Interview

A VIEW FROM

NEW SEC CHIEF ACCOUNTANT CONRAD HEWITT

BY RAMONA DZINKOWSKI

On July 24, 2006, Chairman Christopher Cox welcomed Conrad Hewitt into the fold as the new chief accountant of the Securities & Exchange Commission (SEC). Hewitt has more than 30 years' experience as a leader of one of the world's largest accounting firms, a strong background as a regulator, and recent service as chairman of 10 audit committees. From 1995 to 1998, he was California's superintendent of banking and commissioner of the California Department of Financial Institutions. From 1972 to 1995, he was the managing partner of Ernst & Young and its predecessor firm, Ernst & Ernst, in the firm's Northern California (1986-1995), Seattle (1979-1986), and Honolulu (1972-1979) regions. He began his career as an auditor in the U.S. Air Force at Strategic Air Command Headquarters.

In this exclusive interview, Hewitt shares his views on some of the current priorities and other pressing issues facing the SEC at this time.

SARBANES-OXLEY ACT SECTION 404

RD: The May 11 Roundtable demonstrated the need for specific "how to" guidance beyond the COSO framework in implementing Section 404. Can you comment on the status at this time (post-July 11 concept release) and the agenda going forward for all companies? What are the key considerations on the part of the SEC and Public Company Accounting Oversight Board (PCAOB) in amending Auditing Standard 2 (AS2)?

CH: We're waiting until the end of the comment period and looking forward to using that feedback to generate some guidance for management on performing the assessment and so forth. I think we know there's a need for this guidance, and it's a very important project for us. Of course the PCAOB is working very diligently to amend AS2, and their representatives have made it clear they want to integrate changes into the new AS2 guidance to improve the efficiency of the AS2 process. I'm sure that the changes in the amendments will ensure that the audit of internal controls is focused on the right areas. The focus should be on the high-risk areas more than the low-risk or moderate-risk areas. Thus, the results still should be significant benefits of internal control reporting that can be achieved without the unnecessary excessive-cost situation.

XBRL

RD: The SEC continues moving forward toward the adoption of XBRL by U.S. companies. It has issued a formal request to software vendors for help in developing an XBRL-based analytical tool that it could add to the website where public company financial filings are posted. On one hand, the auditing, IT, and investment communities may be touting XBRL as a panacea for collecting and analyzing information and improving transparency. On the other, corporate America isn't yet convinced of the benefits of XBRL, given the uncertainty over the

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DISCUSSES REGULATORY ISSUES.

costs associated with identifying and tagging the financial information they generate. In your view, what role will adopting XBRL play in restoring investor confidence in America, and who will benefit most?

CH: XBRL seems like a very logical and efficient process to accumulate the data. The data has to be segmented properly for everybody to access it and use it for their own needs, whether it be investors or banks. XBRL has the potential to access and analyze just by automation of the tasks that must be done manually today. Comparisons across companies, across industry lines, and within industry should be easier, and investors will have the ability to review and consider more information in a timely manner. That's one of the objectives of it. We would expect that investors at all levels of the market should be able to benefit from this. I understand that the Federal Reserve and the FDIC [Federal Deposit Insurance Corporation] are already using XBRL fairly successfully, but that's a different situation. They have monthly call reports, the data is well segmented to begin with, and it is fairly

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homogenous compared with other types of industries or companies.

RD: What ongoing measures will the SEC put in place to help companies understand and implement XBRL?

CH: We're looking at that and reviewing it. We want to see that it gets launched as much as possible. We're seeing how we can be a partner in that process, and that is Chairman Cox's concept also.

RD: Do you foresee a time where companies that are not XBRL compliant will come under greater scrutiny than XBRL-compliant companies from the SEC, auditors, ratings agencies, and the investor community at large?

CH: That is difficult to say at this point in time. It is a fairly hypothetical question. I expect that those companies using XBRL might have a larger following in the investment community than those not using it. It depends on the cost of adoption for all size companies, small and mid-cap companies as well as large-cap companies. If the cost is low, then I'm sure everybody will use it. But if the cost is high, then some of the small public companies might not benefit from it.

RD: Do you see this moving into the regulatory realm at any point?

CH: I think someday it may be if it is common usage and it gives us more information to use and easier access to that information, comparatively speaking, among companies. Then we'll certainly use it.

RULEMAKING AT THE SEC

RD: Former SEC Acting Chairman Cynthia Glassman has recently commented that she would like the SEC to intensify its focus on issues such as auditor concentration in the accounting industry. What, in your view, is the role of the SEC and the office of the chief accountant in minimizing the negative impacts of this oligopoly?

CH: Of course we are concerned about the negative impact stemming from the fact that there are so few large auditing firms. I started with the Big 8, then I retired with the Big 6, and now there are the Big 4. But the market dynamic has had a lot to do with that, just as have the large size of companies and the need for global firms. U.S. companies doing business overseas have changed the marketplace of how you audit, what capital you need to audit, and the capability you need to audit. We are interested as to whether our rules and regulations contribute to this.

