Record of Proceedings of

SEC ADVISORY COMMITTEE ON

IMPROVEMENTS TO FINANCIAL REPORTING

OPEN MEETING

Thursday, March 13, 2008

2:59 p.m. to 6:48 p.m.

Laurel Heights Conference Center

Sublevel 1 Auditorium

University of California - San Francisco

San Francisco, CA

COMMITTEE MEMBERS PRESENT:

Robert C. Pozen, Committee Chairman
Susan Schmidt Bies
J. Michael Cook
Jeffrey J. Diermeier
Scott C. Evans
Linda L. Griggs
Gregory J. Jonas
William H. Mann, III
G. Edward McClammy
Edward E. Nusbaum
David H. Sidwell
Thomas Weatherford

COMMITTEE MEMBERS ABSENT:

Dennis R. Beresford
Joseph A. Grundfest
Christopher Liddell
James H. Quigley
Peter J. Wallison

OFFICIAL OBSERVERS PRESENT:

Dan Goelzer for Mark Olson

OFFICIAL OBSERVERS ABSENT:

Robert Herz

Charles Holm

Kristen E. Jaconi

Philip Laskawy

SEC AND COMMITTEE STAFF PRESENT:

Conrad Hewitt, SEC Chief Accountant

James Kroeker, SEC Deputy Chief Accountant

Jeffrey Minton, SEC Office of the Chief Accountant

Wayne Carnall, SEC Chief Accountant, Division of Corporation Finance

Shelley Parratt, SEC Deputy Director, Division of Corporation Finance

Russell Golden, FASB Senior Advisor to Committee Chairman

PANELISTS:

Barbara Roper

Elizabeth Mooney

Stephen Meisel

John Huber

Manish Goyal

Steven Bochner

Jack Acosta

Scott Taub

Scott Richardson

Dennis Johnson

Salvatore Graziano

Randy Fletchall

Jonathan Chadwick

C O N T E N T S

P R O C E E D I N G S

MR. KROEKER: I'll go ahead and call the meeting to order. I want to thank -- I particularly want to thank the panelists for agreeing to come and join us. I certainly look forward to the discussion. I also want to thank a couple of staff people in particular, but -- the entire staff -- but there were a couple people in particular that put a tremendous amount of effort into making sure that we could bring the CIFiR show on the road. Brett Williams spent a lot of time researching locations and put a tremendous effort into this, as well as Dana Swain and certainly a number of other staff. And if I begin to mention them all, I'll forget somebody.

With that, I do also want to highlight that the statements of many of the panelists -- or that the panelists have provided -- are available. They are available as handouts here. There are a number of attachments to John Huber's statement that aren't in the package but that are available online. For anyone that is listening online, the statements are available in the "Comments" section of the CIFiR web site.

And with that, I'll turn it over to you, Bob.

INTRODUCTORY REMARKS

MR. POZEN: Thank you very much. And I also want to thank the staff from the SEC and the PCAOB and the FASB for doing such an excellent job.

And I guess I would like to make sure that everybody begins by knowing everybody else, so maybe we could just quickly go around the room and the committee members could introduce themselves and just their affiliations.

Scott?

MR. EVANS: Scott Evans, TIAA-CREF. I'm on the standard-setting subcommittee.

MR. SIDWELL: David Sidwell, same subcommittee as Scott. I'm the CFO of Morgan Stanley.

MR. POZEN: I don't think we'll need to do the subcommittee, since we're meeting as a whole committee to educate.

Ed.

MR. NUSBAUM: Ed Nusbaum, Grant Thornton.

MS. GRIGGS: Linda Griggs, Morgan Lewis & Bockius.

MR. JONAS: Greg Jonas from Moody's Corporation.

MR. COOK: Michael Cook. I'm unemployed.

MR. POZEN: Mike is here as a member of several audit committees, probably the head of several audit committees.

MR. DIERMIER: Jeff Diermier, CFA Institute.

MR. MANN: Bill Mann, with the Motley Fool.

MR. WEATHERFORD: Tom Weatherford, independent board member.

MR. MCCLAMMY: Ed McClammy, CFO, Varian, Inc.

MS. BIES: Sue Bies, representing, as a former bank regulator, the bank regulators.

MR. POZEN: I know Joe Grundfest said he was under the weather today, so he may or may not show up; and he sends his regrets if he can't.

I'd also like just sort of -- maybe we can just go in alphabetical order and we'll sort of ask for testimony in reverse order.

So, Jack, you want to begin?

MR. ACOSTA: Jack Acosta; and my background is primarily finance, CFO of multiple companies. Now I primarily sit on boards as chair of audit committee.

MR. BOCHNER: I'm Steve Bochner, a partner with Wilson Sonsini Goodrich & Rosati.

MR. GOYAL: I'm Manish Goyal, research analyst with TIAA-CREF.

MR. POZEN: Better be careful. Your boss is here.

MR. HUBER: John Huber, partner, Latham & Watkins.

MR. MEISEL: Steve Meisel, partner, PricewaterhouseCoopers.

MS. MOONEY: Elizabeth Mooney, Capital Group Companies.

MS. ROPER: Barbara Roper, Consumer Federation of America.

MR. POZEN: Yes. And I want to thank all the witnesses for taking the time to come out here. Some of you, I know, have traveled quite a distance; and others it's a little closer. But we are trying to have not just a Washington-based set of public meetings; but we will have one in Chicago, I think in May, so we're trying to make sure that -- and in New York probably in July -- so we want to make sure that people from various parts of the country have a chance to make known their views.

We also have comment letters; and we have circulated a summary of the comment letters to the committee so I'm not going to go over them now, but just to note for the record that these are available in the public file for anyone who wants to see them.

Now, our procedure for today is pretty simple. We're going to have two panels, each of which will last, say, an hour and a half, maybe an hour and forty minutes. We'll take a break between them. This is the first panel. And we've asked each of the members of the panel to make a short statement -- and we're going to be pretty tough about that -- at five minutes. Some people have submitted a statement in writing. So we have those; and you should assume that we have read those and not necessary to read them again. But, obviously, if you want to make some comments on them.

And then what we're hoping for is, after people make their statements, is to have some real discussion based on these issues so that we can be better informed. Our objective in putting out what we call the “interim report” – “interim progress report” -- was to get our views out so that people could have a chance to comment. We will be putting out a final report at the beginning of August so this is in the nature of a draft. We very much welcome input, both by comment letters and through these public forums that we're going to have, so that we can become educated, that we can understand better how people reacted to this.

It may be the case that we haven't fully understood certain points of view. It may be the case that we have not communicated clearly enough our point of view; and so this is a good way in which we can learn, hopefully, about how to reach better conclusions than we did or to improve them.

As you know, we have twelve what we call developed proposals; and we tried to put them out in some detail; and then we have other issues that we're going to consider, going forward. This meeting is to focus on the developed proposals and especially the set that relates to what's sometimes called subcommittee 3.

So I think what we're going to do here is just go in reverse alphabetical order and just go through.

And, Barbara, would you start us off?

PANEL ONE - RESTATEMENTS AND

DISCUSSIONS OF DEVELOPED PROPOSALS

MS. ROPER: As director of investor protection for the Consumer Federation of America, my job is to advocate on behalf of typical retail investors. Now, the typical retail investor may never look at a financial statement, yet they have a strong interest in ensuring that financial reporting is reliable and that errors, when they occur, are corrected quickly, because their ability to retire in comfort increasingly depends on the health of the capital markets. And the health of the capital markets depends on reliable financial reporting.

Despite the reforms that have been adopted since Enron, investors remain very concerned about the accuracy of financial reports. According to an AARP survey released last year, 79 percent of investors think financial and accounting standards should be strengthened; 3 percent think they should be loosened. That's why we strongly oppose the recommendations that we believe would weaken the materiality standard and provide less transparency around the reporting of financial statement errors.

The committee has argued that these changes are needed to reduce the number of unnecessary restatements; but the report, at least, provides no evidence that a significant number of unnecessary restatements are currently occurring. We believe the assumption that the fact that a restatement has no significant market impact is a poor basis on which to determine that it's not significant to investors.

Moreover, the committee has not -- or the report has not -- provided any evidence that the benefits of reducing these restatements -- they are indeed unnecessary -- outweighs the risks that errors will go on -- that material errors will go uncorrected if the proposed changes are adopted, which we believe would be the case. The report argues that the current approach is too conservative; and it suggests that new guidance is needed on the materiality and emphasizes the concept that the evaluations of materiality should be based on a reasonable investor, how an error affects the total mix of information available to that investor using a sliding scale that includes both quantitative and qualitative factors.

I admit I'm confused. I just reread SAB 99. All of those principles are in there, clearly articulated. It says, for example, that a matter is material if there is a substantial likelihood that a reasonable person would consider it important. It makes it absolutely clear that both quantitative and qualitative factors have to be taken into account in making these assessments. It talks about the total mix of information.

So why do we need new guidance? The report suggests that new guidance is needed because the committee believes too many materiality judgments are being made in practice without full consideration of how a reasonable investor would evaluate the error. But if that's happening, it does not appear to me to be happening because there is a flaw in the existing guidance. It, frankly, sounds to me the committee is second-guessing the judgments made about materiality by auditors and issuers today.

One issue is clearly the desire of the committee to make it easier to have quantitatively large errors excused as immaterial, based on qualitative factors, something SAB 99 does allow, albeit in limited circumstances. Past experience tells us that encouraging a move in this direction is just a bad idea. Think Enron in 1997, when Arthur Andersen acquiesced to Enron's argument that adjustments that would have reduced its net income by nearly 50 percent were immaterial. You know, think about Waste Management; or just read more recent headlines, for example, where auditors have rubber-stamped highly questionable arguments that large errors are immaterial. So large errors may not be by definition material; but if this approach is encouraged, it will be abused, in our opinion. For that reason, we believe the presumption should always be that a qualitatively large error is material.

But if you insist on doing something in this area, we could consider a proposal to allow quantitively large errors to go uncorrected in certain circumstances, if managers and auditors were required to disclose that the report includes uncorrected errors, the amount and nature of those errors, and the basis of the decision that they are not material.

The report also suggests that we need new guidance on when and how to correct an error; and it makes a number of suggestions that we believe would allow more errors that are, in fact, significant to investors to avoid restatement. These include allowing past errors to go uncorrected on the highly questionable assumption that they're irrelevant to current investors.

And as I read this, I was curious. Who are these current investors? Do they include potential investors who may be evaluating a company stock to determine whether they want to purchase it? If so, on what basis could one assume that they have no interest in following historical trends, something that proposals that would not require past errors to be corrected would make significantly more difficult? And if the term "current investors" does not include potential investors, why on earth not? For that matter, on what basis do you decide that current investors don't have a similar interest in following trends or that interim reports aren't relevant to these investors?

And the point that really sort of bewilders me is that, having identified incomparability and inconsistency as the leading causes of avoidable complexity, on what basis have you determined that reducing comparability and consistency in this area improves financial reporting? We simply don't agree.

We are concerned that the committee invites a return to self-restatement when it suggests that errors that are found close to the next reporting period may not need to be corrected until the next report. I suspect that a lot of errors will magically be discovered close to the next reporting period if this approach is encouraged. I suspect investors won't appreciate having those kinds of accounting games.

In an ideal world, our policies would strike a perfect balance. They would ensure that all material errors are corrected and that no unnecessary restatements occur. As you may have noticed, however, this is not an ideal world. Too many issuers have shown themselves willing to game the system and too many auditors have shown themselves willing to let them. Given that reality, in our opinion it is far better for investors to err on the side of conservatism and risk causing a few unnecessary restatements than it is to focus so hard on reducing unnecessary restatements that we allow material errors to go uncorrected. Because of what we believe is a fundamentally flawed focus on reducing restatements instead of reducing errors, we fear that these recommendations, if adopted, will reduce transparency; will increase investor confusion; will undermine investor confidence; and will, in fact, invite a return to the kind of shoddy practices of the all-too-recent past. But that, of course, is just my professional judgment.

MR. POZEN: Do you want to say -- okay. Then we're -- okay. Thank you very much.

Elizabeth.

MS. MOONEY: Thank you, Chairman Pozen and other members. Thank you very much for the opportunity to be here today to testify on the topics of materiality and restatements. They are two very important topics to investors.

I'm an analyst with the Capital Group Companies, which manages, through affiliates, American Funds, as well as institutional, endowment, and private-client accounts. Capital Research and Management and Capital Guardian Trust Company buy and hold equities and fixed-income investments and securities for the long term. We actively manage well over a trillion of assets and have over 350 analysts and portfolio managers globally throughout the organization. We conduct intense on-the-ground company research and are current and reasonable investors who are very heavy users of and rely on financial statements. These are my own views and I surveyed my investment colleagues with several questions; and I wanted to discuss the results of the survey with you.

First, we oppose a company's and its auditors' decision not to correct financial statements for a large, quantitatively significant error. Correcting such an error is relevant; and the restated information would likely have an effect on our evaluation of the company's securities, going forward. We emphatically oppose having anyone other than investors themselves determine whether quantitatively significant errors provide relevant information to investors. This was a 75-percent response to this. That is, whether such errors are capable of making a difference in user decisions. Quantitatively large errors should not be deemed immaterial by the company and auditors.

Second, we believe a company should restate previously reported amounts for individual income and expense items on the income statement, even though the previously reported net income number would not change as a result. We are very interested in the corrected individual components of the income statement and use the changes in specific income and expense items over time as part of our trend analysis. This detailed information is critical for projecting a company's future results, future earnings and cash flows and, in turn, the evaluation of debt or equity securities. As such, net income is merely a starting point for analyzing a company's historic performance and should not be viewed as the only important amount on the income statement for assessing materiality of possible restatements.

Third, we believe that even if a material error does not affect the annual financial statements in a company's most recent 10-K filing, historical results should be restated. One analyst asked if this was a joke. Corrections should not limited to results presented in the current report being filed. Even such errors that do not affect the annual financial statements included in the company's most recent filing with the SEC are relevant to current investors.

Fourth, we believe that both interim and annual results need to be restated if affected by material error. The same results and principles should apply for both, as we rely on both sets of results. Again, trend analysis or understanding the variance in reported amounts over time is very important. Making an adjustment for a large quantitative error in the following period or annual statement to avoid correcting the actual prior period or periods -- interim statements -- affected will result in distorting the interim current and prior reporting periods. This has a negative report on the usefulness of trend analysis.

Fifth, we agree with the part of CIFiR's Developed Proposal 3.2 that suggests current disclosure is not consistently adequate for the needs of investors. Yes, we do get confused when a company provides little or no disclosure once it has announced a reporting issue and/or a possible restatement until it issues its revised financial report. Disclosure is a concern and investors want to be their own decision-makers on which errors -- material under SAB 99 -- are unimportant in their investment theses. Moreover -- 94 percent said this -- companies should disclose their bases for materiality, how they assess materiality, and the amount of uncorrected errors as of each reporting period. I'm aware that this committee has proposed a professional judgment framework, given that professional judgment is integral to materiality and used when assessing materiality. I just want to say that investors are very interested in having disclosure of the key risk areas in the financial statements from the perspectives of each manager and the auditors.

And I also -- on professional judgment, before I continue on materiality, I just want to read an excerpt from our testimony from February 4th to the Treasury Advisory Committee on the Auditing Profession. This was delivered by Paul Haaga, vice-chairman of Capital Research Management

Company, just that we do not believe that providing audit firms a safe harbor or business judgment rule is necessary at this time. Investors place reliance on auditors as experts who spend a significant amount of time examining the companies they audit. The judgments made by the auditors should be informed by their expertise and time spent on the audit engagements. Recent history has shown that these judgments have been poor in so many instances that we believe it's unwarranted to provide a safe harbor for judgments related to historical numbers and to take away the deterrent of litigation.

Overall, the analysts and portfolio managers that I surveyed place a very high level of importance on having comparable, consistent, and accurate historical financial statements for analyzing a company, conducting trend analysis, and forecasting future results. Using a scale of one equals not important and five equals very important, nearly all respondents believe that having such information is very important and the remaining view it as important.

If the market is getting it wrong by punishing a stock in reaction to a company's restatement, then the company should disclose more information. The lack of transparency is what creates unwarranted confusion and unnecessarily penalizes valuations. If high-quality information is provided, reasonable investors can quickly digest it and move forward. If restatement information is misinterpreted initially, clarity helps the stocks rebound sooner. We see it time and time again.

Fortunately, the Sarbanes-Oxley cleanup is mostly behind us for accelerated filers; and the number of restatements is on the decline.

In conclusion, current guidance provided by the courts and SEC for assessing materiality as appropriate, in my opinion -- our opinion. On behalf of investors -- and as one reasonable investor put it to me -- please don't change a word of SAB 99.

Thank you.

MR. POZEN: Thank you, Elizabeth.

Stephen. Mr. Meisel.

MR. MEISEL: Chairman Pozen and members of the committee, SEC staff, and observers, good afternoon. Thank you for inviting me here today to respond to your questions on behalf of the Center for Audit Quality relating to the developed proposals for materiality assessments and the process for reporting errors.

Although the number of restatements declined in 2007, the number of restatements has grown substantially over the last several years. The committee's progress report describes a number of contributing factors to this growth, including an observation that it may be the result of an overly broad application of existing materiality guidance.

The terms "unnecessary" and "necessary" have been used when describing restatements, creating the perception that some restatements are being processed for immaterial items -- items that are not important to a reasonable investor. This leads us to question whether the areas that were determined to be material were, in fact, not material; and whether the disclosures of the error correction were useful to investors. To provide better information to the market, additional guidance on materiality judgments and, separately, the process for and disclosure of correction of errors should be enhanced.

The three key themes to materiality and error correction guidance are: First, all errors need to be corrected, yet not all need to result in a restatement; Second, the materiality of an error should be evaluated from the perspective of a reasonable investor and should consider all surrounding facts and circumstances; and Third, transparent disclosures are essential to communicating material errors to investors.

The committee's recommended enhancements to existing SEC material guidance should not be viewed as facilitating the obfuscation of material errors or permitting material errors to remain uncorrected under the guise of qualitative judgments. In fact, all errors need to be corrected so that a company's underlying financial records are complete. It is determining what constitutes a material error and how the error should be corrected and disclosed that wants enhancement.

It is important to align materiality adjustments with investor needs. The materiality of any one piece of information should be judged based on the total mix of information. For example, an interim period is part of a larger mix of information available to a reasonable investor. That is not to suggest that interim financial statements are unimportant; rather, it's an acknowledgment that certain factors are evaluated differently in the materiality analysis related to financial statements. As such, there may be instances when an amount that might appear to be large would be unimportant to a reasonable investor when viewed within the context of all surrounding facts and circumstances. Likewise, there may be instances when an amount that might appear to be small would be important to a reasonable investor, given the surrounding facts and circumstances.

Transparent disclosure should be provided to inform investors that a material error occurred, the impact of error on the period in which it originated, and the period in which it is corrected, and any implications the error has on the company's business. These disclosures should provide comparable financial data and insight regarding the likelihood that such an error could occur in the future.

In summary, there are two separate and distinct steps: first, the determination of whether or not an error is important to an investor, given all the surrounding facts and circumstances; and second, the forms of disclosure for the correction of an error that is important to a reasonable investor, such as restating prior periods or correcting the current period. The committee's recommendations will enhance the usefulness of information provided to investors regarding the correction of errors in financial reporting.

Again, thank you for giving me the opportunity to share these perspectives with you. I would be pleased to respond to your questions and comments to assist the committee in this important matter.

