and with the ultimate goal of providing transparent financial information that will allow investors to see the underlying economic consequences of transactions and events affecting the registrant. If we do not consider investors' need for transparent information in the particular situation before the staff, we would be failing to meet our statutory mandate.

*Meetings Regarding Accessibility of Guidance and Positions on Accounting Issues*

The draft report recommends that OCA meet with representatives of the accounting profession and registrants to determine (1) how best to disseminate information on rules and interpretive guidance and (2) how the SEC could provide additional written information on the reasons for its decisions, especially when it involves complex and unusual accounting issues.

We believe that additional discussions with registrants and accounting firms about how we disseminate SEC guidance and decisions would be helpful and appropriate. Indeed, our current procedures for dealing with accounting issues were developed through consultations with representatives of the accounting profession. We anticipate either adding these issues to our periodic meetings with the AICPA's SEC Regulations Committee and other appropriate committees, or convening a special meeting to discuss these two points.

As noted in the draft report, however, the Commission and staff currently have significant outreach programs to inform the public of our decisions and positions on accounting issues, including rules and releases, Staff Accounting Bulletins, Question and Answer documents, announcements at private sector meetings, speeches, public correspondence files, and informal advice given in telephone calls. The purpose of each of these communications is described below.

*Commission rules and interpretations.* The Commission adds new requirements through the adoption of rules in accordance with the Administrative Procedure Act. For example, all proposed rules are published for public comment. Final rules are published in the Code of Federal Regulations. The Commission, either at the time it adopts a new rule or otherwise, also may vote to issue interpretive guidance explaining its intention behind a rule or how it believes a rule should be read and applied by registrants. Proposed and final rules, and final interpretive guidance, are published in the Federal Register and on the Commission's web site.

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Various private publishers, such as Commerce Clearing House, Warren Gorham & Lamont, and others, also publish these rules and regulations in loose-leaf binders that are periodically updated. These services typically include a section labeled the "Codification of Financial Reporting Policies," which was established in the early 1980s to simplify accounting research by arranging interpretive guidance by various categories and accounting topics. Commission rules and interpretations also are searchable through various internet sources, such as West Law and Lexis.<sup>3</sup>

*Staff Accounting Bulletins.* In the mid 1970s, the Commission became concerned that larger registrants and accounting firms that dealt with the staff on a regular basis, and routinely received comments and interpretative advice from the staff, had an advantage over smaller registrants and firms that were less likely to be aware of the staff's views. To remedy this imbalance, the Commission authorized the staff to issue Staff Accounting Bulletins ("SABs"). In the release announcing the first SAB, the Commission stated:

"The process of financial reporting is dynamic and evolutionary. Consequently, new or revised administrative interpretations and practices must be implemented in response to changes in the reporting process. While large accounting firms who practice before the Commission have many opportunities to exchange information and views with the staff, the Commission has been concerned about comments that small accounting firms have fewer such opportunities and may be at an unfair competitive disadvantage because there has been no formal dissemination of staff positions.

"The announced series of bulletins attempts to curtail these problems by making available to the public a compilation of certain existing staff interpretations and practices and by providing a means by which new or revised interpretations and practices can be quickly and easily communicated to registrants and their advisors. Thus, this series should not only reduce the staff's workload by eliminating repetitive comments and inquiries, but also save registrants both time and money in the registration and reporting process."<sup>4</sup>

SABs are staff interpretations of existing rules and accounting principles. SABs do not impose new requirements. SABs describe how the staff, in conducting the review and comment process, applies accounting literature and disclosure requirements to new or persistently recurring transactions and events. This serves two important public policy purposes. It streamlines the review and comment process and accelerates companies' access to the markets. And, it gives smaller companies and accounting firms the same knowledge of the staff's positions that the larger companies and accounting firms gain from their almost daily contact with the staff.

<sup>3</sup> Attached for your information is a matrix indicating some of the resources containing accounting guidance used by the staff and available to the public.

<sup>4</sup> Release Nos. 33-5640, 34-11790, 35-19235; Accounting Series Release No. 180 (November 4, 1975) [40 Federal Register 53557 (November 19, 1975)].

