

**SEC REGULATIONS COMMITTEE**  
**Joint Meeting with SEC Staff**  
**June 12, 1997**  
**SEC Headquarters—Washington, D.C.**

**HIGHLIGHTS**

**I. ATTENDANCE**

**A. SEC Regulations Committee**

Robert H. Herz, Chairman  
Val Bitton  
Rusty Brinkman  
Mike Foley  
Jay Hartig  
Tom Milan  
Eric Press  
Arthur Radin  
Keith Sandefur  
Stewart Sandman  
Bill Travis  
Bill Yeates

**B. Securities and Exchange Commission**

*Division of Enforcement*

George Diacont, Chief Accountant

*Office of the Chief Accountant*

Steve Swad, Deputy Chief Accountant  
Robert Burns, Chief Counsel  
Scott Bayless, Assistant Chief Accountant  
Donna Coallier, Professional Accounting Fellow  
Jeffrey Jones, Professional Accounting Fellow  
Mike Kigin, Associate Chief Accountant  
Bob Lavery, Assistant Chief Accountant  
Robert Lipe, Academic Accounting Fellow  
Leslie Overton, Assistant Chief Accountant  
Armando Pimentel, Professional Accounting Fellow  
Bob Uhl, Professional Accounting Fellow

*Division of Corporation Finance*

Robert Bayless, Chief Accountant

*Division of Investment Management*

Larry Friend, Chief Accountant

*Division of Market Regulation*

Kim Earle, Assistant Chief Accountant

C. AICPA

Annette Schumacher Barr, Technical Manager

D. Guests

Kenneth Chatelain (Coopers & Lybrand)

Joe Graziano (Grant Thornton)

Wendy Hambleton (BDO Seidman)

**II. INTRODUCTION OF NEW PAFs**

Steve Swad introduced two new Professional Accounting Fellows (PAFs): Bob Uhl (formerly of Deloitte & Touche) and Jeffrey Jones (formerly of KPMG Peat Marwick).

**III. STAFF CHANGES/REORGANIZATION**

Robert Bayless noted the following recent staff changes in the Division of Corporation Finance:

Craig Olinger has been promoted to Deputy Chief Accountant.

Melanie Dolan has been named an Associate Chief Accountant.

Don Walker has been named an Assistant Chief Accountant in the Banking group.

Mr. Bayless added that the Division is considering adding two more offices (there are currently nine) to redistribute work loads more efficiently and effectively. He distributed a document summarizing the current organizational structure of the Division. The summary is included as ***Attachment A*** to these highlights. Mr. Bayless also said that the

Division is performing an internal review of the comment letter and issue resolution process to identify possible improvements or enhancements that can be made.

#### **IV. TRAINING MANUAL UPDATE**

Robert Bayless noted that the staff is revising the Division's Staff Training Manual in an effort to keep it current, useful and accurate. He added that the staff would be happy to consider recommendations that would improve the Manual. He emphasized that the manual is intended to serve as instructional and informative guidance for the staff; it is not to be cited either by the staff or by registrants as authoritative material.

#### **V. CORPORATION FINANCE MASTER SPEECH OUTLINE**

The Division of Corporation Finance Master Speech Outline, entitled *Current Issues and Rulemaking Projects*, has been updated since December 31, 1996 and can be found on the SEC's Website (<http://www.sec.gov/rules/other/cfcr0597.txt>). Robert Bayless indicated that he would try to inform the Committee when future changes are made to the outline.

#### **VI. DERIVATIVES DISCLOSURES**

Armando Pimentel noted that, despite Congressional scrutiny of the SEC's derivatives disclosure rules, the adoption schedule as published in the Rule remains in effect. The staff has committed to reviewing the operation of the rule one year after implementation. As part of its review, the staff will analyze the disclosures and other data received from the first group of filers under the new rules. Mr. Pimentel discussed the staff's interpretive responses to the following implementation issues:

##### **A. *Accounting Policy***

Disclosures are required for All registrants beginning with quarterly or annual reports for the period ended June 30, 1997. The policy disclosure is required in each Form 10-Q beginning with the June 30 period (if the accounting policy disclosures are not included in the company's most recently filed Form 10-K) and in the first Form 10-K. After the first Form 10-K, policy disclosures are required in 10-Qs only as the policies change. Of the seven items for which policy disclosures are required, only those related to material items need to be provided. Unusual accounting policies should be disclosed if they produce results that differ materially from more typical alternatives.

