

# Unlocking the potential of disclosure committees

Leading practices and trends



# Contents

Introduction	1
Executive summary	3
Survey results and interviews	7
▶ Characteristics of respondents	8
▶ Organization of the disclosure committee	13
▶ Function of the disclosure committee	20
▶ Interactions with external auditors, other external advisors and the audit committee	23
▶ Effectiveness and streamlining	24
▶ Challenges, strengths and weaknesses, efficiency, complexity	25
Emerging SEC data trends	28
Appendix A: Jump-starting a disclosure committee – an eight-step road map to success	30
Appendix B: Sample disclosure committee charter	31
Appendix C: A self-assessment checklist	33
Appendix D: Excerpts from Sections 302 and 906 of the Sarbanes-Oxley Act	34



# Introduction

Accounting rules and Securities and Exchange Commission (SEC) regulations governing corporate reporting keep changing, with predictable results: as the goal posts continue to shift, disclosure burdens mount. New regulations and accounting standards enacted in the wake of high-profile financial failures meaningfully expanded the scope of corporate disclosures and accountability, while also stepping up investor and government scrutiny. At the same time, companies keep moving into new markets around the world, increasing the volume and complexity of reporting requirements.

These burdens fall heaviest on the chief executive officer (CEO) and chief financial officer (CFO), who must certify the validity and completeness of disclosures under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 (SOX). But do they have all of the information they need to fulfill that mandate?

With so much in flux, and so much at stake, it is imperative that companies take a fresh look at their reporting processes to make sure that their disclosures are appropriate and robust, that they meet regulatory and investor expectations and that their CEO and CFO are being fully supported.

As part of that reexamination, companies should explore the role that disclosure committees can play to underpin and help ease disclosure burdens on their audit committees and finance functions, and improve their disclosure controls.

With that goal in mind, the Financial Executives Research Foundation (FERF) – in conjunction with EY – has prepared this report about disclosure committees, to examine why companies have them, how they are positioned in the overall organization and in what ways they are used to drive efficiency, effectiveness and accountability.

The project began earlier this year when we sent a web-based survey to senior financial executives who are members of Financial Executives International (FEI) and to clients of EY. The survey consisted of more than two dozen questions about disclosure committees. We received more than 100 responses from companies in a wide variety of industries. Eighty-one percent of the respondents are publicly traded companies, and more than half have revenue exceeding \$2 billion a year.

To complement those results, we conducted in-depth interviews with more than a dozen experts who have extensive experience in this area – as committee members, non-member participants, audit committee members and external counsel.

Although disclosure committees are not required under SOX, the watershed Act that imposed tough new mandates for controls and disclosures a dozen years ago, many companies have formally chartered them in the wake of SOX's passage – so many that it can be said that the committees are becoming a customary feature of corporate governance.

The reason for their popularity was reflected again and again in our survey results and one-on-one interviews. Companies see great value in centralizing their thinking about disclosures, helping the organization's finance function, other senior management and audit committee to anticipate and assess the full range of disclosure issues they face – whether small or large, regularly scheduled or borne of crisis – and to act in a coordinated manner. For their part, CEOs and CFOs gain comfort from the work that their committees perform.





All of this assumes, however, that the committees are thoughtfully constituted and then managed in a conscientious and consistent way that taps their full potential.

Our report reveals a picture of leading practices that is still coming into focus, with consensus in some areas and differences in others as companies feel their way in structuring and operating their committees.

That said, the broad range of experiences and findings presented here – a roster of successes but also of midcourse corrections – should prove helpful to senior executives who already have such committees and are looking to maintain or improve their value, and to those who are still thinking about forming one.

And because companies have on occasion failed to disclose pertinent information and triggered the receipt of an SEC comment letter – forcing a restatement of a financial filing or sometimes causing hefty penalties to be imposed on the company and senior executives – it behooves all members of a disclosure committee to use the committee to its full potential. In furtherance of this goal, we hope you find our report helpful.

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## Executive summary

Most companies consider disclosure committees to be an important tool for effectively promoting compliance with the 2002 SEC rules for disclosure controls and procedures, as well as the certification of annual and quarterly reports. These rules (e.g., Rules 13a-14 & 15 and 15d-14 & 15) were adopted by the SEC in 2002 following passage of the Sarbanes-Oxley Act, sweeping legislation that refocused companies on the importance of internal control.

The rules require that SEC registrants establish, maintain and evaluate the effectiveness of their “disclosure controls and procedures.” They also require the CEO and the CFO to certify the company’s financial and other information contained in annual and quarterly reports. The officers are required to certify<sup>1</sup> that they are responsible for establishing, maintaining and regularly evaluating the effectiveness of their company’s internal controls. Separately, under Section 404 of SOX, management must assess and report on the effectiveness of their company’s “internal controls over financial reporting,” or ICFR, a review commonly made in accordance with the COSO framework.

Although a disclosure committee is not itself a requirement under either SOX or the 2002 rules, establishing one was recommended by the SEC. (See sidebar.) A well-managed disclosure committee can help senior financial executives discharge their complicated and time-consuming responsibilities while also serving as an integral part of risk mitigation. Despite that, precisely how such committees are established and operated is still very much a work in progress – even 12 years after SOX was enacted.

In fact, many companies are coming up short on implementation, according to one of the experts we interviewed, Brinkley Dickerson, a leading securities and transactional attorney who is a partner in Atlanta at Troutman Sanders.

“Over the course of many seminars, I informally surveyed thousands of attendees representing a meaningful slice of the public company population,” Mr. Dickerson said. “I start by asking, ‘Do you have a disclosure committee?’ A substantial majority of the attendees will raise a hand. Then I ask, ‘OK, how many of your disclosure committees meet consistently, have an issues-focused agenda (i.e., are not a substitute for just a drafting session), get input from the top management team on issues within their knowledge, and track their work so that they can develop some sort of knowledge base over time?’ Only a few hands are left up. Sometimes, very few.”

And that’s the critical dividing line, he said. “Where a disclosure committee includes the right people and goes through the right process, it is a positive process. Where it does not, it is not. In fact, at that point, its mere existence is a potential liability as people within the corporate organization are relying on it for activities that it is not performing.”

Specifically, it is quite important for the disclosure committee to interact with the audit committee, many of the experts said. And yet, 43% of our survey respondents who have disclosure committees conceded that there was *no* formal interaction.

<sup>1</sup> Under Sections 302 and 906 – see Appendix D.

“I have found myself disappointed about the lack of audit committee participation,” a New York-based external counsel, another of the experts we interviewed, said of his experience in general. “Anything you can do to increase the engagement of the audit committee, and the board of directors, is good.”

To learn more, we sought to obtain answers to the foundational questions that we posed in our survey, such as:

- ▶ What is the committee's role?
- ▶ Who are the official members?
- ▶ How often should they meet?
- ▶ What interaction does the committee have with the CEO, the CFO, the audit committee and external counsel and auditors?
- ▶ How does the committee evaluate what to discuss?
- ▶ How does it resolve disputes?
- ▶ Can it be both effective and efficient?
- ▶ And finally, how do you start one?

How those questions are answered, and how those answers are then implemented, will determine whether a company adds a potent new layer of protection or is lulled into a false sense of security.

Mindful of this and the need to go beyond the face of our survey results, we decided to conduct one-on-one interviews to gather additional perspectives on our findings.

So how are the disclosure committees going about their business?

Here is a summary of findings from the 106 responses to our survey and the feedback we received from the experts we interviewed:

- ▶ A well-run committee offers immense value, providing company leaders, as well as subject matter experts, the opportunity to convene regularly to discuss current and potential issues.
- ▶ The committee gives the CEO and CFO a measure of comfort in fulfilling their certification duties.

- ▶ Some privately held companies establish disclosure committees, even though they are not required to make disclosures, in order to identify internal risks and to create a “world class” finance function.
- ▶ Committee membership typically includes senior-level executives. The corporate controller or chief accounting officer (CAO) is almost always a chartered member. The general counsel or equivalent is another very common choice.
- ▶ Participation often extends to non-standing committee members, such as business unit heads and managers of external reporting, who attend regularly or as needed, with external auditors often observing. The goal is to add expertise, accountability and transparency by having “the right people in the room.”
- ▶ Companies often employ subcommittees or “working groups” to focus on a specific disclosure topic and/or provide the drafts for the disclosure committee to review.
- ▶ Sixty percent of the respondents’ committees report directly to the CFO, with the CEO named by only 45%. Many of those interviewed said that solid reporting lines to *both* the CFO and CEO is the most effective structure, as they are both responsible for certifications – and almost 30% of the respondents’ committees are using that structure. Indeed, when the reporting line is only to the CFO, the CEO risks not being fully informed because communication from the disclosure committee through the CFO might be “screened.”
- ▶ Only 32% of disclosure committees indicated that they address proxy statements and 25% address 8-Ks.
- ▶ Disclosure committees usually meet four or more times a year, normally for an hour. The meetings almost always occur after the month-end general ledger has closed and work has begun on quarterly and annual financial statements.
- ▶ Seventy percent of the respondents said that their committees are governed by a charter. A formal delineation of roles and responsibilities makes the process more efficient, many said.

- ▶ Nearly two-thirds of the respondents typically don't receive formal training on disclosure matters. Many of those interviewed said that members don't need to be experts about disclosure, so long as they are experts in their own operating areas.
- ▶ More than 85% of the respondents use the full draft filings to facilitate discussions. Most of those interviewed said, however, that they rely on the subject matter experts on the committee to identify issues that are material to the financial statements.
- ▶ As noted, 43% of the disclosure committees involved in the survey have no formal interaction with the audit committee. The interviewees indicated that the audit committee is typically more a source of oversight of the disclosure committee's processes than a group that provides approval.
- ▶ Among the key challenges facing the committees is the tendency to become a "drafting" body. In addition, the members must find ways to remain "fresh," be consistent in their decisions and have the bandwidth to address multiple projects simultaneously.
- ▶ Companies must be alert to common committee weaknesses, such as a failure to be proactive and the possibility that the CFO or CEO might become overly reliant on the committee's decisions. "A CFO and CEO should not hide behind other employees' certifications but get the facts themselves," said the New York-based external counsel.

