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1           At our April 4th open meeting, we discussed the  
2           need for AS 5 to make clear that the audit is scalable to  
3           account for the fact that companies come in different shapes  
4           and sizes and different complexities, and we were  
5           particularly focused on smaller companies.

6           So I want to begin by asking how does AS 5 do this  
7           specifically?

8           MS. PALMROSE: Well, let me start out by saying,  
9           first of all, its principles based. It offers the  
10          opportunity for the auditor to make judgments based on the  
11          facts and circumstances, and it's a risk-based approach, and  
12          so scaling is a natural extension of this approach.

13          Second of all, AS 5 includes specific discussion on  
14          scaling the audit based on size and complexity of the  
15          company, and the staff agrees with this discussion and that  
16          scaling is the most effective way to get -- that reflects  
17          this natural, as I said, extension of the risk-based  
18          approach.

19          Third, the Board made an important change from  
20          their December proposal. Not only did they have a special  
21          section that talked about scaling, but what they did is they  
22          imbedded scaling concepts that can apply in particular to  
23          small companies throughout the standard to help illustrate  
24          and provide a little bit more context and guidance in that  
25          setting.





1 MS. PALMROSE: Well, I think that's overstated, but  
2 I certainly would be glad to provide some comments here. And  
3 the answer is yes, at the direction of the Commission.

4 Actually, our Office of Economic Analysis will be  
5 conducting an analysis to address whether the costs and  
6 benefits of implementing Section 404 are in line with our  
7 expectations.

8 The Office of Economic Analysis is working with the  
9 staffs of the other offices and divisions, and we have  
10 started the process of planning such a report. So we would  
11 be hopeful that those plans would be well in line within the  
12 not too distant future.

13 As part of this, I should reaffirm that -- and in  
14 light of this direction, we're also revisiting the other  
15 research that has been done in what I call the growing  
16 literature and research related to the implementation of SOX.

17 So it's not just our own efforts that we're  
18 considering, but we're considering the efforts of others, and  
19 that's informing not only how we think about the issues but  
20 also how we're developing our own study as we go forward.

21 So the answer is yes. We're working in a number of  
22 ways to move this project along, and we recognize its  
23 importance. And it's really part of our over-arching  
24 activities in a number of ways to work on the implementation  
25 of 404.

1                   MR. HEWITT: I might just add on that point, if I  
2 may, KPMG, there are other organizations also that do studies  
3 on these costs and benefits. And KPMG just came out with  
4 their third annual benchmark study of 404, and it will be  
5 interesting to see next year's.

6                   Because these costs won't be known until the end of  
7 this year or early next year as to what these actual costs  
8 are because of AS 5. There will be a lot of other  
9 information available that we'll be able to look at.

10                  CHAIRMAN COX: Thank you for that. One of the  
11 concerns that we've heard repeatedly over the past years  
12 relates to management feeling that it's constrained by the  
13 auditor in the development and execution of their own  
14 evaluation of internal control over financial reporting under  
15 404(a).

16                  What is different about AS 5, as it's finally  
17 before us, that provides us comfort that that problem has  
18 been fixed?

19                  MS. PALMROSE: Let me start off, and others can  
20 jump in here. First of all, there's a big change. AS 2 had  
21 what was known as the 40s paragraphs, which, essentially,  
22 required that the auditor evaluate management's process.  
23 Those are no longer in the standard. So there is no  
24 requirement in the standard for the auditor to explicitly  
25 evaluate management's process.















1           We should be clear this standard is consistent with  
2 the definition of "reportable condition," which is very well  
3 understood in the accounting literature.

4           As I mentioned, in connection with Audit Standard  
5 5, implementation will be of the utmost importance. Even a  
6 well-constructed definition would be meaningless if the  
7 implementation is not carried out properly.

8           I just have a few questions for you. I know the  
9 hour is getting later. Paragraph 30 of AS 5 directs an  
10 auditor to ask himself "what could go wrong" within a given  
11 significant account or disclosure.

12           What boundaries are there to this question to  
13 ensure that an auditor does not invite mountains out of  
14 molehills through a series of extrapolations of what could go  
15 wrong? After all, it was just this type of thought process  
16 that led to so many problems under AS 2.

17           MS. PALMROSE: Let me answer that question. First  
18 of all, it's important to note where paragraph 30 appears.  
19 It's in the context of identifying significant accounts and  
20 relevant assertions.

21           In other words, what it is directing is for the  
22 auditor to think about the likely sources of potential  
23 misstatements that would cause the financial statement to be  
24 materially misstated. So materiality, what matters, what's  
25 important, bounds that discussion.











































1           To the extent that the recent comment letters  
2 raised issues concerning the standard, most, if not all, such  
3 issues had already been raised and considered by the PCAOB in  
4 the course of its comment process.

5           I'm pleased to vote to replace AS 2 with AS 5, and  
6 I think that this new standard has the potential to result in  
7 lower cost than AS 2 while remaining consistent with investor  
8 protection.

9           I'm also very pleased that AS 5 is aligned with the  
10 interpretive guidance that the Commission issued recently for  
11 management. Through the revised standard and our guidance  
12 management and auditors will be directed to focus on areas  
13 that matter most, including those that pose a high risk of  
14 fraud.

