

## Navigating the SEC Comment Letter Database

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The SEC Comment Letter Database is a relatively new and increasingly important source of information for valuation specialists to consider. An understanding of the research capabilities available in using the SEC Comment Letter Database will aid the work of valuation specialists who perform valuation services for SEC registrants specifically and for financial reporting purposes in general. In addition to being a potential means to increase valuation specialists' knowledge base and the quality of their analyses, the SEC Comment Letter Database may also provide useful information in the areas of practice development and risk management.

In the past, it was not uncommon for a valuation specialist to hear about an SEC "red flag" from an auditor or valuation colleague, supposedly based upon a comment letter, without being able to review the source document. This situation began to improve after May 12, 2005, when the SEC began publicly releasing both reviewed staff comment letters, *and* registrants' response letters relating to disclosure filings made after August 1, 2004.<sup>1</sup>

### **What are SEC comment letters and what is their purpose?** According to the SEC<sup>2</sup>:

Disclosure filings made with the SEC are in certain cases selected for review by staff. For many years, the Division of Corporation Finance and the Division of Investment Management

have provided filers with comments on filings where they believe the filing could be improved or enhanced...The letters set forth staff positions on a particular filing only and do not constitute an official expression of the Commission's views. Further, these letters set forth the staff's position, are limited to the specific facts of the filing to which they apply, and do not apply to other filings.

There are two types or purposes of comment letters<sup>3</sup>:

- To describe the letters that individuals and entities submit in response to requests for public comment on proposed rulemaking or other agency activity, and
- To refer to the correspondence that issuers and SEC staff exchange concerning disclosure filings.

From the SEC's perspective:

- The comments are issued where the SEC believes the filing could be improved or enhanced;
- The comments reflect staff positions on a particular filing only and, therefore, the comments do not reflect an official expression of the SEC's views; and
- The comments are limited to the specific facts of the filing to which they apply and, therefore, the comments do not apply to other filings."

1 As of the date of the writing of this paper, found at [http://searchwww.sec.gov/EDGARFSCClient/jsp/EDGAR\\_MainAccess.jsp](http://searchwww.sec.gov/EDGARFSCClient/jsp/EDGAR_MainAccess.jsp).

2 SEC press release dated June 24, 2004, found at <http://www.sec.gov/news/press/2004-89.htm>.

3 [www.sec.gov](http://www.sec.gov)

# BUSINESS VALUATION UPDATE

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The receipt of an SEC comment letter is a ‘big deal.’ Based upon my discussions with SEC registrant personnel, the receipt of an SEC comment letter often results in significant time and energy among internal management personnel, external auditor, and outside counsel in reviewing the comment letter and developing appropriate written responses. This process may involve multiple rounds from and to the SEC. Registrant responses to comment letters may range from short bullet point answers to re-writing multi-page, lengthy disclosures to adequately meet the SEC’s requirements for providing meaningful disclosures to investors. Although the receipt of comment letters periodically is not unexpected based upon a perceived “cycle” to the SEC’s review process, the scope and extent of comments can vary considerably.

Comment letters are heavily reviewed and scrutinized by accountants and attorneys in order to ascertain trends regarding areas in which the SEC is seeking enhanced disclosure by SEC registrants.<sup>4</sup>

Historically, only a small portion of issues raised in comment letters were relevant to valuation specialists. However, the increased prevalence of fair value measurements may increase the frequency of such valuation-related comments in the future.

Potential uses of the SEC Comment Letter Database for a valuation specialist include:

1. Performing research related to a valuation for financial reporting purposes;
2. Gathering market intelligence useful for practice development; and
3. Monitoring risk issues to the valuation firm.

Obviously, the first use would also be relevant for SEC registrant personnel who perform internal valuations for GAAP-compliance purposes. Below is further discussion regarding each of the above uses.

<sup>4</sup> Tammy Whitehouse, “A Library of SEC Comment Letters Arises,” *Compliance Week*, February 20, 2008.