MR. POZEN: Thank you very much.

MR. HUBER: This is John Huber. Thank you, Mr. Chairman.

I've been a securities lawyer for 33 years, both at the SEC and in private practice. I actually learned how to love accounting in the Division of Corporation Finance. Everyone laughs when I say that. But I do love accounting; and I find the trend with respect to restatements in the past five years very disturbing. When one out of five public companies has had a restatement in the last two years, that is a very disturbing trend. And as one of the people that gave you MD&A in the early 1980s in terms of trends and known uncertainties, I can tell you that if I was writing your MD&A, that would be a very large trend and a known uncertainty; because if everybody has one, the marketplace will soon draw its own distinctions as to what is important and alternatively decide how to differentiate between restatements that can affect the market and enterprise value of a company and those that do not. Thus, not all restatements are created equal. The market views some restatements as a selling event when investors stampede out of the stock; yet other restatements are viewed as a buying opportunity by market professionals resulting in the stock prices not going down or going up.

The time needed to resolve restatement situations can result in market professionals, such as hedge funds, or shareholder activists buying the debt of a company that is in default under its debt covenants for the failure to file timely periodic reports; or buying the common stock of the company that has an “accounting problem” and put it in play. The result in both situations can be a determination by the company's board of directors, because of their fiduciary duties, to consider strategic alternatives, which can result in selling the company at a fire-sale price. For long-term shareholders, the short-term gains of others results in selling their investment on the cheap. For employees, it means the loss of jobs when the company is sold.

The developed proposals present a way to resolve the dilemma which has existed about materiality and restatements. I support Developed Proposals 3.1, 3.2, and 3.3. They are consistent with what I believe in, in terms of my practice both at the SEC and in private practice. Specifically, I do not view the proposals as changing materiality. Rather, I think they are directed at restatements. I think they are directed at the issues that this committee was charged to look at.

When I was a young attorney at the SEC, I was taught -- and this was in the 1970s, so this predates SAB 99 by 24 years -- that the dollar that takes you from a profit to a loss is material. Now, nobody called that a qualitative factor, but the fact of the matter is people looked at that as being material. Similarly, the staff then -- and I would respectfully submit the staff today -- looks at a sliding scale with respect to the idea that something that is quantitatively large can be qualitatively immaterial. The classic example there is cash-flow restatements; and, as a person who has done a large number of cash-flow restatements, I can tell you that they were a large proportion of the 1,600 restatements in the year 2006. So those sorts of quantitatively large errors can be qualitatively immaterial.

SAB 108 was a response from the staff to companies using the Iron Curtain approach exclusively and ignoring the roll-over approach when they found errors. This allowed errors to build up on the balance sheet that became material over time but were not corrected. Although necessary at the time, perhaps the abuse the staff saw in the past has been resolved. If so, SAB 108 should be revised to differentiate how the roll-over and Iron Curtain methods are applied by making their use depend on whether the financial statements have been issued. Once a company issues financial statements, it should be required to restate only if there is an error that is material under the roll-over approach. Thus, the Iron Curtain method would be applied only prior to the issuance of a financial statement rather than after issuance.

Contrary to what some people might think, addressing restatements while maintaining and clarifying materiality will result in investor protection and promote the public interest. Rather than being confronted by a blizzard of restatements that are difficult to differentiate, investors will be able to distinguish between restatements that truly represent changes to the financial statements that a reasonable investor would consider in making an investment decision on the one hand and accounting errors that would not change the perspective, prospects, or business of their companies on the other. Restatements are expensive in terms of time, effort, diversion of management resources, expense, litigation, capital formation. Accounting errors that are material will still require time, effort, and expense, as they do now; but they would not be as frequent; and accounting errors that are not material would be handled in a manner to avoid a restatement.

Critical to this is full disclosure. I'm a disclosure lawyer. I write disclosure every day. And the fact is all of the points that are made in these recommendations are predicated on full disclosure. This is not something where the numbers would be changed and there wouldn't be an explanation. I, as a securities lawyer, would insist that there be disclosure of how they were changed, why they were changed, and for what periods. It's the who, what, when, where, why, and how of disclosure.

So my only point here is that from a perspective of looking at this, these proposals are proposals that I support. And since the framework was mentioned, I would like to mention the idea that -- and we'll cover this in the next panel -- but I don't view the framework as a safe harbor. I view the framework as something -- as a necessary analogue to the implementation of 3.1, 3.2, and 3.3. And frameworks have been done successfully in the past.

MR. POZEN: Thank you.

Manish Goyal.

MR. GOYAL: Thank you. Thank you for inviting me before the advisory committee on improvements to financial reporting. It's an honor to be here.

I'm Manish Goyal. I'm a research analyst for TIAA-CREF. My comments and suggestions are limited to the development proposals 3.1, 3.2, and 3.3. In general, I support the proposals.

I believe that the balance should be maintained between the duty of accuracy of financial statements and timeliness, something very critical. As an equity analyst primarily covering technology, I care about the accuracy of financial statements in order to get a useful picture of the company's historic growth. Hence, large quantitative errors and material errors must be restated.

Secondly, the timeliness of financial statements on a going-forward basis is extremely crucial as these companies have short product cycles and face dynamic market environments. The companies in the process of restating actual statements prior to the last five years do a great deal of disservice to their existing stockholders and employees by reporting very limited financial data. The timeliness of quarterly financial statements is significantly compromised while companies and their auditors work on the accuracy of the historical statements. I find it extremely difficult to gauge the current underlying business strengths during the dark period which could last anywhere from four to eight quarters.

I would like to see the following included in the developed proposals: Firstly, a company under the restatement process should be required to announce the scope of errors and estimate the range of impact on its revenue earnings and cash flow. Secondly, I believe that the proposal should require companies to disclose more detailed current quarterly financial data for more than just revenue and cash during the period of investigation that could help investors better understand the ongoing fundamentals. Finally, in the interest of timeliness, companies should be allowed greater flexibility in estimating amounts prior to the last five years, depending on the nature of the investigation and the magnitude of errors. Minor disagreements between accountants and independent auditors on estimates must not delay the release of financial statements. I would prefer to have financials released with additional disclosures on areas of agreement amongst the accountants and their auditors than to be left in the dark with zero information to base my decisions on. Investors should be allowed to make their own judgments as to the relevancy of minor disagreements on estimates of the auditors. In short, I would like to bring in the timeliness variable in this discussion.

Thank you.

MR. POZEN: Thank you very much.

Steven Bochner.

MR. BOCHNER: Thank you very much for having me here today. And I apologize to everybody from the SEC in the audience that I've got my back to you. But at least I can't see their expressions while I'm giving my remarks. And maybe that's a good thing.

As I indicated in my prepared statement, I served on the SEC advisory committee on smaller public companies; and you may know that one of our 33 recommendations that we delivered to the SEC was actually in this area dealing with materiality and restatements. And I'm really pleased to see that you're moving the ball forward on this important topic. Our advisory committee received a lot of data and heard testimony regarding the significant increase in restatements and we were aware of and focused on the subjective nature of materiality judgment calls and the hindsight nature with which these decisions were made. We came up with a couple of suggestions, or suggested areas of inquiry, that are indicated in my statement and in the final report we delivered in April '06. But these examples suggest a conceptual approach that's very consistent with the proposals outlined in your progress report and one that I'd like to strongly support as well today.

Like you, I believe that we should separate materiality assessments for disclosure purposes from a restatement determination. And in listening to my prior co-panelists here, I haven't heard anybody take the view that we shouldn't disclose material errors. I think everybody is in agreement about that. I think really what we have to focus on is whether a restatement the right way to correct those errors. That's a completely different inquiry; and I sense some confusion when I hear people talk about this area, because people all of a sudden focus on stealth restatements. Gee, you're not talking about disclosure. And I think you've come at it in a very appropriate way of separating those two things and looking at those two things separately.

I've got an example in my statement that I'll repeat here, which was assume an issuer discovers that an error was material seven quarters ago -- disclosure and correction of that error serves our markets very well. A restatement might not -- the time, expense, disruption, management time, and so on -- might not serve our markets well; and so there might be a different mode of correction. I think that thinking is very consistent with your proposals.

I'd like to further illustrate the problem with restatement determinations in the context of the reasonable-investor test that's set forth in SAB 99. In the reasonable-investor test -- we lawyers love the reasonable-investor test. We labored long and hard and lost a whole bunch of cases on this topic. It has a storied history in federal case law; and it works really well in the context of disclosure decisions. Because it's subjective and because materiality might be judged with hindsight and materiality is often assessed with hindsight based on whether the stock actually moved way back when you made the judgment call, decisions like closing the trading window and whether to disclose are made very conservatively by well-counseled companies. When in doubt, disclose is good policy. When in doubt, restate may not be good policy.

Because the same standard is applied in both situations, I think it's not surprising that both of our bodies have suggested this approach, which is to separate the disclosure requirement from the mode of correction. One could imagine an extension of our current 8-K rules that would require the filing of an 8-K short of a restatement any time a material error is corrected perhaps or maybe any time any sort of correction is made. So there you have full disclosure. An 8-K would be filed. It would be prominent. There'd be no stealth restatements. And I encourage you to continue down that path; and I think that general approach is correct.

While on the topic of SAB 99, I do think SAB 99 should be interpreted to cut both ways. I know from experience that there's a lot of confusion, both among private practitioners and I think even at the staff level, so you're clarifying that one way or another would be quite helpful.

I believe the going-dark phenomena caused by our inability -- company's inability -- to file periodic reports often due to a restatement does not serve our markets well either. I agree with your observations that issuers should be allowed and encouraged to provide information to the market, even if it involves a partial filing. I think some information is better than no information; and the liability issues could be addressed by looking at the current safe harbor -- perhaps a modified safe harbor – for forward-looking information. Your committee was asked by the SEC to find ways to increase the usefulness of financial statements while reducing complexity. And I think this area of restatement determinations is unnecessarily complex and uncertain; and I believe you're on the right track.

Thank you.

MR. POZEN: Thank you, Steven.

MR. ACOSTA: I guess going last has its benefits, but not least. That's for sure. I'll try hard not to repeat what has already been said by many of the panelists today.

I certainly would like to start out by thanking the committee for allowing me to participate on this panel. The topics being addressed -- materiality and restatements -- have been in need of better guidance and clarification for sometime, so I thank you for your efforts in researching the issues, gathering the relevant information, and developing proposals to address improving our collective interpretation of how we might determine what is viewed as material and its impact on whether or not a restatement is necessary, either for an interim period or the annual financial statement.

So let me just say that I'm supportive of the proposals 3.1, 3.2, and 3.3. And while I believe the proposals as stated can have a positive impact if interpreted from a reasonable investor perspective, there is a significant requirement or need to develop consistent methodology for ways of determining what is important to that current reasonable investor. I do believe that the concept of using a sliding scale to evaluate qualitative as well as quantitative information in making a determination if an error is material and therefore requiring restatement, is the appropriate direction for companies to follow. I do believe there is significant judgments applied today in many instances, but there is a lack of consistency across auditing firms and companies in determining what requires a restatement.

Just an example is the stock options backdating issues that impact many companies and investors. Some companies went back ten years, which does not appear to meet the materiality standards that have been applied to other types of errors. But because the stock options backdating was highly visible, a different standard may have been applied than in other cases.

Another important issue that hopefully these proposals will help clarify is a tendency to apply a current thinking on technical topics to prior years. I have encountered situations where auditors were using then current guidelines -- in this case, 2006 -- including nonpublic views from the SEC technical experts and applying them to look at decisions that were made in 2001 and 2003, before the guidance was issued. Therefore, I am encouraged that these proposals when taking the current reasonable-investor perspective can help clarify what actions to take, especially related to restatements in previous periods for errors which were not at the time viewed as material.

I would also comment that the suggestions and proposals surrounding disclosure requirements on the nature of errors, impact of errors, and management response are thoughtful and reasonable and consistent with what we are doing in 404 today. So while the nature of these proposals are positive and constructive and I support them in providing a more consistent way to determine materiality and approaches to restatement, if necessary the most significant concerns that I have is the retraining that is required to have the different decision-making bodies -- the financial statement preparers, SEC, FASB, PCAOB, and auditors -- being able to interpret facts and circumstances similarly and understand how a reasonable investor would react to any specific error, given the litigious nature of society and particularly in business today.

So with that I just want to thank you for the opportunity to share those comments. And I look forward to the discussion.

MR. POZEN: Thank you very much for all of your testimony; and I think that it was very useful.

And I guess I'm going to now ask various members of the committee to ask questions; and I'm going to start with people who were most involved with these issues and start with Mike Cook and then move on across -- down the aisle here.

MR. COOK: Thank you.

I would like -- I'm not going to ask a question. I'm just going to say to all of you, thank you very much for your input. Thank you very much your time and the thought that's gone into the comments you've made. We appreciate it. And we know you're all busy folks and you've got lots of people who are interested in what you think about lots of different subjects, so for you to come and spend time with us and share your statements is appreciated. I will assure you personally -- and I'm sure my colleagues will do the same thing -- that every thought you've shared with us we will carefully consider. We will look at all of these inputs. And in particular -- and one of the things that I will be absolutely certain we do -- because this is like a lot of things where we've been through many drafts and have had lots of inputs and we do it and we do it and we do it and we think when we get to the end, we've got it all right; and we have excellent staff support to help us get it right. But to the extent that we have left open any areas of potential misunderstanding, I will assure you we will give those the highest level of attention, because a couple of things are most important.

I heard -- I thought I heard -- and, again, I'm not quite sure that maybe I was misunderstanding what was being said, but I thought I heard the notion that there would be instances where we would be supportive of the noncorrection of errors. And I would want to tell you we are absolutely not supportive of any notion of not correcting errors -- well, de minimis -- we're not talking about, you know, small, small things that all of us would agree wouldn't influence anybody's judgment. But any error that has any possibility of being significant we are expecting that it will be corrected and it will be corrected promptly. We'll take a look at that specific point about the next time the financial statements are issued, because that was an attempt to add a practical aspect to it; but if it leaves open something that is broader in terms of possible mischief than what we thought we were doing, then we'll tighten that up, because that certainly was not our intent.

MS. ROPER: If I can clarify a broader concern we have about that, which is -- and I'll do it just by quoting from the investors' technical advisory committee to the FASB, certainly an expert group of investors.

When a material error is corrected, it is important that investors be provided corrected financial statements that present all periods in a consistent and comparable manner. Investors should not be required to adjust prior-period financial statements to make them comparable.

In other words, we should not shift the responsibility for getting the consistency and incomparability onto investors and away from the restatement process.

MR. COOK: Barbara, again -- and I don't want to be argumentative at all with them or with any of y'all, because we're all trying to get your help, not take sides on these issues. But that is -- that particular quote that's there -- we don't disagree with at all. If there is a material error, the prior periods must be corrected; and the financial statements for those prior periods must be corrected and made comparable if it's material. I believe that was what they were talking about. I'd agree a hundred percent with that statement. We are not suggesting that if it's material that prior financial statement wouldn't be corrected.

We have a view about the definition of materiality -- application of the guidance and the principles to make a judgment about whether something is material. But when it's material there must be timely correction of the prior financial statements to put them on a comparable basis. So I believe we are saying the same thing. Again, I'm going to go check our words to be sure that we haven't left open that possible misunderstanding, because I don't think when we’re talking about a material error, we have any difference of opinion about what needs to be done.

MS. GRIGGS: I think that we did say that if that material error was not material to current investors -- and you pointed out something that we did not intend. We did not intend not to include potential investors. You're absolutely right. We meant current stockholders and potential investors, so that's a clarification that I think your guidance is helpful for.

But what we were saying with respect to errors is that if current investors and potential investors would have no interest in the correction of the errors because either the financial statements are so old that they're not looking at it anymore or the company has completely changed or it affects the discontinued operation so it is not relevant -- and I'm sure there are other examples, we're just saying in those situations we didn't think it had to be corrected, not that it wasn't material at the time, just that it didn't have to be corrected.

MR. JONAS: Just to clarify, "corrected" means restatement. And the reason I think Mike gave his opening comment was, even if you have an error that you do not deem to be material, you will correct it no later than the current period. In other words, we did not countenance any errors being spread to the future.

MR. COOK: Or it's not corrected at all.

MS. GRIGGS: Yes. I guess if it affects retained earnings -- I mean if it's old, it would be corrected.

MR. COOK: But it would be corrected and disclosed is the presumption.

But anyway, the point I was -- I may have kind of gotten -- maybe I messed it up. I don't know. I don't think so. But the point I was going to make is that I don't think we have a difference of opinion. The words may not be as clear in some places as they should be. We need to take a very good look at that and be sure we are not appearing to countenance noncorrection of errors and noncorrection or nonrestatement of items that are deemed to be material to those prior financial statements. So that was the notion I was trying to say.

And the same thing with SAB 99. We did not disagree with the content -- the existing content -- of SAB 99. We just don't think it's balanced. It's sort of one-sided. Little items can be material, but big items maybe won't be. And we think the guidance needs to be sharpened up and balanced, and that's the recommendation. But it is not to abandon the existing guidance that says small things, if they involve management integrity, if they involve decisions about meeting loan covenants -- lots of different qualitative things -- the trends of earnings, things of that kind -- can be small and they can be material. We don't disagree with that notion at all. We're just suggesting that sometimes things that are larger than this minimum threshold for materiality may not be something that requires a restatement. But, again, I think we are fairly close on what we are trying to accomplish, but maybe we can say it better; and I certainly assure you, we will do that.

One thing that I'd like to repeat that we're all in favor of is fewer errors. So fewer items that any of us are even needing to talk about, but when errors are made one of the things we heard loud and clear and we listened to an investor panel very clearly say to us, we need better disclosure. We need to deal with this dark period. We need to deal with why did something happen and what has been done to prevent it from happening again. Those are some of the very important things that are not necessarily coming out in the disclosure today and we are going to go back and be sure we say those things strongly enough, that those are an important part of the overall message as well.

But we appreciate all the inputs. If the wording isn't what it ought to be somewhere and it's leaving the impression that we are in any way advocating not correcting errors and not restating for material amounts when deemed to be material to the prior financial statements, we'll have to tighten that up and we'll take a look at that other point, Barbara, that you made as well.

MR. POZEN: John, did you have something?

MR. HUBER: Just to follow up on what you were saying about the dark periods, there is a trend with respect to companies' disclosing during the course of a restatement. I commend the 12b-25's that are being filed by companies that are doing this. I would submit that the type of information -- Steve was talking about revenue and cash -- the type of information that you can disclose depends on what you're restating for.

With respect to options dating, there were dozens of companies that were disclosing during the course of it because of the ten-year restatement for a number of companies; and they could in essence give the information that an analyst would want for his or her model because this was an expense item under 123R or APB 25. And so the quantum -- my point is be flexible. But the quantum of disclosure that you can put in a 12b-25 depends on the scope and nature of the error that you're correcting.

MR. POZEN: Linda, why don't we -- you might as well take the floor here.

MS. GRIGGS: I just wanted to respond to John.

I think we recognize that some companies were providing disclosure in the dark period, but I think we heard that that was inconsistent. And I think there needs to be more consistently good disclosure made during the dark period so that investors know what's going on.

MR. POZEN: Greg, do you want to --

MR. JONAS: I have a question for Barbara.

