

SEC Regulations Committee Highlights

Joint Meeting with SEC Staff - October 5, 1999

Location: SEC Headquarters – Washington, D.C.

NOTICE: The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

I. **ATTENDANCE**

A. **SEC Regulations Committee**

Robert H. Herz, Chairman
Ernie Baugh
Mark Bagaason
Val Bitton
Ed Coulson
David Einhorn
Wendy Hambleton
Jay Hartig
Terry Iannaconi
Amy Ripepi
Bob Rouse
Stewart Sandman
Bill Travis
Bill Yeates
Mary Jane Young

B. **Securities and Exchange Commission**

Office of the Chief Accountant

Lynn Turner, Chief Accountant
Scott Bayless, Associate Chief Accountant
Jane Adams, Deputy Chief Accountant
Bob Burns, Chief Counsel
Eric Casey, Professional Accounting Fellow
Pascal Desroches, Professional Accounting Fellow
Andrew Hubacker, Assistant Chief Accountant
Eric Jacobsen, Professional Accounting Fellow
Mike Kigin, Associate Chief Accountant
Jenifer Minke-Girard, Assistant Chief Accountant
Richard Rodgers, Professional Accounting Fellow

Scott Taub, Professional Accounting Fellow
Dominick Ragone, Professional Accounting Fellow

Division of Corporation Finance

C. Robert Bayless, Chief Accountant

AICPA

Jennifer Roddy, SECPS
Annette Schumacher Barr

D. **Guests**

Joe Graziano, Grant Thornton
Ray Faloon, Deloitte & Touche
John Guinan, KPMG
John Wolfson, Deloitte & Touche

II. **PERSONNEL MATTERS**

Office of the Chief Accountant. Lynn Turner stated that announcements for the new Professional Accounting Fellow (PAF) openings will be made shortly. He added that administrative policies have been formalized that will affect the PAF programs. The PAF program has proved to be very beneficial to the fellows, the firms and the SEC in the past. Mr. Turner does not want to jeopardize the future of this program by failing to assure continued compliance with the federal regulations.

Division of Corporation Finance. Robert Bayless stated that the Division of Corporation Finance is also continuing its fellowship program. In addition, the Division is actively recruiting staff for positions at all levels. For example, active recruiting for entry-level positions will take place this Fall on numerous college campuses.

III. **SAB 99**

Mr. Turner stated that the staff has received positive feedback on SAB 99 from various outside parties such as the FEI and the Business Roundtable. With respect to whether the staff will be issuing interpretive guidance on the SAB, Mr. Turner stated that it is unlikely because much of the SAB's guidance is facts and circumstances oriented, requiring judgment on a case-by-case basis (i.e., there is no single answer to cover all situations). He encouraged the firms to get input from the staff if they are planning on issuing interpretive guidance of their own.

Mr. Turner commented on speculation that the SEC staff would consider it an illegal act if registrants did not book all "audit scoresheet" entries identified by their auditors. He stated that this speculation is incorrect.

The Committee asked whether SAB 99 takes an "iron curtain" or a "rollover" approach in assessing materiality at a particular balance sheet date. In reply, Mr. Turner quoted the SAB in saying that "registrants and auditors should assess the effects of all adjustments on the current period." He added that the Division of Enforcement is seeing cases in which misstatements have built up over the years

which should have been evaluated in totality.

If there are specific questions regarding the application of the SAB, they should be submitted to the staff for consideration. Such submissions should include all of the specific facts and circumstances that should be considered.

IV. SEC BEST PRACTICES PAPER

Mr. Turner stated that the staff is nearing completion of its "best practices" policies and procedures manual. The manual will provide guidance on maximizing the effectiveness of communication among the staff, registrants and independent accountants. The staff hopes to have the manual completed by December so that certain portions can be distributed at the AICPA Conference on Current SEC Developments and posted on the Commission's website. The document is expected to be very useful in helping registrants, independent accountants and the staff work together efficiently and effectively.

V. PROPER USE OF THE APPEALS PROCESS

Mr. Turner noted that the staff is experiencing a phenomenal workload and a major staff shortage. There have been observations that the staff is receiving too many accounting-related appeals of matters with little conceptual merit, thereby tying up scarce staff time and resources. Mr. Turner has received recommendations that the appeal process be limited. Both Mr. Turner and Mr. Bayless are reluctant to do this as they believe the appeals process can be a constructive mechanism for all involved parties. Mr. Turner is urging registrants and independent accountants to be cognizant of the problem and to use the appeals process in the most appropriate and effective manner. He cautioned against abusing the system (e.g., frivolous appeals).

