



U.S. Securities and Exchange Commission  
Office of Inspector General  
Office of Audits

Evaluation of the Division of Corporation Finance's  
Disclosure Review and Comment Letter Process



September 13, 2017  
Report No. 542



OFFICE OF  
INSPECTOR GENERAL

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

**M E M O R A N D U M**

September 13, 2017

**TO:** William Hinman, Director, Division of Corporation Finance

**FROM:** Carl W. Hoecker, Inspector General 

**SUBJECT:** *Evaluation of the Division of Corporation Finance's Disclosure Review and Comment Letter Process, Report No. 542*

Attached is the Office of Inspector General (OIG) final report detailing the results of our evaluation of the Division of Corporation Finance's disclosure review and comment letter process. The report contains three recommendations that should help improve the Division's process for documenting comments—written and oral—and ensuring all examiner and reviewer reports that document comments are uploaded in a timely manner.

On August 28, 2017, we provided management with a draft of our report for review and comment. In its September 11, 2017, response, management concurred with our recommendations. We have included the response as Appendix III in the final report.

Within the next 45 days, please provide the OIG with a written corrective action plan that addresses the recommendations. The corrective action plan should include information such as the responsible official/point of contact, timeframe for completing required actions, and milestones identifying how the Division of Corporation Finance will address the recommendations.

We appreciate the courtesies and cooperation extended to us during the evaluation. If you have questions, please contact me or Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects.

Attachment

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# Executive Summary

## Evaluation of the Division of Corporation Finance's Disclosure Review and Comment Letter Process Report No. 542 September 13, 2017

### Why We Did This Evaluation

In July 2016, some members of Congress requested that the U.S. Securities and Exchange Commission (SEC or agency) Office of Inspector General (OIG) and the Comptroller General of the Government Accountability Office (GAO) jointly review the SEC's efforts to implement the agency's 2010 climate change guidance (SEC Release 33-9106), and assess the Division of Corporation Finance's (CF) comment letter process. Based on the request letter and our meeting with Congressional staff and GAO, the SEC OIG agreed to review and report on CF's disclosure review and comment letter process. In a separate document, GAO will report its observations related to climate change-related policies and procedures.

### What We Recommended

To improve CF's disclosure review and comment letter process, we recommend that the Director of CF: (1) establish a mechanism or control for CF staff to trace all comments provided to companies to examiner and reviewer reports before issuing comment letters; (2) establish a mechanism or control that ensures CF staff follow policy to upload all examiner and reviewer reports to the internal workstation before issuing comment letters; and (3) establish detailed guidance on how examiners and reviewers should document oral comments provided to companies during disclosure reviews. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action.

### What We Found

CF established policies, procedures, and internal controls that provide overall guidance for how staff should conduct disclosure reviews and for how information, including comments, should be documented, tracked, and disseminated to companies and the public. We evaluated 95 of the more than 5,000 disclosure reviews conducted by CF staff in fiscal year 2015, and surveyed 325 CF disclosure review staff and determined that staff generally complied with the established policies, procedures, and internal controls. In addition, more than 80 percent of survey respondents felt they (1) received sufficient training to conduct disclosure reviews, and (2) received or provided rationale for any proposed comments to companies that were waived or modified.

Although staff generally followed CF's disclosure review policies and procedures and the results of our survey of CF disclosure review staff were generally positive, we identified opportunities to improve CF's disclosure review documentation. Specifically, we found that:

- examiners and reviewers did not always properly document comments before issuing comment letters to companies;
- some case files were incomplete as of the date CF issued a comment letter to a company; and
- examiners and reviewers inconsistently documented oral comments to companies.

This may have occurred because there are no mechanisms or checks in place to ensure compliance with certain aspects of CF's policies, procedures, and internal controls for documenting written comments. In addition, guidance for documenting oral comments provided to companies is not detailed.

By not consistently or timely documenting written and oral comments, CF may not be able to fully and accurately explain the basis for its actions or adequately demonstrate that reviews were conducted effectively and that comments were appropriately reviewed before issuance.

We also determined that the SEC's Office of Information Technology, in coordination with CF, did not establish or document the system security categorization or security controls for the Comment Letter Dissemination system. We discussed with management these other matters of interest, which did not warrant recommendations.

For additional information, contact the Office of Inspector General at (202) 551-6061 or <http://www.sec.gov/oig>.

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## ABBREVIATIONS

AD	Assistant Director
CF	Division of Corporation Finance
COLD	Comment Letter Dissemination System
DSO	Disclosure Standards Office
EDGAR	Electronic, Data Gathering, Analysis, and Retrieval System
FACTS	Filing Activity Tracking System
FY	fiscal year
GAO	U.S. Government Accountability Office
GSS	General Support Service
OIG	Office of Inspector General
OIT	Office of Information Technology
SEC or agency	U.S. Securities and Exchange Commission
SWAT	System for Workflow Activity Tracking

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## Background and Objectives

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### Background

**Disclosure Requirements.** Companies subject to the registration and reporting requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 are required to disclose certain information to investors through regular filings with the U.S. Securities and Exchange Commission (SEC or agency).<sup>1</sup> Specifically, these companies must disclose the information required by Federal securities laws and regulations and any additional material information necessary to make those required statements not misleading in light of the circumstances under which the statements are made.<sup>2</sup> The standard for determining what additional information must be disclosed is a materiality standard, as defined by the Supreme Court of the United States.<sup>3</sup> As required by Section 408 of the Sarbanes-Oxley Act of 2002,<sup>4</sup> the SEC's Division of Corporation Finance (CF) reviews each reporting company at least once every 3 years. According to CF, CF also reviews a significant number of companies more frequently. Although the SEC conducts reviews of companies' disclosures per Federal law and agency policy, the agency does not evaluate the merits of any transaction or determine whether an investment is appropriate for any investor. Moreover, CF's review process is not a guarantee that company disclosures are complete and accurate. Responsibility for complete and accurate disclosure lies with companies and others involved in the preparation of company filings.

**Disclosure Review Process.** Staff in CF's Office of Disclosure Operations complete multiple disclosure reviews each year in addition to other assigned work. In fiscal years

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<sup>1</sup> The Securities Act of 1933 regulates public offerings of securities, requiring that issuers register securities with the SEC and provide certain disclosures, including a prospectus, to investors at the time of sale, unless an exemption from registration is available. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a -77aa). The Securities Exchange Act of 1934 established the SEC and provided it with broad authority over all aspects of the securities industry, including the power to require periodic reporting of information by companies with publicly traded securities. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a -78qq).

<sup>2</sup> See 17 C.F.R. § 240.12b-20.

<sup>3</sup> Information is material if there is a substantial likelihood that the reasonable investor would have viewed the disclosure as having significantly altered the total mix of information made available. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). See also *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

<sup>4</sup> The Sarbanes-Oxley Act of 2002 requires CF to review disclosures made by issuers reporting under section 13(a) of the Securities Exchange Act of 1934 (including reports filed on Form 10-K), and which have a class of securities listed on a national securities exchange or traded on an automated quotation facility of a national securities association. Pub. L. No. 107-204, § 408(a), 116 Stat. 745, 790 (codified at 15 U.S.C. § 7266(a)). The reviews are to be made at least once every 3 years and include a review of an issuer's financial statements. *Id.* at § 408(a),(c).