I think, in approaching this, our goal was not to reduce the number of restatements but rather to reduce the number of unnecessary restatements -- unnecessary in the eyes of investors. And so I think we all try to look and see was there evidence that restatements -- some restatements -- a considerable portion -- were unnecessary or not. And we did see some evidence of -- some of us who look at these things for a living have our own anecdotal experience which suggested to me that there were unnecessary restatements. But we also saw some statistical-type stuff. But it all suffered from something you pointed out as a flaw. And that is that it was based on market prices, the presumption being that if a restatement occurred and market prices didn't move that that was suggestive that the market did not care. You specifically said you rejected that argument. And if you could hum a few bars for us as to why you felt that thinking was flawed, we are all ears.

MS. ROPER: Happy to.

I mean right in the report, if you look into your footnotes, you'll find several reasons there are serious limitations on difficulty of measuring market reaction, impact on market price factors other than restatement, disclosure at the time of the restatement of other information, so already you've laid out some reasons why there are some serious limitations. In addition, as I'm sure you know, there's been research that shows that how the restatement is announced, how it's announced to the public has at least as much impact on the market reaction as the content of the restatement. There -- it's been suggested to me by someone who knows a lot more about this than I do -- that the expectation of the restatement may already be recognized in the stock price in many of these cases, but that accounting information often lags -- more timely but less verifiable information -- so that it provides feedback rather than a trigger for market reaction.

Beyond that, I think there's a benefit to encouraging small restatements that has nothing to do with market reaction. There's some interesting research underway right now at Wharton that looks at the link between over-confidence in management and accounting fraud. And the notion is that a lot of fraud does not start with an intent to defraud. It starts with a manager who's got some bad news, some difficult times they are trying to deal with, and they think that if they can just keep it under wraps for a short period of time they will get things turned around. And so maybe they engage in a little gray-area accounting. Maybe they fudge things a little bit, a little bit of minor earnings management.

If they don't turn it around they basically have two choices: They can restate and move on; or they can engage in a little more earnings management -- go a little farther. And now they are not only -- now they're covering their past tracks as well as dealing with the current situation. And it is sort of down this slippery slope that a lot of people wind up in fraud.

And I would just suggest that in a system that encourages getting errors out while they're small, while the market is unlikely to have a major reaction, helps to nip this kind of fraud in the bud. And one that says if small investors aren't going to care, you can get away with it without correcting it, without restating it at this point helps to encourage that kind of fraud to persist.

MR. POZEN: I think it is important to clarify that there are two questions. One is whether the error is material and then second is how it's going to be corrected. Maybe we don't communicate this clearly enough.

Our view on the second question is all errors need to be corrected. The question was how they are going to be corrected. And one possibility is to have a restatement of prior years. The cost of that to investors, as has been elucidated, is the dark period. And we find that that's for -- a number of investors have told us it's a difficult time and they're not getting information.

So the question -- and I think I'm asking Steve since he's raised it -- is whether certain errors would be better corrected by correcting them out, filing an 8-K.

The other thing is we always said that whatever errors are corrected there ought to be disclosure that it's being corrected. So those -- it seems to me there are two separate issues that we ought to clarify. One is what's the definition of materiality, which from our point of view -- what we tried to say was we are not trying to change the Supreme Court, because we have no power to change materiality.

There is -- one issue we did raise is the -- I guess you might say -- the nonsymmetrical nature of SAB 99. But our view was once there is a material error, it needs to be corrected but there could be two different methods of correction. One is through a restatement, which would have certain benefits of going back in time consistently for investors but would have certain costs. And then the question was whether there was another approach where you would correct the error and file an 8-K and have disclosure. So I think what we're trying to do is to separate these questions and to really to have a good discussion about both issues.

And so what I want to make clear is our view, as Michael said, all errors need to be corrected and all errors when you correct them, you need to disclose it. Exactly how it would be disclosed, I guess we probably hadn't gone as far as you're thinking, Steve, in terms of 8-K's, but we're not in favor of stealth restatement. So that to me is the debate here, so we ought just to make sure that it's framed in that way. And to the extent that we as a committee didn't clearly state that enough, then we need to be clear about it.

Yes?

MS. MOONEY: There was pretty deep-seated opposition to the asymmetrical aspect of SAB 99 in terms of ever considering a quantitatively large error immaterial, so I think I mentioned that in my testimony.

MR. POZEN: I understand.

MS. MOONEY: And then, secondly, there was very strong support, also, for correcting the prior periods.

MR. POZEN: Yes, I think you've made both points; and I'd like to ask you on the second point, because really there's a bit, I think, of tension here. When you have a restatement -- let's assume there's a material error, but we have two choices at that point -- is -- we have -- let's assume that it just affects the cash flow or doesn't change the net income. If we ask that company to do a restatement, we know there will be a dark period, perhaps as much as a year, versus having -- so there’s a cost to that restatement as well as a benefit versus having that corrected with an 8-K filed to explain what's happened. So I would like to understand between your point of view and Manish's point of view how you evaluate that. We were trying to say that there were two ways to do it and that we could see from an investor point of view there could be costs and benefits on either side.

MS. MOONEY: Well, you could have a disclosure and --

MR. POZEN: The other alternative would be to have an 8-K and a disclosure but not to hold the company -- to put the company in a situation where it would be spending a year or -- God knows, we've seen more of that.

MS. MOONEY: But if you've got the number for the restatement and you've got the -- you know what it is, why is it tough to --

MR. POZEN: I think there is a big difference between making -- filing an 8-K and correcting the error versus going back and restating all your financials for the last five years; and that's what takes -- that's what we understood takes issuers a long time.

Manish, would you like to comment on it?

MR. GOYAL: Using the sliding scale as to how far back do you want to go as an investor to have accurate financial statements. I cover technology companies. Their product cycles are short and they change very quickly, so do I really care that in 1995 financial statements are accurate to the last decimal point? If they are going through an option investigation for the last ten years, maybe not. Maybe if the last five years' financial statements are accurate and they make an estimate what the error was for the previous five years and change the retained earnings, I'll be happy with that, as opposed to seeing the company go through a period -- a dark period of -- if that reduces the dark period from two years to one year. And I have witnessed many companies one after another where unfortunately they fired their auditor and then they fired the management and the new management had to come in and deal with the old auditor to restate and now the old auditor is in tension with the company and is trying to cross all t's and dot all i's, which is taking an enormous amount of time. And I think that is a great disservice to the investors.

MS. MOONEY: That's the exception that proves the rule.

MR. POZEN: Well, let's have -- I don't know. I want to make sure that Greg and Linda have a chance to ask --

MS. GRIGGS: I just wanted to ask you, Elizabeth, a question. You say that all large errors must be restated and you don't see any reason for believing that some of those errors would not be material to investors. You say that the investors alone should make that decision. And I'm just wondering -- I mean that seems like a -- maybe you're right that in most cases large errors have to be restated, but I'm just wondering if you have any room for disclosure.

I guess, Barbara, you suggested that disclosure might be appropriate.

If a company believes that it isn't material to investors, even though it's a large error, would you be satisfied with good disclosure, transparent disclosure, about the error?

MS. MOONEY: If it's not material under SAB 99 as it stands today, yes.

MS. GRIGGS: Well, again, SAB 99 doesn't really speak to large errors. But if management goes through the qualitative analysis and believes it's not material but it's a very large error, would you still believe that disclosure would be sufficient rather than restatement, I guess is what I was asking.

MS. MOONEY: It was 97 percent came back opposed to considering quantitative errors as not material. And they want to know what the restated number is and adjust it for themselves if they deem it after the description it's not material.

MR. POZEN: Let's just be clear. SAB 99 is asymmetrical. It says if you have a quantitatively small error, it can become material by being -- by qualitative factors. It doesn't address the situation that if you had, say, a 7-percent error where you could go the other way. And that is a point that has been made by a number of people to us. And all we were saying or trying to say was that we thought you should be able to consider qualitative and quantitative considerations in all cases.

Now, we would agree with you if there was a 50-percent quantitative error. It's highly unlikely -- in fact, I would say it would be almost -- almost -- impossible to think of a situation where it would be quantitatively going the other way. On the other hand, if there was a 7-percent error or something like this, then you could consider whether there were qualitative factors that would come into play, just as if there was something that's 1-percent, you should consider whether they're qualitative. So that's all we were trying to say: that you should be able to consider qualitative and quantitative errors in all situations.

John.

MR. HUBER: I actually think that the way you pose the question about materiality versus the form of the correction of error is really a focus that we should drill into, because I don't see the recommendations of the committee as being all that controversial. For years you've had corrections of errors under Paragraph 29 of APB 28. For years up until the time that it was done away with, APB 20 -- the fact of the matter is 154 gives you the same sort of flexibility in that regard. My point is that the idea of what's material -- what the committee is really saying should be the sliding scale; and I think that's an issue that can be debated. But for years and years before this committee was instituted, errors have been corrected currently and there has been full disclosure that accompanies those errors.

That's something that has been established for years by GAAP, by APB --

MR. POZEN: So you're saying with a full restatement?

MR. HUBER: Without a full restatement, but with full disclosure. And I think that that is the principle that you're looking at with respect to both 3.2 and 3.3 of the development proposals.

MR. POZEN: Yes, Ed, please.

MR. NUSBAUM: Just a follow-up on a couple of other comments that were made.

Jack, you made a comment about training. And I was curious as to what kind of behavioral changes you were looking for and, of course, anyone else as well for this training.

MR. ACOSTA: Well, as you are well aware today, there is a lot of guidance provided to issuers of financial statements; and there's many different auditing firms; and the interpretation around those can be quite different, depending on what company you're dealing with or what auditing firm or what specific auditors you happen to have at that point in time.

But my comments center more around “Is there a methodology so that we can look at facts and circumstances and draw a similar conclusion?”; and that has been a challenge throughout the industry; and given the -- I mentioned the litigation that goes on as a result of being wrong or presumed wrong in this marketplace. The desire to give out more information knowing that that will be used in a litigation makes it very difficult for people who are looking at a restatement within their company. So the consistency is I think the fundamental issue that I would have in terms of moving forward to the point where you can use the scale, if you have the sliding scale and you're looking at -- and you come to a conclusion, would a reasonable person look at those same facts and circumstances and come to the same conclusion? And chances are there's going to be a lot of interpretation around that. And how do you get to the point where people can feel comfortable, given certain facts circumstances and draw a certain conclusion and be able to present that to the marketplace and have it be okay?

MR. POZEN: Ed, did you have a --

MR. NUSBAUM: Yes, one other quick question, either for John and for either Steve or perhaps -- I just want to talk about this -- or maybe the auditors should do it -- is there any role -- what is the appropriate role for the SEC staff in this whole process, if any?

MR. HUBER: As a person who works with the SEC every day, the SEC staff is involved in review of periodic reports and registration statements all the time. I actually think that the idea of the staff looking at this from the standpoint of the principles that the committee is setting forth is a very good and practical affirmation of a lot of feeling on the staff. I actually think that from the standpoint of how it works, the staff has got to put itself in balance with courts and with the FASB, with the PCAOB. That balance is very important. But the work of this committee can, in essence, verify a great deal of feeling in terms of the review process of the Division of Corporation Finance. The idea of what a reasonable person is -- I don't know if we'd recognize her when she walked in the room, but the fact of the matter is the staff of the Division of Corporation Finance makes materiality judgments every day in the review process, as so do the professionals that work for law firms, accounting firms, and companies.

MR. POZEN: Steve, did you want to say something?

MR. BOCHNER: I think a great thing your committee could do is just provide some better guidance, because when these decisions are made, we sit down with the issuers and the auditors and we hunker down and we figure out whether it's material. And then ultimately there's a filing or a correction; and the staff has to decide did they analyze SAB 99 right? Did they apply 108 right? And I think there's so many fiscal periods to look at and so many different ways. And then you throw in the reasonable-investor test and you really -- you can do a lot of work and a lot of good thinking; and the staff may, for completely valid reasons, disagree with you.

So I think -- I'm just excited to have perhaps a little more guidance coming out that will make it more likely that these judgment calls between issuers, auditors, lawyers on the one hand and the staff on the other hand are more in sync and actually will reduce the dark period and accelerate the correction, whatever they may be.

MR. MEISEL: I would echo both those comments by just adding that I think Proposal 3.1, it talked about the education and it talked about preparers and auditors, but I think you've heard here reaching out to attorneys, to investors, and to regulators as part of that process I think would be very useful.

MR. POZEN: I think, just to be clear, we at least discussed the possibility of having a much more definitive test. But I think we quickly realized that that was not possible; and I think what -- you know, we do think it's a facts and circumstances; and all we really said on materiality was that we believe that quantitative and qualitative factors should come into play.

I think the way in which we tried to be helpful, Jack, to your question, which -- maybe we're at David Sidwell anyway -- is that through another recommendation, we have tried to, let's say, narrow the scope of interpretation.

And, David, I don't know whether you just want to answer that and any questions you might want to ask the panelists.

MR. SIDWELL: We spent a fair amount of time talking about the fact that we want to encourage where the SEC staff sees trends which they believe are not acceptable, so a range of interpretation which has gone beyond what they view as acceptable, that that gets disseminated in a way that is both complete and thorough to all registrants at the same time, as opposed to through the comment period. I think we acknowledge, however -- and I think this is the question -- that if are going to move to more of a principles-based set of standards, there is going to be this period of interpretation where it may be that there is a broader range of alternatives that are at least seen initially as companies with their advisers interpret the principle-based potentially differently. It takes some period of time to narrow those range of alternatives.

So it would be interesting to see your views on, one, how you feel about a period of time where when a new standard is issued that there's this period where there may be different interpretations in the marketplace. It may take some period of time to narrow those range of alternatives.

And, secondly, are there any instances there where you believe that if a company's management has acted in good faith that those are prospective, as opposed to retrospective changes? And we as a committee have spent a fair amount of time on both of these issues. I think it would be an interesting adjunct to the discussion we've just been having if you have some views on those.

MS. ROPER: We do. We're concerned that you're encouraging companies to test the edge of the envelope if there's some sort of implicit understanding that during this period that anything goes; or, if not anything goes -- that's an exaggeration, of course -- but that everybody is free to interpret.

And I guess what I come up against is, when I look at this, I look at a past history where we have seen all of these gains. We have been through this and it was extraordinarily painful for investors and it was extraordinarily painful for the market and the economy. And it makes me very nervous when we see people talking about some kind of safe harbor.

We can't second-guess people. I think you should second-guess bad judgments. So I'm concerned that as part of this sort of broader set of proposals that something that says you're not -- whatever you do now -- you're not going to get corrected; you're not going to get second-guessed. I think it will be gamed. And I think you're really risking a return to the kind of practices that we just went through a little over five years ago.

MR. POZEN: I think we need to clarify two things. One is we not only did not propose a safe harbor. We questioned whether the SEC had the authority to have a safe harbor; so that is not our proposal. People have said that we proposed the safe harbor. To the contrary, we questioned whether it was even legal authority to do that. That will be discussed more in the second session. But I think if we haven't made our view clear enough, we will in the final report.

MR. SIDWELL: I think in one way which is less confrontational in thinking about the question is, let's say, five or six different ways of interpreting a standard emerge. So basically everyone says those seem reasonable. So the question is, however, do you just want to say that narrowed as a range of alternatives? I'm not even trying to make it as if somebody's really trying to push an envelope. The way the standard was written, the way it's been interpreted, has left a fairly broad range of interpretation.

And basically everyone says, You know what? Let's now narrow it. So not in any way trying to say that any company has acted inappropriately, because I think, just to second what Bob has just said, I think for us there is no doubt that on a registrant-specific matter where that is the case, we would say that should be called on as soon as it's observed. So this is where, when you're in a world of less rule-driven standards but where there is more judgment, there is presumably by definition going to be some period where there are people making different judgment calls and --

MS. MOONEY: What is really interesting is the disclosure from an auditor perspective as well as management in terms of where those judgments are in this case.

MR. POZEN: We shouldn't get too far into this, but just to sort of make clear on this point, but if there is a new standard adopted what we were saying is that FASB and SEC should look especially carefully about how it was being interpreted and to make sure that it did not have too broad a spectrum of interpretation and try to keep it narrow and if necessary amend the rule, if necessary issue an interpretation. So I think at least our thinking was the problem now is that a standard comes out and it may be very long and there may be very many different ways in which it's interpreted. It may not even be reconsidered for ten years. So the effort here was to say, as good as you can, you try to predict a standard is going to work, but when it comes into play, you start to see what happens; and we're trying to narrow the range of interpretation during that period. That was the thrust of that thinking.

MR. BOCHNER: So am I wrong in thinking that those who diverged from that, do they have to go back and correct then to the treatment that is determined to be acceptable? Because my understanding is -- and maybe I misread it -- was if they diverge during that period they wouldn't be required -- I mean that would be sort of an understandable leeway for interpretation and that they wouldn't have to correct. So you have a period in which -- and I think if you have a system that says, Okay. We understand there's going to be some divergence, but there's accountability at the end of the line, then you don't get the same extreme span.

MR. POZEN: I think it's a fair question about whether we were specific enough on that, but I think the answer that we were trying to search for is something like this: There is a reasonable band of interpretation; and I think every accountant would look at it and say, let's say, this way or that way. And if it was in that area, then if ultimately the SEC said, okay, go A not B, then if you went B and it was in the reasonable band, it's okay.

On the other hand if you were at C, D, or E, which were not supportable, then you're going to have a restatement, you're going to have an enforcement case. So that was the attempt to try to differentiate between an ambiguity in a standard -- a question where audit firms reasonably thought they were doing the right thing, but it was in a narrow band versus a situation where someone just went off on a frolic or detour, whatever you want to call it.

So that was our attempt there.

MS. ROPER: Well, I would be more comfortable with that approach. It isn't how I read it. Those are awfully hard lines to draw, where -- at what point you have to restate --

MR. POZEN: What we're doing now -- the fact what we do now should bother you a lot more, because what we do is adopt the standard and then people interpret it a whole series of ways and it goes on for five, ten, twenty years; and then finally somebody says, “Well, let's see, after all these different things, maybe here's the way to do it.” What we are saying is, “Let's be realistic when that standard is adopted.” No matter how well you try to predict it, we don't know its impact, so let's look very closely. So, if anything, registrants are going to know that during that period everyone's looking very closely; and then we're going to try to figure out what is the right answer within that short time period.

MS. ROPER: I think that having that kind of scrutiny and having that kind of review early after a standard is released is very positive.

MR. SIDWELL: I think, Barbara, too, we've talked a lot today about the value of disclosure. I think this is also an area where we would not expect to see a change as a result of that narrowing what is acceptable to occur without having full disclosure to the magnitude of the change and giving investors adequate information to be able to analyze the impact of that change.

MR. COOK: I just was going to ask the panel collectively, because I don't think I heard a comment about this, but to me it's one of the more important things that we were trying to communicate in the recommendations is this investors' perspective in making judgments about materiality restatements, whereas today we talked to a lot of folks about this; and the vast majority of the feedback we got was these judgments are not being made in the broad sense of investors' perspective about trend and earnings, mix of information, what's important to the marketplace. But, rather, how big is it? And if it's this big, it gets this kind of a treatment. If it's this big, it gets that kind of a treatment.

One of the most important things I thought we were trying to communicate -- I would hope you would agree with, but if you don't we'd like to hear about it -- is that we'd like people to think of it from an investors' perspective, which includes quantitative considerations. It doesn't eliminate quantitative considerations. It also gets people thinking about what really is important to the marketplace as opposed to just is it 5 percent or more or 3 percent or less or whatever those norms are today. Do you agree with the notion?

MR. POZEN: Steve and then Manish.

