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Record of Proceedings

SEC ADVISORY COMMITTEE ON
IMPROVEMENTS TO FINANCIAL REPORTING

Open Meeting

Friday, May 2, 2008

8:00 a.m.

Donald E. Stephens Conference Center

5555 North River Road

Room 41

Rosemont, Illinois

Diversified Reporting Services, Inc.

(202) 467-9200

1 COMMITTEE MEMBERS PRESENT:

2 Robert C. Pozen, Committee Chairman

3 Dennis R. Beresford

4 Susan Schmidt Bies

5 J. Michael Cook (successful dial in?)

6 Jeffrey J. Diermeier

7 Scott C. Evans

8 Linda L. Griggs

9 Joseph A. Grundfest

10 Gregory J. Jonas

11 Christopher Liddell

12 G. Edward McClammy

13 Edward E. Nusbaum

14 James H. Quigley

15 David H. Sidwell

16 Peter J. Wallison

17 Thomas Weatherford

18 COMMITTEE MEMBERS ABSENT:

19 William H. Mann, III

20 OFFICIAL OBSERVERS PRESENT:

21 Robert Herz

22 Charles Holm

23 Mark Olson

24 Kelly Ayre for Kristen Jaconi

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OFFICIAL OBSERVERS ABSENT:

Phil Laskawy

SEC AND COMMITTEE STAFF PRESENT:

Conrad Hewitt, SEC Chief Accountant

James Kroeker, SEC Deputy Chief Accountant

John White, Director, Division of Corporation Finance

Shelley Parratt, SEC Deputy Director, Division of
Corporation Finance

Russell Golden, FASB Senior Advisor to Committee
Chairman

PANELISTS:

Linda Bergen, Citigroup

Mark Bielstein, KPMG

Kevin Conn, MFS Investments

Jeff Mahoney, Council of Institutional Investors

Ben Neuhausen, BDO Seidman

Brooke Richards, American Express

John Stewart, Financial Reporting Advisors

Lynn Turner, Copera Trustee

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1 P R O C E E D I N G S

2 MR. KROEKER: I'll go ahead and call the meeting to
3 order. There are several people also joining us by dialing
4 in. I wonder, Bob, if you want to have a roll call of those
5 who are dialed in? Would you want to call out their names
6 and see? I know Mike Cook is dialing in.

7 CHAIRMAN POZEN: Mike Cook, are you on with us? Is
8 anyone? Is anyone dialed in on the line?

9 MR. OLSON: Mark Olson here.

10 MR. HOLM: Charlie Holm here.

11 CHAIRMAN POZEN: At the moment, I don't think
12 anyone is dialed in.

13 MR. KROEKER: Yes, we'll check again in a little
14 bit. I did want to thank --

15 MR. OLSON: Can anybody on that end hear me? Mark
16 Olson.

17 MS. AYRE: I can hear you. This is Kelly Ayre,
18 Department of Treasury.

19 MR. HOLM: Are you calling in as well? This is
20 Charlie Holm, I'm calling in as well. I can hear Mark and
21 Treasury but --

22 MS. AYRE: Yes, we hear you, sir.

23 MR. KROEKER: Why don't we get them attached to --

24 CHAIRMAN POZEN: Why don't you start while they're
25 trying to work with that?

1 MR. KROEKER: Yes, we'll go ahead. I did want to
2 thank the panelists that have taken the time out of their
3 very busy schedules to come and provide input for both
4 panels. There's going to be input on Subcommittee 1.
5 Subcommittee 1 is the committee that's looking at the issue
6 of substantive complexity, and Subcommittee 2, looking at the
7 standards-setting process. So, thanks to all the panelists
8 for taking, again, your very busy time to provide input to
9 this Committee.

10 I also want to thank the staff at the SEC. Putting
11 this together on the road is particularly challenging, so
12 thank you to all the CIFIIR support that the staff of the SEC
13 have provided. And also, I wanted to mention that this is
14 also being web cast, so people are able to participate online
15 as well. For those who are participating online, the
16 materials are also available for you online.

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

18 PANEL ONE

19 CHAIRMAN POZEN: Thank you. And I think the full
20 Committee also extends our appreciation to the SEC staff for
21 putting together this booklet and for arranging this meeting
22 today. And I think it might be useful if we just began by
23 introducing the panelists and maybe we'll start with Linda,
24 just say your name and your affiliation so that everybody
25 just knows who everybody else is.

1 MS. BERGEN: I'm Linda Bergen from Citigroup, the
2 Corporate Accounting Policy Department. I'm head of Research
3 and Reporting.

4 MR. BIELSTEIN: I'm Mark Bielstein, I'm with KPMG in
5 our Department of Professional Practice at our National Office.

6 MR. CONN: Kevin Conn with MFS Investments that run
7 our financial services fund. I spend a lot of time with the
8 financial services managements and reading through their
9 financial statements.

10 MR. MAHONEY: Jeff Mahoney, General Counsel to
11 Council of Institutional Investors.

12 CHAIRMAN POZEN: Okay, thank you.

13 MR. NEUHAUSEN: I'm Ben Neuhausen from --

14 CHAIRMAN POZEN: Could everyone speak a little
15 closer to the mic?

16 MR. NEUHAUSEN: I'm Ben Neuhausen from BDO Seidman.
17 I'm the National Director of Accounting for that firm.

18 MS. RICHARDS: I'm Brooke Richards, Vice President
19 of Global Accounting at American Express. And I'm
20 representing the Institute of Management Accountants.

21 CHAIRMAN POZEN: Thank you.

22 MR. STEWART: I'm John Stewart. I'm with Financial
23 Reporting Advisors which is a small accounting consulting
24 firm.

25 CHAIRMAN POZEN: Thank you. I appreciate all of

1 you taking your time to come out. And your mics are not as
2 strong as these mics. I don't know whether you could make
3 sure that we can catch every word that you say.

4 As John and I were talking before, the John, he
5 spells his name right, the other Jon Stewart spells his name
6 wrong.

7 Do we have the people on now who are
8 coming in by phone? Can we take a roll call? I notice
9 Mark Olson, are you, can you hear me?

10 MR. OLSON: I can hear you but I don't think you
11 can hear me.

12 CHAIRMAN POZEN: Yes, we can hear you. And Mike
13 Cook?

14 CONFERENCE OPERATOR: Okay. Mr. Cook, Michael is
15 trying to get into the conference call but there isn't a port
16 available for him. We would still need to add a port and
17 join him to the conference. Thank you.

18 CHAIRMAN POZEN: It sounded like the conference
19 operator.

20 MS. BERGEN: She said there wasn't a port for him
21 to get in and there apparently aren't enough lines.

22 MR. OLSON: Bob, this is Mark Olson. I just had
23 added a port.

24 CHAIRMAN POZEN: Well, I think we're going to
25 proceed with Mark on the phone and we're going to leave it to

1 the technicians here to see if they can figure out how to get
2 the other people in. I apologize for the technical
3 difficulties.

4 Just to introduce what we're going to do and give
5 the lay of the land here, we have this booklet which you all
6 have which is the summary of status report of each of the
7 subcommittees. This is the follow up to our interim progress
8 report which was issued in February. The objective here is
9 to get public input and testimony from experts on the work of
10 Subcommittee 1 and Subcommittee 2. Our approach will be that
11 we will run this first session until about 10:45 to 10:50,
12 and we will concentrate on the subjects in Subcommittee 1
13 which is substantive complexity, to be distinguished from the
14 session that will run from 11:00 o'clock to 12:45 which is
15 Subcommittee 2 and which will be on the process, the FASB
16 process of adopting standards and the implementation guidance
17 and other process issues.

18 So, I think what we're going to do is, without
19 further ado, I'm going to turn the meeting over to Sue Bies
20 who is head of Subcommittee 1. And we are not going to have
21 opening statements. With a panel this large, by the time we
22 finish with opening statements, there would be no time for
23 questions. So, we're going to launch right into questioning
24 and Sue is going to take the lead. Thank you.

25 MS. BIES: Thanks, Bob. And I'm going to sort of

1 kick off the comments and the other three members of my
2 committee will jump in with questions in that. First I want
3 to just thank the SEC staff people who have been so great in
4 supporting our committee -- We tend to have vigorous
5 discussions when we meet and they have been very good in
6 responding to our various inputs and things in drafting and
7 we thank you very much for all of your help on this.

8 What we thought we'd do today is sort of walk by
9 topic through the questions that we sent to the panelists
10 ahead of time. And so, the first area we'd like to have you
11 engage in a dialogue with us is around the whole mixed
12 attribute model. I think we want to really focus on two big
13 issues, and that is, how far should fair value accounting go?
14 Since it's something that's been talked about for
15 quite a few years, it's gotten recently more attention. And
16 what are the issues if you go beyond trading assets and fair
17 value?

18 And then, after we've had a bit of discussion in
19 that, we'd like to then turn to the second issue which we
20 have called in a very technical way the "chunking" issue
21 where we're trying to deal with how do you relate the income
22 statement and the cash flow statements, especially if you do
23 things that are fair valued where the gains and losses aren't
24 realized. And as a former bank regulator, this is something
25 we care a lot about, especially in today's world where gains

1 were booked but never realized, so it's phantom capital as
2 far as a regulator is concerned. So, we'd like to talk about
3 some of the things we've laid out that would sort of help us
4 find a better way to relate all that information together in
5 various financial statements.

6 So, let's start with the scope of fair value. How
7 far should fair value go? And whoever would like to sort of
8 kick that off then we can get the dialogue going here.

9 MR. STEWART: Sue, do you have in mind financial as
10 well as non-financial assets?

11 MS. BIES: Yes.

12 MR. STEWART: And liabilities?

13 MS. BIES: Yes.

14 MR. STEWART: As opposed to just financial?

15 MS. BIES: Well, that's where we want some input.

16 MR. STEWART: Well, I'll get it started. I mean, I
17 think what's important is two broad things. One, what the
18 users of financial statements, what are they interested in
19 and what would be most helpful to them. They, after all, are
20 the consumers of what we do. I think accounting is in the
21 business of communicating and it's a practical art
22 to try to help communicate.

23 So, and then there is the issue of whether it's
24 doable. If you can't do it, it's not very useful I would
25 think. If the guys in Kokomo, Indiana, I'm from Indiana so I

1 can talk about Indiana, if the guys in Kokomo can't do it,
2 it's not going to be productive, it's not useful. So, with
3 regard to what investors seem to need, I think that the input
4 I read from surveys including those at CFA are mixed. The
5 CFA institute seems to be very big on financial instruments
6 being at fair value and maybe more than that. On the other
7 hand, some of the other surveys, I've seen a couple from
8 PricewaterhouseCoopers that did some good surveys of users, a
9 recent one from Europe, indicate that they are not at all as
10 thrilled with fair value even for financial instruments as
11 the CFA people are.

12 So, I think, from what I read, and I'm not a user,
13 I'm a doer, I'm a practitioner, so I can maybe weigh in on
14 the second thing as to whether things are doable, but in
15 terms of what investors need, I think it's not clear to me.
16 My bias growing up was to be in favor of fair value. That's
17 what I always thought made sense. On the other hand, the
18 users don't seem as excited about it as other users do, and
19 I'm confused, if you will, as to what they want and need.
20 But that's the first issue.

21 As to the doability, I think we're finding with
22 Statement 157 that even for financial instruments it's a
23 challenge. And then, when you get outside of financial
24 instruments, it's even more challenging. So, I think that
25 there has got to be a lot of education at the colleges, of

1 practitioners, at appraisal firms, to get us up to speed to
2 more of it if in fact it's needed.

3 So, let me stop at that point and see if others
4 want to jump in here.

5 MS. RICHARDS: I guess I can go next. Do I need
6 to --

7 CHAIRMAN POZEN: I'm afraid our mics still are not
8 working that well, so you'll have to really get up close.

9 MS. RICHARDS: Okay. Well, I believe, I'm somewhat
10 of a proponent of fair value although I do think it should be
11 taken slowly and in caution so that all the problems can be
12 resolved and the preparers can do it. I'm not sure about the
13 user view. I know that there are different types of users
14 and maybe for some it's useful, for others maybe not just
15 like John said.

16 I think where fair value is good is where there is
17 uncertainty. For example, guarantees and contingencies.
18 When there is uncertainty, instead of having a yes or no
19 answer, I think it's better to incorporate that uncertainty
20 into the measurement. And I know it's not always easy but I
21 think it's the most representationally faithful measure of
22 anything with uncertainty, and even uncertainty in amounts.

23 Stock compensation --

24 CHAIRMAN POZEN: I'm sorry, I didn't quite get your
25 point. You think fair value should be used or should not be

1 used when there is uncertainty?

2 MS. RICHARDS: I think it should be used.

3 CHAIRMAN POZEN: Okay. Can I ask you what is
4 usually called level 3 information? How do you feel about
5 that evaluation of, that's a very high level of uncertainty.

6 MS. RICHARDS: I think level 3 has been used for a
7 long time. It's, in my experience, not always
8 a hundred percent precise. I mean, it's never a hundred
9 percent precise, but yet it's better than zero.

10 MS. BIES: Can I make sure we're talking the same
11 terminology? If we can differentiate between risk and
12 uncertainty? I mean, conceptually, uncertainty is a concept
13 that by its definition you don't know what it is. You just
14 know that there's other random factors that could affect the
15 value of a variable, but it isn't systematic that it can be
16 measured in a normal volatility measure or statistical model
17 which is more of a risk. And you can have wide-ranging risk
18 variation, 6 sigma, 12 sigma, and some statistical
19 test.

20 So, there's a wide variability in terms of risk
21 measurement, but the uncertainty is something that really
22 cannot be defined. It's been one of the issues that I know
23 both economists and accountants have struggled with for
24 years. So, I want to make sure I understand, are you talking
25 really about the uncertainty, trying to measure that, or are

1 you talking about the volatility in measurement that are in
2 most models including the third level models?

3 MS. RICHARDS: I guess I would point specifically
4 to FAS 5 on whether you either have something on your books
5 or nothing on your books for contingency. And instead, I
6 believe that you should fair value that contingency and that
7 would be a better representation of that contingency.

8 MR. GRUNDFEST: I just wonder if we're
9 really talking around what the issue is, so let me try to
10 crystallize matters and bring things to a point.

11 First observation, I think it's fair to say that we
12 can all agree that the accounting system is massively,
13 internally inconsistent in its treatment of various forms of
14 assets and liabilities. Is that fair? Does anybody want to
15 argue the system is consistent and coherent? Anybody?

16 MR. CONN: What do you mean by consistent, sir?

17 MR. GRUNDFEST: That if you have one piece of
18 paper, it's valued the same way regardless of what the paper
19 is, how it's structured and who is holding it.

20 MR. CONN: And you're talking about financial
21 instruments now?

22 MR. GRUNDFEST: A mortgage, right? You take a
23 mortgage --

24 MR. CONN: But not a plant or an intangible or good
25 will or --

1 MR. GRUNDFEST: You take a mortgage, the accounting
2 for mortgages is very different depending upon whether it's
3 still held as a mortgage by the bank that originates it or
4 whether it is put into some sort of credit
5 derivative and then sliced and diced, and then you wind up
6 holding the very highest tranche of a portfolio which is
7 actually worth more than that one mortgage. And you can be
8 forced to account for it at a lower price even though it's
9 exactly the same mortgage. I mean, that's an unassailable
10 fact.

11 The system is internally inconsistent, and it's
12 internally inconsistent in a way that's very hard to
13 rationalize other than the process and the policy and the
14 politics of how we do our accounting. Bob? I mean, how --

15 MR. HERZ: I don't know if I'd, your securitization
16 example, I'm not sure that is exactly the same. But I think
17 just use the basic issue of securities, based on
18 whether they're held to maturity, available for sale, or
19 trading. And you get three different measures. You also get
20 different measures if it's hedged or not or hedge accounting
21 elected or not.

22 So, I agree with you. Any one security, that
23 security could be held in four or five different forms of
24 accounting.

25 MR. GRUNDFEST: So, you ask "What is this thing

1 worth?" Well, then the question is why are you asking, and I
2 can give you seven different numbers and all of them are
3 entirely consistent with GAAP, okay? So, that's where we
4 are. Now --

5 MR. STEWART: But isn't the question what is
6 useful --

7 MR. GRUNDFEST: Well, right. Now, we're getting to
8 the question of what's useful, all right.

9 MR. STEWART: As opposed to what's consistent.

10 MR. GRUNDFEST: Right. And just my first
11 observation is that seven different numbers for the same
12 thing doesn't strike me necessarily as being useful. All
13 right. So, I agree with you about useful. Now let's get to
14 useful.

15 In normal trading conditions, when you look at
16 market prices, it's clear that market price is
17 something that you need--very, very useful. Now, let's ask
18 ourselves what's the price, okay? A price is going to
19 reflect three different things at any point in time: the
20 market's assessment of the cash flows that you're going to
21 get from the instrument; the cost of trading the instrument;
22 and also the market's perception of the financial strength of
23 the people who are holding the instrument so that if the
24 market perceives that there are people that are holding an
25 instrument that may have to be selling a lot of it quickly,

1 the market can freeze up.

2 The prices can go very low, nobody wants to buy
3 something of which there's going to be a great deal for sale
4 in the near future. And you can then wind up
5 getting a price that reflects, for perfectly understandable
6 reasons, an exit value that is different from what everybody
7 would agree is the long term value of the cash flows like
8 would be generated by that underlying instrument. I think
9 we've actually seen that.

10 And now, the really interesting question going back
11 to the issue of what's useful? What does the market
12 need to know? It goes back to the traditional problem of
13 central banking that Governor Bies knows real well is if you
14 look at the traditional business of banking, it's a -- trade,
15 all right. What you're doing is you're lending a loan.
16 You're lending money 30 years to homeowners and what
17 you do is you're borrowing for it, you're taking in deposits,
18 you have six-month CDs, demand money, and if
19 you're going to have a problem with the value of the assets,
20 the central banker has got to figure out, is this a solvency
21 problem or an illiquidity problem?

22 Well, if you were to apply FAS 157 to all of
23 traditional central banking, everything becomes a solvency
24 problem because you mark everything to an exit value. And
25 you can never really have people come into a situation to

1 solve illiquidity problem because by the definition of 157,
2 it's never a liquidity problem; it always becomes a solvency
3 problem. So, there's a sense in which the whole history of
4 central banking, if you look at it carefully, is
5 fundamentally incompatible with the implications of 157. And
6 as Governor Bies pointed out, not only do we have problems
7 with phantom capital in situations where mark-to-
8 market allowed you to create capital that never really
9 existed, we can also just by the same logic have problems
10 with phantom losses where mark-to-market can create
11 situations where you have to go out and raise physical
12 capital in order to cover losses that as a practical matter
13 were never really there. All right?

14 Now, ladies and gentlemen, that I think is the
15 problem. We can talk around a whole bunch of other things,
16 and also at the end of the day, even if we agree that these
17 are the problems with 157, we have to do something better.
18 Is there something better? Can 157 be improved? Can the
19 system be rationalized? I think as we look at the
20 financial markets, that's the challenge they're facing.

21 MS. BIES: Mark, you were going to make a comment a
22 minute ago?

23 MR. BIELSTEIN: Yes. And maybe I'll try and tie it
24 into those comments as well, but I think generally speaking,
25 and following along what John said, you've obviously got to

1 take into account what the users are really looking for and
2 can best use them in their analysis. But generally speaking,
3 I believe that the use of fair value in more situations for
4 financial instruments is better than less in that the use of
5 fair value for financial instruments reduces much more
6 complexity in financial reporting, whether it's on the
7 preparer side or the user side, than not. And you just think
8 about all the things we do in financial reporting now, and
9 I'm talking about the use of fair value with changes in fair
10 value through earnings.

11 For example, we spend a lot of time
12 trying to figure out when to move stuff from other
13 comprehensive income and equity over to the income statement.
14 And you know, some of those exercises are really not all that
15 useful. And using fair value for financial instruments I
16 think resolves many of the problems that we deal with in the
17 complexity and practice today.

18 Now, obviously, you've got to make sure that's what
19 the users need. And maybe there's different ways to address
20 some of the issues about illiquid markets and the fair value
21 determinations in illiquid markets as compared to 157. But
22 generally speaking, I would think having that information is
23 better than not having it. And some of the issues that you
24 raised, I think, are a regulatory issue, not necessarily an
25 accounting issue as to if the fair value is X and that

1 creates a capital issue under the current regulatory, maybe
2 there is a regulatory issue as to whether that's the number
3 they ought to be using.

4 MR. GRUNDFEST: But Mark, here is my question. You
5 say if the fair value is X as though you have a great deal of
6 confidence in terms of knowing what that fair value is.
7 In the real world, that fair value may be a wide
8 range of numbers reflecting a wide range of forces that have
9 nothing to do with the actual intrinsic longer term value,
10 although it is a correct measure of the immediate
11 exit value.

12 So, you're skating around all those questions by
13 simply saying, well, we're better off with the fair
14 market value. How do you, you've got to get into the
15 plumbing. How do you come up with the fair market
16 value? What does it measure? And is that the thing that we
17 actually want?

18 MR. BIELSTEIN: Well, I appreciate there may be
19 things you might want to reconsider with the 157
20 measurements. I think a lot of the things you can do with
21 that is do disclosures and what the estimates are and the
22 basis for the estimates that the company is using so that the
23 users understand that information. But it seems to me the
24 use of a fair value estimate for financial instruments, even
25 in illiquid markets, is better information than cost.

1 MR. GRUNDFEST: I guess I'd be interested in
2 knowing both.

3 MS. BIES: And that, gentlemen, let me use that as
4 a segue into the next part of this question. One of the
5 things the Subcommittee has been throwing around is to really
6 look intensely at the proposals FASB is coming out with and
7 others to really find a better way to relate the cash flow
8 statements, especially within a fair value framework, so that
9 however we're going to do this, we can quickly identify
10 what's realized and unrealized. Because a mark-to-market on
11 a loan, we know at the end of the day that no borrower is going
12 to pay a penny more than they borrowed. So, any gain on a
13 loan for any reason, credit, quality improvements or interest
14 rate movements, is never going to be realized. It's just a
15 timing difference.

16 And so, what we've proposed is, going back to one
17 of the points that Joe just made, is that we've developed a
18 framework that really rests not on an individual asset or
19 liability but more based on the activities. And while that's
20 difficult under 115 and we are still struggling with the
21 definition of activity, what we want to say is that's really
22 what we think users would like to have, and it's more
23 relevant in the way businesses are operated that you really
24 look at what is the earnings recognized today and what is the
25 cash flow recognized from the different activities that go on

1 in an organization.

2 But we need to somehow true up what's going on in
3 the cash flow statements with what's going on in the income
4 statement so that we can look across and sort of say, well,
5 if we do use a fair value, then how much of that is realized?
6 And how much of it is new loans extended? How much is loans
7 paid down? How much is due to other things that
8 affect true cash flow so that we can get the quality of
9 what's flowing through the income statement because today we
10 can't see it in a straight fair value or for the parts that
11 are historic cost that we've got an ability to see on the
12 historic cost what is that mark-to-market but lay them out in
13 a more parallel framework based on activities.

14 And that's one of the proposals we've been kicking
15 and we'd like comments. Linda?

16 MS. BERGEN: Yes. I fully support an
17 activity-based accounting model. If the purpose of financial
18 statements is to explain to the user community the company's
19 business, then basing the accounting on the types of
20 activities that entity conducts makes all kinds of sense to
21 me.

22 For example, if a company trades their securities
23 inventory and their commodities inventory, it makes all kinds
24 of sense for that entity to report all of that at fair value,
25 the best measure of fair value they can get. And if it's a

1 trading inventory, exit value does make some sense even
2 though there may be distortions in various markets. But for
3 the producer of that commodity or the ultimate user of that
4 commodity to report those same instruments at fair value
5 doesn't make a lot of sense because they are not going to be
6 buying and selling them in the long term. The farmer is
7 trying to protect his profit on his crop and the user wants
8 to contain his inventory costs. So, I think activity-based
9 accounting is the right way to go.

10 In terms of extending a fair value model to loans,
11 well, I think it depends. Whether that gain or loss on a
12 loan is ever going to be realized depends upon where you are
13 in that process. If that loan is going to be traded, if it's
14 going to be sold, then that rise or decline in value will be
15 realized in the intermediate sense. Ultimately, you're
16 correct, what will be gained in cash flows from that loan is
17 fixed, or at least as a maximum. So, it depends on how the
18 entity is using that loan should determine how they value it.

19 To value contingent liabilities at fair value other
20 than at the time you acquire them and through a purchase
21 doesn't make any sense to me. I'm not sure that litigation
22 liabilities are not traded. They're never going to be sold.
23 Who would assume them unless you sell the entity that has
24 that litigation outstanding. So, that kind of use of fair
25 value I think is a misuse.

1 MS. BIES: Mark?

2 MR. GRUNDFEST: Just another quick comment about
3 the use of fair value for financial instruments. I would
4 also say that that is highly dependent on, I think, a
5 financial statement presentation project that the FASB is
6 already working on and ties in to some of your comments, Sue,
7 that in order to continue to use fair value for financial
8 instruments in more cases than we do now, and really even as
9 we do now, we need better distinctions in the financial
10 statements between what are changes in fair value as compared
11 to the other operations. And it seems to me that the
12 financial statement presentation project has the opportunity
13 to do that.

14 MS. BIES: Anybody else who'd like to comment on
15 the mixed attribute model in general?

16 MR. CONN: Susan, I have just one comment.

17 CHAIRMAN POZEN: You're going to have to speak a
18 little closer.

19 MR. CONN: I have one comment. As a user
20 of the statement as an investor, the migration to fair value
21 is absolutely terrific. We're absolutely 110 percent
22 supportive of that. Some prices in a lot of the capital
23 markets right now are irrationally priced. So, many
24 managements I talk to say, "Look, we're having to mark these
25 things at 50 cents on a dollar, they're not going back to

1 par, they're probably worth 80, we don't know. But forcing
2 me to mark to 50 cents on a dollar is putting added pressure
3 in our balance sheet and making us more stressed than we
4 would be if we could apply some judgment."

5 And so, the level 3 bucket I find to be incredibly
6 useful as an analyst. And I look at it before I see
7 managements. And some of the disclosure is terrific in level
8 3. It's gotten a lot better.

9 But I would propose adding a little bit more
10 context and texture to that because oftentimes I'll look at
11 that disclosure, I'll ask management a question about level
12 3, and it's very easy to parry the questions
13 because they're -- so, that's the only, and what would you
14 add? You'd add things like the type of assets in level 3,
15 how they came to value them, because there is nothing in the
16 level 3 asset buckets that tell you what's the
17 unobservable input.

18 So, a little bit more clarity around level 3, not a
19 ton, but a half page or a page would be very helpful.

20 MS. BIES: Let me follow up on that. Kevin, would
21 it be helpful if there was more of what I call "walk forward"
22 kind of reporting? Because now you just sort of get a
23 moment-in-time picture in the disclosures that if you learn
24 something about what part of the change in fair value was due
25 to actual losses taken, what was set aside for future losses,

1 what was because of change in loans outstanding. I mean,
2 because right now in the disclosures, there's none of that
3 information there, yet the framework we use for historic cost
4 are portfolio volumes, following up on Linda's point. You
5 have that walk forwarding through the loan loss provision
6 information.

7 MR. CONN: I think that kind of information would
8 be very helpful, yes. It would help clarify some of the
9 complexity out there.

10 MS. BIES: What troubles me about the use of the
11 mixed attribute model is when you have two different
12 accounting policies being used for the same type of activity
13 for the same kind of instrument. For example, in your loan
14 book where you have loans carried at amortized cost less an
15 allowance, and you have purchased some loans, those loans are
16 going to be reported at full fair value based on the date you
17 acquired them, and then you'll start accumulating an
18 allowance should you need one going forward for that. But
19 when you look at your loan loss statistics, they're not going
20 to be consistent because you're going to show a lower rate of
21 loss in the purchase loans than you are in your originated
22 loans, and it doesn't necessarily make economic sense that
23 that's the right way to view it.

24 It also creates huge complexity in needing to have
25 two separate accounting systems to record and track the

1 various types of loans, two different ways of measuring
2 impairment or valuation problems in those loans. That kind
3 of inconsistency bothers me.

4 MR. STEWART: I said this before but I think the
5 surveys are very insightful. And if you haven't, maybe
6 you've seen them all, but there's one very recently for
7 European investors that was somewhat supportive of your idea
8 about operating and not operating, that the basis for
9 carrying the financial asset or non-financial asset would be
10 dependent on whether it's operating, whether it's illiquid.
11 So, I recommend, these are people that we are serving, right,
12 the users of the financial statements?

13 And therefore, I really, and they send very
14 conflicting and inconsistent messages from survey to survey --
15 the CFA does surveys of the financial institutions.
16 They are not consistent with the PWC surveys. They are not
17 consistent with this recent European survey. And maybe
18 someone can figure out why they're inconsistent. Maybe there
19 is a good explanation.

20 Point two is the schedule that you guys are talking
21 about that goes from a cash flow statement, from the income
22 statement. I think that would be very difficult practically
23 to do. Maybe it would be useful, but I think there is going
24 to be a lot of questions of all these columns you have,
25 distinguishing whether this is kind of a recurring kind of an

1 adjustment or something different than that, the accrual of
2 interest. I think it would be very difficult for preparers
3 to do that. Maybe it would be useful but it would be hard to
4 do in my view.

5 MS. BIES: Bob?

6 MR. HERZ: Just one point. I've seen all those
7 surveys, too. In fact, the PWC survey, a lot of the people
8 in there were members of what's called the Corporate
9 Reporting Users Forum (CRUF). We met with that group in
10 London last week as part of our meeting with the IASB. And I
11 don't think they stated categorically that for financial
12 instruments they want fair value. Most of the rest of the
13 surveys, the non-fair value is more around the non-financial
14 stuff, around intangibles and purchase accounting which they
15 don't find particularly useful, things like that.

16 But there was discussion specifically on that point,
17 and they had a bunch of them there that wanted
18 fair value for financial instruments, which matches the much
19 more extensive surveys that, the systematic surveys that CFA
20 Institute had done of thousands of users here.

21 MR. STEWART: Well, I don't know, I'm not a user.
22 But here, I'll read to you what a recent survey shows, not
23 the CRUF one. "Mark-to-model fair values are regarded as
24 significantly less decision useful than both market-based
25 fair values and historical cost measures for practically all

1 asset classes." So, that would include financial
2 instruments. That's what this survey shows and I don't know
3 what is right.

4 I mean, I'm a practitioner, not a user. But users
5 ought to get to decide this, it seems to me, and drive the
6 decision making. You know, it could be credit users like
7 Greg or others. But I think these guys, we ought to pay
8 attention to what they're saying, and they're not all saying
9 the same thing.

10 MR. SIDWELL: Mark, you had mentioned that you
11 think fair value for financial instruments is a good thing.
12 I was wondering if you could give your opinion on
13 non-financial assets and non-financial liabilities.

14 MR. BIELSTEIN: I would not suggest at this point
15 expanding the use of fair value on a recurring basis for
16 non-financial assets and liabilities. My thoughts were
17 specifically related to financial. Now, for example,
18 business combination accounting, we obviously need to use
19 fair values in the initial measurements. I think one of the
20 questions that the panel had or that the Committee had
21 related to whether any of the provisions of Statement 141R
22 should be delayed on contingent assets and liabilities. I
23 think, for those, I would continue to do what those standards
24 said and see how that goes in the implementation rather than
25 deferring those.

1 MR. GRUNDFEST: Could I interrupt for just a
2 second? And please, Mark, I beg your indulgence? It's the
3 law professor in me that's screaming, can I go Socratic for
4 five seconds? This is a cold call, this is the worst thing
5 in the world.

6 If market value accounting is good for a financial
7 asset, why isn't it also good for a non-financial asset for
8 exactly the same reasons that it's good for a financial
9 asset, whatever you happen to think those reasons are?

10 MR. BIELSTEIN: I actually believe that for
11 non-financial assets where, you know, manufacturing plants
12 and those kinds of things, that the use of fair value for
13 those is not the same as for financial instruments.

14 MR. GRUNDFEST: Why?

15 MR. BIELSTEIN: That information may not be as
16 useful. Now, again, that's a question for --

17 MR. GRUNDFEST: May not be as useful? Suppose you
18 have a company that has no financial instruments whatsoever
19 and the only thing it has is its manufacturing plant, it's
20 not useful, it's essential. You can't live without it.

21 MR. BIELSTEIN: You can't live without?

22 MR. GRUNDFEST: What do you care what the
23 historical cost is of that building? You want to know what
24 its current market value is. It's the only asset the company
25 has.

1 MR. BIELSTEIN: Well, in some part, the users are
2 going to make those judgments based on the operations that
3 are flowing out, that are reflected in the financial
4 statements.

5 MR. GRUNDFEST: Well, then why don't we say the
6 same about the financial instruments?

7 MR. BIELSTEIN: And again, this is a question for
8 the users of the financial statements as to what's more
9 useful to them. If I'm thinking about it from my
10 perspective, and obviously that is not a user, but what
11 reduces complexity in the financial statements, we have much
12 more complexity and financial reporting in the various models
13 we use for financial instruments than we do outside of the
14 financial instruments.

15 MR. GRUNDFEST: But isn't that a good thing?
16 Because then we can get the market value numbers that we all,
17 and perfectly, understandably, say are more valuable for us.

18 MR. BIELSTEIN: Let me --

19 MR. NEUHAUSEN: But I think there is a difference.
20 At least, I perceive a difference between the financial
21 assets and the plant. Financial assets are much more liquid,
22 they're much more easily replaced.

23 MR. GRUNDFEST: Oh, really? Financial are always
24 much more liquid?

25 MR. NEUHAUSEN: Not always, but I think generally.

1 MR. GRUNDFEST: But what happens when they're not?

2 MR. NEUHAUSEN: And companies tend not to sell off
3 their entire plant in single transactions. They might sell
4 isolated plants, but for the most part they're held for
5 operations over a long term. And I'm not convinced
6 that today's exit value on plant is generally going to be
7 that useful when you move over to the liability side of the
8 balance sheet.

9 MS. BIES: But let me follow that thought because
10 this is part of what gets me confused over the people who
11 push fair value accounting. When you talk about
12 non-financial assets, I think part of it is that we go back
13 to this concept that accounting should reflect the earnings
14 process of the company or its various business activities.
15 So, you wouldn't want General Motors to recognize all the
16 future cash flow they're going to get from a plant the day
17 they open it, because they're going to have to run that plant
18 and it's more important to know what's going on in that plant
19 period to period. And so, we've got a tradition of having
20 accounting that I think most people are comfortable with in
21 the way the automobile plants are run day to day.

22 When we get to financial instruments though, we
23 tend to not look at the activity. We tend to look at just
24 the asset. If your trading activity, I grant the activities
25 trading goes through earnings right away through fair value,

1 I have no problem with that, but if you're basically someone
2 who is borrowing funds, say your company -- you're borrowing
3 to fund your company -- what does the mark-to-market on a
4 periodic basis tell you about that company? Because, again,
5 if I was wanting to lend more money to that company, I'm
6 interested in what the cash flow is and how much debts are
7 already incurred, I would think I have a different framework
8 than a fair value framework which would make it much better
9 for me as a potential debtor to value that company.

10 So, I think that's the issue that we're struggling
11 with in the framework. We're going to run out of time here,
12 so let me just, I would like to see if we can get some
13 comment on the proposed schedule. John Stewart mentioned he
14 thought it would be difficult. It's on page 16 of our
15 Subcommittee report at the first section of the booklet that
16 you got because we've been sort of looking at how we lay out
17 these activities. And if any of you have any input on that,
18 that would be very, very helpful to us.

19 MS. BERGEN: I like the example. I thought it
20 looked good. I would want to test it at a real company
21 probably like John said. I'm not sure where some things
22 would go in some of the columns.

23 CHAIRMAN POZEN: Well, can I follow up on that? I
24 guess the implications of this sort of schedule is that you
25 would have the potential for two EPS's: one where you would

1 have what we have now for EPS, and the second is you would be
2 dividing between those things that are sort of coming out of
3 core earnings versus fluctuations in the trading portfolio or
4 in currency, maybe even unfunded pension liabilities. So,
5 the unrealized paper losses or gains that then -- some of which
6 flow into the income statement and some of them don't -- would
7 sort of be captured. So, what a company would have and in
8 talking to analysts and talking to investors is the ability
9 to say this is sort of our core earning power, and then our
10 income statement includes a number of these factors which
11 move around and we're not, you know, and they'd move for
12 market reasons, currency reasons, et cetera.

13 And this was sort of our attempt to deal with
14 probably the debate on fair value. Well, we're not going
15 to solve it here in this Committee,
16 but to try to illustrate and drive home to investors that
17 there is really a difference in the quality of earnings
18 between one sort of core earnings and these other things.
19 So, that's what we're really trying to get to. And we'd
20 really like feedback as to whether or not those sorts of
21 things make sense.

22 I mean, we're essentially taking the active
23 securities portfolio, the fluctuations and segregating it
24 out. We're taking some of these things that are now hidden
25 away -- what's that part of the balance sheet -- oh, right,

1 OCI and sort of making them a little more salient.

2 So, that is the basic idea. And we would like to
3 get feedback as to whether that does lead you to sort of two
4 EPS's and whether that makes sense.

5 MR. CONN: What are the two EPS's?

6 CHAIRMAN POZEN: You've got to speak up a little.

7 MR. CONN: Yes, could you hum a few more bars about
8 the EPS's? I'm not following.

9 CHAIRMAN POZEN: Well, I think the implications are
10 that if you take your overall income, your overall EPS, and
11 you were to segregate out these things like the gains and
12 losses on your trading portfolio or currency fluctuations,
13 these sorts of things, so then you would have a second number
14 which would say, you would essentially say the total minus A
15 equals X. And so, you sort of have a, here X then would
16 represent some sort of core earnings EPS because it would
17 have segregated out these fluctuations because they're not
18 realized gains.

19 MR. CONN: Right, but some of those fluctuations
20 are part of the regular business of the company.

21 CHAIRMAN POZEN: Well, that is --

22 MR. CONN: Like a financial institution, the
23 trades, that, you know, whether it's realized or unrealized,
24 for treasury bills it's probably not very important. But I
25 understand your point if you're saying, and we see this for

1 oil and gas companies who are not doing hedge accounting.
2 They're marking to market their derivatives. They found hedge
3 accounting to be too complicated so they report the mark-
4 to-market on their derivatives outside of core earnings which
5 is, I think, one of the points you're making, Bob, that might
6 be useful.

7 I don't know whether this would be useful
8 or not because I'm not a user of financial statements. I do
9 believe that it would be complicated to prepare. And so,
10 there's really two issues: can it be done by companies, but
11 also is it useful? I think it would be complicated to do but
12 I don't know if it's useful or not. That's --

13 CHAIRMAN POZEN: Well, I agree with your point
14 certainly. Financial institutions represent a special
15 challenge in terms of what's core and what's non-core. But
16 we're still looking at the general concept. I don't know
17 whether anyone else wants to comment?

18 MS. BERGEN: Yes, I do. I think that there's a
19 lot. This schedule raises more questions in my mind than it
20 provides me with answers, primarily because how you define
21 what's up-rating, investing and financing I think are very
22 different for a manufacturing or retail company than it would
23 be for a financial institution. And I think that's one of
24 the key problems for financial institutions with the cash
25 flow statement today.

1 But I think what you're trying to get at is what is
2 the mark-to-market, and I think that you could simply
3 disclose that information. We're already disclosing what the
4 mark-to-market realized and unrealized on the level 3 assets
5 which are your most tentative valuations. So, if we were
6 required to break out our principal transactions line between
7 commissions fees and mark-to-market, I think you've got the
8 information you're looking for without creating a huge
9 reconciliation spreadsheet.

10 I'm not sure that cash basis earnings is
11 meaningful. I think that's why GAAP says accrual basis
12 earnings is the right way to go for corporations. Cash basis
13 revenues and expenses are manipulable. When did you send out
14 your last batch of invoices?

15 CHAIRMAN POZEN: I think we would tend to see sort
16 of systematic accruals within the operating income as opposed
17 to, I mean, these are difficult questions but I think we
18 would tend to see systematic accruals within operating
19 income. And I guess the motivation here was to look at what
20 companies put in their earnings press releases which gets
21 pretty quickly to a core earnings cash notion.

22 MS. BERGEN: Well, I was sort of positive. If you
23 look at your sales, if you're only interested in the accruals
24 that are still in effect at year-end, look to your balance
25 sheet. You've got it, that's your accounts receivable. But

1 if you're looking at how did the company earn its money, were
2 they truly cash sales or were sales for credit, and then you
3 had collection on those sales, you're looking for different
4 kinds of information. Are you looking to those cash flows to
5 be cash in/cash out or just the net cash flow for sales,
6 for example? And you'd have the same sorts of
7 questions about every other item on here.

8 This kind of a schedule I think raises lots of
9 questions about feasibility. I think you can more simply get
10 to the tentativeness of the reported earnings through a
11 couple of other key disclosures.

12 MS. BIES: I think Ed's got one more question.

13 MR. McCLAMMY: One follow up question was for
14 Brooke. You had talked about you thought it would be helpful
15 to fair value contingencies. And I guess I struggled, maybe
16 you can help me, if someone from your accounting organization
17 came and said I have to fair value this piece of litigation
18 that we're facing where someone has sued us, how would you
19 suggest that they go about coming up with a fair value to put
20 a single number into the P&L?

21 MS. RICHARDS: Probability-weighted model. So,
22 most companies would have a whole list of contingencies and
23 they assign some sort of probability to that, maybe not
24 numerical but at least qualitative probability. And then,
25 from that, I think you could probability weight all amounts

1 and come up with a single estimate.

2 MR. McCLAMMY: And who is going to be in a position
3 to put those probabilities down there for a litigation? Are
4 we expecting -- maybe I should ask the attorneys. Are the
5 attorneys who are present today, who would be willing to put
6 a precise probability number on a piece of litigation?

7 MR GRUNDFEST: Zero.

8 MS. GRIGGS: Most of us wouldn't.

9 MR. McCLAMMY: I'm sorry?

10 MS. GRIGGS: Most of us wouldn't. And most kinds
11 of litigation you couldn't do that. I guess there's some
12 routine litigation that you get all the time; those you could
13 probably put some probability weightings on. But certainly
14 there is an awful lot of uncertainty in how litigation will
15 turn out and I think a lot of it, I mean, lawyers are
16 certainly not in a position today to put weightings on most
17 of that.

18 MS. RICHARDS: No, I think some of them might have
19 a zero.

20 MR. STEWART: But when you have a binary outcome
21 like 100 or zero, and those are the only two outcomes, and
22 you say, well, they're about 50-50. So, if you could come up
23 with those, which, you know, I don't know, I couldn't do it.
24 But if someone could, then you'd book 50 which is a number
25 that will never happen. You're either going to pay 100 or

1 you're going to pay zero. So, the 50, I'm confused why that
2 would be helpful to somebody.

3 MR. McCLAMMY: Right.

4 MR. STEWART: But, so I'm kind of with you on the
5 contingent liabilities being difficult, but the FASB is
6 moving more toward where Brooke is describing as I
7 understand. And IAS 37 --

8 CHAIRMAN POZEN: I think it's --

9 MR. HERZ: IASB has been moving that way. We have,
10 we're still at the kind of threshold in all of that. In
11 fact, even the business combinations, we've backed off of in
12 that as far as front booking of things. So, my own
13 view on that would be, in your example, you could
14 show the 50 but then the underlying information, any point
15 estimate is no good without understanding the underlying
16 information, the distribution underneath it really. That's
17 really where the richness of the information is. But the
18 point --

19 MR. STEWART: 141R requires fair value of lawsuits.
20 If it's more likely than not you're going to lose, you have
21 to fair value it. Hopefully Linda can do that.

22 MS. GRIGGS: It would be a challenge.

23 MR. STEWART: I mean, we're going to have to do it
24 under 141R starting next year.

25 MR. HERZ: Not for all of them.

1 MR. STEWART: The ones that are more likely than
2 not, you'll have to fair value them. I think that would
3 be --

4 MS. GRIGGS: And those are the ones that are
5 assumed in litigation. So, maybe there's some analysis done
6 in, not litigation, assumed in an acquisition, maybe there's
7 some analysis done at that point. It's going forward that I
8 think is very difficult.

9 MR. STEWART: I think it will be difficult even for
10 the ones in acquisitions.

11 MS. RICHARDS: Well, currently, we do have some
12 contingencies on the balance sheet, so contingencies that are
13 probable, then there is, you know, the 141 contingencies that
14 are going to have to be fair valued. And you talk later
15 about competing models. So, I would want to know what makes
16 some contingencies different than others that they should get
17 a different model.

18 MR. McCLAMMY: But I think under the current
19 accounting, it's under FAS 5 for those contingencies, and
20 there's a probability aspect. But once you have the
21 probability aspect, you go to, if there is no best point, you
22 go to a range, then you're accrued to the bottom of the range
23 and disclose the range. And in my mind, that's very
24 different than saying pick a point, that you're forced to say
25 there is no range, you have to pick a point.

1 MS. RICHARDS: I don't know if you have to pick a
2 point. You have to model scenarios and assign a probability
3 to each scenario instead of just picking one point estimate.

4 MR. NEUHAUSEN: But in the end, after you model the
5 probabilities, you mathematically come to a single number.

6 MS. RICHARDS: Yes. I'm not saying it's easy.

7 MS. BIES: Okay. I'm going to move on now to the
8 next topic because we're running out of time for our
9 Subcommittee's ability to ask questions. So, we want to move
10 on to bright lines. Let me just sort of reference the
11 questions that our Committee is going to ask about this.

12 The whole purpose of this big Committee is to deal
13 with complexity. And part of what our Subcommittee has been
14 looking at is we have developed over the years a lot of
15 bright line tests. And we've seen where a lot of
16 transactions get structured to be on one side or the other
17 of that bright line test, whether it's leases or I could
18 argue what's more relevant in the last several months, a lot
19 of the structured CVO's, CLO's, various kinds of securities
20 that are out there, or liquidity guarantees or whatever that
21 have popped back on financial institutions' balance sheets,
22 and created losses that really weren't being recognized in
23 the financial statements.

24 So, we really have two areas of questions we would
25 like your feedback on. Many people have told us that they

1 like bright lines because it simplifies things, so keep them
2 because we're trying to make accounting less complex. On the
3 other hand, with all these surprises that are coming and the
4 structuring that goes on, are we better off going to
5 something that is a framework that is more proportional? So,
6 it isn't all a light switch you turn on and off for
7 recognizing a capital lease or for a securitization where
8 you're managing the securitization, and you're going to
9 provide all the liquidity when it gets into trouble, so
10 basically you still have the exposure. Should you just go
11 ahead and recognize it proportionally all the time and not
12 only when it hits bottom and you've got to come in as a
13 savior of the structure?

14 So, if you could talk a little bit about bright
15 lines in general, and whether you see it as a complexity
16 issue or whether you see it as something that could be
17 handled in a different way than have the bright line test.
18 Linda?

19 MS. BERGEN: Yes, I think bright lines can be
20 useful in certain circumstances if they are not
21 definitive on off switch but if they're giving you a sense of
22 what's the principle underlying the standard. So, for
23 example, using equity method accounting, there's
24 that 20 percent threshold for significant influence but it's
25 not a firm 20 percent, it's 20 percent and then you look for

1 the indicators of whether or not you in fact have significant
2 influence. But it gives you a sense of where the thought
3 process was in developing the concept of where it's
4 appropriate to use equity method accounting.

5 Similarly, well, let's see. It's kind of an
6 anti-abuse provision. And so, it says if you're
7 in this neighborhood, you ought to be considering whether or
8 not you have significant influence. And I think that makes a
9 lot of sense.

10 To use proportional recording, you might not be
11 able to do proportional consolidation for an equity method
12 investment that you have. You may not have access to that
13 information or you may not have it on a timely basis in order
14 to incorporate that information in your own financial
15 statements. So, I think you have some trouble there. Also,
16 how low would you go with your proportional recording if it
17 was 10 percent, if it was 5 percent? At what point does it
18 no longer make any sense to record your proportional share of
19 the assets and liabilities, revenues and expenses of whatever
20 it is that you're doing proportionally?

21 So, I think there should be some threshold before
22 you would even consider proportional recording.

23 MR. STEWART: I think, I would say that bright
24 lines have their place. I'm more upbeat about bright lines
25 than the tenor of your report. And I'll give you a few

1 examples where I think it's quite useful and some examples
2 where it's not including proportionate.

3 Let's say that the standard says you need to
4 classify cash and cash equivalents in a certain way which
5 Statement 95 says to do. So, what is a cash equivalent?
6 Now, if we sent Bob, he could come up with maybe a 92-day
7 cutoff, and Susan could be 30, and David could be, well,
8 anything that's trust preferred is okay because it's liquid.
9 Everybody would come up, I suspect, in good faith with a
10 different answer. And I'm not sure that's useful.

11 The FASB said 90 days is a good cutoff. I think
12 that's a very practical solution that results in
13 comparability, that the users understand. They know that
14 bright line, it isn't hurting anybody. Society wins because
15 everybody doesn't have to go out and create their own model.

16 On the other hand, lease accounting is I think an
17 evil bright line, if you will, and I think Statement 13 is
18 absolutely broken. The FASB is right to reconsider it. And
19 that plays well to a proportionate model. If you're leasing
20 half the life of the asset, then book half of the liability.
21 Absolutely.

22 Consolidation, it doesn't work proportionate. The
23 model is control. You either have control or you don't have
24 control. You can't do proportionate in that case.

25 So, I think standards setting is a real art and the

1 standard setters should use bright lines when it achieves a
2 particularly good outcome and should stay away from them when
3 they don't. And that's not easily defined, but I'm more
4 upbeat about bright lines than the tenor of your report.
5 There's a hundred examples, like the cash flow one. There's
6 two or three in 123R, there's a six-month test, there's a 5
7 percent test that actually are very helpful to practitioners,
8 and I think helpful to users understanding what the speed
9 limits are.

10 MS. RICHARDS: I would avoid the use of bright
11 lines unless they're really necessary. And I think that if
12 you can have a more robust principle and encourage looking at
13 the substance of a transaction, and I liked Hypothesis 3.2,
14 talking about training in substance and getting people to
15 step back and look at what, you know, instead of focusing on
16 rules - rules and bright lines -- what is it that I am looking
17 at here? What is the economic phenomena and accounting for it
18 in that way? And I know that would be judgment, that would
19 encourage judgment calls, but I think bright lines cause
20 complexity and structuring opportunities.

21 MS. BIES: Ben?

22 MR. NEUHAUSEN: In our comment letter, we suggested
23 a little bit different way of looking at it. The Committee
24 used the term proportionality, and we thought really another
25 way of looking at it is to say as the standard setter

1 approaches the accounting for a class of transactions, the
2 ideal would be to come up with one accounting model for that
3 class of transactions. So, for example, all leases, picking
4 leases as an example, all leases would be recorded on the
5 balance sheet by the lessee based on the right to use the
6 asset and the obligation to pay rent. So, we'd have one
7 model effectively say all leases are capital leases but you'd
8 measure them based on the terms of that lease rather than
9 having two different categories of leases: operating and
10 capital.

11 Now, we used to have two different categories of
12 business combinations, purchases and pooling of interests, and
13 a horrendous set of bright lines to differentiate them. The
14 FASB swept all that away with Statement 141, said all
15 business combinations are purchases. So, the ideal solution
16 is to have a single model for a class of transactions. But
17 that will not always work.

18 Now, there are some classes of transactions I think
19 the standard setters are going to conclude -- let's say it's
20 sales of financial assets, transfers of financial assets --
21 the standard setter most likely is going to conclude that
22 they don't all fall into one bucket. They are not all sales,
23 they are not all collateralized borrowings. And so, then you
24 do need some dividing line between the two different models.