**B. *Location of Disclosures***

The staff encourages registrants to place derivatives disclosures (including accounting policies) all in one place.

**C. *Cash Flow, Earnings or Fair Value at Risk***

The rules require disclosure of only one of the three, if all are material. If others are material, they should be commented on.

**D. *Hedging Anticipated Transactions***

If an issuer uses derivatives to "hedge" anticipated transactions (such as sales denominated in a foreign currency) and those anticipated transactions are included in the registrant's estimate of the market risk exposure (e.g., included as part of the sensitivity or Value at Risk (VAR) amount reported), then the quantitative disclosures should include all anticipated transactions for the period of the currency being hedged. (In this case, "hedge" does not necessarily mean hedges in accordance with FASB Statement No 52, *Foreign Currency Translation*.) For example, if a registrant uses a hedging instrument to hedge 30% of anticipated sales denominated in a foreign currency for six months and chooses to voluntarily include the anticipated foreign currency sales in its quantitative disclosures, it should include 100% of those anticipated sales for the six month period.

**VII. STATUS OF COMPANY REGISTRATION PROPOSAL**

Robert Bayless stated that the staff is working on proposed rules to implement company registration. The proposed rules will incorporate the spirit of the Company Registration Proposal. With respect to timing, he is uncertain when the proposal will be finalized and presented to the Commission.

**VIII. "PLAIN ENGLISH" PROPOSAL**

The Division of Corporation Finance is analyzing comments on the "Plain English" rule proposal and hopes to have draft final rules to the Commission within the next few months. The staff is optimistic that final rules will improve disclosures. A number of issuers have voluntarily adopted "Plain English" principles in their 1933 and 1934 Act filings, including in notes to financial statements and MD&A. The staff members who are working on the final rules are also working with FASB on their disclosure effectiveness project.

## **IX. INTERNET ACCESS**

**Robert Bayless stated that a few issuers have invited their shareholders to represent that they have access to the Internet and are willing to go online to retrieve their annual report and Form 10K rather than receiving it in the mail. He stated that an increasing number of registrants are using are using electronic delivery to supplement current reporting and prospectuses. To facilitate the use of electronic media, the Commission provided some interpretive guidance in Release No. 33-7233, and cited examples of the use of electronic media in Release No. 33-7288.**

## **X. INDEPENDENCE STANDARDS BOARD**

**Bob Burns discussed the newly-created Independence Standards Board (ISB) and the interpretation-oriented Independence Issues Committee (IIC). The new structure was created because the accounting profession and the Commission and staff believe that many of the current rules and interpretations do not address issues in the current business environment and the auditing profession. Chancellor Allen of Delaware was chosen as the initial Chairman. It is expected that all ISB members will be announced shortly and that the Executive Director will be chosen by early July. Also, the ISB could hold its first meeting as early as July. The Executive Director will be viewed as a key person in the process -overseeing the response to all requests for interpretation.**

## **XL COST SAVINGS IN PRO FORMA FINANCIAL STATEMENTS**

**Bob Herz noted that the Committee's Filing Issues Task Force has discussed the issue of cost savings in pro forma financial information. He asked whether the staff would be willing to participate in a working group to address the issue and provide specific guidance for determining when pro forma adjustments for cost savings and related items may be considered "factually supportable", as well as possible alternative presentations for other related proforma information. Robert Bayless stated that his staff would welcome any observations that resulted from the group's discussions.**

## **XII. UPDATE ON NEW 10A RULES**

**Scott Bayless described the staff's early experience with implementation of Section 10A of the Exchange Act and the SEC's recently adopted rules to implement that Section. The staff has received fewer than 10 letters from issuers and auditors to date. Some of the auditor letters were submitted as SECPS notification letters and were filed within the five day period for SECPS letters (but not within the one day period required by Section 10A). Because of their content, the letters were in substance 10A letters and were treated as such. George Diacont noted that the Division of Enforcement has encountered a number of situations where Section 10A**

was not properly complied with. He offered the following recommendations:

- Section 10A letters should be sent to the *Office of the Chief Accountant*. Sending the letter to a different office within the Commission (such as Consumer Affairs) will cause delays in the process and may trigger a violation of the Section's one-day reporting requirement.
- The letter should explicitly state *what the illegal act is* and what effect it has on the financial statements. The staff believes that the law and the rules require a description of the illegal act.
- Auditors need only determine that *it is likely* that an illegal act has occurred to trigger consideration of the auditor's responsibilities under Section 10A.
- If the auditor has determined that it is likely that an illegal act has occurred, the illegal act is material to the financial statements, and management has not taken timely and appropriate remedial action, the auditor's obligation to submit a 10A letter to the SEC would *not* be relieved by resigning from the engagement.
- Information filed in a Form 8-K filing should not be inconsistent with that filed in a Section 10A letter. The staff believes it is difficult to conclude that an unremedied illegal act as reported in a 10A letter would not constitute a "disagreement" as defined in Item 304 of Regulation S-K.