MR. GOYAL: You know, there is a quantitative aspect to it. How much, how big, of an error should be restated? And then there should be a timing aspect of it. There should also be a timing aspect of it. How far back do you want to go to restate? Because the further back you go, you have -- it takes longer. And then, again, the timeliness is compromised. For those who are proponents, you know, of correcting all errors by restatement should also think about do we want to go back five years for restatement? Or for smaller errors do we want to go back ten years? Sometimes the errors may not be as relevant to a current investor if they occurred many years ago.

MR. COOK: Do you agree with the basic notion: An investors' perspective is what we are trying to apply and should be trying to apply in making these judgments?

MR. GOYAL: I'm sorry. I --

MR. COOK: I didn't disagree with anything you said. I was just sort of re-asking the question I asked for. Do you agree that the notion we have here that the investor perspective is the perspective that should be brought to bear, including quantitative --

MR. GOYAL: Oh, sure. Absolutely.

MR. POZEN: Steve. And then I think Scott has a question. And Susan has a question; and Jeff has a question.

Just so that everyone has a chance to talk.

MR. BOCHNER: I certainly agree that the investor perspective is the right one and clearly the one that SAB 99 instructs us in sort of the issuer community -- advising community -- to use. I think now it only cuts one way, so the analysis really is how big is it? Gee, if that's big, restate. That's often a default today and you never get to reasonable investor, even though you try; and I've had these discussions before.

And then if it's not that big, then you go through the qualitative analysis and one of those things can sort of pop up and go, jeez, we did kind of -- we had the tyranny of small numbers and it changed the profit to a loss and I guess we've got to restate. The fact scenario that I think is going to focus on is one I've had where seven quarters ago there was a classification issue. It doesn't change EPS at all. And if Manish is my reasonable investor and he says, “Look, from an investor perspective, that doesn't make any difference to me at all. I'm not going to change my decision to buy or hold. Yeah, it looked kind of big, but it doesn't matter. It doesn't change EPS.”

And I think all we're -- or some of us -- are suggesting is that in that scenario paying the money to the auditors or putting everything on hold and going through the restatement process that costs x dollars, wouldn't it be better just to be able to disclose that if we conclude a reasonable investor doesn't care and pay x minus y dollars. And I think -- I, for one, think that would be a good result.

MR. POZEN: Scott.

MR. EVANS: Actually, it's just the topic I wanted to follow up on, at the risk of beating this to death, but it does seem there are still -- auditors, preparers, and lawyers talking past investors who are well represented here on this issue. And your comments, Manish, Elizabeth, and Barbara, when you were talking, suggested that the primary concern was that the transparency in disclosure was going to be sacrificed in order to reduce the costs of restatements. While you agreed about doing something about the dark period, this was something that you weren't willing to yield on. You didn't think we had a restatement problem per se.

The panel came back and said, We're not going to sacrifice disclosure. We'll use the 8-K; we'll use some sort of other mechanism, but we just don't want to go through this dark period creating restatement process.

There still seems to be some reluctance on your part. One of the things, Barbara, that you said is that you don't want to impose a burden on investors. What burden or lack of transparency do you see in the type of suggestions that are being made for disclosure but not for restatement in these types of situations and why would that not do the trick for you as investors -- retail investors or institutional investors?

MS. ROPER: Well, as I said, the point is that if you want to be able to compare period to period to period, they need to be prepared on a comparable and consistent basis; and if they're not prepared on a comparable and consistent basis, then the burden shifts to the investor to make those adjustments, instead of being able to look at the periodic reports and know that in each case they're consistent.

Now, obviously, there is some point where that becomes a waste of effort and there are certain situations. But I think it is -- we have a history of issuers and auditors getting together and deciding that things aren't relevant to the reasonable investor. I mean we have -- we have lots of cases that start with materiality being manipulated by an issuer who said -- Waste Management being another one -- where the issuer said it's not material and the auditor agrees. And so where there is a question -- as I said, we can -- we can talk about an approach that says, Okay, we're going to disclose the uncorrected errors. This is the nature and amount of those uncorrected errors. This is the reason for determining that they're immaterial. We can talk about that as a way to deal with some of these borderline cases, but in general we think that we -- that we benefit from a more conservative approach that investors benefit and market confidence benefits.

MR. POZEN: I think the question that Scott is asking, he's assuming it's material. Then you have a choice. You can either go back and have a full restatement or you can correct and have an 8-K. I don't believe, in either Enron or Waste Management, anybody disclosed the material error in any form --

MS. ROPER: 1997, Enron had adjustments suggested by Arthur Andersen that would have reduced net income that year --

MR. POZEN: But when you have --

MS. ROPER: -- from 108 million to 54 million; and Andersen agreed to go along with it. Had they stopped at that point -- had they -- had they used today's conservative approach to materiality, we might not have gone through --

MR. POZEN: I don't know think you're being fair to Scott's question. Scott isn't saying it would have been disclosed.

MS. ROPER: But I think I answered his question in terms of saying we want period-by-period-by-period comparability between reports.

MS. MOONEY: There have been quite a few academic studies come out that do say that the quality of the disclosures do not come close to the quality of what you get on these financial statements in terms of audit confidence and integrity of the numbers.

And, secondly, investors across the board do download the numbers from the data services; and if it's in the disclosure it does get lost in time; and you can't -- I mean I had a couple of responses where they want ten to twenty years. Now, I'm not going to say that that is standard, but there are analysts that --

MR. EVANS: So it's a question of quality and consistency of the information. And particularly it's reached the retail investors, who would have a harder time coping with unique disclosures that don't fall into that data services and so forth. That's what gives you the reluctance? So if there was a way of creating disclosure without the disruptive process that we have for restatement disclosure of the metric comparability and historical consistency methodologies, then that would be fine with you? It's a question of the data quality that you're looking for.

MS. MOONEY: I'd have to see what it looked like.

MR. POZEN: I want to make sure that it's Susan and Jeff and then we get to other people.

Susan.

MS. BIES: Thanks, Bob.

I want to sort of take this in a little bit different direction. We've been focusing an awful lot on the numbers themselves and the restatements and the comparability. In the 3.2 discussion, though, there are suggestions about disclosures, about what was the root cause of the error, how was it detected, what is management doing about internal controls, did it affect debt covenants and other things. Could you talk a little bit about these kinds of issues, because some of the things we are suggesting -- for example, if it was due to a system conversion that you detected an error, you might not have the historic data to do the restatement. Would it be sufficient to just say it was detected in the audit of a new system; we don't have the old data; or it was a lot of business we just started -- would that help with some of this? Because I found this section where it talked about the nature of the errors and management controls and corrections going forward. I thought it may be helpful to deal with some of these gray areas around judgment, but none of you really focused a lot on it; and I just would like to get any reaction about that Section 3.2 discussion.

MR. POZEN: Anyone want to respond to that? I think Susan is saying that the disclosures we were suggesting go further than a lot of the disclosures that you see now, so it's not --

MR. HUBER: Let me start out. I think the idea of an 8-K is a wonderful idea, if you're prepared to disclose.

The concepts here are very difficult concepts. The idea of all restatements created equal is incorrect. All restatements are not created equal. They are different and they have different people, different issues. Just to add to what Susan was talking about, say, for instance, you acquired a new company and you found out that the new company had fraud; and all of a sudden you're sitting there with a problem. I think what the staff tried to do with respect to 4.02 of 8-K is the maximum that you can do with respect to an 8-K on a timely basis to say whether the financial statements are or are not reliable, okay? After that you start to go into this question of what can you disclose, when can you disclose it? And I agree with the idea of getting rid of the dark period. I'm all for the idea of 12b-25's coming out on a periodic basis and disclosing what you know when you know it. But please understand that in the normal course, if there is a hint of fraud, the practice today is to bring in an independent law firm with forensic accountants to do a full-scale and complete investigation; and people start to focus on that investigation.

Auditors don't want to have things disclosed unless and until that investigation occurs. The example there is Krispy Kreme. Several years ago when Krispy Kreme's investigation was done and the audit firm bounced the investigation, they had to go back and start over again. So the concept of disclosing things on a regular basis is complex; and it has lots of nuances with it; and the fact is you're not helping investors -- and I can give you examples -- by putting out information that you then have to recant. Saying something is important and timely means it's also full, complete, and accurate.

MR. POZEN: That's exactly our dilemma in the dark period, that it's hard to encourage these issuers to disclose, because they're all afraid that they have to wait till the completion.

Manish?

MR. GOYAL: I'm totally agreeing. All I'm going to suggest is if there is a way to push the companies to have a standardized disclosure or a set of comments they must make during dark period, that would be beneficial.

MR. HUBER: My one response to that -- the framework will go a long way to do that from a professional standards standpoint and from the standpoint of inside auditors outside the company as well as attorneys and accountants and business people inside. The framework actually gives that level of confidence that can actually help people with respect to getting out of the dark ages and going into the sunshine.

MR. POZEN: Jeff.

MR. DIERMIER: Scott was talking about and that is it seems to me that I certainly at this point don't have an adequate set of information in terms of the component costs of restatements. I have heard a lot of talk about dark-period costs. Well, they certainly seem to be pretty significant, but as it was suggested earlier, when we finally get through all the correction and actually figure out what the correction is, then if you don't restate past figures, then all investors end up doing that, so hundreds and hundreds of people -- my staff -- many years would be guessing all the time. And so you can have hundreds do it or you can have a company do it. Now, of course, maybe tomorrow, with XBRL, the ability to restate and reclassify --

MR. POZEN: I don't think we should count on that to solve all these problems.

MR. DIERMIER: Not in Bob's lifetime. In segments, not focused just on the earnings-per-share number. I think that we really would be helped if we had a better understanding of the costs of the components of this restatement issue. And I don't know if the Treasury report is going help us there and how far along it is.

MR. POZEN: It's a good question and I am not sure how much will come out of that study, but it is something to the extent that -- Manish or Stephen -- could give us some concrete examples or some cost data on that that would be helpful in terms of our determination.

Bill, I want to give you a chance to ask questions.

MR. MANN: You know, I -- as someone who also deals a lot with individual investors, I agree with Barbara's sensitivities greatly; and I have a little difficulty coming at the issue from one of allowing preparers to game the system. My question is at what level do you consider are we fomenting fraud? Are we making it so that it's easier for companies to deceive investors in the hope of making it easier for them?

MS. ROPER: I'm not sure I understood the question.

MR. MANN: In terms of making it -- in terms of making it easier for investors to -- I mean really the problem that we have is -- I can think of certain companies where you get a phone book and you have things that are disclosed but they're hidden in plain view. So it's something that we're trying to get at from a complexity standpoint. At what point do you think that we are making things too complex?

MS. ROPER: I guess I would say a couple of things to that. A recent academic study shows that complexity actually doesn't appear to be a significant factor in most of the restatements occurring today. They looked at restatements across the '90s and 2000s; and the majority of them are just plain errors. And then there is the issue of standard complexity -- the complexity of the accounting standards themselves but they found very little evidence that trying to get around bright lines or what not were significant issues.

But beyond that, our real concern is the kind of culture you create, the kind of message that you send to companies. Most of the things that are in, say, SAB 99 are in direct response to practices that were prevalent at the time it was adopted; and I think, you know, we find ourselves, at least as investors, in an atmosphere of where finally it is conservative and there is an assumption that it's better to get it out and get it out fast and correct it, get it out and move on. I mean we breathe a sigh of relief, only to hear that this is now evidence of a problem; and that is confusing to us. And that to us, when the messages that come out of the SEC or committees like this or what not are that we need to lighten up. Ah, no. So it's big, you know, maybe it's not so important, you know. So that just to us sends the message of a cultural change; and I think that encourages not so much fraud -- like I said, it's the sort of kind of accidental fraud I just described earlier where people slip into errors.

But in response to your earlier question, yes, we are supportive of the idea of doing better disclosure, both around financial statements themselves so investors are better able to understand what's in there and during the dark periods. I think that's a positive proposal that -- and if you go and look at the letter from the ITAC, the Investors' Technical Advisory Committee, they have a number of good suggestions with that regard that we would also endorse.

MR. POZEN: I think the study you're talking being did say that complexity is not a critical factor in terms of the restatements. It doesn't say it's the way standards are set -- written. It also had an interesting finding that the restatements were being made now on smaller and smaller amounts; and so I think that's something that people have to take into account also.

MS. ROPER: Will it be a success if we go back to having restatements with really big market impacts? I mean will that be a measure of the success of this committee?

MR. POZEN: Again, the question that's being asked is whether you're going to have correction and disclosure versus a full restatement. No one is suggesting that you're not going to have disclosure and a correction. I can assure you that if within Enron somebody had disclosed those things, they wouldn't have gotten very far. It did not matter whether it was a restatement or not. So we are fully supportive of the notion of a correction and a disclosure. The only question that we were debating, as Scott said, whether you need to go back and restate for three, five, ten years. I hope that we can keep those two questions separate, because they are, at least in our view, very separate questions.

MR. EVANS: It sounds almost like the burden of proof for you all is that this notion that we have about disclosure without restatement that the quality of the disclosure has to be such that investors feel that there's no loss versus what they would have gotten from a restatement. And that's the burden of proof that you would have to accept. Is that a fair --

MS. MOONEY: The feedback I got is they want to see the restated income statement on all the components restated and a disclosure -- what's been done -- and decide for themselves if that is something they should exclude as immaterial. So they want to see the restated amounts --

MR. POZEN: I want to make sure that we give Ed and Tom a chance to raise any questions.

MR. MCCLAMMY: No specific question. I think one thing we need to keep in mind is, as we looked at this, we were trying to, say, get a balance between getting the information out there and the cost of providing the information. It's been brought up a couple of times there's huge costs to companies that go through this, because people are trying to protect their positions as they go through it. So it really comes down, I think, to a cost-benefit analysis of the process versus the benefit to the investors. But I think the investors do need to realize that there is a cost to the investors of going through it as well. So I think, as several people have said, we are not trying to cut off information at all. We are just trying to come up with a way of getting that information out that is not costly to the company, i.e., therefore costly to the investors; and there's a balance that we need to work on to get to the right spot on that.

Steve -- I'll turn the floor to Steve.

MR. BOCHNER: You could actually imagine, if your committee did this the right way, that this would cut the other way and you would have more -- you would -- today there's a lot of pressure -- issuer pressure -- not to restate when there's a close call. There's a lawsuit that comes in. There's expense. There's a going dark. If you take that pressure away and you say, Look, if you're going to correct you got to file if it was material to a prior period way back when, you're going to have to file an 8-K. You may not have to restate. I think you could actually end up with more disclosure. Would sort of take all this pressure off the issuers trying to manage their business and doesn't want to go dark and doesn't want to get sued and so on; and you might actually encourage more error-correcting; or at least the incentives might work that way.

MR. POZEN: Tom, did you want to --

MR. WEATHERFORD: Well, being a former CFO and current audit committee chair, I've never had that much experience with restatements, but the ones I have had it's obvious there's a lot of confusion around at the company level and even the individual partner level of what should be restated. And a lot of times the audit firms will push it back on the companies to say, “Is this material to the investors?” So you've got the cat basically saying what he should do in terms of being in the hen-house or not? I think that a lot of restatements are done today because companies feel that it's better to restate, even if it's immaterial. And I think when you see the word "restatement" out there on a press release or whatever, it causes a lot of panic. And I think the individual investor overreacts to that, loses in that case. So when we talk about material restatements, we've got to figure out; and I think the impact on the investor is important. And I think if you restate everything, companies are not perfect. Errors happen. And I don't think Enron would have stopped being fraudulent just if they had done a restatement. Crooks are crooks and crooks will always be crooks; and you're always going to have a high percentage. But I do think today, as an audit committee chair, what I see is the role of the auditor and the company saying, “We need to restate, because it's the safest way of doing it, even if it's immaterial. And I think there needs to be a balance here.”

MR. POZEN: Are there other people who would like to -- from the committee -- make a comment or any questions? Greg?

MR. JONAS: These are quick and certainly not on the grand scale of some of the questions that have preceded it, but I wanted to make sure I understood, Elizabeth, a couple of the points that you made. One was, in your opening comments, you noted that you thought materiality ought to run to the geography on the income statement, not just the bottom line. Were you under the impression from reading our material that we are not sympathetic to that observation?

MS. MOONEY: Yes.

MR. JONAS: Okay. So you felt we were kind of bottom-line oriented in our view of materiality, that we weren't thinking about geography on the balance sheet or income statement or cash-flow statement?

MS. MOONEY: Yes.

MR. JONAS: That was not our intention, so that's why I'm clarifying, is I want to make sure that what gets in the final report is clear on these points.

Were you under the impression that we were suggesting basically to throw out SAB 99 and rewrite it?

MS. MOONEY: That it was going to be rewritten or tweaked to some degree.

MR. JONAS: Tweaked or rewritten?

MS. MOONEY: Tweaked, changed.

MR. POZEN: We were clear that we were saying that quantitative and qualitative should be considered in all situations. Other than that --

(Simultaneous discussion.)

MR. JONAS: Our perception is that is we are making a very modest proposal to the interpretation. In fact, we didn't even argue -- we talked ourselves into thinking anyway, that we weren't even changing SAB 99; we were only -- we were making clear --

(Simultaneous discussion.)

-- in order to change how it's actually applied in practice. But was your perception from reading our stuff that we were more than tweaking, we were proposing some major changes?

MS. MOONEY: No.

MR. JONAS: That's all I have. Thank you.

MR. POZEN: Yes, Jeff.

MR. DIERMIER: This is related to Tom's comment. We might ask the staff to see if there are any studies done in terms of the response -- I know market prices --

Barbara, you're absolutely right. A lot of this is out in front of the marketplace. But I firmly believe the market does a great deal of discrimination in terms of the type of restatement, the quality. And that it's a typical kind of corporate attitude that, “Geez, if I restate, my stock's going to be killed” and that's that fluff that's out there. And I think there's a great deal of discrimination that goes into, depending on the disclosure of the restatement. Maybe a few years ago during the midst of all the kind of bad behavior, the market would have that very emotional behavior; but the market is a learning mechanism, so by definition it would be learning; and it would be nice if we had some studies to look into those elasticities.

MR. POZEN: Well, I think we are coming now to the end of the time for this panel. And I guess -- again, I want to make clear that we, at least, were trying to distinguish the question of materiality from how the error was corrected; and I think Greg is right to say that we thought we were proposing a very small tweak to SAB 99 on the first question.

But we were having an active debate on the second question about how this is best done; and I think Susan correctly raises that we were trying to actually have the idea of an 8-K with more information than is usually given. Maybe it could be done that way. So -- and our attempt here was to get out errors -- more errors -- quickly and better disclosed so that we share this. And the question is -- in our minds -- is whether a restatement is actually achieving that. We know that a restatement does provide analysts -- and I happen to be involved with a lot of analysts -- with a long history, which they all like. There are costs to it; and that's what we're struggling with, whether we could encourage people to disclose more errors and disclose them more quickly and not impose the costs about how we do that. And I think the idea of having an 8-K is something we need to consider, because the last thing we want is stealth disclosures. To the contrary, our alternative is a correction that's very much out there. It may not be a full restatement, but it's out there; and it contains a lot of the quite significant information.

We appreciate all of the input. Obviously, we have had a panel that has a diversity of views; and we appreciate that; and I think we also got very good feedback about certain parts of the report. Perhaps we weren't as clear as we should be; and that's one of the advantages of having a progress report. So thank you again.