## SEC guidance on disclosure committees

Although disclosure committees are not specifically required by the SEC, the agency made the following comment in its final rules regarding certification and disclosure controls and procedures:<sup>2</sup>

"As discussed in the June Proposals, we are not requiring any particular procedures for conducting the required review and evaluation. Instead, we expect each issuer to develop a process that is consistent with its business and internal management and supervisory practices. We do recommend, however, that, if it has not already done so, an issuer create a committee with responsibility for considering the materiality of information and determining disclosure obligations on a timely basis.<sup>3</sup> As is implicit in Section 302(a)(4) of the Act, such a committee would report to senior management, including the principal executive and financial officers, who bear express responsibility for designing, establishing, maintaining, reviewing and evaluating the issuer's disclosure controls and procedures."

In its release of the Proposed Rule on Certification of Disclosure in Companies' Quarterly and Annual Reports, the SEC noted:

"We believe that all members of a company's senior management, including members of the company's board of directors, should accept and acknowledge an active role in the disclosure that their company makes in its quarterly and annual reports and reinforce their accountability for the accuracy and completeness of this disclosure. We believe that any senior corporate official who considers his or her personal involvement in determining the disclosure to be presented in quarterly or annual reports to be an 'administrative burden,' rather than an important and paramount duty, seriously misapprehends his or her responsibility to security holders."<sup>4</sup>

<sup>2</sup> <http://www.sec.gov/rules/final/33-8124.htm>.

<sup>3</sup> Officers and employees of an issuer who have an interest in, and the expertise to serve on, the committee could include the principal accounting officer (or the controller), the general counsel or other senior legal official with responsibility for disclosure matters who reports to the general counsel, the principal risk management officer, the chief investor relations officer (or an officer with equivalent responsibilities) and such other officers or employees, including individuals associated with the issuer's business units, as the issuer deems appropriate.

<sup>4</sup> "We note, as the Advisory Committee did, that improved Exchange Act report disclosure may improve disclosure for Securities Act purposes, since seasoned issuers generally incorporate their Exchange Act reports into their Securities Act registration statements. Consequently, investors in general stand to benefit from greater involvement by members of the company's board of directors and senior executives in the preparation of these reports."





## Survey results and interviews

In this section, we analyze the results of the survey. The survey questions dealt first with the characteristics of the respondents. A series of substantive questions then explored how the companies organized their committees, defined their functions and structured their interactions with the audit committee, senior management and external advisors. Finally, the respondents assessed committee effectiveness.

As noted above, we supplemented the results of the survey with a series of interviews with people who have deep knowledge of how these committees work. A selection of their comments follows summaries of the survey results. At the end of this section of the report, those interviewed step back a bit and offer their views on four broad topics: challenges that committees face, their

strengths and weaknesses, their contribution to making reporting more efficient and how they handle complicated disclosures.

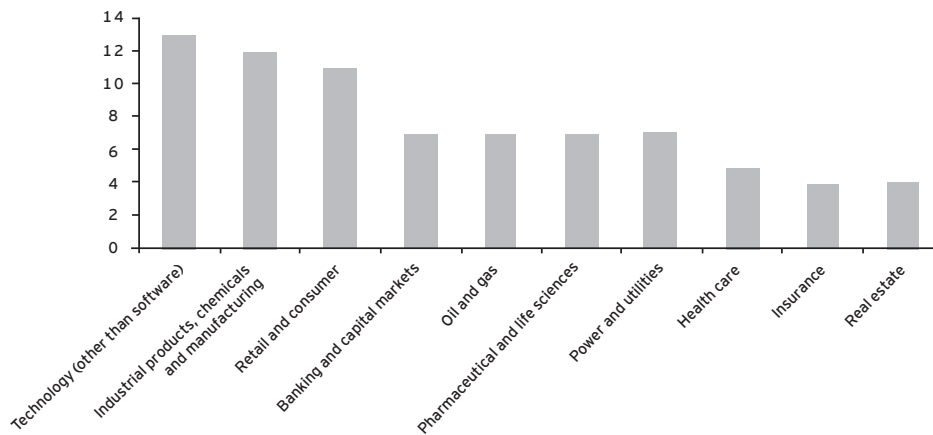
We have sifted through all of these responses to identify some of the most important building blocks in the establishment of a disclosure committee. An eight-step road map can be found in Appendix A. And to get things started, we are including a sample disclosure committee charter and, once your committee is up and running, a sample disclosure committee self-assessment checklist in Appendices B and C, respectively.

## Characteristics of respondents

1. **Industry representation.** The 106 respondents come from more than 30 industries. Technology (other than software) has the most representation, with 13 respondents. Industrial products, chemicals and manufacturing is the next biggest category, with 12 companies, and retail and consumer is third, with 11.

### Industry representation

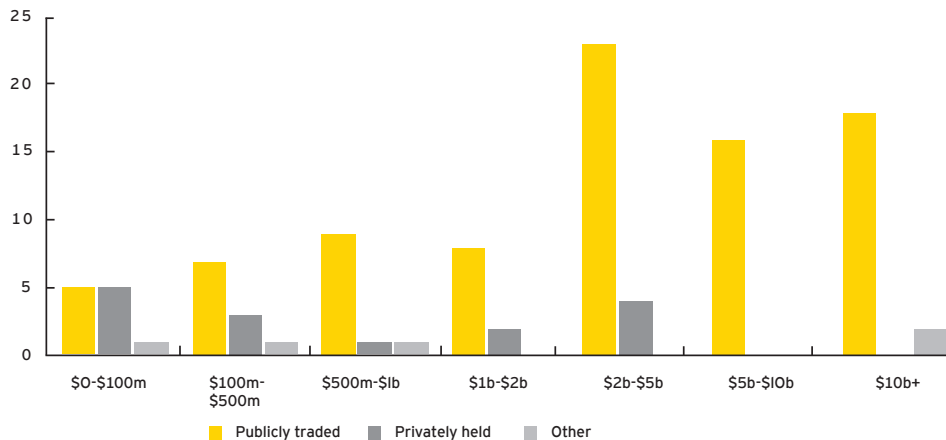
(n = 106)



2. **Ownership structure.** Of the 106 respondents, 81% are companies with publicly traded equity securities, 14% are private and 5% are "other," a category that encompasses nonprofit entities and privately owned companies that have registered with the SEC because of public borrowing.
3. **Revenue.** Annual revenue for the respondents ranged from less than \$100 million to more than \$10 billion. The majority – 57, or 53% – had more than \$2 billion in revenue.

### Range in revenue

(n = 106)



4. **Presence of disclosure committee: the reasons for establishing one and the value they can bring.** Ninety-seven of the 106 respondents, or 92%, indicated they either have a formal disclosure committee or have another group in place with similar responsibilities. That group might be a company's existing SEC external reporting team or a specially formed executive management committee or controller committee. In the group that has a disclosure committee, eight companies are privately held. Private companies typically have no SEC obligations regarding disclosure – some nonetheless have a disclosure process, including a committee, for identifying inherent risks, among other reasons.

*Our interviews produced a variety of perspectives about the history and structure of disclosure committees, including the reasons that companies establish them and the value they hope to receive.*

*Most of those interviewed said that the enactment of SOX and its requirements for certification were the prime reasons for the formalization of their committee. High-level executives typically are members, they said, but to ensure in-depth discussions, companies are moving toward "having the right people in the room," even if they are not official members. And the potential "value add" of a committee is to have an open line of communication with everyone in the organization who has an impact on the disclosure process. Moreover, committees have even begun to obtain and review sub-certifications from members within the organization.*

"We became an SEC registrant in 2005, and that is what triggered the creation of a disclosure committee, post-SOX, post-Enron," said the CAO of a bank. Each quarter under SOX, he said, "every member of the disclosure committee is required to sign a sub-certification to support our 10-Qs and 10-Ks, and obviously to support the external SOX certifications in our filings that have been done by our CEO and me." The committee, he continued, "also vets disclosure issues that come along that are material."

A leading technology firm established its disclosure committee in connection with SOX's enactment, according to two executives there. As for the value add, members of the committee are very diversified and

therefore bring a lot of experience to the discussions. They include the corporate controller, the general counsel and the heads of communications and investor relations (IR). "It's a cross between finance and non-finance," said one of the executives, a senior director of corporate accounting and reporting. So it's important, she continued, to "make sure the right representation of the business is there ... I think we have pretty good coverage."

Non-members also participate in the meetings, added the other executive, a senior manager, from the tech firm who talked with us. He mentioned directors of finance and managers, like himself, with responsibilities for SEC reporting. In this company's case, external auditors participate as observers, with an understanding that they can voice opinions when they feel strongly about specific disclosures. "It helps that they're at the meeting," the senior manager said, in the sense that they can better understand the issues. Otherwise, "they will be lost in translation."

An executive from a consumer products company said that although that firm's disclosure committee was in existence even before SOX, it became an official practice as a result of the act. Since then, its responsibilities have expanded. Its value, the executive said, comes from serving as a central venue for broad-based discussions among key managers and auditors, whether members of the committee or not.

Ken Kelly, the president of KK Advisory LLC, an adviser on accounting and controllership issues, recounted the experience of a company where he formerly served as

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**– Michele Hooper, founder and CEO of the Directors' Council**

controller and CAO. The disclosure committee there predated SOX, but once SOX was in place, it formalized the arrangement with a charter, which stipulated that the CAO serve as chairman. The benefits, Mr. Kelly said, were numerous: the committee provided consistency and had a formal structure, underscoring the responsibility held by each of its members. Moreover, the due diligence it performed "provided comfort to our CEO and CFO for their certification process – we would summarize to them the process, the results of the process and our conclusions."