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## 1. Performing research related to a valuation for financial reporting purposes.

There are several potential opportunities for using the SEC Comment Letter Database in this area. First, the database is another potential source for either the development of market participant assumptions or an assessment of whether a subject entity's assumptions are consistent with market participant assumptions.<sup>5</sup> Potential useful searches are those related to a particular competitor or market participant or broader searches for SEC registrants within a particular SIC Code. For example, if working on a valuation related to Accounting Standards Codification 805 - Business Combinations (ASC 805), then frequently discussed assumptions under the market participant concept include the types of intangible assets chosen for recognition, asset discount rates, customer attrition rates, revenue growth rates, and asset useful lives, among others. In addition, searches could be done related to valuation methodologies utilized by asset type.

Second, the database could help the valuation specialist develop an understanding of whether certain valuation issues consistently arise in a particular industry. For instance, there may be scrutiny regarding why certain types of intangible assets have not been recognized under ASC 805 or the valuation methodology used to value other intangible assets. Developing such an understanding may be especially useful during either the proposal phase or planning phases of an engagement. Although such issues, to the extent they exist, may be well-known by valuation specialists who focus on a particular industry, the issues may not be well-known among valuation specialists who are exposed to more diverse industries.

Similarly, research may provide the valuation specialist with an understanding of comment letters a registrant client has received in the past and the nature of any valuation-specific comments. It is possible that such an understanding could be used by a valuation specialist to assist

such a client in attempting to document valuation analyses and conclusions in a manner that would limit future comment letters. Although beyond the scope of a typical valuation engagement, assuming a valuation specialist has a good understanding of the issues involved, this sort of value-added client service may be well-appreciated by an SEC registrant client.

Third, research of the database may provide insight into an audit firm's approach to valuation related to a particular asset or issue. Assume a hypothetical scenario where a valuation specialist will be performing an ASC 805 valuation for a client that is audited by Deloitte. The valuation specialist could search for the word "Deloitte" for registrants under a relevant SIC Code to see if any comment letters may be found referencing Deloitte's valuation of acquired intangible assets for a market participant in that industry. References in the comment letters may range from discussion of specific assumptions and methodologies used to the attachment of an entire report as an exhibit. To the extent such documentation exists, it could potentially provide a valuation specialist with insight that could be helpful in planning the valuation services to a firm's audit clients and the types of questions that may be raised upon an SAS 73 review by the valuation specialists of the audit firm.

Although not a substitute for a thorough analysis of the subject intangible assets under the current ASC 805 engagement (and/or a dialogue with a client's auditor), such research could provide useful additional information to consider by the valuation specialist. However, it is important that any such research related to a valuation performed by an audit firm's valuation specialists *not* be considered as some sort of guarantee related to how that audit firm will address a similar situation under a subsequent SAS 73 review for a different valuation engagement. Reasons for a perceived departure from the precedent valuation include that certain valuation practices may evolve over time, there may be different personnel involved with the valuation found using the database and the SAS 73 review of a third-party valuation, and, finally, there may be a difference in key facts and circumstances related to each engagement.

<sup>5</sup> See Accounting Standards Codification 820 - Fair Value Measurements and Disclosures for a discussion of market participant concept.

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Fourth, information culled from the database can contribute to a valuation specialist refining his or her “best practices” regarding valuations for financial reporting purposes. For example, if a valuation specialist finds what he or she believes is a “gray area” that is addressed in great detail within the database, the valuation specialist can use such information to improve analytical methodologies or report content to raise the quality of the analysis included in a valuation report. Rather than providing a one-time benefit, such research may provide carry-over benefits to other future engagements.

