

DISCLOSURE FILINGS EXAMINATION AND ACCOUNTING REPORTS

EXECUTIVE SUMMARY

Our audit of the Division of Corporation Finance's examination and accounting report process found that the process was generally achieving its objectives (e.g., documenting the scope of the filing review, providing the staff with timely and substantive supervisory review comments).

We are making several recommendations to improve the process, including: reminding Division staff and supervisors to upload reports to the filing folder in the Commission's Electronic Data Gathering Analysis and Retrieval system (EDGAR), clarifying the EDGAR uploading guidance, and safeguarding sensitive information. During the audit, we also discussed other issues with senior management.

Commission management generally concurred with our recommendations.

SCOPE AND OBJECTIVES

Our audit objective was to evaluate whether the Division of Corporation Finance's examination and accounting report process was achieving its objectives.

During the audit, we interviewed Division attorneys and accountants, and analyzed judgment samples of Examination and Accounting reports, among other procedures.

The audit was performed from September 2003 to May 2004 in accordance with generally accepted government auditing standards.

BACKGROUND

The Division of Corporation Finance has approximately 415 staff (mainly attorneys and accountants) of which approximately 80% are assigned to one of 11 industry groups. These groups are primarily responsible for reviewing registrant filings submitted pursuant to either the Securities Act of 1933, the Securities Exchange Act of 1934, or the Trust Indenture Act of 1939. The Division also has various support offices (e.g., Office of the Chief Counsel, Office of Rulemaking).

The Division uses a screening process to determine the scope of a filing's review (including whether a review is conducted or not). If a filing is reviewed, the main types of reviews are:

Full Review:	This consists of legal and accounting reviews
Full Financial:	This consists of only an accounting review
Monitor:	A filing is monitored for specific disclosure issues

In fiscal year 2003, the Division reviewed 3,780 filings.

After the staff complete their review, they prepare either an examination (legal review) or accounting (accounting review) report. The reports consist of a checklist of steps performed and a narrative section. Below each checklist step, there is a place to provide comments, as warranted. The narrative section of the report conveys information (*e.g.*, background information about the registrant, a description of the transaction, significant issues identified by the staff) to the staff's supervisor.

After the staff complete the report, a supervisor reviews it. Once this review is completed and appropriate changes are made, a comment letter (if applicable) is sent to the registrant. Depending on the type of review, the comment letter consists of accounting and legal comments. Some of the comments require immediate corrective action by the registrant (*e.g.*, a restatement of the financial statements), while other comments require corrective action to be implemented in future filings. Some comments ask for additional information from the registrant. Once the staff analyzes the additional information, they may request immediate or future corrective action, make an enforcement referral, or drop the issue.

The Division currently has six different report combinations with different checklist steps and narratives. The reports differ depending on the review type (legal or accounting), the type of filing being reviewed, and whether the staff is reviewing the filing for the first time (*i.e.*, before issuing the comment letter). Thus, a filing given a Full Review that had comments issued would have several associated reports.

AUDIT RESULTS

We found that the Division's examination and accounting report process is generally achieving its objectives. However, we are making some recommendations to improve the process, as discussed below.

REPORT CHECKLISTS

According to Division personnel, the report checklist represents the minimum requirement of issues to consider when reviewing a filing. The checklist also serves as an important reference tool, especially for new staff.

At the beginning of the audit, we found that the checklists for the reports had not been updated in several years. Thus, significant disclosure and accounting issues

had not been incorporated (*e.g.*, issues related to the Sarbanes-Oxley Act) and irrelevant items had not been removed. As a result, some staff modified the checklist themselves. We previously recommended (Audit No. 259 dated February 2, 1998) that the checklists should be periodically reviewed and revised as necessary.

During the audit, the checklists for the examination reports were updated, and management began to update the checklists for the accounting reports. Thus, we are not making any audit recommendations regarding this issue.

UPLOADING REPORTS

According to Division policy, reports, comment letters, and correspondence with the registrants should be uploaded (*i.e.*, posted) to the non-public section of EDGAR. This material serves as a historical record of the work performed and a reference tool for future filing reviews. We previously recommended (Audit No. 326 dated August 15, 2001) that the Division remind staff and supervisors to upload documents and that the Division periodically test to determine if the documents are being uploaded.

We found that reports are not consistently uploaded to EDGAR. Approximately, 16% (28 of 180) of the reports we attempted to locate were not uploaded to EDGAR. Our judgmental sample of 180 filings consisted of both examination and accounting reports for various types of filings. In addition, we found that some reports were uploaded to the wrong section in EDGAR (*e.g.*, uploaded to the company folder instead of the filing folder). Also, some Division personnel uploaded the draft and reviewed versions of the report, while others uploaded only the reviewed version.

Recommendation A

The Division of Corporation Finance should ensure that reports are uploaded to EDGAR by: (1) reminding its staff and supervisors to upload reports and other documents to the filing folder in EDGAR, (2) clarifying the EDGAR uploading guidance regarding which version(s) of the report should be uploaded, (3) periodically testing that the documents are being uploaded, and (4) reflecting the results of the testing in staff performance appraisals.

SEARCHABLE DATABASE

Division management currently relies on both formal and informal methods (*e.g.*, Assistant Chief Accountant meetings) to communicate issues to the staff. According to many Division personnel, the communication process could be improved. One area of improvement would be communicating unique accounting issues that have been identified, and how they are resolved. Division personnel generally believed that a searchable database of prior reports would improve communication.

During the audit, the Division implemented a new procedure. After completing a filing review, a closing memorandum is prepared. The memorandum includes

information about material issues considered and how they were resolved. The memoranda are searchable and should be uploaded to EDGAR (see “Uploading Reports” above). In addition, the Division is developing a new computer system with improved search capabilities. The system is expected to be implemented in the near future. Thus, we are not making any audit recommendations regarding this issue.

NON-PUBLIC INFORMATION

Commission Regulation SECR 23-2 requires all staff to protect non-public information (e.g., market sensitive). Section 3a(12) states that, “it [non-public information] should be kept out of view from those without a need-to-know. Non-public (SEC Restricted) information in physical or electronic form must not be left unattended unless it is secured by a physical or electronic lock.”

Some of the industry groups do not adequately safeguard their reports. In these industry groups, a staff member puts a paper copy of the draft report in an “in-box” in a common area in the Division’s office space. The report is left there until a supervisor takes it to review. Anybody walking past the “in-box” could read the report. Some of the reports could contain market sensitive information (e.g., a reviewed 10K filing in which the staff is requesting that the registrant restate its financial statements).

Also, if a report containing market sensitive information were to be uploaded to EDGAR (see section on “Searchable Database”), this could (depending on when it is uploaded) also create an opportunity for unauthorized individuals to obtain market sensitive information.

Recommendation B

The Division of Corporation Finance should (1) move “its in-boxes” to a more secure area, and (2) evaluate its EDGAR uploading policy for reports containing market sensitive information.