GLOBAL EXCHANGE REGULATION

RD: Do you see an eventual convergence of international securities regulations?

CH: Securities regulators around the world have been working together for over 20 years now. The International Organization of Securities Commissions (IOSCO) is constantly trying to find an effective means to regulate the markets and eliminate differences in regulation. The question is how this can be done without harming investor protection. That is not easy to do. I was a state financial institution regulator for the state of California, [along] with 49 other state regulators. We all had different regulations and different laws. We were trying to do the same thing and that was protecting the depositor. So I think we will always have differences, but the theme is to protect the investor.

RD: Can more interpretive guidance and principles-based standards work in the U.S. under the current environment of ultra-conservatism in public accounting?

CH: It remains to be seen, but I think that we all want principles that reflect the accounting economic substance of the transaction. Maybe over the years the rules have overtaken the principles. There are a lot of forces that drive the desire for more and more guidance. It's clear that accountants—and I'm talking about management accountants—accountants in companies, not just public accountants—are motivated these days to certainly make sure that their method of accounting is acceptable. It's kind of interesting because not more than six to eight years ago accountants felt that anything that wasn't specifically prohibited was okay, meaning that overly aggressive interpretations of the literature could emerge. Now I think it is in the other direction, meaning that accountants think that anything that isn't specifically permitted must be wrong, and [this] potentially results in some overly conservative interpretations. I believe, and my staff does too, that the right answer is of course between these extremes. Accountants need to become more comfortable applying the literature that is out there in ways that are consistent with the underlying principles and the economic substance of the transaction and provide transparent information to investors.

PROJECTING PENSION OBLIGATIONS

RD: Recently the Financial Accounting Standards Board (FASB) decided to require companies to report on future pension liabilities (projected benefit obligations), taking into consideration future pay increases. Projecting

future salary increases doesn't represent a present liability and thus doesn't belong on the balance sheet, according to pension actuaries and corporate executives. How do you see this debate unfolding, and what are some of the issues that are likely to arise with respect to disclosure and comparability of financial reports between companies?

CH: FASB issued PBO [Statement of Financial Accounting Standards (SFAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)"] as phase 1 of the pension project. It's a continuation of the measurement that was adopted in Statement 87 ["Employers' Accounting for Pensions"] many years ago, except it was disclosed in a footnote basically. The debate back then was about the appropriate measurement attribute. It was a long one, and I anticipate that there will be significant discussion on phase 2 of this project. I think it is important to note that when the FASB added pensions to its agenda, it was stated that the measurement questions would be handled in phase 2, with the objective only to get the current measurement on the books instead of in the footnotes, where it has been for many years. I see this debate as very similar to the one that was held concerning stock options. I see an analogy between the two situations here.

AS THE NEW SEC CHIEF ACCOUNTANT

RD: What are your objectives going forward as the new chief accountant at the SEC? How do they vary from the objectives of your predecessors?

CH: I know my predecessors have always done an outstanding job, including the Acting Chief Accountant Scott Taub, whom I look forward to working with. I was a former regulator as a superintendent of banks and a commissioner of the Department of Financial Institutions for the state of California. I gained a tremendous experience that will help me in my role as a regulator here as the chief accountant. Also, I have a great deal of practical experience as a previous chairman of 10 audit committees, various other committees, and 10 boards. Prior to that, I spent 33 years in the public accounting arena. Those are all experiences that I will bring forth to protect investors, and that is the main objective of my role.

RD: In your view, what is the present and future role of the SEC in restoring investor confidence in the U.S.?

CH: I don't know if they have to restore investor confidence right now. It seems that in the current marketplace here in the United States, investors seem to be well served with a lot of information. The investors have been helped in the U.S. with the 10-K and 10-Q filings, which have been more timely. It's important to remember that there will always be a situation where a specific company does not abide by the regulations or law or accounting principles or pronouncements. That creates a problem, especially if it's a large company. We can't always prevent that. Just by the sheer number of companies out there, it is going to happen.

RD: Can you speak to the top five SEC priorities for the coming year?

CH: I believe that we will be coming out with a couple of items soon, like Staff Accounting Bulletin 108, as we call it, on corrections of errors in previous years. We plan to announce some guidance for external auditors and accounting personnel on various situations concerning FASB 123(R) ["Share-Based Payment"] and the various practices out there in terms of dating—the measurement date of stock options and those types of things. Just staying abreast with what's going on with FASB's current projects is a high priority of ours. We are also working with the PCAOB on amending AS2 and working with the International Accounting Standards Board on the convergence of the International Financial Reporting Standards and U.S. GAAP.

RD: What is the role of the professional accounting bodies/associations in achieving the SEC priorities?

CH: We work very closely with the accounting associations and accreditation bodies, and they have been very cooperative. I see it as a partnership almost. Our priorities are very similar on both sides. In terms of training, things change over the years. For example, in auditing, I remember when statistical sampling came into vogue. That was a big change, and people had to be trained on how to use statistical sampling. I see items like that evolving all the time. To me, training for management accounting and finance personnel, as well as for public accountants, should be a very high priority for everybody. ■

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