U.S. Securities and Exchange Commission

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by

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Thank you for that kind introduction. I still can't get over how nice people are when they introduce me as someone from the SEC. I guess it is one of the perks of joining the agency, together with criticism for perceived under-regulation, threatened over-regulation, calling for either too much or too little disclosure (or both) and beating my dog. (For the record, I don't have a dog.) But the introductions are non-pareil. I can tell you that no one was ever as generous in introducing me when I was their outside counsel.

Seriously, my move to the SEC, from an extremely fulfilling and exciting practice, was motivated at least in part by a belief that the regulation of our capital markets can be updated and improved. I thought then, and I think today, even after the debacle of Enron and the other events of recent months, that our capital markets and regulatory system are the best in the world. But even the best system can be improved, and in our case for the significant benefit of investors, issuers and others.

I am not going to speak this afternoon about Enron itself, and indeed, given the Commission's and others' ongoing investigations, it would be improper for me to do so. What I am going to speak about are the lessons of Enron and the aftermath of Enron. Enron is a tragedy, for its investors and for its employees. Enron has also produced a crisis of confidence among participants in and observers of our capital markets, who are shaken at the realization that such a massive unraveling of a company and evaporation of

tens of billions of dollars of seeming value could occur in such a short time.

Everyone exploring the Enron debacle therefore quite understandably seeks answers to the question, "How can we prevent another Enron?" Even though that question is difficult, I would submit it is not the only question we should be asking. For Enron is one of those catalytic events that puts the entire structure of regulation, in this case capital markets regulation, into play. And so I believe we should also be asking ourselves, "How can Enron provide an opportunity to improve our system?"

In answering both those questions, we must be exceedingly careful not to over-react, not to regulate for the sake of regulating, and especially not to take steps that pose a significant risk of harming the system rather than improving it. The injunction to physicians, "First, do no harm!" applies equally to regulators.

But caution does not preclude action, even bold action, that is sensible, and we are determined to act where we are convinced that doing so will prove beneficial.

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Before I spend some time speaking about the SEC's initiatives, I want to touch on an important related principle.

Enron appears among other things to have been a product of massive failures across the spectrum of actors, protections, checks and balances, and gatekeepers in our capital markets system. But in answering the question, "How does one protect against these kinds of failures?" and without reference to Enron specifically, while the performance of all the actors and gate-keepers should be scrutinized and their performance strengthened, the only answer that nearly promises success is to concentrate first on the integrity and performance of corporate management. President Bush in his ten-point plan announced on March 7 of this year recognized that very important truth, and it is central to our approach.

The vast majority of corporate executives want to do the right thing, to act in the interests of the corporation and its investors. One of the most important roles of legal advisers is to help corporate management do the right thing, to provide both guidance and reinforcement where necessary. Corporate lawyers, both outside lawyers and general counsels and other inside legal staff, represent the corporation and its shareholders. They are professionally obligated to advocate forcefully legitimate views and interests of their clients. But it must surely be apparent from Enron that it does not serve the interests of the client — the corporation and its shareholders — and is therefore not the "right thing," to find ways to avoid disclosure and other legal requirements, even though the course of action being considered is arguably within the letter of specific applicable rules.

Compliance with financial reporting and disclosure and other rules cannot

properly be a game, where victory goes to those who get farthest away from the spirit of what is required while staying within the literal reporting requirements. Government through regulation and enforcement can play an important role in bringing that message home. I would commend your attention to a Commission settlement with Edison Schools announced just this past Tuesday, where the Commission found violations of our disclosure requirements in cases where the accounting conformed to GAAP.

Even with vigorous enforcement, however, government through regulation cannot succeed alone in eliminating this practice. You are a first line of protection, whether you are an in-house or outside legal adviser. General counsel and other members of the corporate legal staff are not only members of corporate management but also members of the Bar, who must be faithful to their professional obligations. Outside counsel are trusted advisers with the same professional obligations.

You in those positions should bring a broad perspective to broad questions. When faced with a difficult disclosure issue, the question should be, "Will the proposed language provide a true and complete explanation for investors?" and not "Does the proposed disclosure meet the literal reporting requirements?" I would submit that following very literal approaches to answer broad questions may lead to violations of our requirements and in any event is rarely in the best interests of the client — the corporation and its shareholders — especially when the risk of loss of investor and public confidence is considered. You owe it to your corporate client, to its shareholders and to management to provide clear advice as to what is in the best interests of the corporation.

There are also very important developments in the area of corporate governance where both inside and outside counsel can play a very important role. In particular, we welcome your views and support in the comment and implementation processes that we expect to see in the next month or so following what we expect will be important recommendations in the corporate governance process from the New York Stock Exchange and the Nasdaq.