25 And I think your report identifies three different

1 approaches. You talk about bright lines, you talk about
2 presumption, and you talk about indicators. And I think each
3 of those have their place in certain situations. You know,
4 Linda referred to the presumptive approach that we use for
5 non-controlled investments, deciding whether to use equity
6 method where there is ability to exercise significant
7 influence, or use cost method because there is not ability to
8 exercise significant influence. And the standard says there
9 is a presumption that 20 percent is the dividing line but you
10 can overcome the presumption based on the preponderance of
11 the evidence.

12 In practice, that has worked pretty close to a
13 bright line. I bet 99 percent of the time companies do
14 follow the 20 percent presumption, so the result is very
15 close to what you'd have for a bright line. But there is a
16 little bit of give at the margin and companies can look at
17 individual facts and circumstances.

18 Now, I think a downside there, when you have a
19 presumption and allow it to be rebutted is that only those
20 companies who want to rebut it are going to marshal the
21 evidence to rebut the presumption. It's not necessarily
22 going to be an even-handed analysis of all the facts and
23 circumstances.

24 The final point I wanted to make goes to something
25 that's in your report about economic substance. And I'm very

1 leery of thinking that accountants in practice can take
2 either a presumptive approach or an indicators approach and
3 analyze a transaction and come up with the economic substance
4 in a neutral way. I guess I've been in the profession long
5 enough and been through enough good faith arguments with
6 people who disagree vociferously about the economic substance
7 of transactions to think that that's going to get any
8 consistency in practice.

9 I think, ultimately, the economic substance has to
10 be judged by the standard setter. And that should be part of
11 the basis for conclusions in the standard, how the standard
12 setter analyzes the economic substance, and practitioners and
13 auditors should abide by that. I just don't think it's
14 feasible to have every practitioner, every preparer making an
15 independent judgment on economic substance because they will
16 be inconsistent. In good faith, they will disagree on the
17 economic substance of the transactions and they'll come up
18 with different accounting. And I just don't think that is a
19 feasible approach to have decisions --

20 MR. KROEKER: Bob, two quick things. I've been
21 told that people who have dialed in should now be able to
22 speak --

23 CHAIRMAN POZEN: Okay.

24 MR. KROEKER: And we have a request from those
25 listening online. I guess they're interested in what you

1 have to say and they can't tell who's talking, so if people
2 can introduce themselves before their comment, that would be
3 excellent.

4 MR. STEWART: This is John Stewart. I'd like to
5 pile on Ben's point about the economic substance. A long
6 time ago, when the FASB began consideration of securitization
7 accounting, it led to Statement 125. I was convinced that I
8 knew the economic substance of a securitization. And I
9 thought they were all borrowings, that they all belonged on
10 the balance sheet. And I wrote very lengthy letters and
11 articles about why I thought I was right.

12 I sent that to the Chief Accountant of the SEC at
13 the time who also I had great respect for or I had great
14 respect for, and he called me back and said, John, you're
15 absolutely wrong, that the economic substance of these are
16 sales. So, here I thought were two, I thought I was
17 principle-based, he was principle-based. I thought they were
18 all borrowings, I still think I'm right, by the way, and I
19 think he probably thinks he's still right, but he absolutely
20 disagreed with me about what the economic substance was.

21 So, we had the same facts. And if the standard
22 just said follow the economic substance, I believe that would
23 create chaos in our financial reporting. So, I agree a
24 hundred percent with Ben's comment.

25 SPEAKER: Right. Well, I do agree with Ben.

1 MS. BIES: Kevin Conn. Can I --

2 MR. CONN: Yes, Kevin Conn with MFS. I have to
3 admit that I'm much more of a fan of the proportionate
4 accounting model. I'm not an expert at lease accounting.
5 But the rule-based things for financials creates a lot of
6 exotic off balance sheet vehicles which are a testament to
7 the creativity of accountants but which are not -- you know,
8 in my investing career, many times those vehicles have come
9 back onto the balance sheet to create meaningful asset
10 losses, to create meaningful liquidity risks. And the
11 argument is that they're low probability or that they are
12 safe assets. But I've seen it too many times that they are
13 either unowned by any entity or that they are mismatched in
14 terms of asset duration, liability duration.

15 And I don't think that the issue is with the broad
16 sweep of off balance sheet assets and liabilities, but for a
17 portion of it. I think that there should be either more
18 disclosure or more estimates of probability of
19 coming back on balance sheet, or more. I mean, I don't know,
20 there is something in many financial statements, maximum
21 probable loss or maximum possible loss for off balance sheet
22 vehicles and for SPE's. And it's usually a huge number and
23 there is absolutely no reconciliation of how they got to that
24 huge number.

25 It can be tens of billions. It can be between 100

1 and 200 billion. And there is no explanation given for how
2 they got to that number. And yes, it's very, very unlikely,
3 but capital markets are volatile. They are unstable. They
4 are not liquid often. And so, to pretend that they are I
5 think is quite dangerous.

6 MS. BIES: Jeff Mahoney?

7 MR. MAHONEY: I generally agree with Brooke on this
8 point. I mean, we have a number of examples of bright line
9 tests that have created very detailed, voluminous guidance.

10 MS. BIES: Could you speak up a little louder,
11 Jeff?

12 MR. MAHONEY: Excuse me. We have a number of
13 examples of bright line tests that have created very
14 detailed, voluminous guidance to try to maintain that bright
15 line. And we have a number of examples of financial
16 engineering around those bright lines. The SEC staff talked
17 about this in connection with their report in response to
18 Section 401(c) in Sarbanes-Oxley. And they generally requested
19 that the FASB try to stay away from bright lines, and I think
20 that's the right approach.

21 I'm sure John is correct that there are some good
22 bright lines in the literature. But I think in general we
23 should try to avoid bright lines because of the problems that
24 result in the complexity of literature and the financial
25 engineering, neither of which are good for investors.

1 CHAIRMAN POZEN: Well, I think, I guess I was
2 trying to get some more reaction to what we might recommend
3 in the area of off balance sheet accounting. I think we all
4 agree that securitization is a positive development and we
5 don't want to close it down. I think the question is what
6 sorts of disclosures should the sponsors of off balance sheet
7 be making at what point, and what exactly should be there.

8 So, I was hoping that we could get some input. We
9 have some very big issuers here of -- users of off balance
10 sheet -- and I think sometimes it is a little disconcerting to
11 the investment community when all of a sudden 20 or 30
12 billion dollars are taken onto the balance sheet of a
13 financial institution. So, the question is what -- on the
14 other hand, we don't want people to disclose things that have
15 very low likelihood of probability so I'm trying to get some
16 input as to what -- might be a reasonable suggestion
17 for us.

18 I don't know, Linda, do you want to address that?

19 MS. BERGEN: Well, I think Citigroup is -- Linda
20 Bergen from Citigroup. We have greatly enhanced our
21 disclosures in our fourth quarter, our annual report, in our
22 10-Q that soon will be filed today. We've added even more
23 disclosures. We have extensive disclosures about the kinds
24 of off balance sheet vehicles we have, what our roles are
25 with respect to those vehicles, when we have made a decision

1 that we now need to consolidate a vehicle, what changed, what
2 caused us to have to make that decision. And we also provide
3 information on our maximum exposures about what we include in
4 those numbers. And we've also added a lot of information
5 about the key inputs in our valuation methodologies.

6 CHAIRMAN POZEN: So, when did that information on
7 liquidity puts get added?

8 MS. BERGEN: In the year-end annual report.

9 CHAIRMAN POZEN: I see. Now, I guess the question
10 is whether -- if I remember the literature, it sort
11 of says you're supposed to disclose informal and formal
12 obligations. So, I mean, was the general understanding that
13 liquidity puts did not have to be disclosed before the end of
14 last year?

15 MS. BERGEN: Well, they were included in our
16 maximum exposure because those were contractual arrangements
17 and they were in place. It's the question of when we had to
18 actually fulfill, perform on those obligations or when we
19 actually entered into new obligations that didn't exist
20 previously. That's what triggered the on balance sheet
21 activity.

22 CHAIRMAN POZEN: Kevin, do you have anything to say
23 about those?

24 MR. CONN: Well, no, the disclosure from Citigroup
25 in the last two to three quarters has been terrific. I

1 really have to say that the amount of detail and the level of
2 knowledge that an investor can take from that has been great.
3 The problem is if you go back to the first and second quarter
4 or to the 2006 10-K, I think with the rationale that it's a
5 low probability that things will come back on balance sheet,
6 a lot of the liquidity backstop lines were included in lines
7 of credit and sort of rolled up into a big number. And it
8 wasn't quite clear exactly what the exposure was.

9 So, the issue, and I've lived through many of these
10 off balance sheets coming back on balance sheet, created with
11 asset losses, and I go back and do some forensic accounting
12 and say, gee, what did I miss in the Q or the K that would
13 have pointed me to this big asset loss? And I am
14 consistently disappointed that I cannot find any clue or a
15 hint about this loss coming. And I don't think it's more
16 complicated than adding some sort of bond book type
17 description to the assets.

18 So, just as companies describe their current
19 investment book many of the things off balance
20 sheet are like securities books. Just add some description
21 of ratings, geography, and just a little bit more description
22 of what the assets are, because if it's a common line of
23 credit or if it's a common backstop line, that's not an
24 issue. But if it's something a little bit more exotic with a
25 different probability of coming back on balance sheet, then

1 that's something that investors should probably know about.

2 CHAIRMAN POZEN: Can I just have clarification on
3 this point? This is Bob Pozen. Are we saying that liquidity
4 puts, if they're contractual for instance, do not have to be
5 disclosed unless there is a probability of their being drawn
6 down?

7 MS. BERGEN: No, they're disclosed.

8 MR. CONN: No, they're disclosed off balance sheet,
9 but oftentimes some of the -- well, I'm sorry. Linda?

10 MS. BERGEN: They are disclosed. You know, we
11 disclose the kinds of contractual arrangements we have and
12 what we estimated our maximum loss could be under those. But
13 they were, Kevin is right, it was grouped in with larger
14 numbers.

15 CHAIRMAN POZEN: So, they are aggregated into --

16 MS. BERGEN: Yes.

17 CHAIRMAN POZEN: Con?

18 MR. HEWITT: Yes. Last month, Corp Fin issued a
19 letter concerning 157 and the letter was a clarification
20 relating to GAAP. The letter focuses on movements in and out
21 of level 3 hierarchy in 157. They felt the users needed more
22 information as to what went into that number created through
23 your assumptions and range of values and those types of
24 things. And we purposely put it into MD&A on the premise
25 that this financial crisis and this problem that we have with

1 level 3's will go away sometime in the future as opposed to
2 putting it into the footnotes. So, we think it would be
3 helpful for the users to have the additional disclosure, these
4 level 3 items.

5 MS. BIES: I want to follow up, Con, on what you
6 just said because I think this is one of the challenges that
7 the current situation I think is bringing to the fore.
8 Organizations who are heavily involved in creating and
9 managing these kinds of structured instruments I think do a
10 good job of estimating the risks that they see in there but
11 they are risk-based models. And most of them are not very
12 effective at dealing with systemic risk which is what we've
13 got now. A large part of this is sort of an uncertainty of
14 what could happen.

15 And so, if you look at the Basel Banking Committee,
16 it's one of the things that we struggled about over the
17 years, you can look and base risk models on what has been
18 observed historically. But when you get a systemic event
19 that is so widespread, the models don't capture that.
20 They're not robust enough to imagine what could happen when
21 it goes beyond one player who is not a material part of that
22 market.

23 And that's one of the challenges I think, and
24 whatever we do, whether we stick with bright lines or go to
25 proportionality, whether we need to recognize that the

1 uncertainty which is what I call this unmeasurable piece, is
2 something that we just have to realize cannot be quantified
3 in a meaningful way. We can maybe try but everyone needs to
4 realize it just can't be measured. The Basel Committee is
5 still trying to figure out how to measure liquidity risk
6 which is a central part of all of this.

7 There is, you know, people have been working on
8 this for years who are experts. There is no real model out
9 there to deal with this effectively that anybody is totally
10 happy with. And I'm just wondering if more of the kind of
11 descriptive information would be much more useful than trying
12 to quantify a lot of these things and these instruments. And
13 are we so focused on moment-in-time fair value kind of
14 disclosures instead of the more qualitative that could maybe
15 lay the framework for a user to know what is out there from a
16 contingency perspective of these unusual events? Would that
17 be more useful instead of focusing so much on what drives a
18 lot of the recognition.

19 MR. STEWART: This is John Stewart. Kind of pick
20 piling on Citigroup some more. I did not, I have not
21 conquered reading their annual report. It's 200 pages with
22 one small picture and it's a lot to read. But there was one,
23 I did bump across one table that I thought was exceedingly
24 helpful to me. I'm not an investor but that I thought would
25 be helpful. It's like on page 86 where they have like three,

1 I think it's, help me out here, Linda, three or four
2 columns.

3 They have all their SPE's in this one table. They
4 have those that are QSB's and therefore are presently not
5 consolidated, but they got all the numbers there and by
6 category like credit cards and whatever. Then they have
7 those that are VIE's covered by FIN 46R, and those are broken
8 down into two columns, one on balance sheet and one off
9 balance sheet. And then a grand total of everything, and by
10 type.

11 So, it's your point, Susan, they don't try to
12 evaluate necessarily everything, but you have all the gross
13 numbers in a pretty format, for just a couple of pages, that I
14 really learned a lot and I thought was very good.

15 MS. BERGEN: Thank you.

16 MR. STEWART: Did I have the right page number?

17 MS. BERGEN: I think so.

18 MR. NEUHAUSEN: One thing that I would encourage
19 here, at the risk of jumping ahead to your preliminary
20 Hypothesis 5 which comments that historically disclosure
21 standards have developed in a piecemeal manner, and that this
22 would maybe be a good place off balance sheet to try and do
23 it in a more systematic way and integrate the GAAP
24 disclosures with the MD&A disclosures and the subject
25 disclosures that Conrad Hewitt just mentioned, and the SEC's

1 off balance sheet disclosures, try to pull it all together in
2 one place in an integrated way.

3 MS. BIES: Thank you. All right. Let me move on
4 to the last area that we have proposed that we'd like to get
5 your comments on that really deals with a lot of the
6 exceptions and industry specific rules that are out there.
7 We're thinking here about, again, complexity. And
8 so, why do we have special rules for special industries when
9 what we really need is a good general principle?

10 And Bob Herz won't be surprised at this, to me one
11 of the keys is revenue recognition where those of us in the
12 EITF for years, a lot of the cases that came to us were
13 because we didn't have a good revenue recognition standard.
14 Another example is why does oil and gas have a
15 separate type of accounting than other extractive industries?
16 And I can go on and on.

17 And we also touched a little bit earlier about the
18 alternative accounting where sometimes you can account for
19 things in different ways. So, we wanted to know in terms of
20 again our mission of thinking about ways to deal with the
21 complexity issue. Are the types of things we have sort of
22 raised for discussion here today areas that we should
23 continue to pursue? Do you like the direction we're going
24 in? And we're open to comments in any of these that you all
25 may have. Mark?

1 MR. BIELSTEIN: Let me speak to industry specific
2 guidance. And generally speaking, my view is that industry
3 specific guidance is not necessarily all bad. I think there
4 are probably opportunities to get some of the variations out
5 of that. But before you talk about industry specific
6 guidance, I think it's necessary to talk about, to kind of
7 break it into two parts and appreciate that there is a wide
8 spectrum here. But to some extent, there is industry
9 specific guidance that creates specific industry models. For
10 example, investment company accounting, in that it's just a
11 very different fundamental accounting model.

12 I'm not sure we want to do away with the way mutual
13 funds report their financial information. That seems to me
14 to be a pretty useful approach. But that is a very different
15 fundamental model, so I would not try and do away with mutual
16 fund accounting. Or another one would be broker dealer
17 accounting, similar to that. So, those are kind of different
18 fundamental accounting.

19 The other industry type guidance I think generally
20 has been developed over the years in an attempt to apply the
21 general principles of what we have in other accounting areas
22 to specific transactions in those industries. For example,
23 oil and gas. Those issues about oil and gas accounting and
24 what do you capitalize when you drill an oil and gas well are
25 kind of unique to that industry. And there are a number of

1 those kind of areas where that kind of industry guidance
2 might very well be appropriate because the transactions are
3 unique to the industry.

4 Now, I do appreciate the fact that in revenue
5 recognition, for example, there's probably ways that you
6 could bring some of that closer together. But for the most
7 part, I think that even the revenue recognition guidance
8 primarily developed because people were trying to take the
9 general principles of revenue recognition to the extent we
10 had them. Is the earnings process complete? Is the sales
11 price collectable? And try and apply it in specific fact
12 patterns. And I'm not sure that's all that bad.

13 MS. BIES: Linda?

14 MS. BERGEN: Yes. I would second part of what Mark
15 is saying in that industry guidance isn't all bad. I think
16 where industry guidance runs into problems is when the
17 industry guidance is describing activities which may be
18 performed by entities that fall within the official scope of
19 that guide or it may be performed by entities outside the
20 official scope of that guide, so that if you were to take
21 those industry principles and let anyone who has comparable
22 activities use those same sets of principles, I think you
23 would get a better accounting solution. And I think that is
24 very much in line with your move towards activity-based
25 accounting.

1 MR. STEWART: Yes. This is John Stewart. I
2 thought you guys were off base, to be blunt, on the
3 specialized industry for two reasons. One, definitionally,
4 you got it wrong. You know, you say mortgage banking isn't
5 specializing. Statement 65 applies to anybody who does
6 mortgage banking activities. It isn't limited to mortgage
7 bankers. Software development, revenue recognition applies
8 to everybody who develops software, not to a specialized
9 industry. BDO Seidman made these points in their comment
10 letter and I think they're right on.

11 There's a number of things where I think you got it
12 wrong in terms of that being a specialized industry. It
13 absolutely is activity based just like you're recommending.
14 But you're criticizing, I think, those particular standards
15 because they're industry; they're really activity based.

16 Secondly, I think there is a market need for
17 incremental guidance. I one hundred percent agree with Mark
18 and Linda that AcSEC and other bodies, they aren't just making
19 this up for fun. I mean, there has been an expression of a
20 need, there is a void, to help practitioners take general
21 standards and get them down to their particular industry, the
22 airline industry or whatever.

23 So, I think you guys are off base on this industry
24 thing. You are too harsh on it. It is useful and I think
25 you definitionally got it in part of it wrong. So, that's

1 kind of blunt but that's what I think.

2 And I don't put it in the same category. You teed
3 this up as these are all about exceptions. I don't think the
4 industry guidance is necessarily an exception from our
5 general accounting standards. So, I don't put industry
6 guidance with the scope exceptions or alternative models at
7 all. I think they're a completely different category.

8 MS. BIES: Any other comments on this topic? All
9 right. I guess we've got a couple of minutes, so I guess,
10 why don't we conclude by letting any other members of the
11 Committee, anybody else have any questions? Jeff?

12 MR. DIERMEIER: On all topics? Just a point of
13 clarification earlier, maybe related to something you said,
14 Kevin. My understanding, and Russ certainly could clarify on
15 this, and that is that 157 suggests that companies should not
16 basically value assets at fire sale prices. Is that correct?

17 KEN: You're right.

18 MR. DIERMEIER: Okay. So, that gets to the issue
19 that Joe mentioned, this is Jeff, Joe might have mentioned
20 earlier, and that is I think the entire effort here seems to
21 be focused on trying to come up with an unbiased estimate of
22 what might be the current value. Even for a current value of
23 a loan, just from the standpoint of an investor, there are
24 transactions going on in the marketplace at securities prices
25 and they're doing that on the basis. It's just like looking

1 at an NAV for a mutual fund, trying to understand basically
2 as much information as they can about the nature of the
3 business and a loan that may be deeply
4 underwater but likely in the future could generate a higher
5 rate of return because it's basically in difficult shape.
6 And as a result, at this point in time going forward, has a
7 higher risk premium. And therefore, might earn a higher rate
8 of return but there is risk that it may not pay off at all.

9 It's something that is very valuable to the
10 marketplace in understanding the kind of book because you're
11 comparing two companies that on the surface look
12 identical, but one is running a much higher book of business
13 than the other. By definition, the marketplace needs that
14 information to be able to put a different risk premium and
15 price listings differently.

16 So, it seems like there's a little
17 bit of misunderstanding here about the notion of,
18 certainly in the current marketplace a lot of people think
19 securities have been marked down to a level that they're
20 bound to bounce back. Well, that's quite a market judgment.
21 As a former investment professional running a firm, try doing
22 that all the time, I'll tell you our performance would have
23 been just terrific.

24 At the same time, we also could look at some cost
25 price values that are out there and you could say, "Well,

1 they're certainly not very representative." They are clearly
2 biased from that particular standpoint. So, the effort here
3 to try to come up with an unbiased estimate I think is really
4 what we're talking about in terms of a lot of these
5 financials.

6 But there seems to be a lot of confusion, Kevin,
7 out there in terms of the notion that firms
8 somehow are marking down to fire sale prices. Why do you get
9 the sense of that?

10 MR. CONN: Well, one example of that is, I'm not
11 going to name the name of the company, but they have an
12 asset-back security that's backed by student loans that is
13 guaranteed by the federal government trading at 87 cents on a
14 dollar. And many people in the room probably say that's
15 worth, the federal government is probably worth 99 or 100,
16 you know, a dollar, and yet they are forced to take a 12-cent
17 mark on that. And they try to describe that to investors and
18 of course we're skeptical sorts by nature and we're like, you
19 know. But the burden on the company is to go through and say,
20 "Look, these are irrational prices."

21 I mean, and I don't know how you define this, it
22 goes back to how you set pricing, but that's clearly one
23 example that it's irrational. And many will say, "Look,
24 they're not going back to par but they're not worth 40 cents,
25 and if you make us mark into 40 cents, then we're going to

1 have a huge balance sheet problem. We're going to have to
2 issue a lot of equity, and then we'll be overcapitalized a
3 year out when these things bounce back."

4 And I do think it varies asset class by asset
5 class. Obviously, the student loans that are federal
6 guaranteed are a unique example. There are some that are not
7 coming back. But that's sort of a lot of the dialogue around
8 fair value that's going on right now.

9 MR. DIERMEIER: Which gets a lot to the --

10 MR. CONN: Sorry?

11 MR. DIERMEIER: To the accounting versus
12 regulatory/statutory capital issues. In the paper itself, in
13 the document, one can read it one way. One can read this as
14 to say that we're suggesting that the FASB needs to slow
15 down, that they've gone too far, that they've been too
16 aggressive with fair value accounting. Is that the sense of
17 the panel? Or is the panel's sense as mine is, the sense of
18 PriceWaterhouseCoopers, CRUF and ourselves and the CFA
19 Institute that actually they're doing a pretty fine job about
20 this?

21 We want you to get into non-financials, I can
22 understand why that is a whole different kettle of fish but
23 -- I'm sorry, I shouldn't say whole, right, because once you
24 get to real estate property in the value of McDonald's
25 properties in terms of the real estate, it gets a little

1 closer, of course there's those kind of things. But what's
2 your sense in terms of the FASB in their attempts to handle
3 this whole fair value issue?

4 MR. STEWART: I wouldn't restrict them if they
5 thought that was useful, but that they need to talk to users.
6 You know, on the non-financial, none of the surveys I have
7 seen have led the users to be crying for fair value
8 information. Mr. Grundfest raised that question earlier. I
9 think users aren't interested in it from what I can see.
10 Their non-financial things are quite different than financial
11 things because a treasury bill is worth the same
12 whether Susan holds it or David holds it, but a plant can be
13 worth very different things depending on how it's used.

14 And so, but I would, if I were you, I would not
15 recommend that the FASB restrict them or require
16 them not to do more fair value. I'd leave it up to them, the
17 FASB and the IASB. I mean, I think they should be cautious
18 about it and let the marketplace catch up in terms of how to
19 do it in operationality issues. But I don't think your panel
20 should say stop or anything like that.

21 MS. RICHARDS: I agree. As I said before, I do
22 like fair value, that I would move slowly, take caution and
23 make sure that it's operational and useful.

24 MR. BIELSTEIN: This is Mark Bielstein. I guess
25 just to follow on with my earlier comments, I think there's

1 really two sides to fair value. One, the user perspective,
2 and I'll let the users address that. From the preparer or
3 auditor perspective, although there are challenges in trying
4 to deal with fair values particularly when you're getting to
5 level 3, I think as I said earlier, I believe overall the
6 use of fair value for financial instruments will eliminate
7 more complexities than it creates from the preparers, the
8 auditors in just many of the issues that we deal with.

9 MR. MAHONEY: Jeff Mahoney. I agree with that
10 comment.

11 MR. SIDWELL: Can I ask a follow on question to
12 Kevin? Some of I think why fair value was being used for
13 financial instruments is to make it irrespective of intent.
14 In the example you gave where you have a difference between
15 the current price of a security or instrument and what is
16 perceived as fundamental value, in that scenario, the one you
17 gave, how do you feel if a company begins to sell those
18 securities? So, it begins to realize the current marks they
19 have it valued at, and basically the marks they had are very
20 close to the transactions that they have.

21 So, for instance, Coulter & Company's 331 has those
22 securities valued I think you said at 60 cents, 70 cents on
23 the dollar and -- to realize a portion of that portfolio at
24 those marks. How do you feel about that? And how would you
25 deal with the fact that as people look at concentrations,

1 people tend to say, you know what, irrespective of
2 fundamental value, I have an over-concentrated position, I
3 don't want to continue to have that level of risk so I'm
4 going to begin to transact?

5 I think if you look in history, whether it was the
6 Latin America or LDC issues in the 80's, whether it was the
7 highly leveraged transactions sort of a little after the LDC,
8 there's always this history of people saying the markets have
9 now changed. It's about almost as Susan's point about
10 systematic risk, that people say I'm too concentrated, I no
11 longer want to take this risk, I'm going to reduce my
12 positions when I can. How do you reconcile those two views
13 in what you are suggesting?

14 MR. CONN: You know that you raise a great
15 question, David. I just, some of the observable prices, if
16 you apply them, you know, say someone wants to sell
17 a small piece of a portfolio and you observe those and
18 you think the price is irrational. So, the 88 cents on the
19 dollar for the federally guaranteed student loan ABS, should
20 that firm go price all their student loan ABS's at 88 cents
21 on the dollar? I would say that feels unfair to me. That
22 feels like too harsh a mark.

23 So, do you have to mark entire books to that low,
24 distressed observable value in a time of crisis, I think is
25 not fair to the companies. Now, I want to make sure that I

1 say this, Dave, in the context that I'm a huge believer in a
2 migration to fair value accounting in general. So, that's
3 the context of it.

4 But some of the prices now are creating activities
5 within financials which I think are not productive. So, and
6 some of the markets are not liquid and potentially
7 the treatment, a level 3 treatment or a non-mark to market
8 type or a mark to model approach to fair value is more
9 appropriate than marking to an observable price.

10 MR. SIDWELL: Because it does seem to me, just to
11 push it down a little bit on this, that if you again look at
12 any of these periods in our history, that what the analysts
13 then do is get the detail of the notionals or some other
14 means of saying I now need, I cannot form a judgment about
15 what marks I would apply, and basically value the whole
16 portfolio that way irrespective of holding.

17 So, I guess I'm struggling a little bit with this,
18 how you lay into this view that some day if it all goes well,
19 they can hold it longer so they'll get more value from it
20 which I view is an investment decision separate from how you
21 value a financial statement today decision. You may want to
22 disclose information that enables people to gather that, but
23 I think history has told us that investors, because I
24 remember the tables about lots of developed countries and it
25 was very explicit what countries and investors put a specific

1 or analysts put a specific mark against -- country and said,
2 you know, X bank is undervalued to the tune of X
3 billion dollars based on those marks.

4 So, I don't know how we implicitly put into an
5 accounting model this aspect of duration of being able to
6 hold on to something to realize fundamental value.

7 MR. CONN: You know, it's very hard, David, to
8 defend having assets on bank balance sheets that are
9 way off fair value for long periods of time. I'm not
10 suggesting that in any way because that can create a whole
11 other set of issues.

12 MR. McCLAMMY: Susan, can I? I just wanted to
13 clarify the position because there is some discussion of we
14 shouldn't tell the FASB to stop their efforts in looking at
15 fair value. A recommendation was that they should be
16 judicious in expanding the use of fair value until they finish
17 their measurement framework process. In no way it was saying
18 stop, it was just saying think and, as someone
19 said, proceed cautiously until you have that framework in
20 place.

21 And I think we even carved out a couple of areas
22 like 133 that we said we thought it desperately needed to be
23 looked at on the hedge accounting fund and don't wait until
24 you finished the framework to look at that. I think behind
25 that was more an air of concern when we said be judicious,

1 think about where you're heading until you have that
2 framework in place, related not so much to financial
3 instruments and re-looking at how things are
4 currently being done like hedge accounting. It was more our
5 sense that there seems to be a trend moving in the area of
6 more to non-financial assets and liabilities with 141
7 certainly being an example of that, so saying just
8 be cautious of expanding it into these kind of, these new
9 areas before we have that framework.

10 MR. GRUNDFEST: You know, correct me if I'm wrong
11 but I think the general consensus of the Subcommittee is that
12 fair market accounting is a very good idea, but we
13 have various concerns about how the idea is implemented, all
14 right. And it's easy to implement in some situations under
15 some circumstances, and I think people can easily embrace it.
16 In other situations, people say fair market value and they
17 assume that simply using those three words solves all
18 problems when the reality is very different and it's very
19 messy and it's very ugly and people just hope that they can
20 slide over the fact that the plumbing doesn't work by simply
21 saying fair value accounting.

22 And the problem is it's difficult dealing with a
23 standard that people can't implement effectively, especially
24 at a time when it's most important that the standard be
25 implemented effectively.

1 MR. STEWART: I think your recommendations would be
2 buttressed if you could cite some evidence like user surveys
3 and things. I don't recall that being in your report, maybe
4 it is, but you know, that's what we're all about, right,
5 helping out these users? And I didn't see much reference to
6 them that I recall in your report, supporting the conclusion
7 you just articulated. This is John Stewart.

8 MS. BIES: Okay. Jeff has the floor next and then
9 we'll come back.

10 MR. DIERMEIER: I just had a question for Linda, and
11 maybe it's old biases or concerns about European banking
12 institutions. But on the loan portfolios, and I guess some
13 of the work that we've done recently suggest that less than
14 20 percent, maybe 18 percent of the pools of assets are
15 actually now characterized as held to maturity so that that
16 categorization is going down quite a bit. But does it
17 encourage additional risk-taking on the part of the financial
18 institution if in fact their loan portfolios don't have to
19 see current sunshine?

20 I know it's been a concern of a lot of our
21 investors in terms of the way a lot of the European banks
22 have conducted their businesses over the years, apologies for
23 those on the phone. But our sense is that this sunshine of
24 having to try to mark those to market because there are very
25 active marks out there in the marketplace,

1 you can sell your loans at above par value so to speak.
2 Aren't you concerned that basically holding loan portfolios
3 at cost and not reflecting the true volatility that is
4 associated with those securities encourages excessive risk
5 taking? Or do you think that somehow the Basel rules or risk
6 rating somehow solve for all that?

7 MS. BERGEN: No, I don't think that holding loans
8 on your books at cost less an allowance inspires you to take
9 additional risks. And I think your statistics are not quite
10 right about the percentage of loans that are held for
11 investment versus held for sale. I think a much greater
12 proportion are actually held for investment if you look at
13 loan books versus what's actually categorized as loans held
14 for sale. I can't give you a number. Certainly, at
15 Citigroup that's not accurate.

16 I think that the allowance process is a very
17 troubled process because of what GAAP requires today, and
18 that is that it doesn't allow you to take into account
19 estimates for loans that have not yet been evidenced
20 deterioration in value. It has to be inherent in the loan
21 already. That doesn't make a whole lot of sense to me.

22 But to require that you record loans at fair value
23 may or may not be appropriate depending on the kind of loan
24 it is. Yes, credit card receivables can be securitized.
25 Yes, Citigroup is a huge securitizer of credit card

1 receivables. Mortgage loans can be securitized but there are
2 many other categories of loans that are not quite, that don't
3 have an actual market for them, of various commercial loans
4 you're not going to securitize.

5 MR. DIERMEIER: But you would agree though that most
6 of the change in those values would be due to general
7 interest rate conditions?

8 MS. BERGEN: And credit. Oh, the changes --

9 MR. DIERMEIER: And credit.

10 MS. BERGEN: And credit. Clearly, credit is a big
11 factor with loans.

12 MS. BIES: Okay. Greg, do you have a question?

13 MR. JONAS: I want to address industry guidance to
14 come back to that topic for just a minute because I, let me
15 replay back what I think I heard. I want to make sure I got
16 it right.

17 It seems to me that those of you who, and I think
18 it was most of you, who are fans of industry guidance were
19 fans to the extent that the industry guidance is activities
20 based and apply to all transactions across all industries of
21 that type. So, really to the extent there's activities based
22 guidance in industry guidance, it's really a misnomer to call
23 it industry guidance. It's really transaction guidance, no
24 different than the transaction guidance that exists all over
25 the literature.

1 But I would also think that there are some examples
2 of industry guidance that are just plain industry guidance
3 that contradict, if it wasn't an activity being done in that
4 industry, the accounting would be different. Are there no
5 such examples of pure industry guidance that contradicts
6 general guidance? And John, you are articulate in this
7 matter.

8 MR. STEWART: I think there are some. But if you
9 go down the list in your Appendix B, you know, a lot of them
10 are activity based.

11 MR. JONAS: Yes.

12 MR. STEWART: You list them as
13 exceptions, kind of bad, and they're not bad. They
14 are activity based.

15 MR. JONAS: Right.

16 MR. STEWART: In addition, even the ones that are
17 industry based, I think in part they're trying to apply a
18 broad principle. You know, like there are some special
19 transactions, AcSEC is working on airlines, Ben, you could
20 help me out on this, you know, what's a lease? Well, there
21 is a broad standard that tells you what's a lease. Well,
22 it's in EITF Issue 01-8. But in applying that to the airline
23 industry, it's helpful to get some incremental thoughts from
24 experts so that practitioners don't have to invent it
25 themselves. It seems like that's a good thing for society

1 that people don't all have to go research exactly how 01-8
2 applies to airlines.

3 So, I think you're right, Greg, there are some that
4 are like that. But I don't think, on balance, I think having
5 grown up in specialized industries as a young auditor, banks,
6 insurance companies, broker dealers, we would have been lost
7 without some industry guidance. Our clients would have been
8 lost. We auditors would have been lost because the broad
9 standards are way too broad to be operational.

10 So, on balance, I am in favor of industry guidance.
11 I think your report is on balance negative. And yes, it's
12 not pure either way, but on balance I think you're on the
13 wrong track.

14 MR. JONAS: And just one follow-up with you
15 specifically on that. To the extent that we could find
16 examples in industry guidance where it's just plain industry
17 and it contradicts general guidance elsewhere, would you be
18 in favor of at least getting rid of that?

19 MR. STEWART: Yes.

20 MR. NEUHAUSEN: And I think Mark Bielstein, this is
21 Ben Neuhausen, I think Mark Bielstein made that point, too,
22 that there is some cleanup that could be done. But I think
23 the overall tenor of the report way overstates the problem
24 and it ought to be focused more on these narrower situations
25 where there is some very specific industry guidance that's

1 inconsistent.

2 MR. STEWART: If you guys ban it, it will come
3 back. I mean, it's market driven. It will happen. Either
4 the accounting firms will do it or somebody will do it. It
5 will happen.

6 MR. BIELSTEIN: This is Mark Bielstein. I guess to
7 follow up on that, I'm not sure you can just automatically
8 say you get rid of all of it, Greg. I think there are
9 certain instances where you might look at that and say it's
10 still good. For example, the investment company accounting,
11 it's just a different model. It says if you hold an
12 investment that might otherwise be an equity method
13 investment or a controlled entity, that an investment company
14 doesn't consolidate an operating company. My reaction is
15 that's probably the right answer, but it is different than
16 what we would do in other situations.

17 I'm not sure, if you really have an investment
18 company, whether it's useful to start consolidating operating
19 companies into that, in their financial statement
20 presentations. So, there might be a very limited number of
21 those situations but there probably are some.

22 MR. STEWART: This is John Stewart. On that point,
23 I think, Greg, you could even argue that an investment
24 company is activity based. If other people did exactly the
25 same activity and didn't have the label investment company, I

1 think the accounting should be the same. Investment
2 companies aren't the same as operating companies, and
3 therefore, that's activity based.

4 MS. BIES: But let me follow up on that. This is
5 where I think we're trying to make the distinction. When the
6 investment companies do take, as is happening now, the lines
7 are blurring with say private equity firms, others where
8 they're taking large enough stakes that they can exert
9 control, should that portion of their portfolio be accounted
10 for just like anybody else on equity method?

11 MR. BIELSTEIN: This is Mark Bielstein again. As I
12 said, if you've really got a good definition of an investment
13 company, and I've had the opportunity to spend a lot of time
14 trying to do that in some work on AcSEC with Ben, I don't
15 think it's necessarily useful to consolidate those operating
16 companies. But that's an issue that obviously different
17 people have different opinions on.

18 MR. McCLAMMY: But shouldn't it come down to
19 whether they're exerting control? Or if they have a
20 significant enough stake, it's hard to believe they're
21 sitting inactively on the sidelines.

22 MS. BERGEN: This is Linda Bergen. I think
23 the cue there would be whether they're participating in the
24 governance of that institution because it fits in with their
25 own operations or if it's to ensure that their investment

1 comes to fruition. I mean, the ultimate goal, if you're an
2 investment company, is to realize a gain when the investee
3 either goes public or is sold so that the investors will
4 realize a profit. You're not doing it because you're in the
5 business of doing whatever it is that investee does.

6 And to make an investment, if a financial
7 institution, for an example, makes an investment in a
8 telephone company, of what possible value would it be to put
9 a bunch of telephone poles on the financial institution's
10 balance sheet? It just isn't meaningful information, even
11 though there might be control being exerted for a certain
12 period of time until that investment is sold.

13 MS. BIES: But I'll play devil's advocate to the
14 extent that financial institutions, as part of their
15 derivatives trading in energy in that they are getting into
16 activities to manage production of power. Should they not
17 then go to equity method on those?

18 MR. McCLAMMY: So, the telephone poles don't go on
19 but their earnings or the losses go on.

20 CHAIRMAN POZEN: I do have to speak up for mutual
21 funds -- I tend to be sympathetic with the notion that of all
22 the industry specific standards, they're actually probably a
23 stronger case for them than others, not surprisingly. But I
24 think it's a rare case when a mutual fund is actually
25 exercised in the control --

1 MS. BIES: Right.

2 CHAIRMAN POZEN: This is an unusual case. And
3 maybe in that exception, there should be a difference. But
4 it's an extremely rare case.

5 MS. BIES: Right. And I think that's the only
6 point we were trying to make, it should be investment
7 activities rather than everything in that company treated the
8 same way to look at the individual activities, what we were
9 trying to get to.

10 MR. McCLAMMY: I'm sorry. One of the places that
11 we thought it created a lot of complexity of having industry
12 specific guidance is that if someone talked about, well, what
13 if someone else has that type of activity? You know, should
14 they then be applying that industry specific guidance? And
15 there's, I think there's a huge amount of effort that goes
16 into people then trying to keep up with all the different
17 industry guidance and saying where might my transaction fit
18 into one of these other industries.

19 And every time the FASB looks at a new
20 pronouncement, shouldn't they be addressing where all the
21 exceptions are in those different industries, and then
22 addressing not just let's push them aside but they really
23 should be going through industry by industry and saying does
24 that exception still apply or should that industry be swept
25 into this broader standard? So, it may be a good thing. I

1 think it clearly, for the overall, particularly preparers and
2 also users, I think it does create an overall complexity.

3 MR. STEWART: This is John Stewart. But I think
4 the point some of us are making is that your report defines
5 this incorrectly. You list as industry specific software
6 development. I think Statement 86 et cetera deals with all
7 industries that happen to develop software, all of them. It
8 doesn't just deal with people who say they're a software
9 development company.

10 MR. McCLAMMY: Was that in the appendix?

11 MR. STEWART: Yes.

12 MR. McCLAMMY: Yes, I've --

13 MR. STEWART: Well, there's a whole list of them.
14 It's just not, oil and gas is the same. Anybody who does oil
15 and gas accounting follows Statement 19 et cetera. Mortgage
16 banking, everybody who does mortgage banking follows
17 Statement 65. So, I think you definitionally are off base
18 with saying that those are industry specific. They're not.

19 MS. BERGEN: Can I just address -- this is Linda
20 Bergen. Can I address the question of complexity that Ed
21 raised? I think that complexity is not going away
22 because the complexity in accounting principles is a
23 reflection of the complexity in the business world today.
24 And that is going to be with us. It's only a question of how
25 we get our hands around that complexity and develop an

1 understanding that can be then communicated to investors.
2 So, one way or another, we're going to have to deal with
3 complexity.

4 MS. GRIGGS: I wanted to go back to the
5 reconciliation chart because both Linda and John made points
6 that I would like to understand better. I'm not an
7 accountant, I'm not a preparer, I'm a lawyer. So, I want to
8 understand what the consequences of the recommendation are.

9 I thought, as an observer of financial information,
10 that reconciliation would be very useful. But I'm troubled
11 by John and Linda, your observations that it might be
12 difficult because after all our mission is to reduce
13 complexity, not increase it. So, if you could just give me a
14 little color on your observations that it might not be doable
15 to do that reconciliation, I'd appreciate it.

16 MR. STEWART: Ladies first.

17 MS. BERGEN: Ladies first. This is Linda Bergen.
18 I think what I was trying to say is are you trying to get at
19 the cash flows or the accruals that are on the books at year
20 end? Because if so, you are already disclosing that in your
21 balance sheet. Or are you looking for all the revenues that
22 were accrued during the course of a year? And then, what
23 portion of those were collected? That's very different
24 information. So, you'd have to be clear about what it is
25 you're asking people to do.

1 In terms of recurring valuation changes, I think
2 you have an easier way of getting at it simply by asking
3 people to disclose either on the face of the income statement
4 or in a footnote what portion of their transaction revenues
5 are mark-to-market. Principal transactions is typically
6 where a broker dealer or a bank shows the changes in value of
7 their securities portfolios so that, you know, you'll have
8 that information which is in your column D. Column E,
9 impairments, are already disclosed in a number of different
10 footnotes on the financial statements. If you have
11 impairments to your intangible assets, that shows up in the
12 intangible note. If you have other sorts of write-downs,
13 they do get disclosed.

14 So, maybe you're pulling it together in one place,
15 that's possible. But I am not sure going through the
16 exercise of trying to reconcile this is very useful. Then I
17 think for a financial institution, you have a
18 whole different question of how do you categorize things. A
19 loan for a financial institution is not an investing
20 activity, it's part of their operations. And therefore,
21 the --

22 MS. GRIGGS: But isn't that
23 inherent in your cash flow statement already?

24 MS. BERGEN: Well, but in the cash flow statement
25 today, loans are required to be shown as investments

1 regardless of whether you're a financial institution.

2 MS. GRIGGS: Which should be following that same
3 categorization. But what I was asking is, is this doable? I
4 understand that you think the information is all available
5 other places. I just thought you had said it wasn't really
6 doable.

7 MS. BERGEN: Depending on how you set up the rules
8 on what you're looking for, I think you could have very
9 different answers. For example, if we had to show how much
10 money came in through our deposits and how much went out as
11 withdrawals from accounts, you'd be looking at numbers in the
12 tens of, or maybe hundreds of trillions of dollars on an
13 annualized basis. Is that information overload? Is it
14 useful? I'm not sure it is.

15 MR. STEWART: I was going to comment. Go ahead.

16 MR. HERZ: I was just going to say, I mean, the
17 schedule is very much like something we have been working
18 with. And the approach as to what's investing versus
19 financing versus operating would be within certain boundaries
20 of management decision. They'd have to then describe what
21 they think is operating. For example, as to, you know, these
22 are what we think are our operations and describe that,
23 obviously for financial institution, Linda says, a lot of
24 what might be -- as investing or financing or somebody else
25 would be part of their operations.

1 MS. BERGEN: Yes, as long as they have flexibility
2 in the description of what can go into those various
3 categories, you can have it at least come up with an answer
4 that makes some sense.

5 MS. GRIGGS: I'm not saying it's not doable. That
6 was my basic question. Is this doable?

7 MS. BERGEN: It would require gathering all kinds
8 of data that isn't currently collected.

9 MR. STEWART: I'd have three points. One, I don't
10 know whether it's useful or not, I'm not a user. Second, I
11 do understand the FASB is pursuing it. My point was an
12 operationality point, not a bookkeeper point if
13 you will. I thought column C, D and E would be in practice
14 difficult to distinguish. They all have similar things.

15 So, if you mandate that we have to have a C and a D
16 and an E rather than have them all together, that would be
17 hard. That would be, how do I distinguish a recurring
18 valuation change from an other, help me out, hum a few more
19 bars as my friend Greg Jonas says sometimes. Could you help
20 me with that? I don't, you would have to have a lot more
21 guidance and detailed rules, principles, bright lines to help
22 make those distinctions.

23 MS. GRIGGS: That's helpful, thank you.

24 MR. McCLAMMY: Wait, wait. Aren't you doing that
25 already when you use phrases like extraordinary?

1 MR. STEWART: We almost never have extraordinary
2 anymore. We have basically eliminated the notion of
3 extraordinary. The FASB has.

4 MR. McCLAMMY: I think most of what we had in that
5 column, and this was basically pulled from something that the
6 FASB is looking at, but those two columns you can almost look
7 at as a recurring and the other valuation changes that is
8 changes in fair values, and whether those were just, if you
9 look at one, it's fair values that you would probably be
10 changing over a quarter, and the other would be a specific
11 event impairment that happened, that would change the value.

12 So, whether those columns are the correct
13 columns, I think it was more of an intent to
14 separate out cash activity from accrual activity from fair
15 value adjustments. And we'd leave it to the FASB to decide
16 what the appropriate columns are.

17 MR. STEWART: Good strategy.

18 MS. BIES: Yes?

19 MR. EVANS: I wanted to go back for just a minute
20 to John Stewart's comments about the pace of the change in
21 fair value accounting. I thought you made an excellent point
22 which I agree with that it is for users after all that we
23 designed these financial statements and that perhaps we ought
24 to solicit the opinions of users for this and other
25 momentous changes in accounting.

1 But I'm interested in what your hypothesis is about
2 how users would view Joe's statement about the pace of change
3 from financial fair value to non-financial fair valued
4 assets. And then I'm interested in the reactions of the
5 users that we have in the panel to your hypothesis. Thank
6 you.

7 MR. STEWART: My hypothesis as to what users --

8 MR. EVANS: Yes.

9 MR. STEWART: I don't, and all I know about users
10 is what I read in the newspaper and surveys. So, it's all
11 very distant. The impression I have is, and this may be
12 wrong, the impression I have is users, not surprisingly, are
13 not a monolith. Just like we accountants are not a monolith,
14 like you lawyers -- I don't know if you're a lawyer, but the
15 lawyers are not a monolith.

16 We all don't think the same way. That's true of
17 users as well. I think the credit analyst types think
18 somewhat differently than the equity analyst types. And so,
19 I wouldn't pretend to speak for any of them.

20 But the impression I have is, one, they're not a
21 monolith. Two, some are pretty downbeat about ever going to
22 fair value for the operating plant, ever. Some might be more
23 upbeat about it some day if we could figure out how to do it
24 objectively. But I have the impression that some users in
25 some groups would say never to that. The historic cost,

1 depreciation, all that stuff, serves their need.

2 So, I don't have a hypothesis, I guess, as to the
3 pace of change.

4 MR. EVANS: But your guess would be that those
5 lovers of historical accounting would predominate? Is that
6 your --

7 MR. STEWART: Lovers, I'm not quite sure what you
8 mean by that, that sounds a little --

9 MR. EVANS: Those in favor of the --

10 MR. STEWART: The surveys I have read, the two PWC
11 surveys in 2007 of users, it's not a survey of them, they did
12 a survey of users, this new European study. I don't know
13 about the CFA, I've lost track. They did a recent survey on
14 financial institutions but none of them -- none of them, the
15 surveys that I just mentioned -- are advocates of fair value
16 for plants.

17 They don't say we'd like to get there some day.
18 They just say, but again, I'm not a user.

19 MR. EVANS: Right.

20 MS. RICHARDS: I guess the question is, is there a
21 way to give everybody everything that they want, because
22 everybody wants different things. And I don't think there is
23 any simple way, but maybe it requires some thought
24 if you have mixed attributes, perhaps you could have, I don't
25 know in the disclosures or a separate statement the current

1 model, fair value model. That would maybe be one way of
2 giving everybody everything, giving people that want the
3 current and the fair value. However, that would cause
4 preparers to have to have a pretty big burden to get fair
5 value for everything on their balance sheet.

6 MR. STEWART: This is John Stewart. And I'd like
7 to add one thing to my -- I am a user in one small way. I'm
8 a part owner of a company, there are four of us. And we get
9 monthly financial statements. We prepare them and try to
10 follow GAAP. The only real liability we have is a lease. We
11 rent space.

12 I don't care about the mark-to-market fair value of
13 that lease. I do not care. I'm interested in the rent we
14 pay. I'm interested in our billable hours. I'm interested
15 in collecting receivables. I am not interested -- now, I'm
16 an owner, maybe that makes me not a user, but I don't care
17 about the mark-to-market of that lease.

18 MR. MAHONEY: Jeff Mahoney. The Council of
19 Institutional Investors doesn't have any policy on this
20 issue. But Mr. Diermeier can correct me if I'm wrong, but the
21 CFA Institute has long said that fair value information is
22 the most relevant information for financial decision making.
23 They've gone on to say that our goal is for fair value to be
24 the measurement attribute for assets and liabilities, not just
25 financial assets and liabilities, assets and liabilities.

1 I agree with John that not all investors agree with
2 the CFA Institute on that point, but I think many do. And
3 certainly, then when you go to the issue of financial assets
4 and liabilities, I think there is very broad support in the
5 user community for full fair value for all financial assets
6 and liabilities.

7 And I'd say, in response to John, I think that some
8 users oppose full fair value for all assets and liabilities
9 because they think they're going to lose historical cost and
10 other information. I think if you survey them and tell them
11 that you won't lose that information, that that will also be
12 provided, I think you would have pretty broad support for
13 fair value for all assets and liabilities from the user
14 community.

15 MR. EVANS: So, it's your assertion that there is a
16 strong consensus among institutional investors in favor of
17 aggressive deployment of fair value accounting across asset
18 type? Is that, did I hear you right the first time?

19 MR. MAHONEY: The Council of Institutional
20 Investors does not have a policy on fair value accounting.

21 MR. EVANS: No, I understand. But you're referring
22 to the CFA --

23 MR. MAHONEY: I think CFA Institute is one of the
24 major user groups in this country and their position is
25 pretty clear on this. And I think a lot of, not just their

1 members but other users agree with that position.

2 MS. BIES: I want to play devil's advocate on this
3 for a minute because as a former bank examiner, and I think
4 looking at what's happened in the financial markets, making
5 loans based on collateral fair value of assets and
6 liabilities with ignorance of what operational results are
7 and what cash flows are is what's gotten us in the dilemma
8 that we're in. And fair value of all assets and liabilities
9 seems to me just like John pointed out for his company in
10 their own lease, what I'm interested in is what John's
11 operating results are and can they cash flow that fixed
12 payment on that lease. I want to know about it, but to fair
13 value it doesn't really tell me anything.