Disclosure committees add tremendous value to the financial reporting process, said Michele Hooper, founder and CEO of the Directors' Council, which works with corporate boards on independence, effectiveness and diversity. Ms. Hooper offers the perspective of someone who has sat on a number of audit committees over the years. If a company doesn't have a disclosure committee or its equivalent, she said, "I would want to know how they make decisions about disclosure matters." The committee, she added, serves as a forum for its members "to rigorously review and debate whether or not to make a disclosure so that if somebody from outside questions why the company didn't disclose something, there is a rationale behind it."

The director of financial controls and policies at a business services company said that the primary purpose of the committee at his firm is to review the financial results before they are published. The committee also reviews internal and external representation letters and certifications to ensure their completeness. The committee serves as "a key control to make sure, first, from a representation letter perspective that everyone is in alignment [and] that nothing material has been overlooked, and second, that everybody internally has attested to our internal letters. The committee also serves as a final wrap-up before the financial statements are issued. The internal representations are designated to the subject matter expert in that area. For example, if it is a

representation for a finance issue, the financial group will sign that particular representation."

When his industrial manufacturing company formalized its disclosure committee in the wake of SOX, a former CAO said, it expanded the membership to include business unit presidents, the chief information officer (CIO) and a number of corporate leadership teams (legal and internal and external audit). The move was designed to give comfort to the CFO and CEO. "They knew they had a complete package that could, in essence, give them the ability to make the representation (certification) that they had to make," he said. Without such a process, "I don't know how your CEO could read a 10-Q or 10-K and just talk to the controller – with the controller saying, 'Yeah, trust me. It is all in there.'"

"This process was really beneficial from the tone-at-the-top perspective," the former CAO said, "in that the CEO/CFO was able to see the weakness, if any. He could then say, 'Well, I'd like that fixed.' From a corporate integrity perspective, you can't beat that process. It evolved from a basic Q&A session to an international discussion with all the key leaders at the table."

"The committee provided a great education process to the corporate leaders about what was important to get covered and the need for tighter internal controls over the certification process," the former CAO said. "You could miss something big if you don't drive a process that makes the guys who run those businesses get involved," he added. "Top-level management should be involved, and knowledgeable. Business unit presidents should be involved. The controller, the CFO, legal, the CEO should all be involved, asking the fundamental question, 'Is there anything out there that we don't know about and should know before we file the financial statements?'"

The responsibility of the committee also expanded, the former CAO said. One change added an information process related to representation letters required for auditors. The change ensured that senior leadership



had a forum in which they could fully understand the representations that they would be making to the auditors. It worked this way: the representation letters were passed on to each business unit president for input and certification. Any changes from prior quarters would need to be reported back to the CFO and CEO before their final sign-off. The CFO and CEO would each have the opportunity to question the representations.

A former CAO at a pharmaceutical company recounted a similar history. Pre-SOX, his former company held meetings to discuss disclosure. After SOX, the company formalized the meetings and the group holding them, giving it the disclosure committee moniker. The new committee continued to reach out to business units for feedback on press releases and the 10-Qs or 10-Ks for validation of disclosure items for which the units were responsible. In addition, the company would have calls with external SEC counsel twice a quarter – once for the press release and once for the 10-Q or 10-K.

The committee had three levels. First, the work began in a subcommittee, which prepared the initial draft of the pertinent documents (10-Q, 10-K and press releases) for presentation to the disclosure committee. Next, the disclosure committee met to discuss the drafts, as well as other company-wide issues that were relevant to the financial statements or press release, and follow up with a call to external counsel. Finally, the items that were discussed and an updated financial statement would be reviewed by an executive-level disclosure committee. The executive-level meeting included the CFO and CEO, along with the general counsel, staff, investor relations and others. This formal meeting was designed to provide the CFO and CEO with enough support to make their certifications; it also served as a final review of the 10-Q and 10-K before they were sent to the audit committee.

Overall, the former CAO said, the committee was critically important in meeting regulatory demands and opening lines of communication with business units so that issues weren't missed. Also, he explained, "The committee allowed us to have consistency of members reviewing the documents – this was very important."

The CAO and the controller at a private company indicated that the motivation for establishing their disclosure committee, which is still in the process of being formalized, is to have a "world class" finance function. From a business perspective, the disclosure committee is intended to identify inherent risks within the organization, as well as to enhance reporting requirements for lenders and government agencies that oversee the company's money-transmission services. As for the value add, the CAO said he expects the committee to provide complete visibility into potential issues that may affect financial reporting and to validate some of the operating activities and "norms" within the company. The CAO has tentatively been designated to serve as the committee chair.

**"The committee provided a great education process to the corporate leaders about what was important to get covered and the need for tighter internal controls over the certification process," a former CAO said. "You could miss something big if you don't drive a process that makes the guys who run those businesses get involved."**

## Beware the gaps

Disclosure committees have great potential – if managed effectively, the committees are very helpful. But if there are shortcomings or omissions, they can be very dangerous, said Mr. Dickerson.

“You have a CEO thinking that the disclosure committee is off doing something useful,” he said, “but if it is not, there are gaps in the system that he doesn’t even know about.”

For a disclosure committee to be effective, its process has to be well considered and sufficiently empowered, Mr. Dickerson said, citing three essential rules:

1. It can’t act like a drafting committee. If the members are merely soliciting random comments for input to make documents better, that’s not enough.
2. It has to have the right purpose. The fundamental purpose has to be gathering information from others in the company that could be material to SEC filings. The more input of “true and genuine knowledge” gathered from within the organization, the better. The range of areas that should be included depends on the organization’s particular sensitivities. Areas that have the most importance, he said, are those that generate liability. Some key questions to ask:

- ▶ How do you describe sales, what changed and why did it change?

- ▶ How do you describe your cost of goods (services) sold, what changed and why did it change?
- ▶ How do you describe your liquidity position?

Input from individuals with firsthand knowledge in these areas is critical.

3. It must address enterprise risk management (ERM). This input is vital – it allows the disclosure committee to view the risks of the organization, and then quantify and prioritize them. However, ERM normally focuses on the downside and therefore has to be carefully balanced with appropriate positive information.

“The disclosure committee has to evolve as part of the culture of the organization,” Mr. Dickerson said.

“Participation has to be viewed as not just a job requirement or as a distraction, but as an opportunity to do good work, which is consistent with generating a culture of compliance.”

“The committee and the committee process will need to have the right stature. Committees have to be managed efficiently, need to be focused on the areas that must be discussed and their meetings need to have a beginning, middle and end so that they don’t become the drudgery that people want to avoid. If those things are not done, the committee will fizzle out and need a booster shot to get going again.”

“The disclosure committee has to evolve as part of the culture of the organization. Participation has to be viewed as not just a job requirement or as a distraction, but as an opportunity to do good work, which is consistent with generating a culture of compliance.”

– *Brinkley Dickerson, a securities and transactional attorney*

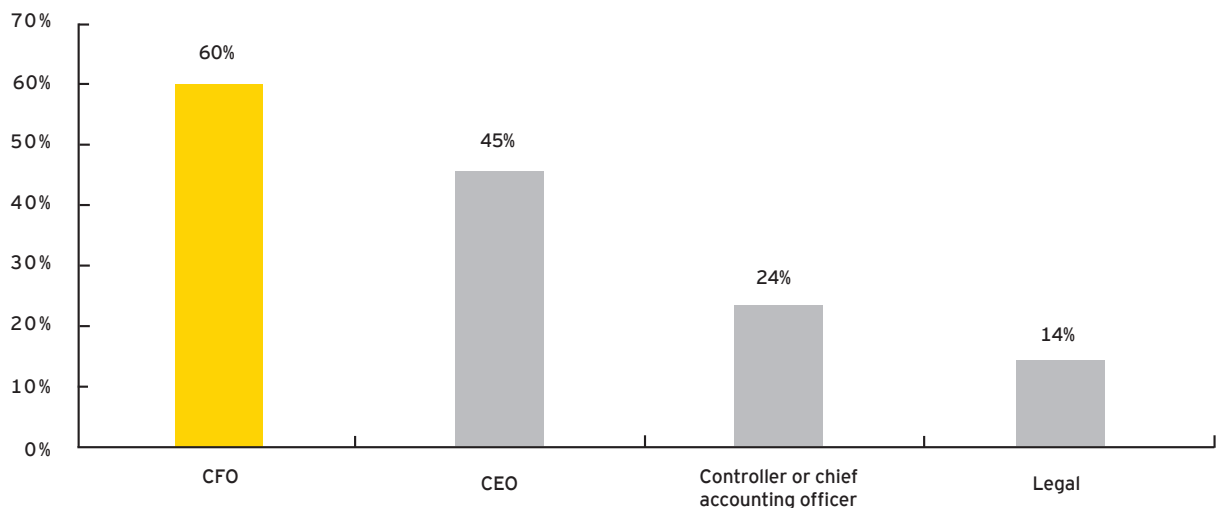
## Organization of the disclosure committee

These questions explore reporting lines, functions and other operating characteristics.

5. **Reporting lines.** The survey participants were given the option to select all reporting lines that were applicable - and it turned out that more than one-quarter of their committees report to both the CEO

and the CFO, a reflection of the central role those executives play in the certification process. Of the 97 companies that have a disclosure committee or something similar, 58, or 60%, use a reporting line to the CFO, and 44, or 45%, have one to the CEO - and between those two groups, almost 30% of the respondents' committees report to both. Next most popular: the controller/chief accounting officer (24%) and legal (14%).

Reporting lines  
(n = 97)



Respondents could choose all direct reporting lines that were applicable. Almost 30% said that their committees directly report to both the CEO and the CFO.