We are going to take a five-minute break here -- maybe even ten minutes. Then we'll come back at five after four with the next panel. Thank you very much.

(Break)

PANEL TWO - PROFESSIONAL JUDGMENT AND

DISCUSSION OF DEVELOPED PROPOSAL 3.4

MR. POZEN: Well, why don't we get started. John's already been introduced, so why don't we start with Jonathan Chadwick; and just tell us -- repeat your name and your affiliation.

MR. CHADWICK: Jonathan Chadwick with Cisco Systems. I'm the chief accounting officer.

MR. POZEN: Thank you.

MR. FLETCHALL: Randy Fletchall. I'm a partner with Ernst & Young. I'm the current-year chairman of the American Institute of CPAs; and I'm a member of the executive committee of the Center for Audit Quality.

MR. POZEN: Very distinguished.

MR. GRAZIANO: Sal Graziano, partner with Bernstein Litowitz Berger & Grossman.

MR. POZEN: Could you tell us, Sal, where you're located.

MR. GRAZIANO: I am located in New York City.

MR. POZEN: Thank you.

MR. JOHNSON: My name is Dennis Johnson. I'm the head of global corporate governance for CalPERS.

MR. POZEN: Thank you.

John.

MR. HUBER: I'm still John Huber from Latham & Watkins.

MR. POZEN: I'm glad there's been no magical transformation in the last ten minutes.

MR. RICHARDSON: Scott Richardson from Barclay's Global Investors. I'm the global head of credit research;

and I serve on our firm's proxy committee.

MR. POZEN: Thank you.

MR. TAUB: Scott Taub, managing director with Financial Reporting Advisors. We provide consulting services to public and private companies on financial reporting matters.

MR. POZEN: Thank you very much.

I think most of you who have been here probably know who the committee members are, so I'm not going to go through that. But we, first of all, appreciate your taking the time, especially people who have traveled far to come here and to share your views with us.

Those of you who have submitted testimony, we do have the testimony and people have read it in advance. We are -- the objective here is to have some short statements -- five-minute statements -- and then to have an active discussion. As I think you heard from the prior panel, we put out an interim or progress report in order to get feedback. We surely have been getting feedback. Sometimes we not have communicated as clearly as we should have. Other times people may have misunderstood what we wanted to do. So the attempt here is to really have, after the opening statements, to have a real open dialogue in which we can learn from you; and, hopefully, you can give us feedback that will be useful in writing a final report, which is due at the beginning of August.

So we will continue our methodology of starting from the backwards alphabet. And, you know, Scott, I've read a number of your columns. Very glad to meet you. Maybe next time you'll be a little kinder to me in some of those columns. Oh, sorry. There are some disadvantages with having your name associated with the committee.

MR. TAUB: I think I may need to withdraw the comments I already submitted.

Well, thank you for the invitation to be here today. As most of you know, I spent four and a half years at the SEC as deputy chief accountant and acting chief accountant part of that time. None of the issues I addressed at the SEC bothered me as much as trying to find a way to get more professional judgment into financial reports than I perceived to be there. I met preparers that had made deliberate decisions to avoid using judgment because of the fear of being second-guessed. They actually said, I refuse. I will not use judgment. I encountered auditors who were uncomfortable with treatments that were different from the ones they thought were safe, even if they thought the other treatments provided better accounting. And I encountered regulators that thought only one interpretation could be acceptable, even where I could see several.

It's not unusual these days for accountants to proceed as if our jobs are to comply with the written literature -- no more and no less. Knowledge and expertise is sometimes applied only insofar as considering whether the literature specifically allows or specifically prohibits a particular treatment.

Other times the term "professional judgment" is wielded as a weapon. It suggested, absent a specific prohibition, any practitioner's conclusion that a treatment is acceptable must, by default, be considered a reasonable application of judgment. These kinds of mindsets just helped to foster accounting-motivated transactions and complexity in accounting due to an ever-increasing need for interpretive guidance.

The progress report issued by the advisory committee seems to suggest that the framework would enable more use of judgment because of some combination of the following three things: One, the framework would improve the quality of judgments by reminding preparers and auditors of things to consider in dealing with the interpretive issues, thereby resulting in more knowledgeable conclusions; two, regulators are already willing to accept reasonable judgments but preparers and auditors do not believe this to be the case and the endorsement of the framework by the SEC and PCAOB would give preparers and auditors something tangible to point to so that they will feel comfortable in applying judgment;

and, three, perhaps endorsement of a framework like the one in the proposal will cause regulators to be more accepting of good professional judgments than they are today.

Now, I agree that endorsement of a framework like this could conceivably close some of the gaps between what preparers and regulators believe is reasonable. I do think the SEC staff already tries to accept good-faith judgments and so I don't think that implementation of the framework would actually result in the SEC accepting a lot of conclusions that it wouldn't have otherwise accepted as being reasonable.

Now, some might suggest that means the adoption of the framework is unnecessary; however, it might also suggest that adoption of the framework won't impede the SEC's work. And it is clear to me that preparers and auditors fear being second-guessed and that fear is affecting their actions in ways that are not healthy for the capital markets. If adopting the framework would ease these concerns because the SEC will formally be on record with respect to the use of judgment, then perhaps it is a beneficial thing to do.

The progress report does make clear that following the framework would not insulate an accounting judgment from being deemed an error. This is important, because having good faith doesn't mean you don't wind up making a mistake. The progress report does contemplate, I believe, that a company that followed the framework would not be deemed to have committed a securities-law violation, even if the accounting were found to be in error. This seems to make sense to me as well. I don't think the SEC enforcement staff ought to be spending a lot of time going after people that tried to do it right, used reasonable diligence, and just made a mistake. On the other hand, there is a risk, as the progress report notes, that a framework like this one could get treated like a rule. In that situation, it could become a burden to preparers who already thought they were doing a good job applying judgment. Worse, it could lead to a situation where any judgment that didn't incorporate all of the suggested steps is presumed to be inadequate and an indication of poor faith. Although there's nothing in the recommendation that actually suggests that this should happen, I have seen similar things happen before; and so I do understand where the concerns come from.

Others have raised the concern at the opposite end of the spectrum -- that the framework could be used by companies intent on a deception to escape the consequences of their actions. I have no doubt that if this framework were implemented, somebody would try to do just that. It happens every time. But in my experience I think it's better to allow policy-makers to set the rules they believe are best and leave handling the abusers to the enforcement function, rather than simply refusing to put out the rule for fear that somebody might violate it.

Further, I would like to suggest that concerns about the framework becoming a de facto rule and about potentially inappropriately protecting those intent on deception would both be reduced if the framework were adopted as a working policy of the SEC rather than as a legal safe harbor. Letting the SEC use it as a working policy means that the judgment about who deserves the benefits of a framework and what the consequences are of having used or not used it would be made by SEC staff, who generally have expertise in financial reporting matters, rather than by lawyers, judges, and juries, who may not.

In the end I think CIFiR ought to be commended for trying to address this issue. I tried for four and a half years. You've made more progress than I have already. If I had to vote --

MR. POZEN: But you were doing other things.

MR. TAUB: If I had to vote now, I would be trying to give the framework a try as an SEC working policy, because I'm not satisfied with the way things are working now. And this proposal does represent a real attempt at improvement. But I would point out that it's only going to work if the various participants in the financial reporting process believe it will work. The success of this proposal is directly tied to whether preparers, auditors, investors, and regulators believe in it. So I will be very interested to see how the comments come out on this, because if we wind up in a situation where a significant part of the market thinks that this proposal will fail or that it is done in bad faith, then it's not going to work. And although I'm a proponent of trying to do something because I don't like the way things are now, pushing a solution that parties don't believe in is probably not worth our efforts.

Thank you.

MR. POZEN: Thank you, Scott.

We have another Scott, Scott Richardson.

MR. RICHARDSON: Thank you. I think my comments will be a little briefer. I think I'm the only investor representative here.

MR. POZEN: I don't think that's true. Dennis is representing a little pension fund. Like they said at Dartmouth College, it's a small college, but there are those who love it.

MR. RICHARDSON: Good point.

So I'll give a little perspective on BGI, the size of the operation, distinguish the active business from the indexing business, and then place the financial reporting system or the information that comes out of that in some director-investor context. And then I'll make my comments around the professional judgment, with that background.

Currently, BGI has roughly $2.1 trillion under management. About 450 billion of that is actively managed. That spans a lot of different asset classes. The lion's share of that is in equity. There's -- we have probably 60, 70 billion active in fixed income. That's my primary responsibility. A lot of that has to do with corporate credit. So my background is going to speak to both the equity and the creditor use of this information, so it's a broader stakeholder perspective.

MR. POZEN: Someone on the committee knows a little about credit, Greg.

MR. RICHARDSON: Greg may know a little. We may use rating information once in a while in our investment decision. So, lastly, the financial information, again, is very central to that.

Some examples of how we would use this information in an active business is building out return forecasts, so it's a central component to shaping our view of good companies from bad companies from an expected-return perspective. We use this information to build risk models. We have an extensive arm of the firm tailoring, tweaking risk models specifically to different portfolio objectives. Likewise, to transaction-cost models. Those three ingredients together -- and that will determine the shape of a given portfolio.

Now, we also have an extensive proxy voting perspective. This is where Dennis could shed some more light. We find the financial reporting information central to a lot of our proxy voting issues. I think the restatement discussion you heard earlier would have touched on this. We've built out recently a very quantified way to rank firms on the basis of perceived restatement risks and that can help guide our voting decisions.

A general comment: With that active investor background, uncertainty is central in everything that we do. It's a fact of life. If I told you the degree of precision that we have in forecasting returns, you'd be shocked. It's around 1 percent. If you'd ask where is the summary statistic of our skill, that's pretty low. That means 99 percent of the stuff -- the realized variation of returns we can't explain. Okay. But with 1 percent, that's a very attractive business model. Okay. So we're working in an inherently uncertain business environment. It's a fact of life. We accept that. So I'm viewing professional judgment from that perspective. It's a fact of life.

When we use that information, I very much like the idea of substance over form. Going away from a rules-based mentality to something more principles-based is a very good thing that will capture the truth of the underlying economic reality better. Does that introduce additional flexibility into the system? Yes. Scott touched on that. Will managers occasionally abuse that discretion? Of course. As an investor, I think an easy away around that is to expand the disclosure regime. So if you give to the users of the financial statement the choice of information, from which one realization of one outcome came from, that allows the user to reverse-engineer those financial statements. It means currently we get point estimates for all the line items in the income statements and balance sheets. I think it would be very useful to expand that to include second-moment disclosures, so how reliable, how certain are you to expect that information? That will summarize a lot of the professional judgment aspect. So if there's uncertainty -- and that's a concern that a preparer and an auditor has -- they can convey that information through such second-moment disclosures. So I think substance over form -- critical. A way to address that, get people comfortable, is to expand the disclosure base of the financial reporting system.

MR. POZEN: Thank you. John.

MR. HUBER: Thank you for the opportunity to speak on professional judgment. I view professional judgment as the analogue to the other recommendations that the first panel talked about. And I've got a footnote to that discussion at the end of my remarks.

But to focus on professional judgment, I'd like to echo a theme from Scott Taub with respect to the idea of the psychology that we are working under in the current environment. And that psychology is really one in which a lot of people and a lot of companies are concerned about making a mistake about, in essence, sticking their head out of the shell and actually taking the risk that they sometimes believe that a restatement, even a restatement for an immaterial amount, is something that they can't be criticized for. Now, the difficulty with respect to that sort of approach is often that the restatement results in the stock drop; results in problems; and that, quite frankly, doesn't help investors either. The other side of that coin are people that will say, “Show me where it's written that I have to do this. Show me where it's written that we have to do the restatement.” And the fact of the matter is, that sort of mentality is not necessarily one that you would embrace from an investor-protection standpoint.

There was a commission. It was not a committee. It was the Treadway Commission. Jim Treadway came out with a list of principles that I commend to the committee's attention, because they're equally applicable now. The best one was tone at the top. And the idea of tone, the idea of a framework and its relationship to tone is the psychological point that I would commend to the committee's attention. We're all wrapped up with respect to qualitative, quantitative, complexity -- that sort of thing. But at bottom this is about people. And the fact of the matter is right now a lot of people are afraid with respect to making decisions. And I agree with Scott. This isn't going to change the attitude of the Division of Corporation Finance. Their view with respect to how to review these things will not change.

But I respectfully submit it can change the attitude of a lot of people to show them that there is a framework. It's not a rule; and I really don't believe it should be a safe harbor in any way, shape, or form. And it's probably going to be used by companies that already go through the process in the same way; and it may be abused by some. But my point is it's time to do something like this, because a lot of people are just looking for the kind of guidance that a framework can give.

And, with that, I'd like to go back to a point that was made in the first panel, because the point that was made in the first panel was that financial statements that are not restated cannot be comparable, cannot be shown on a consistent basis. I wanted to disagree at the time, but, quite frankly, we didn't have time.

My point is footnotes to financial statements can indeed set forth what that number would look like. You can have that under generally accepted accounting principles today with respect to that sort of a point. The narrative disclosure and the filing does the same thing. So my point is comparability and consistent application and consistent presentation is a false issue with respect to the proposals that the committee is looking at.

And so, with that, I turn it over to the chairman.

MR. POZEN: Thank you, John.

Dennis Johnson, CalPERS.

MR. JOHNSON: Mr. Chairman, members of the committee, I'm pleased to be here today to represent CalPERS in the discussions before you on the progress report of the SEC advisory committee on improvements to financial reporting. Thank you for your work on improving financial reporting, as we believe the advisory committee's work is timely and critical to all investors.

CalPERS is the fourth-largest retirement system in the world and the largest public pension system in the United States, managing approximately 240 billion in assets. CalPERS manages pension and health benefits for approximately 1.5 million California public employees, retirees, and their families. The work of CIFiR is important to CalPERS and our members. CalPERS has a significant financial interest in the integrity of financial reporting.

Many of you have had a chance to read CalPERS' written testimony. I would like to briefly comment on two topics: investor needs and professional judgment.

There are five investor needs that I would like to address. First, materiality should be evaluated not only from a reasonable current investor's perspective, but from the perspective of all investors. Second, we do not believe that the proposed sliding scale for evaluating errors protects the interests of all investors. Third, companies should disclose their bases for materiality, how they assess materiality and the amount of uncorrected errors of each reporting period. Fourth, when an error is corrected, financial statements from all periods should be corrected for comparability and not aggregated and flushed through the current period. Fifth, financial statement disclosure should be done in a manner consistent with recommendations made on December 13th, 2007, by the Investors' Technical Advisory Committee of the Financial Accounting Standards Board.

There are four points that I would like to make on professional judgment. First, professional judgment will be strengthened by more complete documentation practices, greater availability of relevant information, and better communication between management, directors, and external auditors. Second, investor input is required during the establishment of a useful framework to improve the application of professional judgment. Third, the Financial Accounting Standards Board must also be involved in the development of a framework to guide the use of professional judgment. Fourth, safe harbors should not be made available to accountants and auditors. We do not have any evidence that the granting of such provisions protects investors, improves one's accuracy when applying judgment, improves the quality of management decision-making, or improves the quality of the audit.

Thank you for inviting me to share CalPERS' views with you today.

MR. POZEN: Thank you for that very crisp presentation.

Salvatore Graziano, please.

MR. GRAZIANO: Thank you for having me here this afternoon as well. I noticed that I submitted one of the longer written presentations, so I will now make one of the shorter oral presentations.

MR. POZEN: We very much appreciate that.

MR. GRAZIANO: I am a partner at a 50-lawyer law firm that represents public pension funds primarily in securities litigation. I've personally litigated securities fraud cases, including accounting fraud cases against both issuers and accountants, so I'm often involved in situations where things have gone wrong; and I think that is an important perspective for this committee to consider what the effects of these proposals will have in the situations that have gone wrong, both in terms of enforcement and civil litigation. I've seen firsthand how difficult these cases already are to prosecute against both issuers and accountants. I am concerned that Proposal 3.4 will further raise this bar to a level that will be quite difficult to meet, even in the most meritorious cases. I hope that my views today will be helpful to the committee with this perspective in mind.

Again, my submission in writing was quite long. I just wanted to give you a brief summary of it, which is that Proposal 3.4 is bad for investors because it would make pursuit of fraudulent accounting by regulators and civil litigants even more difficult than it already is, thereby making accountants less accountable. It will make it more difficult for competent, honest auditors to challenge management's “judgment,” thereby encouraging fraudulent accounting; and it will reduce the transparency, comparability, and uniformity of financial statements while increasing their complexity, therefore further harming investors. Ultimately, I believe this will result in more scandals of the kind that plagued in the first half of this decade; and the beneficiaries in the short run will be dishonest managers and compliant auditors.

One brief additional comment on safe harbors: I think you'll hear now the third time in a row that safe harbors should not be endorsed. I did notice that this committee has not specifically proposed or endorsed safe harbor, but I can't stress how important it is to discourage any safe harbor in this situation.

Thank you.

MR. POZEN: We have definitely gotten the message on safe harbors. We thought we had been clear, but obviously in this area one can't be clear enough.

Randy?

MR. FLETCHALL: Thank you for the opportunity to testify today. I applaud the SEC and the committee for their excellent work on improved financial reporting. In particular, the committee's progress report contains a number of proposals that, if adopted, could help improve the quality of the U.S. financial system and ultimately strengthen the U.S. capital markets.

I am involved with various organizations, so I should say at the outset the comments that I make today -- the views are my own.

Today I wish to emphasize the committee's endorsement of a professional judgment framework is particularly significant and necessary. The committee proposes a framework for SEC adoption that strikes a proper balance of providing clarity and protection to preparers and auditors without giving anyone a free pass to rely on unreasonable exercise of judgment. The committee successfully identified the necessary components of a professional-judgment framework and that established adjustments should be exercised and evaluated. Among other things, the framework requires contemporaneous documentation of the alternatives considered and the conclusions reached and provides elements of professional judgment that are based on a critical and reasoned evaluation and made in good faith. As recognized by the committee, clarity with regard to how professional judgment should be exercised and evaluated will become increasingly important as the U.S. shifts to a more principles-based accounting standards which rely to an even greater extent on professional judgment.

The committee's proposed framework will provide a number of benefits to investors by enhancing the structure and discipline surrounding the decision-making process. The framework will increase the likelihood that the process used by preparers and auditors will consistently be robust, objective, and appropriately documented. This will help increase the quality and consistency of the judgments relied on by investors. The framework will remind the investment community that judgments are an inherent part of preparing financial reports and auditing them. And the financial statements and audit reports should be read with that in mind; and the framework will reduce a number of unnecessary restatements allowing investors to focus on a smaller number of truly important restatements in their decision making.

Now, I understand that some have questioned the need for a professional-judgment framework providing specific examples to prove the need is very difficult, both because of client confidentiality issues and because we could easily end up arguing over any given example, whether it's on one side of the line or the other. But I wish to strongly emphasize for the committee that the numbers do speak for themselves.

Between 1997 and 2005, the number of restatements per year increased five-fold. In 2006 alone nearly 1,500 restatements of financial statements occurred. In addition, I can assure the committee that in my own personal judgment from my own experience and discussions with others, there is indeed a problem with reasonable good-faith decisions by preparers and auditors not always being respected but instead being overturned by regulators, a problem that requires a strong response. The problem is real; and the committee is on the right track to fix it.