14 I just feel that moving to fair value acts very
15 much to create more of these asset bubble kind of panics in
16 the market and that's what these are really, panics. And I
17 really question the users who say we want everything fair
18 valued. Well, you know, okay, but why? What decision would
19 you make?

20 When we look at the way banks underwrite loans, for
21 example, one of the concerns we've got right now around the
22 optionality of fair value on hedging is their own credit mark.
23 Most debt covenants, when you lend to a company, care a whole
24 lot about how much debt leverage there is in that
25 organization. Now, you've got companies about to go under,

1 and if they were choosing the fair value option on their
2 debt, they'd be writing down that debt. When they write down
3 their own debt to fair market value, that's an increase in
4 their income that adds to their income number which ends up
5 in equity. And so, it's difficult for a bank to enforce the
6 debt covenants that it's got.

7 It's one of the reasons bank regulators back all
8 that stuff out of our measure of regulatory capital. (Sounds
9 of thunder.) Oh, gosh, I spoke too much. The gods are
10 angry.

11 MR. WEATHERFORD: There is the answer.

12 MS. BIES: All right, I give up. But I am very
13 worried about moving toward basing everything on collateral
14 value. I'm very concerned about the systemic issues that
15 we've got. When the real, I mean, when you judge management
16 of a company, you want to know what's happening in the
17 operational results. And that's why we wanted to break out
18 operating activities, and we need to define what it is by
19 each company in what lines of business that they're in.

20 But to base things on the balance sheet, I think
21 back to the dot com era, too, when all the companies who were
22 entering into these business lines, they were valued based on
23 future cash flows, none of which were ever realized. They
24 didn't even have revenue yet. And the market burst that
25 bubble.

1 So, I just, I really think people need to say what
2 is the information you want. You maybe disclosed it, but
3 should it be the key measure of recognition in the income
4 statement? I think those are different issues that need to
5 be thought through on these things.

6 MR. HERZ: Yes, we obviously like this schedule if
7 it could be operationalized. That will be field tested
8 fairly extensively. But I think this kind of either-or, I
9 think that's part of just the logic here in the schedule and
10 project. People say either or, and part of my problem is
11 that accounting does not mirror a lot of economics right
12 now.

13 This schedule helps to segregate different types of
14 economic phenomena like flows from changes in stock values,
15 changes in values in assets and liabilities. And there are
16 different types of flows. There are flows, there are cash
17 flows, there are the contractual accrual type flows. And
18 then there are all sorts of changes in stock values in assets
19 and liabilities some of which are based on like loan loss
20 reserves, other estimates. Depreciation is an estimate.
21 There is no transaction there. And fair value is another
22 type of change in stocks. And it's not to me an either or.

23 Now, sometimes it's very important to understand
24 the original cost information. It has impacts on taxes,
25 potential taxes, things like that. It has impacts on

1 estimated replacement sometimes and all that. But to kind of
2 debate over one or the other to me is I think
3 getting to somebody's comment here, that it's not that
4 productive of one because I don't think we need to settle for
5 either or.

6 The real key is segregating the information based
7 upon different economic attributes and characteristics. And
8 I think analysts, or investors, when they do that, they do
9 this kind of information. They apply different multiples.
10 They'll apply more than a one multiple to flow
11 information. It depends on what kind of flow, whether it's
12 an operating flow core or non-core. They're applying one
13 multiple to the changes in the stock although some of the
14 changes in the stocks that we have here now under existing
15 accounting don't make a lot of sense because they're not
16 economically based.

17 So, I feel fairly strongly about this
18 after many years of looking at this that it's an unproductive
19 debate to have the fair value versus cost type of thing. And
20 let's get back to kind of fundamental economics in the way
21 people or investors actually try to look at the information
22 and use it.

23 CHAIRMAN POZEN: Yes, I know Jeff is trying to get
24 into that.

25 MR. DIERMEIER: I very much support the comments

1 that Bob made there. And for those who read carefully our
2 final edition of our CBRM, it's very clearly stated that we
3 strongly support fair value for financials. And so, you
4 know, softened up a little bit on the non-financial element
5 but still with the theoretical notion that the fair value
6 across whole assets and liabilities makes sense but not
7 suggesting that we prescribe that somehow we just
8 jump right into that.

9 But, John, I will say to you as an investor that I
10 am very interested in what your lease payment might be two
11 years from now when your lease is up. And I bet you do care
12 about that, too.

13 MR. STEWART: I do, too, and it's disclosed, so it
14 doesn't have anything to do though with fair value. I'm not
15 an investor but I think --

16 MR. DIERMEIER: No, but as an investor, I would take
17 that in consideration if I'm going into business --

18 MR. STEWART: Absolutely, so do I. That isn't the
19 point I was making though. I don't think I communicated that
20 well. Did I or are you confused about that? You are? I
21 agree you need to know the future cash flows from the lease.
22 The question was the fair value of the lease that goes up and
23 down based on the rents, markets changing, was the point that
24 I don't --

25 MR. DIERMEIER: Doesn't that kind of connect

1 together? That's how that stuff works.

2 MR. STEWART: Well, I would recommend to your
3 Committee that you look up all these surveys that have been
4 done. And I find them very confusing because some of the
5 surveys of users say turn left. Others say turn right. And
6 I'm not surprised that they're not all saying the same thing.
7 I would just recommend that you read them all because they
8 give you a very different feeling, and I have no idea what's
9 right because I'm not a user, I'm a practitioner.

10 MS. BIES: Did you have any --

11 MR. EVANS: No, I didn't have any. I had a similar
12 reaction to Bob's comments that Jeff did. And my guess is if
13 you could put the discussion on fair value in the terms that
14 Bob just did and look at it broadly, look at it as additive
15 to the set of information that investors and users have
16 today, that you'd find a broader consensus.

17 MS. BIES: Okay. Bob, do you --

18 CHAIRMAN POZEN: Yes. I wanted to go back, I got
19 from the panel's general thrust that there was less than full
20 enthusiasm for industry-specific standards. But someone said
21 they had a different view, they viewed that very differently
22 than scope or alternative accountings or models. And so, I
23 guess I was looking for a little support in those areas, that
24 if you could explain what you thought about those
25 recommendations and proposals we were making.

1 MR. STEWART: Well, I think, this is John Stewart,
2 I think you and Susan teed it up and maybe it's in your
3 report that industry guidance was an exception. I think she
4 introduced it today that way and maybe that's the way
5 it's -- I don't view it as an exception. I think a lot of
6 industry guidance is fully consistent with GAAP generally. I
7 think much of what you call industry guidance isn't. It's
8 based on activities like software revenue recognition.

9 How about real estate? Sales of real estate you
10 list as industry guidance. Selling real estate, Statement 66
11 applies to every company that sells real estate.

12 CHAIRMAN POZEN: Yes, okay.

13 MR. STEWART: It isn't industry guidance.

14 CHAIRMAN POZEN: I think we understand that. The
15 question is so what about them, but do you support our view
16 that there should not be the scope exceptions and should not
17 be alternative accounting guidance or alternative accounting
18 methods for the same transaction? And then we also talk
19 about use of different models, it's just trying to --

20 MR. STEWART: Right, okay. So, we're moving away?

21 CHAIRMAN POZEN: Yes, correct.

22 MR. STEWART: Okay. Scope exceptions, each of
23 these has their own story, if you will. Scope exceptions, I
24 think, are very much dependent on how the standard setter
25 defines the scope. Just to give an exaggerated example,

1 let's say the scope of this project is accounting for debits.
2 Now, that's probably pretty broad and we might have to have
3 some exceptions to that.

4 In derivative accounting, for example, and we kind
5 of all pick on 133, has a very broad definition of what a
6 derivative is. Therefore, a simple purchase commitment to
7 buy tissue paper is a derivative. Do we need to account for
8 a simple purchase order to buy paper or tissue paper as a
9 derivative? I don't think we need that to be a derivative.
10 So, the FASB scoped that out. I thought that was a good
11 decision.

12 2/10 Net 30 on a receivable, a trade receivable has
13 an embedded derivative in it. Do you think it's useful,
14 practical, helpful to people to unembed and separate,
15 bifurcate that embedded derivative in 2/10 Net 30 trade
16 receivable? I don't think that we need to do that. The FASB
17 wisely made an exception for that.

18 So, if you go down the list of exceptions in 133,
19 scope outs, whatever, I think they were done for judicious
20 reasons. There was an understandability, understandable why
21 they did them. But yet there are exceptions. That, I think,
22 the reason there are exceptions is they defined derivative in
23 my view too broadly. So, they were kind of compelled to make
24 these exceptions.

25 I think those exceptions in this case are good. If

1 we try to apply 133 without the exceptions, I don't think we
2 could do it. So, but some exceptions are bad, but you know,
3 you're going to have to define it a little bit more precisely
4 I think. It's not, I think to say get rid of all exceptions
5 is not a good strategy. I think the standard --

6 CHAIRMAN POZEN: I think our position was a
7 presumption against these exceptions and scope exceptions,
8 but that they could be overcome in a particular situation.

9 MR. STEWART: Well, I think that's all dependent in
10 the art of standard setting and how they define the scope. I
11 think some of the problems we have today are we have scopes
12 that are wrongfully decided or too broad.

13 MS. RICHARDS: This is Brooke Richards. I'm going
14 to pick on 133 as well because it's the easiest one to pick
15 on. I could pick on 150 I guess as well, too. But I agree
16 with a lot of what John said. I think that a standard with a
17 lot of exceptions may lead you to believe that there is a
18 flaw in the way that accounting standard was written.

19 So, whenever you get to a point where you're
20 saying, well, what about this, what about that, what about
21 this? Well, then, I think you should step back, a standard
22 setter should step back and say, "Maybe my standard,
23 maybe my principles are wrong." "Maybe what I'm trying to get
24 at in this accounting is wrong." 133 was probably defined, I
25 don't know, maybe derivative was defined wrong, maybe exactly

1 what the FASB was trying to accomplish with derivative
2 accounting was wrong. And so, therefore, they had to put a
3 lot of the scope exceptions in.

4 And then there is also the, the hard part of 133 is
5 bifurcation. The FASB put in an abuse prevention to say that
6 unit of account if you can't embed something,
7 so then what that did was that caused a bunch of other scope
8 exceptions just for one simple abuse prevention provision.
9 And that makes people go out on a witch hunt for embedded
10 derivatives which usually you don't find a lot of
11 them. So, I think that could have probably been written in a
12 better way.

13 Another factor that causes scope exceptions is a
14 short term fix, and I think that was mentioned in the report.
15 When you have, when the FASB believes there's a short term
16 fix that needs to be done, perhaps it does need to be done,
17 but then that causes a lot of complexity. And so, if there
18 is a short term fix, then there should be some dedication to
19 getting the long term fix done to eliminate that complexity.

20 MR. NEUHAUSEN: This is Ben Neuhausen.

21 CHAIRMAN POZEN: Sorry. Can you just, Ben? It's
22 Ben, just to enunciate it for the people on -- it's Ben
23 Neuhausen, yes. I just wanted to tell the people who are on
24 the -- so now please, Ben.

25 MR. NEUHAUSEN: Okay. I just wanted to add on I

1 think the recommendation from the Committee would be more
2 balanced, I think, if it addressed both the way the standard
3 setter sets the scope as well as suggesting that scope
4 exceptions be minimal. You know, that the scope should be
5 defined very carefully to begin with, and then there
6 shouldn't be as much of a need for scope exceptions. But to
7 just say blanket no scope exceptions without addressing the
8 other side which is how the standard defines a scope in the
9 first place I think is not balanced.

10 CHAIRMAN POZEN: Thank you. Mark?

11 MR. BIELSTEIN: Yes. This is Mark Bielstein.
12 I think clearly there are opportunities to
13 reduce some complexity by limiting the
14 alternative policies, scope exceptions, different models,
15 that clearly could be done. But as others have indicated,
16 there are reasons for those things and I think just saying
17 overall that those should be eliminated is troublesome
18 because there are reasons, as people have indicated, for 133,
19 for example, to have scope exceptions.

20 There's also reasons for different models. For
21 example, the impairment test which I think was one of the
22 things that you all have in your paper. You know, there are
23 probably opportunities to reduce the number of different
24 types of impairment tests or make them more consistent, but I
25 don't think we're going to end up with the same kind of

1 impairment test for deferred tax assets that we have for
2 intangibles or property equipment because deferred tax assets
3 are not measured on fair value. It wouldn't make sense to
4 use a fair value measurement when we're evaluating deferred
5 tax assets. So, to some extent, you're going to have
6 different models because the underlying accounting is
7 different.

8 One of the areas about competing models which we
9 really haven't touched on this morning which I think is one
10 of the biggest areas of need in reducing complexity is in the
11 area of accounting for debt and equity instruments and trying
12 to figure out which is which and trying to figure out how you
13 account for conversion features and things like that. We
14 just have a number of different models for when we
15 separate things. How do you separate them in all of them?
16 And that is, I think, has got to be right at the top of the
17 areas of complexity that we have in accounting today that
18 really needs some fixes in the near term. And I appreciate
19 that's on the FASB's agenda, has been for a while, but that's
20 something that needs some real fixes there.

21 CHAIRMAN POZEN: Thank you. Denny?

22 MR. BERESFORD: There's been a comment that's been
23 made on two, three occasions now, maybe more than that about
24 specialized industries versus activities. And I think John
25 has given the example a couple of times about software

1 development. Mark, I think, gave the example of oil and gas.
2 But it seems to me at a fundamental level we could be talking
3 about cost incurred in anticipation of raising revenues, that
4 that's a real, that's more of a fundamental, it's probably
5 the revenue recognition issue.

6 I guess the question is how do we parse these
7 things? How do we determine what is a specialized activity
8 versus a specialized industry versus a very fundamental thing
9 like what's an asset, what's a liability?

10 MR. STEWART: This is John Stewart. I'm not sure
11 your Committee should, if I could be so bold. I think that's
12 what the standard setter should do and make that call. And
13 if we have the right processes and the right people, they'll,
14 hopefully, make the right calls. You guys aren't
15 in the standards setting business I don't think. And I think
16 all the mechanisms we have, the EITF, you know, I'm not sure
17 what we're going through, but IFRIC in the future, I think
18 they've got to be the guys and ladies who try to deal with
19 your question.

20 When a standard is written, it's so broad a level,
21 everything is interrelated and you're lost as to what to do.
22 Practitioners like me are lost as to what to do. On the
23 other hand, you can burrow too deep, and therefore, you could
24 only apply it to this one narrow area, that's not helpful
25 either. So, it's a real art, I think, to have the right

1 blend of scope, principle, rule, bright line,
2 whatever, and it's different from different things.

3 So, I don't know the answer to your question,
4 Denny, but I am not convinced that you guys have to decide
5 that.

6 MS. BIES: Why don't we, now in the time that's
7 left us, I would like to give each of the panelists a chance
8 to make any kind of concluding comments on either something
9 you've already said that you wanted to reassert or if there
10 is something we didn't touch on that you'd like to make a
11 comment on. And if you each would take about
12 three minutes or so, that would be great as we go through it.

13 John, let me start at your end of the table. We'll
14 just then move on down, if you would?

15 MR. STEWART: Well, I, you know, let me, as I think
16 I've said, I think accounting is a practical thing. I think
17 it has to be helpful and communicate. I don't see it as a
18 science in which we're trying to discover gravity. There
19 aren't any truths like that. I think it's all about, I think
20 Russ Golden made a speech recently where he talked about he
21 was in the communication business, if I remember right, I
22 agree with that.

23 And therefore, I think we also have to always be
24 mindful about whether the standard can be actually
25 implemented by regular human beings. You know, if a standard

1 is really cool but it can't be done, that's not helpful to
2 anybody, the auditors, the preparers or the users of
3 financial statements.

4 I think there's rules versus principles --
5 I find a dichotomy that I don't understand. I see
6 it in the press. I'm not familiar with how you define a
7 principle versus a rule. I wouldn't know what one is one and
8 one is the other. Thou shalt not steal -- is that a
9 principle or is that a rule? I mean, I think that's, as you
10 guys I think maybe you're getting to, it's not a good
11 productive debate.

12 I think there are some situations where exceptions
13 are useful, some scope exceptions. I agree with you that
14 should not be the norm, but I think they are useful from time
15 to time. Speed limits are helpful to both users and
16 preparers I think in some cases as are bright lines in some
17 cases.

18 Economic substance is not a powerful enough concept
19 to be made operational. Ben made that point. I agree with
20 that. I gave my example.

21 I think complexity is very, is all about, we've got
22 some bad principles like lease accounting. We have overly
23 broad scopes. We have inconsistent principles, competing
24 models that you described. My definition of complexity is
25 quite different than the one you guys have in your report,

1 but I think those are the major reasons for complexity,
2 results that don't make sense, lack of symmetry, et cetera.

3 I think we do need implementation guidance. We
4 just can't have really, really broad things. I think the
5 world needs an implementation guidance. A recent survey of
6 IFRS users indicates they want some more guidance, more
7 specificity.

8 And I think, last, standard setting, as I mentioned
9 a couple of times, is a real art. And I think we're going to
10 talk about standard setting later today and it's a real heavy
11 responsibility but it is an art that requires balancing all
12 these competing things.

13 MS. BIES: Thank you.

14 MS. RICHARDS: Okay. This is Brooke Richards.
15 First, I want to commend the Committee. I think they're
16 doing a really good job in moving in the right direction.
17 And also, the FASB for what they do. I know, I've been on
18 their side and I know it's not an easy job.

19 Also, I didn't say my disclaimers that my views
20 represent my own views and not American Express. And I
21 wasn't even able to pull the IMA that I'm representing. So,
22 I'm here as a technical accountant.

23 I think that the world is not a perfect world and
24 there is never going to be, accounting is not perfect, there
25 is never going to be a perfect answer. But simplicity,

1 consistency, substance are all good things and I think that's
2 what this report is getting at and should be continued.
3 Continuous improvement is always good. It's hard, it's hard
4 for people to change, but it can be done.

5 Also, just a point of clarification. When I said
6 before I think substance is a really important thing, an
7 economic phenomena, representation of faithfulness of the
8 economic phenomena, I'm not saying that the FASB should just
9 say do that. I think that the FASB needs to say what that is
10 in their standard. And then, I think also as in one of your
11 hypotheses, that it would be good to have some training for
12 accountants and everyone in the profession that it touches to
13 learn to look at the spirit of a standard and take
14 a step back and apply common sense and look at
15 what is the principle that the FASB puts forth in a standard
16 and to apply that. And I think that we would have
17 a lot better accounting if we were all able to do that. I
18 may be a bit utopian but at least it's worth the effort.

19 As far as principles, I see the principles that the
20 FASB has been working on and they've made a lot of
21 improvements. And I think in my world, John said is 'Thou
22 shalt not steal' a principle? No, and I think that's a rule.
23 But I think 'respect others' is a principle, and that in
24 following that principle, you should not steal. So, that's
25 my definition simple of a principle and a rule.

1 I think that's about it. So, just thank you for
2 allowing me to present my opinions. And keep up the good
3 work.

4 MS. BIES: Thank you. Ben?

5 MR. NEUHAUSEN: This is Ben Neuhausen. I'd like to
6 join Brooke in saying that I think the Committee has done a
7 very good job in teeing up the issues. I think I'd like to
8 focus on two issues in my final comments.

9 One was something we talked about in our comment
10 letter in terms of opportunities for simplification, and the
11 Committee talked about eliminating competing accounting
12 models. And we also suggested that another area of
13 complication and diversity is the way assets and operations
14 get grouped for different purposes in accounting. We gave
15 the example of the different grouping for segment reporting
16 versus how reporting units are analyzed for purposes of
17 impairing good will, and then how discontinued operations are
18 defined.

19 There's three very different levels within the
20 company, and we see over and over again in accounting what
21 some of the board members have referred to as this unit of
22 account issue. Are we looking at the individual transaction?
23 Are we looking at a group of similar transactions? And it's
24 very inconsistent from area to area and there's probably some
25 low-hanging fruit to simplify in that area by converging on

1 the grouping of assets and the grouping of operations.

2 The other thing we really didn't get to talk to
3 today, your new preliminary hypothesis 5 on the disclosure
4 framework is a very good idea. I think that disclosures do
5 tend to grow like top seed because they're done individually
6 project by project. There is some duplication between SEC
7 disclosures versus GAAP disclosures. And it would be good to
8 take a comprehensive look at what it is that we're trying to
9 accomplish with disclosures and then try to rationalize the
10 existing requirements.

11 MS. BIES: Thank you, Ben. Jeff?

12 MR. MAHONEY: Jeff Mahoney. Thank you for the
13 opportunity to appear before this group. Before I go into my
14 comments, I want to again emphasize for the record that these
15 comments are my own and do not represent the views of the
16 staff or board or the general membership of the Council of
17 Institutional Investors. Like my fellow panelists, I commend
18 the Subcommittee for its hard work in what is a very
19 difficult area, the topic of substantive complexity in
20 financial reporting.

21 I think your recommendations with respect to fewer
22 bright lines, fewer exceptions, I think those are quite
23 positive and can have a positive impact on high quality
24 financial reporting and reducing complexity. I agree with
25 John that there's good bright lines and

1 evil bright lines. The extent your recommendations can
2 reduce those evil bright lines, I think that's a positive for
3 investors and financial reporting. And the same thing with
4 the exceptions, there may be some positive ones but
5 exceptions could also create complexity and reduce the value
6 of financial information to investors.

7 I also would join Ben and I would support the
8 recommendation along the lines of the disclosure framework.
9 I think that's a very good idea. I am the co-chair of the
10 Investors Technical Advisory Committee and we wrote a letter
11 to the FASB supporting a disclosure framework project. I
12 think that can improve the quality of information and the
13 usefulness of information. I think it can also create some
14 efficiencies in the standard setting process if there is a
15 disclosure framework in place that's applied in an ongoing
16 basis. So, I think that would be a positive recommendation
17 for a number of reasons.

18 There's potentially two areas in your report that I
19 think some investors might have some concerns about, ones
20 that are the one we already discussed about with respect to
21 fair value accounting. I think a recommendation suggesting a
22 delay or deferral of fair value accounting until the
23 conceptual framework is completed, I do not support that
24 recommendation. I think the FASB and the IASB and I think
25 the SEC staff in the past have concluded that the two can be

1 done at the same time and I think the SEC staff has said
2 before in published reports that developing some of the major
3 projects that the FASB is working on including revenue
4 recognition, that the learning from that can be used to
5 develop the conceptual framework concurrently. So, I would
6 not put off moving towards more fair value until the
7 framework is done which we know is many, many years away.

8 I think the second area that I would just raise as
9 an issue, it's my understanding the Committee's mandate was
10 to examine the US financial reporting system in order to make
11 recommendations to reduce complexity in the financial
12 reporting system. So, I think the mandate is quite broad and
13 I believe at least some investors including this very small
14 investor is somewhat disappointed that the Subcommittee on
15 substantive complexity has focused almost exclusively on
16 accounting standards in the FASB. I think there are a number
17 of other actors out in the financial reporting system. There
18 are a number of other issues out in the financial reporting
19 system that create complexity in that system. It's not just
20 all accounting standards in the FASB.

21 There are certainly issues there as well and you've
22 dealt with a number of them, but there's much broader issues
23 with respect to complexity in this system. And I think some
24 were hopeful, some investors were hopeful that there would be
25 more recommendations addressing some of these other areas.

1 That completes my comments. Thank you again for allowing me
2 to participate this morning.

3 MS. BIES: Thanks, Jeff. Kevin?

4 MR. CONN: Yes, Kevin Conn with MFS Investments.
5 Thank you also for inviting me to the day today. And as
6 with everyone here, as I read through the report, I was
7 absolutely excited. You know, every proposal I saw, I was
8 like, oh man, this is just a terrific direction to head in,
9 so I want to commend the Committee for coming up with some
10 terrific proposals. The ones I didn't say I'm into are ones
11 I didn't understand. But the rest of them, I really agreed
12 with generally.

13 The two points we talked about during this session
14 that I have a lot of energy around, one was a little bit more
15 exploration around special purpose entities off balance
16 sheet, a little bit more disclosure, a little bit more detail
17 about what those are. There are many off balance sheet
18 vehicles which I think are plain vanilla. You know, they're
19 not exotic animals, you know, there is no real issue there.
20 But there are some, and I don't know how big it is, but they
21 probably could use some more attention.

22 The second was this fair value issue around
23 distressed markets. This one is complicated and I don't know
24 what the answer is. But what's happening now in some cases
25 doesn't seem to be fair to the companies and helpful to

1 investors.

2 And then, finally, the complexity issue is one that
3 I found very refreshing to see in the report. And as a user
4 who sort of, you know, spends a lot of time going through a
5 lot of documents very, very quickly, oftentimes you don't
6 have a chance to go refresh on an accounting statement. And
7 so, anything that can be done to make things less complex
8 would be very helpful.

9 And anything to help comparability, so I think in
10 part of the document there was something about
11 different alternatives to calculate things, I spend a lot of
12 time trying to get to apples to apples numbers and it's
13 incredibly frustrating. And every company has their special
14 definition of earnings, their special definition of cash
15 flows. And I find it discouraging, the amount of time I have
16 to spend to get things on an apples-to-apples basis. So,
17 just as a sort of theme, all of the things that had been
18 written and discussed and proposed around making things more
19 comparable and simpler I quite agree with. Thanks for having
20 me.

21 MS. BIES: Thanks, Kevin. Mark?

22 MR. BIELSTEIN: Mark Bielstein. I think you all
23 have done an excellent job of identifying some of the reasons
24 that we have complexity, whether it's alternative accounting
25 models, scope exceptions, to some extent industry standards.

1 But for whatever reason, I think we could probably all
2 identify the top areas where there is significant
3 complexity, whether that be derivatives in financial
4 instruments, consolidation under variable interest entities,
5 and Statement 140, debt equity classification, revenue
6 recognition. You know, there are a probably a handful,
7 whether it's five or six different areas. And for whatever
8 reason, whether it's because of scope exceptions, alternative
9 accounting treatments or otherwise are the real areas that I
10 think are important that the standard setters need to focus
11 their attention on. And whether it's due to scope exceptions
12 or alternative accounting models or whatever, I'm not sure it
13 really matters, but those are the areas that I feel strongly
14 that there needs to be some priorities identified
15 particularly with the potential movement towards IFRS and all
16 of those things.

17 I think, also, it's important to recognize and this
18 is really just an observation and it may or may not turn out
19 this way, but I think it's important to observe that the
20 reduction in complexity very well may increase volatility in
21 reporting financial results. And you know, obviously that
22 depends on what you do to reduce complexity, but because some
23 of the complexity is caused by exceptions, other
24 comprehensive income and those kinds of things, if you do
25 away with some of those, you're going to increase volatility

1 and that's just the potential result.

2 I also agree with the comments that Ben and Jeff
3 made, that I think it's important to think about disclosure
4 issues and frameworks for disclosure, the way we get
5 disclosures now where it's just a continuing add on list of
6 just about everything you could think of about an area when a
7 new standard comes out. And all of that may be very well and
8 good but it's just gotten to the magnitude where you end up
9 with trying to go through a list of several hundred pages to
10 make sure you get all the disclosures in there. It is not an
11 effective way to continue trying to address disclosure
12 issues. Thank you.

13 MS. BIES: Thank you. Linda?

14 MS. BERGEN: Yes. Linda Bergen. I'd like to say
15 thank you for having me come and speak with you today. I
16 agree with many of the issues that you raise in your reports.
17 I think there are opportunities to streamline rules that
18 would mandate using more judgment. And the question I have
19 there is whether variability in judgments would be accepted.
20 People are afraid of being second-guessed if their judgments
21 turn out not to be where the SEC ultimately is, their view is
22 to settle on a particular issue because no one wants to be
23 required to have to restate their financial statements.

24 I think with respect to specialized industry
25 accounting, I support it where it really reflects a

1 specialized activity. And I think that very often that
2 specialized accounting ought to become generalized GAAP, and
3 so that anyone who engages in those same sorts of activities
4 ought to be able to use the same sort of activities.

5 There are several comments in your papers that deal
6 with structuring in the sections on bright lines and how
7 structuring is a bad thing. And I think that is misguided.
8 I think that companies will always have objectives and there
9 will always be opportunities to structure transactions, to
10 get companies both the economic and the accounting and the
11 regulatory outcomes that they need in order to have
12 positive business outcomes. And I think that to a
13 large extent, standard setters ought to ignore the said
14 structuring opportunities. I think what regulators and
15 standard setters ought to do is focus on what are the
16 appropriate principles.

17 Structuring will happen no matter where the line is
18 created. There are some really smart people in the banking
19 community who are paid to figure those things out, and that
20 will happen. And I think you just need to accept it.

21 With respect to the outcome, bank capital, broker
22 dealer capital, and probably insurance company capital are very
23 key drivers in why companies attempt to structure
24 transactions. And I would point out to you that structuring
25 isn't just changing words on a piece of paper. It's actually

1 changing the transaction so that there is a difference in the
2 economics. Sometimes it may be marginal, but there is a
3 difference. And that can't be ignored.

4 So, thank you for having me here today.

5 MS. BIES: I want to just give our thanks to the
6 whole panel today for taking the time to think about these
7 issues and give us your comments and traveling, for some of
8 you, to come to this panel today. So, thank you very much.

9 CHAIRMAN POZEN: Well, we are now going to take a
10 break until 11:00 o'clock. Some of you are going to come
11 back. And I think there should be, it looks like coffee back
12 there and there are various other things. So, we're going to
13 take a break, and for those people who are on the phone
14 lines, we'll be back at 11:00 o'clock. Thank you.

15 (Off the record.)

16 PANEL TWO

17 CHAIRMAN POZEN: We are now approaching full house.
18 We have one new panelist here, Lynn Turner. Lynn probably
19 doesn't need much introduction to this group, the former
20 Chief Accountant of the SEC, now a professor at the
21 University of Colorado, am I right, Lynn?

22 MR. TURNER: Oh, I haven't taught for about three
23 or four years. I'm just trying to go fly fishing and stay
24 retired but very well.

25 CHAIRMAN POZEN: Fly fisherman extraordinaire among

1 many other talents. So, we are now going to have a session
2 which we're going to focus on Chapter 2. David Sidwell and
3 his Subcommittee have done an excellent job in this and I'm
4 going to just hand it over to David.

5 MR. SIDWELL: Thank you. And as we heard before,
6 thanks everyone on the panel for coming today and speaking
7 with us. We hope, obviously we had sent out the reports in
8 February and in the package of materials that you have for
9 today's meetings, you have an update on some of the thinking
10 that we've done since then. Obviously in terms of process,
11 we're still obviously trying to get as much input as we can.
12 We have benefited from a number of comments in the letters
13 that we've received. We would very much like to get your
14 views.

15 We thought, what we'd like to do is to begin by
16 asking each of you for what are the top two or three things
17 that you think are issues and issues that we should spend
18 some more time thinking about and to get your views. We
19 would then like to basically look at some of the areas in our
20 reports and some of the points that you make and ask you
21 questions so that we can further our thinking.

22 So, Linda, I'm sorry, you're at the beginning of
23 the line over there. Would you mind please beginning with
24 some overall thoughts? I'm obviously cognizant of time so I
25 want to make sure that we have time to not just hear from

1 each of you on your overall points but then we can delve down
2 into some of the issues that you raise. So, Linda, thank
3 you.

4 MS. BERGEN: Okay. I'll start off with a few
5 comments, and I'm sure I'll have more later as other things
6 are discussed. There is an emphasis here on the critical
7 importance of having users involved in the standard setting
8 process. I agree that users should be involved. However,
9 when it comes to users on the standard setting boards, I
10 think one of the difficulties is that, at least historically,
11 many of the users who have been represented on the FASB board
12 have been more interested in disclosure than having a
13 sufficiently detailed understanding of accounting. And I
14 think in order for a user to be an effective standard setter,
15 they need to have both characteristics in order to be most
16 productive. So, that is one of the key things that I think
17 needs to happen in order for the user input into the standard
18 setting process to be most valuable.

19 One of the things we have noticed in the standard
20 setting process is that the comment letter procedures often
21 seem to be pro forma instead of substantive, that the
22 comments that are received from the preparer community are
23 often not taken seriously. And that has led to a number of
24 amendments to standards very shortly after they have been
25 released. And we think that, I've heard comments that come

1 in from users being summarized glibly as we didn't hear
2 anything new that we hadn't taken into account before. And
3 therefore, there was nothing substantive received, and
4 therefore, board members feel free to go ahead and
5 finalize the standard that's been drafted.

6 So, I think there has to be greater attention to
7 the comments that are actually submitted. I think in that
8 regard, your request for more field testing would be
9 extremely helpful in bringing to the board's attention what
10 the operational issues are in trying to implement a draft
11 standard. I think it also would be useful for the user
12 community to do the pre-reviews. I like your suggestions
13 there. And that would, I think, avoid a lot of the
14 disclosure that perhaps is never used or never understood,
15 and it would also ease the burdens on the preparer community.

16 For every new standard that comes out, we can't
17 just push a button. Very often there are significant systems,
18 development processes that are needed, and it takes money and
19 it takes time to develop the systems to do it right so that
20 the effective dates of standards have to be set with
21 appropriate room to get all this work done. Otherwise,
22 people scramble and it's an area that can lead to mistakes
23 that could have been avoided. And I think I'll stop there
24 for right now.

25 MR. SIDWELL: Thank you. Mark?

1 MR. BIELSTEIN: This is Mark Bielstein. Just a
2 couple of things and starting with an overall observation
3 that I think your thoughts and work in this area is very
4 difficult because I believe one of the most critical issues
5 about the standard setting process at this point is how the
6 FASB is going to interact with the IASB if there is some kind
7 of move towards IFRS here in the US. Obviously you have a
8 timing problem with that, but it seems to me if there is
9 something that heads down that direction, determining the
10 FASB's role in that and how it works both in the interim and
11 once you get there seems to me to override all
12 these other issues to some extent.

13 As Linda indicated, the field testing I think is
14 critical. We've seen in recent years whether you go back to
15 Interpretation 46 and 46R, Statement 150, Statement 157, a
16 number of areas where shortly after issuance of a fairly
17 major standard there has been significant changes to it that
18 needed to be made. Those changes were good and it's good
19 that those actions were taken, but it would have been helpful
20 to try and identify some of that earlier on, and it seems to
21 me field testing might be one way to accomplish that. You're
22 never going to find all of the quirks in it but more field
23 testing should be helpful in that regard.

24 As a separate area, I believe the role of the
25 Emerging Issues Task Force needs to be reevaluated and not

1 just because of the body, but the EITF was originally set up
2 to try and address interpretation issues in a timely manner.
3 With the additional due process procedures that have been
4 added to that process which they were added for a reason and
5 potentially good to do that, the EITF cannot address things
6 in a timely manner like it once could. And so, either the
7 role of the EITF needs to be reevaluated or reconstructed to
8 be able to do that, or there needs to be some other mechanism
9 to try and provide, even if it's not authoritative, guidance
10 in a timely manner.

11 And then, the fourth observation which may not come
12 to be a surprise to this group is that I would probably not
13 fully support some of your observations about the
14 non-authoritative guidance that may be issued by accounting
15 firms and others. I think the issue is if that guidance is
16 good guidance which obviously the issuers of that guidance
17 think it is, then we would do it. That is helpful to people
18 in trying to apply the standards in specific circumstances.

19 MR. SIDWELL: Thanks, Mark. Kevin?

20 MR. CONN: Yes, Kevin Conn with MFS. I actually
21 don't have a lot of energy around many of these issues or
22 strong points of view other than to say that it's gratifying
23 to be an investor and be invited to participate. The
24 leanings in the Committee to invite more investors to come
25 and speak I think would be a terrific thing.

1 I think as I read through some of the things, we
2 are not accounting experts. We don't have the
3 time, oftentimes, to become experts at each specific
4 accounting discipline. So, I think it's important for the
5 Committee to understand sort of how really users use the
6 information, what's important, what's not important. And I
7 think that's in the proposal as it stands right now.

8 MR. SIDWELL: Great, Kevin, thank you. Jeff?

9 MR. MAHONEY: Jeff Mahoney. Just to pile upon
10 Kevin's comments and some of the other earlier comments, I
11 like your language around the preeminence of investors and
12 users in standard setting. I think that's very important.
13 There has been clearly an imbalance in the input to the
14 standard setting process historically, dominated by the Big
15 Four firms and large companies mainly. I think we can all
16 agree that investors are the main customers of financial
17 reports. And as the main customers, I think they should be
18 more involved in the development of the product.

19 That said, I think John Stewart and many others
20 have been actively involved, and we have a great set of
21 accounting standards because of their hard work and
22 expertise. But I think we have to get users more involved.
23 Linda commented that there may not be a lot of users that
24 have accounting expertise. I think that's probably true and
25 I think we need to develop that over time somehow. The FASB

1 has a number of user groups. I'm involved in one. I think
2 over time there will be more users who have the accounting
3 expertise to actively participate and benefit the standard
4 setting process.

5 As a former FASB staffer, I have to
6 disagree with Linda's comments on comment letters. I think
7 the FASB by and large does an outstanding job on their
8 analysis of the comment letters and considering those
9 comments and making changes to the proposals based on those
10 comments. I think you can compare the FASB to others, I
11 won't name any names, but I think as far as reviewing comment
12 letters and making changes to proposals, I think the FASB
13 does a pretty good job in that.

14 Field testing, I certainly support field testing.
15 I think the problem with field testing historically is that
16 the FASB has had problems getting anyone interested in doing
17 a field test. They take a lot of time and it's very
18 difficult to get anyone to do it. I think to the extent they
19 can get people to do it, it's very helpful. But I don't
20 think I would suggest that the FASB hasn't been trying to do
21 field tests. I think they do, it's just that they haven't
22 been able to get people who are willing to volunteer to do
23 those tests. And I don't know how to correct that problem
24 but I think it's been a problem of volunteers, not a problem
25 that they don't want to do it.

1 As far as cost benefit analysis, I don't think, and
2 this was in my letter, I really don't think we should put a
3 greater emphasis on cost benefit analysis. I think the FASB
4 does a pretty decent job in soliciting from companies and
5 auditors the cost of implementing standards and then taking
6 that information and trying to make a judgment about how the
7 standard should be modified based on those costs. But
8 really, as I said in my letter, that analysis really had been
9 kind of a cost-cost analysis. I mean, how can we reduce the
10 cost of implementing the standard and still get an approved
11 reporting as a result?

12 We don't really have what is a cost benefit
13 analysis. And until we have a way to do that for accounting
14 standards, I really wouldn't further emphasize cost benefit
15 analysis. I think the cost benefit analysis should be a
16 focus on what is the cost to investors and what is the
17 benefit to investors. That should be the main focus since,
18 as I said earlier, they are the main customers of the product
19 we're producing. Thank you.

20 MR. SIDWELL: Thank you. Ben?

21 MR. NEUHAUSEN: Ben Neuhausen. I'd like to focus
22 on two areas. One, non-authoritative guidance, and the
23 other, the standard setting process. With respect to
24 non-authoritative guidance, I think the Subcommittee
25 recommendations seem to imply that non-authoritative guidance

1 is a problem and that it is a driver of complexity, and
2 therefore, it would be desirable to deliberately try to
3 reduce non-authoritative guidance.

4 By contrast, I think that non-authoritative
5 guidance is a symptom of complexity in the authoritative
6 standards, that it arises because preparers and practitioners
7 want additional guidance because they find the authoritative
8 standards very hard to read, very hard to understand, very
9 hard to apply. And they want the non-authoritative guidance
10 to help them apply the authoritative standards. And so, I
11 think if there is a problem with non-authoritative guidance,
12 the solution lies in simplifying the authoritative standards,
13 not in trying to reduce the number of people who are issuing
14 non-authoritative guidance.

15 With respect to the standard setting process,
16 I think there is room for improvement. I think the
17 Committee recommendations to do more field testing, have user
18 pre-reviews are both good ideas. And I also agree with Linda
19 Bergen's observations that I think the FASB's use of the
20 comment letters could be better.

21 We cited in our comment letter a number of cases
22 where the FASB has significantly revised or deferred
23 provisions in newly issued standards. And we think in many
24 of those cases, those issues were raised in the comment
25 letters. It's just that somehow the importance of the

1 comment or significance of the issue wasn't recognized before
2 the final standard was issued and only became clear after the
3 final standard was out, and that somehow a better process of
4 analyzing the comment letters would have picked up some of
5 those issues on a more timely basis.

6 MR. SIDWELL: John?

7 MR. STEWART: This is John Stewart. Mark mentioned
8 the international thing and that does bring a whole new ball
9 game to this and the FASB's meeting with the IASB in late
10 April on the MOU and kind of their strategy. Really maybe
11 you guys will have to think about how that impacts your
12 recommendations.

13 Second, I agree with the emphasis on the user.
14 They are the customer, I said that this morning multiple
15 times. I firmly believe that that's why we exist, to help
16 those people. But I'm not a hundred percent sure what the
17 best way to get that input is. They ought to absolutely have
18 input.

19 Now, let me, maybe this is a bad analogy and I'm
20 sure people will climb on me if it is a bad analogy. Let me
21 try it out; I borrowed this actually from Amy Ripepi, one of
22 my partners. She describes a situation where we're building
23 in the bay area a new bridge across whatever they have out
24 there. And so, we talk to customers --

25 MR. GRUNDFEST: It's called the bay.

1 MR. STEWART: Thank you. You're out there, right?

2 MR. GRUNDFEST: Yes.

3 MR. STEWART: Good. So, we're building a new
4 bridge. And we talk to consumers about what they need, you
5 know, they need the bridge to be here, and this is the level
6 of activity, they need how many lanes or whatever. But when
7 we get around to building the bridge, the consumers are not
8 part of the group that's building the bridge. That's the
9 civil engineers.

10 So, it seems to me that we ought to have
11 accountants set accounting standards. And consumers are the
12 users who use the information, but I don't think they've got
13 necessarily the skills, and I don't mean that in a demeaning
14 way. They don't have the background, if you will, to do the
15 actual accounting standard writing. Anyway, think about it.
16 That's my reaction.

17 The FAF changes, I agree with Amy, the FAF changes,
18 I'm confused about what their purpose was. I don't happen to
19 agree with them and they never articulated that I have seen
20 why they made these changes going to five people and lodging
21 all this power in good old Bob over here. Nothing, I like
22 Bob a lot, but no one is smart enough in my opinion to be the
23 sole determinant of what issues get added or subtracted from
24 the agenda. So, I don't happen to agree with that. I know
25 that's going to happen to the EITF as well. But why they did

1 it, maybe I'd be more upbeat about it if I understood why,
2 they identify why they lodged this power in my friend Bob.

3 Field testing, I think the FASB could do better on
4 field testing simply by applying their proposals to EITF
5 issues. I mean, we have them since 1984, just hundreds and
6 hundreds of very practical issues. They don't have to go
7 outside their building. They could take their proposals like
8 on revenue recognition and see if it answers the EITF issues.
9 They wouldn't even have to go, and I think Jeff is right,
10 it's hard to get people to participate. I think he made that
11 point. But you don't have to.

12 I think the FASB does a weak job in doing that and
13 then later implementing or describing what the impact is on
14 the EITF issues. Take FIN 46R, they just kind of almost
15 added half of the EITF issues. Oh, you better read FIN 46R
16 without giving people more help. So, I think on revenue
17 recognition, I'm repeating myself, they can analyze those
18 issues and see if it actually helps answer the questions in a
19 better way.

20 I think there is a problem sometimes with the
21 several do-overs that we've had that had been mentioned by
22 several people along the line here where I think the FASB
23 could have done a little bit more homework on how operational
24 their proposal was. As I mentioned this morning, if you
25 can't do it, if the preparers can't do it, it's really bad

1 because it's not going to help anybody -- the users, the
2 auditors, anybody.

3 I think, and last, I think standard setting is, as
4 I mentioned this morning, an artful blend of principles and
5 rules and people. And the key to a good standard setting
6 process is not only the process itself, exposure drafts and
7 all that, it's very important that the right people with the
8 right attitudes get picked to do it.

9 MR. SIDWELL: Lynn?

10 MR. TURNER: Thank you. Lynn Turner. As usual,
11 let me just follow up by saying I do agree with what John
12 says on the FAF things. However, I don't agree with him on
13 who should be writing these rules. I think as the Committee
14 has talked about in the report, there is need for much more
15 investor participation, and I think it should be in the form
16 of involving participation, not just advisory boards and
17 moving from one out of seven to one out of five. It doesn't
18 equate to more -- one is one. And if you're really serious
19 about additional investor representation, I think you'll
20 change that number one to a higher number. And I think if a
21 serious effort is made to go get the people, you will be able
22 to turn around and find the people.

23 So, I just note that, in fact, as I look around the
24 table here, there's many of us, current and former
25 regulators, current and former standard setters, people out

1 of the national offices, we have all been involved with the
2 standard setting process and we have all been ones that have
3 come up with the standards that we're all now criticizing.
4 So, I don't know but what we've met the enemy and it's those
5 of us around the table here. So, I certainly hope you'll
6 continue to get the input from additional investors because
7 we have not done a good job as an accounting profession and I
8 think you'd have to give us a fairly poor grade if you would
9 in what we've come up with. Although it's still all in all a
10 pretty darn good product compared to what's happened
11 elsewhere.

12 I agree, I think you've made some good points about
13 the standards needing to be more understandable. I do think
14 the standards should have the objectives laid out right up
15 front. I mean, it should just say, paragraph 1, here is the
16 scope, paragraph 2, here is the objectives that we're trying
17 to get to. And I think that would be very helpful.

18 I think there was talk about cost versus benefit.
19 If I apply the cost benefit test that you've got in the
20 document though, we would have never seen the statement on
21 retiree healthcare cost issued. And that has perhaps been
22 the most important standard that has ever come out of the
23 FASB so I'd ask you to go back and take a look at that
24 because I think your cost benefit standard is not a cost
25 benefit standard. It reads like it's a cost standard and

1 we'll worry about the benefits later on and certainly OPAFS
2 -- ever come out under that standard.

3 On the complexity type stuff and trying to get that
4 out of the standards, we just have to keep in mind that we do
5 billions of transactions in business today and it's not just
6 financial instruments, it's affiliations, it's partnership
7 agreements, it's marketing agreements. And I don't know that
8 you're ever going to make the accounting for those simple.
9 We by necessity in the business side create tough complex
10 transactions, and sometimes you just can't boil it down to
11 simple financial reporting. And that's where the analysts
12 come in and I think the analysts on a whole do a good job of
13 being able to cipher through that if you've got good
14 disclosure. I think this ITAC letter, too, you mentioned, I
15 think there just has to be improved disclosure here around
16 things like judgments and key assumptions so the people can
17 get better clarity about that and better understanding.

18 In terms of the complexity though, and Mark
19 mentioned it earlier, the EITF's role, I think the EITF, if
20 you'll look at red books today, the red books today are
21 actually now thicker than what the actual standard books are.
22 And yet there is not a single word in your report about the
23 EITF. There is no one that has created complexity in
24 financial reporting in the US like the EITF. John just
25 mentioned the hundreds and hundreds, I'm sure it's thousands

1 and thousands of issues. I'd recommend that once and for all
2 you put the EITF to bed and out to pasture. As long as you
3 leave the EITF in place, you will not change complexity. You
4 will not reduce complexity. And you will not reduce the
5 myriad of rules. So, I'd strongly urge you to get rid of the
6 EITF.

7 And with that though, I do think there is one thing
8 that needs to be done. And that is I think there needs to be
9 a catch-all rule. With all the business transactions we do,
10 I don't think anyone can expect the FASB to write a rule for
11 every type of new transaction, and they just can't keep up
12 with it. I mean, you do due process, you ask everyone to do
13 due process here. There needs to be in those types of
14 situations a catch-all rule though that turns around and says
15 if the FASB hasn't done a rule on something but there is very
16 material information out there, then that information
17 regardless of whether or not a rule exists needs to be
18 disclosed to investors. We don't have that today.

19 So, we get new types of transactions. And you say,
20 well, the SEC is not supposed to tell anyone about it or take
21 a position on it. What are they supposed to do? That's
22 their rule as a regulator. You're telling the FASB go do it
23 and go through all this due process, it will be three, four,
24 five years before they can ever get to it. And in that
25 intervening time period, what are we as investors supposed to

1 do? Avoid the disclosure and the information on it? Not
2 have good accounting?

3 And I think that's a system that you've got to
4 think about whether or not in fact you're asking to get
5 established. And I'd certainly recommend that you think
6 about whether or not you need the catch-all rule that says if
7 there isn't a rule out there but there's material information
8 to investors, that information still needs to be disclosed
9 and put out there. And I think that would be most helpful.

10 And finally, I just, I think you've got to have
11 strong SEC enforcement. I think when there's a lack of
12 regulation, you pay a severe price in the markets. Investors
13 pay a severe price in the market. And I think with companies
14 constantly coming to the SEC and asking them for their
15 opinion, the SEC staff can't just sit there and say we're not
16 going to give you an answer. And if they see situations
17 developing, I remember on the SPE issue in the late 80's,
18 that issue started to develop, the Chief Accountant then at
19 the time started to speak to those of us in the profession
20 and tell us these are problematic, you need to start thinking
21 about what that is. The SEC Chief Accountant needs to be in
22 a position to do that, to turn around and protect the
23 investors. And that needs to carry some weight with it given
24 how quick these transactions can come up.

25 And I remember after he started doing that in the

1 mid 80's to late 80's, then one of the big accounting firms,
2 the head of their national office wrote to the SEC in the
3 summer of '90 saying I agree with you but I've got other firms
4 that are allowing this to happen, and therefore, you've got to
5 go deal with it or I'm going to allow it to happen. And given
6 that it takes time to deal with those, you've got to let the
7 SEC be able to step into those and do what they've got to do
8 to protect the investors or you're going to have problems in
9 the system. So, I'll end at that.

10 MR. SIDWELL: Thank you, Lynn. What we'll do now
11 is go thematically across some of the issues that you've
12 raised. We obviously spent a lot of time as a Committee
13 talking about the whole question of investor involvement, and
14 obviously some of that is how to define an investor. And we
15 spent a fair amount of time trying to focus on that. Some of
16 the comment letters we've received have asked us to do more
17 on that and we I think appreciate any views you have.

18 The second thing that has come up in the
19 commentary, and we spent a lot of time discussing it, is this
20 practical aspect that John has raised about how do we
21 actually get people to get involved. So, we've noticed a
22 real improvement that the FASB has made in terms of setting
23 up user advisory groups of various constituents. And
24 obviously a lot of what we're suggesting is predicated by
25 people who are really willing to participate throughout the

1 process of setting a standard and really help identify is
2 this going to make things better.

3 So, it would be great if we could hear from you,
4 and maybe start with you, Jeff, on how you think about how we
5 move forward on this whole question of investor involvement.

6 MR. MAHONEY: Jeff Mahoney. As I indicated in my
7 earlier comments, I agree with John and others that as far as
8 the FASB board goes, we need investors who are experts in
9 accounting. And I don't think there's a big pool of those
10 or, to the extent they exist, those people are particularly
11 interested in sitting on the FASB. So, as you said, the
12 question is how do we find those people, how do we identify
13 those people, how do we develop those people?

14 And as I indicated earlier, I think one way to do
15 that is what Chairman Herz and Don Young and others at the
16 FASB has tried to do is to set up more groups where they
17 identify investors and bring them in and get them involved in
18 the process that way. I think that's made a significant
19 improvement as it is, just having individual groups focused
20 on the investor community participate in the process. The
21 FASB, because of that, receives much more input from the
22 investor community than they did previously which was very
23 little at all. And you know, John's analogy about the
24 bridge, I think in many cases the investors said, the
25 customers said don't build the bridge and the FASB went ahead

1 and spent ten years building the bridge. And I think we have
2 to avoid that going forward.

