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By Stephen Barlas, John Fusco, Kevin Johns, Mike Osheroff, Kathy Williams

GOVERNMENT

SEC Final Rule on Use of S-3

By Stephen Barlas

Here is a final rule connected to the Dodd-Frank Act (DFA) that affects the ability of corporations to issue debt securities. The rule comes out of Section 939A of the Act, which requires the U.S. Securities & Exchange Commission (SEC) to remove any reference to credit rating agencies from its rules. The SEC has a number of separate regulatory proceedings under way stemming from that requirement. The one we are concerned with here makes some changes for companies who offer nonconvertible securities, other than common equity, and want to register that offering on Form S-3.

Many large SEC-reporting subsidiaries of well-known seasoned issuers (WKSIs) currently rely on the investment grade eligibility criteria in Form S-3. The key requirement in the SEC proposed rule was that to use Form S-3, a company must have issued at least $1 billion in nonconvertible securities, other than common equity, in primary offerings for cash over the prior three years (as of a date within 60 days prior to the filing of the registration statement). The SEC proposed that standard as a way of assuring investors that the company issuing the bond is "widely followed" in the investment community. But that test perturbed many companies. Michael J. Cave, president of Boeing Capital Corporation, told the SEC, "That test would impede the cost-efficient and flexible access to capital currently enjoyed by many widely followed issuers of public debt. Many such companies do not publicly issue $1 billion in debt securities every three years." He asked the SEC to supplement that criterion with an alternative providing that a majority-owned subsidiary of a WKSI would be eligible for Form S-3 if that subsidiary has at least $1 billion in consolidated assets or at least $1 billion in outstanding publicly issued debt securities.

The final rule the SEC quietly issued on August 11 provides two alternatives that may allay the concerns of Boeing and many others, particularly energy company subsidiaries, who were particularly worried about the original proposed rule. The final rule allows use of S-3 when (1) the issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of nonconvertible securities, other than common equity, issued in primary offerings for cash, not exchange, or (2) is a wholly-owned subsidiary of a WKSI as defined in Rule 405 under the Securities Act.

The "wholly-owned subsidiary language" in alternative 2 stops short of what many WKSIs wanted, which is deletion of the "wholly-owned" qualifier. The SEC declined to do that. Sean Davy, managing director at the Securities Industry and Financial Markets Association, says, "The SEC adopted some significant suggestions, but not all, that the industry and issuers put forth. We believe the changes do reduce the impact on issuers and hope the remaining impact is not more significant than estimated—which will be borne out only over time."

PCAOB Considers Auditor Rotation

In August, the Public Company Accounting Oversight Board (PCAOB) took the first step in requiring companies to rotate auditors when it issued a Concept Release soliciting public comment on ways that auditor independence, objectivity, and professional skepticism can be enhanced, including through mandatory rotation of audit firms. With comments due in mid-December, there will be a fairly long lead time on this. If there is to be a standard, don't expect it for a year or more.

The PCAOB seems to be taking a more aggressive stance these days under Chairman James Doty, who took the post in January 2011. Doty served as general counsel

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at the SEC from 1990 to 1992, during President Bill Clinton's first term. The PCAOB chair position had been vacant for about 18 months prior to Doty taking over. Daniel Goelzer, a Board member, warmed the seat as acting chairman.

Mark Olson had been chairman up until mid-2009. Prior to heading the PCAOB, Olson served nearly five years as a member of the Federal Reserve Board of Governors and the Federal Open Market Committee. He was a partner at Ernst & Young before that. His frame of mind was an accountant's, and Doty's is a litigator's. That's a big difference, and it's reflected in part by Doty's statement accompanying the auditor rotation Concept Release: "Since the PCAOB began its work, our inspectors have identified hundreds of audit failures." He wonders out loud whether auditors face pressure to protect long-term client relationships to the detriment of investors and our capital markets.

Aside from considering a standard on auditor rotation, the Doty PCAOB issued an earlier Concept Release in June that presented several alternatives for changing the auditor's reporting model and seeking comment on these or other alternatives that could provide investors with more transparency into the audit process and more insight into the company's financial statements or information outside the financial statements. That comment period closed on September 30. The PCAOB held a roundtable on September 15 to get views on the alternatives, which include (1) an auditor's discussion and analysis, (2) required and expanded use of emphasis paragraphs, (3) auditor assurance on other information outside the financial statements, and (4) clarification of language in the standard auditor's report.