I recommend that the committee's proposed framework be clarified in only two ways. First, the committee should make it very clear that there's no suggestion that financial statements of preparers need protection from a review and analysis by their independent auditors. The appropriate relationship between preparers and auditors should include a robust exchange of views, particularly at the time accounting and reporting decisions initially are being made. Within the context of that relationship there's simply not the kind of concerns as when preparers and auditors are dealing after the fact with government regulators. The committee should not want to interpose itself into the auditor/client relationship, which is already governed by substantial professional literature, or in any manner weaken the role of an independent, objective audit, a role that's very essential to investors in the markets.

I note that the committee has inserted a footnote in its progress report to address this issue. I would only suggest that the committee go further by carefully and consistently removing from the text any suggestion that the professional-judgment framework approximate financial statement preparers from their auditors. It's important the framework not alter that important relationship between issuers, including management and audit committees, and auditors. In fact, I would encourage the committee to consider adding some commentary that emphasizes and fosters the effectiveness of those relationships.

Second, the committee should consider requiring enhanced disclosures within the element of its framework. As recognized in the committee's report, the current proposed framework does not necessarily establish professional or new disclosure requirements from those already required by the SEC. I believe that the SEC should consider additional disclosures than those currently required in order to fall within the framework. The increased transparency of important financial reporting decisions will provide another significant benefit to investors in addition to those that I mentioned earlier.

Finally, I want to comment on the form of the framework. The committee's progress report, as has been noted here, recommends that the commission implement a professional judgment framework and leaves resolution of the form to the commission either by a rule or by a policy statement. A rule, which is more formal, has advantages over a polity statement. A rule provides greater stability and consistency in regulator conduct. It is because a rule carries with it the full force of law and is more likely to be consistently accepted by the regulatory staff, as definitive statements of how issues should be handled rather than policy preferences that can be changed or minimized. My belief is that the commission should impose a rule, as a rule can be much more effective in establishing a professional judgment framework that produces the desired behavioral changes. However, a strong and clear commission policy statement establishing a framework perhaps would go a long way to producing the same desired change. It would clearly be my second choice.

In summary, creating a professional judgment framework will help create an environment where good-faith professional judgment receives appropriate respect. The framework would also decrease the number of restatements in the Unites States that result from differences in judgment, differences that are reached in hindsight, and differences that too often reflect regulators' preferences for how certain items should be handled when there is more than one right answer that actually exists. These restatements strike doubts in investors regarding the quality and accuracy of U.S. financial reports. Everybody's been working diligently over the past several years to remove such doubts and restore investor confidence. Reducing the number of unnecessary restatements will further increase investor confidence in our financial reporting system and thereby our market's financial health and stability.

MR. POZEN: I just want to say, Randy, that footnote was, you know, does represent the committee view and if you -- if there were -- if you would take the time to write us a letter or an e-mail in which if there were other sentences in the report that were problematic, they weren't intentional. So we didn't mean to disturb that relationship and anything you can be specific on in terms of giving us guidance or words would be helpful.

MR. FLETCHALL: Chairman, thank you very much for that. And we will, in the comment letters of each of the organizations I'm involved with, try to help deal with that.

MR. POZEN: As I say, since we are in agreement with the principle, the more specific -- we don't need a general -- you don't have to convince us of the point. We want to know if there are sentences that are bothersome. We'd like to know them.

Jonathan.

MR. CHADWICK: I felt like being controversial and actually weighing in for safe harbor, but I don't think I will. (laughter) That's the only issue on the table here.

So good afternoon. I am Jonathan Chadwick. I'm senior vice president and corporate controller at Cisco Systems. I'm the principal accounting officer. I'm also a member of Financial Executives Institute, FEI -- their committee on corporate reporting -- although the views expressed today are really my own and not necessarily those of FEI.

So, in general, we are very supportive of the work you're doing and the SEC advisory committee on improvements in corporate reporting and its ongoing objectives to reduce complexity.

The focus on the end-user of the financial statements should be particularly beneficial; and we encourage the committee to continue to use this orientation as a very critical lens regarding the benefit of the proposed changes. Ensuring that financial statements have indeed become more understandable and useful should be considered a key acid test for the success of this important effort.

So in your view the judgment framework not only is aligned to a principles-based standards approach but is in itself a principles-based approach to the methodology of good decision making. We should view the framework as the set of concepts and principles that define a reasonable person's approach to the application of judgment. We should not let it denigrate into a check-the-box formality; and we would be very much opposed to a codification of a set of rules for the judgment-making process. Its use should extend into the basic building blocks of both preparers and auditors and become an inherent aspect of the training of accounting professionals. We believe that embedding the concepts from the framework into accounting degrees, the CPA exam, and into ongoing training and development will bring positive impacts beyond the judgments themselves and will eventually improve the effectiveness of our financial reporting. Maintaining the spirit of what is intended is going to be key.

Among the potential elements of the thought process mentioned in the progress report are analysis of the transaction, review and analysis of the relevant literature, alternative views or estimates, consistency of application to similar transactions, and the appropriateness and reliability of the assumptions and data used.

I feel it's really important to note that in today's world, good companies are already following this type of framework. For example, when an emerging accounting topic arises, most companies are already going through an exhaustive effort to support their conclusions. Typically, the analysis starts with gaining an understanding of the business purpose and the accounting guidance. Companies are also analyzing differing viewpoints, of which I note there can be many and often writing white papers to support their conclusions. The documentation that is prepared to support a company's accounting position is generally discussed with their auditors and their audit committees and on the size of the topic we're talking about.

And I would suggest that while these steps may be considered best practices, they are, in fact, necessary practices in today's complex environment; and it is perhaps disappointing to note that the committee believes that such a fundamental framework does, in fact, need to be adopted in whatever form, but we do believe that it will be especially important as we learn how to operate within a more principles-based standards environment, for example, under

IFRS.

Users of the framework for accounting judgments will be both financial statement preparers and auditors. Application of the framework should ultimately be inherent in both groups but may require a change in mind-set in going from a checklist mentality to one of judgment and principles. And while today's accounting in the United States is more rules based, we do anticipate movements towards a more principles-based approach with less specific guidance. This change of thought process will need to be supported by regulators in not second-guessing reasonable conclusions and creating mistrust. We believe that this framework for decision-making can aid in preparation for this mind-shift change. And as such, the SEC advisory committee recognizes that the framework would affirm that reasonable professional judgments can differ and that differences do not suggest that one judgment is necessarily wrong and the other correct.

Now, in terms of documentations and disclosures, however, we should be careful that the application of the proposed framework does not create any additional documentation requirements per se, but that appropriate contemporaneous record-keeping should be a natural outcome of its use. It is the substance of the decision-making process that we seek to improve and not simply the form.

The level and type of documentation may vary, depending on the size and nature of the transaction and other relevant factors. And, similarly, transparent disclosure of significant accounting judgments should be a natural outcome of the application of the framework, but, again, we believe we should be careful not to prescribe exact form and leave it to the judgment approach.

And as an example, we understand that there is no similar codified set of rules in the IFRS world, but we do observe that companies adopting IFRS are generally providing greater levels of explanation and disclosure regarding their accounting policies in the principles-based standard environments.

So, in summary, we are supportive of the broad efforts of the committee, including the progress report. A significant amount of progress has been made in a relatively short period of time. The judgment framework is a key outcome of these efforts. It is designed at the appropriate principles level and is, in fact, consistent with the practices at most companies today. As regulators, preparers, and auditors, we will all need to ensure that we do not have the unintended consequence of codifying it and denigrating it into yet another element of check-the-box compliance. There should be good natural outcomes with respect to compliance, documentation, and disclosures. And we need to collectively remove the aura of mistrust that may exist as a basis for introducing the judgment framework. And, as I promised, we should not view it as a safe harbor except perhaps in the sense that reasonable, good-faith judgments made by preparers and auditors in accounting and financial reporting matters should be respected by regulators.

The judgment framework should be viewed as just sound, good business practice; and we should ensure that the principles and concepts are embedded in our respective organizations, especially as we contemplate this significant shift to IFRS over the coming years.

Thank you.

MR. POZEN: Thank you very much.

I think let's -- Greg, did you want to open the bid?

MR. JONAS: This is a question for Mr. Graziano. And let me preface this by saying you have surely forgotten far more than I will ever know about civil fraud litigation, so it is with great modesty that I ask this question.

But I could see that if what we were proposing was a process, meaning telling people what to do or a checklist, meaning when you're done with it, you're complete. I could see that if that's what we did, it could constrain second-guessing, could constrain civil litigation. What I don't understand and am wondering what I'm missing is what I perceive we're proposing is nothing more or less than saying as a literature in auditing and accounting has said in many places, “Hey, here's twelve things to think about.” So in my experience when you say there's twelve things to think about and I would argue that maybe at least four of those are things today that people don't often think about, that first that does not constrain any second-guessing. If anything, it gives those who wish to shoot at quality judgments more to shoot at. I don't see how that constrains. Can you help me out with your view that you somehow get shut down here if we propose this twelve-element framework?

MR. GRAZIANO: Okay. Well, first I'm looking at the nine elements on page 69 of the report, so I'll use those for my comments. And just taking a step back, generally the importance of rules to me and what I do cannot be understated. I have one example that's slightly off, but I think important for the committee to think about; and then I will go through with what I would do if I were forced with these nine sets of criteria, how I would analyze them. But, first, the importance of rules.

When Sarbanes-Oxley passed, one relatively unnoticed change was that options had to be reported within two days of being granted. That was not a major development, but what it caused, because you had now a firm two-day rule, was a revelation of over a hundred public companies previously backdating stock-option grants. So rules matter and rules are very helpful. But let's talk about what I would do if I were forced to live within this framework. I think the key to me is that judgments have to be documented contemporaneously, that the documentation has to be detailed and disciplined, that -- what I fear most is a checklist approach with vaguely drafted documentation with as-of dating that will later be used as very powerful defense, because in our cases what matters is proof of scienter, proof of knowing or reckless behavior on the part of the internal and external accountants. If the accountants are able to say, I went through the nine items on page 69 of the report and I have this one-page summary of what I did, therefore I used my judgment, that will absolutely be a defense in civil litigation. The lack of restatements that has often been talked about today, which is reducing the amount of restatements per se -- the lack of restatement is a powerful defense in civil litigation. So this earlier panel, when we talked about what would change if we had more disclosure, less restatements, how would investors be harmed?

One more item I'd like to put on the table on that consideration is that I can assure you if there are less restatements but nonetheless just as material what you will see before the regulators in the courts we didn't restate, we used our judgment, we are not liable.

So those are my concerns, generally speaking.

MR. POZEN: I read your testimony; and I had a number of specific questions.

And, first of all, your observation about stocks and options, I don't know whether it's true, because I think the options backdating was revealed by a set of statistical studies done actually in the years before 2002. And it was done by an academic group that showed that there was a high probability so that this -- I think most of the options backdating occurred before Sox, so I mean --

MR. GRAZIANO: Can I respond to that?

MR. POZEN: Yes.

MR. GRAZIANO: Okay. Actually, you know, I worked with those professors quite extensively in a number of civil cases; and what they needed, what they were missing from their research was what happened after Sox. That gave them the powerful evidence they did not have. Yes, the patterns were very suspicious before Sarbanes-Oxley, but the fact that inside corporate managers could no longer time their grants as well when they had to report it within two days of receiving a stock-option grant is what gave them the ability to reach their final conclusion that, in fact, backdating was occurring.

MR. POZEN: I agree that once you had a two-day rule they couldn't backdate, but I actually still disagree that that actually produced the result. I also in my spare time happen to be a professor.

But the second thing is I read your testimony to say actually more that -- a second point is that you say that the WorldCom perpetrators capitalized line cost when the rules clearly forbid doing so. I don't understand -- I agree in WorldCom they chose to capitalize line cost rather than expense them. And so that surely wouldn't be defensible under any accounting judgment framework because it directly violates the rules. So I'm having a hard time understanding how a judgment -- how that case would in any way be impacted by the judgment framework.

MR. GRAZIANO: Clearly I think the point about WorldCom is actually slightly different. The point there is even in the face of rigid rules, there are abuses. The concern then is if the rules are less rigid, become a much more judgment or principles-oriented, you will see more rather than less violation. That is the point of the WorldCom example.

MR. POZEN: Well, then I guess the third point is -- that's what I get out of your testimony in general is that it's not so much the accounting framework. Your main concern is you don't like the move toward principles and away from specific rules; and I think it's a legitimate debate. But to the extent that the world is going that way, quite frankly, neither you nor I will have a lot of control over that. But I think that seems to the nub of your concerns, but -- as opposed to the accounting framework.

MR. GRAZIANO: I recognize that is a freight train I may not be able to stop. I do acknowledge that. And where I go from that is looking at page 69, for example, the nine components of exercising judgments. I don't see enough teeth there, to be frank with you. I don't see any requirement to detail the exercise of judgment contemporaneously in a detailed, documented way. I am concerned --

MR. POZEN: Do you -- I guess maybe we weren't clear, but I thought we said you had to not only explain your choice but you had to document it contemporaneously. I think that is part of our --

MR. GRAZIANO: I understand that, but I don't see the teeth behind that. I don't -- if I looked at this page and I was an auditor I wouldn't really know how much I had to put on that work paper at the time, as opposed to what I would do today.

MR. JONAS: Guilty as charged. It is not that level of detail that turns this into a rule, agreed; except today there is none. Wouldn't you argue that the twelve items we've listed is better than the zero items that exist today? And, if not, why?

MR. GRAZIANO: Yeah. I don't think I agree that today there is none. I think the auditing standards do require a contemporaneous documentation, but what I would do is urge this committee to see if it could perhaps put more teeth into this page and into this proposal in general so that, you know, it actually becomes a very helpful guide to an outside auditor who is now confronting an inside company manager and saying to him, “Look, I have to prepare this whether you like it or not and my document is going to have go over the fact that 87 out of 90 companies are doing this way and you're one of the three.” I think that would be very helpful.

MR. POZEN: Two things: We heard from a number of people involved in the PCAOB inspection process that actually nondocumentation was a big issue for them, that they -- noncontemporaneous documentation -- so they felt that although you may say that is prevalent, it doesn't seem to be that prevalent or at least there are a number of cases where people are not documenting.

Second of all, the reason we were reluctant to have a very specific set of documentation requirements that pretty much it depends on the importance of it. I think that goes back to something Scott was saying is we're a little worried. We don't want to create a situation where people feel like they have to have a huge documentation on every small accounting judgment. We're sort of trying to say let's have the appropriate documentation for the level of judgment.

The third point is you had -- I mean, again, if you think that there are specific factors or toning of the factors that could improve those, we welcome your specific suggestions, because except for the thing on documentation, because we don't -- we're trying to reach a balance and between not just piling up lots of documents for no reason.

MR. GRAZIANO: Yeah. And just two brief reactions to that. First, consistent with my view that rules matter and rules are very important, I'd rather see rules -- more rules rather than less -- in terms of the documentation requirement. The PCAOB inspections you talk about are typically not public. There is some public discussion of them after the fact, but you don't know which company and --

MR. POZEN: No. We don't know that either, but what we do know is that when talking to the people at PCAOB they say that one problem that occurs when they find -- when you say to them well, when you find problems in the audits, and they say one problem that occurs more often than you would think is that people say they've exercised judgment but when they ask for contemporaneous documentation, it's not there. And so they get ex post facto documentation; and I think we would all agree it would be a truer process if it was done at the time.

MR. GRAZIANO: Yeah, and one other thing that I see -- and I've seen very often in terms of the documentation that does exist -- I don't know whether the PCAOB has noticed this or not -- is that even in documentation drafted by the national office of the big four accounting firms, the documentation is very thin. Witnesses are often deposed on documentation and tell you things in their testimony that is not in the documents; and it's very hard, two or three or five years later to know what has happened at the time the judgments were made.

MR. POZEN: Yes. I think we have John and maybe Randy wanted to talk.

MR. HUBER: Let me just try a couple of things. I'll try the last one first about lack of documents by auditors.

While AS 2 was replaced by AS 5, AS 3 was not changed; and the one point that I can tell you there is the documentation of auditors is huge. And the fact of the matter is, relatively speaking, from even five years ago AS 3 requires much more documentation. One of the criticisms that you can have of the PCAOB inspectors is that they are document-driven with respect to the review that they do, but the fact is the audit firms are preparing it. I've seen it. I've worked with it; and I can tell you that they do it.

Second point: I wrote rules for the SEC for six years. Most of the rules you guys like I wrote; if you don't like them, I didn't write them. Okay. The fact of the matter is there are two types of rules --

MR. POZEN: The ones that you wrote and the ones everyone else wrote.

MR. HUBER: I haven't written any lately, but the fact of the matter, okay, there are two types of rules: legislative rules and interpretive rules. And the fact is if you do this, as a rule, it will be an interpretive rule, like Rule 176, which is an interpretive rule with respect to due diligence. Rule 176 is about that long, okay? It does not do very much in terms of specifics, but it gives the kinds of elements that people should take a look at with respect to due diligence. I commend that to your attention, because as a rule-writer I can tell you that the great fear of a lot of people -- and I saw it myself when I was doing the tender-offer rules -- was a court case coming down the pike that will, in essence, write the rule for you before you can write the rule. And that's the kind of situation that we are in.

I'd rather have the committee set forth a framework, whether it be, as Scott suggests, a nonrule that is followed or rule. I would like to have the committee do it in a decent fashion with the benefit of input from investors and from everybody else rather than to have a court case come down and, in essence, make the rule for all of us.

And as much respect as I have for the judicial system, having this highly technical area taken care of by a framework is a far, far better thing.

And as I said in my remarks, we need it. We need it from the standpoint of preparers and from the standpoint of auditors. And I think, if I may make one last point here, there has to be a distinction between auditors and the preparers with respect to the framework. In other words, just like the commission came out with its own management guidance on 404, there has to be a reflection of the in-house -- the company preparers -- with respect to this; and the same standard for auditors should not necessarily apply with respect to the company people.

MR. POZEN: I think on that point we have had considerable discussion on that issue --

MR. COOK: You know, Bob, it might help though to go to John's point, which is a point I was going to make. You've got in this discussion this focus on these things to think about, as if this is only for auditors. This is not only for auditors. This is first and foremost for the preparers; secondarily, for the auditors evaluating the judgments the preparers have made. So the context of our remarks here should at least recognize we're not talking about auditor documentation in the first instance. We're talking about preparer documentation and then auditor documentation --

MR. FLETCHALL: I was going to add a comment about documentation. And while the names of the issuers were not actually disclosed, if one spends time looking at the publicly available portion of PCAOB inspection reports, a fairly common theme is an absence of documentation and sufficient audit evidence basically to support, I'll say, the issuer's accounting treatment. So in that sense, I do believe that this framework will improve our preparers' documentation contemporaneously with the decisions made. And we seldom have an issue, I would say, of insufficient audit evidence if we have a very good basis from a preparer, where we usually start having these issues or if a preparer doesn't have good documentation, the auditor puts some together and it’s not deemed to be sufficient for the inspectors.

MS. GRIGGS: I just had a question. I'm not sure who the best person is to ask this.

Some of the criticism of this framework is that it will result in additional costs to companies because there will be an adverse inference in litigation if there is no such documentation, that they didn't do the work; and then they make -- I guess, Jonathan -- your point that companies do it now so you don't need it, so why do you write anything when, first of all, good companies are doing it and having it in writing is just going to cause additional costs for companies and will possibly adversely affect them in litigation if they haven't perchance documented a particular judgment. And I'm just weighing that on balance.

And I know, Scott, you sort of raised those same points.