(FYs) 2015 and 2016, Disclosure Operations staff conducted disclosure reviews of over 5,000 companies each year. CF selectively reviews company filings both to monitor and to enhance compliance with disclosure and accounting requirements. CF concentrates its review resources on disclosures that appear to be inconsistent with SEC rules or applicable accounting standards, or that appear to be materially deficient in their explanation or clarity.

Each FY, CF management develops goals for the filing review program. The goals include reviewing companies pursuant to Section 408 of the Sarbanes-Oxley Act of 2002 with a particular focus on Sarbanes-Oxley Section 408(b)(3): issuers with the largest market capitalization. In addition to setting goals for annual reviews, CF screens all initial public offerings and other registration statements, as well as other transactional filings such as proxy statements. CF reviews a substantial percentage of registration statements filed by new issuers.

After selecting companies for review, CF determines the scope of each review (full, full financial, or targeted)<sup>5</sup> and delegates to legal and accounting staff in 11 Assistant Director's (AD) offices authority to complete each review.<sup>6</sup> According to CF officials, CF relies on its ADs to determine how a review is conducted. Depending on the type of review conducted, staff assess selected disclosures for compliance with applicable laws, regulations, and disclosure requirements. Since many disclosure requirements are based on a company's materiality determinations, CF may question materiality determinations and request explanations of disclosure decisions. However, the SEC has previously noted in a 1999 Staff Accounting Bulletin that the evaluation of what is material is for a registrant and its auditor to determine after considering "all the relevant circumstances."<sup>7</sup>

Each disclosure review includes an examiner and a reviewer. The examiner conducts an initial review of the disclosure and may propose comments to issue to the company, as discussed further below. The reviewer reviews the examiner's work and may agree

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<sup>5</sup> CF defines a full disclosure review as one that includes both accounting and legal input, whereas a full financial review includes only accounting input, and a targeted review focuses on a specific area in a disclosure that accounting or legal staff, or both, may review. According to CF staff, targeted reviews are not common for annual reviews but more common for repeat issuer registration statements and other transactional filings.

<sup>6</sup> AD offices within CF's Office of Disclosure Operations are organized by industry so similar disclosures are reviewed by the same office.

<sup>7</sup> SEC Staff Accounting Bulletin, Materiality, "Assessing Materiality" (1999) (emphasis in original). CF examiners and reviewers are not aware of all the relevant circumstances for a materiality determination, and are limited to the information provided in a registrant's filings. The materiality evaluation, as well as the accuracy and quality of the information disclosed, remains the responsibility of the registrant.

with, modify, waive, and/or add comments to the ones proposed by the examiner.<sup>8</sup> According to CF officials, a reviewer's evaluation of an examiner's work may be oral or written, or a combination of both, and the majority of second level reviews are documented in writing. Additionally, CF support offices may provide comments to include in correspondence to a company.<sup>9</sup> CF guidance requires the examiner and reviewer to manually upload evidence of their reviews (for example, examiner and reviewer reports) in an internal workstation.<sup>10</sup> Internal work papers, including examiner and reviewer reports, are considered internal work papers and are not available to the public or searchable through *sec.gov*.<sup>11</sup>

**Comment Letters.** After examiners and reviewers complete their reviews of a company's disclosure, CF may send the company approved comments in the form of a comment letter.<sup>12</sup> The comment letter may request that the company provide specific information for clarification or to elicit better compliance with applicable requirements. In response to a comment letter, a company may revise its financial statements, amend a disclosure to provide additional or enhanced information, or agree to revise its financial statements or other disclosures in future filings with the SEC. CF will continue the review and comment process with a company until all comments are sufficiently addressed. No sooner than 20 business days after completing each review, CF makes its comment letters and corresponding company responses related to that review publicly available on *sec.gov*.

The following figure from an October 2016 U.S. Government Accountability Office (GAO) report on supervisory internal controls depicts CF's disclosure review and comment letter process.<sup>13</sup>

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<sup>8</sup> During our case file review, we found a single instance of a staff member serving as both the examiner and reviewer. Subsequent to that review, CF issued guidance stating that staff members may not serve as both the examiner and reviewer unless the staff member is an AD, Senior Assistant Chief Accountant, or Branch Chief.

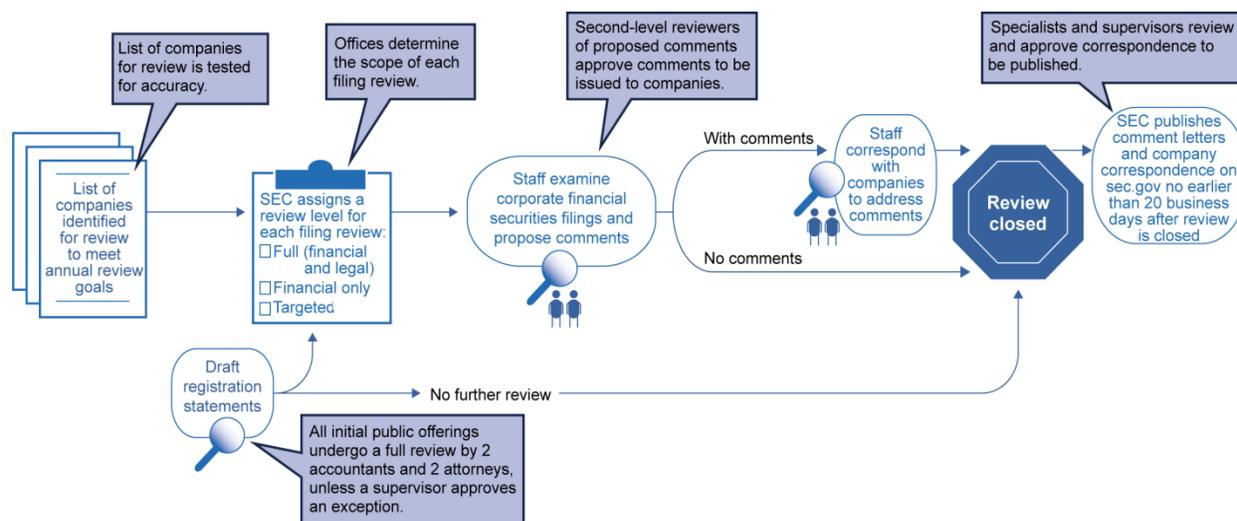
<sup>9</sup> CF support offices that may propose comments to staff who conduct disclosure reviews include the Office of International Corporate Finance, the Office of Mergers and Acquisitions, the Office of Structured Finance, and the Office of Global Security Risk. According to CF officials, these proposed comments are subject to review by the AD office reviewer assigned to the filing review.

<sup>10</sup> Evidence of reviewer input can be reflected in the internal workstation as a notation on the examiner's report or as a separate reviewer's report. For the purposes of this evaluation, references to reviewer report, unless otherwise noted, encompass both notations in the examiner's report or a separate reviewer report.

<sup>11</sup> Nothing in this sentence affects the Government's release authority pursuant to the Freedom of Information Act, 5 U.S.C. § 552; the Privacy Act of 1974, 5 U.S.C. § 552a; or any other applicable law.

<sup>12</sup> In specific and limited instances, staff may provide a company oral instead of written comments.

<sup>13</sup> U.S. Government Accountability Office, *Securities and Exchange Commission: Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency* (GAO-17-16, October 6, 2016). Figure and figure title modified by the U.S. Securities and Exchange Commission, Office of Inspector General.