A Good Issue

This correspondence is being sent to compliment the July 2011 issue of *Strategic Finance*. Being retired after a successful career, and having not only a bachelor's in Accounting but also a master's in Economics and certified as a CMA for the last 27 years, I still find it daunting to keep up in a constantly evolving managerial accounting environment. Not only did the articles help me in this respect, but I was pleasantly surprised to read articles related to the private investing activities that currently occupy a substantial amount of my time (including capital losses, hedge funds, and not-for-profits).

Keep up the good work!

Kevin Johns, CMA

Correction to September Taxes

I read the article on the real tax rate on precious metals in the referenced publication [Taxes, September 2011]. In the fourth paragraph from the end there appears to be an error. It states that for Platinum the rate remains high at 33% and then indicates that is higher than the marginal tax rate on ordinary income. The marginal tax rate on ordinary income is 35%. I believe that should have said higher than the rate on collectibles, which is 28%. Overall a very good article.

John C. Fusco, Jr., CPA

Sharing Your IMA Life

Most IMA® members share a strong spirit of camaraderie. What have your experiences as a member of IMA been like? Do you have a story about them you'd like to share? If so, please consider writing an IMA Life column that will be published in *Strategic Finance*. You can be a student member, a young professional, in the midst of your career, or retired. If you would like to write an IMA Life article, please e-mail Kathy Williams at kwilliams@imanet.org.

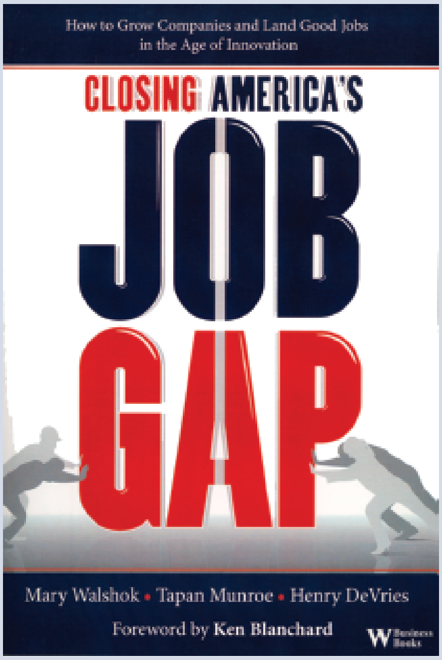
BOOKS

Overcoming U.S. Unemployment

During the 1950s and 1960s, the United States was the top economic powerhouse in the world, but traditional industry and employment have been declining for many years. Other countries have increasingly come to supply both the brawn and brains of traditional production and new industry. The U.S. has become a debtor nation that buys its goods on credit from others while its own workforce languishes with stubborn unemployment.

What can be done? In *Closing America's Job Gap*, Mary Walshok, Tapan Munroe, and Henry DeVries examine regional areas that have escaped the current recession and enjoy robust employment opportunities in order to identify potential solutions to increasing unemployment. The authors examine the unique factors that combined to promote economic growth in these areas and identify four overarching themes: basic research, financial support, community attraction, and ready employee skills. Sections of the book are focused on these areas and on individual employees who participated in the economic resurgence.

Particular emphasis is placed on covering the lack of available workers with the right skills. After all, not many university or investment firm presidents will be reading *Closing America's Job Gap*, but there will likely be many workers wondering what they can do to get or keep that job. And what they can do,



according to the authors, is focus on continuing education and skill development, particularly in areas that are in current demand or will be shortly in the future. The authors assert that the problem isn't just that there aren't enough jobs, it's that the new jobs being created require different, newer skill sets.

It used to be that a degree from a good university was the key to lifelong employment. But in a time when entire fields of industry are becoming obsolete or being sent overseas, continuing education to meet new challenges is essential. Courses covering almost any field can be taken from any location, whether it's local community colleges, in the evening and on weekends at universities, or online education. But which courses to take, and what additional skills should be developed? The natural inclination is to augment your current skills, but the authors emphasize expanding those skills to meet future challenges—finding the skills to keep pace with innovation and progress. There are economic risks in identifying and developing talents for which there is no current demand, but the alternative is to play it safe with a skill set that quickly becomes outdated.

Truly closing America's job gap will take investment in and cooperation of research institutions, financial providers, community leaders, and employees willing to continually learn new skills and even change fields. As a nation, the U.S. can't rest on its past laurels as it imports the goods and services it needs and exports its standard of living. It can't reinvent its economy simply by encouraging the philosophy of "every man for himself." By bringing all of its economic and social resources together to provide the goods and services of tomorrow and good jobs for all, the authors argue, it can make progress. It's certainly a risky proposition, but in today's modern economy, we are no longer competing with just the Joneses but rather with the entire world.—Mike Osheroff, osheroff@wa-net.com