3 MR. SIDWELL: Scott, do you have --

4 MR. EVANS: Yes. I wanted to follow up on the
5 bridge analogy which I think is terrific for the situation
6 that we have. And in our recommendations, there are
7 investors participating in several levels of
8 activity regarding this bridge, from the governance to the
9 people that are charged with building the bridge
10 to the FAF to the actual engineers that are out there putting
11 the thing up and designing it to the groups of people as Jeff
12 referred to that are actually going to use the bridge.

13 And the new thing that we have suggested in
14 addition to this more participation, more members of the FASB
15 who are users, more members of the FAF who are users is an
16 official user committee to do a pre-review. And it's a group
17 of users who are going to sit down and look at the design for
18 the bridge and talk about whether and how they'll use the
19 bridge. They may say, you know, about the new bay bridge, we
20 don't need it, we take the barge, it's cheaper. We're not
21 going to use this bridge. Or it doesn't have enough lanes,
22 I'll never get across in rush hour traffic.

23 Back to Linda's point, and you heard from
24 Kevin, the user is not necessarily focused on the intricacies
25 of design. He or she is focused on whether the thing is

1 useful. And we design the bridge and we design the
2 accounting standard for the user. So, one of my questions is
3 whether this formalization of the user input is a good
4 development and whether it will actually give investor users
5 the power to speak about the usefulness of the design of the
6 standards or whether we've gotten some comment letters that
7 it's just another cog in the wheel that's just going to delay
8 the process of bringing out new standards.

9 MR. STEWART: I don't feel, John Stewart,
10 knowledgeable enough about how the users bring their needs,
11 so I'm going to let Jeff or others respond. I agree with, it
12 seems like they're getting more input than they have before
13 and I think that's incredibly important. I guess I also, my
14 intuition says that users are not a monolith, that they all
15 don't say exactly the same thing, so that's part of the
16 FASB's job is to weigh the different input they get. Just
17 like we accountants think differently about accounting
18 standards, I'm sure the users are not, as I have indicated
19 and the survey has indicated, that they're not all on the
20 same page. And that's what makes the standard setting jobs
21 hard. But I don't know about, to answer your question,
22 whether your new proposal will help or not.

23 MR. SIDWELL: Jeff or Lynn?

24 MR. TURNER: A couple of thoughts. I think you
25 pose a very valid and very good question. First of all, let

1 me give kudos to Bob Herz because Herz and Don Young have
2 brought up and started up the ITAC, and I think the ITAC goes
3 a long ways as I read through your report. What you're
4 asking for I think has already been done to some degree by
5 the ITAC and in fact even on the agenda setting, I think you
6 really sit and know how it operates, the FASAC does a lot of
7 that. But Bob probably even gets more input from the 12 of
8 us on the ITAC than he'd probably care to have to listen to,
9 maybe anyone would have to listen to.

10 But anyway, so I think he's done that. But to get
11 more involvement, a lot of these shops don't have someone
12 that focuses just on accounting type issues. For example, at
13 Colorado -- where I'm at, we've got a \$43 billion fund. We
14 don't have an accounting analyst. We've got portfolio
15 managers that manage specific portfolios and their CFA's so
16 they very well know it. But would I say that they are per se
17 an accounting expert? No. But some of the shops do.

18 Capital Group which is the largest active fund
19 manager in the United States has people and they are very
20 good and Bob has got them involved. CalPERS now has
21 dedicated to it. Jeff, and the Council for Institutional
22 Investors, has set up now an informal working group to try to
23 develop more of these. That's occurred in probably just the
24 last four or five months. So, there are efforts underway.

25 As that effort develops so, I think you've got to

1 turn around and make it very clear to investors that their
2 voice is relevant. If you're only one out of seven people on
3 a board, you've got to ask yourself why go there and why go
4 do it, especially if you take a pay cut. And I think you
5 have to, one, increase them, make them relevant, increase
6 their voting significantly. And the second thing you've got
7 to be willing to do then is pay them to get there. People
8 aren't going to take a 50 percent pay cut to go do this stuff
9 and so you've got to be willing to pay them commensurate with
10 what they are worth.

11 MR. EVANS: If I could have a follow up? I
12 completely agree with you that for the members of the FASB
13 who might be investors that you need a certain degree of
14 accounting expertise. It goes without saying. But for the
15 user group that would be doing pre-review, wouldn't you
16 actually be better off with just standard users --
17 portfolio managers, analysts, serious retail investors who
18 would look at this and say "This works. I'm going to have
19 enough lanes to get across the bridge and the toll is right
20 and I'll have everything I need," because that's who we're
21 designing the standards for?

22 MR. TURNER: I'm not sure I would totally agree
23 with you, Scott. The ITAC does do, just so you know, Bob and
24 his group does bring to us where they're developing new
25 standards, so like redoing the SPE stuff, he's brought to us

1 a number of the issues, some of them nicely outlined and are
2 not bad earlier this week. And so, he has brought that stuff
3 to us and they have actually asked us for input.

4 So, when you talk about pre-reviews, that's already
5 occurring. And I can tell you, we're providing again a ton
6 of impact or comments on that already. And there are 12 in
7 that group. There's credit rating agencies, there's analysts
8 at the Wall Street firms, there's financial analysts that
9 provide research to many, many institutions.

10 But there are, I've got to tell you, especially in
11 my days at Glass Lewis, I visited with hundreds of investors
12 and many, many portfolio managers. And some are very good
13 and some are not very good. It's just like with any
14 business. And especially when you get into areas like the
15 indexing and all, you know, those, I'm not going to go get a
16 portfolio manager to do this who is involved with an index
17 fund because they aren't into this as much as they are into
18 their indexing.

19 So, I think in general, just to say portfolio
20 managers doesn't get it done. It's specific people who fill
21 that role and really understand. The person at Cap Group,
22 for example, when she gets involved and there are issues that
23 come up like with the SPE, she turns around and surveys all
24 of her portfolio managers. She really understands it. She
25 puts the question to all the portfolio managers, then gathers

1 that survey information back in and takes that and then feeds
2 that on to Bob or the group.

3 And I've seen Jeff and his group do some
4 outstanding work in this same way. Jeff goes out and once a
5 month sends out questions to the CFA people, asks them for
6 input on specific issues, gathers it and then that
7 information is provided on to whoever is asking for it, the
8 FASB or whoever. So, the users have processes in place to
9 get you the data and it can be done. I'm not sure if people
10 always listen to the data on a number of the, quite frankly,
11 on a number of the standards.

12 If you look at pensions, you look at OPAFS, you
13 look at derivative disclosures, when those standards, even
14 140, when those standards were all initially developed, there
15 were user comment letters that said you've got problems in
16 these and we need additional disclosures. And yet those
17 requests were ignored and we never got the disclosures until
18 one, two decades later. I mean, what Bob just put out on
19 derivatives which is tremendous and a tremendous improvement
20 is what investors asked for back when 133 was originally
21 proposed.

22 And that's why I think one of the key things that's
23 really great in your report and I give you kudos for is that
24 you're saying let's make the investor preeminent. So, when
25 you create the mission statement for the FASB, it says first

1 and foremost the investor is preeminent, and I think what's
2 good for them will be good for those of us who have been in
3 business, then I think that will cause them to look more
4 closely at the comment letters and you'll get some of these
5 things done on the first round rather than the second or
6 third.

7 MR. EVANS: So, would you agree then that the more
8 that we could formalize the investor review process which as
9 you describe is already pretty well along to make it more
10 public, to give it more publicity and weight in the standard
11 setting process the better? It would facilitate the objectives
12 that you currently have on ITAC and the other user inputs and
13 assure that preeminence to a greater extent.

14 MR. TURNER: Yes, I think to the extent you can
15 formalize a preeminence, that's helpful. Again, I'll say at
16 this point in time, I think those of us in ITAC, and I'll let
17 Jeff chime in here on his own, I think we feel that
18 the board doesn't always agree with us but I think the
19 board does listen to us. And I think the FASB staff does
20 listen to us. So, you can formalize whatever, but I think
21 that has already been accomplished and is working pretty
22 well.

23 MR. SIDWELL: I know, Joe, you have a comment.

24 MR. GRUNDFEST: Yes, a couple of questions
25 actually. You know, part of the conversation here, one way

1 or another, circles around the idea of information flows and
2 whether we have information failure. Just, you know, first,
3 you don't have to have accountants on staff in order for you
4 to be able to get the information you need if you think that
5 there is an accounting issue, all right. There are all sorts
6 of consulting firms you can go to and you can rent the
7 expertise and buy the reports and have other people look into
8 them. I won't advertise by mentioning some of them
9 but everybody really knows who they are, okay.

10 So, the fact that some organizations have
11 accountants on staff and others don't is certainly true, but
12 I'm not sure what it proves. Second, if the general
13 perception is that this additional accounting information in
14 terms of interpreting it has value, well, then it would seem
15 that it's rational for portfolio managers to go out and to
16 buy this expertise, hire people in or what have you. So,
17 is there a market failure here? Is it that accountants
18 are able to add more value that generates more alpha, and
19 because they are accountants they're discriminated against
20 and they're not appreciated and they're not --

21 CHAIRMAN POZEN: That's a new category.

22 MR. GRUNDFEST: No. I mean an insular
23 minority worthy of constitutional protection, I suppose. So,
24 one question revolves around the idea of are we talking about
25 a potential market failure? And if we are, what is it and

1 how does it work?

2 Second, if we look at our society at any one
3 function market, there are many important markets in which
4 people rely on third parties to interpret complex
5 information. Medicine, okay, prescription drugs in
6 particular, we don't let people make decisions about which
7 prescription drugs to take, all right. You have to have a
8 trained person, a physician to provide a
9 prescription for you. In the law, a person who
10 represents himself, has a client for a fool, all
11 right. You can run down all sorts of areas where information
12 intermediaries arise naturally, and in some situations are
13 put in place by the law.

14 So, the question then is there is an inherent
15 amount of complexity and difficulty in understanding this
16 stuff, and isn't it also optimal that society rely on
17 information intermediaries? Because otherwise, everybody who
18 wants to buy a stock in the United States has to be presumed
19 to have something like a CPA degree. It becomes a very
20 difficult equation that way.

21 MR. TURNER: Joe, first of all, let me come back
22 and say I'd rephrase it, is there a market value, I'd
23 rephrase it, is there inefficiencies in the market. And I'd
24 only point to the sub-prime problem to say not only are there
25 inefficiencies --

1 MR. GRUNDFEST: I agree.

2 MR. TURNER: But in the short run, there can be
3 tremendous and great inefficiencies. And the information --

4 MR. GRUNDFEST: I agree. But let me tell you where
5 I think that example goes. That example goes to making sure
6 that you get the appropriate information out to the
7 knowledgeable people in the market who can then further
8 disseminate it appropriately. And the real information
9 failures I think occur, and we can use the medical analogies
10 as well, when you don't get the appropriate information out
11 to the docs in a way that allows them intelligently to
12 prescribe, that's a real failure. When you don't have the
13 appropriate information about sub-prime and what the risks
14 really are and how all of this stacks up under a variety of
15 scenarios, that's a real failure. So, we're in total
16 agreement on that level.

17 MR. TURNER: Yes, and I think that's why I came
18 back to the point and made two points on the disclosures
19 about judgments, there needs to be a lot more because that
20 information has clearly not gotten out there. And you've got
21 to have the catch-all because you can't expect the FASB to
22 write a new standard for every new thing coming down the
23 road. And I know some of the firms have written comment
24 letters recently on the business judgment thing urging much
25 more disclosure, and I couldn't support them more on that.

1 And I think it runs to this very problem of information is
2 the lifeblood of the markets.

3 If you don't have the appropriate information in
4 the markets, they will be inefficient and maybe highly
5 inefficient, as we've recently seen, in the short run. And
6 the short run is not necessarily just a quarter or two. It
7 can be an extended period of time until the information comes
8 out, gets analyzed and there is enough participants in the
9 market that re-price the market. Now, there will be some
10 investors that -- quite frankly not all portfolio managers are
11 equally smart.

12 And so, you are going to have some
13 bad pricing that isn't inefficiency, just bad pricing on the
14 part of investors. And there is nothing we can do to, when
15 people make stupid decisions when they had all the
16 information, we can't help them out. The market in the end
17 though will take them out of the market.

18 But what we can do is for those who can make
19 informed decisions and then just adjust the pricing because
20 they're smarter, we can get them the information. And right
21 now, we are getting them the information. Bob wrote an Op-Ed
22 earlier this week on the 140 stuff that for the most part,
23 not entirely Bob, but for the most part I thought was pretty
24 good and he talked about the information that we need. We
25 just didn't get that out there. And yet we, you know,

1 someone should have known. And some very small participants
2 in terms of numbers did realize it and act on it.

3 CHAIRMAN POZEN: One of the problems we have is
4 just a focus issue as investors because
5 analysts look very broadly at a lot of things and it's
6 not clear until quite late in the game that this accounting
7 issue is really important. So, it's hard for analysts to get
8 worked up if you have a big shop like capital research work
9 and that they can have somebody who specializes in that,
10 well, that's a great step. And Joe is right, you can hire
11 third parties to do accounting and many people do. But
12 you've got to first decide that that's an issue worth
13 focusing on. And people like Kevin Conn who are in the
14 banking area, that's what they do, so they're focused on it
15 because of these issues.

16 But in other areas, it takes a while. And I have
17 to say I have sympathy for Bob Herz about the difficulty of
18 getting the investing community to really put the resources
19 into these accounting committees. It's the minority of us
20 rather than the majority of us who do it.

21 MR. SIDWELL: Jim, you had a question?

22 MR. QUIGLEY: I just wanted to ask Kevin and Jeff
23 also, both of you made the comments as you were going through
24 your preliminary thoughts that you "were not accounting
25 experts or investors," "We're not accounting experts or

1 investors, don't have the time to become accounting experts."
2 Is it possible for us to get the voice of the investor in the
3 process short of having investors on the FASB itself and
4 through advisory committees or through ITAC? Can that notion
5 of preeminence be accomplished and can we actually have the
6 right expertise we need for board members that have, that in
7 fact are investors in the way that we have defined them?

8 MR. CONN: Yes, this is Kevin Conn with MFS. Yes,
9 I don't know if they should be on committees or exactly what
10 role they should have. The points of views I think need to
11 be shared and be part of the dialogue, absolutely. And I
12 would suggest usefulness to Scott's question, the usefulness
13 of the information to allocate capital versus conceptual
14 precision or some balance of the two. I mean, you don't want
15 something that is conceptually incorrect obviously, but you
16 also want something that's useful.

17 And so, and maybe the criteria is, is this useful
18 for investors to allocate dollars to different investments.
19 You know, just balance that criteria with the criteria of we
20 want to have the exact right way to think about things. So,
21 I don't know if they need to be on committees or not. That's
22 for you guys to decide. But to have some input to the
23 dialogue is, one, appreciated, and two, I think will make it
24 more productive because, you know --

25 MR. QUIGLEY: I was just trying to really clarify

1 and understand your thinking on that. With respect to the
2 recommendation of the investor as preeminent in the process,
3 we in our thinking have felt that meant representation on the
4 governance, that meant representation on the board, actual
5 FASB members. And as I've listened to you, I've just tried
6 to understand, do you believe that the investor voice could
7 be preeminent in a process something short of being board
8 members with pre-implementation reviews or very active
9 participation on these advisory committees where that becomes
10 a loud voice in the standard setting process but it is short
11 of a board member?

12 MR. MAHONEY: This is Jeff. I would support having
13 investors involved in the entire process, having them on
14 advisory groups, having them on the board, having them
15 involved in the governance of the foundation. But I
16 understand that it may be difficult, particularly on the
17 board level, it may be very difficult to find the accounting
18 expertise and the willingness of the individuals who have
19 that expertise to sit on the board. So, that's I think the
20 more difficult one.

21 But as far as the advisory groups and in the
22 governance, the foundation if there remains a foundation, I
23 think there is no reason why we can't get more investors
24 involved in both of those right away. I think Bob, Chairman
25 Herz has already done that with ITAC, the user advisory group

1 and investor task force as far as committees, but I think if
2 we're going to keep the Financial Accounting Foundation, I
3 think we need to get more users involved there.

4 And then over time, I think we can identify and
5 develop people with the sufficient accounting expertise to
6 participate on the board. And I think once we identify those
7 people and there is a group of them that we can access, then
8 we should seek to increase the level of investors on the
9 board itself.

10 MR. CONN: Yes, I would second that, Jim. I would
11 agree. This is Kevin Conn with MFS. I agree with Jeff that
12 investors should be a strong voice in terms of being on
13 committees. My hesitancy before is just because I'm not
14 familiar with how the process works, so I didn't know if they
15 could have some voice, how impactful a survey is. But I do
16 think they should be there to vote on things and to bring the
17 usefulness criteria to the dialogue as well as the conceptual
18 in the exactly correct framework.

19 MR. DIERMEIER: Jim, if I could mention, make a
20 comment there. To the degree that my membership who have
21 read what we put out and I think interpret it in a proper
22 way, they have assumed that there would be complete
23 involvement all the way through the process on governing
24 boards. If for some reason we thought some pre-review panel
25 would somehow satisfy that, we need to be very clear about

1 that. And I can assure you that we will hear very loudly and
2 clearly from them because those members believe that we've
3 tried the other approach for a long time.

4 MR. SIDWELL: Thank you. Ed?

5 MR. NUSBAUM: Thank you, Dave. I'd just like to
6 dig a little deeper on the user perspective. Jeff, you
7 mentioned that the cost and benefit should be measured from
8 the perspective of the user. And I absolutely agree. I
9 just, where I'm struggling is sort of how you do that.
10 What's the process? And what should we, you know, the
11 standard setting process, how does that, what is the
12 effective way, other than just asking?

13 Obviously we've been talking about putting people
14 on committees, that's very helpful, and asking people what
15 they think. But sometimes when you just ask, you know, if
16 you just ask somebody, 50 years ago did they need a
17 personal computer, they'd say no. And you think
18 about the conversation with fair value this morning, how
19 would people really use fair value information? What would
20 be the benefit? What would be the cost to the user?

21 And so, do you have any thoughts on the process for
22 getting us there?

23 MR. MAHONEY: Jeff Mahoney. That's the problem
24 really is how do you do it. And I've looked at this a little
25 bit and no one has come up with the solution yet. And so, my

1 comment is until we do come up with that solution, we
2 shouldn't put a greater emphasis on this cost analysis
3 because I think that just adds more layers to the process,
4 extends the standard setting process even further if that's
5 possible. And I think at the end of the day, you end up with
6 a product that often isn't what investors would want.

7 So, I don't have the answer to that question. I
8 think a lot of people have looked at that and still have not
9 come up with anything yet. I think we need people to
10 continue to research that issue and try to come up with a way
11 that we can truly do a cost benefit analysis from a user
12 perspective.

13 MS. BIES: Dave?

14 MR. SIDWELL: Thank you. Susan?

15 MS. BIES: Let me just sort of follow up on this
16 line of thought because from two perspectives, one is that as
17 you were mentioning from the user's perspective, larger shops
18 tend to have in-house accounting experts that they can rely
19 on that the smaller don't. The same thing for preparers, the
20 small companies don't have in-house experts on things. And
21 whether there should be either a phased-in period that
22 smaller organizations would have a longer time, I'm talking
23 about preparers now, they don't have as big of an investor
24 base. They tend to be more closely held. But the fact that
25 if something has to be redone, they wouldn't have to do it

1 then again and they could learn.

2 So, would you be in favor of some kind of, from a
3 cost perspective, allowing small to mid-size companies a
4 little longer to implement? Is that something that is a
5 possibility in looking at some kind of a cost benefit where
6 the preparer cost could be high for a certain group?

7 MR. MAHONEY: Jeff Mahoney. I certainly support
8 giving smaller companies more time to adopt a standard and
9 learn from the larger companies initially. I think the FASB
10 has done that on a number of occasions and I think that's
11 been appropriate. I think there is a difficulty in defining
12 what is small, that's the issue. But to the extent that you
13 can get over that and that's not easy to get over, but to the
14 extent you can, I personally would be fully supportive of
15 giving them more time, letting them use the experience of the
16 larger companies before they have to actually implement.

17 I think that's a good idea. The FASB has done it a
18 number of times in the past. I think they should continue to
19 consider doing that on projects going forward.

20 MR. SIDWELL: Can I just draw this bit to a close?
21 Because I think it's been very useful to us to really focus
22 on your views on investor involvement and that scenario, that
23 obviously we have got very central to what we are trying to
24 develop. I would like to cover a few other areas as well.

25 One of the topics in the areas of standard setting

1 process that we've given some additional thought to in
2 discussions with Bob Herz and also in response to many of the
3 comment letters that had been written which is we had in the
4 original report talked about an agenda advisory group. And
5 as you can see from the status report we'd put out, we're
6 thinking of changing the name of that to be much more of a
7 financial reporting working group concept because as we had
8 originally framed this, we thought it would be very useful to
9 the process that given how important it is to any reporting
10 system to be clear about what is it that's on the agenda,
11 you're trying to deal with it, who is actually dealing with
12 the current issue of what time frame with what other groups
13 participating. We felt there would be real benefits if there
14 was a group that was pulled together that was in our current
15 term really focused on all of the issues in financial
16 reporting.

17 So, we were thinking that this would involve,
18 besides Bob as chair of the FASB and obviously onto the FAF
19 changes having responsibility for the agenda but including
20 many other groups at the senior level, whether it's the SEC,
21 whether it's PCAOB, users, to really help identify what are
22 the big issues, who should be dealing with those issues and
23 how is that going to get done. None of you raised this as an
24 issue this morning. Many of the comment letters focused on
25 is this an overlap with FASAC, how do we really get this to

1 work effectively. Any views on that? Because I must admit a
2 couple of points this morning pointed that probably this area
3 of agenda setting is a very important area for us to make
4 sure we're focused on. Dennon Locke or somebody I haven't
5 heard from in a while have any views to get us going?

6 MR. BIELSTEIN: This is Mark Bielstein. You know,
7 to some extent, and I'm not sure exactly how far you're
8 suggesting you take this advisory group, but I mentioned
9 earlier the EITF. One of the original goals of the EITF was
10 to address those kinds of emerging issues. Now, that group
11 was actually intended to solve the issues. I think here
12 you're just trying to get them identified.

13 I think that's an okay process. My expectation is,
14 through whatever mechanism, the FASB is becoming aware of the
15 issues that need to be addressed in a relatively timely
16 manner. Now, whether that's through FASAC, through EITF
17 topic submissions, through their just informal process with
18 the SEC and discussions with accounting firms and preparers
19 and the investors task force, my expectation is there aren't
20 many real big, major issues that they're not finding out
21 about. But having a group like this that would formalize
22 that process might help particularly in the new agenda
23 decision process.

24 MR. SIDWELL: I think we were also, in doing this,
25 focused on it wouldn't just deal with those issues that the

1 FASB might deal with. It could deal with areas that others
2 involved in the financial reporting community might also be
3 engaged in giving a guidance on.

4 MS. BERGEN: So, are you saying, David, that you
5 would allocate the work that this agenda committee decides
6 needs to be done among FASB, the SEC, the PCAOB? Is that
7 what you're suggesting?

8 MR. SIDWELL: Well, I think we, to use an example,
9 some of the guidance that has come out of the audit quality
10 group of the large firms, we were thinking this is a good
11 forum before any guidance is given by any of those senior
12 groups, that it's a good forum to say what is the issue, who
13 should deal with the issue, is the solution that is being
14 identified on this issue something that everyone engaged in
15 the financial reporting process is comfortable with? So,
16 something very real time, just making sure that if the FASB
17 feels it has a strong view, that it should jump in and be the
18 leader of providing that guidance, that the opportunity is
19 there.

20 And I think we would agree with what Mark had said,
21 that, Sonia and I had discussions with many participants,
22 that there is a very much strong but informal network working
23 today. We were trying to see some formalization of that
24 process.

25 MR. TURNER: But David, here is the concern I have

1 with it. What I really don't understand about this agenda
2 committee, and first of all, I think it's preeminent and very
3 important that the FASB maintain their independence and other
4 people don't dictate to them what their agenda is. I think
5 if someone should dictate their agenda to them from time to
6 time, it probably should be the SEC in the role of protecting
7 investors. That's one place where I'd probably draw a line.

8 But you and I have both sat on FASAC, I think even
9 together at times, and when I look at what you just described
10 and what you're talking about, it's what we all did on FASAC.
11 We talked about issues. We even did the annual survey.
12 People filled it out. And we turned around and said here's
13 what the issues are and what needs to be addressed.

14 I've never seen a FASB chairman and board members
15 who didn't know what the issues were and what needed to be
16 addressed. Then it became an issue of do they have
17 the resources to go do it within the context of what they
18 have to do from due process. So, I'm not exactly sure really
19 what you're trying to achieve here and what your stated point
20 is really what you're achieving. I think the vehicle is
21 already there and it seems to me we're just heaping
22 bureaucracy here on top of bureaucracy. You're going to add
23 another component at a cost to the FASB where those resources
24 could perhaps better be spent on staff or other areas.

25 I just, you know, I've sat around that FASAC table

1 and what you just described is exactly what we turned around
2 and did. And to add another layer on top, I just don't know
3 that I see the bang for the buck.

4 MR. SIDWELL: Ben and then --

5 MR. OLSON: David, this is Mark Olson --

6 MR. NEUHAUSEN: This is Ben Neuhausen. You know, I
7 have not been on FASAC but I have always read the FASAC
8 materials. In my sense of the FASAC agenda discussions and
9 your agenda survey is that it was largely reactive. It was
10 setting priorities for the issues that the FASB had already
11 identified that were either on the agenda or were potential
12 agenda items, but that FASAC was not doing, was not asked to
13 do sort of fresh thinking about what else maybe should be on
14 the agenda that isn't there now. And that's what I thought
15 was the value of this new committee, what was incremental
16 beyond what FASAC or other groups accomplish today.

17 MR. SIDWELL: John, do you want to go next? And
18 then, it sounded like Mark Olson has a comment, too. So,
19 John, after you we could hear from Mark.

20 MR. STEWART: Okay. I kind of agree with Lynn. It
21 wasn't clear to me what the value added was, how this was
22 bringing something new. I think Lynn is right, that the FASB
23 is on top, you know, understands most of the hot topics. I
24 wasn't sure what this group would do that wasn't happening
25 elsewhere. And the FASAC, they do ask in the survey

1 about new stuff, so I don't know if it gets read but
2 they do ask about something new that the FASB ought to be
3 working on that they aren't working on. But this seemed, you
4 know, I couldn't, you didn't convince me yet that this was a
5 good idea because I wasn't sure what more it was going to do
6 that isn't already happening somewhere else.

7 CHAIRMAN POZEN: I think one thing it might do is
8 take things off the agenda which doesn't seem to be a
9 strength of the current system.

10 MR. STEWART: Yes, but Bob decides that all by
11 himself. You've just got to have lunch with him or
12 something.

13 MR. SIDWELL: Let's all listen very carefully and
14 see if we can hear Mark Olson, and then Bob wanted to make a
15 few comments. Mark, can you speak loud?

16 MR. OLSON: Can you hear me, David? Hello, can you
17 hear me?

18 MR. SIDWELL: Barely but keep on going and try and
19 speak loud. Mark, go --

20 MR. OLSON: There is a working relationship among
21 the parties, among the FASB, the SEC and the PCAOB at the
22 moment. But I think that that's primarily for the purpose of
23 internal communication and for the purpose of making sure
24 that each of us know what is on the agenda for the others.
25 But that sounded quite different from an agenda setting

1 group. If we were invited to participate in an agenda
2 setting group, I think that the work product would be far
3 different from just the communications vehicles that have
4 been established up to this point. So, I would be
5 encouraging about the effectiveness of a group that were
6 directed in the way that you're suggesting.

7 MR. SIDWELL: Thank you. I think we all heard
8 that, so we appreciate it. Bob, do you want to go next?

9 MR. HERZ: Well, I think that the thought here was,
10 and whether it would be something FASAC-like or whatever,
11 would be that we have FASAC, we have other groups, the PCAOB
12 has a group, there's some overlap between that. There is the
13 CAQ now, and of course very importantly, there are the users.
14 But because issues often come up, some of them are issues
15 that are much more what I'll call supply side oriented, you
16 know, one firm doesn't agree with the other firms, doesn't
17 agree with the SEC. Somebody thinks the auditors are
18 interpreting something wrong, you know, forcing level 2 or
19 level 3 would be better.

20 You know, those kinds of issues that come up, you
21 get a more real time group that say these are the issues in
22 the system. Because we, I think in our country generally,
23 you know, we've kind of added on different groups at
24 different points in time, the FASB, the PCAOB, SEC's got its
25 mandate in that. But we're a little Balkanized. I think

1 it's more, to me it's better to address things in terms of
2 the reporting system, not just whether it should be an FASB
3 issue or a PCAOB issue or say here's an issue, how are we
4 going to deal with it and who is going to deal with it kind
5 of thing.

6 I think you'll observe in some other countries that
7 they have what they call financial reporting councils that
8 are a little bit different in function but at least they get,
9 you know, it's a more coordinated type of response to things.
10 And I think that was kind of the view in that. I think there
11 was also a thought that that might be important in the future
12 if we were to go to IFRS in this country and what would be
13 the architecture in this country for dealing with the many
14 interpretation issues that are likely to arise and how, you
15 know, or just application issues and all that, to deal within
16 the whole system rather than FASB go write something, SEC put
17 out something, that it would be just a much more holistic way
18 of dealing with reporting issues.

19 And it may be that, for example, to Scott's point
20 there, that the issue comes up and the firms
21 disagree or the SEC, for whatever reason, and you
22 get a bunch of users in there and they say we
23 don't really care about this issue, but we do care about
24 another issue that's in there that isn't kind of
25 the constant issues that are being generated by the supply

1 side of the equation.

2 MR. STEWART: Some of the things you were
3 describing was a role that the EITF had and I was surprised
4 to hear that Lynn would like to do away with it. He made a
5 hand signal, I wasn't sure what that meant. But I'm
6 surprised at that. I think the EITF has an important role to
7 fill and take some of the pressure off these implementation
8 issues that come up where people in good faith absolutely
9 disagree with each other.

10 MR. HERZ: Yes, but the EITF generates its own
11 work. It's like one thing begets another thing begets, and
12 it's always --

13 MR. STEWART: Let me give you an example, all
14 right? A real life example where the EITF played a role and
15 brought the accounting firms and the SEC together so life
16 could go on and we could be friends again. This
17 was, you know, you prepaid for some supplies that are going
18 to be used in an R&D project. The principle is clear.
19 Statement 2, expense R&D. But the groups were absolutely,
20 hundred percent divided. The SEC actually made companies
21 restate over this. And someone needed to take that issue and
22 resolve it. They were both arguably understandable answers.
23 Expense immediately, expense when you use the supplies.

24 Okay, so how do we solve it? Did anybody care?
25 Someone must care, it made a big difference to the income

1 statement. So, what group is going to solve this in the
2 future if we do away with the EITF that brought the parties
3 together. Users were kind of represented at the EITF or
4 getting more so, and this was an opportunity. If we do away
5 with EITF, who is going to deal with that.

6 MR. HERZ: I don't, I mean, the thought would be
7 that this group would say we think we have a real issue here.
8 The users would say "Yes, we do care about this
9 issue, it makes a real difference" and say "How are we going
10 to deal with it?" Well, the way to deal with it would be we
11 ought to have some standard setting activity. It may be then
12 that the EITF is an appropriate vehicle for doing that, but
13 there may be a bunch of other issues. People just say no,
14 it's more an issue of auditing guidance. Don't put out
15 another piece of EITF literature when it can be solved in a
16 different way.

17 MR. STEWART: Okay. I'm good on that. I mean, I
18 think the EITF, I was on EITF for a long time. I thought we
19 knew where things, if we can do them and things we couldn't
20 do. There were some issues that did seem like auditing
21 related and not what we could do.

22 I think there needs to be a group to deal with, I
23 know it adds to the literature and I know you guys think,
24 some of you guys think that's bad somehow. I actually think
25 that it's sometimes helpful to know what the answers are so

1 that users get a consistent answer out of their constituents.

2 MR. SIDWELL: So, Susan, you're going to wrap up
3 this section?

4 MS. BIES: Well, I just would like to say I think
5 there is a role for the EITF. And I'll give, I've been off
6 the EITF for over seven years but a lot of the issues when I
7 was on it dealt with revenue recognition and we had a lot of
8 discussions. You remember, Bob, you were sitting around the
9 table, too, for some of these, that we kept saying we're
10 dealing with issues that really are here because the FASB
11 hasn't acted. Well, we still don't have a revenue
12 recognition standard and it's been all these years, and yet
13 users and preparers need some clarity on what to do in the
14 interim.

15 And I'm very concerned if it gets wrapped in the
16 bigger FASB broad standard setting that how do you deal with
17 things as they quickly emerge? This world is changing so
18 quickly. So, I'm very uncomfortable to do away with the
19 EITF.

20 MR. SIDWELL: Okay. Jeff and then Mark, and then
21 we'll move on.

22 MR. MAHONEY: Jeff Mahoney. Just a quick comment
23 in response to Susan's comments. One thing that has changed
24 since you've left is now they have FASB staff positions.

25 MS. BIES: I understand that but I'm just still

1 saying.

2 MR. SIDWELL: Mark?

3 MR. BIELSTEIN: The only observation, I agree
4 completely with what John was saying about the EITF and the
5 usefulness of it. Under our current procedures, my concern
6 is the EITF is not able to act as timely as it once could.

7 MR. SIDWELL: This is actually probably a really
8 good lead in to one of the other areas that we've received a
9 lot of commentary on. And I think there's some
10 misunderstanding and we obviously need to clarify what we
11 were trying to sense is on the whole area of what is
12 authoritative interpretive guidance and what is
13 non-authoritative. And Ben, you raised this point earlier on
14 as one of your issues.

15 I think what we were not trying to do, to use a
16 double negative, was to in any way stop the flow of
17 information, flow of people's opinions on what a particular
18 standard meant or how a particular kind of question should be
19 answered. What we were focused on, however, and we did
20 receive a lot of feedback on this was we need to be clear
21 about what is authoritative and what is just implementation
22 guidance which doesn't necessarily have an authoritative
23 label ahead of it. So, our intention had been that for
24 things to be authoritative predominantly it would come from
25 the FASB. And as many of you talked about, there had been a

1 lot of amendments to standards as part of, in a way, the
2 formalization of implementation guidance when it's clear that
3 an amendment to the standard needs to be made.

4 But we were not trying to in any way stem the
5 question of people issuing implementation guidance. We were
6 just trying to avoid one person's implementation guidance
7 necessarily being more authoritative than somebody else's
8 unless it was issued by the FASB or from the SEC with
9 sufficient due process.

10 Do you have any views on this that you could share
11 with us? Because one of the things we've heard a lot of, and
12 particularly when we had the panel in December, was currently
13 what happens is too much, as soon as either it comes out of
14 the SEC or comes out of one of the audit firms, it is
15 interpreted by everyone, this is now what we have to do. And
16 we were trying to create much more of an ability with
17 sufficient due process and thought on an issue that that was
18 an acceptable alternative as long as it matched the standards
19 of care involving the audit firms et cetera.

20 Any views that would help us to think further about
21 this? Mark?

22 MR. BIELSTEIN: Yes. As being part of
23 a group that provides non-authoritative guidance to our own
24 firm and to clients in other situations, in the questions
25 that arise when people look at that, I don't think there is

1 any question that they realize that what we put in our
2 interpretations is not authoritative. I mean, that's very
3 clearly pointed out in some of those discussions.

4 Now, obviously when there is difference of views in
5 non-authoritative guidance, whether it be between different
6 organizations or whoever is putting that out, the preparers
7 and the auditors ultimately have to make a conclusion as to
8 whether one is more appropriate than the other, whether more
9 than one is acceptable, and that's where appropriate
10 judgments come into play. But I don't see a lot of confusion
11 about what is the authoritative literature as compared to
12 what is not authoritative.

13 MR. SIDWELL: Ben?

14 MR. NEUHAUSEN: Ben Neuhausen. I think, to a large
15 extent, this issue of what is authoritative versus what is
16 non-authoritative is going to be much clearer in about a year
17 when the FASB codification goes final because that will be
18 all the authoritative literature in one document, and then
19 anything that is not in the codification will by definition
20 be non-authoritative. Now, I think you are right that
21 sometimes if guidance comes out from an accounting firm, it
22 can sometimes be taken as authoritative. But I think that's
23 really dependent on the quality of the analysis.

24 And I think sometimes some of the
25 non-authoritative guidance from the accounting firm links the

1 guidance so clearly to the authoritative literature that
2 there just is no other way to interpret it, and then becomes
3 authoritative by virtue of its intellectual strength, not
4 just because an accounting firm put it out but because the
5 argument is so strong. In other cases, as John was alluding,
6 accountants in good faith could reach different
7 interpretations, and so one firm's guidance would be
8 non-authoritative because there is another equally good way
9 of analyzing the authoritative literature.

10 MR. SIDWELL: Linda, do you have a view as a --

11 MS. BERGEN: Yes. As a preparer of financial
12 statements, we certainly look to the authoritative guidance.
13 SEC speeches, we can certainly consider them authoritative
14 even though they may not officially be because that's what
15 the SEC is going to be looking for when they review our
16 financial statements. So, de facto, that kind of guidance
17 does become authoritative.

18 But I don't see what's wrong with the hierarchy
19 kind of concept that we have today with the SEC, as the
20 chief standard setter, delegating most of the work to
21 the FASB and the EITF, and as you move down the hierarchy,
22 you get different levels of how good is this
23 guidance. That seems to me to be quite reasonable.

24 I guess where we have trouble is when there is
25 conflicting guidance among the Big Four firms or when like

1 papers are written by groups we've never heard of. You know,
2 they suddenly popped up and yet they now do
3 certainly contribute to our understanding of what is
4 appropriate accounting standards.

5 There ought to be, I guess, some official hierarchy
6 and perhaps you're reorganizing that hierarchy. The
7 codification, Ben, I think will be a good thing, but as I
8 understood what I read is that a lot of the SEC literature
9 won't be in that codification, at least not in stage 1. So,
10 without that, it's not quite complete.

11 MR. SIDWELL: Thank you, Linda. Denny, you next,
12 and then --

13 MR. BERESFORD: Could someone, I mean, maybe John or
14 somebody or Jim clarify that point?

15 MR. KROEKER: Well, one, our speeches aren't part
16 of the authoritative literature. They won't be included in
17 the codification. But SEC's guidance is going to be included
18 for ease of reference in the codification. However, the
19 official source of SEC literature doesn't come through a
20 codification. It comes through the Commission.

21 There will be pieces of staff guidance that are
22 going to also be included while non-authoritative might be
23 useful for people's reference, for example, staff accounting
24 bulletins, so that would be in the codification. And I think
25 it's already in the draft or the version that's online.

1 CHAIRMAN POZEN: But there was a curlicue about
2 whether or not for some technical reason they could be
3 formally included in codification?

4 MR. KROEKER: They're in there but that doesn't
5 become the source for authoritative guidance. The FASB or
6 the FAF isn't the publisher of authoritative guidance for the
7 Commission.

8 CHAIRMAN POZEN: I see.

9 MR. SIDWELL: Denny, you had a question?

10 MR. BERESFORD: I guess I'd like to go back to a
11 comment that Mark made at the very beginning about it's hard
12 to stop the accounting firms from issuing their own guidance.
13 But to both Mark and Ben in particular, with the
14 authoritative codification sometime in the relatively near
15 future, and other non-authoritative literature including the
16 accounting firms, including speeches, whatever it might be,
17 do you think it's possible that accounting firms can accept
18 more than one approach within their own practice for some of
19 these issues? I guess I would give John's example of
20 expensing or not expensing the supplies in anticipation of an
21 R&D project for example. Ben's comment about the
22 intellectual arguments or whatever, I would assume that both
23 sides of that particular argument felt that they had
24 intellectually analyzed it properly and come up with
25 different answers.

1 My question is are corporations then going to be
2 bound by the accounting firms' non-authoritative guidance?

3 MR. BIELSTEIN: This is Mark Bielstein. Denny, I
4 think we do that, go through that process today. And I think
5 there are facts and circumstances where maybe our firm would
6 put out guidance based on how we think a new standard should
7 be applied, based on our interpretation. Another firm or
8 another organization might put out the guidance and would
9 look at that and we may run into situations where somebody,
10 one of our clients would follow the other guidance. We'd
11 look at it and say, well, in some cases that may be a
12 reasonable interpretation and we wouldn't necessarily object
13 to that. In other cases, we would go through that evaluation
14 and it's possible to say, well, we appreciate this other
15 organization came up with this guidance but in this
16 particular case we just don't think that's right.

17 So, I think we go through that process today and
18 make those determinations as to whether that's a reasonable
19 approach based on a review and judgment of the facts and
20 circumstances. And it will be different answers in different
21 circumstances depending on what the issue is.

22 MR. BERESFORD: So, you don't think things will
23 change very much under the codification approach?

24 MR. BIELSTEIN: Well, I think the codification, as
25 Ben said, will clarify what's authoritative and

1 non-authoritative if people are confused by that. I think
2 the codification will be a great help in trying to find all
3 the authoritative literature. It's a huge benefit so it will
4 be some place that's easily accessible. I don't think it
5 will necessarily change the judgments that we try and go
6 through in how we address issues today.

7 MR. SIDWELL: Lynn, you had a couple of thoughts?

8 MR. TURNER: Well, I honestly think this is an issue
9 that's been with us for as long as the profession has been
10 around and I don't think there is any silver bullet. I
11 remember when I was at the Commission the first time from '89
12 to '91, the AICPA-SEC regs committee came to us at the time
13 because we didn't publish our speeches and harangued us and
14 harassed us. And after I left, about the time Walter Schultz
15 came in, then they started making the speeches, probably
16 because the profession and everyone had come in and asked for
17 them to turn around and be public. And the reason was people
18 wanted the answers to a question and they wanted to know what
19 the answers were.

20 And so, all of a sudden speeches started getting
21 made public. And no sooner did speeches started getting made
22 public than people who didn't like the answers in the
23 speeches turned around and said don't make the speeches
24 public anymore. And so, this thing has gone back and forth.
25 You like the answer if it gives you the answer you like; if

1 you don't like the answer that it gives then don't
2 make it public or don't hold me to it.

3 I think the firms have done a tremendous job of
4 putting out the information. As a CFO, I reached out and
5 tried to get whatever information I could from Don or Ben
6 Shaw, the UCM stuff from Mark Schopf because they would
7 provide me information that would help me do a better job of
8 my accounting. And I don't know why anyone would want to
9 take that away from me.

10 And from time to time, to John's point about the
11 EITF and one that would support his view is we
12 constantly saw where three of the, or at that point in time
13 for the five firms that go off and come up with one answer
14 and all of a sudden one firm would come up with another
15 answer and you'd wonder why and it seemed to be totally off
16 the reservation. And the firms used the EITF to bring the
17 one back on to the reservation.

18 So, those type of issues have come up and maybe
19 it's why Spacek quite frankly said the only way to deal with
20 this is just to create an accounting court on these issues,
21 you should just take the issues to the accounting court and
22 let them decide the issue and get on with it. But I
23 certainly would be disappointed if someone turned around and
24 said we don't want the accounting firms to put out their
25 view. I mean, I want as a CFO to be able to go to my

1 accounting firm. I want to be able to get their advice. And
2 if they put it in writing and put it out there in a
3 publication, more kudos to them. That's great.

4 And let's not, everyone understands it's not
5 authoritative. The notion of what's authority or not, I
6 think that's a cop out and a hoax. We all have access to a
7 digital search system now on any of this stuff. You can
8 quickly go search, and when you do those searches, you know,
9 automatically what is and isn't authoritative.

10 So, it's anyone that can run a computer with
11 what is now fourth grade literacy on a PC knows how to
12 do it, can do it, so it's not that tough to figure out.

13 MR. BERESFORD: Lynn, I think the problem is right
14 now it's going to be very easy to do that for the
15 authoritative stuff, but for the non-authoritative stuff
16 that's everything in the world. And not everybody has access
17 to all of the accounting firms' literature, for example, or
18 all of the other interpretations that might be around. I
19 mean, in an ideal world, I think that would be terrific but I
20 don't think we're quite there.

21 MR. McCLAMMY: And I think one place this came up was
22 particularly for small and mid-size companies. I think it's hard
23 enough for the large companies in the US to keep up with all of
24 the SEC speeches and different sources of unauthoritative GAAP
25 that's coming out. But for a small or mid-size company

1 to keep up with it is just totally impractical. I think
2 the thought was more not that the SEC shouldn't be giving
3 the kind of guidance they're giving in speeches, but it should
4 be coming through one voice from the SEC, so you know if you
5 look at that one source, that you have their feelings and you
6 don't have to go all over the place searching for it.

7 MR. SIDWELL: Bob, and then John Stewart.

8 CHAIRMAN POZEN: Yes, I just want to make clear, I
9 don't think our recommendation is in any way to stop the
10 firms from issuing whatever learning and analysis they have.
11 It's just to make clear to the extent it's not clear that
12 it's not authoritative.

13 I think the more, and I think probably it's fair to
14 say that at least once this codification comes out it will be
15 pretty clear, but you do have groups like the AICPA and now
16 the Center for Audit Quality. And when they put out things,
17 I think that's a little less clear cut as to what their
18 status is, whether they're speaking, then it's not the firm,
19 it's somehow the industry. And I was wondering whether,
20 Mark, you took the same view as to pronouncements by those
21 sorts of organizations?

22 MR. BIELSTEIN: I think Ben is part of that AICPA
23 that's --

24 CHAIRMAN POZEN: Okay, well, we'll have Ben answer,
25 too.

1 MR. BIELSTEIN: But I can, I mean I think those
2 kinds of, that kind of literature coming out from an
3 organization like either the AICPA or the Center is useful
4 because it does have a broader distribution potentially than
5 just one firm doing something. And you know, I'm not sure
6 there's a great deal of confusion about what's authoritative
7 or not, but I think those organizations putting out some of
8 that information to their members is useful and helpful.

9 CHAIRMAN POZEN: Well, when I ask for a memo from
10 my audit firm on what's GAAP, AICPA things show up as GAAP.

11 MR. NEUHAUSEN: Ben Neuhausen. There is some
12 confusion I think specifically with the AICPA because AICPA
13 documents used to be authoritative. And so, certain of the
14 audit guides, certain of the statements of position are
15 authoritative. Accounting guidance from those documents will
16 be in the FASB codification. But I think it will be very
17 clear going forward with the new AICPA documents that they
18 will say in them that they are non-authoritative.

19 MR. SIDWELL: John Stewart?

20 MR. STEWART: I would ask you just to think about
21 the real world process and how it works when a new
22 standard comes out. The FASB has issued 141R and Statement
23 160 that are big deals. First of all, they come out and then
24 the accounting firms understandably write, well, here is what
25 they're trying to say. Now, that might be a criticism of the

1 standard, but anyway, they write those things. And they're
2 very useful, we learn a lot from them. I used to do it in my
3 old life but I read all the stuff that comes out.

4 And then, time goes by and firms begin to talk
5 to each other and they realize that they don't agree on a
6 particular point. And then, more time goes by and so there
7 needs to be pressure taken off, is it important or not. And
8 I don't know how this is going to work in the world of IFRS,
9 but someone needs to answer the question maybe. Maybe
10 it's not important. But there needs to be pressure taken
11 off, who is going to do that.

12 Then, more time goes by and they begin to publish
13 Q&A books. These are great books, they're very useful in
14 answering questions. We accountants answer questions. So,
15 what would you, I think all that is good. And at some point,
16 if they can't resolve it amongst themselves, the SEC needs to
17 resolve it or the EITF or give a speech. Or someone needs to
18 know the answers.

19 I don't agree with Lynn that if we didn't like the
20 speeches, we didn't want them published if we didn't like the
21 answers. We wanted to know what the SEC had to say and we
22 followed it once they spoke. So, the real world needs some
23 implementation guidance, non-authoritative or otherwise,
24 because not everybody can do it themselves.

25 MR. SIDWELL: And we agree with that. And I think

1 all we were trying to do is differentiate between that which
2 is authoritative and just really clarify where the line is
3 between it and non-authoritative.

4 We've got ten minutes left, if the Chairman will
5 allow us that amount of time.

6 CHAIRMAN POZEN: Sure.

7 MR. SIDWELL: We've covered I think the structural
8 issues, if you like, that had been raised by many of you.
9 What other areas do other members of the Committee or the
10 panel just want to raise in these last few minutes? One I
11 might quickly raise is just your views on post-adoption
12 reviews. We had originally proposed almost a bright line on
13 that which we're now thinking about backing away from and
14 saying that there are enough processes that really will focus
15 on when is the right time when a standard needs to be
16 amended. Denny?

17 MR. BERESFORD: David, I'd just like to challenge
18 John's comment. It seems to me that at least part of the
19 thinking up until now is that we don't have to have an answer
20 to everything, that we should be willing to trust the
21 judgment of accounting firms and their clients and so forth
22 to come up with reasonable answers within principles, within
23 broad objectives. And apparently John feels differently. I
24 know a lot of people feel differently about that, and that's
25 pretty fundamental to what we've been doing in this whole

1 project.

2 I'm not sure that there's one specific
3 recommendation that says exactly that, but I think that is
4 really kind of a principle underlying what we're doing here
5 is that we don't have to have an answer to every question
6 going forward.

7 MR. STEWART: This is John Stewart. I
8 think that that as a value is a tough judgment as to how much
9 non-comparability do you all think is acceptable. If you
10 think there needs to be very little, then we'll need answers
11 to most all of the questions. If you or users are willing to
12 tolerate a significant amount of non-comparability, a
13 significant amount of non-comparability, then we don't need
14 to answer all the questions.

15 I was brought up thinking we need comparability,
16 and therefore, think most questions do need to be answered.
17 But if someone decides we don't need that much --

18 CHAIRMAN POZEN: Well, I think that's true, that
19 you do give up a little non-comparability. The problem, as I
20 think a number of people have said, is we can't possibly
21 answer all the questions here. And that's, people can,
22 there's a bit of schizophrenia. On the one hand, people
23 complain that Bob's standards are much too long, they're much
24 too long because people keep asking very specific questions
25 so that it's sort of like a game that you can

1 never win. And then, the second thing is we know that the
2 more precise we give an answer, the more likely someone will
3 figure out a way to structure around it.

4 So, I think these are the two concerns that people
5 have, that if we go down the route that we've been trying to,
6 we'll just get longer and longer standards. We'll never
7 answer all the questions. We answer the questions we do, and
8 then people are extremely clever in using that to come to
9 results that people feel concerned about.

10 MR. STEWART: Yes, well, I don't agree with some of
11 that. I don't think, I don't complain about Bob's standards
12 being too long. I complain about them not being --

13 CHAIRMAN POZEN: Well, if I took a search of the
14 literature, how many people complained about how long the
15 hedging thing is. I bet you there were a thousand comments
16 there.

17 MR. STEWART: Yes, I was speaking for myself. I'm
18 here only representing me and no one else. But I don't
19 complain about his standards being too long. I complain
20 about them not being easy to understand or operationalize.
21 That's not the same as being too long.

22 And then, second point is I don't agree that every
23 time we answer a question someone will structure around it.
24 I don't think that's true in a lot of questions that come up.
25 There are just good faith differences where we need an

1 answer. They're not structuring devices that someone is
2 going to do something bad. They just want to know what the
3 answer is.