*Those interviewed were asked to provide insights about which reporting lines make the most sense. Many were strongly in favor of direct lines to both the CEO and the CFO because both were responsible for certification and needed unfiltered access to critical information.*

One of the interviewees, the bank CAO, felt that the CFO and CEO should both be at the end of the line with oversight, since they are the executives who must sign off on certifications. "Normally," he said, "the CFO is going to sign off before the CEO - the CEO should be the last guy in the lineup." At his bank, he said, once the disclosure committee has met its obligations, the members sign a sub-certification, which enables the senior executives to sign off externally. "So when we talk about disclosure committees reporting [more often] to the CFOs, [and] CEOs coming in second, even if the disclosure committee

didn't report to the CEO, I would think that there's going to be some pretty good communications going on between the CFO and the CEO to make sure the CEO is well informed of everything before he signs off."

Another interviewee, the executive from a consumer products company, said that dual reporting lines to the CEO and CFO were considered essential at the company for making quick and efficient decisions.

The CAO of a service company also supports a dual reporting line. If a committee reports to the CFO but not to the CEO, the CEO may not hear all the information firsthand - and the CFO could well add a screening process to the flow of information. "For that reason, there should be a direct line to both the CEO and CFO."



Mr. Kelly of KK Advisory said that the disclosure committee at his former company has a double solid line to the CEO and CFO, an arrangement spelled out in its charter. The reason, as others have said, is to facilitate their dual responsibility for certification. He doesn't believe that a disclosure committee should have a direct reporting line to the audit committee because it should already be providing a full report to that group, detailing the process that the CFO and CEO went through to reach decisions about certifications. In any event, he noted, "the audit committee is not responsible for the certification of the controls – management is."

The disclosure committee at the technology firm does not formally report to either the CFO or the CEO, the executives there said. Instead, the committee documents that it met and makes recommendations to the CEO and CFO. The committee does meet with those executives when the certifications are signed.

Mr. Dickerson noted that for a CEO or CFO to effectively claim the benefit of the work of a disclosure committee in the event of a challenge to the required certifications, the CEO and CFO need some level of insight into what the committee has done, most likely something beyond a simple certification.

- 6. *Frequency of meetings.*** The disclosure committees in our survey normally meet four or more times a year. In fact, not one of the committees among the 87 respondents met fewer than four times a year. Of the 78 public companies that responded, 37, or 43%, said that they held more than four meetings a year.
- 7. *Length of meetings.*** Committee meetings usually last for one hour, as indicated by 60% of the 89 respondents, and are held in a variety of ways – in person or via phone or video conference. More than one-third, or 36%, said that their meetings typically last for two hours.
- 8. *Keeping records.*** To keep track of the discussions, 58% of the respondents said that they maintain minutes, while 29% indicated that the certifications they issue serve as their records. Twelve percent said that they rarely prepare any formal account of their discussions.
- 9. *Timing.*** Eighty-eight percent of the disclosure committees meet after the period end.
- 10. *Formal charter.*** The composition and accountability of the committees are generally governed by a formal charter. Of the 92 respondents to this question, 64, or 70%, have such a charter. (A sample charter can be found in Appendix B.)





***Are disclosure committees more effective if they have formal charters that outline the members' roles and responsibilities? Most of those interviewed said "yes" – particularly from a legal standpoint.***

"A charter is always a good thing," said the New York-based external counsel, adding that it brings rigor to the process. For example, if followed properly, the charter may help from a litigation defense standpoint – "if a certification [Sections 302 and 906] is ever challenged by the SEC or the Department of Justice, the charter is a good starting point to demonstrate that the company has a good process. At that point, demonstrating that the work of an unchartered disclosure committee should protect you from charges of shortfalls in the disclosure controls will be an uphill battle."

The CAO of the bank said that his charter does indeed contribute to effectiveness. "Our charter is actually a part of an overall larger set of documentation," he said. "We have a document called 'Disclosure Controls and Procedures,' which goes into a bit more detail about the roles of different people and who is responsible for what. And the disclosure charter is an appendix to that document."

The disclosure committee at the technology firm also has a formal charter, but it doesn't fully spell out roles and responsibilities of each member, the executives there

said. Nonetheless, the members manage to sort things out without hurting their effectiveness, they added. For example, although the charter does not designate a formal chair, the CFO always acts in that capacity. The members "know what hat they wear," one of the executives explained.

The consumer products company has a formal charter as well, and adheres to it, the executive there said. But, the executive added, the marching orders are flexible enough to permit committee members to address significant issues that arise even though they are not explicitly identified in the charter.

The former CAO of the pharmaceutical company saw no practical difference in having a formal charter but did say it was very important to maintain from an internal control standpoint. The auditors would look to this document, he said, to see how the disclosure committee functioned in the post-SOX era. The disclosure committee at his old company functioned just as effectively in its pre-SOX incarnation as it does in its post-SOX formal life, he added.

The service company's CAO said that a charter really helps only those charged with reporting to the CEO and CFO. "It helps guide the co-chairs in terms of making sure that what gets covered in the meetings supports the certifications of the CFO and CEO."

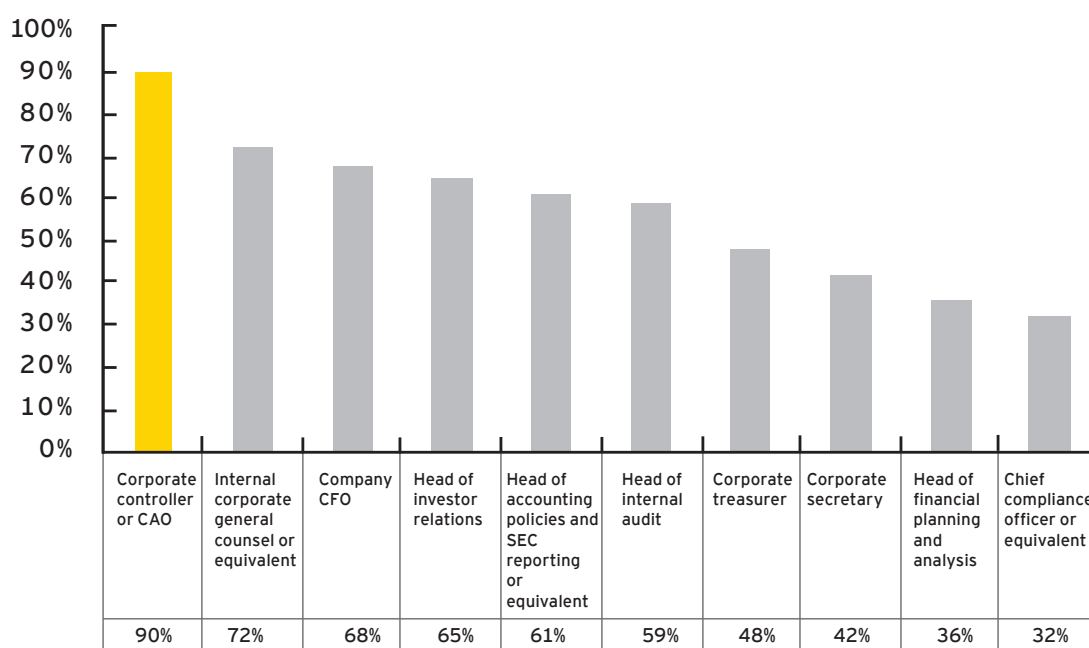
**"A charter is always a good thing," said a New York-based external counsel, adding that it brings rigor to the process. For example, if followed properly, the charter may help from a litigation defense standpoint – "if a certification [Sections 302 and 906] is ever challenged by the SEC or the Department of Justice, the charter is a good starting point to demonstrate that the company has a good process."**

**11. Membership ranks.** The survey participants were asked to describe the composition of their committees, matching their chartered or official members with 25 company roles. Of the 97 respondents, 87, or 90%, indicated that the corporate

controller or the CAO almost always was a chartered member. By contrast, the audit committee chair and the head of sustainability reporting were rarely official members. The chart below shows the top 10 roles held by official members.

## Most frequent member roles

Respondents were asked to select all roles that applied to their situation (n = 97)



Less frequently cited roles included CEO, chief risk officer, director of accounting policy or equivalent, operating unit presidents or equivalent, head of human resources, head of corporate communications/director of corporate communications, operating unit CFOs or equivalent, and chief operating officer.

On an occasional basis, standing participants in committee meetings include others who are not official chartered members. The most frequently cited role that falls into that category is director of accounting policy, named by 12% of the 97 respondents. The head of accounting policies and SEC reporting and the head of internal audit were the next most cited roles. In some other instances, representatives of official members appear on their behalf.

*Those who were interviewed identified another category of committee participant: so-called observers who have no official or ongoing role but who are invited to join particular meetings to hear what's going on and sometimes to add their points of view.*

For example, the technology firm, as noted earlier, invites the firm's manager of external reporting. On the same basis, it also invites its external auditors to observe. "They attend to listen to the back and forth between management" about a particular issue, one of the firm's executives said, "and then if they feel strongly about something, they'll voice their opinion."

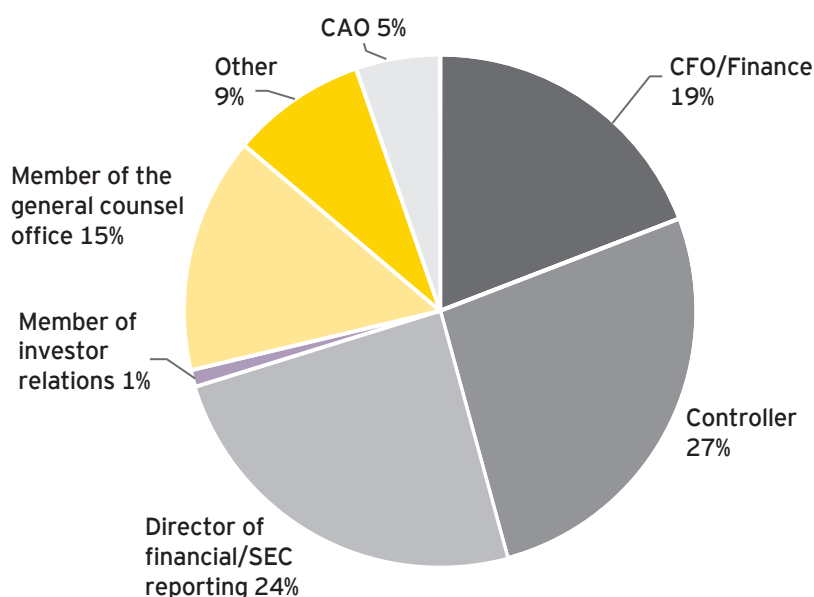
**12. Choosing the members.** Who appoints the members of the committee? The answers from 82 respondents revealed several approaches. Approximately 30% said


that the decisions were made on a joint basis – by a combination of a CFO and CEO or a general counsel with a CEO or CFO or both. On a stand-alone basis, the CFO made the most appointments, garnering 22% of the responses. Next in line was the CAO, at 13%. Among the others named were the disclosure committee and the general counsel. In two cases, the charter or alternative document dictated the guidelines for choosing appointees. In only two instances, the audit committee made the decision.