## **2. Gathering market intelligence useful for practice development.**

Research of the database may be used by a valuation specialist to gather information to assist in marketing efforts or to better understand the competition. For example, if targeting a specific SEC registrant for valuation services, a search of the database may reveal valuation issues dealt with previously by the registrant. Such valuation issues may represent areas that the valuation specialist should obtain a solid understanding about before engaging in discussions with the SEC registrant target. In addition, replies to comment letters by an SEC registrant may identify whether a previous valuation was performed internally or through the services of a third-party valuation specialist, which would be useful information to a valuation specialist attempting to establish a relationship with that registrant. Please note that the identity of the specific valuation firm may not be referenced specifically but instead referred to in general terms such as, for example, “independent valuation firm.” If more than one valuation firm is identified in replies to comment letters, then this may indicate that the SEC registrant is open to receiving bids for engagement opportunities and does not have a preferred valuation services provider.

## **3. Monitoring risk issues to the valuation firm.**

Most valuation firms include language within reports that discuss circumstances in which the name of the valuation firm may or may not be

disclosed. In particular, most valuation firms have language either in the terms and conditions within an engagement letter or in the valuation report that prohibit the disclosure of the valuation firm to the SEC. For example, a valuation report may have text similar to the following:

Valuation Firm X does not consent to be “expertised” with respect to matters involving the Securities and Exchange Commission. For purposes of this report, the foregoing sentence means that Valuation Firm X shall not be referred to by name or anonymously in any filing or document.

In spite of such language, based upon research of the database, I was able to find numerous instances where not only the name of the valuation firm was disclosed, but also instances where entire valuation reports were included as exhibits in registrant responses to comment letters. Although these particular disclosures and attachments may have been provided with the consent of the valuation firm, it may be helpful for valuation specialists to monitor the database for unauthorized disclosures.<sup>6</sup> Given the public availability of the database, valuation firms may want to add language that specifically addresses comment letters, including any limitations regarding usage of the valuation firm’s name and report in any correspondence to the SEC. In addition, since it is possible that an SEC registrant may inadvertently misrepresent a valuation firm’s analysis regarding a particular matter, I believe that most valuation specialists would welcome the opportunity to review a client’s responses to comment letters regarding relevant valuation issues before such responses are sent to the SEC.

**Searching the Database.** The database currently includes tens of thousands of instances of correspondence between the SEC and registrants. Fortunately, the database is searchable using numerous search criteria. A “Full-Text

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<sup>6</sup> A full discussion regarding the implications of disclosure of a valuation firm’s name or references to an independent valuation firm to the SEC or within an SEC filing are beyond the scope of this paper.

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Search” allows a search of the full text of all EDGAR filings submitted electronically during only the last four years from the search date.<sup>7</sup> The full text of a filing includes all data in the filing itself as well as all attachments (such as exhibits) to the filing, which in some instances may include supporting documentation, such as a third-party valuation report. Full-Text Search uses a *conceptual* search engine rather than a *key word* search engine to search and retrieve the information sought. Therefore, the search may retrieve some results that are conceptually related to provided search terms but do not necessarily contain the precise search term.

Full-Text Search is available using either *natural language* or *Boolean* search operators. A natural language search enables a search for a concept by using the language that one would use to express that concept to another person. Boolean