4 CHAIRMAN POZEN: Well, I guess you're correct and
5 it's not every case in which that's happening. But Bob would
6 be the first to say he's trying to make it clear. The
7 problem is he can't make it clear enough. There are always
8 ambiguities.

9 MR. TURNER: But again, there is no silver bullet
10 here, and I actually wholeheartedly agree with John on this
11 point. The bottom line is you've got a lot of
12 people asking questions about how do I get to an answer on
13 this or that. If they're asking the questions, there's a
14 reason they're asking the questions. There is a reason the
15 CFO or controller wants to know those answers. You can't just
16 turn around and tell them no, that just doesn't work.

17 And so, I think John is absolutely right. And for
18 me, as someone who has run an investor research firm, Bob,
19 consistency and comparability is the hallmark. If we lose
20 consistency and comparability, I think we've got a problem.
21 And I think to that point I couldn't agree more with John.

22 MR. SIDWELL: Joe, hold on a second. Mark first
23 and then you, Joe.

24 MR. BIELSTEIN: Just a quick observation to follow
25 along with some of these comments. I think it's also

1 important, particularly because we deal with new standards,
2 to recognize that we all get smarter as we deal with the
3 standard over time. And just because we may have thought one
4 provision of Statement 157 when it first came out should be
5 interpreted one way but through continued work and dialogue
6 new information comes to light and, well, maybe another way
7 is a better way to interpret that, I think it needs to be
8 recognized that those things are going to occur over time in
9 some cases. And that doesn't necessarily mean that the first
10 interpretation was necessarily an error or wrong.

11 CHAIRMAN POZEN: Yes, I agree with that.

12 MR. SIDWELL: Joe, do you want to have the last
13 word?

14 MR. GRUNDFEST: No, but if I might ask a question?
15 There is a similar problem in the common law system, all
16 right, you know, and the legal system operates through common
17 law process and the courts just answer the cases that are
18 before them and they try not to reach any farther than that
19 and to the extent the judiciary currently has a style that
20 involves minimalist judging, you know. Yet we're able to
21 make that system work, all right. We're able to make it work
22 reasonably well, not perfectly.

23 And what I wonder is, is there something that the
24 accounting standard setting system can learn from the common
25 law process? And let me suggest what it might be, and it's

1 not a perfect match. In the common law process, the vast
2 majority of the cases wind up being settled because the
3 people have to sit down and intelligently predict what the
4 reasonable resolution would be if he went to trial. And it's
5 just too expensive and dangerous to go to trial, so everybody
6 is always inferring where the law will go. And we don't do a
7 bad job of that, not a perfect job, all right.

8 Now, the difference in the accounting area is you
9 don't have the discipline of an adversary process given the
10 way it's currently operating. You have instead a standard
11 and then you have a transaction that's not specifically
12 covered or you think it's not specifically covered. You sit
13 down, the reporting company sits down with its auditors and
14 they come up with an interpretation and nobody knows about
15 that interpretation. It's in effect a secret communication
16 between the auditor and the company.

17 Now, what would happen if every time an issue of
18 that sort came up -- that it was a requirement that the
19 interpretation be made public in effect and be exposed so
20 that that could be criticized and commented on and literature
21 could develop around that interpretation, all right? Now,
22 you can do the exposure without identifying the company. You
23 can even set up a mechanism if you want where you can do the
24 exposure without identifying the audit firm that adopted that
25 interpretation. There are a variety of ways that that can be

1 structured.

2 But you then have the discipline of in effect
3 saying, wait a minute, if I'm taking this interpretation, if
4 I have to expose it, will I then be called out by the system
5 and by my peers for being an idiot? All right, for taking a
6 totally unreasonable interpretation and caving one way or
7 another? So, to me, the irony is here we are in a system
8 that's talking about transparency, that's talking about
9 disclosure, that's talking about clarity, yet many of the
10 most difficult issues are raised, addressed and resolved in
11 secrecy.

12 So, let me just suggest that as an approach, that
13 if you put a question to your auditor, in order for you to be
14 able to rely on your auditor's answer, you have to make
15 public sufficient information that would allow third parties
16 to understand the question asked, the answer given, all
17 right. And I understand there can and should be a debate
18 about whether you identify who the audit firm is, do you
19 identify the company, you know, there could be commercial
20 reasons for not doing that. But that way, we get the
21 discipline of a piece of the common law process operating in
22 accounting.

23 MR. TURNER: Joe, I would tell you that there is a
24 good component of exactly that in what was proposed by
25 Leonard Spacek who was chairman of Arthur Andersen at the

1 time. And I'd urge you to go back and take a look at his
2 recommendations in doing it, and it was along those lines.
3 It set up what he then called an accounting court, but it
4 would do I think and accomplish exactly what you're trying to
5 do.

6 MR. GRUNDFEST: I don't think you need an
7 accounting court at all.

8 MR. TURNER: Well, but it got it out publicly and
9 people had to --

10 MR. GRUNDFEST: So, why has the profession not done
11 that?

12 MR. TURNER: Because people don't like things out
13 in public.

14 MR. GRUNDFEST: Why do they not like things out in
15 public? Because they don't like what will happen, so maybe
16 that's the reason why we should figure out how to get it out
17 in public.

18 MR. TURNER: And I would totally support you on
19 that.

20 MR. GRUNDFEST: Well, when Lynn and I agree on
21 something, we've got to watch out.

22 CHAIRMAN POZEN: I think this is going over the old
23 ground of, I mean, I think everybody would agree that it's
24 useful to clarify certain things but we can't clarify
25 everything. And if we could only figure out where exactly to

1 be in the middle, we would all solve that particular
2 solomonic problem.

3 But I think we've come to the end of this session.
4 We appreciate very much all of you participating. We
5 appreciate those people who have been patient enough on the
6 phone where they haven't been hearing so well. And we will
7 now have a lunch break and we will back around 1:30 to have
8 Bob Herz from FASB addressing us. Thank you
9 very much.

10 (Lunch recess.)

11 CHAIRMAN POZEN: For this part of the meeting, we
12 want to have Bob Herz from FASB who is going to make a few
13 remarks and some discussion. I wanted to personally thank
14 Bob for the amount of time and effort he has put into our
15 Committee and for the very serious and good faith
16 negotiations between FASB and David's Subcommittee. I think
17 they've been fruitful in really working toward a common goal.
18 So, thanks for that and please take the floor, Bob.

19 MR. HERZ: Thank you. As you know, for a number of
20 years before this Committee was --

21 CHAIRMAN POZEN: You've got to speak into the mic.
22 We're still --

23 MR. HERZ: Yes. For a number of years before this
24 effort was formally created, I had kind of, I guess for want
25 of a better word, been kind of vocal and almost lobbying for

1 an effort like this to be created because I felt from my own
2 particular perch in this system that there were a lot of
3 issues both with complexity and also with barriers to
4 improving the reporting system for the benefit of investors
5 and other users.

6 So, really I just want to personally thank each of
7 the people, each of you on the Committee, the observers, the
8 terrific staff for participating in this effort and really
9 getting engaged in what is I think a very, very important and
10 necessary effort. You know, that's why we were very pleased
11 to donate a lot of Russ' time and our board members as active
12 observers and other staff help as well. And certainly I give
13 you my commitment that we will carefully consider any final
14 recommendations of this group that are directed towards our
15 activities.

16 CHAIRMAN POZEN: Bob, I'm going to just say that we
17 were hoping for a little more and, you know, what we would
18 like to be able to say in issuing the final report is that
19 you support the report or you endorse it or this sort of
20 thing. And as I have said to you, if there are issues, we
21 should try to work them out. So, that would be helpful in
22 terms of getting it some credibility.

23 MR. HERZ: Let me make my comments. I think --

24 CHAIRMAN POZEN: Okay, thank you.

25 MR. HERZ: I think that, from

1 our perspective, obviously all of what's in the report is
2 relevant, but particularly the work of Subcommittees 1 and 2.
3 I think we agree with the thrust of many, many of the key
4 recommendations, you know, the preeminence of users. They
5 are the customer. I think that gets to the heart of the
6 purpose of financial reporting. The notion of trying to get
7 more towards the single standard setter, we've been trying to
8 do that. And many of the issues and recommendations related
9 to substantive complexity, relating to notwithstanding some
10 of the comments in different industry accounting models,
11 optional accounting methods, competing models and the like.

12 I would make just one very minor point on one of
13 the comments in, I think it's Subcommittee 1's report on
14 substantive complexity, or at least the updated status
15 report. It indicates that IFRS has less options in competing
16 models. I think that's true in an absolute sense but I think
17 you ought to recognize also that they have an option for fair
18 value on a lot other things including property, plant and
19 equipment, investment properties in that. That optional use
20 of fair value is much more prevalent in their literature than
21 it is in ours at the moment.

22 There are two other perhaps more significant
23 matters related to substantive complexity that while the
24 drafts of the status reports touch on that, I thought I'd
25 just give you, really encourage you to maybe do a little

1 further work on it and consideration. First, I'll deal with
2 the issue, I'll call it "short-term-ism" and the
3 hyper focus on quarterly earnings and earnings guidance and
4 the whole kabuki dance that goes on in our system around
5 that. There is a brief mention in Subcommittee 4's report
6 that thought about that and that some view it as a source of
7 complexity, but other groups have been looking at that. And
8 that is true, I've been part of some of those other groups.

9 I think from where we sit, it is a major driver of
10 complexity in our system. I think the desire for accounting
11 methods that enable companies to manage, control,
12 screw with the reported earnings to make them leads often to
13 requests for build-to-suit accounting models or smoothing
14 devices, and in some instances, the structuring of
15 transactions to achieve the desired accounting results. And
16 we do our best to react to that and try not to give
17 in to all of that but the pressure is constant and it is a
18 pervasive issue, I believe, in our financial reporting
19 system.

20 I don't know everything to do. I think that
21 actually there's a number of things in the report taken as a
22 whole now that actually ought to take some credit for it that
23 I think may help with this issue. It may not be enough
24 exploration but there are some things. I think we talked
25 about the issue, the 'chunk-alizing' the financial, the

1 schedule and all of that. That may help along the
2 lines of our financial statement presentation project.

3 I think Subcommittee 4's recommendations relating to
4 key performance indicators and enhanced business reporting
5 and approved disclosures and quarterly press releases, and
6 corporate web sites, I also think that could help because it
7 brings more granularity, more information, too. It might
8 help get away from the whole focus on just one
9 number each quarter and guessing the one number each quarter.
10 And then, I think the judgment framework might help also in
11 this regard.

12 I think it's important, but I think it's also
13 important that there be some message given, I guess it's kind
14 of in the report but that people treat financial reporting as
15 a communication exercise and not just trying to
16 comply or in some cases an opportunity to spin, to paint
17 pictures that, you know, may not be as flattering as the
18 underlying reality. And I would refer you to what I think
19 was a pretty good discussion in a prior SEC report to
20 Congress, I think it was the one on off balance sheet
21 arrangements but it might have been the one on principles
22 based accounting. That has a good discussion about this
23 whole issue of financial reporting as communication and the
24 like. So, I think that is a very important point when you're
25 talking about substantive complexity in our system.

1 Another issue that I think is related to
2 substantive complexity, relates to the education and training
3 of accountants. Now, I was pleased to see that this issue is
4 now being touched upon in Subcommittee 1, in the status
5 report, in preliminary hypothesis 3.2. It does deserve
6 consideration. There was some mention that the Treasury
7 Advisory Committee is also looking at that. I'm not sure
8 they're looking at it in all the elements that I would think
9 it would need to be looked at and discussed.

10 I guess that, to me, it kind of boils down
11 to a couple of important and related things. If accounting
12 is supposed to reflect the "economic substance," or
13 the economic reality and it's supposed to be meant for the
14 users, the consumers of the information, that I think we need
15 to question to what degree our current accounting education
16 system and training system provides a good enough grounding
17 for accountants in the modern era on both economics and
18 understanding how the financial information actually is used.
19 I don't know how much is now taught at basic.
20 My own believe is that you ought to learn economics,
21 both macro and micro, before you start getting into debits
22 and credits and all the rules in all of that.

23 And I also think you should learn to understand
24 financial analysis, security valuation, business valuation.
25 And I think we find that, as we develop new

1 standards, part of the problem is people say I wasn't taught
2 this stuff. I didn't learn it. I wasn't taught it this way.
3 And then, it becomes kind of foreign and it does present a
4 barrier in the system to moving forward the development of
5 accounting that better serves the users and that better
6 reflects the economic reality. So, I'd encourage you to -- you
7 mentioned it now in the preliminary hypothesis -- I would
8 encourage you to explore that, think about it.

9 Next, I'm sure that Bob, Jim and Russ
10 will come down the home stretch and pull the report together.
11 I think it's important that you identify and eliminate any
12 obvious potential and internal inconsistencies in the
13 recommendations so that holistically it seems to make sense.
14 Now, one set of recommendations that Subcommittee
15 2 has done and we talked about it today again is the user
16 preeminence. I think that is key. It is absolutely
17 important. I think you need to gauge your own, the rest of
18 the recommendations you have throughout the report against
19 that goal in mind. And I'll just tell you that I think that
20 you'd have heard from some of the users today but if we talk
21 to some of the users there are some of the elements in the
22 report that they don't view as consistent with that point of
23 view and the like.

24 I think we had some discussion today about
25 the fair value issue and we certainly agree that there

1 is a need for a measurement framework but I would not be in
2 favor of kind of a blanket moratorium. I mean, we've gotten
3 urgent requests from the people in the brokerage and
4 commodity trading area to clarify that physical commodity
5 inventories that are traded can be carried at fair value
6 because the SEC staff probably correctly has interpreted a
7 50-year-old piece of literature saying that generally can't
8 be the case. Yet it's used as a part of an integrated
9 trading strategy. So, we're going to do something on
10 that.

11 We were visited a month or so ago by the REIT
12 industry, not just the preparers but the key group of
13 investors also and they said they want to move to fair value,
14 that the current REIT financials at historic cost are
15 misleading. And so, I think again, you know, caution I agree
16 with. Moratoriums, I think that would be a little
17 bit unwise.

18 Finally, I have to mention of course what I think
19 was brought up in the second panel a little bit with what
20 from our perspective is clearly the elephant in the room, and
21 that is convergence and moving to IFRS in this country. You
22 know, Subcommittee 2's status report I think does a good job
23 of laying out that conundrum and issue and we're kind of
24 caught in midstream here. This Committee began in August and
25 since then a lot of things have been going on a parallel

1 track related to our financial reporting system that could be
2 very, really threshold issues for the whole system. And
3 we have been proceeding in our organization and I think
4 with agreement of the SEC staff, certainly our trustees,
5 that we think the right place to get is to a
6 single set of high quality standards and do it sooner rather
7 than later. And it's important that we finish up as soon as
8 possible on some of these major joint projects we have with
9 the IASB.

10 I think that the SEC, you know, Chairman Cox has
11 said he has asked the staff to develop a roadmap to get to
12 that point with a date certain and the like. And so, in our
13 discussions more recently with Subcommittee 2, what we did is
14 we took some of the recommendations and we said they're very
15 path -- how do they get implemented? They're all good
16 recommendations, okay. It's a question of how we would
17 implement them. And that implementation could be quite path
18 dependent.

19 And we went through this and said okay, if you go
20 under a presumption which has been the working presumption,
21 or I don't know if it's a presumption or constraint so far,
22 that US GAAP is going to be around for a
23 significantly long period of time in this country, and
24 convergence is not a priority, then here is how we would
25 attempt to implement with it. If on the other hand we're on

1 this other path which we are increasingly going
2 down and we hear people in the system saying that that seems
3 to be the path that most people want us to go down, here is
4 how we would implement it and it would be a little bit
5 different in some cases. I think that's not to
6 knock the recommendations per se because I think, we think,
7 do we good cost benefit this idea of going back
8 post implementation -- those ideas are all
9 good ideas? I think this idea of a financial reporting
10 working group is a good idea under either path type of thing.

11 So, I just wanted to alert you to that. And really
12 I alert you to it because I think that, if I were a
13 voting member of this group, I would probably say, of course
14 you're going to know a little bit more in June-July, if in
15 fact that is the path we seem to be going down, to have a
16 report that is premised on another path may not be ideal. It
17 would be, it could be a little bit awkward. And I
18 understand, I completely understand how we've gotten here
19 because there has been this parallel track going on in it.
20 But I just think that it is very important that
21 a report that should have some durability and
22 long-lastingness to it, that people just say, well, that's
23 nice but that has nothing to do with what's going on. That's
24 all I had.

25 CHAIRMAN POZEN: Well, I wanted to give everyone an

1 opportunity to ask any questions of Bob. Does anyone
2 have -- Jeff?

3 MR. DIERMEIER: And I know I think we've asked --

4 CHAIRMAN POZEN: You're going to again --

5 MR. DIERMEIER: This is Jeff Diermeier. Can you tell
6 us a little bit more about the IASB-FASB joint presentation
7 project and what the timing is expected on that?

8 MR. HERZ: The financial statement presentation
9 project?

10 MR. DIERMEIER: Yes.

11 MR. HERZ: Yes. We had hoped to get out a first
12 document, a discussion paper laying out the model including
13 something like that schedule you have there and the
14 operating, financing, investing distinctions and some other
15 stuff probably about to wrap June or July I think it is. And
16 the IASB's process demands for anything major, they have
17 three steps. A discussion document that will be out for
18 exposure probably six months because when you're dealing with
19 them, they have to translate it into different languages and
20 all of that, so that will be out then. We'll probably have
21 public roundtables in different parts of the world, get the
22 input and then we would take that and do what we call
23 redeliberate towards an exposure draft. I would think that
24 would come out probably towards the end of '09 to go through
25 another round in all of that.

1 So, this project could be finished probably in 2011
2 kind of time frame.

3 CHAIRMAN POZEN: Scott?

4 MR. EVANS: Yes. Bob, you mentioned that you found
5 in several places in the report inconsistencies with the
6 notion of investor preeminence which you support. Then you
7 mentioned fair value. But I wonder if there are any others
8 that sort of are large in magnitude that we ought to really
9 focus on.

10 MR. HERZ: Yes. Again, some of these, it's more
11 from my talking with some of the investors. I think this
12 issue of cost benefit, there is a view that in some places
13 you're just trying to throw more sand into the gears. I
14 don't think that was what was the intention at all but people
15 are reading it that way on things like that. I'd have to go
16 back through it in my notes to all that but, you know, you
17 talk to some people and they say, gee, I hear that but it
18 seems a lot -- oh, the materiality guidance I've heard about,
19 the restatement, some users would say, look, I want the data
20 we cast, I don't care.

21 MR. EVANS: We heard that one in San Francisco
22 quite clearly.

23 MR. HERZ: Yes, so they kind of say I hear they say
24 user preeminence but all their recommendations don't seem to
25 stack up against that in a couple of places.

1 CHAIRMAN POZEN: Other comments or questions? I
2 just want a take on the international, Bob. I guess this is
3 something that David and I have really struggled with. And I
4 guess in the end, the position that's in this paper is pretty
5 much our position.

6 It's very difficult for us to deal with a moving
7 target. And second of all, this is a moving target in which
8 the difference in opinion between some of the big, heavy
9 players is very large. So, it's, you know, I appreciate your
10 position. I appreciate Chairman Cox's position. I don't
11 really believe that it's a good idea for us to try to make a
12 big move in this area. And we've thought about various
13 things we could do but I don't know if they're realistic.

14 The other thing is, and you may disagree with me on
15 this, Bob, but I've always taken the view that most things
16 take longer than people expect. So, I guess
17 Greenspan was worried that we were going to run out of
18 treasury bills, but I wasn't worried. And I'm not
19 worried that FASB is going to go out of existence too
20 quickly.

21 MR. HERZ: I'm not either, Bob. Things are, other
22 parts of the world are moving quickly and the desire amongst
23 a lot of parties in this country to get there is fairly
24 significant as long as it's high quality.

25 CHAIRMAN POZEN: That there is what?

1 MR. HERZ: As long as it's high, you know, remains
2 high quality. It's the, you know, our goal is since this all
3 started has been single set of high quality standards.

4 CHAIRMAN POZEN: Well, I can just, I have two data
5 points that have happened recently. One is in the companies
6 that I'm quite involved with which are large companies and
7 the global companies. I must say, I don't see a strong
8 militant effort to get into IFRS. I just don't see it.
9 I mean, they'll go along with it but this is not at the top
10 of their priorities.

11 And the second is I think what happened with
12 Societe Generale where they moved the loss to the year
13 before, that caught people's attention.

14 MR. HERZ: Yes, but that --

15 CHAIRMAN POZEN: Because that was not what most of
16 the people in the investor community thought was a good
17 result.

18 MR. HERZ: That was not a standards issue. That's
19 an issue of application.

20 CHAIRMAN POZEN: Of application and interpretation.
21 And I think all of us are sophisticated to know that that's
22 probably going to be where the rubber really hits the road is
23 the interpretation of these standards. And if the result of
24 IFRS is that France can decide that it's okay for Credit
25 Suisse to move small, several, you know, billion dollar loss

1 from one year to another -- Societe Generale, sorry, you
2 know, it's -- sorry.

3 So, all I'm saying is that I think we have done the
4 best we can on this. But if anyone in the Committee
5 disagrees, I think David actually has bent over backwards to
6 try to do this and what we've written there. So, Greg, did
7 you have something?

8 MR. SIDWELL: We should probably, there's one
9 other, there's one important dimension which is the
10 process --

11 CHAIRMAN POZEN: You have to speak closer into
12 that.

13 MR. SIDWELL: The process to resolve many of these
14 issues is ongoing at the SEC.

15 CHAIRMAN POZEN: Yes.

16 MR. SIDWELL: So, one of the issues we had as a
17 Subcommittee is how do you engage where the SEC is very
18 active soliciting points considering the comments that we've
19 received before, discussing with regulators around the world.
20 It's, I think as you say, Bob, it's very much a timing issue
21 for us to productively add value. And I think the decision
22 was that we couldn't add that value. I don't know if you
23 want to add anything, Jim.

24 MR. KROEKER: Yes, certainly there is a very active
25 process going on at the SEC, as everyone around this table

1 knows, to consider those very issues. John, his chief
2 accountant is working with Julie Erhardt on a roadmap to
3 outline these exact issues as Bob talked about. So, I think
4 there was some tension about what is it, while there's a
5 process to reach out and get input from others to in fact
6 develop this roadmap, that what is it that would be done from
7 this Committee to add to that roadmap before it's even seen
8 the light of day. The process is ongoing.

9 MR. HERZ: Well, it gets to the point that Bob said
10 we'd like you to endorse the recommendations and all that.
11 I'm telling you that on the path we're currently going, we
12 sat down with the IASB last week at clearly the request of
13 the SEC staff and updated our, the process of updating our
14 MOU. And that's going to be the focus of a lot of our
15 attention in the coming years. And it's going to demand
16 working processes with them that demands some changes and the
17 like. That doesn't make what you're doing irrelevant and all
18 that, but it makes the implementation of them, will be
19 implemented in ways that are appropriate for that.

20 CHAIRMAN POZEN: Well, I think all we would say,
21 Bob, is the sorts of process suggestions we made, field
22 studies, user consultation, post adoption review, we would
23 hope that they would be built into whatever global standard
24 process that's set up. I just don't think there is much more
25 that we can add to this.

1 MR. HERZ: Yes.

2 CHAIRMAN POZEN: But I mean, I think we, you know,
3 the Committee ought to feel comfortable with this because I
4 think what David has written in Subcommittee 2 is pretty much
5 where we are now, and which is basically saying it's moving
6 fast and other people are focused on it and just it's not
7 amenable to our participation. So, if there is someone who
8 disagrees on the Committee, we ought to take that up. But if
9 not, and Bob, in terms of the report, I would hope we could
10 work out language because we can say in our report we
11 recognize this is happening, we recognize your MOU, we are
12 hoping that the sorts of things that we suggest --

13 MR. HERZ: I think the status report does a good
14 job, so it's incorporating that into the final report.

15 CHAIRMAN POZEN: Yes, Greg?

16 MR. JONAS: I don't know if what I'm about to say
17 constitutes disagreement, but it does constitute a view that
18 I think the most important issue in all of financial
19 reporting infrastructure is the one that Bob has teed up.
20 And I think that even the work that the SEC has got underway
21 is going to be a roadmap to a destination that is still
22 relatively near term.

23 I have not heard anyone articulate a vision for
24 what the end state might be between the national standard
25 setters and the global standard setters. And if groups like

1 ours don't take that fundamental question up, who in the heck
2 does it? I mean, everybody else in the world is so concerned
3 with the day to day and the politics of immediacy,
4 necessarily so, that they formed groups like ours to try to
5 give a vision for the way forward that's longer than tomorrow
6 but kind of put a stake in the ground for the goal. And I
7 was hoping that we could get that, be a catalyst for getting
8 people talking about that end game and not just interim steps
9 along the way.

10 CHAIRMAN POZEN: Well, I guess, I think if there is
11 a question about whether we as a Committee can come out and
12 say that we believe there has to be one global interpretive
13 process and that we cannot allow national countries to go off
14 and interpret it whatever way they want, I think we would
15 definitely have consensus on that. That's a lot different
16 than trying to work out what exactly that means. But I'm not
17 sure that we can really work out that more because we don't
18 have a lot of the other pieces in place.

19 The other thing, Greg, is there are going to be a
20 lot of forums and there are going to be a lot of new advisory
21 committees on this one which are just focused on that set of
22 issues. So, I for one would be comfortable making, and I ask
23 you, David, making some general statements and adding a
24 paragraph or two about what we would like to see in terms of
25 interpretation and not have this become a national

1 smorgasbord which I think it has some possibility of
2 becoming.

3 MR. SIDWELL: We've got, as you've seen, our status
4 reports and preliminary wordings, so I think to the extent
5 people have comments on that and suggestions as to how we
6 might make it more substantive, we'd be really willing to
7 hear them. I do know that the question of the role of
8 national standard setters is one that the SEC is
9 considering. And I think this is just one of those things
10 until you really know what the end stake you're shooting for,
11 I think it's very odd for us to do that and I must admit I
12 think to do it well, we as a Committee would want to say,
13 "Well, how is this working in Australia or Canada or you name
14 any other country?" And I just don't think we've vested the
15 time to do that.

16 So, I think there are a whole series of factors
17 that I think this is in the best hands of the SEC right now
18 to continue the process they're on. I think we may need to
19 leave for others the work that, to be honest, I think we'd
20 have liked to have done ourselves at this point.

21 CHAIRMAN POZEN: Ed?

22 MR. McCLAMMY: Yes. We had a panel and their
23 subcommittee was comprised of users, preparers and auditors.
24 And from all three groups, one of the areas connected to
25 complexity that came up was the pace of change of the major

1 pronouncements that are coming out, and therefore, the
2 difficulty of keeping up with that. And I think what came
3 out of those discussions was it's partially because we're
4 addressing stand-alone issues, plus we're trying to address
5 the move to get more in line with an IFRS perspective.

6 So, I think the one thing that may be worthwhile
7 for us to address as a Committee is not to say should we get
8 there or not, but if we're headed in that direction, is it
9 better to get there from a complexity standpoint through
10 continuing on the path we're on, or just saying, as most
11 countries are doing, by X date we would be on IFRS and not
12 have the number of pronouncements that come out
13 between now and then. So, I do think that's worth
14 having.

15 CHAIRMAN POZEN: Well, it's a reasonable point but
16 I think that is precisely the focus of the SEC. And I
17 presume there will be a real proposal on that exact point
18 within the next month or two --

19 MR. KROEKER: I think those are the exact issues
20 that would be identified in a roadmap by the Commission which
21 is going to be, if and when you get to that point, put out
22 for public comments. So, I think it's --

23 MR. McCLAMMY: So, maybe it's not even a proposal
24 from us. Maybe it's just an acknowledgment through a
25 process. We've heard from these various groups that this

1 transition approach is creating complexity and it's something
2 that the SEC should consider. You know, not that we're
3 saying go the other direction, but that added complexity they
4 bring should be considered.

5 CHAIRMAN POZEN: Well, I'm not sure we can take
6 this a lot further. I do think the SEC will tee that precise
7 issue up. And what I have taken away from this is we should
8 try to bulk up the material that's in the status report now
9 on two points. One is to recognize as clearly as we
10 can that FASB is entering into this period with IASB, and
11 therefore, we realize that some of its resources are going to
12 go that way, and that we hope that our proposals, the process
13 proposals and other proposals will be integrated into that
14 new body. And second of all, I happen to agree strongly with
15 Greg on the national, you know, against national
16 interpretation which you can already see sort of building up.
17 And it would probably be, in my humble opinion may, you know,
18 bubble up to the US Congress in terms of what our ability is
19 to interpret this in the United States.

20 MS. GRIGGS: Yes. It would have to go to the US
21 Congress. The SEC has a statutory responsibility to set
22 accounting standards in the 33 Act. So, I think, I mean our
23 laws would have to be changed.

24 CHAIRMAN POZEN: Yes. And the SEC has the right
25 effectively to veto FASB.

1 MS. GRIGGS: That's exactly right.

2 CHAIRMAN POZEN: So, these are the sorts of issues
3 that are going to come up. But I think we can make clear our
4 position that whatever this goes, it should be a uniform and
5 consistent interpretive process and try to bulk that up.

6 MR. WHITE: Bob?

7 CHAIRMAN POZEN: John?

8 MR. WHITE: Just being on the drafting team here,
9 we're obviously working on a roadmap. That would be a
10 proposed roadmap that we would send to the Commission and
11 then the Commission would have an open meeting and would put
12 that out for comment. And you know, the time period between
13 when the Commission puts something out for comment and when
14 it would adopt something on a final basis, in other words,
15 adopting a final roadmap is roughly four, five,
16 six months gap in between those time periods.

17 And as to when, at least my personal view would be,
18 when the Commission would be able to do this, I mean, it's
19 not going to be this month, to start with that. So, you
20 know, I don't know whether it's June or July or later, but I
21 mean just in, and to look at kind of the term of this
22 Committee, I guess I'm just trying to give you a few dates to
23 look at. But I would have thought the earliest we'd get a
24 roadmap out would be sometime around when this Committee
25 finishes its charge.

1 MR. SIDWELL: I think --

2 MR. WHITE: A proposed roadmap out.

3 MR. SIDWELL: One thing we could do in the drafting
4 of the final report, I think there are things, for instance,
5 we've put in wording now about design of standards, there
6 could be some of that which gets integrated with Subcommittee
7 1's so that it becomes a bit more of a package that could be
8 handed off to whoever the standard setters are. So, I think we
9 could think about, without a huge amount of reorganizing of
10 our report, making some slight changes so that the
11 design of standard has all these elements of no
12 rules, bright lines and all of those other things that we've
13 talked about. And it's sort of done in a more integrated
14 way.

15 MS. BIES: And I would support David's idea because
16 our Subcommittee has talked about that. In fact, one of the
17 things we would hope is that IFRS doesn't diverge into
18 industry specific accounting and some of our weaknesses. And
19 so, we've tried in ours to be saying we would hope, again,
20 that whoever the standard setter is, these are principles
21 that are broadly applicable. So, I think we as a
22 Subcommittee would support doing something like that.

23 MR. KROEKER: Just to clarify the timing of the
24 roadmap into this Committee, I mean, it's certainly possible
25 there could be a proposal out before that as well. It's just

1 in time to, you know, if the goal is to have a voting
2 document at the July meeting, it would be pretty tough timing
3 in terms of the impact of that roadmap on the report.

4 CHAIRMAN POZEN: Well, I don't view this
5 Committee's role as including commenting on our proposal. I
6 mean, if individual members or groups you've involved with
7 want to comment, that's perfectly reasonable. But as a
8 Committee, I don't think we should be in the position of
9 commenting. It will be an XBRL proposal which people may
10 like or not like, and so people should feel free to do that.

11 Well, let me -- Bob, I think we're just going to
12 have to leave it at that in terms of international. And I
13 think the three things that are said are all things that we
14 can do and should do. Let me just go through the dates to
15 start on the most practical level here. Our report needs to
16 be published on August 3rd which is a Monday. And we have a
17 conference call set for July 31st in which we will approve
18 the final, final document. And I think that date Dana has
19 endeavored to get as many people's schedule as she can.

20 And then, we have a meeting scheduled for July 11th
21 in Washington, DC. And we have the possibility, if needed,
22 to meet the night before, the afternoon before if we need
23 more time. But essentially, what I would like to do is to
24 ask all Subcommittees to submit drafts by June 26th so that
25 we have a full working document. Then the staff can go over

1 and that we can turn around something so for the July 11th
2 meeting, that we should have drafts in reasonable shape of
3 all the different chapters. Our experience has been that it
4 will take the rest of the month to turn this into a final
5 document because between the various people who believe they
6 have to review it and executive summaries and checking, et
7 cetera, we'll use the time, I have no doubt.

8 So, I have scheduled, at least on my calendar,
9 Subcommittee 1 on June 6th. And also, I think, I assume
10 that's in the San Francisco area?

11 MS. BIES: I think we're going to have a conference
12 call after this meeting sometime next week to see if we can
13 do it by phone versus in person. But you know, we are going
14 to have a meeting of some sort.

15 CHAIRMAN POZEN: Okay. And then, Subcommittee 2 in
16 New York the same day?

17 MR. SIDWELL: On the 6th, yes.

18 CHAIRMAN POZEN: On the 6th. And then, June 12th,
19 the third, Subcommittee 3 and 4 in Washington. So, that's
20 what I have.

21 So, I think people should feel
22 pretty good because we're pretty far along here. I think
23 there are a number of things that need to be tied up, but I
24 think we are pretty far along. And I would like to know go
25 through each Subcommittee, if you don't mind, in backwards

1 order so that we can sort of tie down everything. And I'll
2 sort of -- in each of these, I'll tell you what my, sort of
3 as a preliminary hypothesis, the way I'm seeing each of the
4 Subcommittees.

5 I think XBRL is obviously finished and out the
6 door. I think the web site is well done. To the extent that
7 the report could include anything that's a visual with the
8 web site, that would be a plus. I don't know how possible
9 that is.

10 I think you have now put up three new proposals.
11 One is for enhancing the relationship between the earnings
12 and the web site. And second is the executive summary. And
13 third is KPI's. So, I think we might want to just get, you
14 give us a short minute on each and then to see what the
15 reaction is.

16 I just want to make two other remarks. One is that
17 I think it is necessary in terms of consistency to make sure
18 that KPI's talk enough about activities, that they don't
19 contradict Subcommittee 1 on industry. So, we just need to
20 make sure that that gets reconciled.

21 And then, I'll just throw out here that the one
22 other thing your Subcommittee could do if you choose or
23 Subcommittee 3 could do it because just is this question of
24 CEO's projecting earnings guidance, I mean, that
25 has been written up now by, I would say at least three or

1 four different organizations. The question is whether this
2 Subcommittee wants to add that to our cup of tea. I
3 personally have been on two of those groups that came out
4 against it, so I support it. But I don't think it's
5 necessary for us to do, but the question is whether people
6 want to add that.

7 So, Jeff, why don't you give us the three things
8 that you've now proposed. We can discuss them and then
9 talk about this projection issue.

10 MR. DIERMEIER: All right. First, I'll talk about
11 the KPI's. In here, our role really we think is more of, one
12 of being an enabler. I think we all agree that a critical
13 tool of functioning capital market is information pertaining
14 to the fundamentals of the business so that in open market
15 investors can reflect their views and allocate capital and
16 then returns for risks taken. Those fundamentals involving
17 both return and risk characteristics are in part captured by
18 a company's financials but much is not.

19 There are some who for years have worked on an
20 elegant set of unified financial and non-financial measures
21 such as EBR, balanced score card, Gartner Group, whereby the
22 business could be understood by a cohesive, rather complete
23 look. I think it's really good stuff and worthy of
24 commendation as to kind of an ultimate goal as people think
25 about the way in which businesses come together in their

1 business reporting function. But in the end, we decided that
2 to try to make some kind of recommendation in terms of a
3 structure to key drivers of business or KPI's would just be
4 beyond our scope, might seem too prescriptive. And maybe for
5 some, that would seem like it gets too close to valuation as
6 opposed to providing information.

7 So, given where we are right now, we thought better
8 for a diverse market with different points of emphasis and to
9 analyze the fundamentals and basically at competitive
10 frameworks, that what we should do is encourage somehow the
11 enhancement of the way in which companies put forth
12 non-financial information. When I say non-financial
13 information, I'm not talking about adjusted-adjusted
14 earnings, but truly, the kinds of things that
15 people look at, making sure of viables, you know, the real
16 underlying business elements.

17 And we're not suggesting a mandate. We're not even
18 suggesting that SEC would lead this effort, but that there be
19 support for private sector initiative that basically would
20 help provide more of a common language for some of
21 the terms that would be agreed upon by either industry groups
22 or some kind of a group like I mentioned before, that there
23 can be brought some consistency. Right now, we have an
24 environment where if you look at a company and their use of
25 certain key indicators, much of this of course is already

1 suggested by the SEC in terms of the MD&A, but if you look at
2 company reports on KPI's, they don't use terms that are
3 identical. They may change the definition themselves. I
4 remember back in the days when CAMRA was having difficulty
5 and the way in which they would basically report
6 their store sales, stores kept dropping in and out of that
7 depending on the circumstance as it would be.

8 And so, what we'd like to do is encourage some kind
9 of private sector initiative that would address issues like
10 understandability, consistency, relevancy, comparability. In
11 my dream of dreams which is not in the report but just to
12 give you some context, it would be wonderful if industry
13 groups could actually come forth with a term, let's
14 call it Term X, where there would literally be a little
15 trademark next to it, and if my company then used that term
16 with that little mark next to it, everybody would realize in
17 kind of a dictionary, almost a taxonomy sense, that that
18 meant exactly what the other firms in my industry that are
19 using the same term --

20 CHAIRMAN POZEN: You mean industry groups or
21 activity groups?

22 MR. DIERMEIER: Activity groups.

23 CHAIRMAN POZEN: Well, I think, okay, I think
24 people have read the proposal and I think that's a good
25 summary. I personally think the Subcommittee has done a very

1 good job, but I want to get people's reaction to this. So,
2 David?

3 MR. SIDWELL: I thought it was actually well done
4 and I'd be very supportive of that direction.

5 MS. GRIGGS: Jeff, I just had one question. In
6 defining KPI's, you also include supplemental, non-GAAP
7 financial reporting disclosures, and I didn't know what that
8 meant. Are those non-GAAP financial measures the way we've
9 heard that term used? Or is that another, I mean, are KPI's
10 non-GAAP financial measures sometimes? I know a lot of them
11 are not. I guess they're a lot better not based on numbers
12 in the financial statements.

13 MR. DIERMEIER: Yes, I don't think we can limit it
14 to just non-financial measures. And Amy drafted this
15 information, so you know that Amy drafted this very carefully
16 to include a formality there that would have to be required.
17 So, it's not just non-financial measures; it would also
18 include non-GAAP financial measures. But here our focus is
19 really not to be, when we use that term, not to be
20 suggesting we're talking about adjusted-adjusted-adjusted
21 earnings, but things that of course may have a financial
22 character or could be a ratio.

23 CHAIRMAN POZEN: I think what she meant was that
24 some KPI's can be GAAP, based on GAAP, and some can be
25 non-GAAP. And to the extent that they're non-GAAP, they need

1 to follow the rules on that. But I think Linda is right,
2 that could be explained a little better.

3 MS. GRIGGS: Yes.

4 CHAIRMAN POZEN: Any other? Yes, Ed?

5 MR. McCLAMMY: Yes, I think one thing we need to
6 keep in mind with these, I mean, you're saying, which I think
7 is very positive, to kind of put the investor with the same
8 eyes that management is looking at the business. But a lot
9 of the measures that management looks at the business
10 internally, you're willing to take a wider range of accuracy
11 than you're willing to put into a Q or a K. So, there may be
12 some trends that you can follow very closely within the
13 management, but as long as you can sense an overall trend,
14 you're happy and wouldn't go out and say, well, let's audit
15 this and see if people are doing it exactly right.

16 So, I think there's, we need to, it can be very
17 tough for some of these things to say let's have assurance on
18 them. And in understanding that they can -- we actually get
19 one that in the K we point-blank say these are
20 meant to just show broad trends and not specific underlying
21 data because some of, and I will give you an example, some of
22 them we get from salespeople, and how accurate can you
23 control a salesperson of how a customer is doing something.

24 MR. DIERMEIER: Yes, we have assiduously tried to
25 stay away from that subject. One of our members may try to

1 press the issue.

2 MR. McCLAMMY: Yes, right.

3 CHAIRMAN POZEN: Well, I think there are two, there
4 are several different points that you're making and they're
5 all important. First of all, this is voluntary. Second of
6 all, we are not saying it has to be in the 10-K.

7 MR. McCLAMMY: Okay.

8 CHAIRMAN POZEN: And third of all, if it appears in
9 the 10-K, we should make clear that it will go in the MD&A
10 section and will be sort of subject to that class that these
11 are a lot softer. And I think those are all important
12 points, and I think we have an agreement that there is no
13 auditor assurance on KPI's. We should proceed on that
14 assumption.

15 MR. DIERMEIER: Mostly we do.

16 CHAIRMAN POZEN: Okay. Let's talk about the,
17 what's the next one you want to talk about, Jeff?

18 MR. DIERMEIER: Improved quarterly press releases,
19 and that does enter in a little bit what Bob mentioned
20 earlier. You were suggesting a best practices using NIRI,
21 FEI, CFA Institute. We've had a number of discussions on the
22 whole issue of, since when we started this whole Committee,
23 this process, we had a lot of discussion about how important
24 the quarterly press release is. Some people would argue that
25 it's the most important release in terms of what many

1 investors look at.

2 And so, this hypothesis is not as grand as any of
3 the others but suggested various industry groups get together
4 and maybe there can be some improvements right now NIRI
5 pulling their own folks. In a typical press release, a huge
6 proportion of the firms will actually include some kind of
7 income statement, balance sheet statement. But I think the
8 percentages in terms of cash flow statements runs around
9 50-some percent. Obviously from an investor standpoint, it
10 would be nice to know that all these things kind of hang
11 together. We'd like to see, it's supposed to be required, it
12 doesn't always look that way that the GAAP figures
13 have preeminence within the document, that there's, it's easy
14 to reconcile the two, that it doesn't get buried back. As
15 Bloomberg pointed out, company -- a while ago that the
16 reconciliation buried back on page 72, somewhere
17 where it's really hard to be able to work on that.

18 We went so far as to also discuss whether we should
19 recommend that the quarterly release and the press release go
20 out the same time as the 10-Q. My membership would actually
21 be in favor of that. Chris' firm actually moves in that
22 particular direction and we had discussion with that. The
23 folks from NIRI pointed out that a lot of their firms,
24 particularly the smaller firms, were trying to report on
25 dates that the big firms aren't dominating the news. We'd

1 have some difficulty with that. So, we're not making a
2 specific recommendation there.

3 We were a little bothered by the fact in the theory
4 of financial reporting, that in a way, the full
5 quarter hasn't been revealed until the 10-Q comes up because
6 without having the disclosures, you don't have the full
7 context. But as we know, basically the way things have
8 evolved in the marketplace, most firms allow the window for
9 senior officers to transact securities occurs right after the
10 press release comes up but doesn't wait until the Q. So, and
11 kind of the theory before all the information comes out,
12 we're not going to make a strong recommendation there. We
13 also --

14 MR. SIDWELL: Jeff, did you consider the tradeoff
15 in that wording between timeliness and completeness?

16 MR. DIERMEIER: We did from the standpoint, and
17 interestingly, David, in our survey, our members were elated
18 to see the report, the quarterly press report come out later.
19 They're very comfortable with that, but of course there's a
20 few risks mentioned. I don't know how real it is but firms
21 are afraid that if they're sitting on material information,
22 that the longer they sit on it, the more likelihood they may
23 have some difficulties with that.

24 CHAIRMAN POZEN: Well, the long and short of it is,
25 if Amy were here she would tell us that this was proposed by

1 the SEC. It's been vetted a number of times. And basically,
2 for better or worse, this would hold up the 10-Q and hold it
3 up by a week in a lot of cases. And so, I think you,
4 personally I think you made the right decision. In the ideal
5 world, it would be nice to have them together, but it's hard
6 for us to be in a position of essentially delaying it.

7 MR. BERESFORD: As I recall, very early on, we had
8 some brief discussion about rather than discouraging non-GAAP
9 additional information, actually encouraging it in some
10 cases. And that kind of ties in to your last, your KPI issue
11 a little bit. But as of right now, at least the way it's
12 worded right now, it doesn't say anything other than give the
13 GAAP presentation preeminence which of course is important.
14 I'm just wondering if the Subcommittee had thought about
15 that, whether that's something that the Committee wants to go
16 more with it.

17 CHAIRMAN POZEN: I think that's the intent of the
18 Committee.

19 MR. BERESFORD: I haven't done a study but it seems
20 to me that it's almost the exception rather than the rule now
21 that somebody doesn't have non-GAAP presentation of one sort
22 or another.

23 MR. DIERMEIER: And it's mentioned in the text but
24 not in the bolded print, so that's something that I think we
25 should move up, Denny, that's a good point.

1 The last paragraph in the text talks about the fact
2 that the Subcommittee briefly discussed the notion of
3 providing earnings guidance. In late September I think it
4 is, NIRI, CFA Institute, Aspen Institute, CED, Business
5 Roundtable, Chamber of Commerce and another group is going to
6 have a forum on this whole subject as we continue.

7 CHAIRMAN POZEN: Well, let's see, I mean, let's do
8 it without allocation of responsibility, I probably, since
9 it's already been written several times. The question is
10 does the Committee feel that we want to take on this issue?
11 And I really, I don't know, Linda or Greg, I just
12 say do we want to, I mean, when you sort of -- I guess
13 there's an issue, two issues. One is whether we agree that
14 we should discourage CEO's from projecting earnings in the
15 next quarter. What people have usually said is if you have
16 to do it, do a range and do it on a yearly basis so it gives
17 you more flex. It's really an anti-short-time which I think
18 there's general sympathy. But I don't know whether the
19 Committee wants to make that plunge. I don't know.

20 MS. GRIGGS: Well, I know that a lot of my clients
21 are not giving guidance on a quarterly basis anymore because
22 I thought the trend was against that. I think it's --

23 CHAIRMAN POZEN: Yes. It is against it.

24 MS. GRIGGS: Yes.

25 CHAIRMAN POZEN: But it's still probably --

1 MS. GRIGGS: I think I would be very supportive of
2 seeing something like that in this report.

3 CHAIRMAN POZEN: Let's just go through Greg. Do
4 you -- how do you feel? You can say neutral.

5 MR. JONAS: Yes, I think I would be supportive
6 about speaking out about short-term-ism and things that can
7 be done to encourage -- there's two ways to go. We can
8 either discourage short-term-ism through some policies, or we
9 can encourage more long-term thinking. I'm in the latter
10 camp.

11 CHAIRMAN POZEN: But we're asking, I mean, we're
12 not going to have time to do a grand thing on short-term-ism
13 and long-term-ism.

14 MR. JONAS: But we are. The essence of KPI's is to
15 do exactly that. The reason many investors default to the
16 quarter is because financial reporting doesn't give them
17 something that allows them to look down below.

18 CHAIRMAN POZEN: Well, I hope you're right but I'm
19 not sure --

20 MR. GRUNDFEST: Can I just make --

21 CHAIRMAN POZEN: Joe?

22 MR. GRUNDFEST: I mean, how many times do we all
23 say, well, one size doesn't fit all, and here we
24 are trying to get everybody into the same bikini. It just
25 doesn't work. So, number one, I agree short-term-ism can be

1 a real problem. There are situations where it can be abused.

2 But there are other situations where you've got
3 some companies that say, look, I've got good visibility for
4 three months, now you're asking me to tell you where it's
5 going to be in a year? Good luck to you, my friend, all
6 right. You've got other companies that say, look, I've got a
7 bunch of variability; I don't know how it's going to come in
8 over the next three to six months, but I've got a better idea
9 where we're likely to be in a year. And to say that all
10 companies need to be treated alike, one way or the other, I
11 think is not realistic.

12 CHAIRMAN POZEN: Joe, would you -- I'm sorry.

13 MR. GRUNDFEST: No, go ahead.

14 CHAIRMAN POZEN: Would you support rather than a
15 general thing just being against projection of earnings, the
16 next quarter's earnings? Or do you think that's too --

17 MR. GRUNDFEST: You mean, be against projection of
18 earnings all together?

19 CHAIRMAN POZEN: Projection of earnings by the CEO
20 for the next quarter. I mean, the proposal is you would say
21 you're against that, that's the proposal.

22 MR. GRUNDFEST: You know --

23 CHAIRMAN POZEN: You would be against it?

24 MR. GRUNDFEST: No, I mean, it's, look, I can
25 be -- I think it's a bad idea but I don't think that the

1 Committee should come out and tell people not to do that. I
2 think we can explain and warn why it's not a wise thing to do
3 and observe that the trend is in the opposite direction. But
4 I could see situations where it's a perfectly
5 legitimate thing for a CEO to do.

6 MS. GRIGGS: What about in the context of the KPI
7 discussion to make the point that Greg just made which is
8 that the disclosures of KPI's, the additional information may
9 result in less of a need for companies to try to release or
10 give quarterly earnings guidance? I mean, I think Greg's
11 point was well taken.

12 CHAIRMAN POZEN: I must say I'm not sure that's
13 factually true.

14 MS. GRIGGS: No?

15 MR. GRUNDFEST: And the other thing is the way
16 information flows, if we say, well, all right,
17 companies, you shouldn't make quarterly projections, so CEO's
18 stop making quarterly projections. But if an analyst says,
19 gee, we're projecting you at 35 cents a share and the guy
20 says I'm uncomfortable with that, well, we're projecting you
21 at 31 cents a share, I'm getting comfortable with that, or
22 we're projecting you at 28, I'm comfortable with that. I
23 haven't made any projections, I've just expressed comfort.

24 CHAIRMAN POZEN: Thom, you wanted to say something?

25 MR. JONAS: I would be supportive of us addressing

1 it and coming out with a recommendation. I think it's
2 guidance, it's not a hard and fast rule. But I think we
3 should provide some guidance.

4 CHAIRMAN POZEN: Okay. Thom?

5 MR. WEATHERFORD: Yes. I think it's not as simple
6 as saying do it or don't do it because I think if you talk to
7 investors and we're supposed to be here having the investor
8 view, the investors will say they want guidance. Whether
9 it's short term or long term, they want guidance because
10 reality is, especially in this volatile market today, the
11 investors are primarily short term.

12 MR. SIDWELL: I think it should be --

13 MR. WEATHERFORD: And so, I think to tell a CEO you
14 can't give guidance puts a company at risk. Look at Exxon
15 that just announced \$11 billion of net income and their stock
16 tanked because --

17 CHAIRMAN POZEN: I don't, just two things. We
18 wouldn't be telling you can't do it, we would be discouraging
19 it. But the second thing is there actually has been a lot of
20 work done among the institutional investor community, and
21 generally the institutions support not projecting, not having
22 the CEO project earnings because it tends to lead to some
23 pretty bad behavior at the end of the quarter.

24 MR. WEATHERFORD: For 0.1 percent of the population
25 I think that's true.

1 CHAIRMAN POZEN: Well, but I respect your position.
2 Ed?

3 MR. WEATHERFORD: But I also think you need to have
4 a combination, back to the KPI's, as I think to give the
5 investors a full view is you have to have the combination of
6 guidance and KPI's that they can understand. And they can
7 see the trend of the business by looking at the trend of the
8 KPI's. Then they'll decide whether to believe the guidance
9 or not.