15           Our staff has worked very closely with the PCAOB in  
16 our oversight role, and I think that the outcome here has  
17 been very productive.

18           At an open meeting on April 4, 2007, the Commission  
19 provided our staff with direction to work with the PCAOB in  
20 four particular areas -- alignment of AS 5 with the  
21 Commission's management guidance, improving the discussion of  
22 scalability within the standard, clarifying the auditor's  
23 ability to exercise judgment and following a principles based  
24 approach to determining when and to what extent auditors can  
25 use the work of others.

1           I'm pleased that AS 5 responds to these concerns  
2 that we raised at that meeting, and I'm optimistic that our  
3 interpretive guidance and the PCAOB's AS 5 will provide a  
4 useful coordinated framework for both management and  
5 auditors.

6           Included in AS 5 is a definition of "significant  
7 deficiency" that matches the definition the Commission  
8 recently published for public comment. The comments received  
9 strongly support that definition, and I'm pleased to support  
10 adopting that definition as well.

11           The definition focuses squarely on matters that are  
12 important enough to merit attention by those responsible for  
13 oversight of the company's financial reporting. An important  
14 benefit of the proposed definition is the flexibility that it  
15 will provide to management and auditors to use their  
16 judgment.

17           While I certainly agree with the criticism that the  
18 costs and burdens of implementing Section 404 of  
19 Sarbanes-Oxley have been far too high it is important to  
20 remember that there are real benefits to both companies and  
21 shareholders when issuers comply with Section 404, including  
22 management's renewed sense of ownership over controls,  
23 innovative ways to make controls more efficient, better  
24 financial reporting and disclosure and the detection of  
25 problems before they become more serious.

1           All of these benefits improve investor confidence  
2 and the integrity of our markets. By focusing on the areas  
3 of highest risk, we can best achieve meaningful investor  
4 protection without excessive costs.

5           The combination of the new AS 5 and the definition  
6 of "significant deficiency" that we are considering today and  
7 the guidance for management that we have already published  
8 will serve these important goals.

9           You've answered an awful lot of questions. I just  
10 have one area that I'd like to focus on, and it's one that  
11 others have expressed concern about, which is, obviously, the  
12 importance of implementation in achieving the goals that were  
13 intended by these important changes in AS 5.

14           Can you give us a little more specificity on how  
15 you intend to monitor implementation and whether there are  
16 any particular metrics that you're thinking of utilizing,  
17 either our staff or the PCAOB, to assess the goals have been  
18 achieved with AS 5?

19           MS. PALMROSE: We can talk about that in several  
20 ways. In terms of the specifics on whether the auditing  
21 standard is working, the inspection process clearly provides  
22 a very useful context to do that.

23           COMMISSIONER NAZARETH: But again, even as to the  
24 inspection process are there particular things that we intend  
25 to look at as we inspect the inspection process?

























1                   COMMISSIONER CASEY: Can you speak a little bit  
2 more about the guide again, about how it's going to work for  
3 smaller companies that you're drafting?

4                   MR. WHITE: It is, we hope, a plain English  
5 user-friendly document that will help a smaller company when  
6 they are confronting, I guess you would say, starting down  
7 the road of management guidance of what's out there and the  
8 steps they need to go through.

9                   As I mentioned earlier, this was actually, I think,  
10 a request of the chairman when he was testifying a few weeks  
11 ago on the Hill. We thought it was a great idea, and we've  
12 gone to work on it. I think we're going to be actually done  
13 with it pretty soon.

14                  COMMISSIONER CASEY: Great. Thank you. I have no  
15 additional questions.

16                  CHAIRMAN COX: Is there any other question or  
17 discussion? If not, we'll move to a vote on the two  
18 proposals.

19                  First, does the Commission vote to approve the  
20 Public Company Accounting Oversight Board's Auditing Standard  
21 No. 5 and related Independence Rule 3525 and conforming  
22 amendments?

23                  COMMISSIONER ATKINS: Aye.

24                  COMMISSIONER CASEY: Yes.

25                  COMMISSIONER CAMPOS: Yes.

1 COMMISSIONER NAZARETH: Yes.

2 CHAIRMAN COX: And the item is approved. Second,  
3 does the Commission vote to amend Exchange Act Rule 12b-2 and  
4 Rule 1-02 of Regulation SX to define the term "significant  
5 deficiency"?

6 COMMISSIONER ATKINS: Yes.

7 COMMISSIONER CAMPOS: Yes.

8 COMMISSIONER CASEY: Yes.

9 COMMISSIONER NAZARETH: Yes.

10 CHAIRMAN COX: And that matter stands approved.  
11 Thank you all once again for outstanding work, and I want to  
12 take this opportunity also to thank the chairman of the  
13 PCAOB, Mark Olson, the entire Board and their staff once  
14 again. This was very much a collaborative work over a long  
15 period of time, and I think we all have a lot to be proud of.

16 (A brief recess was taken.)