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SABs also pull together guidance that is spread out in several different areas in the current accounting literature about a topic, such as materiality or revenue recognition. For example, the Second Circuit Court of Appeals recently cited SAB 99 on materiality as being “thoroughly reasoned and consistent with existing law ... we find it persuasive guidance for evaluating the materiality of an alleged misrepresentation.” *Ganino v. Citizens Utility Company*, 228 F.3d 154 (2d Cir. 2000). Furthermore, following the issuance of SAB 101 on revenue recognition, the staff reviewed disclosures in annual reports for year-end 2000 and found that only about 4 in 100 companies indicated they made an accounting change to comply with the accounting literature discussed in SAB 101. The reference by the Court to SAB 99 and the available statistics on SAB 101 indicate that the staff’s efforts to consolidate and to facilitate retrieval of, rather than change, the accounting literature has been successful.

The issues discussed in SABs typically arise in the review and comment process. Generally, before a SAB is issued, the general content and staff views to be expressed in the SAB are discussed with registrants, accounting firms, standard setting bodies, trade groups, other impacted regulatory agencies, all relevant Commission offices and divisions, and other interested parties.

SABs are published individually in the Federal Register at the time they are issued and are reprinted, by topic, in a SAB Codification that is published by private publishing houses, typically in the same binder series that contain Commission rules and releases.

*Question and Answer Interpretive Documents.* On occasion, a Commission rule or a Commission or staff interpretation will generate a series of questions from registrants and accounting firms. For example, after the Commission adopted new proxy disclosure requirements related to the fees for audit, non-audit, and high technology services billed to registrants by the auditor of the registrant’s financial statements, the staff received questions about the categorization of fees, where the disclosure should appear in the proxy statement, and so on. The staff, therefore, posted on the Commission website a “Q&A” document that distributed its answers to these questions to a wide audience.

*Announcements at Private Sector Meetings.* OCA makes announcements at the meetings of the FASB’s Emerging Issues Task Force (“EITF”), which are published in the minutes of the EITF’s meetings and disseminated to various subscribers of the FASB’s publications. These announcements typically clarify the parameters of what the staff views as an acceptable answer to an accounting issue under discussion by the EITF, or in some cases, in lieu of discussion by the group.

We also meet periodically with representatives of various AICPA committees and registrant organizations such as Financial Executives International. During calendar year 2000, I participated in over 100 meetings with representatives of the accounting profession, accounting standard setters, analysts, and business and industry. At those meetings, OCA often provides an update on current or unusual issues coming into the office and the staff’s preliminary views on those issues.

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*Letters to Professional Organizations.* Periodically, the staff will send letters to the AICPA or another professional oversight organization, such as the Public Oversight Board, to explain its current interest in an issue or to highlight problem areas in recent filings with the Commission. Many of these letters do not discuss staff positions, but are meant to focus registrants' and auditors' attention on the issues. When the issues may have a broad application, we post these letters on our web site to provide insight to the staff's thinking on the issues.

*Letters to Registrants.* While the staff maintains a public file of staff interpretive positions given to individual registrants, few letters are forwarded to that file due to confidentiality requests and similar concerns. This is one reason the staff conducts its outreach program of SABs, speeches, meetings with professional organizations, and so on, to disseminate its views on current accounting issues. The staff believes this is one area where the meetings you propose would be especially helpful.

When the staff issues a letter, or a final letter is submitted to OCA by a registrant in accordance with the OCA's public protocol, it should be emphasized that the staff's position applies only to the facts in that letter. Other registrants, therefore, must evaluate their own unique facts and decide, at their own risk, whether the position expressed by the staff would be applicable to their particular circumstances. OCA encourages registrants conducting such an analysis to consult with the staff so that we may reach agreement on the issues before a filing is made with the Commission.

*Speeches.* Speeches can be an effective way of informing the public of emerging or recurring issues, and of relating the staff's experiences in dealing with those issues. As a result, in 2000, I gave 25 speeches to organizations of investor groups, accountants, lawyers, businesspersons, audit committee members, academia, and others.

Nonetheless, for many years OCA staff did not publish their speeches because of the concern that registrants or accounting firms would over-generalize the statements made by one staff member and misapply those statements in broader or different circumstances than discussed in the speech. In the early 1990's, however, the profession informed the staff that some accountants were tape recording staff speeches at conferences and then having them typed and circulated at their firms. To avoid errors that might occur in this process, and to provide an equal access for smaller firms that either could not attend the conferences or did not have the resources to process the speeches internally, the profession urged the staff to reconsider its policy of not publishing its speeches. Accordingly, starting about 10 years ago, the staff began distributing to the public copies of its speeches at certain conferences. Once the SEC developed a web site, these speeches were placed on that site.