MR. POZEN: I should point out that we did include a sentence or two to say that this would be nonexclusive. There is an attempt by us to say this isn't the way you can go about this, because if people have better ways to support them. But, nevertheless, the point Linda makes could be come about, so --

MS. GRIGGS: I'm just curious --

MR. POZEN: Jonathan, you want to respond?

MR. CHADWICK: I would say from my perspective, I don't see any additional costs, not because we are not documenting any today, but because we are going through this process; and I'd like to think we are not an exception, but it's just a standard practice. So the additional costs per se of this -- it only starts becoming additional costs if you all impose a framework that is absolutely prescriptive as to form. I could show you a set of binders with a bunch of white memos. And I understand the point that's just been made with respect to documentation. As I've understood the shift over the last five years, the burden is on the issuer to take a position with respect to accounting standards; and I actually think that shift is absolutely appropriate. As an ex-auditor myself I would assist my clients coming to the conclusion they should be coming to more often than not more than ten years ago; and I think that shift has actually been beneficial. But I can tell you for companies -- certainly mine and others that I was speaking to last week -- absolutely the reaction when reading the framework is that it seems to be written in a way that -- this is an assumption that we are not doing that, and I would say for certainly the caliber of the organizations that I've been mixing with over the last couple of weeks, there's a very strong sense or feeling that this is a really good framework that puts people on notice, frankly, as to what should be an acceptable level or standard, but to prescribe an exact form of documentation would be a mistake. But I don't see any additional costs, frankly, around this. I see clarity.

I can't speak for what other companies are doing, but I think, if I could just make a comment, I think where the additional disclosure -- I think where the additional documentation actually does come out is as we become more principles-oriented, I think you're going to find a natural requirement for more disclosure in the financial statements, which I think can only be a good thing.

MR. POZEN: Scott. And then we'll come back.

MR. TAUB: Myself, I look at the way this is written and I think it shouldn't impose additional costs for the very reasons that Jonathan has described. The firms that are already doing it are already doing it. Firms that aren't already doing it -- well, then this is going to be helpful; and I don't perceive that as a burden. But I have seen things go awry. I recently found out at a meeting that a speech that one of my staff people made in 2005 had caused valuations of customers' relationships to be done in only one way for the last three years in purchase accounting, when that wasn't the intent at all. It was merely to point out something that one company had done wrong. So I worry about unintended consequences like that. And that's why I said in my opening remarks that I understood the concerns. I think the committee, though, has tried to be very careful to write this in a way that that shouldn't happen, but that doesn't mean it won’t.

And one brief comment in regards to the contemporaneous documentation. Just to make clear my support for this framework is in part because the framework I think makes very clear that the evaluation and the documentation needs to be done when you initially account for the transaction, not two years later when the SEC asks about it in a comment letter, because routinely I would see that. The SEC could ask. The company would say, Okay. We have now analyzed it; and in our judgment the accounting we accidentally did two years ago without even realizing this was an issue turns out to have been correct. Well, that doesn't do anything for me. This framework, I think, is quite clear that you got to be doing this when you initially do the accounts.

MR. POZEN: Dennis?

MR. JOHNSON: I just want to say from an investor's perspective I hope the two positions that were just noted about cost are correct. But to the extent that they are incorrect, I would just say the costs that would be incurred or that could be incurred from implementing this framework, we think, would pale to the costs associated with the decline in market value in the event that our portfolio companies get involved in substantial restatement.

MR. POZEN: I notice, Dennis, that CalPERS took a pretty strong position against the safe harbor but seemed to be in your letter relatively supportive of what might -- I don't know what exactly the term here is -- but a flexible framework or policy framework.

MR. JOHNSON: That's correct.

MR. POZEN: So that seems to work. And I think that probably would keep costs reasonable; but understand your point.

Greg, you wanted to ask.

MR. JONAS: It was a question for Dennis; and maybe it was just my confusion so, please, just clarify if I am confused. I had thought that you were kind of downbeat about our framework, not in love with it.

MR. POZEN: I don't know if we insist on that high a level of enthusiasm.

MR. JONAS: But I suspect that you would agree that bad judgments are at the heart of a lot of problems that CalPERS and other investors see and suffered through. And so our goal here is to raise the quality of judgment, so if we're missing the mark, how should we go about raising the quality of judgment?

MR. JOHNSON: We do support in principle the framework that you are endorsing. I would just reiterate what's in our written testimony as well as in my oral comments that input, for example, from the investment community in finalizing this framework and getting companies to adopt we believe would strengthen it, would not constrain it, reduce the flexibility that currently exists but would just add another important perspective that we think would reinforce the protection of investor assets.

MR. JONAS: Thank you for that comment.

MR. POZEN: Could I also -- I know this goes to the prior panel, but I did want to make sure that we understood this. You were against the sliding scale, if --

MR. JOHNSON: That is correct.

MR. POZEN: If you could just give us a little explication on that, because we were trying to say that in all cases you need to consider quantitative and qualitative and that essentially the higher the quantitative then sort of qualitative would have to be much higher to overcome it if qualitative was lower. So it was an attempt maybe not as articulate as we should have been, but it was an attempt to convey that. I wanted to understand what was the concern.

MR. JOHNSON: To the extent that the language could establish a stronger relationship between the quantitative and qualitative considerations that you'd mentioned, that would be of importance to us. What we are concerned about is what, in our professional judgment, might be a very large quantitative adjustment that is not deemed to be material. But yet a series of subjectively chosen qualitative issues that could be material -- again, something that would just establish a closer relationship between those two to provide some guidance on when materiality can be defined -- we think that would be beneficial.

MR. POZEN: Scott, did you want to say something?

MR. RICHARDSON: Asking for precision on something that's inherently uncertain, I think, is impossible, so this is by its nature an unwieldy beast.

MR. POZEN: I think you're absolutely right, but I guess we've internally debated. We could have just said you need to consider quantitative and qualitative factors in both directions. So some people have said sliding scale helps them think about it. Other people say, Well, it sort of conveys an image that doesn't work for them, so -- yeah, so maybe the argument is that, you know --

MR. RICHARDSON: You should look at both, for sure. I think a good example would be, like, how you vote on a restatement. So a company has had a restatement and it comes to the directors for a vote. What information should we look at to vote and have to meet our responsibilities? We look at both qualitative and quantitative information, for sure. Do we have anything in our proxy guidelines that says 50% vote on this, 25% vote on this? No, it's very much a case by case with some underlaying structure. To the extent you've got reasonable quantitative metrix, it might be that the stock market will tell you the economic materiality of the restatement. You get the cleaner vent date around when it's announced. And then you might say, Should we automatically vote against members of the audit committee? Maybe not. It could be something that's reasonably beyond their expectations to report as part of the internal audit process.

MR. POZEN: Yes, Dennis?

MR. JOHNSON: If I could just also say that we would be very sensitive to a series of relatively small quantitative restatements leading over time to be a very material quantitative restatement. And so, again, just being able to establish a stronger relationship between the quantitative and qualitative considerations, we believe, would protect the interests of investors.

MR. POZEN: Thank you. I don't know -- Ed?

MR. NUSBAUM: Randy made a comment earlier in your comments about the need for improvements and disclosure relative to the items that would be discussed or addressed by this judgment framework. I'm curious, Randy, if you want to maybe expand on what you had in mind or what you think we should say. And perhaps it would be useful if either Scott Richardson or John Huber or Dennis, from your perspective if you think there's anything we should do in terms of enhanced disclosure -- something we've struggled with as a subcommittee, I must admit.

MR. FLETCHALL: In other parts of the report, I certainly see that struggle; and I'm trying not to create a disclosure overload and, in fact, deal with what you currently are having to deal with. I mean things need to come out of there. If we're talking about something so important that these are the critical accounting calls -- these are the accounting --

MR. POZEN: But that's exactly the point that we've been debating. We thought for while we should say if it's a critical accounting policy and that's where you're making the choice between Policy A and B that there should be disclosure, but that's pretty clear in the requirements, that the concern we had was that if you go sort of down to lower-level judgments and sort of how much public disclosure -- we are not asking people for documentation -- but how much disclosure outside of critical accounting policies do we really want to put in the 10-K's or 10-Q's? So I think that's the nature of Ed's questions. And we struggled with that a lot.

MR. FLETCHALL: And some could be just maybe fully dealing with the spirit of the current rules and making sure there's enough robust disclosure under those, as well as I think you could look at the list of -- the ITAC has been referenced and they had some ideas. Or you can go back as far as the 2000 rule proposals in critical accounting policies and accounting estimates for some additional elements, not for every accounting decision that's made, Chairman, but for those that are most critical and those estimates that are subject to the most uncertainty, you know; a little more perhaps on subjectivity, on the assumptions, on how they change over time. And, again, to borrow from Jonathan, many good companies, many good disclosures are getting probably almost that right now.

MR. POZEN: I think that would probably amount to our emphasizing -- remember, as you know, critical accounting policies are ones that are both material and involve significant judgment, so we would be emphasizing to the registrants something that then Jonathan, obviously, already does, that they should give good explanations of their choices of critical accounting policy, which I don't think we have any problem. We just thought that that was sort of -- we basically said you should follow current disclosure requirements rather than select that. But we can easily give that as an example, since obviously that's the most important.

MR. FLETCHALL: That would be one that's the most important that comes to mind to me.

MR. CHADWICK: Perhaps there's one other thought as well, because I think we're going to -- I'm guessing, but I believe we're going to find there is less prescription in the form of our rules. I hope that's going to be the case at some point.

MR. POZEN: Well, I think at this table, we're not --

MR. CHADWICK: I know. I know.

MR. POZEN: -- so if we move to IFRS, it will surely be true.

MR. CHADWICK: But with that presumption perhaps in mind, I think one of the things I think we're likely to see without less prescription publicly, I think we're going to require more prescription inside the company about what the actual application of a particular framework is going to be or a particular rule set is going to be. So my point here is to the extent that there is a known difference in practice but one that is perhaps not clear to the investor as you specifically disclose it, I think that would be -- if you know there's variations in practice and you don't have a clearly disclosed set of accounting practices with respect to that, I think the disclosure has failed in that regard.

MR. GRAZIANO: May I add something as well?

MR. POZEN: Sure.

MR. GRAZIANO: There was one question earlier that actually went unanswered, which is “Should there be an adverse inference if there isn't contemporaneous documentation internally?” And I think this plays well with what we just heard from Jonathan, because my response to that is, why not? Why shouldn't the SEC in looking at companies or civil litigants be able to argue for an adverse inference? Isn't that the best way to encourage contemporaneous documentation, that companies will know if they don't comply and they don't -- this is not about what they say publicly but what they record internally. Why not? Wouldn't that be a good thing?

MR. POZEN: Well, I guess, Salvatore, I believe if we made this what John would call a legislative rule, then if you didn't have documentation, it could be used against you. But that means if you do follow all the procedures it can be used for you. So I don't think you would like that.

MR. GRAZIANO: But I think that's where this --

MR. POZEN: I'm not sure you could have it both ways.

MR. GRAZIANO: No. But I think that's where this page is going. Whether or not we call it a safe harbor, I think the effect of something like this is a sort of safe harbor that will be argued vigorously in the courts, not as a technical safe harbor, but it will be, “I complied, I followed the nine steps before I acted reasonably.” I think --

MR. POZEN: We did try to preface that, also, with you had to act in good faith and, you know, we tried to put some considerable rubber in it. But I understand your point.

I want to make this -- Jonathan and then John -- Dennis, excuse me -- Dennis and then John.

MR. JOHNSON: I just wanted to call to the committee's attention language in our written testimony. And we would just encourage the committee to look at the time period in which an error is actually disclosed; and it is our position that that should be disclosed during the period in which the error was identified.

MR. POZEN: You mean, just so I'm clear, that if it was in a quarter it means that in the next quarterly report? You wouldn't ask for a special quarterly report?

MR. JOHNSON: That is correct.

MR. POZEN: At the next quarter.

MR. JOHNSON: That is correct.

MR. POZEN: I think that is our general view, too.

MR. RICHARDSON: I think the origination of the question was at the heart of disclosure. I think that's it. A lot of the discussion has been about documentation internally, that the preparers and the auditors would have access to, but as an investor we don't get to see any of that. We're limited to what's in the externally prepared financial report -- general-purpose financial reports.

MR. POZEN: That is why we were -- that's why the discussion here focused on critical accounting policies, because by definition those are ones that are material and involve judgment.

MR. RICHARDSON: They get some disclosure, but to go to back my earlier point, there are first-moment disclosures and second-moment disclosures to get at the heart of the volatility. So, indeed, that would be something I think very important to a consumer.

MR. POZEN: That's a good point. We haven't really focused on the level of disclosure for those things.

MR. HUBER: I would respectfully submit that you don't need a rule for everything and that sometimes what you need is to focus on an existing rule; and critical accounting policy started out as critical accounting policy, which was nothing more than a regurgitation --

MR. POZEN: Did you write that rule, John?

MR. HUBER: No, that's not mine. I like it. I like it, but it's not mine. Okay.

The fact of the matter is when it started out, it was nothing more than a regurgitation of what was in the footnotes to the financial statements. Through staff comment in the division and through rule-making proposal professionals it became critical accounting estimates. This is a relatively new rule; and the fact is that in terms of looking at the kind of process that companies go through to get used to that sort of a rule, the point that Randy made is an excellent point with respect to focusing in on it. The point that Jonathan made about having -- if there is a divergence of practice in a particular area, that is something that should be there because that's part of the judgment process with respect to it. And, if indeed, there was an alternative that the company could have picked -- for example in software revenue recognition, whether it's SOP 97-2 or 104, to discuss that sort of a point is very important with respect to the idea of showing the judgments that are involved. I would submit, however, that you don't need to have a new rule, because this one is already there. It has to be enhanced in terms of the disclosure and it has to be enhanced in terms of the review process. And, quite frankly, people like Scott and Dennis have got to insist that companies do that level of disclosure, because then you'll see people coming up to the level that Dennis wants.

MS. GRIGGS: John, the thing that the committee was struggling with was whether we should build into the framework just a reminder that there needs to be adequate disclosure, because I agree with you the rules are there. But is it something that should be built into the framework? It really is a reminder. The framework isn't a rule --

MR. POZEN: It sounds like John is saying maybe in the preface or something, just cross-reference that this is there and it's already there and it's to be taken seriously because it's an important disclosure.

MR. HUBER: My answer to you is just a reference to critical accounting estimates is not something that Salvatore would like, okay? Because from my standpoint it's everything. In other words, that's one place to put this, but you've got the rest of MD&A.

MR. POZEN: That was our problem, that if you mention just one thing, people would say, “Well, what about something else?”

MR. HUBER: Exactly; and I would submit that it's the whole megillah with respect to that sort of thing, because I mean a year ago people wouldn't have focused on, you know, the idea of the third level of 157 with respect to liability, okay? And would they have put in the same quantum of disclosure a year ago in the 2006 10-K that they did for their 2007 10-K? The answer is no. Do you want to add a rule to do that? No. You want the markets to tell you how to do that and you want circumstances -- facts and circumstances to do that.

MR. GRAZIANO: Can I make a brief point on that?

MR. POZEN: Sure.

MR. GRAZIANO: I don't actually understand the concern that disclosure will lead to litigation. In fact, disclosure in my opinion is what prevents litigation. The more disclosure at the time of these initial financial statements coming out about what the judgments were and how they were made, the more difficult it is to bring a case. These cases happened because of lack of disclosure.

MR. POZEN: I think the concern is to try to focus the disclosure on material significant accounting policies that are the ones that really drive the financial statements and drive the litigation ultimately and that when we explore the issue of judgment, it's judgment at so many different levels, some of which is relatively trivial or just very mundane; and we didn't want to clutter up the 10-K's with that sort of disclosure, so trying to focus on the important things. But I think your point is well taken.

MR. GRAZIANO: It's a difficult thing to prescribe. I think the individual issuer knows what the real issues are and there's just -- it's going to be up to them if they're going to comply or they're going to take the risk.

MR. POZEN: Susan, I think you wanted to --

MS. BIES: I'm a little confused over different people using at different times the words "risk," "uncertainty," and "volatility." Let me tell you what's troubling me here. We're talking about a judgment framework around accounting policies. And to the extent you have emerging practices or transactions or lines of business or products or whatever, there is some uncertainty. That's what I think this rule will help lay framework on the judgment that needs to be used to how do you account for something that really hasn't existed before.

I would hope no one is confusing market volatility or change in the accuracy of an estimate with the terms "risk" and "uncertainty." Risk and uncertainty are two very different things. Clearly what we are going through now in subprime, there is a lot of volatility. If there was better disclosure, I think people shouldn't be surprised. Fair value isn't the answer. But there needs to be better disclosure about how volatile it is and people should say, “We are only using a hundred days' back-look involved,” knowing that that didn't include the housing-market shakeup would have told a user of statements that you are grossly underestimating volatility here.

On the other hand, the lack, as we have learned in hindsight -- I wasn't this smart when I was on the fed board -- the fact that banks changed and other mortgage lenders changed from underwriting first the ability to repay and secondarily looking at the asset value to see if the home would be the second source of repayment to just looking at the asset value grossly made all of the measurement models for risk off-base and in an asset bubble on housing made it even more problematic. That wasn't disclosed at all. That's uncertainty -- how you apply a risk model in a new world.

And I think one of the things that we need to be clear about here is the better this disclosure is around risk measurement periods and when uncertainty is created -- because models don't work -- is a moment of measurement. I think it's different than the principle we are trying to get at here for a framework of how you choose appropriate accounting policy. And I just -- I get troubled that we seem to be using them interchangeably in some of these comments; and I see them as very different issues between risk and uncertainty over measurement and uncertainty over the appropriate accounting policy.

MR. POZEN: Scott. You can see why Susan was a very effective bank regulator.

MR. TAUB: Believe me, I met with her in her role; and I agree.

I agreed with 90 percent of what you said, Sue.

MS. BIES: That's a record for us.

MR. TAUB: I agree. The one thing I did want to point out is that the framework -- the progress report does indicate estimating the actual amount to record as one of the items of judgment. So when you get to measurement, I think we do need to acknowledge that this framework is intended to apply to judgments about measurements.

MS. BIES: Right. The only point I was trying to make is any measurement, when you have the dynamics of measuring losses or risk, is brand-new. You have no historic data. By definition, your confidence interval is going to have a fat tail. It's not reliable.

MR. TAUB: Well, that's a bigger indictment of accounting.

MR. RICHARDSON: You can disclose that information. So it's a level for which there is no reliable market. If you're off the spreads a few points, no one's in play. Do you use a model? Which model? Do you use distributional assumptions?

MR. POZEN: We have Greg and then David.

MR. JONAS: The reason I wanted to butt in is I wanted to particularly follow up with Scott on this point, because you made in your comments, appropriately, a big deal of the uncertainty, the ranges around key judgments. That was in our mind when we were thinking about this stuff. Let me ask you -- let me posit what I think to be a fairly common scenario in a tough judgment and then ask you what ideas you might have for the type of disclosure that would be most useful to you in getting around this range around the stuff.

So I make a judgment and in the running I had three choices: A, B, and C. I picked C and I followed the framework to pick it. What would you ask the company to say? What would be most useful to you about the three choices?

MR. RICHARDSON: Some measure of the relative dispersion across those choices. Now, is it at -- if it's only three, it may be difficult to get a good measure of that dispersion. But I guess in most instances there's a lot more than three choices. There's a lot of statistical measures that could be put here, but in terms of your sentiment from earlier, currently there's nothing.