**13. Leadership role.** Of 94 responses received for this question, the controller was named most often as the coordinator of the committee's activities or as its chair, chosen by 27%. The director of financial/SEC reporting was next, with 24%, and the CFO/Finance drew 19%.

## Coordinator or chair of disclosure committee

(n = 94)





**14. Training.** Periodic training and guidance about changes in disclosure requirements is rare – about two-thirds of the respondents, or 66%, said that they don't normally receive such help.

*Most of those who were interviewed said that training should be required, although some said that formal training was unnecessary given the level of experience and competence of those typically serving on committees. Many felt that it wasn't necessary for all members to be disclosure experts so long as others on the committee filled that role.*

"We don't have any formal training for our disclosure committee," said the bank CAO. "In the case of a new reporting requirement, such as a new FASB standard, the informal training includes shared memoranda and discussion with the committee. When I think about experience and the composition of our committee, I'm not sure they need formal training. If there was a major overhaul in membership, I would say, 'Yeah, we probably need to be thinking about some formal training.' But we've had pretty good stability in terms of turnover. I'm not suggesting that some training would be a bad idea, but it hasn't been an issue for us."

One of the executives from the technology firm said that some level of training is important. For instance, he said, "any time we have a new member, we'll spend an hour or two explaining a list of responsibilities."

The consumer products executive felt strongly that training was essential, and that education about changes in disclosure requirements is necessary for an effective committee. The executive's company regularly provides members with updates about the changing disclosure landscape and how those changes affect financial statements and the firm as a whole. This allows the members to stay on the cutting edge, the executive said.

The former CAO of the industrial manufacturing company said that all business unit presidents were "trained" by members of the controller's team to be aware of disclosure issues that might have an impact at the business unit level.

For his part, Mr. Kelly doesn't feel that it is necessary for all members to become "experts" in disclosures. The CAO, after all, should bring the disclosure committee up to speed on new requirements through summarization. Training should be limited to what is going on in the environment and about responsibilities, consequences and process, and not necessarily extend to technical issues.

The former CAO of the pharmaceutical company said that the disclosure committee members did not receive formal training, but were well versed nonetheless about Regulation FD and attended seminars on the latest disclosures. Members who were non-accounting and non-SEC legal did not need an in-depth level of training, he said, because they relied on subject matter experts such as himself for an understanding.

Disclosure committee members are knowledgeable by virtue of their other job responsibilities, said the service firm's CAO. "They may not all be experts in accounting and disclosure requirements, but they are all bringing to the table a perspective of what they believe is material information that should be disclosed to our investors. Their skill and capabilities in their 'day jobs' make them qualified for the disclosure committee." That said, when it comes to accounting disclosures, the team does receive training. One example of a change that merited training is the recent release of the new revenue recognition standard.





**15. Dispute resolution.** Fifty survey participants responded to a question about resolving disagreements. Half said that when a decision is needed, the issue usually gets escalated to senior management, typically the CAO, CFO or CEO. In a few cases, the general or corporate counsel makes the call. Otherwise, decisions are made by consensus of the disclosure committee (38%).

***Most of those we interviewed favored consensus as the way to resolve disputes, although some thought that certain committee leaders should retain veto power.***

“We typically drive toward a consensus by taking votes,” said the bank CAO. “It’s not to say that we don’t occasionally have debates in our disclosure committee, but we’ve been pretty successful at getting consensus.”

The committee at the technology firm also typically reaches a consensus, albeit driven by different members depending on the issue. “As we do not have a formal chair to make the final decision,” one of the executives there said, “we ensure that the disclosure committee is made up of a cross-section of people, [giving us a] ‘natural decision-maker’ for each type of disclosure. Certain disclosures lend themselves to where you kind of know who the decision-maker among the committee is – who the primary one would be, whose voice would carry the most weight, in other words. For example, the corporate controller has the voice when it comes to general footnote issues. Another process that we find helpful is to prepare different options for each discussion point.”

A consensus-driven approach is also used by the consumer products company. The committee members look to each other’s experience, rather than to a single decision-maker, to reach sound judgments, the executive there said.

At Mr. Kelly’s former company, consensus was also used, but with a twist – a veto could undo it. The member with the most experience regarding the disclosure under consideration would have the veto power, he explained. “We would rely on the expertise within the committee” to determine the final decision. But, of course, he added, the CFO and CEO would have the ultimate say.

The former CAO of the industrial manufacturing company said much the same thing. He felt strongly that the initial decision should be reached through a consensus driven by the most knowledgeable people – subject to being overruled by the CFO and CEO, who were committee members.

The service company uses a hybrid approach, the executive there said. It sometimes reaches decisions by consensus, but other times, the committee’s two co-chairs call the shots. The co-chairs would also sign off on minor issues that did not warrant discussion by the full committee.

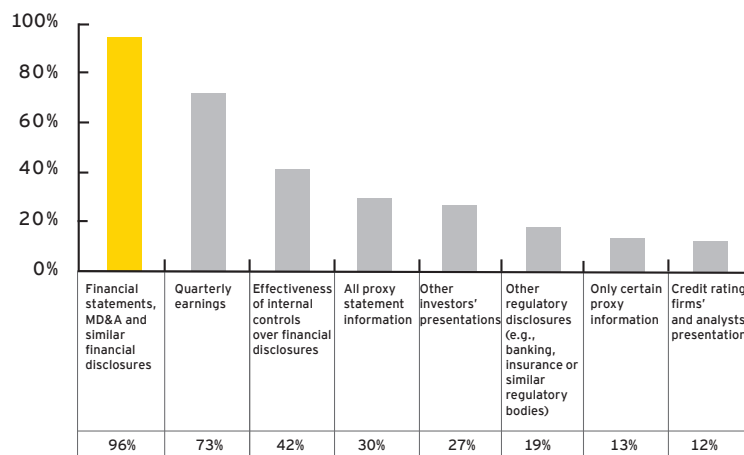
## Function of the disclosure committee

This section discusses how disclosure committees handle their review function.

**16. Topics of discussion.** Almost all of the 97 respondents, 93, or 96%, said that they regularly address financial statements, MD&A and similar financial disclosures when they assemble. Other frequent topics include quarterly earnings, cited by 73%, and the effectiveness of internal controls, 42%. Respondents were allowed to select as many topics as applied.

### Disclosure topics addressed

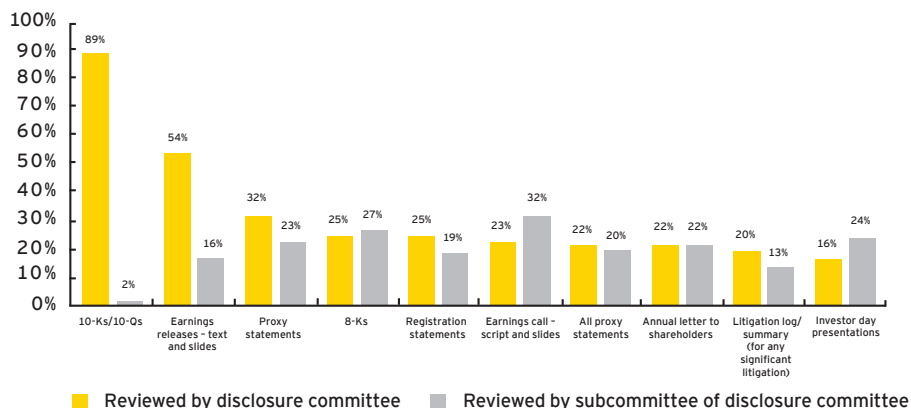
Respondents were asked to select all topics that applied to their situation (n = 97)



**17. Areas of accountability.** Although we found that disclosure committees commonly look at financial statements, MD&A and similar disclosures, they typically are accountable, under their charters, for quarterly and annual financial statements, the text and slides for earnings releases, and proxy statements. Most of the 16 categories included in the survey question are first reviewed by a subcommittee to ease the burden on the full committee, according to the respondents.

### Areas of accountability

Respondents were asked to select all topics that applied to their situation (n = 97)

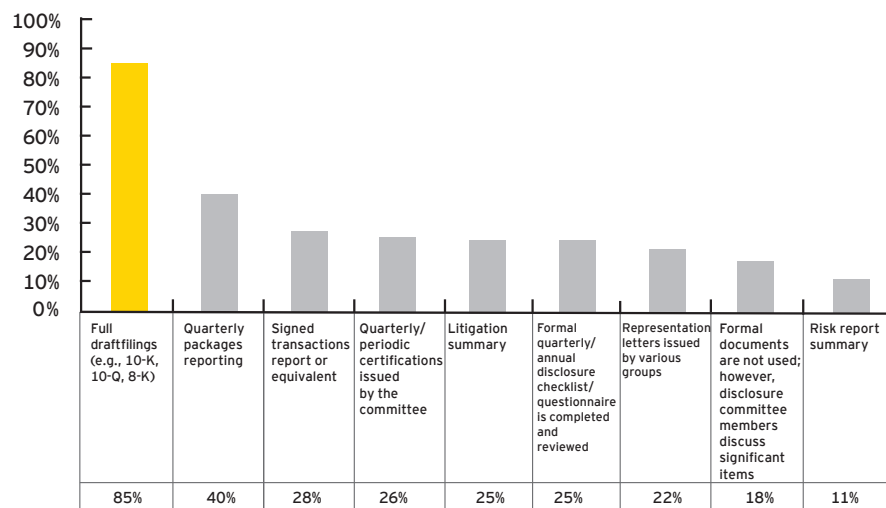


**18. Operating process.** Most of the committees – 81% of the 91 respondents – review disclosures all at once. By contrast, 16% review different parts in different meetings.

