

# IMA Responds to the SEC

IMA President Margaret Butler sent this letter to the SEC, requesting the Commission to expand the definition of “financial expert” under the Sarbanes-Oxley Act. As a result of this and other corporate requests, on January 15 the SEC voted to expand the definition and changed the term to “audit committee financial expert.”

December 31, 2002

Mr. Jonathan G. Katz

Secretary

U.S. Securities and Exchange Commission

450 Fifth Street, N.W.

Washington, DC 20549

Subject: File No. S7-40-02

Dear Mr. Katz:

The Institute of Management Accountants (“IMA”) appreciates the opportunity to respond to the Securities and Exchange Commission’s Proposed Rule: Disclosure Required by Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002, Release nos. 33-8138 and 34-46701. Overall, we are supportive of the Commission’s initiatives in the area of reforming corporate governance and internal controls and procedures for financial reporting. The focus of our comments is on the definition of a financial

expert that has been proposed by the Commission. We are concerned that the proposed definition is more restrictive than necessary in determining whether an audit committee member qualifies as a financial expert. We believe that the qualifications identified in the Sarbanes-Oxley legislation are a useful starting point for assessing a candidate's suitability for serving in this important role, but they are by no means determinative. In addition, we believe that there are other considerations that are not identified that also bear on this decision, which are discussed further below. It is in the public's best interest that the most qualified financial experts are identified to serve on audit committees. We are concerned that the restrictive nature of the criteria will have the opposite effect, by discouraging otherwise capable individuals from seeking these positions because they know that their prospective employers will be unable to select them. Our specific comments follow.

The IMA supports the requirement for disclosure about financial experts serving on a company's audit committee. With the sudden loss of investor confidence in the quality of accounting and financial reporting by public companies, investors will naturally place more emphasis on the audit committee as a steward of investor protection. It is therefore important for investors to have relevant information about the financial expertise and backgrounds of the individuals serving on the Audit Committee.

The IMA notes that the initial focus on audit committees began in 1999 when the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees recommended that the NYSE and NASD require listed companies to have an audit committee comprised of a minimum of three directors, each of whom is financially literate, and further that at least one member of the audit committee have accounting or related financial management expertise. The Committee stated that the audit committee clearly has a more recognizable need for members with accounting and/or related financial expertise, where expertise signifies past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which demonstrates the individual's financial sophistication. While the recommendation resulted

in new listing standards being adopted, companies have not been as rigorous as they might have been in interpreting "financial literacy." Accordingly, changing the behavior of companies in seeking the right financial talent for the audit committee remains a key challenge.

As the Commission indicated in the proposed rules, for an audit committee member to serve in this important role, they must possess the level of financial expertise necessary to "...serve as a resource for the audit committee as a whole in carrying out its functions." We believe in order to perform the role of financial expert well, it will be essential for audit committee members to have a depth of understanding accounting and financial reporting that will permit them to critically assess their company's policies and disclosures and to challenge inappropriate practices. Because they also have responsibility for oversight of internal and external audit some understanding of the auditing literature is also an important consideration. Finally, and perhaps most importantly, is an indication of the individual's commitment to ethical conduct. In our opinion, an individual that possesses world class financial expertise will not succeed in fulfilling the desired role as a director without having the will to stand up for what he or she knows is right. At some level, the failures of the recent past are equally

attributable to directors who were unwilling to take a contrary position to management on aggressive accounting and financial reporting practices.

The IMA believes that the proposed rules defining the “financial expert” need to focus on all of the relevant facets of experience without being overly prescriptive about what is required. Those rules should allow for experience obtained in functions outside those narrowly defined by the factors listed in the proposal in identifying qualified financial experts. For example, IMA believes that individuals holding appropriate professional certifications such as the Certified Management Accountant (CMA) or the Certified in Financial Management (CFM) may possess the requisite knowledge, skills, and abilities to be effective in serving as financial experts. Indeed, one of the earliest individuals to receive the CMA certification recently was named the new Audit Committee Chair of WorldCom, Inc. who will be involved in establishing and monitoring their controls. Our reasoning in support of this view follows.

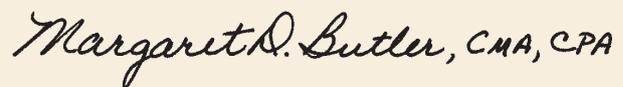
The CMA and CFM contribute broad-based management perspectives to an entity’s operations. In fact, the depth and breadth of the examinations make it necessary for successful candidates to demonstrate mastery in the entire spectrum of areas discussed above rather than a narrow focus on auditing. All CMA/CFM certificate holders have passed an examination covering the topics needed by today’s financial managers. For example, topics covered for the CMA and CFM include: (1) Economics, Finance, and Management, (Part 1); (2) Financial Accounting and Reporting (Part 2 CMA); Corporate Financial Management (Part 2 CFM); Management Reporting, Analysis, and Behavioral Issues (Part 3); and Decision Analysis and Information Systems (Part 4). Ethical considerations based on IMA’s Standards of Ethical Conduct are tested throughout the examination parts. Under the Code’s Objectivity expectations, for example, the CMA/CFM has a responsibility to disclose fully all relevant information that could reasonably be expected to influence an intended user’s under-

standing of the reports, comments, and recommendations presented in the financial information. In July of this year, the IMA asked its members to reaffirm their commitment to compliance with the IMA’s Standards of Ethical Conduct.

Recognizing the need to certify a professional’s proficiency in management accounting and financial management, the IMA created the CMA certification program in 1972 and the CFM program in 1996. These globally recognized designations are on-line, real time examinations at national and international exam sites. IMA has been serving the business community and the accounting profession since 1919, and current membership exceeds 67,000. More than 24,500 professional accountants and financial managers have earned the CMA certification while 2,600 hold the CFM. International interest in the IMA and our certifications has grown rapidly in recent years, as management accounting issues have become an increasingly important component in a successful global economy. As a result, approximately 10% of IMA members reside outside the U.S. and have earned CMA and/or CFM designations. Many CMAs and CFMs hold dual certifications, i.e., CPA, CFA, and/or CIA.

We suggest that the proposed financial expert requirements be modified to ensure that individuals with this kind of experience and demonstrated commitment to ethics are not automatically disqualified from serving as financial experts on audit committees. We would be pleased to meet with representatives of the Commission to further discuss how the CMA and CFM designations are responsive to identifying and attracting qualified financial experts to audit committees of public companies.

Respectfully submitted,



Margaret D. Butler, CMA, CPA  
President, Institute of Management Accountants