**Figure. CF's Disclosure Review and Comment Letter Process**

 Internal control(s) used at this stage in the process

SEC Securities and Exchange Commission

Source: GAO summary of Securities and Exchange Commission information. | GAO-17-16

Comment letter information related to completed filing reviews is searchable on [sec.gov](http://sec.gov); however, the website presents information by company or other filer, not by comment letter subject. Therefore, specific comment letter subject search results are subjective and depend on key word searches that may result in false-positive responses or may exclude other pertinent comment letters that did not contain the key word.

According to CF staff, CF is developing a new system to improve and streamline certain aspects of the disclosure review process. Specifically, the System for Workflow Activity Tracking (SWAT) will automate certain aspects of the review process such as providing notifications of filing review status to other review team members. In addition, according to CF officials, SWAT will generate a draft comment letter based on comments input into and approved within the system. The reviewer or another designated AD office staff member will review and revise the draft letter to ensure that it meets CF's policies for format, tone, and content. Once the draft letter is approved, a final comment letter will be generated within SWAT.

In its October 2016 report, GAO noted that CF has been developing SWAT since 2013. According to CF staff, in October 2016 CF began a pilot of SWAT in one AD office, began training another AD office, and intends to fully implement SWAT during FY 2018. While SWAT implementation will affect the workflow of filing reviews and facilitate electronic document retention of examiner and reviewer work products, it will not affect the policies and procedures applicable to the substantive work of reviewing filings.

## Objectives

Our overall objective was to review CF's process for issuing, tracking, and facilitating public access to comment letters and related correspondence. To address our objective, we:

- reviewed applicable Federal laws, regulations, and CF policies and procedures;
- interviewed knowledgeable personnel;
- surveyed 325 staff assigned to the 11 CF AD Offices who either performed a disclosure review as an examiner and/or served as a reviewer of an examiner's work in FYs 2015 or 2016 (and received responses from 202 staff, or about 62 percent);
- evaluated a non-statistical, judgmental sample of 95 case files from the more than 5,000 disclosure reviews conducted by CF staff in FY 2015; and
- relied on information maintained in (1) external and internal versions of the SEC's Electronic, Data Gathering, Analysis, and Retrieval (EDGAR) system;<sup>14</sup> (2) CF's Filing Activity Tracking System (FACTS);<sup>15</sup> and (3) CF's Comment Letter Dissemination (COLD) system.<sup>16</sup>

Appendices I and II include additional information about our objective, scope, and methodology; our review of internal controls; prior coverage; and the results of our survey of CF staff.

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<sup>14</sup> EDGAR has an external public interface (*sec.gov*) that performs automated collection, validation, indexing, acceptance, and forwarding of submissions by companies and others who are required by law to file forms with the SEC. It also houses all correspondence associated with a disclosure review and allows the public to search the correspondence and required company filings. In addition, EDGAR has an internal non-public interface (internal workstation) for staff to manage company filings and upload internal work papers, such as examiner and reviewer reports that document disclosure reviews.

<sup>15</sup> CF uses FACTS to track the progress of disclosure reviews with some fields automatically updated from information uploaded into EDGAR.

<sup>16</sup> CF uses COLD to indicate which material it will disseminate to the public after a filing review is complete.

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## Results

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### **Controls Over CF's Comment Letter Process Are Generally Effective But Could Be More Consistently Implemented**

CF established policies, procedures, and internal controls that provide overall guidance for how staff should conduct disclosure reviews and for how information, including comments, should be documented, tracked, and disseminated to companies and the public. We evaluated 95 of the more than 5,000 disclosure reviews conducted by CF staff in FY 2015 and determined that staff generally complied with the established policies, procedures, and internal controls. This observation is consistent with the results of our survey of CF staff, as more than 80 percent of survey respondents (both examiners and reviewers) felt they received sufficient training to conduct disclosure reviews. Additionally, more than 80 percent of survey respondents (both examiners and reviewers) indicated they received or provided rationale for any proposed comments that were waived or modified. Furthermore, most examiners who responded (about 77 percent) indicated that they believed reviewers rarely or never unduly waived or modified proposed comments;<sup>17</sup> and most reviewers who responded (about 97 percent) stated that examiners never or rarely expressed that the reviewer unduly modified their comments.<sup>18</sup>

Although staff generally followed CF's disclosure review policies and procedures and the results of our survey of CF disclosure review staff were generally positive, we identified opportunities to improve CF's disclosure review documentation. Specifically, we found that (1) examiners and reviewers did not always properly document comments before issuing comment letters to companies; (2) some case files were incomplete as of the date CF issued a comment letter to a company; and (3) examiners and reviewers inconsistently documented oral comments to companies. By not consistently or timely documenting written and oral comments, CF may not be able to fully and accurately explain the basis for its actions or adequately demonstrate that reviews were conducted effectively and that comments were appropriately reviewed before issuance.

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<sup>17</sup> This reflects 116 of the 150 survey respondents who answered this question.

<sup>18</sup> This reflects 123 of the 127 survey respondents who answered this question.

**Examiners and Reviewers Did Not Always Properly Document Comments Before Issuing Comment Letters to Companies.** The 95 case files we reviewed from FY 2015 included 1,117 comments disseminated to companies in comment letters. We found that 47 of these 1,117 comments (or about 4 percent) were not documented as required in either examiner or reviewer reports maintained in the internal workstation. Through our discussions with CF's Disclosure Standards Office (DSO),<sup>19</sup> we determined that 26 of these 47 comments were from 5 examiner/reviewer reports not uploaded to the internal workstation before issuance.<sup>20</sup> The remaining 21 comments originated from support offices (for example, the Office of International Corporate Finance or the Office Mergers and Acquisitions) and were not documented in a similar way to the ones added by staff from the AD Offices.<sup>21</sup> Specifically, according to DSO staff, examiners and reviewers in these cases documented that they received comments from support offices but did not document the actual comments or supervisory review of those comments.

As previously discussed, CF examiners are required to upload examiner reports and reviewers are required to upload evidence of their review in the internal workstation. The reports contain proposed examiner comments and the reviewer's modifications, waivers, or additions to the proposed comments. In some instances, support offices and management<sup>22</sup> will propose comments to include in the final comment letter. According to CF memos, at minimum, discussions with support offices must be memorialized in the examiner's or reviewer's report, and according to CF officials, the reviewer is responsible for reviewing any proposed support office comments. There are no requirements for documenting management comments in examiner or reviewer reports; however, according to a CF official, examiners will usually document these comments in their reports. With the exception of management comments, the number of comments in the letter should reconcile with the number of comments in the reports. However, CF does not have a mechanism in place to ensure all examiner and reviewer reports are uploaded in the internal workstation.<sup>23</sup> Furthermore, guidance for

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<sup>19</sup> DSO evaluates CF's supervisory controls to support the required Dodd-Frank certification. As part of its annual assessment, DSO evaluates CF's disclosure review policies and results and may also recommend process improvements within CF.

<sup>20</sup> The AD office responsible for these reports subsequently uploaded the reports in the internal workstation.

<sup>21</sup> According to DSO staff, CF generally includes support office comments in the comment letter, although reviewers can modify or waive support office comments if they choose.

<sup>22</sup> According to CF officials, in addition to examiners, reviewers, and support offices, AD office management, Associate Directors with AD oversight, or other members of CF senior staff may also propose comments to include in a comment letter. For the purposes of our report, and unless otherwise noted, we collectively refer to these groups as "management".