Registrants and their auditors may contact Scott Bayless in the Office of the Chief Accountant with specific questions regarding Section 10A reporting requirements.

### **XIII. DIVISION OF ENFORCEMENT UPDATE**

George Diacont discussed the following issues recently encountered by the Division of Corporation Finance:

#### **A. Interim Filings**

The staff is very concerned about audit firms who provide advice to registrants about how to account for a transaction in interim financial statements. If the auditor has reason to believe that the registrant is not properly accounting for a material transaction (even if the client acts contrary to the auditor's advice) and performs any of the services listed in paragraph 5 of Statement on Auditing Standards (SAS) No. 71, *Interim Financial Information*, (including assisting in the preparation of the interim statements), the auditor may be responsible for taking action as described in paragraphs 20 - 22 of SAS No.71. Formal engagement of the auditor to perform a SAS No. 71 review is not necessary to

establish the auditor's obligation. Furthermore, securities laws and regulations permit the SEC staff to seek a "cease and desist" order against anyone who is found to have "caused a violation" of the securities laws. The standard of conduct that could result in a cease and desist proceeding might be negligence, although the staff would be inclined to pursue more egregious violations. In addition, the staff is inclined to take similar action against a partner who, through consultation regarding treatment of an accounting issue, becomes aware that a client is intentionally violating GAAP in interim financial reports and the partner consulted takes no action to stop it. The partner consulted could be held responsible if his or her involvement was significant enough that a consultation memo is drafted.

#### **B. Foreign Corrupt Practices Act**

For the first time in 10 years, the Division of Enforcement brought an action against a registrant (Triton) that violated the Foreign Corrupt Practices Act in the payment of bribes and kickbacks. The staff expects to prosecute more of these cases in the near future.

The staff is also pursuing a "books and records" case (the Evergreen case) involving corporate political contributions. The company prevailed upon employees to write blank checks that were used to make political contributions. Company reimbursements to the employees were inappropriately classified as employee bonuses or consulting fees.

#### **XIV. COURT DECISIONS**

Mike Kigin discussed the following recent court decisions on enforcement cases:

*Checkosky and Aldrich.* The Commission agreed that negligent conduct could in certain circumstances form the basis for charges of improper professional conduct under Rule 102 (e). This case has been appealed by the respondents to the D.C. Court of Appeals.

*Dana and Dettinger.* The Commission dismissed this case which was appealed based on the ruling in the *Patricia Johnson* case regarding statute of limitations, without addressing whether the statute of limitations applies to Rule 102(e) proceedings.

*Potts.* The Commission's decision is pending in this case involving a concurring partner who had knowledge that GAAP and GAAS were violated.

*Craig Stayner.* Pending oral argument before the Commission based on the *Patricia Johnson* decision, and other issues.

*Russell Ponce.* The staff is appealing to the Commission the decision the Administrative Law Judge rendered in favor of the respondent.

#### **XV. STAFF IDENTIFICATION IN COMMENT LETTERS**

The Committee noted that comment letters no longer identify the Associate and Assistant Chief Accountant associated with the filing. In some cases, the lack of this information makes it difficult to identify the staff member who can explain or discuss a comment. Robert Bayless replied that the document he distributed summarizing the current organizational structure of the Division (Attachment A) should help in this identification. He noted that the primary and secondary accounting reviewers are always identified in the comment letter. An Assistant Chief Accountant's name is included in the letter only if one participated in the review. However, registrants may request at any time that an Assistant or Associate Chief Accountant review a comment or issue raised in a comment letter.

#### **XVI. DISCLOSURES UNDER FASB STATEMENT NO. 123**

The staff has taken the position that the disclosures required by FASB Statement No.123, *Accounting for Stock-Based Compensation*, including the value of options granted and pro forma net income, cannot be considered immaterial. This is based on qualitative concerns, including a heightened investor interest in the value of options granted and the staff's view that options are related party transactions. Users of financial statements are also interested in the assumptions used in the calculation, even if no material pro forma expense results.