**19. Facilitating the discussion.** In order to facilitate discussions, most committees – 85% of 97 respondents – use the full draft filings of quarterly and annual reports. A variety of other forms and tools are used, as noted in the exhibit below.

### Forms and tools used by disclosure committee

Respondents were asked to select all topics that applied to their situation (n = 97)



**20. Issues faced.** The survey participants were asked for examples of key issues that had been resolved by the disclosure committee. Weighing in on the magnitude of disclosure was a common theme, representing more than half of the responses. This set of issues included deciding whether something was material, and thus needed to be disclosed, as well as matters relating to MD&A, risk factors, commitments and contingencies, and subsequent events. The committees appeared to have an integral role in the formation of company policy. Some of those interviewed indicated that the committee, on occasion, was the deciding factor in the issuance of an 8-K.

*Those interviewed were asked to describe the process they used to determine what needs to be discussed – and the mechanisms they employ to stay on top of changes in disclosure rules and their potential impact. Many depend on committee members with special expertise in the disclosure area and/or awareness of particular issues that need addressing. These members include senior managers, subject matter experts and those involved with the preparation of financial reporting documents. Seeking guidance from internal and external auditors and counsel was also cited. Two mechanisms that were mentioned: designating a specific committee member to put together materials for each meeting and using a disclosure questionnaire to develop topics.*

The bank CAO was confident of his group's ability to stay abreast of the most relevant topics. "We have several people on the disclosure committee who are the top managers in our bank," he said. "So they should have a pretty good idea of major things that are going on in our bank in terms of potential disclosure topics that we need to be thinking about. Besides this, the SEC reporting group (along with me and our internal SEC counsel in our oversight capacities with that team) has fairly extensive experience in financial reporting, so we are collectively able to assess what disclosures are necessary."

At the technology firm, members who have involvement with the financial reporting documents will take the lead on most of the related topics. "In a preparation or review role, there is some understanding of what's in the documents," one of the executives there said. "Leading up to the 10-Q and the disclosure committee meeting, we're involved in the earnings process alongside legal, investor relations and the finance functions. So we're hearing what the key highlights and issues they're going to talk about on the earnings call are, so that when we get into the 10-Q or 10-K, we know where to focus our writing [in the financial statements]. And then, when we get into the disclosure committee, since you've been involved in the whole earnings process, you're able to pinpoint where there's potential controversy or potential areas we need to talk about."

At the consumer products company, a designated member of the disclosure committee is in charge of preparing materials in advance of the quarterly and annual review of the financial statements. The materials consist of division representation letters, the status of outstanding cases handled by compliance, a summary of quarterly SOX results, communication by external auditors and quarterly earnings releases along with regulatory filings.

Mr. Kelly used "inside and outside experts to come up with what is appropriate to discuss." Overall, he made sure to "really involve the correct people," a group that included internal and external counsel and external auditors.

The director of financial controls and policies at the business services company identified the subject matter experts on the committee as the drivers of the discussion. "The assistant controller will discuss financial results, the CAO will discuss non-routine general ledger entries or unusual transactions, investor relations will discuss the script for the investor call and lawyers will talk about their next procedures," he explained. External auditors are also present, and they discuss their audit procedures and any findings that they want to bring to the attention of management. Finally, the director of controls will discuss the certification process, as previously mentioned.

The former CAO of the pharmaceutical company would compile a "list of issues" that was the primary driver for the press release and quarterly year-end financial statement discussions. This list includes critical material issues to be included in the document.

The vice president of financial reporting is in charge of determining the agenda at the service company, the executive there said. That agenda is based on quarterly close meetings, as well as feedback from various divisions to make sure that nothing important has been overlooked.

The CAO of the private company tends to develop topics by reviewing a standard questionnaire. A "filter" process is also used. "The filter will include financial materiality and assessing inherent business risk," he said.



## Interactions with external auditors, other external advisors and the audit committee

This section discusses groups or individuals – external auditors, other external advisors and the audit committee – that the disclosure committee interacts with and/or seeks guidance from.

- 21. External auditors.** More than half of the 97 respondents indicated that external auditors are involved in or interact with the committee, including 30% who said that the auditors review their minutes. Eleven percent said that their auditors, although not formal members of the committee, attend the committee's meetings.
- 22. Other external advisors.** Forty-one percent of the 97 respondents said that they rely on external counsel for support with SEC issues. Almost an equal number, 40%, said that they don't use any external experts, relying instead on the knowledge within their organization. One-third, or 34%, indicated that they would use their external auditors as needed.
- 23. Audit committee.** Forty-three percent of the 91 respondents indicated that the disclosure committee has no formal interaction with the audit committee, whereas 29% said that disclosure committee members summarize that committee's process in reports they send to the audit committee. One-fifth of the respondents indicated that they report their disclosure decisions, or share a summary, with the audit committee.

*Those interviewed were asked to describe interactions with their audit committee. Many cited a close relationship, born of a recognition that the audit committee's role is to hold the disclosure committee accountable. The audit group's function, as one of the experts said, is to provide "oversight" and not act as a "rubber stamp." Too often, though, an external counsel said, the audit committee is not engaged enough with how the disclosure committee operates.*

"We have a disclosure policy that is approved by our audit committee annually," said the bank CAO. "In addition, the audit committee is responsible for approving the annual and quarterly filings. Apart from meetings held every other month, to align with board of directors' meetings, the audit committee has four conference calls that are tied to the three 10-Q filings and the 10-K filing

in the course of the year. The primary purpose of each of those calls is for the audit committee to receive the recommendation from the disclosure committee and to discuss and approve the filing of the 10-Q and the 10-K. The disclosure committee's actions are summarized in a one-pager that we provide to the audit committee that outlines some of the more significant disclosure issues in that particular filing. The audit committee, as well as the full board, receives a draft of our 10-Qs and 10-Ks a week or so before each of those conference calls. So they've already gotten a look at our draft filings before we have those calls to approve the filing."

Two members of the disclosure committee at the technology firm meet with the audit committee to discuss the most recent filings. The meeting follows completion of the draft of financial statements for the audit committee's review.

The disclosure committee at the consumer products company meets or interacts with the audit committee on several occasions each year. The contacts allow the audit committee to understand the deliberation and the process that the disclosure committee used to arrive at its conclusions. Those contacts spark healthy discussions, the executive there said, enabling the committees to appreciate each other's point of view, thus improving the decision-making process.

In the experience of the New York-based external counsel, however, audit committees, as well as independent directors, do not have enough participation in the disclosure process. "You frequently end up with several important and often challenging disclosure questions, and there is a range of outcomes. I would like to see the audit committee hear the choices and hear where [the disclosure committee] wants to be on the continuum of possible disclosures. In many cases, [the audit committee] only wants to know if what is proposed is acceptable."

In Mr. Kelly's view, the audit committee should be responsible for making sure that management is properly carrying out its disclosure responsibility and has the ability and the process in place to effectively do that. In other words, "what comfort are you giving me that you're doing this to an appropriate level?" At his former organization, the audit committee had the ability to call any disclosure committee member with questions. What's more, several disclosure committee members attended audit committee meetings. For example, the head of investor relations, the director of accounting, the CFO and the head of internal audit all presented the disclosure committee reports and were asked many questions.

**“As an audit committee member, I am most interested in things that the disclosure committee chose not to disclose but had a lot of conversation about. I am more interested in items that came close to the line, yet the committee chose not to disclose at this time.”**

**– Michele Hooper, founder and CEO of the Directors’ Council**

The director of financial controls and policies at the business services company said that his disclosure committee shares all items discussed in its meetings with the audit committee. In fact, there is a similar meeting with the audit committee in which the CFO, the CAO, the assistant controller and the general counsel again go through the results and findings before filing the reports.

Michele Hooper, who has served on a number of audit committees, views disclosure committees as “the ‘belt and suspenders’ for an organization to make sure it has the appropriate people in the room to discuss what needs to be disclosed in the financials. This makes the process more robust and more accurate.” Based on her experience, Ms. Hooper expects to see interaction between the two committees. As a matter of fact, she says the audit committee has a responsibility to provide “oversight” and not act as a “rubber stamp.” And she looks to the disclosure committee to perform a thorough review of the items being disclosed, to have a vigorous and knowledgeable discussion of the activities of the organization and a clear understanding of the timing of potential disclosures.

“As an audit committee member, I am most interested in things that the disclosure committee chose not to disclose but had a lot of conversation about,” she said. “I am more interested in items that came close to the line, yet the committee chose not to disclose at this time.” If there was disagreement, Ms. Hooper expects that the disclosure committee took the various views into account and either through research of its own, or through advice from others (external counsel, for example), gave the matter another review. From Ms. Hooper’s perspective, the audit committee should go beyond the review of the quarterly and annual reports and each year assess the

“controls” around the financial reporting process, which includes the disclosure committee. Typical questions that should be asked include: “Who was in the disclosure committee meeting, what is the disclosure control process and how were issues resolved?”

## **Effectiveness and streamlining**

**24. Effectiveness.** Forty-five percent of 97 respondents said that their disclosure committee is effective, without qualification. Another 37% agreed that their committee is effective, but noted that it serves solely to address regulatory SEC and accounting requirements, such as approval of the 10-K and related certifications. And 18%, while also saying that their committee is effective, suggested that its operations could be enhanced in some key areas.