<sup>23</sup> According to CF officials, when fully implemented, SWAT will generate a draft comment letter based on comments input into and approved within the system. The reviewer or another designated AD office staff member will review and revise the draft letter to ensure that it meets CF's policies for format, tone, and content. According to CF officials, once the draft letter is approved, a final comment letter will be generated within SWAT.

memorializing comments from support offices is sparse and only requires CF staff to document any discussions with those offices. CF guidance does not specifically require examiners and reviewers to document proposed comments received from support offices or management.

By not ensuring that all reports are included in the internal workstation, comments from support staff are reviewed and documented, and management comments are documented before issuing comment letters to companies, CF may not maintain a complete and accurate record of its disclosure reviews, such as the comments issued to a company and the basis for CF's actions. In addition, CF may be less able to demonstrate that disclosure reviews were conducted effectively and that comments were appropriately reviewed before issuance.

**Some Case Files Were Incomplete As Of the Date CF Issued a Comment Letter to a Company.** In our review of 95 case files from FY 2015, we determined some case files were incomplete as of the date CF issued a comment letter to a company. Specifically, 4 of the 95 case files we reviewed (about 4 percent) did not include reviewer reports for all comment letters sent to companies, although we were able to verify a comment in the comment letter to an examiner report.<sup>24</sup> In addition, we found that examiners and/or reviewers for 12 of the 95 case files we reviewed (or about 13 percent) did not upload all their reports in the internal workstation before CF issued a comment letter. As previously stated, this may have occurred because, although CF staff is required to upload examiner and reviewer reports in the internal workstation, there are no mechanisms or checks in place to ensure compliance, or requirements to upload reports before issuing a comment letter.

Examiner and reviewer reports demonstrate that CF performed disclosure reviews effectively and that comments were appropriately reviewed before being issued to companies. In addition, CF staff is required to review comments issued to a company in prior reviews or a recent prior filing in connection with their current review to reduce possible inconsistencies with previously issued comments. Therefore, it is important for CF to properly document disclosure reviews—including evidence of supervisory review—by uploading all examiner and reviewer reports in a timely manner.

**Examiners and Reviewers Inconsistently Documented Oral Comments to Companies.** CF has issued a series of memos that provide guidance to staff on publicly issuing comment letters. The memos provide general guidance about oral comments, including when to use oral comments and how to document them in work papers and in comment letters. However, we determined that CF's practice for documenting oral comments in the internal workstation is inconsistent. We determined that 26 of the 95 case files we reviewed (or about 27 percent) included oral comments, which staff documented inconsistently. Specifically, examiners and reviewers generally

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<sup>24</sup> During our evaluation, CF provided documentation of the four reviewer reports and uploaded the reports in the internal workstation.

noted in their respective reports that they intended to provide oral comments to companies. However, examiners and reviewers inconsistently documented information about the oral comments they intended to provide. For example, one case file documented the number of proposed oral comments, the reviewer's concurrence that the comments met requirements to be issued orally, and the outcome of the conversation with the company. Another case file only indicated that CF staff provided oral comments to a company.

Although CF established some guidance for documenting oral comments provided to companies, the guidance does not specify how examiners or reviewers document the rationale for issuing oral comments, the number of oral comments issued, or the outcome of the conversation with a company after staff issued oral comments.

As a result, we could not always determine how CF staff concluded that oral comments were appropriate, the total number of oral comments provided to companies, or the outcome of those comments once provided to a company. Maintaining this type of documentation is important as staff is required to review comments issued to a company in prior reviews or a recent prior filing in connection with their current review to reduce possible inconsistencies with previously issued comments. Further, a CF internal control requires filing reviews to be properly documented in order to demonstrate that reviews were conducted effectively and comments appropriately reviewed before a disclosure review is completed.

## **Recommendations, Management's Response, and Evaluation of Management's Response**

To improve the Division of Corporation Finance's disclosure review and comment letter process, we recommend that the Director of Corporation Finance:

**Recommendation 1:** Establish a mechanism or control for Corporation Finance staff to trace all comments provided to companies—including comments received from support offices and management—to examiner and reviewer reports before issuing comment letters.

**Management's Response.** The Director concurred with the recommendation. The Director stated that, once fully implemented, the System for Workflow Activity Tracking (SWAT) will be able to track the origin of comments included in the final comment letter. Management's complete response is reprinted in Appendix III.

**OIG's Evaluation of Management's Response.** Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon verification of the action taken.

**Recommendation 2:** Establish a mechanism or control that ensures Corporation Finance staff upload all examiner and reviewer reports to the internal workstation before issuing comment letters.

**Management's Response.** The Director concurred with the recommendation. The Director stated that, once fully implemented, the System for Workflow Activity Tracking (SWAT) will capture evidence of examiner and reviewer reports and will serve as the foundation for a comment letter. Management's complete response is reprinted in Appendix III.

**OIG's Evaluation of Management's Response.** Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon verification of the action taken.

**Recommendation 3:** Establish detailed guidance on how examiners and reviewers should document oral comments provided to companies during disclosure reviews, including the decision to issue oral comments, the number of oral comments staff intend to issue, and the outcome of oral comments.

**Management's Response.** The Director concurred with the recommendation. The Director stated that the System for Workflow Activity Tracking (SWAT) is designed to facilitate documentation of oral comments issued by staff members. The Division will also establish detailed guidance on how examiners and reviewers should document oral comments within SWAT. Management's complete response is reprinted in Appendix III.

**OIG's Evaluation of Management's Response.** Management's proposed actions are responsive; therefore, the recommendation is resolved and will be closed upon verification of the action taken.

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## Other Matters of Interest

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The COLD system is a custom or user-developed application<sup>25</sup> that was deployed over 10 years ago before the SEC implemented certain information technology system controls. CF's Office of Disclosure Support uses the COLD system to review and prepare staff comment letters and track a filing from the time of final disposition to the release of material to the public. CF's Information Technology Office, not the SEC's Office of Information Technology (OIT), is the COLD system's information owner. However, we determined that the SEC's OIT, in coordination with the CF, had not documented the COLD system's security categorization or security controls (that is, requirements) in accordance with current SEC policies.

According to OIT, the COLD system is categorized as a general support service (GSS) tool that inherits virtually all of its controls from the GSS and, therefore, does not require a separate assessment, including a system security plan. Although OIT asserted that the COLD system is a GSS tool, we noted that the GSS's system security plan does not include the COLD system as a component within the GSS's system authorization boundary. Moreover, the COLD system has several tailored security controls, such as its own access control policy and procedures and controls for account management, which are not addressed in the GSS system security plan.

We shared our observations with CF and OIT officials and, as a result, in July 2017 OIT officials stated that they had requested from the COLD system owner an updated system categorization worksheet and a system security plan so that OIT could better evaluate the COLD system. We encourage CF and OIT management to continue working together to ensure sufficient COLD system security controls exist and are properly documented.

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<sup>25</sup> According to SEC guidance, user developed applications are internally-developed minor software tools including spreadsheets, personal databases, and SharePoint workflows used to support a financial system or financial transaction.

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## Appendix I. Scope and Methodology

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We conducted the evaluation from November 2016 through September 2017 in accordance with the Council of the Inspectors General *Quality Standards for Inspection and Evaluation* (2012). Those standards require that we plan and perform the evaluation to obtain evidence sufficient to provide a reasonable basis for our findings and recommendations. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our evaluation objectives.