10 CHAIRMAN POZEN: Ed?

11 MR. McCLAMMY: Yes. We actually changed a couple
12 of years ago to just giving annual guidance for all the
13 reasons we're just talking here, and very infrequently update
14 that unless something significant has changed. I think it's
15 probably unrealistic to think that management will then get
16 away from focusing on quarterly results because whether you
17 put the guidance out or first call says here is what the
18 number is, if you miss that number by a pin, you get
19 punished. So, I'm not saying people do anything on a
20 nefarious way to try to get that result, but to just take
21 that number first call out of your mind is impossible.

22 CHAIRMAN POZEN: No, I think you're right on that,
23 but I guess it does, most people would say it's a little less
24 pressure if you've said it. And --

25 MR. McCLAMMY: Yes.

1 CHAIRMAN POZEN: But on the other hand, there is
2 massaging going on as Joe says.

3 MR. McCLAMMY: Certainly less pressure from a legal
4 requirement to update.

5 CHAIRMAN POZEN: Right.

6 MR. McCLAMMY: But I agree with their proposal.

7 CHAIRMAN POZEN: Sue?

8 MS. BIES: I guess, coming into this meeting, my
9 feeling was to stay silent on it. I didn't feel that it
10 would really add a lot --

11 CHAIRMAN POZEN: Which is still definitely a
12 possibility here.

13 MS. BIES: -- to what our main objective is. And I
14 don't find that it's sort of a real issue we should get
15 involved in. And I say that mainly because of the current
16 circumstances where it's better in periods of volatility and
17 uncertainty for the CEO's to be talking a lot more. And I
18 don't want to imply they shouldn't be. So, but in normal
19 times, I don't like to focus on quarterly earnings. So, I
20 just, I'm uncomfortable getting a rule that works in all
21 scenarios, I guess.

22 CHAIRMAN POZEN: Okay. David?

23 MR. SIDWELL: That's where I am. I think it feels
24 awfully bright line-y. And I think we should be allowing
25 judgment, that's the whole basis of many of our

1 recommendations.

2 CHAIRMAN POZEN: Scott?

3 MR. EVANS: Yes, I'm against having a rule like
4 this. While I personally hope that the culture of financial
5 markets continues to move towards longer term data, I think
6 for us to say that we should limit the information and the
7 dialogue between investors and the managements of the
8 companies is very counterproductive.

9 CHAIRMAN POZEN: I think we have enough of a split
10 of opinion here. I think we're just going to, I'm just going
11 to cut off debate and say we'll continue this. We don't have
12 to say anything. Lots of other people have addressed the
13 issue.

14 MR. DIERMEIER: Bob, I would suggest why don't I
15 draft something and then you can shoot it down, because the
16 pulpit this group has is really quite potent --

17 CHAIRMAN POZEN: Jeff, you are free to draft it but
18 I think the message is pretty strong here that there are
19 quite different opinions on this. And I don't think we're
20 going to have a consensus and I have to agree with Sue that
21 this is not a, it's really a little, it's not key to our
22 whole mission. And I don't want to break the consensus that
23 we have on that basis. You're going to give us the executive
24 summary?

25 MR. DIERMEIER: A very quick executive summary.

1 We've talked about that quite a bit as part of the filed
2 annual and quarterly report, so something that
3 we'd either hyperlink or would link through to other
4 information and really provide for I think the serious retail
5 investors and others, a roadmap or an ability to have
6 context.

7 CHAIRMAN POZEN: Yes. I think this, in terms of
8 retail investors, this is, as Bob said, this is a
9 useful thing. I think we've massaged it down. Is there
10 anyone who has any concerns about that? Denny?

11 MR. BERESFORD: I think this would be a mistake.
12 First of all, it's a preliminary hypothesis. I guess we need
13 to develop it more, but honestly I think documents are so
14 long now that nobody is going to read just the first three or
15 four pages. And the list of things that we have in there is
16 so comprehensive, I recognize we're --

17 CHAIRMAN POZEN: Well, that is actually a point
18 that I made to Jeff.

19 MR. BERESFORD: Can I finish, Bob?

20 CHAIRMAN POZEN: Yes.

21 MR. BERESFORD: The list is so long, I know we're
22 not putting that in as a checklist that everything has to be
23 in there. But this is just how these kinds of things evolve.
24 It was going to be an executive summary. We have an
25 executive summary right now at the MD&A. We are supposed to

1 have some sort of a summary in the CD&A, the compensation.
2 Now we're going to have to have an executive summary of
3 everything. I just think that's overkill.

4 MR. McCLAMMY: Yes, I agree with that. As I look
5 through the items here, a lot of it sounds repetitive to what
6 are in other places, particularly in the MD&A.

7 CHAIRMAN POZEN: Well, I guess one possibility is
8 that this would substitute for the executive summary in the
9 MD&A, that you wouldn't have to have both.

10 MR. McCLAMMY: That's a possibility. The other
11 thing I'm concerned with, if it stands on its own, that
12 you're going to get advice from attorneys probably in
13 particular, well, if you said that, you need to expand to
14 these other areas so people don't take that comment out of
15 context and you'll end up with ten pages --

16 CHAIRMAN POZEN: I'm going to ask you, John, is it
17 possible to see this executive summary as substituting for
18 the executive summary in the MD&A?

19 MR. WHITE: Sorry, say that again?

20 CHAIRMAN POZEN: The points made by Ed and Denny is
21 that you already have an executive summary or something like
22 that at the beginning of the MD&A. If you add this at the
23 beginning of the document, it seems like there are too many
24 executive summaries. So, the question is whether this
25 summary which would be at the beginning of the document and

1 is geared to a retail investor who just wants to see two
2 pages, whether this could substitute for the, that you then
3 would not have the summary of the MD&A? You would not have a
4 summary in the MD&A, you would just have the whole MD&A?

5 MS. GRIGGS: But there isn't a summary required in
6 the MD&A.

7 MR. WHITE: Yes, I was going to say, there is not a
8 summary required so I would have thought the answer to that
9 would be yes.

10 CHAIRMAN POZEN: Well, I think, I would say this,
11 Jeff. Here is worth putting some time in, I think to make
12 this, get the support of the full Committee, I think you need
13 to do two things. One is cut it down a little because you
14 could read those requirements to include a lot. And then,
15 second of all, we could probably get some data that says that
16 there are a number of companies that already do a summary at
17 the beginning of the MD&A and that this could play that for
18 all so that we wouldn't have that repetition.

19 So, I think this is something that your
20 Subcommittee can work on and I think you've heard
21 the comments here. So, if you, you know, I think people --

22 MS. GRIGGS: The other thing you might consider is
23 just making a recommendation that the SEC encourage companies
24 to do this. Because again, I think it's good encouragement
25 just like the Commission encourage companies to put in the

1 overview in the MD&A. In that way, it will be a little bit
2 more flexible and maybe then can evolve into something that
3 really works well.

4 MR. BERESFORD: I agree with Linda. Mandate was the
5 thing that really sort of set me off there.

6 CHAIRMAN POZEN: Well, I don't know that we really
7 need to sort of say whether -- is that, do people, are people
8 prepared to have a mandate here? I think, as opposed to an
9 encouragement?

10 MR. LIDDELL: This is one area I feel strongly
11 about. I don't think the 10-Q's or 10-K's are particularly
12 useful for a great bulk of investors. They are way too
13 difficult to navigate and I think an executive summary would
14 make a huge difference, although I take on board the comments
15 about it being slightly more focused on important areas. But
16 I would certainly support mandating. We've gone on our other
17 areas, we've been happy to be recommending. I think this is
18 one area that's not difficult to mandate and we should.

19 MR. WEATHERFORD: Bob?

20 CHAIRMAN POZEN: Yes?

21 MR. WEATHERFORD: Yes, I agree with Chris, but I
22 also agree with Denny. I think if you take this and add this
23 to what we have today, it doesn't make sense. But I think we
24 need to totally restructure the 10-Q and the 10-K. I mean,
25 I've got one I need to review now that has more pages on

1 footnotes than on MD&A. So, I think there needs to be a
2 balance more towards the MD&A so the investor really
3 understands what went on with the business.

4 CHAIRMAN POZEN: Well -- yes, Scott?

5 MR. EVANS: I think something that Christopher said
6 is clear. If we were to mandate this and this type of
7 summary were to go out, the number of investors that would
8 actually read the material would go up dramatically. And
9 that by itself should support a mandate in it.

10 CHAIRMAN POZEN: Well, I think what you ought to
11 do, Jeff, is write it up as a mandate and see if you can slim
12 it down in terms of what's required, and also put it in the
13 context of supplanting other executive overviews and
14 summaries and see if you can sell it. I think there is
15 probably a majority that wants it, but you also have some
16 good points here.

17 So, I think we're going to go on now, and so, Jeff,
18 I'm going to ask you just to forget about projection of
19 earnings guidance. Just, we've got enough to do
20 and here I think the diversity of opinion is such that, and
21 there are enough committees who have said it and we can just
22 leave the language that's there.

23 On Subcommittee 3, we don't have Mike here and I
24 guess he's probably not on the phone, but I think that the
25 Subcommittee has done an excellent job in really taking the

1 comments that were made in San Francisco and other comments
2 and really working hard on the actual language.

3 And so, I guess I think we're probably at the point that
4 people ought to give to Linda and Greg and Ed word comments
5 if there are really things that people disagree with.

6 I have only one question to raise myself, and Linda
7 and I have discussed this. There is a paragraph that says
8 that SAB 99 should be expanded to include, whatever it's
9 called now, it's not SAB 99, it's some other number, to
10 include guidance on qualitative factors and cash flow and
11 balance sheets as well as income statements. And I really
12 question whether that would lead us in a good direction
13 myself. But people may have different views on that.

14 MR. NUSBAUM: Well, I'll start. I think the intent
15 was not to eliminate SAB 99 or change it significantly, but
16 really to enhance it. And of course, as you know, the
17 biggest thing we were trying to do was to enhance it to cover
18 situations where large errors might not be material which I
19 think is consistent with the total mixed standard.

20 CHAIRMAN POZEN: Well, I think everybody would
21 agree with that. The question is whether you want to, you
22 know, you really want the SEC to be putting out a release
23 that says in the balance sheet here are a number of
24 situations in which you are quantitatively very small but
25 qualitatively you're going to kick into materiality and vice

1 versa.

2 MR. GRUNDFEST: SAB 99 is already causing enough
3 agitation in the world that I think expansions --

4 CHAIRMAN POZEN: Greg, I couldn't hear what you
5 say, can you repeat it?

6 MR. GRUNDFEST: SAB 99 is already causing enough
7 agitation, all right, in the world where
8 expansions particularly of the concept of qualitative
9 materiality I think would cause a lot of concern.
10 I know from my own experience people in good faith attempting
11 to comply with the law have a terribly difficult time trying
12 to figure out ex ante whether something is going to be viewed
13 as being material ex post given the language that you have in
14 the SAB 99. It's a gestalt theory of materiality that says I
15 know it when I see it and I'll know it after the fact.

16 CHAIRMAN POZEN: I don't think this is, if you were
17 to take that paragraph out, it wouldn't detract at all from
18 the general points you're making. The question is really
19 whether we want to get the SEC to --

20 MS. GRIGGS: Yes, I mean, I recommended it because
21 I have had numerous clients struggle with when a cash flow
22 statement would have to be restated for an error in the cash
23 flow statement. It has been a struggle for companies.

24 Now, if there isn't a way to provide guidance,
25 that's fine. Maybe it is too fact specific and maybe there

1 isn't a way to provide any guidance. The factors listed in
2 SAB 99 are really almost all of them more related to the
3 income statement than either the balance sheet or the cash
4 flow statement. And it's really been the cash flow statement
5 more than even the balance sheet that has been difficult for
6 clients. But --

7 CHAIRMAN POZEN: Well, Linda, I don't disagree with
8 you but I think we haven't done the work to say here is what
9 we, you know, then we would really, just to say to the SEC,
10 well, why don't you do this --

11 MS. GRIGGS: That's fair.

12 CHAIRMAN POZEN: I mean, we would have to have a
13 framework and a thought like we have done in all these other
14 areas. And I guess I just don't think we've done the work to
15 be able to make some --

16 MS. GRIGGS: No, we don't recommendations for the
17 kind of guidance the Commission might give. You're right.

18 CHAIRMAN POZEN: And --

19 MR. GRUNDFEST: Your concern, Bob, is that we'd be
20 opening Pandora's Box?

21 CHAIRMAN POZEN: Well, I'm hopeful that we can,
22 with that paragraph out, that we can get the Commission to
23 actually propose something relatively soon. And
24 I'm concerned that that's the sort of thing that then people
25 figure, well, they've got to do that in order to do this and

1 having to think through that. So, other than that, I thought
2 it was really a great job. And I guess, are there any other
3 comments on that?

4 Okay. I think what we really, we can do it
5 offline, we really ought to talk about, since that's so far
6 along, how we deal with the SEC's staff and other
7 constituencies in terms of that, and how we promulgate it so
8 that people who have commented before, I mean, it's on the
9 public record now but we want to make sure that people see
10 the revisions that we've gotten and done. But we can talk
11 about that. I want to, Dave --

12 MR. NUSBAUM: Just a clarification, I mean, this is
13 public information, right?

14 CHAIRMAN POZEN: I understand that, but it's --

15 MR. NUSBAUM: But I think your point is a good
16 point because we have made a lot of changes, a lot of
17 changes.

18 CHAIRMAN POZEN: Yes. We had people questioning,
19 we want to, I think we would like to, we should reach out to
20 people that we want to show the changes.

21 MR. NUSBAUM: Absolutely.

22 CHAIRMAN POZEN: And discuss it with them. David
23 Sidwell is going to have to leave soon so I do want to look
24 at number 2. I think we've talked about the international
25 part and I know that John White has committed to finish the

1 SEC position with you. And I think the one thing, I think
2 you've heard a little, both today and other things is a
3 little concern about playing up too much this cost benefit
4 analysis. So, I think that probably needs to be toned down.

5 I don't know, I think otherwise it's in, again, in
6 pretty good shape. But do people have questions or issues
7 they want to air? Greg?

8 MR. JONAS: I did have a suggestion on the cost
9 benefit analysis. I do have sympathy for --

10 CHAIRMAN POZEN: Speak a little more into the mic,
11 I'm sorry.

12 MR. JONAS: I do have sympathy for what some people
13 have told us which is there seems to be an emphasis more on
14 just reducing cost than there is on giving benefits to
15 investors.

16 The way that the Jenkins Committee dealt with cost
17 benefit analysis is as follows, and I think it could help us.
18 The Jenkins Committee concluded that you cannot measure the
19 benefits, so people who say go out and measure cost and
20 benefits, it can't be done. So, what does one do? Well,
21 what one does is, A, make sure that the benefits are present,
22 meaning that the information is decision useful to the user.
23 Go out and verify that it's decision useful. We have
24 recommendations to do exactly that, through field test with
25 users, getting front-end input with users.

1 Once you determine that the benefits are there,
2 then look for ways to reduce cost by making shortcuts that
3 don't undermine investors' information needs. But the
4 concept of actually going out and measuring cost and
5 benefits, it's my belief and it was Jenkins Committee's
6 belief, simply can't be done.

7 MR. SIDWELL: The way we've articulated it, Greg, I
8 think is very consistent with that which is that what we
9 really want to do is to have a clear statement or
10 understanding from investors/users what benefit does this
11 give you. Is it adding value from where we are today? Is it
12 going to improve your ability to make good decisions?

13 So, we were going to dial back the other aspect, we
14 were going to dial back some aspects of the details, what
15 we'll work on, too, so clarify is that we want the FASB to be
16 more consistent about actually laying out exactly what
17 they've done, not just on the benefits side but to ascertain
18 what the costs are. And we heard, I think we feel there's a
19 fair amount that they can do to better explain that logic
20 behind getting to a decision than they do today.

21 MR. NUSBAUM: David, did you do anything with
22 regard to the user field testing in terms of how that would
23 really work?

24 MR. SIDWELL: Well, we, throughout our
25 recommendations is the idea of getting the users much more

1 involved along the way. One of the concepts behind getting
2 the four statements is, finalized as an exposure draft is
3 that the user group says it will do A, B, C, D, E,
4 F, G for us, and to really try and crisp up on that
5 understanding of that use of that effect.

6 CHAIRMAN POZEN: I think, okay, I think the only
7 other thing I'm hearing is that to the extent that we have
8 this agenda setting committee, that its relationship to
9 other, you know, whether we're putting other committees out
10 of business or just creating a second layer, I think we need
11 to be a lot clearer on what we want to do on that.

12 MR. SIDWELL: There's some commentary actually
13 about, and I think we can leave this a little open, is should
14 it be the executive committee of like FASAC because they have
15 many of these members already. I think we can fine tune that
16 in.

17 CHAIRMAN POZEN: Okay. So, either we're going to
18 expand an existing committee, or if we create this one, we'll
19 have to cut out some other committee.

20 MR. SIDWELL: Yes, right.

21 CHAIRMAN POZEN: Yes, okay. Yes, Sue?

22 MS. BIES: Just one other thing. David just kept
23 using the word user, I like that better than investor because
24 customers will want to look at financial statements and
25 regulators would. And I think the word user is broader than

1 just investor.

2 MR. EVANS: And in the documents, we do talk about
3 the users. I mean, we can go back and forth here but --

4 MS. BIES: There are a couple of places in it though
5 that still say investor. So, define it broadly.

6 CHAIRMAN POZEN: So, just, Scott and Denny, just to
7 review then, there are a number of points on the
8 international side which you're going to bulk up. And then,
9 second of all, the SEC, John, is committed to get the
10 language back to you. Third is reworking of the, toning down
11 the cost benefit. Fourth, we have the word user. Fifth,
12 this question of which, you know, what's going to happen in
13 terms of which committee and that sort of thing.

14 MR. EVANS: Can we direct to some of the existing
15 committees to take up some of these --

16 CHAIRMAN POZEN: Well, I think the staff should be
17 able to handle all of these issues. And I think the only one
18 that has, I mean, these writing things, I think Brett will
19 work that out with David. So, I think we're pretty far
20 along, but I mean I think the key is that when this
21 Subcommittee meets in June 6th, that we have language that
22 then can be approved, so then the whole chapter can be done.
23 And I don't know, this meeting is scheduled for New York, so
24 I don't know whether the Corp Fin is going to, somebody is
25 going to come up there and I think that's probably the one

1 that's going to take the most discussion.

2 MR. EVANS: It's the one place that we're not very
3 close to finalizing.

4 CHAIRMAN POZEN: Okay. Well, I think we can get
5 there. We'll get a draft and then that's probably where the
6 bulk of the time will be spent.

7 MR. EVANS: Yes.

8 CHAIRMAN POZEN: I think the rest of the things are
9 in the nature of embellishing and editing and focusing.

10 And then, Committee Number 1, I guess I'm hearing
11 one thing. I think today we heard a little push back on the
12 industry specific standards, and I think we ought to think
13 about that. And whether, I mean, people have made some good
14 points here and we just need to think about whether we're
15 being a little unrealistic in certain ways or whether, I
16 mean, in principle we want to push back, but on the other
17 hand, some of these things are viewed as helpful to people.
18 So, I think we just need to consider that.

19 Second of all, I'd just say myself I think the
20 'chunking' of income and that discussion is very good. And
21 it's really probably the only thing we can do within the
22 context of fair value as sort of a middle ground position.
23 But I think Joe and I were saying before, I think we need to
24 have a much better explanation of that chart. That's really
25 hard for someone to understand, and we probably ought to have

1 an example whether there is a substantial change in the
2 unrealized portfolio so that we can illustrate a little
3 better what's happening there. So, that chart starts off
4 sort of assuming that you know a lot about what's going to
5 happen before you do it.

6 And then, third of all --

7 MS. BIES: Let me just add to that. I think in
8 tying other things together with that chart, to really make
9 sure we clarify what we mean by activities because that's
10 sort of the whole deal with the business operating part of
11 that chart, and we know we have to get clearer on that.

12 CHAIRMAN POZEN: Yes.

13 MS. BIES: So, I think that would make the chart
14 flow better with the rest of the section that we've written.

15 CHAIRMAN POZEN: And then, the third thing is just
16 the off balance sheet, just to decide what you, in terms of
17 disclosure or other things, you just need to have a position
18 on that. I understand you haven't had that much time to talk
19 about that, so you may want to allocate some of your time in
20 the next month.

21 I don't know whether other people have questions or
22 comments on Chapter 1 that people --

23 MS. GRIGGS: Oh, I had a question on the
24 preliminary --

25 CHAIRMAN POZEN: Could you speak into your mic?

1 I'm sorry, we're really --

2 MS. GRIGGS: Preliminary Hypothesis 5, it sounds
3 very much like in part the critical accounting policy
4 disclosure that is now required in the MD&A. Is your
5 recommendation to put that into the audited financial
6 statements, notes to the financials? Is that where you would
7 be putting it? Because, I mean, the assumptions estimate
8 sensitivity analysis relating to estimates --

9 CHAIRMAN POZEN: Let's, can you get us to the,
10 let's all get to the right page here.

11 MS. GRIGGS: 17.

12 CHAIRMAN POZEN: 17, thank you.

13 MS. GRIGGS: And I think maybe your hypothesis goes
14 a little bit beyond the critical accounting estimates. But I
15 think at least the first sentence of that is really
16 disclosures that I think are now required, maybe not required
17 by a rule but certainly by SEC interpretive releases in an
18 MD&A. But I guess what you're saying is it should be in the
19 audited financials, is that what you're suggesting?

20 MS. BIES: I don't think we have gotten to the
21 point of deciding where it goes. I know we're concerned that
22 some of these may be difficult to audit. So, I think what
23 we're after is really the sensitivity analysis. And the
24 Financial Stability Forum has just issued some new frameworks
25 around disclosure that we want to explore, it just came out

1 about a week ago. And we want to look at that because I
2 think, what we think is important is that investors not only
3 know what the fair value is on these things, but more
4 importantly, what's the volatility there and what are the
5 drivers. And I think that's what we're after.

6 MD&A may actually be a safer place to put it, so I
7 think we still have to go through some of that discussion
8 internally with some of these new proposals out there.

9 MS. GRIGGS: Okay. Well, you should also just look
10 at the guidance on critical accounting estimate because I
11 think the guidance is out there. The SEC has put it out.

12 MS. BIES: But estimating a point is a very
13 different exercise than describing volatility and risk. And
14 what we're trying to do here is to do that broader
15 description.

16 MR. McCLAMMY: But I think that this hypothesis is
17 actually much broader than that. I mean, this is getting at
18 the whole point that disclosures have come together
19 piecemeal. And as one of the panelists said today,
20 you end up going through a hundred pages, checklist of have I
21 covered this, have I covered that, and without then stepping
22 back and saying have I really described what are the key
23 things investors need to know in the footnote.

24 CHAIRMAN POZEN: But I think one of the --

25 MR. McCLAMMY: -- needs to just be totally

1 redressed, and rather than having a piecemeal build up, start
2 with a framework that says here are the key things that
3 investors should know. So, put disclosures on more of a
4 principle based rather than rule based as well.

5 CHAIRMAN POZEN: Well, I think one of the problems,
6 and this may be helpful, I think these are two rather
7 different, they're under the same hypothesis but they are two
8 very, very different proposals.

9 MS. GRIGGS: I agree.

10 CHAIRMAN POZEN: And we really need to separate
11 them out. The second proposal is as you've just well
12 articulated, a request that there be a much closer
13 coordination between the SEC's disclosures and the financial
14 footnotes. I think if there is some, I don't know whether
15 there is already -- Russ, is there something anybody, I know
16 that maybe we have talked about four or five years ago
17 somebody had done some work on this in terms of the overlap?
18 I mean --

19 MR. HERZ: Yes, I did it.

20 CHAIRMAN POZEN: Well, good then. You can --

21 MR. HERZ: It's been seven or eight years ago. I
22 was part of the, it was an SEC GAAP redundancies working
23 party.

24 CHAIRMAN POZEN: And has that been updated at all,
25 Bob? Do you know whether anybody is working on

1 that or has -- well, I guess what I'm saying is we may want
2 to look at least to see what excellent work Bob Herz did and
3 to see whether there were some things that he suggested
4 haven't been done yet. I mean, I'm just a little concerned
5 about just saying we should coordinate, blah-blah-blah. I
6 mean, we don't, there's not enough meat here, we've got to
7 have a little meat as to at least a few examples of things
8 that could be done like you don't have to repeat the
9 footnotes or I don't know, something that would at
10 least -- we obviously can't do a comprehensive study but we
11 could at least have a few illustrations of the sorts of
12 things that we would want. I think --

13 MR. GRUNDFEST: -- should allow a corporation by
14 reference within the same document.

15 CHAIRMAN POZEN: That's good.

16 MR. GRUNDFEST: You would think.

17 CHAIRMAN POZEN: It's a pretty radical suggestion
18 but I think it's --

19 MR. GRUNDFEST: I'm a radical kind of guy.

20 CHAIRMAN POZEN: Yes, we know that, Joe. So, I
21 think that can be separated out. And the other thing on
22 assumptions, et cetera, I think what Linda was saying is, in
23 the alternative accounting policies, they ask you to explain
24 the sort of things like why you chose this one versus that
25 one. But I think, maybe it was Thom or Ed who said that it's

1 a broader, this is a broader thing. And I do think putting
2 it in the MD&A is important because we're asking for a degree
3 of soft information here.

4 MS. GRIGGS: But then it would be a recommendation
5 to the SEC and not the FASB. I just think you want to
6 coordinate and look at what the SEC has already said in the
7 area of critical accounting estimates because I think a lot
8 of that is similar. I know you want to go beyond that, but I
9 think it has to be coordinated.

10 CHAIRMAN POZEN: So, I think, if I have this
11 correct, and the Subcommittee 1 has re-looking at industry
12 specific, a better explanation and better example of chunking
13 income. Third of all, a clearer position on off balance
14 sheet. Fourth is to take this first proposal and sort of
15 relate it to MD&A and other things and direct it to the SEC.
16 And then, fifth is to, in this duplication to go over the
17 excellent work of Bob Herz, to see what we can learn from
18 that and whether there is any literature here, whether
19 somebody has gone over that and done that, or at least it
20 seems to me there are certain obvious areas that are
21 duplicative that we can talk about.

22 Greg, you look like you're about to say something?

23 MR. JONAS: Well, I was just going to comment, Bob,
24 I had one more that I thought, input we got.

25 CHAIRMAN POZEN: Good, good.

1 MR. JONAS: I thought John Stewart was quite
2 articulate about concerns over bright lines. Not arguing
3 that bright lines are always good, but just he saw and I
4 thought others seconded that they saw times when bright lines
5 were entirely appropriate because it limited what otherwise
6 would be diversity in practice that would confound users.
7 That was moving to me, so maybe if we could think more about,
8 you know, sometimes there is a place for bright lines and
9 articulating when that might be.

10 MR. WEATHERFORD: Yes, I heard keep the good bright
11 lines, get rid of the evil ones.

12 MS. GRIGGS: Right.

13 MR. WEATHERFORD: Yes. So, make --

14 CHAIRMAN POZEN: Yes, that's well put, Greg. Other
15 comments that people want to make in terms of either
16 Subcommittee 1 or where we are on any other Subcommittee? I
17 might just say that, maybe Linda and Greg can do a little,
18 since you guys are so far along, do a little work with me on
19 thinking about an executive overview and which we, basically
20 on the status thing, I just wrote very quickly at the end.
21 But in fact, as we know, for a lot of people that's the only
22 thing they'll be reading. So, we'd be spending,
23 working on that. I can try to outline something and then we
24 can think about it.

25 Does either Russ or Jim, do you have any other

1 comments you want to make? Or suggestions?

2 MR. KROEKER: I don't have anything else.

3 CHAIRMAN POZEN: Russ? Greg?

4 MR. JONAS: Just one last thing. Where is Bert?
5 Bert. Correct me if your recollection is different, but
6 Subcommittee 3 had a handful of I would call relatively minor
7 issues but things that we wanted to tee up in the area of
8 compliance that we haven't had time to get to yet because
9 we've had so much input on our first two topics we've been
10 grappling with. But Bert, my recollection is we have a
11 handful of things that we wanted to give some attention to,
12 so I think you can expect a few things from us at the next --

13 CHAIRMAN POZEN: Okay. I think that's no problem.
14 And we can proceed on that basis.

15 So, again, I thank everybody for coming. And
16 really, I think we should all feel good about how far we are
17 along in this process because we have made a lot of concrete
18 proposals. We're really refining them. I think we've gotten
19 good input. I don't think we need more public testimony, I
20 think we have had enough. And I very much appreciate the way
21 in which people have debated issues and really been willing
22 to be very specific about issues. And I think that's really
23 led to very good collaboration.

24 And thanks again to the staff for putting this
25 together. And I think the staff is going to have a lot of

1 work between now and the end of July.

2 (Applause.)

3 CHAIRMAN POZEN: And good luck to everybody in
4 getting a plane. Committee, thanks, and meeting adjourned.

5 (Whereupon the meeting was adjourned at 3:11 p.m.)

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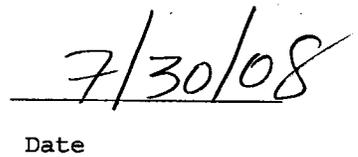
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CERTIFICATION

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



Robert C. Pozen
Committee Chair



Date

Exhibit A

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

**Donald E. Stephens Conference Center, Room 40
Rosemont, IL**

AGENDA

Friday, May 2, 2008, Beginning at 8:00 A.M. Central Time

I. Introductory Remarks – Robert Pozen, Committee Chairman

II. Panel One – Substantive Complexity

Participants:

Linda Bergen – Citigroup

Mark Bielstein – KPMG

Kevin Conn – MFS Investments

Jeff Mahoney – Council of Institutional Investors

Ben Neuhausen – BDO Seidman

Brooke Richards – American Express

John Stewart – Financial Reporting Advisors

III. Break

IV. Panel Two – Standards-Setting Process

Participants:

Linda Bergen – Citigroup

Mark Bielstein – KPMG

Kevin Conn – MFS Investments

Jeff Mahoney – Council of Institutional Investors

Ben Neuhausen – BDO Seidman

John Stewart – Financial Reporting Advisors

Lynn Turner – COPERA Trustee

V. Break

VI. FASB Remarks – Robert Herz

VII. Discuss Reports from Subcommittees

VIII. Next Steps and Future Timetable

IV. Adjournment (expected no later than 4:00 P.M. Central Time)

Exhibit B

Note: These subcommittee reports have been prepared by the individual subcommittees and do not necessarily reflect either the views of the Committee or other members of the Committee, or the views or regulatory agenda of the Commission or its staff.

**SEC Advisory Committee on Improvements to Financial Reporting
Substantive Complexity Subcommittee Update
May 2, 2008 Full Committee Meeting**

I. Introduction

The SEC’s Advisory Committee on Improvements to Financial Reporting (Committee) issued a progress report (Progress Report) on February 14, 2008.¹ In chapter 1 of the Progress Report, the Committee discussed its work-to-date in the area of substantive complexity, namely, its developed proposals related to industry-specific guidance and alternative accounting policies; its conceptual approaches regarding the use of bright lines and the mixed attribute model; and its future considerations related to scope exceptions² and competing models.

Since the issuance of the Progress Report, the substantive complexity subcommittee (Subcommittee I) has deliberated each of these areas further, particularly its conceptual approaches and future considerations, and refined them accordingly. This report represents Subcommittee I’s latest thinking. The Subcommittee’s consideration of comment letters received thus far by the Committee is ongoing and may result in additional changes. The purpose of this report is to update the full Committee, and also to serve as a basis for the substantive complexity panel discussions scheduled for May 2,

¹ Refer to Progress Report at <http://www.sec.gov/rules/other/2008/33-8896.pdf>.

² Throughout this report, the term “scope exceptions” refers to scope exceptions other than industry-specific guidance.

2008 in Chicago. Subject to further public comment, Subcommittee I intends to deliberate whether to recommend these preliminary hypotheses to the full Committee for its consideration in developing the final report, which it expects to issue in July 2008.

II. Exceptions to General Principles

II.A. Industry-Specific Guidance

In the Progress Report, the Committee issued a developed proposal related to industry-specific guidance (developed proposal 1.1). Refer to the Progress Report for additional discussion of this developed proposal. Subcommittee I will consider the panel discussions on May 2, 2008, as well as the public comment letters received, before submitting a final recommendation to the Committee, but at this time, is not intending to propose any significant revisions.

II.B. Alternative Accounting Policies

In the Progress Report, the Committee issued a developed proposal related to alternative accounting policies (developed proposal 1.2). Refer to the Progress Report for additional discussion of this developed proposal. Subcommittee I will consider the panel discussions on May 2, 2008, as well as the public comment letters received, before

submitting a final recommendation to the Committee, but at this time, is not intending to propose any significant revisions.

II.C. Scope Exceptions

Preliminary Hypothesis 1: GAAP should be based on a presumption that scope exceptions should not exist. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB should not provide additional scope exceptions, except in rare circumstances. Any new projects should also include the elimination of existing scope exceptions in relevant areas as a specific objective of these projects, except in rare circumstances.

Background

Scope exceptions represent departures from the application of a principle to certain transactions. For example:³

- SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, excludes certain financial guarantee contracts, employee share-based payments, and contingent consideration from a business combination, among others.
- SFAS No. 157, Fair Value Measurements, excludes employee share-based payments and lease classification and measurement, among others.

³ Refer to appendix A for additional examples.

- FIN 46R, Consolidation of Variable Interest Entities, excludes employee benefit plans, qualifying special-purpose entities,⁴ certain entities for which the company is unable to obtain the information necessary to apply FIN 46R, and certain businesses, among others.

Similar to other exceptions to general principles, scope exceptions arise for a number of reasons. These reasons include: (1) cost-benefit considerations, (2) the need for temporary measures to quickly minimize the effect of unacceptable practices, rather than waiting for a final “perfect” standard to be developed, (3) avoidance of conflicts with standards that would otherwise overlap, and (4) political pressure.

Scope exceptions contribute to avoidable complexity in several ways. First, where accounting standards specify the treatment of transactions that would otherwise be within scope, exceptions may result in different accounting for similar activities (refer to competing models section below for further discussion). Second, scope exceptions contribute to avoidable complexity because of difficulty in defining the bounds of the scope exception. As a result, scope exceptions require detailed analyses to determine whether they apply in particular situations, and consequently, increase the volume of accounting literature. For example, the Derivatives Implementation Group has issued guidance on twenty implementation issues related to the scope exceptions in SFAS No.

⁴ Subcommittee I notes that the FASB has tentatively decided to remove the qualifying special-purpose entity concept from U.S. GAAP and its exception from consolidation.

133. Further, companies may try to justify aggressive accounting by analogizing to scope exceptions, rather than more generalized principles.

Nonetheless, scope exceptions may alleviate complexity in situations where the costs of a standard outweigh the benefits. For example, many constituents would contend that derivative accounting and disclosures for “normal purchases and normal sales” contracts are not meaningful, and thus, are appropriately excluded from the scope of SFAS No. 133.

Discussion

Subcommittee I preliminarily believes that scope exceptions should be minimized to the extent feasible. Possible justifications for retaining scope exceptions include: (1) cost-benefit considerations, (2) the need for temporary measures to quickly minimize the effect of unacceptable practices, rather than waiting for a final “perfect” standard to be developed, and (3) the need for temporary measures to avoid conflicts in GAAP.

However, in cases where scope exceptions are provided as a temporary measure, they should be coupled with a long-term plan by the FASB to eliminate the scope exception through the use of sunset provisions.

Subcommittee I also notes that in certain areas, the SEC staff has issued guidance to address transactions that are not within the scope of FASB guidance, e.g., literature

addressing the balance sheet classification of redeemable preferred stock not covered by SFAS No. 150.⁵ Accordingly, as the FASB develops standards to address these transactions, the SEC should eliminate its related guidance.

From an international perspective, Subcommittee I notes that IFRS currently has fewer scope exceptions than U.S. GAAP. Accordingly, the Subcommittee will draft language for the full Committee's consideration, which if adopted, would encourage the SEC to affirm the IASB's efforts on this path. However, Subcommittee I also notes that, in certain circumstances where IFRS includes scope exceptions, they are sometimes more expansive than those under U.S. GAAP. For example, IFRS 3, Business Combinations, scopes out business combinations involving entities under common control, which results in no on-point guidance for such transactions. Accordingly, Subcommittee I also believes that where IFRS provides scope exceptions, the IASB should ensure any significant business activities that are excluded from one standard are in fact addressed elsewhere. Said differently, the IASB should avoid leaving large areas of business activities unaddressed in the professional standards.

II.D. Competing Models

Preliminary Hypothesis 2: GAAP should be based on a presumption that similar activities should be accounted for in a similar manner. As such, the SEC should recommend that any new projects undertaken jointly or separately by

⁵ Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.

the FASB should not create additional competing models, except in rare circumstances. Any new projects should also include the elimination of competing models in relevant areas as a specific objective of these projects, except in rare circumstances.

Background

Competing models are distinguished here from alternative accounting policies.

Alternative accounting policies, as explained in the Progress Report, refer to different accounting treatments that preparers are allowed to choose under existing GAAP (e.g., whether to apply the direct or indirect method of cash flows). By contrast, competing models refer to requirements to apply different accounting models to account for similar types of transactions or events, depending on the balance sheet or income statement items involved.

Examples of competing models⁶ include different methods of impairment testing for assets such as inventory, goodwill, and deferred tax assets.⁷ Other examples include

⁶ Refer to appendix A for additional examples.

⁷ For instance, inventory is assessed for recoverability (i.e., potential loss of usefulness) and remeasured at the lower of cost or market value on a periodic basis. To the extent the value of inventory recorded on the balance sheet (i.e., its “cost”) exceeds a current market value, a loss is recorded. In contrast, goodwill is tested for impairment annually, unless there are indications of loss before the next annual test. To determine the amount of any loss, the fair value of a “reporting unit” (as defined in GAAP) is compared to its carrying value on the balance sheet. If fair value is greater than carrying value, no impairment exists. If fair value is less, then companies are required to allocate the fair value to the assets and liabilities in the reporting unit, similar to a purchase price allocation in a business combination. Any fair value remaining after the allocation represents “implied” goodwill. The excess of actual goodwill compared to implied goodwill, if any, is recorded as a loss. Deferred tax assets are tested for realizability on the basis of future

different methods of revenue recognition in the absence of a general principle, as well as the derecognition of most liabilities (i.e., removal from the balance sheet) on the basis of legal extinguishment compared to the derecognition of a pension or other post-retirement benefit obligation via settlement, curtailment, or negative plan amendment.

Similar to other exceptions to general principles, competing models arise for a number of reasons. These include: (1) scope exceptions, which, as discussed above, arise from cost-benefit considerations, temporary measures, and political pressure, and (2) the lack of a consistent and comprehensive conceptual framework, which results in piecemeal standards-setting.

Competing models contribute to avoidable complexity in that they lead to inconsistent accounting for similar activities, and they contribute to the volume of accounting literature.

On the other hand, competing models alleviate avoidable complexity to the extent that costs of a certain model exceed the benefits for a subset of activities.

Discussion

expectations. The amount of tax assets is reduced if, based on the weight of available evidence, it is more likely than not (i.e., greater than 50% probability) that some portion or all of the deferred tax asset will not be realized. Future realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income of the appropriate character (e.g., ordinary income or capital gain) within the carryback and carryforward periods available under the tax law.

Subcommittee I preliminarily believes that similar activities should be accounted for in a similar manner. Specifically, Subcommittee I acknowledges that competing models may be justified in circumstances in which the costs of applying a certain model to a subset of activities exceed the benefits. Further, Subcommittee I preliminarily believes that competing models may be justified as temporary measures (such as when they are temporarily needed to minimize the effect of unacceptable practices quickly, rather than waiting for a final “perfect” standard to be developed), as long as they are coupled with a sunset provision. To the extent a competing model meets one or more of the justifications above, it would not seem objectionable to use scope exceptions to clarify which accounting models cover various transactions (e.g., standard A ought to refer preparers to standard B for transactions excluded from the scope of A).

Subcommittee I recognizes that the FASB and IASB’s joint project on the conceptual framework will alleviate some of the competing models in GAAP. However, Subcommittee I would encourage the implementation of this preliminary hypothesis prior to the completion of conceptual framework, where practical, as: (1) the conceptual framework is a long-term project and (2) current practice issues encountered in the standard-setting process will inform the deliberations on the conceptual framework.

Further, as new accounting standards are issued, including that which is issued through the convergence process, any competing models in related SEC literature should be revised and/or eliminated, as appropriate.

Subcommittee I notes that, in certain cases, IFRS currently has fewer competing models. For example, Subcommittee I notes that, unlike U.S. GAAP, the IFRS impairment model is generally consistent for tangible assets, intangible assets, and goodwill. As such, Subcommittee I will draft language for the full Committee's consideration, which if adopted, would encourage the SEC to affirm the IASB's efforts on this path, particularly as it works with the FASB on the joint conceptual framework.

III. Bright Lines

Preliminary Hypothesis 3.1: GAAP should be based on a presumption that bright lines should not exist. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB avoid the use of bright lines, in favor of proportionate recognition. Where proportionate recognition is not feasible or applicable, the FASB should provide qualitative factors for the selection of a single accounting treatment. Finally, enhanced disclosure should be used as a supplement or alternative to the two approaches above.

Any new projects should also include the elimination of existing bright lines in relevant areas to the extent feasible as a specific objective of those projects, in favor of the two approaches above.

Preliminary Hypothesis 3.2: Constituents should be better trained to consider the economic substance and business purpose of transactions in determining the appropriate accounting, rather than relying on mechanical compliance with rules. As such, the SEC should undertake efforts, and also encourage the FASB, academics and professional organizations, to better educate students, investors, preparers, auditors, and regulators in this respect.

Background

As noted in the Progress Report, bright lines refer to two main areas related to financial statement recognition: quantified thresholds and pass/fail tests.⁸

Lease accounting is often cited as an example of bright lines in the form of quantified thresholds. Consider, for example, a lessee's accounting for a piece of machinery. Under current requirements, the lessee will account for the lease in one of two significantly different ways: either (1) reflect an asset and a liability on its balance sheet, as if it owns the leased asset, or (2) reflect nothing on its balance sheet. The accounting conclusion depends on the results of two quantitative tests,⁹ where a mere 1% difference in the results of the quantitative tests leads to very different accounting.

⁸ Refer to appendix B of the Progress Report for additional examples of bright lines.

⁹ Specifically, SFAS No. 13, Accounting for Leases, requires that leases be classified as capital leases and recognized on the lessee's balance sheet where 1) the lease term is greater than or equal to 75% of the estimated economic life of the leased property or 2) the present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90% of the fair value of the leased property, among other criteria.

The other area of bright lines in this section includes pass/fail tests, which are similar to quantitative thresholds because they result in recognition on an all-or-nothing basis. However, these types of pass/fail tests do not involve quantification. For example, a software sales contract may require delivery of four elements. Revenue may, in certain circumstances, be recognized as each element is delivered. However, if appropriate evidence does not exist to support the allocation of the sales price to, for example, the second element, software revenue recognition guidance requires that the timing of recognition of all revenue be deferred until such evidence exists or all four elements are delivered.

Bright lines arise for a number of reasons. These include a drive to enhance comparability across companies by making it more convenient for preparers, auditors, and regulators to reduce the amount of effort that would otherwise be required in applying judgment (i.e., debating potential accounting treatments and documenting an analysis to support the final judgment), and the belief that they reduce the chance of being second-guessed. Bright lines are also created in response to requests for additional guidance on exactly how to apply the underlying principle. These requests often arise from concern on the part of preparers and auditors of using judgment that may be second-guessed by inspectors, regulators, and the trial bar. Finally, bright lines reflect efforts to curb abuse by establishing precise rules to avoid problems that have occurred in the past.

Bright lines can contribute to avoidable complexity by making financial reports less comparable. This is evident in accounting that is not faithful to a transaction's substance, particularly when application of the all-or-nothing guidance described above is required. Bright lines produce less comparability because two similar transactions may be accounted for differently. For example, as described above, a mere 1% difference in the quantitative tests associated with lease accounting could result in very different accounting consequences. Some bright lines also permit structuring opportunities to achieve a specific financial reporting result (e.g., whole industries have been developed to create structures to work around the lease accounting rules). Further, bright lines increase the volume of accounting literature as standards-setters and regulators attempt to curb abusively structured transactions. The extra literature creates demand for additional expertise to account for certain transactions. All of these factors add to the total cost of accounting and the risk of restatement.

On the other hand, bright lines may, in some cases, alleviate complexity by reducing judgment and limiting aggressive accounting policies. They may also enhance perceived uniformity across companies, provide convenience as discussed above, and limit the application of new accounting guidance to a small group of companies, where no underlying standard exists. In these situations, the issuance of narrowly-scoped guidance may allow for issues to be addressed on a more timely basis. In other words, narrowly-scoped guidance and the bright lines that accompany them may function as a short-term fix on the road to ideal accounting.

Discussion

Subcommittee I preliminarily believes that bright lines in GAAP should be minimized in favor of proportionate recognition. As a secondary approach, where proportionate recognition is not feasible or applicable, the Subcommittee recommends that GAAP be based on qualitative factors, supported by presumptions¹⁰ as necessary. Subcommittee I also preliminarily believes that disclosure may be used as a supplement or alternative to the approaches above.

Subcommittee I uses the term “proportionate recognition” to describe accounting for the rights and obligations in a contract. In contrast to the current all-or-nothing recognition approach in GAAP, Subcommittee I preliminarily believes that accounting for rights and obligations would be appropriate in areas such as lease accounting – in effect, an entity would fully recognize its rights to use an asset, rather than the physical asset itself. In these cases, regardless of whether the lease is considered to be operating or capital (based on today’s dichotomy), all entities would record amounts in the financial statements to the extent of their involvement in the related business activities. For example, consider a lease in which the lessee has the right to use a machine, valued at \$100, for four years.

Also assume that the machine has a 10-year useful life. Under proportionate recognition,

¹⁰ In order for the use of presumptions to be meaningful and consistently applied, Subcommittee I preliminarily believes that the FASB should adopt consistent use of terms describing likelihood (e.g., rare, remote, reasonably possible, more likely than not, probable), time frames (e.g., contemporaneous, immediate, imminent, near term, reasonable period of time), and magnitude (e.g., insignificant, material, significant, severe).

a lessee would recognize an asset for its right to use the machine (rather than for a proportion of the asset) at approximately \$35¹¹ on its balance sheet. Under the current accounting literature, the lessee would either recognize the machine at \$100 or recognize nothing on its balance sheet, depending on the results of certain bright line tests.

Similarly, this rights-and-obligations approach may also be relevant in the context of revenue recognition, in particular, in comparison to today's software revenue recognition model.

However, Subcommittee I recognizes that proportionate recognition is not universally applicable. For example, proportionate recognition is not applicable in situations where the economics of a transaction legitimately represent an all-or-nothing scenario.¹² In situations like these, the FASB should consider providing qualitative factors, supported by presumptions, to guide the selection of a single appropriate accounting treatment by preparers. Subcommittee I preliminarily believes qualitative factors, including presumptions, would promote the application of principles over compliance with rules, while still narrowing the range of interpretation in practice to facilitate comparability across companies. Admittedly, presumptions may result in all-or-nothing accounting, but differ from bright lines because they are not arbitrary or determinative in their own right.

¹¹For purposes of illustration, \$35 represents a company's net present value calculations. The example is only intended to be illustrative and is not prescriptive. The basis of proportionate recognition may be an asset's estimated useful life, its future cash flows or some other approach depending on the facts and circumstances.

¹² Examples include determining (1) whether a contract should be accounted for as a single unit of account or whether it should be split into multiple components, and (2) whether a contract that has characteristics of both liabilities and equity should be treated as one instead of the other.

Subcommittee I uses the term “presumptions” to describe a method by which an accounting conclusion may be initially favored (i.e., not stringently applied), subject to the consideration of additional factors. This approach is used to some extent today. For instance, the business combination literature contains an example of a presumption coupled with additional considerations.¹³ There are situations in which selling shareholders of a target company are hired as employees by the purchaser because the purchaser may wish to retain the sellers’ business expertise. The payments to the selling shareholders may either be treated as: (1) part of the cost of the acquisition, which means the payments are allocated to certain accounts on the purchaser’s balance sheet, such as goodwill, or (2) compensation to the newly-hired employees, which are recorded as an expense in the purchaser’s income statement, reducing net income. Some of these payments may be contingent on the selling shareholders’ continued employment with the purchaser, e.g., the individual must still be employed three years after the acquisition in order to maximize the total sales price. GAAP provides several factors to consider when deciding whether these payments should be treated as an expense or not, but establishes a presumption that any future payments linked to continued employment should be treated as an expense. It is possible this presumption may be overcome depending on the circumstances.

¹³ Emerging Issues Task Force (EITF) 95-8, Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination. Subcommittee I notes EITF 95-8 is nullified by a new FASB standard, SFAS No. 141 (revised 2007), Business Combinations. SFAS No. 141 (revised 2007) states “A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is compensation...” However, the guidance in EITF 95-8 is still helpful in describing our approach with respect to the use of presumptions coupled with additional considerations in GAAP.

Finally, Subcommittee I notes that disclosure is critical to communicating with users, either by supplementing financial statement recognition (proportionate or otherwise) or by discussing events and uncertainties outside of the financial statements. Subcommittee I preliminarily believes that in some cases, disclosure may be more informative than recognition, as point estimates recognized in financial statements may provide a misleading sense of precision. Subcommittee I discusses examples of this situation in its consideration of a disclosure framework (section V of this report).

In order for these preliminary hypotheses to be operational, Subcommittee I recognizes the need for a cultural shift towards the acceptance of more judgment. In this regard, Subcommittee I preliminarily believes that professional judgment framework discussed in developed proposal 3.4 is critical to the success of these preliminary hypotheses. Subcommittee I further notes that even if the FASB limits its use of bright lines, other parties may continue to create similar non-authoritative guidance, which may proliferate the use of bright lines. As such, Subcommittee I preliminarily believes that developed proposal 2.4 regarding the reduction of parties that formally or informally interpret GAAP is helpful.

From an international perspective, Subcommittee I notes that IFRS currently has fewer bright lines than U.S. GAAP. Consequently, Subcommittee I will draft language for the full Committee's consideration, which if adopted, would encourage the SEC encourage to affirm the IASB's efforts on this path.

With respect to training and educational efforts, Subcommittee I notes the U.S. Treasury Department's Advisory Committee on the Auditing Profession has offered a number of preliminary recommendations on this topic. The Subcommittee is generally supportive of their direction, and will draft language for the full Committee's consideration, which if adopted, would encourage the SEC to monitor these developments as it takes steps, in coordination with the FASB, to promote the ongoing education of all financial reporting constituents.

IV. Mixed Attribute Model

As previously noted in the Progress Report, the mixed attribute model is one in which the carrying amounts of some assets and liabilities are measured at historic cost, others at lower of cost or market, and still others at fair value. There are several measurement attributes that currently exist in GAAP, all of which result in combinations and subtotals of amounts that are not intuitively useful. This complexity is compounded by requirements to record some adjustments in earnings, while others are recorded in equity (i.e., comprehensive income). For example, changes in the fair value of a derivative may be charged directly to equity, while an asset's current period depreciation expense reduces net income.

Optimally, the FASB should develop a consistent approach to determine which measurement attribute should apply to different types of business activities. While Subcommittee I is aware the FASB has a long-term project to develop such an approach, known as the measurement framework, it advocates three steps in the near term for the Committee's consideration to improve the clarity of financial statements for investors.

First, the Committee should advise caution about expanding the use of fair value in financial reporting until a number of practice issues are better understood and resolved, providing time for the FASB to complete its measurement framework. Second, the Committee should recommend a presentation of distinct measurement attributes on the face of the primary financial statements, grouped by business activities. This will make subtotals of individual line items in the statements more meaningful. Third, the Committee should propose the development of a disclosure framework, which would enable users to better understand the key risks and uncertainties associated with different measurement attributes (refer to section V below).