VI. STAFF ACCOUNTING BULLETINS (SABs)

Mr. Turner noted that the staff is nearing completion of its guidance addressing revenue recognition and restructuring charges. He added that the staff may consider issuing an omnibus SAB that would include these issues as well as other issues that the Committee has addressed and discussed with the staff, such as systematic patterns of treasury stock repurchases, paragraph 48(c) dispositions, paragraph 47(c) alterations of equity interests and valuations of privately issued equity securities. Mr. Turner added that the staff appreciates the input provided by the Committee on these issues and that it is a good example of the profession working with the staff to improve the quality of financial reporting and increase the efficiency and effectiveness of the filing and review process.

VII. EARNINGS MANAGEMENT TASK FORCE

Robert Bayless reported that the Earnings Management Task Force, which has been highly effective in bringing accounting and disclosure issues to the attention of the necessary individuals, is wrapping up its work. For the most part, the staff is pleased with the response received from the filing community regarding the earnings management issues highlighted by the staff last year. While the Division's accounting staff will continue to be alert in its reviews of filings to all of the earnings management issues identified by the task force, the team of reviewers that

comprised the task force will return to normal duties upon completion of outstanding task force reviews.

VIII. **AUDIT COMMITTEE DISCLOSURE REQUIREMENTS**

Mr. Turner noted that the Commission is likely to release its proposed audit committee disclosure requirements this week. The proposed requirements are based in large measure on recommendations recently made by the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. The purpose of the proposal is to improve disclosure relating to the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies. The proposal, which will be available on the SEC's website (www.sec.gov), will have a 45 day comment period.

IX. **POB PANEL ON AUDIT EFFECTIVENESS**

Mr. Turner stated that the staff will testify at this week's public meeting of the Public Oversight Board (POB) Panel on Audit Effectiveness. He added that he looks forward to seeing the final recommendations of the panel and hopes they are both substantive and credible.

X. **GUARANTOR FINANCIAL STATEMENTS**

Within the next month, the staff expects to finalize its new financial reporting rules for issuers and guarantors of guaranteed securities. They will be available on the SEC's website.

XI. **AIRCRAFT CARRIER PROPOSAL**

Robert Bayless noted that, due to the volume and nature of the comments received, the aircraft carrier proposal will likely be reformulated and re-proposed sometime next year. Although the new proposal may contain pieces of the original release, new aspects will likely be introduced.

XII. **CURRENT STAFF ISSUES**

Mr. Turner highlighted the following four issues:

A. **Segment Disclosures**

FASB Statement No. 131, Disclosure about Segments of an Enterprise and Related Information, requires that companies disclose segment data based on how management makes decisions about allocating resources to segments and measuring their performance. The staff has seen a number of filings in which segment disclosures used by companies for external reporting purposes are not the same as the segment data generated for internal decision making purposes. The staff expects accounting firms to send a clear message to their clients that noncompliance will not be tolerated.

B. **Goodwill**

Goodwill lives should reflect both the nature of the industry and the state of the economy. For example, the staff has seen instances in which registrants in the service, high tech and telecommunications industries have assigned goodwill lives of forty years. In the staff's view, this clearly does not make sense given the dynamic nature of these industries, the presence of competitive barriers and the state of the current economy. The staff has drafted a SAB addressing this issue that may include "bright line" guidance restricting goodwill lives.

C. **International Accounting Standards (IAS)**

The staff is getting close to issuing its concept release on IAS. The concept release will address matters such as the quality of financial statement audits and independence, in addition to IAS. The Committee suggested that the staff provide an ample comment period (e.g., 120 days) on the proposal due to its international nature.

D. **Auditor Independence**

There is a "heightened awareness" among the Commissioners regarding the issue of auditor independence and the effectiveness of the firm's quality control (QC) mechanisms to ensure compliance with the independence standards. A number of instances have been noted, both domestically and internationally, that have caused the Commission to question the quality of the firms' QC systems. Both domestic and foreign registrants are required to comply with U.S. GAAS, including all independence rules.

Mr. Turner distributed copies of various letters the staff has issued during the past year regarding auditor's independence and the quality controls firms have in place for assuring independence (see Appendix A).