17 CHAIRMAN COX: The next item on today's agenda is a  
18 recommendation from the Office of the Chief Accountant and  
19 the Division of Corporation Finance that the Commission issue  
20 a Concept Release.

21 The purpose of the Concept Release would be to  
22 obtain information about the public's interest in allowing  
23 U.S. issuers, including investment companies, to prepare  
24 their financial statements in accordance with International  
25 Financial Reporting Standards as published in English by the

1 International Accounting Standards Board.

2 U.S. issuers, of course, currently prepare their  
3 financial statements under U.S. Generally Accepted Accounting  
4 Principles. The Commission has long advocated for globally  
5 accepted accounting standards that are high quality,  
6 comprehensive and rigorously applied.

7 As issuers and investors increasingly look beyond  
8 our borders for opportunities to invest and raise capital  
9 it's critical that the financial information they use to make  
10 their decisions be accurate and timely.

11 Among the obstacles that must be overcome in making  
12 investment decisions are the different ways in which  
13 financial information can be reported. Often the differences  
14 are due simply to the fact that the issuers are located in  
15 different countries.

16 That's why virtually everyone -- issuers, investors  
17 and stakeholders alike -- agrees that the world's capital  
18 markets would benefit from the widespread acceptance and use  
19 of high-quality global accounting standards.

20 Global accounting standards benefit investors by  
21 allowing better comparisons among investment options and  
22 increased access to foreign investment opportunities. They  
23 reduce costs for issuers who no longer have to incur the  
24 expense of preparing financial statements using different  
25 sets of accounting standards.



















1                   We need public input and believe this is the  
2 appropriate time to go out and seek that input, and that is  
3 why we're recommending this Concept Release to you.

4                   We're very interested in all of the views on the  
5 questions that we pose and, as Conrad alluded to, there are a  
6 lot of questions in this release, particularly, or including,  
7 I guess I would say, the questions related to when any  
8 potential change in reporting requirements might occur and  
9 how that should be implemented. So I think this is just a  
10 very exciting time to see this release and to get it out  
11 there to start the dialogue.

12                  Finally, in closing, I'd like to echo the  
13 Chairman's and Conrad's recognition of the staff's work in  
14 preparing the release. I guess I at this time need to go  
15 through the names myself, so I guess I will.

16                  I want to individually recognize again in the  
17 Office of Chief Accountant Julie Erhardt, Katrina Kimpel,  
18 Gina Evan, Jim Kroeker and now I have the benefit of calling  
19 him by how all of us refer to him, Joe U. I stumble less  
20 with Joe U.

21                  And in the Division of Corporation Finance, Craig  
22 Olinger, Sondra Stokes, Paul Dudek and Michael Coco and of  
23 course Rick Sennett in IM all for their invaluable  
24 contributions and I guess I would even say for their global  
25 vision in presenting this matter to you.

1           I guess I'd actually have to say that almost every  
2 one of the people that I've named has spent a lot of personal  
3 time with me teaching this topic to me and helping me  
4 understand it, and I really want to say thank you to everyone  
5 who has helped me with this process.

6           With that I'll turn it over to Katrina.

7           MS. KIMPEL: Thank you. The Office of the Chief  
8 Accountant and the Division of Corporation Finance recommend  
9 that you publish for public comment a Concept Release to  
10 elicit the public's interest in allowing U.S. issuers to  
11 prepare financial statements in accordance with International  
12 Financial Reporting Standards as published by the  
13 International Accounting Standards Board for purposes of  
14 complying with the rules and regulations of the Commission.

15           The purpose of the Concept Release is to seek  
16 information about the potential effects that any such change  
17 may have on investors, issuers and market participants as  
18 well as the accounting profession generally.

19           The Concept Release describes the Commission's past  
20 consideration with respect to reducing disparity between the  
21 accounting and disclosure practices of the United States and  
22 other countries as a means to facilitate cross-border capital  
23 formation while providing adequate disclosure for the  
24 protection of investors and the promotion of fair, orderly  
25 and efficient markets.

1            Accounting standard-setters have been encouraged to  
2 do the same as demonstrated by the Financial Accounting  
3 Standards Board and the IASB being committed for the last  
4 several years to the convergence of U.S. GAAP and IFRS.

5            The Concept Release includes questions about  
6 whether the Commission should allow U.S. issuers, including  
7 investment companies, to prepare financial statements in  
8 accordance with IFRS as published by the IASB, including the  
9 anticipated effects on the U.S. public capital market of  
10 doing so and not doing so.

11           If the Commission were to allow U.S. issuers to  
12 file financial statements prepared using either IFRS as  
13 published by the IASB or U.S. GAAP there would be  
14 implementation matters. For example, the Concept Release  
15 includes questions about the need for education in IFRS for  
16 financial statement users.

17           We also are interested in the issues that would be  
18 encountered by U.S. issuers and their auditors in the  
19 application of IFRS in practice and existing Commission  
20 requirements.

21           Additionally, we are interested in what issuers  
22 believe the cost of converting from U.S. GAAP to IFRS would  
23 be. We are recommending that this Concept Release be open to  
24 public comment for a period of 90 days after its publication  
25 in the Federal Register.











































































































































