**25. Streamlining.** When asked whether their disclosure committee had taken steps to revisit and/or streamline financial statement disclosures, the majority of the respondents, 66% of 92 respondents, said “yes,” that there had been meaningful enhancements, including streamlining. Slightly more than 23% said that they didn’t believe such steps were needed and that their disclosures are reasonably presented.

## Challenges, strengths and weaknesses, efficiency, complexity

*We asked the interviewees to step back and comment on a number of broad issues relating to disclosure committees.*

### Challenges

*Some of the people we spoke with said that their disclosure committee had not faced any significant challenges, yet they were confident in the abilities of the group to confront any that would arise. A few said that there was room for improvement in how their committee operated. Among the challenges that were cited: the difficulty of coming to a unified conclusion to present to the CFO and CEO and coping with the variability of regulatory rules around the world. The need to stay fresh to the task and to be careful about the outcome was another. On that point, Mr. Dickerson warned that without the right commitment from the right people, a mismanaged committee could lull the overall organization into a false sense of security.*

The bank CAO said that his firm's disclosure committee has monitored its performance in part by using a process of self-assessment. "Every year for the last few years," he said, "we've done confidential self-assessment surveys. Our chief risk officer coordinates the self-assessment process for all of our internal bank committees. It's basically a review of how people think the committee is functioning. The disclosure committee has ranked high for the last few years compared with the other committees." (An adapted version of the bank's self-assessment form can be found in Appendix C.)

The members of his committee, he added, are "a very good group who are very clear in what they need to do, and they work really well together. Every quarter there are things that we need to talk about, but I don't think we've had anything that I would call major issues. As proof, we haven't had any restatements in the last few years, and we haven't had any major SEC inquiries or anything like that."

One of the executives at the technology firm said that members of his committee had experienced some bumpy meetings when controversial or particularly

elaborate issues were raised for the first time, spreading apprehension among the group. The solution, he said, was to be proactive about the discussions. "We tried to not wait until the meetings, where it gets a little bit more heated, and so now we'll try to anticipate if a member has a particular view or issue, and then try to get their views in beforehand."

On the rare occasion, he added, the committee can't agree on a recommendation and instead has to choose between a number of proposals backed by different members. "The goal is for the committee to come to a unified conclusion, in order to present the view of the committee to the CEO and CFO. It's always important to make sure the committee has come to a decision before you reach the CEO and CFO."

Mr. Kelly's challenges, from a CAO's perspective, were "to keep it fresh, making sure people don't routinely sign off on things ... this would be through a lot of education. It's through emphasis, it's through communication. So that the process, and responsibility for the process, is well understood and doesn't just become rote."

The former pharmaceutical CAO said there always were challenges in terms of remaining consistent with the document, whether a 10-Q or a 10-K. One example, he said, was the timing of when and where to disclose a contingency within a 10-Q or 10-K. The disclosure committee would also decide whether the contingency was material enough to be included in a disclosure or simply within the "other matters" section of the filing.

Finally, the CAO of the private company said that the primary challenge in forming a disclosure committee for a company that has operations around the world is the variability of the regulatory rules it has to follow. "It is hard to select disclosure committee members," he said, "who can identify and represent information from numerous areas of the world. We normally need members who are versed in government relations, taxes and financial regulations – members who would be able to determine which issues require financial disclosure or further assessment from an audit or accounting perspective. To meet this requirement, it seems that our disclosure committee will have more members than I originally anticipated."

### **Strengths and weaknesses**

*The main strengths that many cited are the expertise and experience of the committee members. As negatives, some mentioned an overreliance by members on those who have strong backgrounds in financial reporting and a failure to be more proactive to anticipate future issues.*

The CAO of the bank felt that the competence of the group was its biggest strength, and its main shortcoming was not being proactive enough. “Well, nothing’s perfect, and this has come through in our surveys: we probably could do a better job of projecting forward. For example, things that might be coming down the pike that our committee ought to be thinking about. We should probably be looking down the road six months, nine months, a year, and considering any new FASB pronouncements or new SEC requirements. Although we talk about those types of matters on an ongoing basis within the accounting department, we don’t talk about it as much at the disclosure committee level, and we probably should.”

The executive at the consumer products company pointed to the committee members’ diverse capabilities, knowledge and experience as their leading strengths, especially valuable traits when it comes to addressing the highly complex issues facing their company.

One potential weakness, said the CAO of the service company, is that some committee members “may have such confidence in the CAO and the other accounting professionals involved in the financial reporting process that there may be an overreliance on their competence and they may not push back or probe as much as they might otherwise.”

At this point, said the CAO of the private company, the only weakness he could cite was the failure, so far, to model his committee against a framework or charter. Without that degree of formalization, “there is not a perceived validity to the committee at a private company that does not have requirements under SEC guidance.” The process is evolving, but right now the level of formalized documentation isn’t where it should be.

### **Efficiency**

*Does a disclosure committee make reporting more efficient or effective? It’s a debate that doesn’t have a clear winner. Overall, those interviewed saw more of an impact on effectiveness than on efficiency. But one outside expert saw gaps in effectiveness and suggested ways for improvement. And someone who voted on the “efficiency” side lauded the committee’s help in reaching good decisions quickly.*

The former CAO of the industrial manufacturing company said that the committee there made the reporting process more comprehensive, rather than more efficient, echoing the views of several others. Thanks to the committee’s efforts, he said, “the key players all knew what the serious topics were to discuss.”

The executives at the technology firm see a mix of benefits: important contributions in the committee’s ability to identify and focus on the most important issues affecting the financial statements, as well as in creating deadlines for “good drafts.”

The strongest vote for efficiency came from the executive at the consumer products company. A disclosure committee definitely does increase efficiency, that executive said, by leveraging the experience and knowledge of committee members. Their contributions help the company quickly and proficiently reach correct decisions on important reporting issues.

The bank CAO presented a moderated view: “I don’t think the disclosure committee has made us inefficient.”

To make gains on the effectiveness front, a committee must be taken seriously by its members, the New York-based external counsel said. They must be willing to raise issues and make sure that they “percolate” up to senior management. A procedure that he suggests is to produce a quarterly “controller’s memo” of the most challenging reporting issues for that period; those “the company needs to think seriously about.” The list should be drafted before the committee meets and should also be sent to the audit committee after the disclosure committee has met and addressed the issues.

### **Complexity**

*We also asked our group of experts to describe how the committees help companies deal with complex or unusual disclosure issues, or how the absence of a committee in that context proved telling. One of the outside counsel we interviewed saw deficiencies in committee performance when it came to complicated filings or those with quick turnarounds. But almost everyone else cited the benefit of having a forum for all key decision-makers to meet when difficult and novel problems surface.*

In his experience, the New York-based external counsel said that 8-K and proxy statement disclosures often suffer in quality because of disclosure committee shortcomings. Since an 8-K is not a periodic filing and must be filed within four days after the occurrence of a triggering event, and proxy statements are filled with information from various sources, these documents don't get the same rigor of review from the committee that a 10-K or a 10-Q does.

Because disclosure controls and procedures are not audited, he added, very often they are not documented. "You may have an entire book of SOX-documented internal controls over financial, but nothing addressing the disclosure controls and procedures, particularly the disclosure committee."

The CAO at the bank noted that management established a sub-group called the Disclosure Coordinators, essentially a SWAT team with a mandate to address more isolated disclosure issues. "It is made up of the controller, the manager of SEC/SOX reporting, the senior deputy general counsel and the director of corporate communications," he said. "This group handles things that come along that might not necessarily require the full disclosure committee, but do require the right people to be involved. For example, after a call with investors, our attorney noted a response from our CEO to a question on that call that required evaluation as to the need for a Form 8-K filing or additional disclosure in our pending 10-Q filing. The SWAT team, including myself, worked through the issue. That is a prime example of how this function can be effective to the process."

The committee at the technology firm has helped with disclosures that might be more subjective than others or have multiple perspectives, the two executives there said. "Anytime there is a restructuring," one said, by way of example, "you're going to get legal, investor relations and accounting's viewpoints because you have to think about the employees as well as the event."

At the consumer products company, one of the most complex recent issues affecting disclosures was the shifting economic and political situation in Venezuela, the executive at that firm said. The disclosure committee was able to quickly and efficiently arrive at conclusions relating to the situation there, the executive said. Without a committee, a resolution would have taken much longer and might not have resulted in the useful and robust disclosures that the company made.

While Mr. Kelly couldn't recall a specific complex disclosure, he noted the benefit of the interactive discussions that committees hold. "When you have a meeting that has all of the people in the committee plus the CFO and the CEO, and they are discussing a topic, they are discussing it interactively, rather than serially. Members could actually explain their position, rather than ask for a direct change to the disclosures."

A very complex issue surfaced at the industrial manufacturing company, its former CAO said, and the disclosure committee was on the case from the very beginning – actually even before the transaction in question materialized, having sensed the issue from trends occurring within the industry. The committee obtained clearance from the SEC along the way, so that when the transaction finally occurred, there were no surprises. "Leading-edge financial disclosures got made even before the transaction ever happened," the CAO said.

The CAO of the service company recalled a debate over the placement of a certain number on the statement of cash flows – should it be presented gross or net? The issue was fully vetted with the disclosure committee as to what should be disclosed if the presentation changed. "We felt comfortable that we could describe the issue and conclusion to senior management and ultimately to the audit committee," the CAO said. "It was good to have the vetting process to ask questions about the external perception (from IR and treasury) if the number was presented differently."

"Having all the players at the table and getting their input" always helps to resolve complex issues, according to the former CAO of the pharmaceutical company. "You come out with a better product with more input."