**Scope.** In July 2016, some members of Congress jointly requested that the SEC Office of Inspector General (OIG) and GAO review the SEC's efforts to implement the agency's climate change guidance (SEC Release 33-9106) and assess CF's comment process. Specifically, the members' July 2016 letter requested that the OIG and GAO determine the following:

1. How did the SEC implement the Climate Change guidance? What steps can the SEC take to ensure that companies understand their obligations under the Climate Change Guidance, and what has the SEC done to assess the effectiveness of the Climate Change Guidance in providing meaningful disclosures to investors?
2. While the SEC "does not track comments considered or issued by subject area," is there any possible way for the SEC to provide information about proposed or considered comments that could be covered by the Climate Change Guidance?
3. After the disclosure review process, is there any way to access or review comments that were proposed or considered on any disclosure, regardless of subject area?
4. Any recommendations on how the SEC can improve its internal controls and procedures to effectively review disclosures by SEC reporting companies.

In September 2016, OIG and GAO personnel met with congressional staff to discuss the request. Based on the September 2016 discussion, it was determined that GAO would address items 1 and 4, while the OIG addressed items 2 and 3. As a result, we reviewed the SEC's CF disclosure review process, specifically parts of the process related to developing comments and issuing comment letters.

**Objective.** Our overall objective was to review CF's policies, procedures, and processes for issuing, tracking, and facilitating public access to comment letters and related correspondence. Specifically, we sought to:

1. gain an understanding of the CF disclosure review and comment letter process;
2. determine whether reviewers may have unduly modified or waived examiners' proposed comments during disclosure reviews, and how often, if at all, reviewers

provided justification when modifying or waiving examiners' proposed comments; and

3. test whether CF followed relevant policies and procedures when conducting a disclosure review, the extent to which reviewers modified or waived examiners' proposed comments or added additional comments to include in a comment letter, and how CF tracked and monitored comments issued to a company.

**Methodology.** We conducted fieldwork at the SEC's Headquarters in Washington, DC. To gain an understanding of CF's disclosure review and comment letter process, we reviewed:

- Federal laws relevant to the disclosure review process, including the Securities Act of 1933, the Securities and Exchange Act of 1934, and the Sarbanes-Oxley Act of 2002;
- regulations that apply to disclosure documents filed with the SEC, specifically Regulation S-X<sup>26</sup> and Regulation S-K,<sup>27</sup> which CF staff noted are of principal importance for most registration statements and annual filings;
- forms filed by companies as part of their disclosure requirement, such as those for an initial public offering statement or for annual reporting requirements;
- SEC policies, procedures, and guidance for conducting disclosure reviews and issuing comments to companies, including internal review guides, process guides, review forms, and relevant internal memos; and
- information technology systems used by CF for the disclosure review and comment letter process, including EDGAR, FACTS, and COLD.

We interviewed CF staff to understand the policies, procedures, and guidelines staff follow when completing disclosure reviews and issuing comment letters; the information technology systems used by CF staff as part of the disclosure review and comment letter process; and quality assurance reviews performed by the DSO.<sup>28</sup> We also met with the SEC's Investor Advocate to determine whether investors have identified concerns related to CF's comment letter process.<sup>29</sup> Finally, we met with OIT staff as part of our review of the information technology systems used by CF.

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<sup>26</sup> 17 C.F.R. Part 210.

<sup>27</sup> 17 C.F.R. Part 229.

<sup>28</sup> We interviewed CF staff in the (1) Office of the Deputy Director for Disclosures, (2) Office of the Associate Director for Disclosure Standards, (3) Office of Disclosure Operations, (4) Office of the Managing Executive, and (5) Office of Disclosure Support.

<sup>29</sup> The Investor Advocate did not identify any concerns.

In addition, we administered a voluntary and anonymous web-based survey to 325 staff in the 11 AD offices within CF's Office of Disclosure Operations.<sup>30</sup> The staff surveyed included all individuals in those offices who conduct disclosure reviews as an examiner, reviewer, or both, and rotational staff in the DSO.<sup>31</sup> We used the survey results to determine whether examiners felt reviewers may have unduly modified or waived examiners' proposed comments during disclosure reviews, and how often, if at all, reviewers provided justification when modifying or waiving examiners' proposed comments. We also sought to determine if staff had other concerns with CF's disclosure review and comment letter process, generally. We administered the survey from March to April 2017 and received 202 responses, a 62 percent response rate.<sup>32</sup> Appendix II contains additional information about the survey, some of the survey questions, and a summary of the survey results.

We also reviewed a sample of FY 2015 CF disclosure review cases to test whether staff followed relevant policies and procedures when conducting disclosure reviews, the extent to which reviewers modified or waived examiners' proposed comments or added additional comments to include in a comment letter, and how CF tracked and monitored comments issued to a company. We used a non-statistical judgmental sampling methodology to determine the number and type of cases to review.<sup>33</sup> Specifically, we stratified the total population of FY 2015 CF disclosure reviews based on factors such as whether CF completed the review as part of its annual review cycle or as a new registrant and whether staff issued comments to a company. From each of the stratified categories, we selected 2 cases per AD office, as applicable, with a maximum number of cases for any category being 22. Based on these parameters, our sample included 95 disclosure review cases of the more than 5,000 completed by CF staff in FY 2015.

To review the 95 cases we selected, we accessed the internal workstation (internal version of EDGAR), COLD, and FACTS and assessed work papers and documentation that demonstrated how staff conducted the disclosure reviews, tracked information on the reviews, and issued comments to companies. We assessed the extent to which staff followed policies and procedures by comparing and tracking information between systems, reviewing examiner and reviewer reports in the internal workstation, and tracking company responses to comments. We also reviewed examiner and reviewer reports to determine the number of comments proposed by examiners, how often a

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<sup>30</sup> Three other CF offices also conduct disclosure reviews. According to CF management, the reviews conducted by those 3 offices are highly specialized and differ from reviews conducted by the 11 AD offices. Except to the extent that the 3 offices provided input to the disclosure reviews conducted by the 11 AD offices, we did not include their reviews in our evaluation.

<sup>31</sup> There are five permanent staff in the DSO. Additional staff work in the DSO on a rotational basis from the 11 AD offices. Our survey included rotational, not permanent, DSO staff.

<sup>32</sup> Because we provided the survey to all staff who conduct disclosure reviews in AD offices 1 through 11 and any DSO rotational staff, a sampling methodology was not required for this survey.

<sup>33</sup> The results of this sample are not projectable to the total population of disclosure reviews completed by CF staff in FY 2015.

reviewer modified or waived those comments, and whether or not the reviewer provided rationale.

**Internal Controls.** We reviewed CF's management assurance statements and risk assessments for FYs 2015 and 2016 to determine whether CF identified any deficiencies or weaknesses in its controls, and to identify internal controls relevant to our evaluation. In its FY 2015 and 2016 management assurance statements, CF did not identify any significant deficiencies or material weaknesses. CF also concluded that financial data and reporting are reliable, operations and programs are effective and efficient, and staff abides by the applicable laws and regulations in the conduct of their work.

Furthermore, in FY 2016, GAO completed its second triennial review of SEC management internal supervisory controls.<sup>34</sup> As part of this audit, GAO tested 15 of CF's 25 internal supervisory controls and did not identify any deficiencies in control design or operating effectiveness.

As a result, we determined that CF has established an effective internal control system. However, as we note in this report, staff did not always follow established policies and some policy requires greater clarification to ensure staff follow CF's internal controls. Our recommendations, if implemented, should strengthen CF's internal controls.