MR. POZEN: It looks in many cases if there are just two or three. But when you say "dispersion," do you mean what would be the dispersion of results?

(Simultaneous discussion.)

MR. JONAS: In my example, there were three in the running but the truth is there's actually 500 possible outcomes but three were seriously considered. In my experience, the typical scenario of a tough judgment. The mind can't deal with 500 scenarios. You need to do something to kind of narrow it. Three are in the running. But your point is -- talk about the three; and then I hear Susan saying -- a point that I agree with -- that if there were 500 in the running, tell me how -- tell me the tales. Give me some rough feel about the tail. Is that what you're --

MR. RICHARDSON: You are not going to be precise with measuring second moment of some of these point estimates that are in the financial statements. But currently there's nothing guarding that. Stock option expense would be a good example.

Four key parameters: volatility, discount rate, dividend yield, and time of maturity. The volatility and time of maturity -- there's huge estimation error around that. People in the company may be in the best position to guide investors with respect to those point estimates, but we're still looking at one number. 35 percent's devolved. Well, was 35 percent coming from 33 to 37 or 20 to 40? That would help a lot.

MR. JONAS: So what I hear John Huber then reminding us is that if we're going to go this extra distance, which makes a world of sense to me, we can't do that for 500 judgments. We got to narrow this down to the vital few; and if the guidance of the commission thought about in critical accounting estimates was a way that we should look to narrow the field.

MR. HUBER: What you really want to avoid is a blizzard of information that just inundates the reader. And if you look at the TSC vs. Northway case where the Supreme Court adopted the "would" test, it was looking at the "might" test -- what might a reasonable investor look at, what may a reasonable investor look at? And in TSC vs. Northway in 1976, the Supreme Court said, we really don't want to inundate investors. So the fact is that's a principle, if you will, that the Supreme Court is laying down with respect to the concepts here.

MR. GRAZIANO: May I say something here?

MR. POZEN: Sure. And then we'll get to David.

MR. GRAZIANO: Going back to the subprime example, nearly all of these subprime issuers did include in their critical accounting policies specific disclosure about how they recorded residual interest and how they recorded loan-loss reserves. However, uniformly those statements were generic in nature and there were no commentary about the decreasing standards being used for underwriting, because the real estate markets were going up, the pressure was there to keep pumping out the loans. So we have to be careful. How do we make that happen? There was absolutely a discussion about the GAAP rules that applied but nothing about the specific circumstances affecting these particular companies.

MR. POZEN: David.

MR. SIDWELL: I'd like to talk just a little bit about the connection that Jonathan and a number of people have talked about. While we've been very company-specific in the way we've talked about this, I think now we're in an environment where there is more principle-based standards; and you end up with companies' individual registrants following this framework documenting. And let's assume that you do have an increased range of alternatives, all of which would be valid by this documentation standard -- contemporaneous, signed off by whoever -- audit committee, auditors, et cetera.

What do you see as the market reaction to that? And at what point do you see and what forces should try and close that range of outcomes, because I think we're going to hear a lot of -- as this principle-based discussion continues -- a lot of concern about range of alternatives. Have any of you given any thought to how you would like to see that happen?

MR. JOHNSON: There has been a longstanding discussion on the quality of earnings driven by the quality of accounting. And companies are compared based on the quality of accounting that they use. And to the extent that a company using more aggressive accounting and more aggressive assumptions, if you will, to make their financial position look more attractive relative to its peers, then that has historically led to engagement by investors with the management and with the board members on this difference, with the expectation of some type of movement toward market standards, if you will; or at least some acknowledgment that maybe how that company is valued would not be a significant or would not be as high as a company who is using a more reasonable or conservative accounting approach. So I think the forces that are at work will continue to be at work; and I think this disclosure could only foster more discussion around that.

MR. SIDWELL: So it's sort of market-based. The market will react. How do you see, let's say, if there emerge five or six different interpretations which are all considered -- you know, these are all fine? Is that something that you'd expect to either have the SEC or the standards-setter narrow that range of alternatives? And over what time frame?

MR. JOHNSON: I don't have a position on the response to your question.

MR. RICHARDSON: Can I ask a question back? Why is it a desirable thing to narrow the range of alternatives?

MR. POZEN: I think the argument is that to the extent that you're trying to have comparable analysis and if people are using different sets of ground rules, then that's a problem. And, second of all, that it's unlikely if there are six alternatives, all six are conceptually equal in soundness, that it may be the case that two, for instance, might be stronger, conceptually, than the others.

MR. SIDWELL: I was actually trying to tease out this conflict between consistency and your judgment of what's appropriate in the circumstances for an individual registrant.

MR. RICHARDSON: Consistency's important. But I want to come back to disclosure. If there's sufficient information there, you can reverse-engineer the choices that were made and then redo it.

MR. POZEN: Yes, Scott?

MR. TAUB: I think the consistency-versus-diversity thing needs to be looked at a little bit deeper in a particular situation. Let's take, for example, depreciation methodologies. We all learned in accounting class that you could do straight-line, double-declining balances, sum-of-the-years’ digits, consumption-based methodologies. There was no principle behind any of them. You just picked. That's bad diversity.

Now, we can disclose. We make disclosures about it so that investors can evaluate and make some high-level adjustments, if they want to get consistency. But in that kind of situation you're talking about diversity with no principle. On the other hand, if the principle for depreciation was choose the depreciation method that most accurately portrays the benefit you achieve from the use of this asset, well, then we might get some choosing straight-line, some choosing double-declining balance, some choosing accelerating, some choosing the decelerating method.

But that would all be fine if they were all adhering to the principle of choose the method that best reflects your consumption. So sometimes I think diversity in outcome is good, because it reflects that people use things in different way. Other times, the diversity is just simply a matter of, “Well, I picked A and he picked C; and we're allowed to do whatever we want.”

MR. SIDWELL: Because I wondered if you -- somebody was going to make the comment that because, I think in the factors that are laid out here -- critical and good faith thought process, consideration of diversity of practice was one of the items laid out here. And when we think about disclosure, is that an area that you'd expect to see greater emphasis on the need to disclose something where it's apparent there is a lot of diversity in practice.

MR. POZEN: Scott, did you want to?

Jeff?

MR. DIERMIER: Couple of comments. Susan, it's good to know that fair value is not the villain here.

And, Scott, I appreciate your comments on economic substance, a non-debatable point, I'm sure.

But I think one of the important things in the -- I'm glad you brought that up, David, because there is an element of market discipline that comes out of this discussion, particularly from Scott and Dennis. You know, investors aren't just looking at financial reporting in terms of X's and O's and the numbers and things like that. They may be using them for getting a sense of what we used to call quality of management, which quality of earnings connects with, so it might affect your proxy voting, might affect the assumptions you use in terms of potential outcomes in our old shop. If the company is rated as D, in terms of quality of management, we wouldn't touch this company -- and quality of earnings in the way they went about their processes were a critical element in that.

This disclosure -- this PJF -- may actually help the market in a lot of ways understand more clearly how companies are thinking about the principles by which they communicate and the trust relationship in financial reporting with their investors and may actually turn out to be a very salutary effect in terms of the ability of the investment marketplace to tease out this notion of what is the quality of management that I'm working with and how do they perceive communicating with their investors at a very nice level.

MR. POZEN: I didn't realize that professional judgment framework had gotten its own acronym -- PJF. I've got to think about that one.

Bill, do you have any questions?

MR. MANN: Yeah, I wanted to ask Scott Taub about one of the points that you made in your document that was well taken was the fact that there's risk that best-practice framework would be treated like a rule, that we'd end up sort of in the same place.

Just in your professional experience, how do you suggest we counteract this?

MR. TAUB: Well, one way I think is to make it more of a working policy than a legal safe harbor and interpretive -- a piece of interpretive guidance rather than something that rises to the level of a formal legal safe harbor.

Beyond that, I have a hard time evaluating, because I take some of Salvatore's remarks very seriously, that no matter how we phrase this, it's going to wind up being brought up in court. And it will wind up, I believe, brought up in two ways: Those that have done it will say, “I've done it, can't touch it.” And when a company hasn't done it, the other side will say, “See, they didn't do it, so you got to assume that they were not acting in good faith.” And I think it's beyond my ability to predict how the courts will really deal with those kinds of things. My hope is that however this is put out, if it's put out, it will have so many descriptors and so much explanation that it's very clear what it should be used for, what it shouldn't, but, you know, at that point, we're at the mercy --

MR. MANN: That sounds like rules.

MR. JONAS: But how do the courts have the jurisdiction to deal with this question? Because in countless places in the literature, there are lists that people -- that the standard-setter has said, “Thou shalt think about the following five areas;” and has this already played out in other areas where standard-setters have introduced a framework?

MR. TAUB: To me, sometimes it's worked well and sometimes it hasn't worked well. And I can't figure out what the factors are that make it work well the times it does and make it not work well the times it doesn't.

MR. GRAZIANO: I think the answer to that is yes and no. I think the difference is this proposal takes things to a level that they haven't been before. Maybe an example, in response to your question, is the standard of field work that requires you to gather competent evidentiary matter that is clearly used by the courts to evaluate whether or not an auditor was acting recklessly or reasonably in situations. But here we're talking about a framework that is so overarching that I think we're well beyond the example I just made.

MR. POZEN: Ed?

MR. MCCLAMMY: An observation: We talked earlier about costs related to this; and I think we should acknowledge that for some companies there will be a cost to implement this. I'm not surprised that all that are here have very large companies that are very well documented. I think, even in this case, midsized companies you'll find have things very well documented. I think where the additional cost is going to come in is related to non-accelerated filers that just don't have the technical staff -- and they probably have some documentation. It's just not going to be at a level that you find in midsized and large-cap companies.

Having said that, I think this is the one area where it's well worth the cost to head in this direction, because I do think it's critical if we're going to a more principles based, that we just have to have this framework and we have to have the documentation behind it. So I think -- I'm not sure what Tom's thoughts are. He's representing a small company, but I think this is a case where the small companies are just going to have to incur the costs.

MR. POZEN: I would say even if we don't go to a principles based, there are more and more judgments in accounting. There's so many complex transactions -- fair value -- just the whole thrust of it. So even whether we go to IFRS or not, you can't just get away from it. And if small companies don't develop this discipline at some point, it will hurt them.

But I don't know. Tom, you're the --

MR. WEATHERFORD: Just one observation as well is what I'm seeing here, especially with -- in this day of Sarbanes-Oxley, especially the young auditors, the young CFOs, I'm seeing basically they're walking away from making a judgment. Being a former CFO, when I made a judgment, whether it was right or wrong, I tried to make the best judgment possible. And I was comfortable with that; and the audit partner was. But in this day of Sarbanes-Oxley, everyone walks away from a judgment. And it makes the job of the audit committee very difficult, because I think in the end it hurts investors by not having this framework.

So I think this framework -- whether these nine points are the right points, Salvatore, or there's nine others -- this starts us on the process of trying to get judgment back at the field level. And we'll make mistakes, but I think it's the right way to go and it's the best thing for investors, in my opinion.

MR. POZEN: Mike.

MR. COOK: Tom said something kind of along the lines of what I was going to say as well, we've had good input and good discussion. We welcome more input and more discussion, but I think we ought to keep this framework in context as well. We're here to make recommendations to improve financial reporting. They may have implications for the judicial system and litigation and so on, but this isn't writing recommendations to make it easier or harder to sue people. That's not what we were charged with doing; and that's not what this was intended to do. I think the same point -- the very engaging discussion about disclosure -- but it reminds me of something we specifically said in here is one of the things this framework is not going to do is to improve GAAP or GAAP needs improvement. It is dealing with GAAP as GAAP is today.

I think some of the same concept applies to the issue of disclosure. To say that everything that is subject to the judgment framework should be disclosed in the financial statements, including all of the alternatives that might have been considered, is going beyond the capabilities of financial reporting in this process. Now, maybe there are other things which show flow from that.

I think a reminder of disclosure obligations and the fact that a lot of things are going to be talked about and dealt with in this framework are the same items that you would expect to find disclosed, but certainly there are going to be things subjected to this framework that are not going to be disclosed in MD&A as critical accounting policies. It will have to do with measuring a particular item. It will have to do with what date a particular transaction is recognized. It's not going to be gone -- you know, every alternative that was considered is discussed in this.

I think we could do some things that get people thinking about the linkage between disclosure and the framework. I think to try and draw that linkage in any specific way would be, one, putting us in a role that we shouldn't be trying to play and probably beyond the capability of what this is about. But I think the notion of kind of keeping them in your thought process as you think about one and think about the other is a very sensible thing that we ought to try and accomplish.

MR. POZEN: I think we're nearing the end here. If there are any more questions or comments that anybody wants to make -- yes, Randy?

MR. FLETCHALL: If there's time available, I would want to go back. I didn't want to disrupt the flow of the introduction. But in the opening remarks when you asked me about specifics on kind of this -- I guess I'm passionate about that auditor/client relationship, I just wanted to go back, because I have heard a little bit here, I've seen some of it in the written submissions and in other forums this concern that some people read this, they feel that auditors are going to be handicapped in doing their job. I want to make sure that is not the case.

MR. POZEN: That is definitely something we've discussed and we in no way want to impair that relationship. So to the extent that you can give us language that would give people comfort and suggest edits, we very much welcome that.

MR. FLETCHALL: And in part I think it's in many cases -- many spots -- I don't know whether it's 8 or 9, where it talks about the one making the judgments and then the other people who evaluate. When you talk about a preparer, it's always included the evaluator as auditor, regulator, third-party litigant; and it gives the feeling perhaps that you're kind of separating the preparer from auditor in this framework, as opposed to keeping them together. So I think that's one of the things that I would suggest -- eight or nine places in here when you're talking -- it's a natural flow that those are all the people that evaluate. But given that special relationship, I think if that word "auditor" is not in there every time you talk about who evaluates the preparer's judgment, you'd be better off.

MR. JONAS: I thought a cornerstone of the auditing literature was management asserts, the auditor attests. Isn't that separation?

MR. FLETCHALL: Yes, it is.

MR. JONAS: Isn't the auditor supposed to be in a second-guessing position? We can't kind of put the auditor and manager in the same bucket and say together they come up with the management view, right? You're not suggesting that?

MR. FLETCHALL: I'm not at all suggesting that.

MR. POZEN: You can see that we've discussed this point at great -- so you can help us on that. And then there's an institutional issue where I think Dan Goelzer would say that PCAOB -- they have a bigger role vis-à-vis the auditor, so who has to adopt the framework for the auditor. So I think there a number of sort of subtleties here that we were trying to do, but we probably didn't get it quite right; and we'd love to have your help.

MR. FLETCHALL: Thank you.

MR. COOK: But I would say, Bob, in response to Randy, agreeing fully with what you said, I think it's very important in the other organizations where you can influence things like this, just don't lose sight of the other side of this. This does not grant any protection to the auditor from doing what the auditors are responsible for doing just because somebody did or did not have a framework. It's challenges that need to be brought -- the challenge of the judgments that have been made have not been diminished by the existence of a framework; and it perhaps in some cases is even enhanced.

MR. POZEN: Okay. Well, again, I thank all of the panel for coming and thank the committee members for joining us and everyone have a good evening. Thank you.

(Meeting adjourned at 6:48 p.m.)

CERTIFICATION

I hereby certify the accuracy of this record of the proceedings of the SEC Advisory Committee on Improvements to Financial Reporting.

Robert C. Pozen — 6/8/08

Robert C. Pozen
Committee Chair

Date

Exhibit A

Open Meeting of the SEC Advisory Committee on Improvements to Financial Reporting

Laurel Heights Conference Center, Sublevel 1
Auditorium University of California – San Francisco San Francisco, CA

AGENDA

Thursday March 13, 2008, Beginning at 3:00 P.M. Pacific Time

I. Introductory Remarks – Robert Pozen, Committee Chairman

II. Panel One – Restatements and Discussion of Developed Proposals 3.1, 3.2 and 3.3

Participants:

Jack L. Acosta – Sumtotal Systems, Inc. Steven E. Bochner, Wilson Sonsini Goodrich & Rosati LLP Manish Goyal – TIAA-CREF John J. Huber – Latham & Watkins LLP Steve Meisel – PriceWaterhouseCoopers LLP Elizabeth Mooney – The Capital Group Companies Barbara Roper – Consumer Federation of America

III. Panel Two – Professional Judgment and Discussion of Developed Proposal 3.4

Participants:

Jonathan Chadwick – Cisco Randy Fletchall – Ernst and Young LLP Salvatore J. Graziano – Bernstein Litowitz Berger & Grossmann LLP John J. Huber – Latham & Watkins LLP Dennis Johnson – CALPERS Scott Richardson – Barclay's Global Investors Scott Taub – Financial Reporting Advisors

Friday March 14, 2008, Beginning at 8:00 A.M. Pacific Time

IV. Panel Three – XBRL and Discussion of Developed Proposal 4.1

Participants:

Steven E. Bochner, Wilson Sonsini Goodrich & Rosati Jeff M. Bodner, Intel Corporation Mark Bolgiano, XBRL US Randy G. Fletchall, Ernst & Young LLP Gregory P. Hanson, ADVENTRX Pharmaceuticals Christopher Montano, Gridstone Research John Turner, CoreFiling

V. Review of Comments Letters Received

VI. Reports from Subcommittees and Discussion:

1 Scope
2 Deliberations
3 Working Hypotheses
4 Current Status and Further Work
5 Coordination with Other Subcommittees

VII. Next Steps and Future Timetable

VIII. Adjournment (expected no later than 11:00 am)

Exhibit B

Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its fourth meeting on February 11, 2008 and its fifth meeting on March 13-14, 2008 and the dates of receipt.

Mar. 14, 2008	Gregory P. Hanson, CMA, Senior Vice President and CFO, ADVENTRX Pharmaceuticals, Inc.
Mar. 13, 2008	Henry Siegel, Chairperson of the Financial Reporting Committee, American Academy of Actuaries
Mar. 13, 2008	Scott A. Taub, CPA, Managing Director, Financial Reporting Advisors, LLC
Mar. 13, 2008	Steven E. Bochner, Partner, Wilson Sonsini Goodrich & Rosati
Mar. 13, 2008	Steven E. Bochner, Partner, Wilson Sonsini Goodrich & Rosati
Mar. 13, 2008	Mark Bolgiano, President and CEO, XBRL US, Inc.
Mar. 13, 2008	Jonathan Chadwick, Senior Vice President, Corporate Controller & Principal Accounting Officer, Cisco Systems
Mar. 13, 2008	Dennis A. Johnson, CFA, Senior Portfolio Manager-Corporate Governance, Investment Office
Mar. 13, 2008	Elizabeth F. Mooney, Analyst, The Capital Group Companies
Mar. 13, 2008	H. Stephen Meisel, Partner, PricewaterhouseCoopers
Mar. 12, 2008	John J. Huber, Latham and Watkins LLP
Mar. 11, 2008	Gilbert F. Viets, Indianapolis, Indiana
Mar. 10, 2008	Salvatore J. Graziano, Bernstein Litowitz Berger & Grossmann LLP
Mar. 3, 2008	Paul Snijders, CEO, Zoetermeer, Netherlands
Mar. 2, 2008	Lawrence A. Cunningham, Professor, George Washington University, Washington, District of Columbia
Feb. 19, 2008	Ilia D. Dichev, Associate Professor of Accounting, Ross School of Business at the University of Michigan
Feb. 19, 2008	John S. Ferguson