The SEC staff continues to be concerned that certain members of the profession may over-generalize remarks made by one staff member at a conference. We look forward to discussing this issue at the meetings you recommend.



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*Telephone Calls.* The staff responds to numerous phone calls requesting accounting and financial reporting advice. OCA staff provides such advice unless it appears that the call involves a new, unusual, or complicated issue. In those cases, the staff will request that the caller submit the question in writing, in accordance with the Protocol for Submissions to OCA. None of the advice given over the phone is binding on the staff because of our limited knowledge of the caller's facts and circumstances.

***General Comments***

There are three overriding points that OCA believes should be noted. First, providing guidance regarding the reasons for the staff's decisions on individual registrant issues can be a two-edged sword. Clearly, the staff attempts to use the vehicles noted above to provide insight into our thinking and approach to issues. The more that registrants and accounting firms can anticipate the staff's questions and avoid or answer those questions, the more investors benefit through an expedited review and comment process and prompt access to the capital markets.

On the other hand, it must be kept in mind that each situation can be, and often is, different. Many of the questions that confront OCA on a daily basis are not specifically addressed in the accounting literature or Commission rules. That is why registrants inquire as to the staff's views, consistent with the AICPA's Best Practices publication. Registrants and auditors appropriately address the more straightforward questions that are answered in the accounting literature, without consulting OCA.

Perhaps more importantly, registrants need immediate answers to have their filings declared effective and to raise capital; they cannot wait for private sector accounting standard setting bodies to deliberate the issues for years, months, or even weeks. The registrant often has to go to market as soon as possible. In these cases, DCF and OCA must make a decision. We consider all relevant literature and the registrant's facts and circumstances, and we adhere to an overriding principle of finding the best method of explaining to investors the financial position of the registrant, the earnings and expenses of the registrant, and the economic consequences of transactions and events on the registrant. These can be very registrant-specific answers and prior staff positions might not be persuasive, particularly positions given to other companies in other circumstances where there is no direct or governing accounting literature or SEC rule. Such prior advice, therefore, must be used judiciously.

Second, OCA recognizes that by trying to provide more, concrete and timely assistance to the public, the number of sources of accounting guidance inevitably increases. We believe, however, that providing this information to the public and accounting profession is a valuable service that benefits investors. This guidance provides helpful advice on how the staff applies existing accounting literature and SEC rules; it is not a means of announcing new accounting rules. As noted above, much of the guidance is placed in the accounting portion of the SEC's web site. We believe that our active outreach program makes OCA's processes more transparent and providing such

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guidance makes OCA, as well as registrants and accounting firms, more efficient in analyzing accounting issues.

Finally, your report notes a stressed relationship between the SEC staff and the accounting profession. The recent public debate over auditor independence and the charter for the POB undoubtedly placed an added strain on all parties. We believe, however, that with the resolution of many of these issues, and subsequent statements by the firms and the AICPA in support of the Commission's final rules, much of this antagonism has subsided. Further advances have included agreement on some aspects of the POB charter, including having the POB oversee more of the profession's self-regulatory programs.

There probably always will be some healthy level of tension and appropriate "give and take" between the SEC and the accounting profession. The key is for both parties to continue to have a frank and open dialogue, and the staff is committed to maintaining such communications.

It also is important to note that, while some in the news media highlighted the differences of opinion regarding auditors' independence, the accounting profession and the SEC staff continued to work closely together in the past few years to better serve investors by, among other things:

- Restructuring the international accounting standards-setting body.
- Implementing new rules related to audit committees.
- Implementing mandatory reviews by auditors of registrants' interim financial statements included in Forms 10-Q, a recommendation that first was made by the Cohen Commission approximately 25 years ago.
- Developing a "tool kit" for auditing revenues reported by registrants.
- Strengthening oversight by US accounting firms of filings made in the United States by foreign registrants, which contain financial statements audited by the US firms' foreign affiliates.
- Strengthening the requirements for "concurring" partner reviews.

***Conclusion***

The review conducted by your staff was thorough and professional, and we appreciate the consideration you gave to our comments and to the documents we supplied throughout the process. I understand that my staff will be contacting your office about certain technical comments on the draft report. We look forward to further consideration

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of your recommendations as outlined above, and to continuing to work with GAO, the  
accounting profession, and others to further explore these issues.