**Computer-processed Data.** GAO's *Assessing the Reliability of Computer-Processed Data* (GAO-09-680G, July 2009) states that "data reliability refers to the accuracy and completeness of computer-processed data, given the uses they are intended for. Computer-processed data may be data (1) entered into a computer system or (2) resulting from computer processing." Furthermore, GAO-09-680G defines "reliability," "completeness," and "accuracy" as follows:

- "Reliability" means that data are reasonably complete and accurate, meet intended purposes, and are not subject to inappropriate alteration.
- "Completeness" refers to the extent that relevant records are present and the fields in each record are appropriately populated.
- "Accuracy" refers to the extent that recorded data reflect the actual underlying information.

To address our objective, we requested access to systems used by CF as part of the disclosure review process: COLD, EDGAR (internal), and FACTS. We assessed the reliability of the data, which required us to test the completeness and accuracy of the data in each system. We did this by reviewing related documents; reviewing related

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<sup>34</sup> U.S. Government Accountability Office, *Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency* (GAO-17-16, October 2016).

internal controls; interviewing knowledgeable CF staff; and conducting walk-throughs, tracing a selection of disclosure reviews through the systems, and manually testing the data for obvious errors or missing information. We also tested like information across the systems to identify any potential errors or missing information. Based on our assessments, we found the systems to be sufficiently reliable for the purpose of this evaluation.

**Prior Coverage.** The SEC OIG has not issued any reports of particular relevance to this evaluation. However, GAO has issued the following five reports:

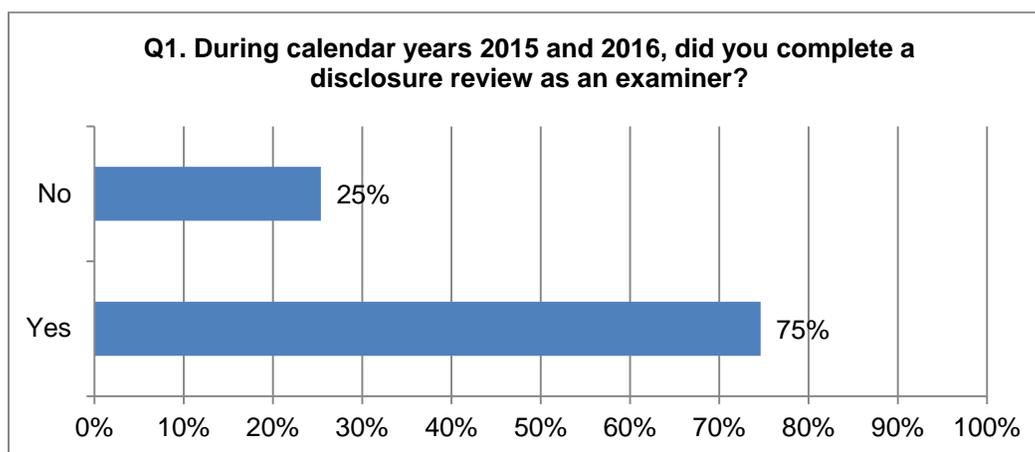
- U.S. Government Accountability Office, *SEC Should Explore Ways to Improve Tracking and Transparency of Information* (GAO-04-808, July 2004);
- U.S. Government Accountability Office, *Continued Management Attention Would Strengthen Internal Supervisory Controls* (GAO 13-314, April 2013);
- U.S. Government Accountability Office, *Initial Disclosures Indicate Most Companies Were Unable to Determine the Source of Their Conflict Minerals* (GAO-15-561, August 2015);
- U.S. Government Accountability Office, *SEC's Plans to Determine If Additional Action Is Needed on Climate-Related Disclosure Have Evolved* (GAO-16-211, January 2016); and
- U.S. Government Accountability Office, *Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency* (GAO-17-16, October 2016).

These reports can be accessed at: <http://www.gao.gov/>

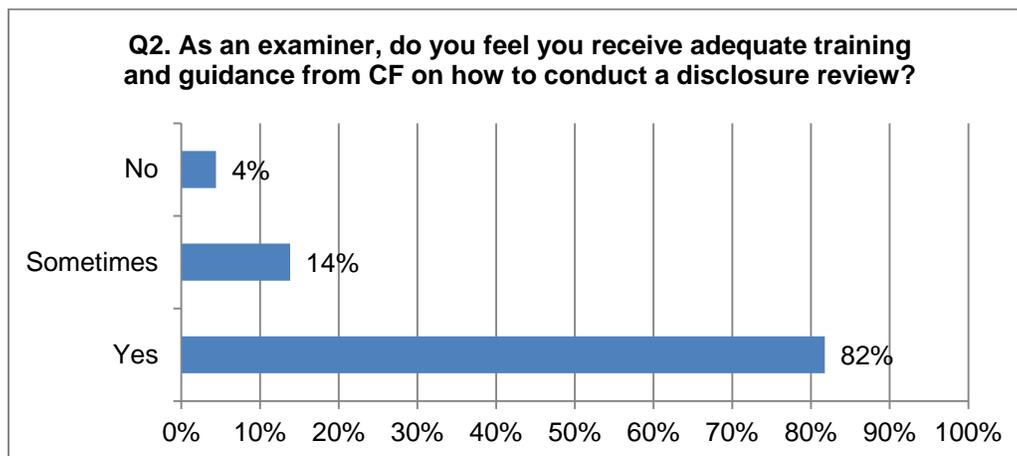
## Appendix II. Summary of Survey Results

As stated in Appendix I, we administered a voluntary and anonymous web-based survey to all 325 staff in CF's 11 AD offices and non-permanent staff in CF's DSO who conduct disclosure reviews as an examiner, reviewer, or both. The survey included 11 questions that asked staff their opinions on training and comment waivers and modifications; whether staff felt comments were unduly waived or modified; and whether reviewers provided rationale for waivers and modifications. The survey did not require respondents to answer all questions, and included close-ended questions and opportunities for staff to provide additional information to open-ended questions. This appendix summarizes the results of the 10 close-ended questions that we asked staff to answer based on their experience as an examiner and/or a reviewer.

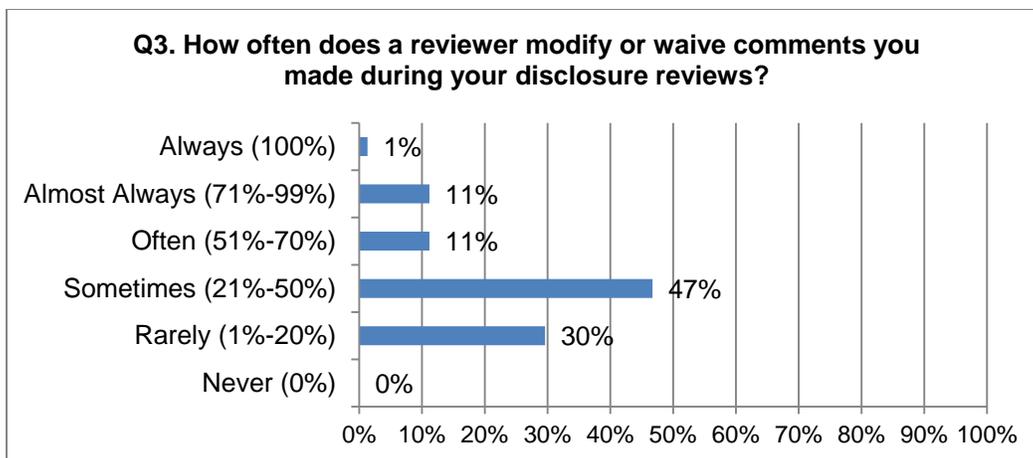
### Examiner Questions (Q1 – Q5):