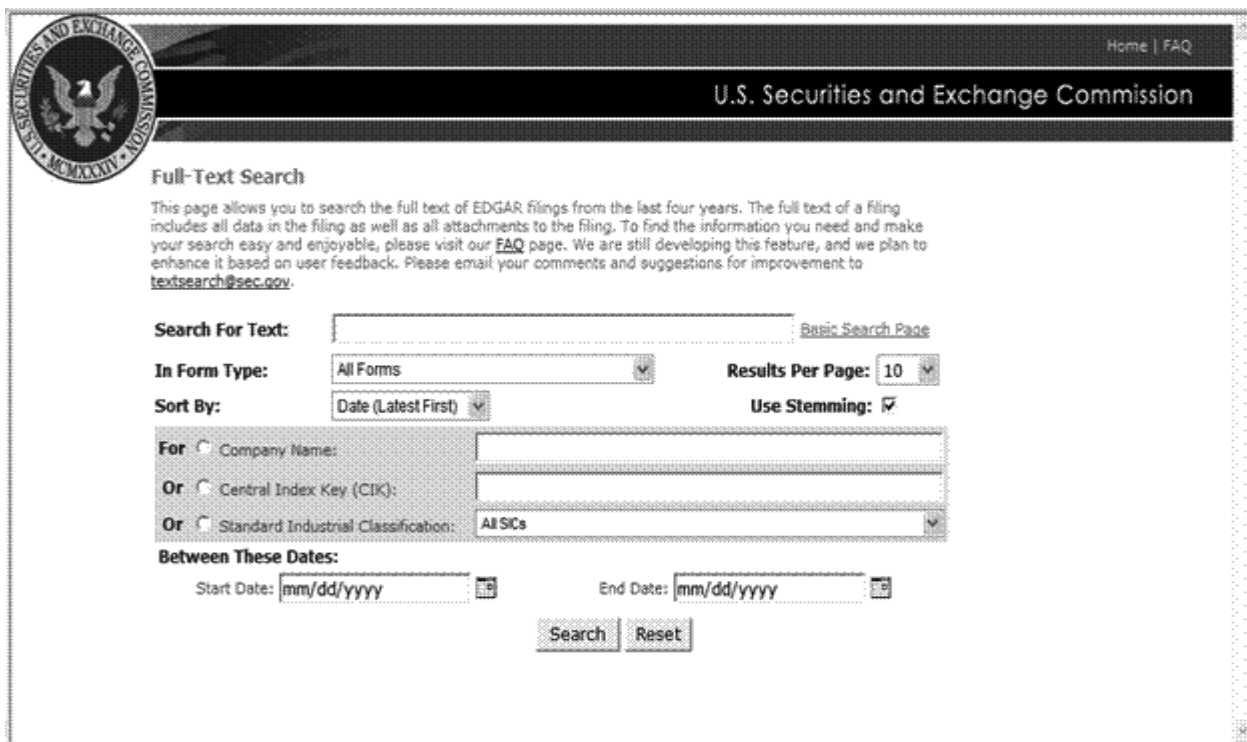
<sup>7</sup> There are numerous third-party, proprietary databases that may offer a larger search of the database. The focus of this paper is on capabilities of the SEC database available to the public for free.

search operators include “AND”, “OR”, and “NOT.” In my experience, Boolean searches are particularly helpful for adding multiple criteria to a search, which is useful in reducing the search results to a more manageable level.

The selection of Advanced Search reveals additional search criteria. A screenshot from the SEC’s website can be found below.

In terms of specifying the universe of correspondence between the SEC and registrants, by using the field “In Form Type,” one can specify that the search focus only on correspondence from the registrants to the SEC. In my experience, a search using the Form Type “CORRESP” is more useful as the letters from SEC registrants typically include the comments from the SEC as well as the responses to the comments by the registrant.

In addition, as shown, data searches may utilize criteria such as company (registrant) name, SIC Code, and date of correspondence.



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## Conclusion

An understanding of the research capabilities using the database will aid a valuation specialist who performs valuation services for SEC registrants specifically and for financial reporting purposes in general. In addition to being a potential means to increase valuation specialists' knowledge base and the quality of their analysis, the database may also provide useful information in the areas of practice development and risk management.

In a subsequent issue of *Business Valuation Update*, I will summarize the results from research of the database over a recent four-year period related to various valuation concepts of particular importance to valuation specialists. My hope is that the results from this research will provide some insight as to items that are being more heavily scrutinized by the SEC and also provide a summary of what I believe are insightful registrant responses to such issues. As the receipt of comment letters generates increased compliance efforts upon company management, auditors, and sometimes their valuation specialists, such an understanding may help these individuals, as appropriate, to better prepare valuation analysis, supporting documentation, and disclosures. Ultimately, such actions may help reduce the frequency or scope of comment letters received by registrants in the future.

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