Sincerely,



Lynn E. Turner  
Chief Accountant

Attachment

**Appendix I: Comments From the Securities  
and Exchange Commission**

**Financial Reporting Requirements**  
**—Retrieval Sources—**

	SEC Docket (published weekly)	SEC Website	Federal Register	Private Publication Services
<b>SEC</b>				
Financial Reporting Releases (FRRs)	X	X	X	X <sup>1/</sup>
Codification of Financial Reporting Releases				X <sup>1/</sup>
Regulation S-X	X	X	X <sup>a</sup>	X <sup>1/</sup>
Accounting and Auditing Enforcement Releases (AAERs)	X	X	X	X <sup>1/</sup>
Staff Accounting Bulletins (SABs)	X	X	X	X <sup>1/</sup>
Frequently Asked Questions (FAQs)	X	X	X	
Staff Speeches		X		
Staff interpretive letters		X		
Joint Interagency letters		X <sup>b</sup>		
SEC staff announcements at Emerging Issues Task Force (EITF) Meetings				X <sup>2/</sup>
Division of Corporation Finance Current Issues Outline		X		
Division of Corporation Finance Accounting Interpretations and Guidance		X		

**Appendix I: Comments From the Securities  
and Exchange Commission**

<b>Private Sector</b>				
Statements of Financial Accounting Standards				X <sup>2/</sup>
Financial Accounting Standards Board (FASB) Interpretations				X <sup>2/</sup>
Statements of Financial Accounting Concepts				X <sup>2/</sup>
Emerging Issues Task Force (EITF) Consensuses				X <sup>2/</sup>
Statements of Position (SOPs) issued by Accounting Standards Executive Committee (AcSEC)				X <sup>3/</sup>
Statements on Auditing Standards (SASs)				X <sup>3/</sup>

Index to Private Publication Services

1. Commerce Clearing House, Prentice Hall, and other commercial publishers. Various major accounting firms also publish SEC rules and interpretations.
2. Publications of the FASB including minutes of and abstracts from meetings of its Emerging Issues Task Force.
3. Journal of Accountancy published by American Institute of Certified Public Accountants.

<sup>a</sup> Also appears in Code of Federal Regulations under Title 17 Part 210.

<sup>b</sup> These letters also are on the bank regulators' websites.

# Appendix II: Comments From the American Institute of Certified Public Accountants



May 31, 2001

Ms. Jeanette Franzel  
Acting Director  
Financial Management and Assurance  
United States General Accounting Office

Dear Ms. Franzel:

Representatives of the AICPA SEC Practice Section (SECPS) appreciate the opportunity to review the GAO draft report on the Securities and Exchange Commission (SEC) Reviews of Accounting Matters Related to Public Filings. We concur with the GAO's proposed recommendations, and believe that if properly implemented they can provide an opportunity to promote improved transparency of the SEC accounting review processes for public filings, and enhance the lines of communication among registrants, the audit profession, and the SEC.

The SECPS represents AICPA members that practice before the SEC and have significant contact with the SEC and its staff on a routine and frequent basis. The mission of the SEC is one of critical importance to individual investors who place their trust in the capital markets. The SEC staff has been appropriately and frequently recognized for the exceptional technical skills, dedication and energy applied in carrying out the SEC's mission. We recognize that the SEC staff executes its critical mission under difficult and challenging circumstances, including pressures that result from market timing and limited resources. The GAO report notes that representatives interviewed in connection with the GAO review conveyed a range of experiences, both positive and negative. It is of great concern to us as members of the audit profession that the GAO review process and report should not result in polarization of the profession and the SEC staff. Rather, we hope that the review process and the report will promote dialogue that will result in improvements in communication and the working environment since it is our conviction that we share a mutual goal of strong and fair capital markets.

With respect to the GAO report, we support the recommendations that the SEC should implement procedures to improve the availability of information to registrants regarding the process for decisions on accounting issues. We also support the recommendations for meetings with the SEC staff, the audit profession and representatives from the registrant community to determine how best to disseminate information on interpretive accounting and disclosure guidance and to determine how the SEC could provide additional written information on the reasons for its decisions, especially when it involves complex and unusual accounting issues.