Preliminary Hypothesis 4: Avoidable complexity caused by the mixed attribute model should be reduced in three respects:

- **Measurement framework – The SEC should recommend that the FASB be judicious in issuing new standards and interpretations that expand the use of**

fair value in areas where it is not already required,¹⁴ until completion of a measurement framework. The SEC should also recommend that, to the maximum extent feasible, the FASB use a single measurement attribute for each type of business activity presented in the financial statements.¹⁵

- **Financial statement presentation – The SEC should encourage the FASB to:**
 - **Assign a single measurement attribute within each business activity that is consistent across the financial statements.**
 - **Aggregate business activities into operating, investing and financing sections.¹⁶**
 - **Add a new primary financial statement to reconcile the statements of income and cash flows by measurement attribute.¹⁷**

- **Enhanced disclosure – refer to section V of this report.**

Background

¹⁴ For instance, improvements to certain existing, particularly complex standards, such as SFAS No. 133, Accounting for Derivatives and Hedging Activities and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, may be warranted in the near term.

¹⁵ To make this approach operational, the FASB might establish a rebuttable presumption in favor of a single measurement attribute within each business activity (i.e., operating, investing and financing). For example, the Board may determine amortized cost is the presumptive measurement attribute within the operating section of a company's financial statements. Nevertheless, the Board would also have to consider whether fair value is appropriate for financial assets and liabilities employed in those business activities, such as certain derivative contracts used to hedge commodity price risk for materials used in the production process.

¹⁶ Subcommittee I is aware of the FASB and IASB's joint financial statement presentation project and is generally supportive of its direction. Subcommittee I also notes that in addition to the three business activities listed here, the FASB's project contemplates two additional types of business activities—income taxes and discontinued operations.

¹⁷ An example of this presentation is included below.

As the Committee noted in the Progress Report, examples of accounting standards that result in mixed attribute measurement include two FASB standards related to financial instruments. SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, permits the fair valuation of certain assets and liabilities. As a result, some assets and liabilities are measured at fair value, while others are measured at amortized cost or some other basis. SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires certain investments to be recognized at fair value and others at amortized cost.

In practice, the costs associated with (potentially uncertain) fair value estimates can be considerable. Some preparers' knowledge of valuation methodology is limited, requiring the use of valuation specialists. Auditors often require valuation specialists of their own to support the audit. Some view the need for these valuation specialists as a duplication of efforts, at the expense of the preparer. In addition, there are recurring concerns about second-guessing by auditors, regulators, and courts in light of the many judgments and imprecision involved with fair value estimates. Regardless of whether such estimates are prepared internally or by valuation specialists, the effort and elapsed time required to implement and maintain mark-to-model fair values is significant. For these reasons, preparers and auditors will likely have to incur costs to broaden their proficiency in basic

valuation matters,¹⁸ and additional education may be required for the larger financial reporting community to become further accustomed to fair value information.

Nevertheless, some have advocated mandatory and comprehensive use of fair value as a solution to the complexities arising from the mixed attribute model. However, opponents argue that this would only shift the burden of complexity from investors to preparers and auditors, among others. Specifically, certain investors may find uniform fair value reporting simpler and more meaningful than the current mixed attribute model. But under a full fair value approach, some objectivity would be sacrificed because many amounts that would change to fair value are currently reported on a more verifiable basis, such as historic cost. These amounts would have to be estimated by preparers and certified by auditors, as discussed above. Such estimates are made even more subjective by the lack of a single set of generally accepted valuation standards and the use of inputs to valuation models that vary from one company to the next. Likewise, significant variance exists in the quality, skill, and reports of valuation specialists, which preparers have limited ability to assess. Finally, there is no mechanism to ensure the ongoing quality, training, and oversight of valuation specialists. As a result, some believe a wholesale transition to fair value would reduce the reliability of financial reports to an unacceptable degree.

¹⁸ For instance, additional training for field auditors may be necessary to lessen dependency on valuation experts.

Therefore, as the Committee noted in its Progress Report, Subcommittee I assumes that a complete move to fair value is most unlikely. Within this context, the partial use of fair value increases the volume of accounting literature. Said differently, when more than one measurement attribute is used, guidance is required for each one. In addition, some entities may operate under the impression that investors are averse to market-driven volatility. Consequently, entities have demanded exceptions from the use of fair value in financial reporting, resisted its use, and/or entered into transactions that they otherwise would not have undertaken to artificially limit earnings volatility. These actions have resulted in a build up in the volume of accounting literature. More generally, some believe that attempts by companies to smooth amounts that are not smooth in their underlying economics reduce the efficiency and the effectiveness of capital markets.

With respect to users, information delivery is made more difficult by fair value. Investors may not understand the uncertainty associated with fair value measurements (i.e., that they are merely estimates and, in many instances, lack precision), including the quality of unrealized gains and losses in earnings that arise from changes in fair value. Some question whether the use of fair value may lead to counterintuitive results. For example, an entity that opts to fair value its debt may recognize a gain when its credit rating declines. Others question whether the use of fair value for held to maturity investments is meaningful. Finally, preparers may view disclosure of some of the inputs to the assumptions as sensitive and competitively harmful.

Despite these difficulties, the use of fair value may alleviate some aspects of avoidable complexity. Such information may provide investors with management's perspective, to the extent management makes decisions based on fair value, and it may improve the relevance of information in many cases, as historical cost is not meaningful for certain items.

Fair value may also enhance consistency by reducing confusion related to measurement mismatches. For example, an entity may enter into a derivative instrument to hedge its exposure to changes in the fair value of debt attributable to changes in the benchmark interest rate. The derivative instrument is required to be recognized at fair value, but, assuming no application of hedge accounting or the fair value option, the debt would be measured at amortized cost, resulting in measurement mismatches. In addition, fair value might mitigate the need for detailed application guidance explaining which instruments must be recorded at fair value and help prevent some transaction structuring.

Specifically, if fair value were consistently required for all similar activities, entities would not be able to structure a transaction to achieve a desired measurement attribute.

Fair value also eliminates issues surrounding management's intent. For example, entities are required to evaluate whether investments are impaired. Under certain impairment models, entities are currently required to assess whether they have the intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. As the Committee noted in the in the Progress Report (see discussion

supporting developed proposal 1.2 to minimize alternative accounting policies) management intent is subjective and, thus, less auditable. However, use of fair value would generally make management intent irrelevant in assessing the value of an investment.

Discussion

Subcommittee I acknowledges the view that a complete transition to fair value would alleviate avoidable complexity resulting from the mixed attribute model. However, Subcommittee I also recognizes that expanded use of fair value would increase avoidable complexity unless numerous implementation questions related to relevance and reliability are addressed (as discussed above), which extend beyond the scope of our work.

Therefore, consistent with current practice, Subcommittee I preliminarily believes fair value should not be the only measurement attribute in GAAP. At present, Subcommittee I believes the Committee should advise caution about expanding the use of fair value until a systematic measurement framework is developed, and in this regard, that phase two of the FASB's fair value option project, which will consider permitting fair value measurement for certain nonfinancial assets and liabilities, should not be finalized prior to completion of a measurement framework.¹⁹

¹⁹Similarly, Subcommittee I preliminarily believes the Committee should recommend that the FASB consider deferring provisions of new standards that are issued, but not yet effective, which expand the use of fair value measurement where it has not been previously required.

At that point, the FASB should determine measurement attributes based on considerations such as business activity, the relevance and reliability of fair value inputs, and other considerations vetted during the measurement phase of its conceptual framework project. While Subcommittee I prefers an activity-based approach to assigning measurement attributes, Subcommittee I is sympathetic to an approach based on the type of asset or liability in question, such as financial instruments vs. non-financial instruments. This is a natural tension that the FASB should address as part of the measurement framework. For example, in one scenario, the Board may determine amortized cost is the presumptive measurement attribute within the operating section of a company's financial statements. Nevertheless, the Board would also have to consider whether fair value is appropriate for financial assets and liabilities employed in those business activities such as certain derivative contracts used to hedge commodity price risk for materials used in the production process.

With respect to financial statement presentation, Subcommittee I preliminarily believes the grouping of individual line items (and related measurement attributes) by operating, investing and financing activities would alleviate some of the concerns about fair value in particular. It would also reduce confusion caused by the commingling of all measurement attributes. Subcommittee I preliminarily believes this presentation would be more understandable to investors, particularly because it would delineate the nature of changes in income (e.g., fair value volatility, changes in estimate) and allow users to assess the degree to which management controls each one.

It may also facilitate earnings analyses by business activities that correspond to the natural elements of most profit-driven entities, for instance, operating income compared to investing or financing results. Under this approach, companies should present earnings per-share computations of the net activity in each section. Further, the addition of a new primary financial statement – the reconciliation of the statements of comprehensive income and cash flows – would disaggregate changes in assets and liabilities based on cash, accruals, and changes in fair value, among others. A visual example of this statement might include the following:²⁰

Reconciliation of the Statements of Income and Cash Flows							
	A Cash Flow Statement	B C D E Non-cash items affecting income				F Income Statement (A+B+C+D+E)	
		B Cash flows Not Affecting Income	C Accruals and Systematic Allocations	D Recurring Valuation Changes	E Other Valuation Changes		
Operating							
Cash received from sales	2,700,000		75,000			2,775,000	Sales
	0		(9,000)			(9,000)	Depreciation expense
	0				(15,000)	(15,000)	Impairment expense
	0			(7,500)		(7,500)	Forward contract adj.
Investing							
Capital expenditures	(500,000)	500,000				0	
Sale of available for sale securities	5,000	(4,900)		350		450	Realized gain on sale
Financing							
Interest paid	(125,000)		(100,000)			(225,000)	Interest expense

Subcommittee I preliminarily believes that the correlation of rows and columns in this schedule will help users assess different elements of financial performance, e.g., sales is comprised primarily of cash receipts, but also end of period accruals. Recognizing

²⁰ Subcommittee I has adapted and modified this table from a similar schedule in the FASB's financial statement presentation project.

companies will use different titles for income statement line items, Subcommittee I preliminarily believes the predominant value of this schedule is the columnar depiction of measurement attributes and the context it provides for earnings analysis. For example, users should be better equipped to form opinions about a company's earnings quality and the predictability of its future cash flows because they are generally unable to prepare similar reconciliations based on today's financial statements. While this revised presentation does not resolve all of the challenges posed by the mixed attribute model, it represents an improvement over the current approach for investors to understand a company's financial condition and operating results.



From an international perspective Subcommittee I notes the mixed attribute model also exists under IFRS. As such, Subcommittee I preliminarily believes that this preliminary hypothesis applies equally to IFRS, particularly as the IASB works with the FASB on the joint financial statement presentation project.

V. Disclosure Framework

Disclosure provides important context for the estimates and judgments reflected in the financial statements. It also highlights uncertainties outside of the statements that could impact financial performance in the future.

Subcommittee I preliminarily believes that any recommendations regarding new disclosure guidance will be most effective and informative for investors if the FASB and SEC update, or as necessary, rescind outdated or duplicative disclosure requirements. Subcommittee I's preliminary hypothesis advocates establishing a process to achieve this goal.

Preliminary Hypothesis 5: The SEC should request the FASB to develop a disclosure framework to:

- **Require disclosure of the principal assumptions, estimates and sensitivity analyses that may impact a company's business, as well as a qualitative discussion of the key risks and uncertainties that could significantly change these amounts over time. This would encompass transactions recognized and measured in the financial statements, as well as events and uncertainties that are not recorded, such as certain litigation and regulatory developments.**
- **Integrate existing disclosure requirements into a cohesive whole by eliminating redundant disclosures and providing a single source of disclosure guidance across all accounting standards.**

The SEC and FASB should also establish a process of coordination for the Commission to regularly update and, as appropriate, remove portions of its disclosure requirements as new FASB standards are issued.²¹

²¹ The Committee considers coordination between the SEC and the FASB in chapter 2 of the Progress Report, particularly conceptual approaches 2.A and 2.C.

Background

Historically, disclosure standards have developed in a piecemeal manner (i.e., standard-by-standard). The lack of an underlying framework has contributed to (1) repetitive disclosures, (2) excessively detailed disclosures that may confuse rather than inform, and (3) disorganized presentations in financial reports. These factors make fulsome and meaningful communication of all material information challenging.

As noted above, disclosure provides important context for the estimates and judgments reflected in the financial statements. However, Subcommittee I acknowledges the perception that amounts recognized in financial statements are generally subject to more refined calculations by preparers and higher degrees of scrutiny by users compared to mere disclosure. As a result, the effectiveness of disclosure standards – whether existing or new – will be governed by the degree to which constituents view them as another compliance exercise rather than an avenue for meaningful dialogue.

Subcommittee I preliminarily believes that a disclosure framework would facilitate this meaningful dialogue between preparers and users. In order for such a disclosure framework to be useful over the long-run, however, it should establish objectives, whose application will vary. Otherwise, disclosure standards will degenerate into myriad rules

because it is not feasible for standards-setters to envision all of the specific future disclosure requirements that would be necessary in different settings.

For example, in the wake of the recent “liquidity crisis,” there has been significant focus on disclosures related to off-balance-sheet entities. Of particular interest is disclosure of structured investment vehicles (SIVs).²² Recently, certain sponsoring banks have provided liquidity support to SIVs that were unable to sustain financing in the short-term commercial paper market. In some cases, this led the sponsors to consolidate the SIVs under FASB Interpretation No. 46(R), which added billions of dollars of assets and liabilities to the sponsors’ balance sheets. Consequently, some constituents have criticized existing disclosure practices and called for standards-setters to require additional “early-warning” disclosure about off-balance sheet activity (e.g., types of assets held by the SIVs, circumstances that may result in consolidation or loss, and methodologies used to determine fair value and related write-downs). Others counter that: (1) major SIV sponsors already disclosed the magnitude of their investments in off-balance sheet entities prior to the liquidity crisis and (2) further detail would have been uninformative and potentially confusing to users because it would have amounted to “disclosure overload.” For instance, at the time the decision not to consolidate was

²² From a review of SEC filed documents, Subcommittee I has identified seven SEC filers that sponsored SIVs around the time of the liquidity crisis. Prior to the crisis, most of these filers did not provide quantified disclosure of the unconsolidated SIVs’ assets and liabilities (in some cases, SIV assets and liabilities were aggregated with the assets and liabilities of other off-balance sheet arrangements—collectively, “VIEs”). Subsequent to the crisis, Subcommittee I notes that some sponsors have expanded their disclosures to include additional quantitative information, as well as qualitative disclosures such as the nature of SIV assets, descriptions of SIV investment and operating strategies, risks related to the current environment, and sponsors’ obligations to the SIVs.

reached, some sponsors may have concluded it was quite unlikely that events which might lead to consolidation would actually occur, and that discussion of these scenarios was unnecessary. These two opposing points of view highlight the tension noted above, namely, that some constituents prefer detailed, prescriptive disclosure guidance, while others favor a more principled approach.

Discussion

Specifically, Subcommittee I preliminarily believes that at a minimum, an effective disclosure framework is comprised of three basic elements: (1) a description of the transactions reflected in financial statement captions, (2) a discussion of the relevant accounting provisions, and (3) an analysis of the key supporting judgments, risks and uncertainties.²³ In the following commentary, we focus largely on the third element.

Within the financial statements, a disclosure framework should more effectively signal to investors the level of imprecision associated with significant estimates and assumptions, particularly some fair value measurements. This can be achieved by disclosing the principal assumptions, estimates and sensitivity analyses that impact a company's business, as well as a qualitative discussion of the key risks and uncertainties that could significantly change these amounts over time. For example, Subcommittee I notes that in

²³ Subcommittee I acknowledges the work of the FASB's Investors Technical Advisory Committee on the topic of a disclosure framework. Subcommittee I preliminarily agrees with the need to establish a principles-based approach to future disclosure standards and has adapted certain elements of ITAC's thinking in this discussion.

certain cases, there is no “right” number in a probability distribution of figures, some of which may be more fairly representative of fair value than others. While SFAS No. 157, Fair Value Measurements, established disclosure requirements that provide insight into Level 2 and 3 fair value estimates,²⁴ it may not be sufficient in all cases. Many investors might find information about the key assumptions in a valuation model, key risks associated with those assumptions,²⁵ and related sensitivity analyses helpful, as well as an understanding of how “fat” or “thin” the tails of statistical modeling techniques are.²⁶

Outside of the financial statements, disclosure of environmental factors may be more meaningful than attempting to “force” a wide range of probabilities into a single point estimate on the balance sheet or income statement. This would encompass events and uncertainties such as relevant market conditions, off-balance sheet activity, litigation and regulatory developments. Some constituents argue that recording an estimate to reflect these events, instead of disclosing them, may actually provide a misleading sense of precision. Alternatively, they suggest companies could communicate to investors more effectively by disclosing the factors that might trigger financial statement recognition, the magnitude of possible and/or probable transactions, and management’s plans in those scenarios.

²⁴ Statement 157 established a three level fair value hierarchy. It assigns highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs that rely heavily on assumptions (Level 3).

²⁵ For example, if a valuation model relies on historical assumptions for a period of time that does not include economic downturns, that fact and its implications may need to be disclosed.

²⁶ In statistics, this notion is known as the “goodness of fit,” which describes how well a statistical model fits a set of observations. These are quantified measures that summarize the discrepancy between observed values compared to values predicted by the model. Large discrepancies can be described as “fat,” while small discrepancies are “thin.”

In any event, Subcommittee I acknowledges some disclosure guidance establishes a “floor” for communication between companies and investors, rather than a “ceiling.”²⁷

Our preliminary hypothesis offers a more cohesive structure for the narrative that supports and explains the financial statements, but Subcommittee I believes preparers should take the initiative in tailoring financial reports for users.

Subcommittee I also recognizes the proposed disclosure framework incorporates factual information that, historically, is presented in audited footnotes, as well as analytical and forward-looking discussions that are typically part of MD&A narratives in SEC filings.

Subcommittee I acknowledges that there are important considerations regarding assurance and legal issues when determining the placement of disclosures in a filing (e.g., footnotes or MD&A). Therefore, an optimally-designed disclosure framework should be developed by the FASB under close coordination with the SEC so that the Commission can amend its guidance accordingly (e.g., Regulations S-K and S-X).

Beyond these concerns, the SEC or its staff should also update, and as needed remove, portions of public company disclosure guidance that are impacted by new FASB standards. Subcommittee I is aware of studies in the past conducted to identify overlaps

²⁷ Subcommittee I notes companies are not precluded from providing disclosure of the type proposed here. Indeed, certain existing guidance is largely consistent with our views, such as APB Opinion No. 22, Disclosure of Accounting Policies, SOP No. 94-6, Disclosure of Certain Significant Risks and Uncertainties, Item 303(a) of Regulation S-K related to Management’s Discussion and Analysis, and FRR 60, Cautionary Advice Regarding Disclosure about Critical Accounting Policies.

of this type.²⁸ Unless the SEC or its staff establishes a monitoring process to update its disclosure requirements, similar studies may be necessary in the future. Additionally, if developed proposal 1.1 to minimize industry-specific accounting guidance is adopted, the SEC or its staff may need to consider revising its Industry Guides in Items 801 and 802 of Regulation S-K.

From an international perspective, Subcommittee I notes that IAS 1, Presentation of Financial Statements, includes some of the elements that Subcommittee I would expect of a disclosure framework, such as a principle for: (1) what the notes to the financial statements should disclose, (2) footnote structure, (3) disclosures of judgments, and (4) disclosures of key sources of estimation or uncertainty, including sensitivity analyses. Nonetheless, Subcommittee I preliminarily believes that its preliminary hypothesis in this area would also result in improvements to IFRS.

²⁸ In particular, the 2001 FASB report on “GAAP-SEC Disclosure Requirements,” which was a part of a larger Business Reporting Research Project.

1. Scope Exceptions

Examples of scope exceptions include:

- SFAS No. 109, Accounting for Income Taxes, scopes out recognition of deferred taxes for undistributed earnings of certain subsidiaries and for goodwill for which amortization is not deductible, among others.
- SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities scopes out certain financial guarantee contracts, employee share-based payments, and contingent consideration from a business combination, among others.
- SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, scopes out goodwill, intangible assets not being amortized that are to be held and used, financial instruments, including cost and equity method investments, and deferred tax assets, among others.
- SFAS No. 157, Fair Value Measurements, scopes out its definition of fair value for guidance related to employee share-based payments and lease classification and measurement, among others. In addition, they delay in the adoption of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are

recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), effectively scopes out these items for a period of time.

- FIN 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, scopes out contracts that have the characteristics of guarantees, but (1) are accounted for as contingent rent under SFAS No. 13 and (2) provide for payments that constitute a vendor rebates (by the guarantor) based on either the sales revenues of, or the number of units sold by, the guaranteed party, among others.
- FIN 46R, Consolidation of Variable Interest Entities, scopes out employee benefit plans, qualifying special-purpose entities, certain entities for which the company is unable to obtain the information necessary to apply FIN 46R, and certain businesses, among others.
- SoP 81-1, Accounting for Performance of Construction/Production Contracts, scopes out certain sales of manufactured goods, even if produced to buyers' specifications, and service contracts of consumer-oriented organizations that provide their services to their clients over an extended period, among others.

2. Competing Models

Examples of competing models include:

- Different models for when to recognize for impairment of assets such as inventory, goodwill, long-lived assets, financial instruments, and deferred taxes.
- Different likelihood thresholds for recognizing contingent liabilities, such as probable for legal uncertainties versus more-likely-than-not for tax uncertainties.
- Different models for revenue recognition such as percentage of completion, completed contract, and pro-rata. Models also vary based on the nature of the industry involved, as discussed in other sections.
- Derecognition of most liabilities such as on the basis of legal extinguishment, as compared to the derecognition of pension and other post-retirement benefit obligations via settlement, curtailment, or negative plan amendment.
- Different models for determining whether an arrangement is a liability or equity.

Exhibit C

**SEC Advisory Committee on Improvements to Financial Reporting
Standards-Setting Subcommittee Update
May 2, 2008 Full Committee Meeting**

I. Introduction

The SEC's Advisory Committee on Improvements to Financial Reporting (the Committee) issued a Progress Report (the Progress Report) on February 14, 2008. In chapter 2 of the Progress Report, the Committee discussed its work to date on the standards-setting process, namely its:

- Developed proposals related to increased investor participation, FAF and FASB governance, standards-setting process improvements and interpretive implementation guidance;
- Conceptual approaches regarding clarifying the SEC's role in standards-setting, design of standards and the FASB's priorities; and
- Future considerations related to international governance.

Since the issuance of the Progress Report, the standards-setting subcommittee (Subcommittee II) has deliberated each of these areas further, particularly its conceptual approaches and future considerations and is in the process of refining them accordingly. This report presents a summary of Subcommittee II's latest thinking and serves as an update to the Committee. The Committee is also hosting panel discussions on May 2, 2008, in Rosemont, IL. Subcommittee II will re-deliberate each of these topics based on testimony received, guidance to be provided by the Committee and comment letters

received thus far by the Committee. The Committee will deliberate any new proposals and proposed revisions to existing developed proposals in July 2008.

II. Current Status and Further Work

International Considerations

The Committee deferred deliberation of international considerations until 2008. Subcommittee II acknowledges that the SEC has already received significant input associated with its (1) removal of the U.S. GAAP reconciliation for foreign private issuers reporting under IFRS as promulgated by the IASB and (2) concept release on the possibility of allowing domestic issuers to report under IFRS as promulgated by the IASB. Subcommittee II also observes that debates regarding both the end state of international convergence (that is, a single set of high quality global accounting standards) and the best way to accomplish that objective in the U.S. (that is, the transition) are underway among standards-setters, their governance bodies, the international regulatory community and others. After discussion with the SEC staff and in light of these ongoing deliberations, which include SEC staff consideration of comments received in response to the concept release, input from roundtables, and the staff's work on developing a roadmap for consideration by the Commission at the request of Chairman Cox, Subcommittee II does not intend to advance detailed proposals at this time.

Although an analysis of how the international standards-setting processes could be improved was not in the Committee's mandate, Subcommittee II believes that many of the Committee's developed proposals and conceptual approaches may be equally applicable in international standards-setting. Subcommittee II also noted that an important U.S. convergence question has not been openly debated in the public forum—how the SEC will fulfill its regulatory responsibility without creating a U.S. jurisdictional variant of IFRS.

Although not intending to recommend detailed proposals, Subcommittee II is deliberating whether the Committee should consider:

- expressing high-level support for moving to a single set of high quality accounting standards in the U.S.,
- supporting the SEC's efforts to develop an international convergence roadmap, and
- encouraging all participants in the financial reporting community to increase coordination to foster consistency in global interpretations and avoid jurisdictional variants of IFRS.

The final determination of whether Subcommittee II's deliberations will result in a developed proposal will not be known until later in 2008.

FASB Dialogue

Since the Committee issued its Progress Report, Subcommittee II has engaged representatives of the FASB in a dialogue regarding the Committee's developed proposals and conceptual approaches. As a result of this dialogue, as well as the public comments received on the Progress Report, Subcommittee II is currently deliberating potential modifications to the Committee's proposal for Committee deliberation as its final recommendations.

A number of tentative modifications are being contemplated, which are summarized as follows:

- International—The Committee's proposals assume that U.S. GAAP will continue to be in use for a number of years. However, convergence matters significantly drive priorities in standards-setting. Subcommittee II plans to propose clarifying the Committee's proposals that will be impacted by the ultimate path chosen by the SEC regarding international convergence.
- Governance—Subcommittee II plans to propose updating the Committee's proposals for recent changes made by the FAF, including emphasizing which proposals have yet to be fully addressed. Specifically, Subcommittee II is deliberating whether the FAF resolutions regarding increased investor representation on the FAF and FASB will meet the objective underlying the Committee's developed proposal. Subcommittee II would also like to emphasize the importance of the FAF establishing clear performance metrics related to the efficiency and effectiveness of standards-setting and may propose withdrawing the statement that academic representation should not be mandated on the FASB.

- Investors—Subcommittee II plans to propose integrating the discussion of investor pre-reviews into developed proposal 2.1 and propose clarifying that although investor involvement in standards-setting has been improved recently, more formalized, structured involvement utilizing existing advisory groups would be warranted, particularly before a document is issued for exposure. In addition, Subcommittee II plans to propose clarifying the Committee’s view about the “significance” of investor involvement to further promote balanced standards-setting.
- Agenda—Subcommittee II plans to propose clarifying that the proposed Agenda Advisory Group was intended to be comprised of key decision makers from the SEC, FASB, PCAOB and other constituent groups that would meet on a real-time basis to address immediate needs in the financial reporting system at large. Such a Financial Reporting Working Group would not solely advise the FASB on its agenda. Involvement of other constituents could be effectuated by leveraging members or executive committees from existing FASB advisory groups. This may require the FAF and FASB to reevaluate the composition and responsibilities of other FASB advisory groups and agenda committees, as well as what input is requested of them and when, to improve the efficiency and effectiveness of standards-setting.
- Field Work—Subcommittee II plans to propose clarifying that the intent of the proposals on cost-benefit analyses and field work were that these processes would benefit from additional consistency across major projects and transparency of the process followed and conclusions reached.

- Periodic Reviews—Subcommittee II plans to propose clarifying that the Committee’s proposals regarding periodic reviews of new and existing standards were intended to formalize existing standards-setting processes for major projects. Subcommittee II may also propose dispensing with a bright line time requirement, due to the inconsistency of this approach with other Committee proposals and the need for the standards-setter and its advisory groups to evaluate the facts and circumstances surrounding each major project.

Clarifying SEC Role in Interpreting GAAP

Subcommittee II understands that the SEC staff is already in the process of instituting internal processes that may address many, if not all, of the points in the Committee’s conceptual approach 2.A regarding SEC interpretations of GAAP. Subcommittee II is in the process of formulating a developed proposal that considers such improvements, which will be presented to the Committee for consideration in July 2008.

Standards-Setting Priorities

Conceptual approach 3.C recommends revisiting standards-setting priorities. However, Subcommittee II acknowledges that convergence matters significantly drive priorities in standards-setting and that the convergence paths being considered by the SEC will directly impact certain of the Committee’s proposals and U.S. standards-setting priorities. As such, conceptual approach 2.C may not lead to a proposal being presented to the

Committee, as this reprioritization is likely already being considered by those involved in the international convergence dialogue and could be addressed with assistance from the proposed Financial Reporting Working Group. However, Subcommittee II is deliberating the feasibility of a phase II codification project, subject to its path-dependency on international convergence matters, within the Committee's discussion of the FASB's current codification project and proposed periodic reviews of existing standards. The Committee will deliberate this topic in July 2008.

Design of Standards

Subcommittee II has drafted a preliminary hypothesis related to the design of accounting standards based on conceptual approach 2.B from the Progress Report for the Committee's consideration, as follows:

Preliminary Hypothesis: The SEC should encourage the FASB to continue to improve the way accounting standards are written by using clearly-stated objectives, outcomes and principles that faithfully represent the economics of transactions and are responsive to investors' needs for clarity, transparency and comparability.

Design of Standards: As noted in the Progress Report, some participants in the U.S. financial reporting community believe that certain accounting standards do not clearly articulate the objectives, outcomes and principles upon which they are based, because

they are sometimes obscured by dense language, detailed rules, examples and illustrative guidance. This can create uncertainty in the application of GAAP. Further, the proliferation of detailed rules fosters accounting-motivated structured transactions, as rules cannot cover all outcomes. As discussed in chapter 1 of the Progress Report, standards that have scope exceptions, safe harbors, cliffs, thresholds and bright lines are vulnerable to manipulation by those seeking to avoid accounting for the substance of transactions using structured transactions that are designed to achieve a particular accounting result. This ultimately hurts investors, because it reduces comparability and the usefulness of the resulting financial information. Therefore, a move toward the use of more objectives, outcomes and principles in accounting standards may ultimately improve the quality of the financial reporting upon which investors rely.

The Committee recognized in the Progress Report that the question of how to design accounting standards going forward is a critical aspect of the standards-setting process and is at the center of a decade-long principles-based versus rules-based accounting standards debate. There has been much discussion in the marketplace on this topic and there are differing views. The SEC has been a frequent participant in the debate and has long been supportive of objectives-oriented standards.¹ Rather than engage in such a spurious debate, the Committee preferred in the Progress Report to think of the design of accounting standards in terms of the characteristics they should possess. There are many

¹ For example, the SEC issued Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter (April 2003), which included numerous recommendations for the FAF and FASB to consider, including greater use of principles-based accounting standards whenever reasonable to do so. The SEC staff also issued Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System (July 2003), which further lauded the benefits of objectives-oriented standards.

publications on this topic written by well-known theorists from the FASB, the IASB, the SEC, accounting firms, academia and elsewhere. The most recent example is an omnibus of this collective thinking published by the CEOs of the World's Six Largest Audit Networks.² Their paper attempts to outline what optimal accounting standards should look like in the future and proposes a framework the standards-setter should refer to over time to ensure that these characteristics are consistently optimized.

The FASB has made recent improvements in how it writes accounting standards as part of its Understandability initiative and Codification project. We support the increased use of clearly-stated objectives, outcomes and principles in accounting standards that bring together this thinking. We believe the highest goal for accounting standards in the future is that they faithfully represent the economics of transactions and are responsive to investors' needs for clarity, transparency and comparability. Accounting standards that meet these criteria, when applied in good faith in a standards-setting system that employs the Committee's other proposals, will foster enhanced comparability and help to restore trust and confidence in financial reporting.

Although Subcommittee II supports increased use of objectives, outcomes and principles, the goal would not be to remove all rules. Rather, we agree with the notion that ideal accounting standards lay somewhere on the spectrum between principles-based and rules-based and that a framework may be helpful to consistently determine where on that

² CEOs of the World's Six Largest Audit Networks, [A Proposed Framework for Establishing Principles-Based Accounting Standards](#), Global Public Policy Symposium (January 2008).

spectrum new accounting standards should be written over time. This would assist the standards-setter in determining rules that might be necessary in certain circumstances. For example, if the standards-setter believes that there is only one way to reflect the economics of a transaction while promoting clarity, transparency and comparability for investors, it would be reasonable to provide prescriptive guidance in addition to objectives or principles.

Exhibit D

**SEC Advisory Committee on Improvements to Financial Reporting
Audit Process and Compliance Subcommittee Update
May 2, 2008 Full Committee Meeting**

I. Introduction

The SEC's Advisory Committee on Improvements to Financial Reporting (Committee) issued a progress report (Progress Report) on February 14, 2008.¹ In chapter 3 of the Progress Report, the Committee discussed its work-to-date in the area of audit process and compliance, namely, its developed proposals related to providing guidance with respect to the materiality and correction of errors; and judgments related to accounting matters.

Since the issuance of the Progress Report, the audit process and compliance subcommittee (Subcommittee III) has received a considerable amount of public comment regarding the developed proposals included in the Progress Report. This public input includes feedback obtained during the panel discussions regarding the developed proposals in Chapter 3 of the Progress Report held during Committee's March 13 open meeting, feedback obtained when certain members of the subcommittee met with the PCAOB Standing Advisory Group (SAG) on February 27, 2008, feedback obtained when the subcommittee met with market participants at our subcommittee meetings and the numerous comment letters received by the Committee. Based on this considerable public feedback, Subcommittee III believes that there are several areas related to the Committee's original developed proposals that warrant clarification by the Committee as well as some additional items that need to be considered by the Committee. This report

¹ Refer to Progress Report at <http://www.sec.gov/rules/other/2008/33-8896.pdf>.

represents Subcommittee III's latest thinking related to the developed proposals in Chapter 3 of the Progress Report and reflects the subcommittee's proposed clarifications for the Committee's consideration related to the original developed proposals. Subject to further public comment and Committee input, Subcommittee III will recommend these revised developed proposals to the Committee for its consideration in developing the final report, which is expected to be issued in July 2008.

II. Financial Restatements

In the Progress Report, the Committee issued three developed proposals (developed proposals 3.1, 3.2 and 3.3) related to financial restatements. These developed proposals have been the subject of public debate and the subject of many comment letters received by the Committee. Subcommittee III believes that one cause of the debate surrounding these developed proposals relates to a lack of clarity regarding the developed proposals.

First, the developed proposals were not intended to recommend elimination of the guidance currently contained in SAB Topic 1M. Instead, the developed proposals were intended to enhance the guidance in SAB Topic 1M. As stated in the summary of SAB 99, which was codified in SAB Topic 1M, "This staff accounting bulletin expresses the views of the staff that exclusive reliance on certain quantitative benchmarks to assess materiality in preparing financial statements and performing audits of those financial statements is inappropriate; misstatements are not immaterial simply because they fall beneath a numerical threshold." Subcommittee III believes that that the guidance in SAB

Topic 1M is appropriate and accomplishes what it was intended to do, which is to address situations where errors were not being evaluated for materiality simply due to the relatively small size of the error. As the SEC staff noted in SAB 99, this concept was not consistent with the total mix standard established by the Supreme Court. SAB Topic 1M was not written to address all situations one must consider when determining if an error is material, yet in practice, SAB Topic 1M is often cited as the guidance to use in all materiality decisions. Because SAB Topic 1M primarily addresses one issue, which was to correct the misperception in practice at the time that small errors need not be evaluated for materiality solely based on their size, Subcommittee III believes that this has resulted in less consideration to the total mix of information in the evaluation of whether an error is material or not. Since this is not consistent with the standard established by the Supreme Court or as we understand it the intent of SAB Topic 1M, Subcommittee III believes that additional guidance is needed to supplement the guidance contained in SAB Topic 1M.

Second, there have been some additional studies of restatements that have been published since the issuance of the Progress Report. The most significant study is the study commissioned by the U.S. Treasury entitled “The Changing Nature and Consequences of Public Company Financial Restatements 1997-2006”, conducted by Professor Susan Scholz of the University of Kansas. Subcommittee III believes that the results of this study are not inconsistent with the developed proposals in the Committee’s Progress Report.

Third, Subcommittee III believes clarifications are needed related to the use of the term current investor in the Progress Report. Some have concluded that this term only refers to investors who currently own securities of a company. Subcommittee III did not intend the Committee's developed proposal to convey such a narrow definition of current investor, so there are proposed edits to the developed proposal to reflect that the correction of an error should be based on the needs of all investors making current investment decisions.

Fourth, there were several public comments related to the use of the term "sliding scale" in the developed proposals in the Progress Report. Many of these comments were concerned that this term was confusing and did not help explain the principles in the developed proposal. Subcommittee III does not believe that the use of this term is critical to the principles articulated in the developed proposals in the Progress Report. Therefore Subcommittee III proposes to remove the use of this term in the developed proposals.

Finally, because Subcommittee III believes that issues related to the dark period, most notably the potential high cost to investors during the dark period, are very important, a new developed proposal is being recommended by the subcommittee to highlight the importance of this issue. This new developed proposal contains substantially the same wording that was included in the Progress Report, but has been moved to give more prominence to this important issue.

III. Judgment

Similar to the reaction to the Committee's developed proposals related to restatements in the Progress Report (Developed Proposals 3.1, 3.2 and 3.3), there has been much public comment related to the Committee's developed proposal 3.4 in the Progress Report related to professional judgment. Subcommittee III believes that the comments it has received during this process have been very helpful to its continuing deliberations on this matter. Based on the comments received, Subcommittee III believes that some changes are necessary to the developed proposal 3.4 in the Progress Report to allow the developed proposal to meet the goals established in that Progress Report without the risks that the subcommittee has been concerned about from the beginning, such as the risk that the developed proposal devolve into a checklist based approach to making judgments and the risk that the proposed framework could be used as a shield to protect unreasonable judgments.

The primary change that Subcommittee III believes should be made is to refocus the developed proposal away from a recommendation for a framework. While Subcommittee III believes that there is great merit in the idea of a framework, the term framework can imply a mechanistic process. Making and evaluating judgments can involve a process, but the notion of a process is dangerous because it implies that an outcome can be achieved. Indeed, no matter how robust a process one uses to make judgments, there can be no guarantee that the outcome will be reasonable. Instead, Subcommittee III believes that a preferable way to accomplish the goals set forth in the Progress Report would be to have the SEC formally articulate in a statement of policy how the SEC evaluates

judgments, including the factors that it uses as part of its evaluation. Therefore, Subcommittee III believes the developed proposal should be changed to formally propose such as statement of policy to be issued.

Some commenters have stated that developed proposal 3.4 in the Progress Report advocates a safe harbor be established for the exercise of professional judgment. Subcommittee III did not intend to advocate any particular way for the implementation of developed proposal 3.4. Instead, this decision was left to the SEC. With the change in focus outlined above, Subcommittee III believes that a statement of policy would be the preferred way to implement the revised proposal and therefore, there should be no reference to a safe harbor in the revised Chapter 3.

Subcommittee III also proposes to remove the use of the term professional when referring to judgment. Subcommittee III believes that there could be a misunderstanding that the term professional implies that one must have a professional certification in order to make or evaluate a professional judgment. While Subcommittee III believes that such professional certifications are important, it did not intend to suggest such a requirement for the application or evaluation of accounting judgments.

Appendix A

Subcommittee III has included as Appendix A to this update a revised version of Chapter 3 from the Progress Report that reflects the proposed edits for the Committee's consideration

CHAPTER 3: AUDIT PROCESS AND COMPLIANCE

I. Introduction

We have concentrated our efforts to date regarding audit process and compliance on the subjects of financial restatements, including the potential benefits from providing guidance with respect to the materiality² and correction of errors; and judgments related to accounting matters: specifically, whether guidance on the evaluation of judgments would enhance the quality of judgments and the willingness of others to respect judgments made.

II. Financial Restatements

II.A. Background

Likely Causes of Restatements

The number of financial restatements³ in the U.S. financial markets has been increasing significantly over recent years, reaching approximately 1,600 companies in 2006.⁴

² A fact is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information available. Basic, Inc. v. Levinson, 485 U.S. 224, 231–32 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

³ For the purposes of this chapter, a restatement is the process of revising previously issued financial statements to reflect the correction of a material error in those financial statements. An amendment is the process of filing a document with revised financial statements with the SEC to replace a previously filed document. A restatement could occur without an amendment, such as when prior periods are revised in a current filing with the SEC.

Restatements generally occur because errors that are determined to be material are found in a financial statement previously provided to the public. Therefore, the increase in restatements appears to be due to an increase in the identification of errors that were determined to be material.

The increase in restatements has been attributed to various causes. These include more rigorous interpretations of accounting and reporting standards by preparers, outside auditors, the SEC, and the PCAOB; the considerable amount of work done by companies to prepare for and improve internal controls in applying the provisions of section 404 of the Sarbanes-Oxley Act; and the existence of control weaknesses that companies failed to identify or remediate. Some have also asserted that the increase in restatements is the result of an overly broad application of the concept of materiality and misinterpretations of the existing guidance regarding materiality in SAB 99, Materiality (as codified in SAB Topic 1M). SAB Topic 1M was written to primarily address a specific issue, when seemingly small errors could be material due to qualitative factors, however, the guidance in SAB Topic 1M is often utilized in all materiality decisions. As a result of this overly broad application of SAB Topic 1M, errors may have been deemed to be material when an investor⁵ may not consider them to be important.

It is essential that companies, auditors, and regulators strive to reduce the frequency and magnitude of errors in financial reporting. When material errors occur, however,

⁴ U.S. Government Accountability Office (GAO) study, Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Updates (March 2007), and Audit Analytics study, 2006 Financial Restatements A Six Year Comparison (February 2007).

⁵ We use the term investor to include all people using financial statements to make investment decisions.

companies should restate their financial statements to correct errors that are important to current investors. Investors need accurate and comparable data, and restatement is the only means to achieve those goals when previously filed financial statements contain material errors. Efforts to improve company controls and audit quality in recent years should reduce errors, and there is evidence this is currently occurring.⁶ We believe that public companies should focus on reducing errors in financial statements. At the same time, we believe that some of our developed proposals in the areas of substantive complexity, as discussed in chapter 1, and the standards-setting process, as discussed in chapter 2, will also be helpful in reducing some of the frequency of errors in financial statements.

While reducing errors is the primary goal, it is also important to reduce the number of restatements that do not provide important information to investors making current investment decisions. Restatements can be costly for companies and auditors, may reduce confidence in reporting, and may create confusion that reduces the efficiency of investor analysis. This portion of this chapter describes our proposals regarding: (1) additional guidance on the concept and application regarding materiality, and (2) the process for and disclosure of the correction of errors.

⁶ A Glass Lewis & Co. report, The Tide is Turning (January 15, 2008), shows that restatements in companies subject to section 404 of the Sarbanes Oxley Act have declined for two consecutive years.

Our Research

We have considered several publicly-available studies⁷ on restatements. The restatement studies we have reviewed all indicate that the total number of restatements has increased in recent years. The studies also indicate that there are many different types of errors that result in the need for restatements. Market reaction to restatements may be one indicator as to whether restatements contain information considered by investors to be material. Based on these studies, it appears to us that there may be restatements that investors may not consider important. We draw this conclusion in part based upon the lack of a statistically significant market reaction, particularly as it relates to certain types of restatements such as reclassifications and restatements affecting non-core expenses⁸. While there are limitations⁹ to using market reaction as a proxy for materiality, other trends in these studies are not inconsistent with our conclusion - - the trend toward restatements involving correction of smaller amounts, including amounts in the cash flow

⁷ Studies considered include the study commissioned by the Department of the Treasury, The Changing Nature and Consequences of Public Company Financial Restatements 1997-2006, by Professor Susan Scholz, An Analysis of the Underlying Causes of Restatements by Professors Marlene Plumlee and Teri Yohn, GAO study, Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Updates (March 2007); Glass Lewis & Co. study, The Errors of Their Ways (February 2007); and two Audit Analytics studies, 2006 Financial Restatements A Six Year Comparison (February 2007) and Financial Restatements and Market Reactions (October 2007). We have also considered findings from the PCAOB's Office of Research and Analysis's (ORA) working paper, Changes in Market Responses to Financial Statement Restatement Announcements in the Sarbanes-Oxley Era (October 18, 2007), understanding that ORA's findings are still preliminary in nature as the study is still going through a peer review process.

⁸ Professor Scholz's study defines restatements related to non-core expenses as "Any restatement including correction of expense (or income) items that arise from accounting for non-operation or non-recurring activities". This definition includes restatements related to debt and equity instruments, derivatives, gain or loss recognition, inter-company investments, contingency and commitments, fixed and intangible asset valuation or impairment and income taxes.

⁹ Examples of the limitations in using market reaction as a proxy for materiality include (1) the difficulty of measuring market reaction because of the length of time between when the market becomes aware of a potential restatement and the ultimate resolution of the matter, (2) the impact on the market price of factors other than the restatement, and (3) the disclosure at the time of the restatement of other information, such as an earnings release, that may have an offsetting positive market reaction.

statement, and the trend toward restatements in cases where there is no evidence of fraud or intentional wrongdoing¹⁰. Also, while there is recent evidence¹¹ that the number of restatements has declined in 2007, we note that the total number of restatements is still significant. We, therefore, believe supplementing existing guidance on determining whether an error is material and providing additional guidance on when a restatement is necessary for certain types of errors, would be beneficial in reducing the frequency of restatements that do not provide important information to investors making current investment decisions.

We have also considered input from equity and credit analysts and others about investors' views on materiality and how restatements are viewed in the marketplace. Feedback we have received included:

- Bright lines are not really useful in making materiality judgments. Both qualitative and quantitative factors should be considered in determining if an error is material.
- Companies often provide the market with little financial data during the time between a restatement announcement and the final resolution of the restatement. Limited information seriously undermines the quality of investor analysis, and sometimes triggers potential loan default conditions or potential delisting of the company's stock.
- The disclosure provided in connection with restatements is not consistently adequate to allow an investor to evaluate the likelihood of errors in the future. Notably,

¹⁰ These trends are addressed in Professor Scholz's study.

¹¹ Glass Lewis & Co. report, The Tide is Turning (January 15, 2008) indicates that approximately 1 out of every 11 public companies had a restatement during 2007.

disclosures often do not provide enough information about the nature and impact of the error, and the resulting actions the company is taking.

- Interim periods should be viewed as more than just a component of an annual financial statement for purposes of making materiality judgments.

II.B. Developed Proposals

Based on our work to date, we believe that, in addressing a financial statement error, it is helpful to consider two sequential questions: (1) Was the error in the financial statement material to those financial statements when originally filed? and (2) How should a material error in previously issued financial statements be corrected? We believe that framing the principles necessary to evaluate these questions would be helpful. We also believe that in many circumstances investors could benefit from improvements in the nature and timeliness of disclosure in the period between identifying an error and filing restated financial statements.

With this context, we have developed the following proposals regarding the assessment of the materiality of errors to financial statements and the correction of financial statements for errors.¹²

¹² We have developed principles that we believe will be helpful in addressing financial statement errors. In developing these principles, we have not determined if the principles are inconsistent with existing GAAP, such as SFAS No. 154, Accounting Changes and Error Corrections, or APB Opinion No. 28, Interim Financial Reporting. To the extent that the implementation of our proposals would require a change to GAAP, the SEC should work with the FASB to revise GAAP.

Developed Proposal 3.1: The FASB or the SEC, as appropriate, should supplement existing guidance to reinforce the following concepts:

- **Those who evaluate the materiality of an error should make the decision based upon the perspective of a reasonable investor.**
- **Materiality should be judged based on how an error affects the total mix of information available to a reasonable investor.**

Just as qualitative factors may lead to a conclusion that a small error is material, qualitative factors also may lead to a conclusion that a large error is not material.

The FASB or the SEC, as appropriate, should also conduct both education sessions internally and outreach efforts to financial statement preparers and auditors to raise awareness of these issues and to promote more consistent application of the concept of materiality.

The Supreme Court has established that “a fact is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information available.” We believe that those who judge the materiality of a financial statement error should make the decision based upon the interests, and the viewpoint, of a reasonable investor and based upon how that error impacts the total mix of information available to a reasonable investor. One must “step into the shoes” of a reasonable investor when making these judgments. We believe that too many materiality judgments are being made in practice without full consideration of how a reasonable investor would evaluate the error. When looking at

how an error impacts the total mix of information, one must consider all of the qualitative factors that would impact the evaluation of the error. This is why bright lines or purely quantitative methods are not appropriate in determining the materiality of an error to annual financial statements.

We believe that the current materiality guidance in SAB Topic 1M is appropriate in making most materiality judgments; We believe that, in current practice, however, this materiality guidance is being interpreted generally as being one-directional, that is, as providing that qualitative considerations can result in a small error being considered material, but that a large error is material without regard to qualitative factors. This one-directional interpretation is not consistent with the standard established by the Supreme Court, which requires an assessment of the total mix of information available to the investor making an investment decision. We believe that, in general, qualitative factors not only can increase, but also can decrease, the importance of an error to the reasonable investor, although we acknowledge that there will probably be more times when qualitative considerations will result in a small error being considered material than they will result in a large error being considered not to be material¹³. Therefore, we recommend that the existing materiality guidance be enhanced to clarify that the total mix of information available to investors should be the main focus of a materiality judgment and that qualitative factors are relevant in analyzing the materiality of both large and small errors. We view this recommendation as a modest clarification of the existing guidance to conform practice to the standard established by the Supreme Court and not a

¹³ Some have argued that, under such guidance, a very large error that affects meaningful financial statement metrics could be deemed immaterial by virtue of qualitative factors. The Committee believes that when one focuses on the total mix of information, the probability of this situation occurring is remote.

wholesale revision to the concepts and principles embedded in existing SEC staff guidance in SAB Topic 1M.

The following are examples of some of the qualitative factors that could result in a conclusion that a large error is not material. (Note that this is not an exhaustive list of factors, nor should this list be considered a “checklist” whereby the presence of any one of these items would make an error not material. Companies and their auditors should continue to look at the totality of all factors when making a materiality judgment):

- The error impacts metrics that do not drive investor conclusions or are not important to investor models.
- The error is a one time item and does not alter investors’ perceptions of key trends affecting the company.
- The error does not impact a business segment or other portion of the registrant’s business that investors regard as driving valuation or risks.

Finally, we recommend that the enhanced guidance suggest some factors that are relevant to the analysis of errors in the cash flow statement and the balance sheet. We note that the existing guidance suggests factors that are relevant primarily to the analysis of the materiality of an error in the income statement.

Internal education and external outreach efforts can be instrumental in increasing the awareness of these concepts and ensuring more consistent application of materiality. Many of the issues with materiality in practice are caused by misunderstandings by

preparers, auditors and regulators. Elimination of these misunderstandings would be a significant step toward reducing restatements that do not provide useful information to investors.