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I'd now like to turn briefly to our agenda in the area of disclosure. Here too I would start with increasing the involvement and accountability of corporate management. The President's ten-point plan called for increased accountability of individual corporate leaders, and we will be recommending to the Commission in the near future that it propose rules that will require those leaders to certify that everything they know that they believe is important to investors has been disclosed in a company's periodic reports. This is a simple but powerful approach. We believe that it will increase involvement of corporate leaders in disclosure, make them focus on what they themselves consider important and improve the overall quality of a company's reports.

In addition, we are pursuing initiatives to make disclosure more timely. We

have already proposed rules calling for current disclosure by issuers of transactions involving their officers and directors, including transactions in equity securities and derivatives, establishment or modification of 10b5-1 plans, and loan transactions. We have also proposed accelerating filings of quarterly and annual reports for domestic issuers with a public float of more than $75 million. Further, in the near future we will recommend to the Commission that it propose a substantial expansion to the items triggering a filing on Form 8-K, to turn 8-K into a true current reporting form.

Finally, I'd like to address one disclosure area in particular where the Commission and staff has been focusing a good deal of recent attention and plans to continue to do so. Management's Discussion & Analysis of Financial Condition and Results of Operations is, after the financial statements themselves, generally the most important portion of an issuer's disclosure. I believe that today MD&A should serve three important related purposes:

- To provide a narrative explanation of companies' financial statements to enable investors to see the company through the eyes of management;

- To improve overall financial disclosure and provide the context within which financial statements should be analyzed; and

- To provide information about the quality of, and risks to, a company's earnings and cash flow, so that investors can make more informed judgments regarding the likelihood that past performance is indicative of future performance.

The Commission and staff have over the years published releases and taken other steps to increase sensitivity to the importance and the requirements of MD&A. Recently, in December 2001 and January 2002, the Commission published two releases, one calling for disclosure of critical areas of accounting judgment and estimations and the other suggesting enhanced disclosure in a number of other areas, including the impact of off-balance sheet financing on liquidity and capital resources. Most recently, the Commission proposed for comment rules requiring disclosure regarding the application of critical accounting policies, including critical accounting estimates.

In that release we also indicate that we are considering further changes. First, we are thinking about recommending the proposal of a mandated summary of MD&A. This is an idea that has found support among investors and also among those corporate officials that most frequently and directly interface with investors, namely financial officers and investor relations officers. In an unscientific sampling, some legal advisers have been skeptical, seeing liability issues in a summary and another hard task with what they perceive as little benefit to issuers. I frankly believe that reaction undervalues the potential advantage to investors (and therefore to issuers) of a concise, clear presentation of management's views of:

- how the company makes money,
- what is most important in understanding the company's financial reporting,
- what financial, operational, macroeconomic or other trends managements pays most attention to, and
- what seems most likely to management to spoil the party going forward.

I also believe attention to the body of MD&A is overdue. MD&A should provide investors with management's view of the financial performance and condition of the business, the additional information necessary to appreciate what the financial statements show and don't show, and the important trends and risks that have shaped the past and are reasonably likely to shape the future. I want to emphasize that we want improvement in quality, not increased quantity, of disclosure. I believe that some of the boilerplate and "elevator music" seen in too much MD&A can be safely eliminated.

Also, we can all identify some of the information that should be emphasized in the coming year, and indeed the Commission has done so in its recent releases. It is important to consider whether there is sufficient disclosure and clarity regarding the use of off-balance sheet financing. Related party transactions merit more attention. Cash, cash flows and liquidity deserve more and better disclosure in MD&A than the rote recitations of the numbers and changes in the cash flow statements that we see too often. As an example, focusing on the specific debt covenants, risks to financing plans and ratings concerns of the particular issuer, rather than generalized disclosure about these subjects, would be a significant improvement in disclosure.

But one size does not fit all companies, even all companies in the same industry, and one size also does not fit all times. To write a good MD&A it is important to think about the company in question and its precise circumstances. While disclosure documents for other companies in an industry are frequently useful, it is dangerous to think of them as templates. And while I have been properly admonished for hyperbole for suggesting that a company start each year with a clean sheet of paper, I believe it is crucial for companies to begin the process of crafting the best MD&A by having financial executives, including CFOs, and even CEOs, think first about what has changed and should be reflected. Contrary to what a lawyer recently said on this subject, this year is not just a mark-up of last year. An appropriately broad view of what is really happening to the company currently is most likely to be achieved if one does not start by strapping on the blinkers of last year's disclosure.

Finally, I am concerned that too much disclosure generally, but particularly too much MD&A, is written as an exercise in minimizing legal risk without regard to the impact on the quality of disclosure. Legal advisers are in a unique position to help recalibrate the focus of MD&A where it suffers from this approach, so that it provides meaningful and informative disclosure while

avoiding unreasonable legal risks. I would submit that both investors and issuers are better served by the latter approach.

You can be sure that those of us at the Commission are single-mindedly dedicated to making necessary improvements to regulation of disclosure and our capital markets. I am equally confident that my audience here today exemplifies the dedicated legal professionals that are helping to keep our markets the best and most honest in the world.

Thank you very much.

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Home | Previous Page Modified: 05/30/2002