

# PLANNING THE ENFORCEMENT OF FULL DISCLOSURE RULES

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## **Executive Summary**

*The Office of Inspector General (OIG) reviewed the Division of Corporation Finance's (CF) internal controls over how it plans the enforcement (compliance monitoring) of its rules. We found that CF reviews company filings to monitor compliance with its rules and develops numerical and timeliness goals for these reviews. Also, CF told us that it has developed, and continues to revise, substantive preliminary review criteria to assist it in selecting filings for review.*

*CF could improve its planning of filing reviews if it developed a methodology for assessing the benefits of these reviews which it could then use to develop results-based goals. To address this, CF is developing a report to evaluate review results. Also, CF should revise its rulemaking procedures as appropriate to reflect its practice of asking for input on potential filing review issues during rulemaking.*

*CF should also use filing review data in its Filing Activity Tracking System (FACTS) more effectively and explore ways to link the various CF databases. In addition, as appropriate in its action memoranda, CF should tell the Commission how it plans to monitor compliance with proposed rules.*

## **Scope and Objectives**

Our audit objective was to evaluate CF's controls over how it plans to enforce its rules. We interviewed Division staff and reviewed relevant laws, regulations and other documentation. Also, we reviewed and analyzed information related to rules issued in fiscal year (FY) 2002.

We conducted the fieldwork between May 2002 and March 2003, in accordance with generally accepted government auditing standards.

## **Background**

CF develops disclosure requirements and reviews corporate filings to monitor compliance. Also, it occasionally reviews disclosures to evaluate compliance with specific rules (special studies).

Filing reviews alone do not improve compliance or disclosure. Filing reviews result in review comments. Companies must then act on the review comments by adding, changing or removing information related to the filing.

CF plans the total number of reviews for each year and sets timeliness goals. CF then tracks the review groups' progress in meeting their targets.

The Sarbanes/Oxley Act of 2002 (Sarbanes/Oxley) required CF to develop more disclosure rules and imposed additional filing review requirements. CF's planning processes are now even more important to ensure that it effectively implements and oversees these additional requirements.

## ***Audit Results***

We found that CF sets numerical and timeliness goals for its filing reviews, but does not have a methodology to assess the benefits of these reviews or to set goals for obtaining the desired benefits. Also, CF's rulemaking procedures do not appear to reflect its practice of getting input on potential compliance monitoring issues during the rulemaking process. Its existing rulemaking procedures tell staff to consider compliance monitoring after rules are issued.

Further, CF does not always input, analyze or use review results data in the FACTS and maintains program-related databases that are not linked and do not share data.

In addition, in its action memoranda, CF does not explain routinely to the Commissioners how it plans to monitor compliance with proposed disclosure rules.

### **Filing Review Benefits**

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CF plans to complete 5,825 issuer reviews in FY 2004. However, CF did not set results-based goals for these reviews. It had not developed a methodology to assess the benefits of these reviews or to set goals for obtaining the desired benefits. The Government Performance and Results Act of 1993 (GPRA), implemented by the Office of Management and Budget (OMB), requires Federal programs to develop goals for their program results.

CF informed us that it is developing a report that will provide retrospective evaluations of filing reviews. These evaluations will assess the benefits provided by the reviews and help CF to develop results-based goals. Also, CF is developing new performance measures for GPRA and Commission reporting purposes. These measures will reflect CF's goals for achieving the benefits identified in its filing review evaluations. In addition, CF will be better able to systematically identify obstacles to providing these benefits, assess the potential impacts of not providing them, and develop appropriate action plans (risk assessment).

#### **Recommendation A**

CF should develop a methodology for assessing the benefits of its filing reviews.

#### **Recommendation B**

CF should develop goals, including GPRA goals, to achieve the desired benefits from its filing reviews and measure progress towards these goals.

### **Recommendation C**

CF should develop a risk assessment methodology based on its desired benefits and goals.

## **Procedures**

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CF's rulemaking procedures do not clearly state that compliance monitoring should be considered during the rule drafting stage. The procedures state that compliance monitoring should be considered after rules are issued. However, we were told that the rulemaking and filing review groups coordinate on compliance monitoring throughout the rulemaking process. The procedures do not reflect actual practices.

### **Recommendation D**

CF should consider clarifying its rulemaking procedures as appropriate to reflect its practice of considering compliance monitoring during the drafting of rules as well as after adoption of rules.

## **Compliance Information**

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CF's FACTS system includes codes to indicate that CF issued comments, requested amendments or supplemental information and noted problems and material issues. CF, however, does not always input, analyze or use this data to develop results-based information as required by GPRA or to identify trends or potential problem areas.

Also, CF maintains filing-related data in more than 10 different databases. These databases, each developed for a specific program purpose (e.g., foreign filings, tender offer filings), were not designed to share information with each other. CF's data and systems should be designed to support information sharing and strategic planning. While linking the various databases could be difficult, CF could benefit. Filing reviewers could research information faster. Also, CF management could more easily obtain and review reports that combine information from across the Division.

### **Recommendation E**

CF should input, analyze and use its FACTS data to develop results-based information.

### **Recommendation F**

CF should explore ways to link the information in its various databases.

## **Compliance Monitoring Plan in Action Memoranda**

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CF submits proposed rules to the Commission under the cover of "action memoranda." Action memoranda summarize the issues covered in the proposed rule.

These memoranda generally do not include information on how CF planned to monitor compliance with the rule. While this information may be unnecessary in some instances (e.g., for rules to implement EDGAR filer manual updates), CF could include this information when appropriate (e.g., for rules affecting disclosure, imposing filing requirements, etc.).

### **Recommendation G**

CF should include information in its action memoranda to the Commission on how it plans to monitor compliance with rules that affect disclosure. If monitoring plans are inappropriate due to the nature of the subject matter of the rule, CF should explain the absence of monitoring plans in the action memorandum.