Developed Proposal 3.2: The FASB or the SEC, as appropriate, should issue guidance on how to correct an error consistent with the principles outlined below:

- **All errors, other than clearly insignificant errors, should be promptly corrected no later than in the financial statements of the period in which the error is discovered. All material errors should be disclosed when they are corrected.**
- **Prior period financial statements should only be restated for errors that are material to those prior periods.**
- **The determination of how to correct a material error should be based on the needs of current investors. For example, a material error that has no relevance to a current investment decision would not require amendment of the annual financial statements in which the error occurred, but would need to be promptly corrected and disclosed in the current period.**
- **There may be no need for the filing of amendments to previously filed annual or interim reports to reflect restated financial statement, if the next annual or interim period report is being filed in the near future and that report will contain all of the relevant information.**
- **Restatements of interim periods do not necessarily need to result in a restatement of an annual period.**
- **Corrections of large errors should always be disclosed, even if the error was determined not to be material.**

We believe that all errors, excluding clearly insignificant errors, should be corrected no later than in the financial statements of the annual or interim period in which the error is discovered. The correction of errors, even errors that are not material, should not be deferred to future periods. Rather, companies should be required to correct all errors promptly and make appropriate disclosures about the correction, particularly when the errors are material, and should not have the option to defer recognition of errors until future financial statements. Notwithstanding the foregoing, immaterial errors discovered shortly before the issuance of the financial statements may not need to be corrected until the next annual or interim period being reported upon when earlier correction is impracticable.¹⁴

The current guidance that is detailed in SAB 108 (as codified in SAB Topic 1N) may result in the restatement of prior annual periods for immaterial errors occurring in those periods because the cumulative effect of these prior period errors would be material to the current annual period, if the prior period errors were corrected in the current annual period. By correcting small errors when they are identified, a company will eliminate the possibility that the continuation of the error over a period of time will result in the total amount of the error becoming material to a company's financial statements and requiring correction at that time. Newly discovered errors that had occurred over a period of time when they were not material, however, would still trigger the need for correction. In the

¹⁴ We understand that sometimes there may be immaterial differences between a preparer's estimate of an amount and the independent auditor's estimate of an amount that exist when financial statements are issued. These differences might or might not be errors, and may require additional work to determine the nature and actual amount of the error. This additional work is not necessary for the preparer or the auditor to agree to release the financial statements. Due care should be taken in developing any guidance in this area to provide an exception for these legitimate differences of opinion, and to ensure that any requirement to correct all "errors" would not result in unnecessary work for preparers or auditors.

process of reflecting these immaterial corrections to prior annual periods, some believe that the prior annual period financial statements should indicate that they have been restated. There is diversity in practice on this issue, and clarification is needed from the SEC on the intent of SAB Topic 1N. We believe that prior annual period financial statements should not be restated for errors that are immaterial to the prior annual period. Instead of the approach specified in Topic 1N, we believe that, where errors are not material to the prior annual periods in which they occurred but would be material if corrected in the current annual period, the error could be corrected in the current annual period¹⁵ with appropriate disclosure at the time the current annual period financial statements are filed with the SEC.

We believe that the determination of how errors should be corrected should be based on the needs of investors making current investment decisions. This determination should take into account the facts and circumstances of each error. For example, a prior period error that was material to that prior period but that does not affect the annual financial statements or financial information included within a company's most recent filing with the SEC may not need to be corrected through an amendment to prior period filings if the financial statements that contain the error are determined to be irrelevant to investors making current investment decisions. Such errors would be corrected in the period in which they are discovered with appropriate disclosure about the error and the periods

¹⁵ We are focused on the principle that prior periods should not be restated for errors that are not material to those periods. Correction in the current period of errors that are not material to prior periods could be accomplished through an adjustment to equity or to current period income (which might potentially require an amendment to GAAP). We believe that there are merits in both approaches and that the FASB and the SEC, as appropriate, should carefully weigh both approaches before determining the actual approach to utilize.

impacted. This approach provide investors making current investment decisions with more timely financial reports and avoid the costs to investors of delaying prompt disclosure of current financial information in order for a company to correct multiple prior filings.

For material errors that are discovered within a very short time period prior to a company's next regularly scheduled reporting date, it may be appropriate in certain instances to report the restatement in the next filing with appropriate disclosure of the error and its impact on prior periods, instead of amending previous filings with the SEC. This option should be further studied with regard to the possibility of abuse and, if appropriate, should be included in the overall guidance on how to correct errors.

Assuming that there is an error in an interim period within an annual period for which financial statements have previously been filed with the SEC, the following guidance should be utilized:

- If the error is not material to either the previously issued interim period or to the previously issued annual period, the previously issued financial statements should not be restated.
- If the prior period error is determined to be material only to the previously issued interim period, but not the previously issued annual period, then only the previously issued interim period should be restated (i.e., the annual period that is already filed should not be restated and the Form 10-K should not be amended). However, there should be appropriate disclosure in the company's next Form 10-K to explain the

discrepancy in the results for the interim periods during the previous annual period on an aggregate basis and the reported results for that annual period.

We believe that investors should be informed about all large errors when they are corrected. Even if a large error is determined to be not material because of qualitative factors, there should be appropriate disclosure about the error in the period in which the error is corrected.

We believe that the issuance by the FASB or the SEC, as appropriate, of guidance on how to correct and disclose errors in previously issued financial statements will provide to investors higher quality and more timely information (e.g., less delay occasioned by the need for restatement of prior period financial statements for errors that are not material and for errors that have no relevance to investors making current investment decisions) and reduce the burdens on companies related to the preparation of amended reports. Since our proposal would require prompt correction and full disclosure about all material errors, all large errors that are considered to be not material as well as many other types of errors, it would enhance transparency of accounting errors and help to eliminate the phenomenon of so called “stealth restatements” – when an error impacts past financial statements without disclosure of such error in current financial filings.

Developed Proposal 3.3: The FASB or the SEC, as appropriate, should issue guidance on disclosure during the period in which the restatement is being

prepared, about the need for a restatement and about the restatement itself, to improve the adequacy of this disclosure based on the needs of investors:

Typically, the restatement process involves three primary reporting stages:

1. The initial notification to the SEC and investors that there is a material error and that the financial statements previously filed with the SEC can no longer be relied upon;
2. The “dark period” or the period between the initial notification to the SEC and the time restated financial statements are filed with the SEC; and
3. The filing of restated financial statements with the SEC.

We believe that a major effect on investors due to restatements is the lack of information when companies are silent during stage 2, or the “dark period.” This silence creates significant uncertainty regarding the size and nature of the effects on the company of the issues leading to the restatement. This uncertainty often results in decreases in the company’s stock price. In addition, delays in filing restated financial statements may create default conditions in loan covenants; these delays may adversely affect the company’s liquidity. We understand that, in the current legal environment, companies are often unwilling to provide disclosure of uncertain information. However, we believe that when companies are going through the restatement process, they should be encouraged to continue to provide any reasonably reliable financial information that they can, accompanied by appropriate explanations of ways in which the information could be affected by the restatement. Consequently, regulators should evaluate the company’s

disclosures during the “dark period,” taking into account the difficulties of generating reasonably reliable information before a restatement is completed.

We believe that the current disclosure surrounding a restatement is often not adequate to allow investors to evaluate the company’s operations and the likelihood that such errors could occur in the future. Specifically, we believe that all companies that have a restatement should be required to disclose information related to: (1) the nature of the error, (2) the impact of the error, and (3) management’s response to the error, to the extent known, during all three stages of the restatement process. Some suggestions of disclosures that would be made by companies include the following:

Nature of error

- Description of the error
- Periods affected and under review
- Material items in each of the financial statements subject to the error and pending restatement
- For each financial statement line item, the amount of the error or range of potential error
- Identity of business units/locations/segments/subsidiaries affected

Impact of error

- Updated analysis on trends affecting the business if the error impacted key trends

- Loan covenant violations, ability to pay dividends, and other effects on liquidity or access to capital resources
- Other areas, such as loss of material customers or suppliers

Management Response

- Nature of the control weakness that led to the restatement and corrective actions, if any, taken by the company to prevent the error from occurring in the future
- Actions taken in response to covenant violations, loss of access to capital markets, loss of customers, and other consequences of the restatement

If there are material developments related to the restatement, companies should update this disclosure on a periodic basis during the restatement process, particularly when quarterly or annual reports are required to be filed, and provide full and complete disclosure within the filing with the SEC that includes the restated financial statements.

Developed Proposal 3.4: The FASB or the SEC, as appropriate, should develop and issue guidance on applying materiality to errors identified in prior interim periods and how to correct these errors. This guidance should reflect the following principles:

- **Materiality in interim period financial statements must be assessed based on the perspective of the reasonable investor**

- **When there is a material error in an interim period, the guidance on how to correct that error should be consistent with the principles outlined in developed proposal 3.2.**

Based on prior restatement studies, approximately one-third of all restatements involved only interim periods. Authoritative accounting guidance on assessing materiality with respect to interim periods is currently limited to paragraph 29 of APB Opinion No. 28, Interim Financial Reporting.¹⁶ Differences in interpretation of this paragraph have resulted in variations in practice that have increased the complexity of financial reporting. This increased complexity impacts preparers and auditors, who struggle with determining how to evaluate the materiality of an error to an interim period, and also impacts investors, who can be confused by the inconsistency between how companies evaluate and report errors. We believe that guidance as to how to evaluate errors related to interim periods would be beneficial to preparers, auditors and investors.

We have observed that a large part of the dialogue about interim materiality has focused on whether an interim period should be viewed as a discrete period or an integral part of an annual period. Consistent with the view expressed at the outset of this section, we believe that the interim materiality dialogue could be greatly simplified if that dialogue were refocused to address two sequential questions: (1) What principles should be considered in determining the materiality of an error in interim period financial

¹⁶ Paragraph 29 of APB Opinion No. 28, Interim Financial Reporting, states the following:

In determining materiality for the purpose of reporting the cumulative effect of an accounting change or correction of an error, amounts should be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings. Changes that are material with respect to an interim period but not material with respect to the estimated income for the full fiscal year or to the trend of earnings should be separately disclosed in the interim period.

statements? and (2) How should errors in previously issued interim financial statements be corrected? We believe that additional guidance on these questions, which are extensions of the basic principles outlined in developed proposals 3.1 and 3.2 above, would provide useful guidance in assessing and correcting interim period errors. We believe that while these principles would assist in developing guidance related to interim periods, additional work should also be performed to fully develop robust guidance regarding errors identified in interim periods.

We believe that the determination of whether an interim period error is material should be made based on the perspective of a reasonable investor, not whether an interim period is a discrete period, an integral part of an annual period, or some combination of both. An interim period is part of a larger mix of information available to a reasonable investor. As one example, a reasonable investor would use interim financial statements to assess the sustainability of a company's operations and cash flows. In this example, if an error in interim financial statements did not impact the sustainability of a company's operations and cash flows, the interim period error may very well not be material given the total mix of information available. Similarly, just as a large error in annual financial statements does not determine by itself whether an error is material, the size of an error in interim financial statements should also not be necessarily determinative as to whether an error in interim financial statements is material.

We believe that applying the principles set forth above would reduce restatements by providing a company the ability to correct in the current period immaterial errors in

previously issued financial statements and as a practical matter obviate the need to debate whether the interim period is a discrete period, an integral part of an annual period, or some combination of both.

We also note that these principles will provide a mechanism, other than restatement, to correct through the current period a particular error that has often been at the center of the interim materiality debate – a newly discovered error that has accumulated over one or more annual or interim periods, but was not material to any of those prior periods.

III. Judgment

III.A. Background

Overview

Judgment is not new to the areas of accounting, auditing, or securities regulation – the criteria for making and evaluating judgment have been a topic of discussion for many years. The recent increased focus on judgment, however, comes from several different developments, including changes in the regulation of auditors and a focus on more “principles-based” standards – for example, FASB standards on fair value and IASB standards. Investors will benefit from more emphasis on “principles-based” standards, since “rules-based” standards (as discussed in chapters 1 and 2) may provide a method, such as through exceptions and bright-line tests, to avoid the accounting objectives underlying the standards. If properly implemented, “principles-based” standards should improve the information provided to investors while reducing the investor’s concern about “financial engineering” by companies using the “rules” to avoid accounting for the substance of a transaction. While preparers appear supportive of a move to less prescriptive guidance, they have expressed concern regarding the perception that current practice by regulators in evaluating judgments does not provide an environment in which such judgments may be generally respected. This, in turn, can lead to repeated calls for more rules, so that the standards can be comfortably implemented.

Many regulators also appear to encourage a system in which preparers can use their judgment to determine the most appropriate accounting and disclosure for a particular transaction. Regulators assert that they do respect judgments, but may also express concerns that some companies may attempt to inappropriately defend certain errors as "reasonable judgments." Identifying standard processes for making judgments and criteria for evaluating those judgments, after the fact, may provide an environment that promotes the use of judgment and encourages consistent evaluation practices among regulators.

Goals of Potential Guidance on Judgments

The following are several issues that any potential guidance related to judgments may help address:

- a. Investors' lack of confidence in the use of judgment – Guidance on judgments may provide investors with greater comfort that there is an acceptable rigor that companies follow in exercising reasonable judgment.
- b. Preparers' concern regarding whether reasonable judgments are respected – In the current environment, preparers may be afraid to exercise judgment for fear of having their judgments overruled, after the fact by regulators.

- c. Lack of agreement in principle on the criteria for evaluating judgments – The criteria for evaluating reasonable judgments, including the appropriate role of hindsight in the evaluation, may not be clearly defined and thus may lead to increased uncertainty.

- d. Concern over increased use of “principles-based” standards – Companies may be less comfortable with their ability to implement more “principles-based” standards if they are concerned about how reasonable judgments are reached and how they will be assessed.

Categories of Judgments that are Made in Preparing Financial Statements

There are many categories of accounting and auditing judgments that are made in preparing financial statements, and any guidance should encompass all of these categories, if practicable. Some of the categories of accounting judgment are as follows:

1. Selection of accounting standard

In many cases, the selection of the appropriate accounting standard under GAAP is not a highly complex judgment (e.g., leases would be accounted for using lease accounting standards and pensions would be accounted for using pension accounting standards). However, there are cases in which the selection of the appropriate accounting standard can be highly complex.

For example, the standards on accounting for derivatives contain a definition of a derivative and provide scope exceptions that limit the applicability of the standard to certain types of derivatives. To evaluate how to account for a contract that has at least some characteristics of a derivative, one would first have to determine if the contract met the definition of a derivative in the accounting standard and then determine if the contract would meet any of the scope exceptions that limited the applicability of the standard. Depending on the nature and terms of the contract, this could be a complex judgment to make, and one on which experienced accounting professionals can have legitimate differing, yet acceptable, opinions.

2. Implementation of an accounting standard

After the correct accounting standard is identified, there are judgments to be made during its implementation.

Examples of implementation judgments include determining if a hedge is effective, if a lease is an operating or a capital lease, and what inputs and methodology should be utilized in a fair value calculation. Implementation judgments can be assisted by implementation guidance issued by standards-setters, regulators, and other bodies; however, this guidance could increase the complexity of selecting the correct accounting standard, as demonstrated by the guidance issued on accounting for derivatives.

Further, many accounting standards use wording such as “substantially all” or “generally.” The use of such qualifying language can increase the amount of judgment required to implement an accounting standard. In addition, some standards may have potentially conflicting statements.

3. Lack of applicable accounting standards

There are some transactions that may not readily fit into a particular accounting standard. Dealing with these “gray” areas of GAAP is typically highly complex and requires a great deal of judgment and accounting expertise. In particular, many of these judgments use analogies from existing standards that require a careful consideration of the facts and circumstances involved in the judgment.

4. Financial Statement Presentation

The appropriate method to present, classify and disclose the accounting for a transaction in a financial statement can be highly subjective and can require a great deal of judgment.

5. Estimating the actual amount to record

Even when there is little debate as to which accounting standard to apply to a transaction, there can be significant judgments that need to be made in estimating the actual amount to record.

For example, opinions on the appropriate standard to account for loan losses or to measure impairments of assets typically do not differ. However, the assumptions and methodology used by management to actually determine the allowance for loan losses or to determine an impairment of an asset can be a highly judgmental area.

6. Evaluating the sufficiency of evidence

Not only must one make a judgment about how to account for a transaction, the sufficiency of the evidence used to support the conclusion must be evaluated. In practice, this is typically one of the most subjective and difficult judgments to make.

Examples include determining if there is sufficient evidence to estimate sales returns or to support the collectability of a loan.

Levels of Judgment

There are many levels of judgment that occur related to accounting matters. Preparers must make initial judgments about uncertain accounting issues; the preparer's judgment may then be evaluated or challenged by auditors, investors, regulators, legal claimants, and even others, such as the media. Therefore, in developing potential guidance, differences in role and perspective between those who make a judgment and those who evaluate a judgment should be carefully considered. Guidance should not make those who evaluate a judgment re-perform the judgment according to the guidance. Instead, guidance should provide clarity to those who would make a judgment on factors that those who would evaluate the judgment would consider while making that evaluation.

Hindsight

The use of hindsight to evaluate a judgment where the relevant facts were not available at the time of the initial release of the financial statements (including interim financial statements) is not appropriate. Determining at what point the relevant facts were known to management, or should have been known,¹⁷ can be difficult, particularly for regulators who are often evaluating these circumstances after substantial time has passed. Therefore, the use of hindsight should only be used based on the facts reasonably available at the time the annual or interim financial statements were issued.

Form of Potential Guidance

We believe that there are many different ways that potential guidance on judgment could be provided. To be successful, however, we believe that guidance on judgment should not eliminate debate, nor be inflexible or mechanical in application. Rather, the guidance should encourage preparers to organize their analysis and focus preparers and others on areas to be addressed; thereby improving the quality of the judgment and likelihood that regulators will accept the judgment. Any guidance issued should be designed to stimulate a rigorous, thoughtful and deliberate process rather than a checklist-based approach for making and evaluating judgments.

One potential way to accomplish the goals we set forth earlier as well as to guard against the potential that such guidance would develop into a checklist-based approach is for the

¹⁷ We believe that those making a judgment should be expected to exercise due care in gathering all of the relevant facts prior to making the judgment.

SEC to formally state its approach to evaluating judgments. As discussed earlier in this report, one of the major concerns surrounding the use of judgment is the possibility of a regulator “second guessing” the reasonableness of a judgment after the fact. We believe that a primary cause of this concern is a lack of clarity and transparency into the process the SEC uses to evaluate the reasonableness of judgments. The SEC has articulated its policies in the past with success. Examples of previous articulations of policy by the SEC include the “Seaboard” report (October 23, 2001) relating to the impact of a company’s cooperation on a potential SEC enforcement case and the SEC’s framework for assessing the appropriateness of corporate penalties (January 4, 2006). We believe that a statement of policy could implement the goals we have articulated and therefore recommend that the SEC and the PCAOB issue statements of policy describing how they evaluate the reasonableness of accounting and auditing judgments.

The Nature and Limitations of GAAP:

Some have suggested that potential judgment guidance for the selection and implementation of GAAP be a requirement to reflect the economic substance of a transaction or be a standard of selecting the "high road" in accounting for a transaction. We agree that qualitative standards for GAAP such as these would be desirable and we encourage regulators and standards-setters to move financial reporting in this direction. However, such standards are not always present in financial reporting today and we cannot recommend the articulation of such standards in an SEC statement of policy without anticipating a fundamental long-term revision of GAAP – a change that would be beyond our purview and one that would not be doable in the near- or intermediate-term.

For example, there is general agreement that accounting should follow the substance and not just the form of a transaction or event. Many believe that this fundamental principle should be extended to require that all GAAP judgments should reflect economic substance. However, reasonable people disagree on what economic substance actually is, and many would conclude that significant parts of current GAAP do not require and do not purport to measure economic substance (e.g., accounting for leases, pensions, certain financial instruments and internally developed intangible assets are often cited as examples of items reported in accordance with GAAP that would not meet many reasonable definitions of economic substance).

Similarly, some would like financial reporting to be based on the "high road" – a requirement to use the most preferable principle in all instances. Unfortunately, today a preparer is free to select from a variety of acceptable methods allowed by GAAP (e.g., costing inventory, measuring depreciation, and electing to apply hedge accounting are just some of the many varied methods allowed by GAAP) without any qualitative standard required in the selection process. In fact, a preferable method is required to be followed only when a change in accounting principle is made, and a less preferable alternative is fully acceptable absent such a change.

We believe that adopting a requirement that accounting judgments reflect economic substance or the "high road" would require a revolutionary change not achievable in the foreseeable future. Our suggestion that the SEC issue a statement of policy relating to its

evaluation of judgments could and we believe would enhance adherence to GAAP, but it cannot be expected to correct inherent weaknesses in the standards to which it would be applied.

III.B. Developed Proposals

We have developed the following proposal:

Developed Proposal 3.5: The SEC should issue a statement of policy articulating how it evaluates the reasonableness of accounting judgments and include factors that it considers when making this evaluation. The PCAOB should also adopt a similar approach with respect to auditing judgments.

The statement of policy applicable to accounting-related judgments should address the choice and application of accounting principles, as well as estimates and evidence related to the application of an accounting principle. We believe that a statement of policy that is consistent with the principles outlined in this developed proposal to cover judgments made by auditors based on the application of PCAOB auditing standards would be very beneficial to auditors. Therefore, we propose that the PCAOB develop and articulate guidance related to how the PCAOB, including its inspections and enforcement divisions, would evaluate the reasonableness of judgments made based on PCAOB auditing standards. The PCAOB statement of policy should acknowledge that the

PCAOB would look to the SEC's statement of policy to the extent the PCAOB would be evaluating the appropriateness of accounting judgments as part of an auditor's compliance with PCAOB auditing standards.

We believe that it would be useful if the SEC also set forth in the statement of policy factors that it looks to when evaluating the reasonableness of preparers accounting judgments.

The Concept of Judgment in Accounting Matters

Judgment, with respect to accounting matters, should be exercised by a person or persons who have the appropriate level of knowledge, experience, and objectivity and form an opinion based on the relevant facts and circumstances within the context provided by applicable accounting standards. Judgments could differ between knowledgeable, experienced, and objective persons. Such differences between reasonable judgments do not, in themselves, suggest that one judgment is wrong and the other is correct. Therefore, those who evaluate judgments should evaluate the reasonableness of the judgment, and should not base their evaluation on whether the judgment is different from the opinion that would have been reached by the evaluator.

We have listed below various factors that we believe preparers should consider when making accounting judgments. The SEC may want to take these factors into account in developing its statement of policy. We also believe that a suggestion by the SEC

that preparers should carefully consider these factors when making accounting judgments would be beneficial in not only increasing the quality of judgments, but also in making sure that the SEC and preparers will be able to more efficiently resolve potential differences during the SEC's review of preparer's filings. The mere consideration by a preparer of these factors in a SEC statement of policy would not prevent a regulator from asking appropriate questions about the accounting judgments made by the preparer or asking companies to correct unreasonable judgments, however. In fact, there is no guarantee that the preparer's consideration of the SEC's suggested factors articulated in a statement of policy would result in a reasonable judgment being reached. Rather, the statement of policy should be designed to encourage preparers to organize their analysis and focus preparers and others on areas that would be the focus of the SEC's review, thereby improving the quality of the judgment and likelihood that regulators will accept the judgment. We encourage the SEC to seek to accept a range of alternative reasonable judgments when preparers make good faith attempts to reach a reasonable judgment. A preparer's failure to follow the SEC's suggested factors in its statement of policy, however, would not imply that the judgment is unreasonable.

We would expect that, in the evaluation of judgments made using the factors that are cited below, the focus would be on significant matters requiring judgment that could have a material effect on the financial statements taken as a whole. We recognize that the facts and circumstances of each judgment may indicate that certain factors are

more important than others. These factors would have a greater influence in an evaluation of the reasonableness of a judgment made by a preparer.

Factors to Consider when Evaluating the Reasonableness of a Judgment

While we believe that the SEC should articulate the factors that it uses when evaluating the reasonableness of a judgment, we believe that the statement of policy would be even more useful to preparers if the SEC also made suggestions for ways in which accounting judgments could be made.

We believe that accounting judgments should be based on a critical and reasoned evaluation made in good faith and in a rigorous, thoughtful and deliberate manner.

We believe that preparers should have appropriate controls in place to ensure adequate consideration of all relevant factors. Factors applicable to the making of an accounting judgment include the following:

1. The preparer's analysis of the transaction, including the substance and business purpose of the transaction
2. The material facts reasonably available at the time that the financial statements are issued
3. The preparer's review and analysis of relevant literature, including the relevant underlying principles

4. The preparer's analysis of alternative views or estimates, including pros and cons for reasonable alternatives
5. The preparer's rationale for the choice selected, including reasons for the alternative or estimate selected and linkage of the rationale to investors' information needs and the judgments of competent external parties
6. Linkage of the alternative or estimate selected to the substance and business purpose of the transaction or issue being evaluated
7. The level of input from people with an appropriate level of professional expertise¹⁸
8. The preparer's consideration of known diversity in practice regarding the alternatives or estimates¹⁹
9. The preparer's consistency of application of alternatives or estimates to similar transactions
10. The appropriateness and reliability of the assumptions and data used.
11. The adequacy of the amount of time and effort spent to consider the judgment.

When considering these factors, it would be expected that the amount of documentation, disclosure, input from professional experts, and level of effort in making a judgment would vary based on the complexity, nature (routine versus non-routine) and materiality of a transaction or issue requiring judgment.

¹⁸ In many cases, input from professional experts would include consultation with a preparer's independent auditors or other competent external parties, such as valuation specialists, actuaries or counsel

¹⁹ If there is not diversity in practice, it would be significantly harder to select a different alternative.

Material issues or transactions should be disclosed appropriately. We note that existing disclosure requirements should be sufficient to generate²⁰ transparent disclosure that enables an investor to understand the transaction and assumptions that were critical to the judgment. The SEC has provided in the past, and should continue to consider providing, additional guidance on existing disclosure requirements to encourage more transparent disclosure. In addition, when evaluating the reasonableness of a judgment, regulators should take into account the disclosure relevant to the judgment.

Documentation – The alternatives considered and the conclusions reached should be documented contemporaneously. The lack of contemporaneous documentation may not mean that a judgment was incorrect, but would complicate an explanation of the nature and propriety of a judgment made at the time of the release of the financial statements.

²⁰ Existing disclosure requirements would include the guidance on critical accounting estimates in the Commissions Release No. 33-8350 “Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations, the Commissions Release No. 33-8040 “Cautionary Advice Regarding Disclosure About Critical Accounting Policies” and Accounting Principles Board Opinion No. 22 “Disclosure of Accounting Policies”. We also encourage the SEC to continue to remind preparers of ways to improve the transparency of disclosure, such as through statements like the Sample Letter sent to Public Companies on MD&A Disclosure Regarding the Application of SFAS 157 (Fair Value Measurements) issued by the Division of Corporation Finance in March 2008.

Exhibit E

**SEC Advisory Committee on Improvements to Financial Reporting
Delivering Financial Information Subcommittee Update
May 2, 2008 Full Committee Meeting**

I. Introduction

The SEC's Advisory Committee on Improvements to Financial Reporting (Committee) issued a progress report (Progress Report) on February 14, 2008.⁵¹ In chapter 4 of the Progress Report, the Committee discussed its work-to-date in the area of delivering financial information including its developed proposals relating to XBRL tagging of financial information and improved use of corporate websites and its future considerations relating to disclosure of key performance indicators, improved quarterly press release disclosures and timing, and the inclusion of executive summaries in public company periodic reports.

Since the issuance of the Progress Report, the delivering financial information subcommittee (Subcommittee IV) has deliberated further the areas of improved use of corporate websites, disclosure of key performance indicators, improved quarterly press release disclosures and timing and inclusion of executive summaries. This report represents Subcommittee IV's latest thinking, including its consideration of input received through comment letters and received orally at the March 14, 2008 Committee meeting in San Francisco and subsequent Subcommittee meeting with industry participants. Subject to further public comment, Subcommittee IV will recommend the following preliminary hypotheses to the full Committee for its consideration in developing the final report, which it expects to issue in July 2008.

II. XBRL

⁵¹ Refer to Progress Report at <http://www.sec.gov/rules/other/2008/33-8896.pdf>.

In the Progress Report, the Committee issued a developed proposal regarding XBRL (developed proposal 4.1). Refer to the Progress Report for additional discussion of this developed proposal. At the Committee meeting on March 14, 2008 held in San Francisco, the Committee received oral and written input from market participants regarding the XBRL developed proposal. The Subcommittee understands the SEC has scheduled an open meeting on May 14, 2008 to consider whether to propose amendments to provide for corporate financial statement information to be filed with the SEC in interactive data format, and a near- and long-term schedule therefore. Subcommittee IV proposes no revisions at this time to the developed proposal.

III. Use of Corporate Websites

In the Progress Report, the Committee issued a developed proposal regarding the use of corporate websites and the development of uniform best practices regarding corporate website use by industry participants (developed proposal 4.2). Refer to the Progress Report for additional discussion of this developed proposal. The Committee heard additional input from industry participants, including newswire services, reporting companies, investors, and securities lawyers regarding the developed proposal as part of the comments received on the Progress Report. The Subcommittee heard from companies and investors about the value of corporate website disclosures as an additional, though not exclusive, means of providing information to the market in a timely manner available to all persons. Subcommittee IV proposes no significant revisions at this time to the developed proposals regarding corporate websites and industry developed best practice guidelines.

IV. Disclosures of KPIs and Other Metrics to Enhance Business Reporting

Preliminary Hypothesis 1:

The SEC should encourage private sector initiatives targeted at best practice development of company use of Key Performance Indicators (KPIs) in their business reports. The SEC should encourage private sector dialogue, involving preparers, investors, and other interested industry participants, such as consortia that have long supported KPI-like concepts, to generate understandable, consistent, relevant and comparable KPIs on an industry-specific and relevant activity basis. The SEC also should encourage companies to provide, explain, and consistently disclose period-to-period company-specific KPIs. The SEC should consider reiterating and expanding its interpretive guidance regarding disclosures of KPIs in MD&A and other company disclosures.

The Committee should further acknowledge the useful work of those consortia that endeavour to go beyond the limited scope of the Committee's recommendation to provide an overall structure which provide a linking of financial and KPI indicators into a seamless whole.

Background:

As the Committee noted in the Progress Report, enhanced business reporting and key performance indicators (KPIs) are disclosures about the aspects of a company's business that provide significant insight into the sources of its value. The Enhanced Business Reporting Consortium,⁵² has stated that the value drivers for a business "can be measured numerically through KPIs or may be qualitative factors such as business opportunities, risks, strategies and plans—all of which permit assessment of the quality, sustainability and variability of its cash flows and earnings." KPIs include supplemental non-GAAP financial reporting disclosures that proponents have stated can improve disclosures by public companies. Such KPIs also may include non-financial measures. KPIs are leading indicators of financial results and intangible assets that are not necessarily encompassed on a company's balance sheet and can provide more transparency and understanding about the company to investors. Proponents of the use of KPIs note that they are important because they inform judgments about a company's future cash flows – and form the basis for a company's stock price. Managers and boards of directors of companies use KPIs to monitor performance of companies and of management. Market participants and the SEC have identified KPIs as important supplements to GAAP-defined financial measures.

The Committee understands that investment professionals concur that investors are very interested in non-financial information as a way to better understand the businesses they invest in. They recognize that financial reports provide an accounting of past events and a current view of the financial condition of the company. The financials are viewed as an end of process result delivered as a combination of market conditions and company business strategies, processes and execution.

⁵² The Enhanced Business Reporting Consortium was founded by the AICPA, Grant Thornton LLP, Microsoft Corporation, and PricewaterhouseCoopers in 2005 upon the recommendation of the AICPA Special Committee on Enhanced Business Reporting. The EBRC is an independent, market-driven non-profit collaboration focused on improving the quality, integrity and transparency of information used for decision-making in a cost-effective, time efficient manner.

The financials are, by their nature, not necessarily forward-looking indicators. Of interest to many investors from a business reporting standpoint is information regarding the fundamental drivers of the business and metrics used to give evidence as to how the business is being managed in the environment it finds itself in. Financial reporting captures some aspects of this but not all and, in fact, financial statements are not currently designed to provide a broader picture of the company and its operations.

From a corporate preparer standpoint, management uses KPIs as key metrics with which to direct the company as part of the strategic planning process both in terms of goal setting and as a way to provide analysis and feedback. In that regard the degree to which companies are comfortable sharing these metrics with shareholders, communication would be greatly enhanced. By its very nature such communication would increase the fundamental transparency of the business.

Numerous prior studies have shown that greater transparency on the part of corporations reduces the company's cost of capital and no doubt improves market efficiency.

Recognizing this, the SEC encourages extensive discussion of the condition of the business in the MD&A. The SEC, in its 2003 MD&A Interpretive Release, stated the “[o]ne of the principal objectives of MD&A is to give readers a view of the company through the eyes of management by providing both a short and long-term analysis of the business. To do this, companies should ‘identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company’.” In this regard, the SEC noted the importance of disclosures of key performance measures - “when preparing MD&A, companies should consider whether disclosure of all key variables and other

factors that management uses to manage the business would be material to investors, and therefore required. These key variables and other factors may be non-financial, and companies should consider whether that non-financial information should be disclosed.” The SEC went on to state that “[i]ndustry-specific measures can also be important for analysis, although common standards for the measures also are important. Some industries commonly use non-financial data, such as industry metrics and value drivers. Where a company discloses such information, and there is no commonly accepted method of calculating a particular non-financial metric, it should provide an explanation of its calculation to promote comparability across companies within the industry. Finally, companies may use non-financial performance measures that are company-specific.”⁵³ This discussion is intended to give information about the business in a way that is consistent with the manner in which the business is run.

Discussion:

The Subcommittee’s hypothesis extends beyond a narrow definition of financial reporting to business reporting more generally. The Subcommittee has been evaluating whether public companies should increase their voluntary disclosure of financial and non-financial performance measures or indicators, such as KPIs. The Subcommittee has examined the current practices of public companies and notes that many companies are already disclosing some company-specific KPIs in their periodic reports filed with the SEC or in other public statements, but these company-specific measures may not necessarily be consistently reported by companies from period-to-period, are not necessarily well-defined, and may not be commonly used by other companies in the

⁵³ SEC, Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 33-8350 (December 19, 2003) (2003 MD&A Interpretive Release).

same industry so that they lend themselves to comparisons between and among companies.

Therefore, as part of its review of KPI disclosure, the Subcommittee has evaluated the kinds of KPIs that should be made available, in what format, and whether they should be consistently defined over time. The Subcommittee has found that various groups, within and outside industries, are working on developing industry-specific and activity-specific KPIs in order to improve comparability of companies on an industry basis.

In developing its preliminary hypothesis on KPIs and other possible metrics to enhance business reporting, the Subcommittee consulted with industry members and others who have been working on this subject. As a result of these discussions and its evaluation of other materials, the Subcommittee preliminarily believes that further exploration of the use of KPIs and other metrics by public companies would be constructive.

Accordingly, for KPI reporting to be most effective and improve user understanding, the Subcommittee is considering that the full Committee recommend that companies should consider the following to improve KPI disclosures.⁵⁴

- Understandability – The Subcommittee believes that a given KPI term, such as "same store sales," would be most useful in evaluating the relevant industry or activity if it had a standard agreed definition in the industry. For that reason, as part of its preliminary hypothesis, the Subcommittee notes that the SEC should explore ways to encourage private

⁵⁴ The Subcommittee notes that the SEC has provided guidance as to some of these matters as well in its 2003 MD&A Interpretive Release as discussed above. The SEC noted that “[t]he focus on key performance indicators can be enhanced not only through the language and content of the discussion, but also through a format that will enhance the understanding of the discussion and analysis.”

initiatives in various industries for the development of standard KPI definitions. It is presumed that there would be some terms that would be macro in nature that companies from all industries would make use of and thus would be activity-based, but it is assumed that many KPI terms would be industry-specific. Once a term has been defined by industry, the SEC and other global regulators should work with industry to support the use of such term in periodic and other company reports, with such modified or additional disclosures as the SEC and other global regulators deem necessary or appropriate. Companies should be encouraged to use such industry-defined terms and to disclose any differences in their use terms from any industry-defined and accepted definition. Companies would still have the freedom to use whatever terms they wished in describing their businesses but would be expected to make clear any differences between their definitions and those that have been industry-defined.

- Consistency – Whether or not a company uses an industry-defined term for its KPI disclosures, the KPI that is used should be reported consistently from period-to-period. Any changes in the definition of a KPI should be disclosed, along with the reasons for the change. KPIs should be reported not just for the current period but for prior periods as well so that investors can assess the company’s development from period-to-period or year-to-year.
- Relevancy - KPI that are disclosed should be important to an understanding and tracking of the business or business segments for which they are used and should align with how reporting companies run their business.

- Presentability – When companies disclose KPIs in their reports and other releases, they should make clear to ordinary investors that the information is intended to provide information about the business of the company that is separate from and supplemental to the financial statements. This could either be done in a separate KPI section in MD&A or in subsections of parts of the MD&A, such as the general business discussion or the discussion by business segment. Segment reporting of KPIs, given the logical connection to business line activities, could be very useful. The inclusion of tabular presentations showing current and prior periods should be seriously considered.
- Comparability – Encouraging companies to use industry-defined KPI's would enable investors to compare companies within and across industries and would also be quite useful at the industry segment level. Once industry-defined KPIs are available, the Subcommittee would hope that investor interest would encourage companies to use commonly defined KPI terms.

The Subcommittee has heard that some companies may be hesitant about increased disclosure of KPIs because of concern that disclosure of these metrics may compromise competitive information.⁵⁵ Neither the Subcommittee nor investors want companies to give away the “crown jewels.” The Subcommittee has also heard questions about the validity of many of such competitive harm claims, particularly where information is widely known within a particular industry. The Subcommittee has heard that there is already so much information about companies that disclosure of unique competitive information would be rare. Nevertheless, the Subcommittee

⁵⁵ The Subcommittee also heard a question as to the liability treatment of KPIs.

preliminarily believes that if a particular KPI could require the disclosure of competitively important information, the affected company could decline to disclose it.

In an ideal disclosure system, non-financial and financial indicators and elements would be presented within a cohesive framework that combines KPIs and other indicators with GAAP data and text discussion in order to create a complete a complete picture of a company. At this time, the Subcommittee believes that having the Committee propose to mandate or suggest such an organized structure is outside the scope of what the Subcommittee is evaluating, might be premature and inappropriate for a regulator or standard setter, possibly being too prescriptive.

Rather, the Subcommittee's preliminary hypothesis provides believes that the SEC should encourage an industry driven initiative with significant investor involvement to develop best practices that companies could follow in developing and disclosing KPIs. Just as financial reporting standards and the recently developed XBRL taxonomy may improve business reporting by creating standardized language, the Subcommittee believes the development of a KPI dictionary, developed on an industry basis but also allowing for company-specific definitions, also could provide valuable information to investors.

Thus, the Subcommittee has developed a preliminary hypothesis that is based on a number of industry-driven initiatives, with significant investor involvement, to develop best practices and common definitions for KPIs that companies could follow in disclosing KPIs. The hypothesis suggests that companies, investors, and business reporting consortiums should work together to develop industry-wide and activity-specific KPIs that conform to uniform or standard definitions,

as well as company-specific KPIs. These KPIs should then be disclosed in a company's periodic reports, as well as other disclosure formats such as earnings releases. The hypothesis suggests that the KPIs:

- be clearly and consistently defined to allow investors understanding of the meanings of the KPIs;
- be disclosed, as relevant, on a company and/or segment basis; and
- permit cross-company and cross-industry comparisons.

The Subcommittee does not believe that the mandatory reporting of KPIs is desirable at this time. Instead, the Subcommittee believes that the Committee should consider encouraging the SEC to promote the development of commonly recognized and defined KPIs by industry groups.

Integration with Other Proposals:

The Subcommittee preliminarily believes that the formalization of KPI disclosures through commonly recognized definitions, will enhance the benefits that will come from other proposals from the Committee. For example, disclosing KPIs on company web sites would allow investors and other users of the reported information to gain an improved understanding of the prospects for a company and could lead to better capital market pricing.

V. Improved Quarterly Press Release Disclosures and Timing

Preliminary Hypothesis 2:

Industry groups, including the National Investor Relations Institute, FEI, and the CFA Institute should update their best practices for earnings releases. Such updated best practices guidance should cover, among other matters, the type of information that should be provided in earnings releases and the need for investors to receive information that is consistent from quarter to quarter, with an explanation of any changes in disclosures from quarter to quarter. Further, the best practices guidance should consider recommending that companies include in their earnings releases the income statement, balance sheet and cash flow tables, locate GAAP reconciliations in close proximity to any non-GAAP measures presented, and provide more industry and company specific key performance indicators.

The SEC should consider reinforcing its view that disclosures in connection with earnings calls posted on company websites should be maintained and available on such sites for at least 12 months.

Background:

As noted in the Progress Report, the quarterly earnings release, often the first corporate communication about the result of the quarter just ended, is viewed as an important corporate communication. This communication often receives more attention than the formal Form 10-Q submission which often occurs a week or two later.

The quarterly earnings release is not currently required to contain mandated information other than that required by the application of Regulation G to the presentation of non-GAAP measures and the antifraud provisions of the federal securities laws. Industry groups have previously coordinated in developing best practices for reporting companies to follow in preparing their earnings releases. In addition, under SEC rules, companies must furnish earnings releases to the Commission on a Form 8-K. Investors and other market participants have expressed concern about the matters relating to earnings releases, including consistency of information provided in such releases, the timing of such releases in relation to the filing of the applicable periodic report, and the inclusion of earnings guidance in such earnings releases.

Discussion:

The Subcommittee has been examining a number of issues relating to the earnings release, including with regard to its consistency, understandability, timeliness, and the continued public availability of earnings conference calls. The Subcommittee had an opportunity to discuss the quarterly earnings release and these related matters with investor and company representatives. In addition, the Subcommittee considered the consistent provision of income statement, balance sheet and cash flow tables in the quarterly earnings release as well as the positioning and prominence of GAAP and non-GAAP figures, GAAP reconciliation, the consistent placement of topics, and clear communication of any changes to accounting methods or key assumptions. The Subcommittee viewed the goal for the earnings release to be a consistent, reliable communication form that all investors can easily navigate.

The Subcommittee also briefly discussed the advisability of requiring the issuance of the earnings releases on the same day that the periodic report (e.g., Form 10-Q) is filed, in contrast to the current practice in which the earnings release often is issued before the periodic report is filed. The Subcommittee heard from company and investor representatives in this regard and took note of the comments that the SEC received in connection with a prior request for comment to tie the filing of the quarterly report to the issuance of an earnings release. The Subcommittee understood that the practices of companies in this regard may differ depending on the size of the company and the company's own disclosure practices. For example, the Subcommittee understands that some large companies issue their earnings release at the same time as the filing of their quarterly reports. The Subcommittee also heard that smaller companies tended to wait to issue their earnings releases so that their news would not be eclipsed by news of larger and more well followed companies. While investors noted an interest in having the earnings release issued at the same time as the Form 10-Q is filed to avoid duplication of effort in analyzing the company's disclosures, representatives of companies and others expressed concern about the effect of delays in disclosing material non-public information about the quarter or year end. Investors also expressed concern regarding the trading of company stock by executives after the issuance of the earnings release but before the filing of the Form 10-Q and questioned whether executives could be prohibited from engaging in trading until after the Form 10-Q was filed.

The Subcommittee determined not to include a preliminary hypothesis that would change current market practice regarding the issuance of earnings releases but would suggest that, instead, the SEC monitor company practices in regard to the timing of the earnings release in relation to the filing of the relevant periodic report with the SEC.

The Subcommittee also heard concerns that companies were not keeping their earnings calls and related information posted on their websites for more than one quarter after the call, thus making quarterly comparisons difficult. The Subcommittee noted that the SEC had suggested that companies keep their website disclosures regarding GAAP reconciliations for non-GAAP measures presented on earnings calls available on their websites for at least a 12-month period and the Subcommittee's preliminary hypothesis would suggest that the SEC reiterate this guidance.⁵⁶

The Subcommittee briefly discussed the practices of some companies in providing earnings guidance or public projections of next quarter's earnings by company officials, since some believe that this practice is an important underlying source of reporting complexity and other accounting problems. The Subcommittee also discussed the provision of annual guidance that may be updated quarterly. The Subcommittee does not intend to continue its evaluation of quarterly earnings guidance or to suggest any preliminary hypothesis regarding the provision of quarterly earnings guidance at this time because it notes that many others are evaluating the issues arising from the provision of quarterly earnings guidance.

VI. Use of Executive Summaries in Exchange Act Periodic Reports

Preliminary Hypothesis 3:

The SEC should mandate the inclusion of an executive summary in the forepart of a reporting company's filed annual and quarterly reports. The executive summary should

⁵⁶ See SEC Conditions for Use of Non-GAAP Measures, Exchange Act Release No. 34-47226 (Jan. 22, 2003).

provide summary information, in plain English, in a narrative and perhaps tabular format of the most important information about a reporting company's business, financial condition, and operations. As with the MD&A, the executive summary should be required to use a layered approach that would present information in a manner that emphasizes the most important information about the reporting company and include cross-references to the location of the fuller discussion in the annual report. The requirement for the executive summary should build on the company's MD&A overview and essentially be principles-based, other than a limited number of required disclosure items such as:

- A summary of a company's current financial statements;**
- A digest of the company's GAAP and non-GAAP KPIs (to the extent disclosed in the company's 10-Q or 10-K);**
- A summary of key aspects of company performance;**
- A summary of business outlook;**
- A brief description of the company's business, sales and marketing; and**
- Page number references to more detailed information contained in the document (which, if the report is provided electronically, could be hyperlinks) .**

Background:

Reporting companies are not currently required to include any type of summary in their periodic reports, although a summary of the company and the securities it is offering is a line-item disclosure in Securities Act registration statements. Companies, therefore, are familiar with the concept of summarizing the important aspects of their business and operations at the time they are

raising capital. The Subcommittee has heard that retail investors find it difficult at times to navigate through a company's periodic reports, including its Form 10-K annual report. The Subcommittee has been evaluating the use of an executive summary in the forepart of a company's annual and quarterly Exchange Act reports to facilitate the ready delivery of important information to investors by providing them a roadmap of the disclosures contained in such reports.

Discussion:

The Subcommittee has been exploring a requirement to include an executive summary in reporting company annual and quarterly Exchange Act reports (Forms 10-K and 10-Q). The Subcommittee has met with investor and company representatives as well as securities counsel. The Subcommittee understands that a summary report prepared on a stand-alone basis would not necessarily provide investors with information they need in a desired format and that investors would not use such a summary. However, the Subcommittee understands that an executive summary included in the forepart of an Exchange Act periodic report may provide investors, particularly retail investors, with an important roadmap to the company's disclosures located in the body of such a report.⁵⁷ The executive summary in the Exchange Act periodic report would provide summary information, in plain English, in a narrative and perhaps tabular format of the most important information about a reporting company's business, financial condition, and operations. As with the MD&A, the executive summary would use a layered approach that would present information in a manner that emphasizes the most important information about the

⁵⁷ Such reports generally are posted on company websites as well so that the executive summaries would be electronically available with hyperlinks to the more detailed information in the relevant report.

reporting company and include cross-references to the location of the fuller discussion in the annual report.

As noted in the Progress Report and as contemplated in the Subcommittee's preliminary hypothesis, the goal of the executive summary would be to help investors fundamentally understand a company's businesses and activities through a relatively short, plain English presentation. An executive summary in a periodic report may be most useful if it included high-level summaries across a broad range of key components of the annual or quarterly report, rather than detailed discussion of a limited number of variables. The executive summary approach may be an efficient way to provide all investors, including retail investors, with a concise overview of a company, its business, and its financial condition. For the more sophisticated investor, an executive summary may be helpful in presenting the company's unique story which the sophisticated investor could consider as it engages in a more detailed analysis of the company, its business and financial condition.

The executive summary in a periodic report should be brief, and it might fruitfully build on the overview that the SEC has identified should be in the forepart of the MD&A disclosure. The MD&A overview is expected to "include the most important matters on which a company's executives focus in evaluating the financial condition and operating performance and provide context."⁵⁸ The executive summary should build on the MD&A overview disclosure and include the following:

1. A summary of a company's current financial statements

⁵⁸ See 2003 MD&A Interpretive Release above.

2. A digest of the company's GAAP and non-GAAP KPIs (to the extent disclosed in the company's 10-Q or 10-K)
3. A summary of key aspects of company performance
4. A summary of business outlook
5. A brief description of the company's business, sales and marketing
6. Page number references to more detailed information contained in the document (which, if the report is provided electronically, could be hyperlinks).

The Subcommittee's preliminary hypothesis provides that the executive summary should be required to be included in the forepart of a reporting company's annual or quarterly report filed with the SEC or, if a reporting company files its annual report on an integrated basis (the glossy annual report is provided as a wraparound to the filed annual report), the executive summary instead could be included in the forepart of the glossy annual report. If the executive summary was included in the glossy annual report, it would not be considered filed with the SEC. The Subcommittee understands that the inclusion of a summary in the body of the periodic report should not give rise to additional liability implications.

VII. Continued Need for Improvements in the MD&A and Other Public Company Financial Disclosures

The Committee noted in chapter 4 of the Progress Report that while investors and other market participants believe that while there has been some improvement in the MD&A disclosures since publication of the SEC's interpretive release in 2003, significant improvement is still needed. The

Subcommittee evaluated the MD&A and other public company disclosures in the context of its preliminary hypotheses regarding disclosures of key performance indicators, earnings releases, and use of executive summaries in periodic reports.

Exhibit F

Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its fifth meeting on March 13-14, 2008 and its sixth meeting on May 2, 2008 and the dates of receipt.

Apr. 30, 2008	American Accounting Association National Tracking Team
Apr. 28, 2008	Carl T. Thomsen, PhD, CPA, Professor of Health Policy and Management, Loma Linda University, California
Apr. 18, 2008	Norman D. Slonaker, Chair, Financial Reporting Committee, Bar Association of The City of New York
Apr. 14, 2008	Barbara Roper, Director of Investor Protection, Consumer Federation of America
Apr. 4, 2008	Arnold C. Hanish, Chair, Committee on Corporate Reporting, Financial Executives International
Apr. 2, 2008	Dina M. Maher, CPA, Senior Director, Credit Policy Group, Fitch Ratings, Inc., New York and Timothy Greening, Managing Director, Corporate Finance, Fitch Ratings, Chicago
Mar. 31, 2008	BDO Seidman, LLP
Mar. 31, 2008	PricewaterhouseCoopers LLP
Mar. 31, 2008	Jeff Mahoney, General Counsel, Council of Institutional Investors
Mar. 31, 2008	Dennis H. Chookaszian, Chairman, Financial Accounting Standards Advisory Council
Mar. 31, 2008	Robert F. Richter, CPA, Consultant, Newtown Square, Pennsylvania
Mar. 31, 2008	KPMG LLP
Mar. 31, 2008	Deloitte & Touche LLP
Mar. 31, 2008	Thomas M. Tefft, Vice President and Corporate Controller, Medtronic, Inc
Mar. 31, 2008	William Widdowson and John Gallagher, UBS AG
Mar. 31, 2008	Ernst & Young LLP
Mar. 31, 2008	Donald J. Boteler and Richard J. Thomas, Investment Company Institute
Mar. 31, 2008	Karen Rasmussen, Chair, Committee on Small and Mid-Sized Public Companies and Taylor Hawes, Chair, Committee on Finance & Information Technology, Financial Executives International
Mar. 31, 2008	The Enhanced Business Reporting Consortium

Mar. 31, 2008 Kurt N. Schacht, Managing Director, and Gerald I. White, Chair, Corporate Disclosure Policy Council, CFA Institute Centre for Financial Market Integrity

Mar. 31, 2008 Gary L. Sandefur, Ohio Society of CPAs, Accounting and Auditing Committee, Columbus, Ohio

Mar. 31, 2008 Cynthia M. Fornelli, Executive Director, Center for Audit Quality

Mar. 31, 2008 Harvey L. Wagner, Vice President, Controller and Chief Accounting Officer, FirstEnergy Corp.

Mar. 28, 2008 David K. Owens, Executive Vice President, Business Operations, Edison Electric Institute

Mar. 26, 2008 Klaus-Peter Feld, Executive Director, and Norbert Breker, Technical Director, Accounting and Auditing, Institut der Wirtschaftsprüfer in Deutschland (Institute of Public Auditors in Germany)

Mar. 25, 2008 John R. Roberts, Saint Louis, Missouri

Mar. 25, 2008 Paul H. Rosenfield, American Institute of CPAs, Lynchburg, Virginia