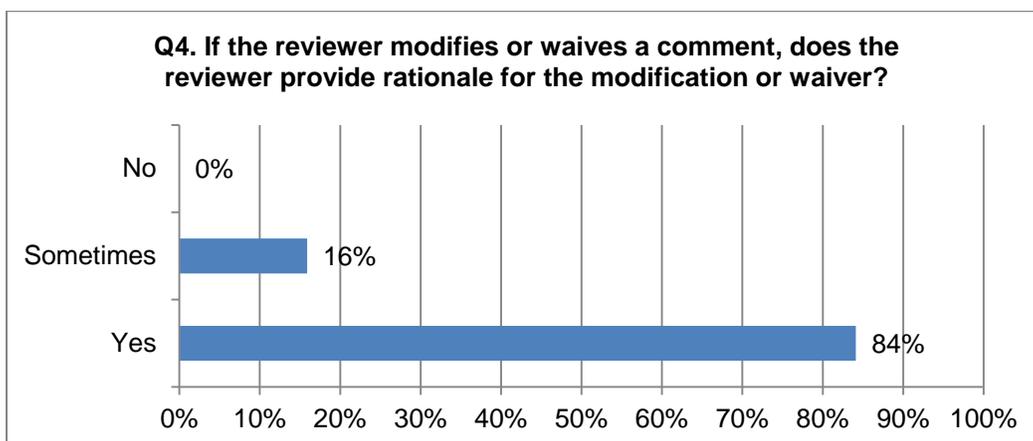
Source: OIG-generated based on 201 CF staff responses to this question.



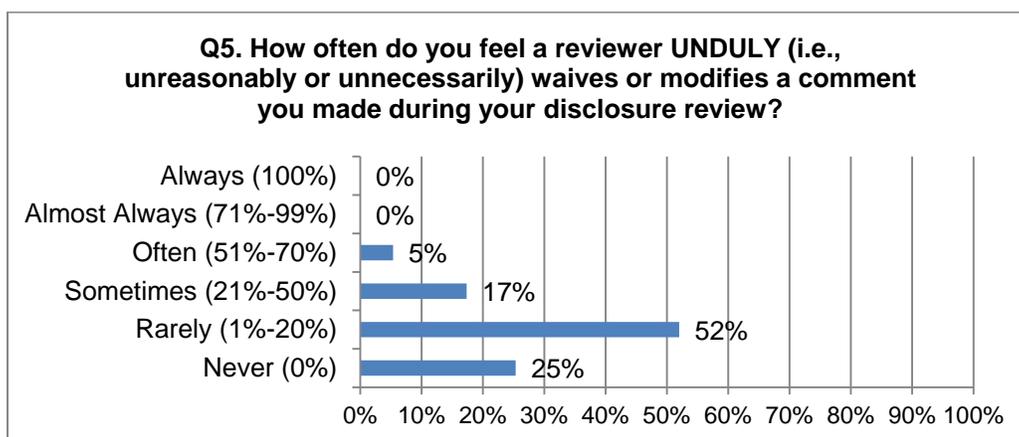
Source: OIG-generated based on 159 CF staff responses to this question.



Source: OIG-generated based on 152 CF staff responses to this question.

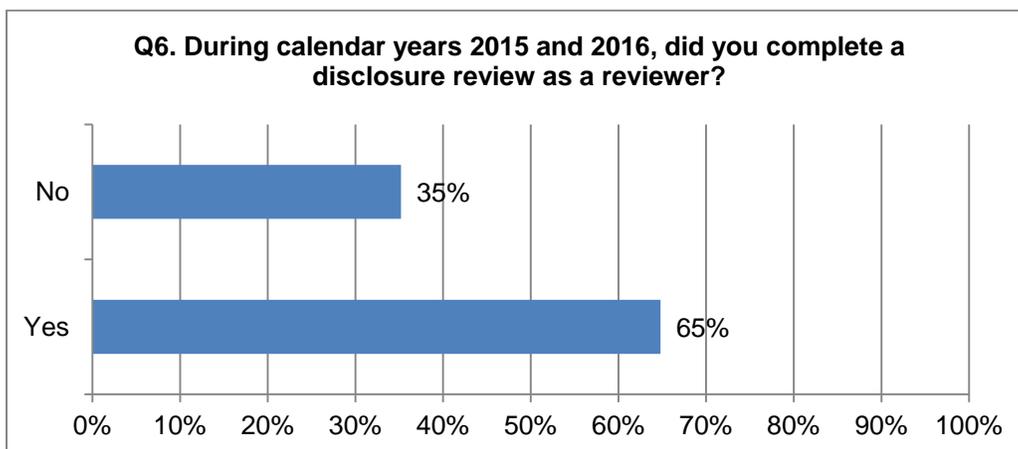


Source: OIG-generated based on 151 CF staff responses to this question.

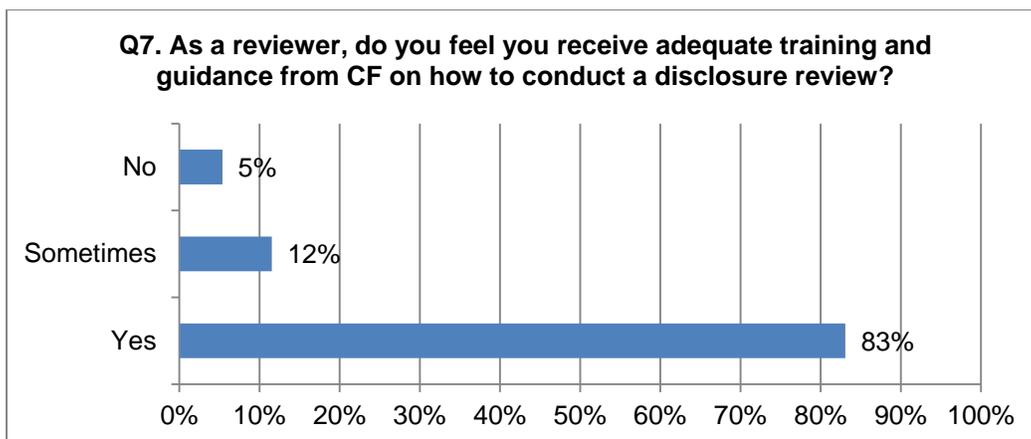


Source: OIG-generated based on 150 CF staff responses to this question.