American Institute of Certified Public Accountants  
1455 Pennsylvania Avenue, NW, Washington, DC 20004-1081 (202) 737-6600 • fax (202) 638-4512

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Related to these recommendations, we believe the following would further improve the transparency of communications and interactions among the SEC and registrants and auditors.

Consultation “white papers”

As is stated in the draft report, SEC staff members prepare “white papers” detailing the facts of registrant accounting issues prior to consulting with standard-setting bodies and the major accounting firms. We believe that these white papers should be available to registrants and their auditors in advance of their distribution to other consulted parties. This practice would allow registrants and their auditors to review and understand the significant facts and analysis considered by the staff in the consultations, thus enhancing the transparency of the review process. We also believe that a synopsis of responses as well as the SEC staff’s final conclusion should be prepared and distributed to the registrant and its auditor, and made publicly available on the Internet on a timely basis.

Timing of responses

The draft report addresses the concern that when an inquiry on an accounting issue is made to the SEC, the timeframe of an SEC staff response is unknown to the registrant and auditor. We understand that the Office of the Chief Accountant (OCA) cannot give a definitive time frame, as an SEC response will depend in part on the timeliness and quality of the responses by the registrant. However we believe that OCA should adopt a policy that specifies a reasonable period of time for responding to accounting inquiries. For example, once an initial letter is received by OCA, the SEC staff would have a specific number of business days to initially respond to the letter, and the same policy would be followed for subsequent correspondence. This policy would not necessarily reduce the ultimate length of time to resolution since the registrant obviously controls the timing of its responses, but it would provide a mechanism for timely feedback with respect to the need for additional information and the status of consideration and resolution by the SEC staff

Private-sector accounting standards-setters

The GAO report notes that the SEC states “If an issue is unclear, OCA will send the issue to the EITF for resolution.” We believe that the SEC’s interaction with private standard-setting organizations, including FASB, AcSEC, and the EITF is critical to the timely identification of issues and development of accounting principles. We commend the SEC for its active role in referring issues to private standard-setters. In view of the increasing complexity of the markets, transactions, financial instruments, and relationships among entities, we believe that there may be many other issues that registrants, their auditors and the SEC should refer to private standard-setters since the issues frequently have far reaching implications for which there are no known precedents or readily adaptable analogies. We believe that deliberations by private sector standard-setters must be allowed to proceed in an open and comprehensive manner. Limitations on the nature of issues that may be addressed or the scope of alternatives that may be considered by the standard-setters lessens the effectiveness of those standard-setters and may impact the

**Appendix II: Comments From the American  
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quality of accounting standards as a result of the failure to consider appropriate accounting and financial reporting perspectives.

We strongly believe that the due process of private standard-setting is at the heart of the quality we enjoy in US generally accepted accounting principles. We encourage the SEC to be even more active in referral of matters to the appropriate standard-setting body in order to increase the effectiveness and quality of those standards. The SEC's actions in referring issues to standard-setters serves to reduce the risk that a failure to consider appropriate accounting and financial reporting perspectives could occur.

Restatements

The draft report states, "the Chief Accountant [is to] be notified if a registrant will be required to restate its financial statements. In such situations, the SEC staff must first get the approval of the Deputy Chief Accountant, and then must discuss the case with the Chief Accountant before notifying the registrant of its decision. The Chief Accountant may overturn the decision of the SEC staff if he becomes convinced that it is the best course of action." We wholeheartedly agree with this policy. One of the most significant actions the SEC staff can take is to insist that a registrant restate previously issued financial statements. It is therefore appropriate that restatement requests require the level of internal review referred to above. We believe that when restatement requests occur, it would be helpful if the staff also communicated to the registrant the name of the SEC official who has been consulted regarding the restatement and whether the issue involves a pre-filing submission to OCA or the matter was identified by the Division of Corporation Finance (DCF). We believe this step would assist in maintaining compliance with the staff's formal policy and would provide the registrant and its auditor with information to facilitate discussions with OCA

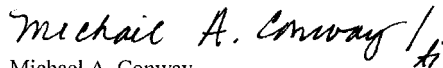
Codification of SEC staff positions

We believe it would be very helpful to registrants and auditors for the SEC to codify staff speeches, white papers and other sources used to support SEC staff positions that are not included in published codifications of federal law and regulations and that have not been subjected to a public exposure process.

\* \* \* \* \*

Thank you for the opportunity to provide our comments.

Sincerely,

  
Michael A. Conway  
Chair  
AICPA SEC Practice Section



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