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

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Exhibit A -- Agenda

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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

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: 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.

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

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