#### **XVII. YEAR 2000 ISSUE**

The Committee asked if the staff would consider a Staff Accounting Bulletin (SAB) describing issuers' reporting obligations related to the Year 2000 computer problem. The Committee indicated that there is a need for information in a vehicle more prominent than the staff's recent announcement expressed in the Division of Corporation Finance *Current Issues and Rulemaking Projects* document that was recently published on the SEC's website (<http://www.sec.gov/rules/other/cfcr0597.txt>). Robert Bayless indicated that the Division will consider the merits of the Committee's recommendation that the Commission or staff issue an interpretive release on the subject.



**The Division's organizational structure follows:**

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Division Director - Brian Lane (202) 942-2800

Deputy Director - Meredith Cross (202) 942-2810

Operations

Associate Director (Disclosure Operations) - Howard Morin  
(202) 942-2830

Associate Director (Small Business) - Albert Dandridge  
(202) 942-2880

Disclosure Support

Senior Associate Director (Legal) - William Morley (202) 942-2820

Associate Director (Legal) - Martin Dunn (202) 942-2890

Associate Director (Regulatory and EDGAR Policy,  
Mergers & Acquisitions) - Mauri Osheroff (202) 942-2840

Associate Director (International) - David Sirignano (202) 942-2870

Division's Office of the Chief Accountant

Associate Director (Chief Accountant) - Robert Bayless (202) 942-2850

Deputy Chief Accountant - Craig Olinger (202) 942-2850  
Liaison to: Foreign Private Issuers

Associate Chief Accountants -

Christine Davine (202) 942-2960

Liaison to: AD #2 (Consumer Related Products)  
AD #5 (Transportation & Leisure)

Melanie Dolan (202) 942-2960

Liaison to: AD #4 (Natural Resources)  
AD #6 (Manufacturing & Construction)

Kurt Hohl (202) 942-2960

Liaison to: AD #7 (Banking & Leasing)  
AD #1 (Healthcare & Insurance)

Doug Tanner (202) 942-2960

Liaison to: AD #3 (Communications & Computers) AD  
#8 (Structured Financing / Real Estate) AD  
#9 (Small Business)

Assistant Directors and Assistant Chief Accountants

Health Care and Insurance - Shelley Parratt (202) 942-1840

Assistant Chief Accountants:

Joel Levine (202) 942-1857  
Carlos Pacho (202) 942-1876

Consumer Products - H. Christopher Owings (202) 942-1900

Assistant Chief Accountants:

Tia Jenkins (202) 942-1902  
Pat Woodbury (202) 942-1761

Communications and Computers - James Daly (202) 942-1800

Assistant Chief Accountants:

Karin French (202) 942-1763  
Ken Marceron (202) 942-1781

Natural Resources - Roger Schwa11 (202) 942-1870

Assistant Chief Accountants:

Ron Kiima (202) 942-1953  
Barry Stem (202) 942-1919

Transportation and Leisure - William L. Tolbert, Jr. (202) 942-1850

Assistant Chief Accountants:

Joseph Hock (202) 942-1901  
Joseph Foti (202) 942-1952

Manufacturing and Construction - Steven Duvall (202) 942-1950

Assistant Chief Accountants:

Jim Rosenberg (202) 942-1803  
John Hartz (202) 942-1798

Banking and Leasing - Peggy Fisher (202) 942-1762

Assistant Chief Accountants:

John Sniegon (202) 942-1765

Don Walker (202) 942-1799

Structured Financing and Real Estate - Paula Dubberly (202) 942-1960

Assistant Chief Accountants:

Linda Van Doom (202) 942-1964

Hugh Miller (202) 942-1962

Office of Small Business - Richard Wulff (202) 942-2950

Assistant Chief Accountants:

Ed Loftus (202) 942-2954

Al Pavot (202) 942-1764

#### Other Offices

Office of Chief Counsel - Cathrine Dixon, Chief (202) 942-2900

Office of Mergers and Acquisitions - Catherine Dixon, Chief (202) 942-2920

Office of International Corporate Finance - Paul Dudek, Chief (202) 942-2990

Office of Information and Analysis - Herbert Scholl, Chief (202) 942-2930

Office of EDGAR Policy - Ruben Gechter, Acting Chief (202) 942-2940