## Emerging SEC data trends

An analysis of SEC filings was performed using the LogixData® SECAalyzer, a data-mining tool that permits context-based searches. For the period of disclosure from January 2009 through mid-November 2014, the analysis revealed the following:

1. A total of 1,046 companies reported that they have a disclosure committee. (Many more companies among the filers may also have committees but didn't disclose that fact or our tool did not identify the particular disclosure since some terminology may vary.)
2. The companies generally said that their purpose in forming a committee was to ensure that information required to be disclosed in SEC reports is recorded, processed, summarized and reported within the time periods specified by the SEC. Some companies also specifically noted a disclosure committee role relating to compliance under Section 404 of SOX.
3. The data indicated that the role of the disclosure committee is expanding. In addition to reviewing financial statements, MD&A, proxy statements and earnings releases, as reported in the survey results above, disclosure committees are also becoming responsible for reviewing conflict minerals and related-party transactions within proxy filings. Here are three examples from company filings of these new areas reviewed by disclosure committees:

### **Conflict minerals**

#### ***Disclosure from a proxy filing, April 2014***

*The Company holds quarterly disclosure committee meetings prior to the submission of quarterly or annual reports on the financial performance of the Company at which areas of risk are discussed, and is currently planning to adopt similar procedures for the Company's submission of its reports on the Company's reasonable country of origin inquiry and due diligence into the source country of certain "conflict minerals" necessary to the functionality of products manufactured by the Company, and reports to the Audit Committee on the results of those meetings.*

### **Related-party transactions**

#### ***Disclosure from a proxy filing, July 25, 2014, regarding prospective related-party transactions***

*The Audit Committee, under its charter, has the responsibility of reviewing and approving in advance any proposed related party transactions as defined under Item 404 of Regulation S-K. The Chief Financial Officer or Controller brings potential related party transactions to the attention of the Company's Disclosure Committee. The Disclosure Committee discusses any related party transactions, which are then brought to the attention of the Audit Committee at quarterly Audit Committee meetings, or more frequently, as required. The Audit Committee then*



*determines whether the related party transaction is approved or denied. Such discussion and disposition are evidenced in the minutes of the Disclosure Committee and the Audit Committee meetings. There were no related party transactions as defined under Item 404 of Regulation S-K during fiscal year ended March 30, 2014.*

***Disclosure from a proxy filing, April 10, 2014, regarding historical related-party transactions***

*As part of the process related to the financial close of each quarter, the Company distributes a disclosure checklist to management of each operating unit and financial function around the world, which seeks to ensure complete and accurate financial disclosure. One part of the checklist seeks to identify any related party transactions. Any previously undisclosed transaction is initially reviewed by: (i) the Company's disclosure committee to determine whether the transaction should be disclosed in the Company's SEC filings; and (ii) by senior management of the Company, including the General Counsel and the Chief Financial Officer, for consideration of the appropriateness of the transaction. If such transaction involves members of senior management, it is elevated to the Board for review. There were no such related party transactions in 2013.*



## Appendix A: Jump-starting a disclosure committee – an eight-step road map to success

How do you design and implement an effective and efficient disclosure committee? And once it is up and running, how do you keep it in top working order?

These eight steps will help you get started – and keep you focused.

1. Develop a formal charter and policy, but also ensure that there is room for flexibility. Meetings should not be restricted to official members of the committee – the doors should be open to other managers within the firm. (See Appendix B.)
2. Invite outsiders, such as external counsel and external auditors, who could add substantially to the discussion as informal observers.
3. Make sure that all committee members have a clear understanding of their roles and responsibilities. Consider an orientation meeting for new members.
4. To make committee meetings as efficient as possible, establish a subcommittee of non-executive members to take the first pass at the material to be discussed.
5. Establish a cross-functional team, including non-standing members, for insight into other areas of your organization. Don't forget to involve the enterprise risk management group.
6. Prepare for all meetings by compiling a list of issues to focus on for the reporting period and crafting alternative options for discussion. In doing so, and to stay abreast of changing disclosure requirements, consider reviewing relevant disclosure checklists and questionnaires from your external auditor.
7. Allow audit committee members to have input into the process. This may help with future decision-making by the disclosure committee.
8. To keep things running smoothly, committee members should periodically perform a self-evaluation. Areas of concern will often surface, prompting reassessments and improvements. (See Appendix C.)



## Appendix B: Sample disclosure committee charter<sup>5</sup>

This Disclosure Committee (the “Committee”) Charter (the “Charter”) has been adopted by the Chief Executive Officer and Chief Financial Officer (the “Certifying Officers”) of [XYZ Inc.] (the “Company”).

### **I. Objective**

It is the Committee's and Company's objective that all public disclosures made by the Company to its security holders or the investment community, including those in its Securities and Exchange Commission (“SEC”) filings, should (i) be accurate, complete and timely; (ii) fairly present the Company's financial condition, results of operations and cash flows in all material respects; and (iii) meet any other applicable laws and stock exchange requirements.

### **II. Organization**

The Committee will consist of individuals in the following positions within the Company: [Chief Financial Officer, General Counsel, Corporate Controller, Chief Accounting Officer, Head of Internal Audit, Head of Investor Relations, and Head of SEC Reporting.]<sup>6</sup> Committee members may be appointed or removed by the Certifying Officers at any time.<sup>7</sup>

One member of the Committee will be designated the chairperson by the Certifying Officers. The chairperson schedules and presides over meetings, and ensures the timely preparation of agendas and written minutes from meetings. Any interpretation of the Charter or the Committee's procedures shall be made by the Committee chair. The chair or the Certifying Officers may include outside consultants or advisors as appropriate.

### **III. Responsibilities**

The Committee, under the oversight and supervision of the Certifying Officers, will facilitate the objectives by:

- ▶ Establishing and maintaining a policy designed to ensure that information required to be disclosed by the Company in its filings with the SEC and other information that the Company discloses to the investment community is recorded, processed, summarized and reported accurately and timely (“Disclosure Controls Policies and Procedures”). Disclosure Controls Policies and Procedures will include policies and procedures to assess the effectiveness of the Company's Disclosure Controls.
- ▶ Evaluating the integrity and effectiveness of the Company's Disclosure Controls as of the end of the period covered by each SEC Periodic Report filed by the Company with the SEC and any amendments to those reports. This may include the use of outside consultants.

<sup>5</sup> This charter is illustrative in nature and should be tailored to the unique facts and circumstances of each company.

<sup>6</sup> The individuals listed here are those who regularly compose a disclosure committee. Other individuals who may be asked to participate in committee meetings include the chief executive officer, the corporate treasurer and the chief risk officer.

<sup>7</sup> In many organizations, the CFO generally appoints committee members; however, in some organizations, the certifying officers, acting jointly, may appoint them.



- ▶ Reviewing all relevant information with respect to the Committee's proceedings, and the preparation of SEC Periodic and Current Reports.
- ▶ Providing a sub-certification to the Certifying Officers before filing each SEC Periodic Report as to (i) the Committee's compliance with the Company's Disclosure Policy and this Charter, and (ii) the Committee's conclusions resulting from its evaluation of the effectiveness of the Disclosure Controls.

In order to execute its responsibilities, the Committee shall have full access to all Company books, records, facilities and employees, including independent auditors.

#### **IV. Process**

The Committee will meet and establish a process in accordance with the Disclosure Policy.

#### **V. Charter Evaluation**

The Committee will evaluate and assess this Charter and its performance annually or upon certain material events.<sup>8</sup> Any changes to the Charter must be approved by the Certifying Officers.

<sup>8</sup> Material events may include significant acquisitions or divestitures, fraud, litigation and insider trading.



## Appendix C: A self-assessment checklist<sup>9</sup>

### 2014 disclosure committee self-assessment

This questionnaire will help identify areas for discussion and evaluation. Regular assessment and continuous improvement are goals of this process. Please address each question by placing an “x” based on the ratings scale provided (i.e., strongly disagree to strongly agree). Also feel free to provide any additional comments or issues in the sections that follow each category.

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree	N/A	Comments
<b>Alignment with committee mission</b>							
(1) Charter accurately describes the committee duties and responsibilities							
(2) Committee executes on its charter effectively							
(3) Committee considers forward/emerging issues to review							
<b>Committee operations</b>							
(4) Committee meeting schedule is appropriate							
(5) Length of committee meetings is appropriate							
(6) Committee agendas focus on the important topics							
(7) Committee spends appropriate time on questions and discussion							
(8) Management and internal resources effectively support committee functions							
<b>Member participation</b>							
(9) Committee composition is appropriate							
(10) Members understand their roles and responsibilities							
(11) Members are assigned to specific tasks and committee projects, as necessary							
(12) Members make regular and valuable contributions to committee work							
<b>Overall</b>							
(13) Committee uses its time efficiently							
(14) Committee functions effectively							
<b>Other comments and observations</b>							

<sup>9</sup> Adapted for general use from a checklist provided by an interviewee.



## Appendix D: Excerpts from Sections 302 and 906 of the Sarbanes-Oxley Act

The Sarbanes-Oxley Act introduced major changes to the regulation of financial reporting practices and corporate governance. Below are excerpts from Sections 302 and 906 of the Act.

### **SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.**

- (a) REGULATIONS REQUIRED – The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that
- (1) the signing officer has reviewed the report;
  - (2) based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
  - (3) based on such officer's knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;
  - (4) the signing officers—
    - (A) are responsible for establishing and maintaining internal controls;
    - (B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;
- (C) have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report; and
  - (D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;
- (5) the signing officers have disclosed to the issuer's auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—
- (A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize, and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and
  - (B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and



- (6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.
  - (b) **FOREIGN REINCORPORATIONS HAVE NO EFFECT.**—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.
- SEC. 906. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.**
- (a) **IN GENERAL.**—Chapter 63 of title 18, United States Code, is amended by inserting after section 1349, as created by this Act, the following:

**§ 1350. Failure of corporate officers to certify financial reports**

    - (a) **CERTIFICATION OF PERIODIC FINANCIAL REPORTS.**—Each periodic report containing financial statements filed by an issuer with the Securities and Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.
    - (b) **CONTENT.**—The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.
    - (c) **CRIMINAL PENALTIES.**—Whoever—
      - (1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$1,000,000 or imprisoned not more than 10 years, or both; or
      - (2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both.

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