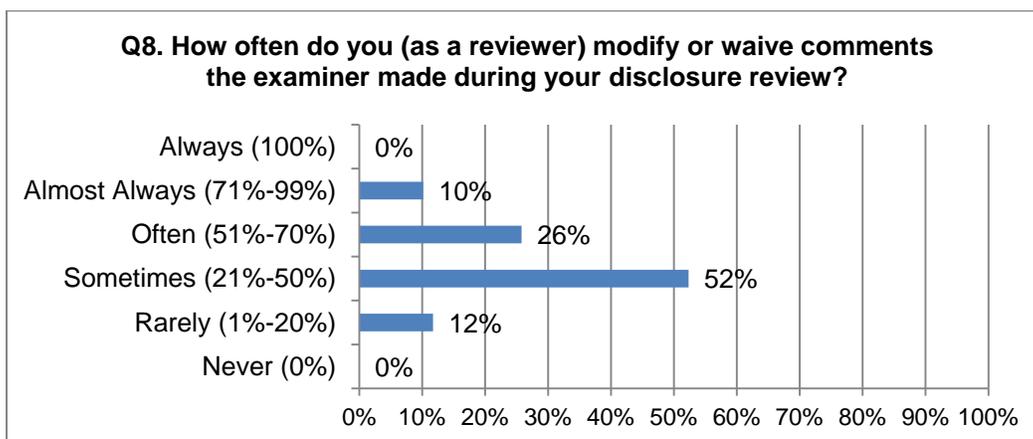
**Reviewer Questions (Q6 – Q10):**



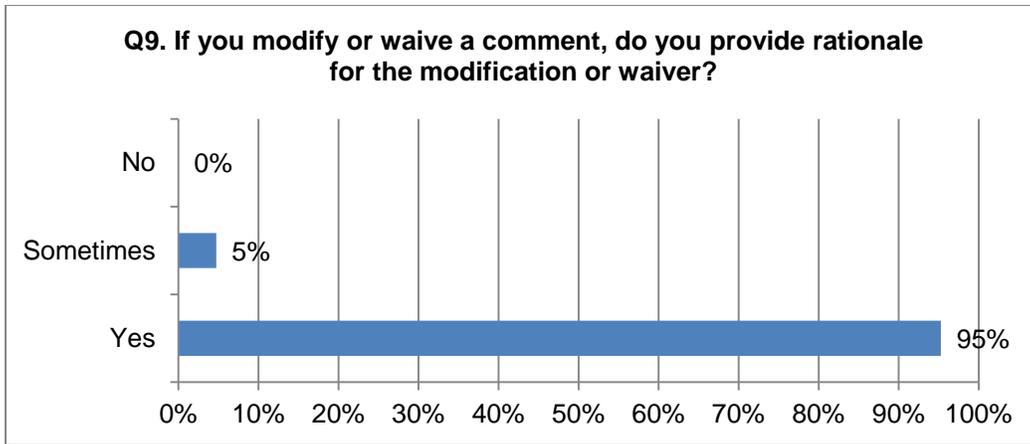
Source: OIG-generated based on 196 CF staff responses to this question.



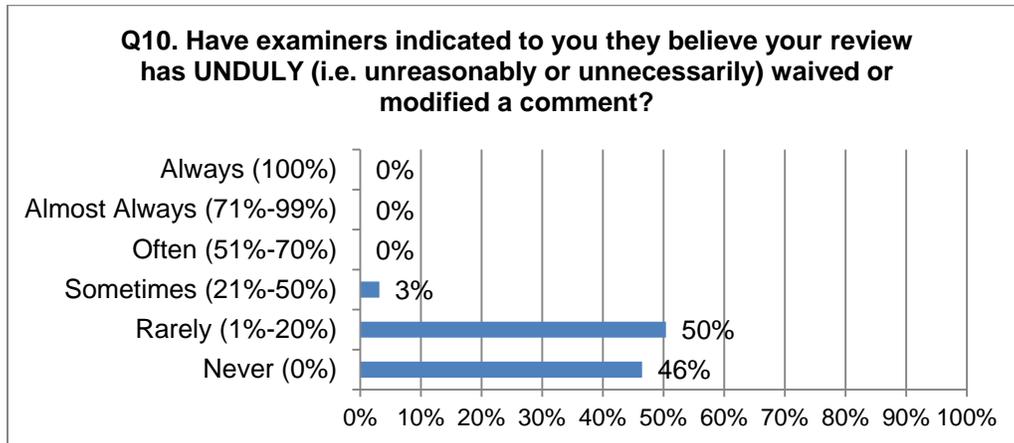
Source: OIG-generated based on 130 CF staff responses to this question.



Source: OIG-generated based on 128 CF staff responses to this question.



Source: OIG-generated based on 127 CF staff responses to this question.

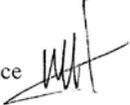


Source: OIG-generated based on 127 CF staff responses to this question.

## Appendix III. Management Comments

### MEMORANDUM

TO: Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects, Office of the Inspector General

FROM: William H. Hinman, Director, Division of Corporation Finance 

RE: Division of Corporation Finance's Response to the Office of Inspector General's Report, *Evaluation of the Division of Corporation Finance's Disclosure Review and Comment Letter Process*

DATE: September 11, 2017

The Division of Corporation Finance submits this memorandum in response to your recommendations in your report entitled *Evaluation of the Division of Corporation Finance's Disclosure Review and Comment Letter Process* (Report No. 542). In your evaluation, you undertook a detailed review of the Division's disclosure review and comment process and provided us with three procedural recommendations.

We thank you and your staff for your careful and thoughtful evaluation of the Division's disclosure review and comment process and we will take steps to implement each of your recommendations.

***Recommendation 1:*** Establish a mechanism or control for Division staff to trace all comments provided to companies—including comments received from support offices and management—to examiner and reviewer reports before issuing comment letters.

Each review of a company filing is undertaken by a team of Division staff members. The examination and review reports that team members create serve as a useful communication vehicle for them to share views on company disclosures as they develop comments on those disclosures. If the reviewer, or his or her managers, edits a final draft of a comment letter prior to sending it to a company, we do not require our staff to revise their completed examination and review reports to reflect such changes. As you note, this longstanding process does not provide us with a mechanism to trace all comments to their author. With our historical approach to a team review under the oversight of our Assistant Directors, we have not found it necessary to do so; however, once we fully implement the System for Workflow Activity Tracking (SWAT), we will be able to track the origin of comments included in the final comment letter in that system. Thus, we believe the most efficient way to implement your recommendation is in our transition to SWAT and we will do so.

***Recommendation 2:*** Establish a mechanism or control that ensures Division staff upload all examiner and reviewer reports to the internal workstation before issuing comment letters.

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We require our staff members to contemporaneously document all filing reviews by storing their examination and review reports in the internal workstation on a timely basis. Like you did, we occasionally find instances where our staff has not followed this procedure and, when we do, our staff members immediately correct the oversight and store their reports in the internal workstation. In our experience, this final procedural step does not call the review into question; rather, we have found that the required examination or review occurred and was summarized in a report. Once SWAT is fully implemented, evidence of our examination and review work will be captured in that system and will serve as the foundation for a comment letter. Thus, we believe the most efficient way to implement your recommendation is in our transition to SWAT and we will do so.

***Recommendation 3:*** *Establish detailed guidance on how examiners and reviewers should document oral comments provided to companies during disclosure reviews, including the decision to issue oral comments, the number of oral comments staff intend to issue, and the outcome of oral comments.*

We have a longstanding practice of providing companies with oral comments in instances where we do not believe developing a written comment is necessary or efficient. For example, in many instances, we identify procedural issues when determining whether to review a filing and issue oral comments reminding the company to complete those steps prior to conducting an offering. SWAT has been designed to facilitate documentation of oral comments issued by staff members. We will also establish detailed guidance on how examiners and reviewers should document oral comments within SWAT, consistent with your recommendation. Thus, we believe the most efficient way to implement your recommendation is in our transition to SWAT and we will do so.

**Major Contributors to the Report**

Carrie Fleming, Audit Manager

Suzanne Heimbach, Lead Auditor

Francis Encomienda, Auditor

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Washington, DC 20549

**Comments and Suggestions**

If you wish to comment on the quality or usefulness of this report or suggest ideas for future audits, evaluations, or reviews, please send an e-mail to OIG Audit Planning at [AUDplanning@sec.gov](mailto:AUDplanning@sec.gov). Comments and requests can also be mailed to the attention of the Deputy Inspector General for Audits, Evaluations, and Special Projects at the address listed above.