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Record of Proceedings

SEC ADVISORY COMMITTEE ON
IMPROVEMENTS TO FINANCIAL REPORTING

Open Meeting

Friday, July 11, 2008

United States Securities and Exchange Commission
100 F Street, Northeast
Washington, D.C.

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1 COMMITTEE MEMBERS PRESENT:

2 Robert C. Pozen, Chairman

3 Dennis R. Beresford

4 Susan S. Bies

5 J. Michael Cook

6 Jeffrey J. Diermeier

7 Scott C. Evans

8 Linda L. Griggs

9 Joseph A. Grundfest

10 Gregory J. Jonas

11 Christopher Liddell

12 William H. Mann, III

13 G. Edward McClammy

14 James H. Quigley

15 David H. Sidwell

16 Peter J. Wallison

17

18 COMMITTEE MEMBERS ABSENT:

19 Edward E. Nusbaum

20 Thomas Weatherford

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22

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1 SEC AND COMMITTEE STAFF PRESENT:

2 Conrad Hewitt, SEC Chief Accountant

3 James Kroeker, SEC Deputy Chief Accountant

4 Jeff Minton, SEC Chief Counsel,

5 Office of the Chief Accountant

6 Nili Shah, Assistant Chief Accountant,

7 Office of the Chief Accountant

8 Adam Brown, Professional Accounting Fellow,

9 Office of the Chief Accountant

10 Shelly Luisi, Senior Associate Chief Accountant,

11 Office of the Chief Accountant

12 John W. White, Director,

13 Division of Corporation Finance

14 Shelley Parratt, Deputy Director,

15 Division of Corporation Finance

16 Wayne Carnall, Chief Accountant,

17 Division of Corporation Finance

18 Russell Golden, FASB Senior Advisor to Committee Chairman

19 Amy Starr, SEC Senior Special Counsel to Director,

20 Division of Corporation Finance

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

2 INTRODUCTORY REMARKS

3 CHAIRMAN POZEN: I want to thank again the staff
4 for doing a great job in producing this draft. I know from
5 prior experience they'll have plenty of chances to do some
6 more work between now and the time we put this out finally.

7 Jim, do you want to give us an opening?

8 MR. KROEKER: Yes, good morning and welcome. I
9 wanted to start the meeting today by just taking a moment to
10 recognize the significant efforts that Brett Williams has
11 made to this committee. His kindness, his generosity, his
12 willingness to help, his enthusiasm were an encouragement to
13 us all, and he will be greatly missed.

14 One of the traditions we have at the SEC when
15 someone leaves is to sign the signing board. We have a
16 signing board outside the auditorium for anyone who would
17 like to provide comments and sign. We intend to frame that
18 and then send it to his family.

19 I'd like to start with a moment of silence
20 recognizing Brett.

21 [Moment of silence.]

22 CHAIRMAN POZEN: I'd also like to point out that on
23 "iii" on the draft transmittal letter, we do have officially
24 a statement about Brett and recognition of his contributions.
25 I hope a copy of that will go to his family so that will be

1 recognized.

2 Again, I want to thank all the other staff members
3 who have done a great job. This has been really a major
4 undertaking.

5 MR. KROEKER: We sent to the full committee details
6 of family contacts and service information.

7 CHAIRMAN POZEN: In terms of introductory remarks,
8 the first agenda item, I'm not going to make very long
9 remarks. Our attempt in this meeting is to reach pretty much
10 final agreement in principle on any issues that are
11 remaining. I believe that the draft is in pretty good shape,
12 and there will, of course, be refinements that various people
13 will want, and I'm hoping we can do a few of those.

14 We have passed out the executive overview just
15 because there have been a few changes that were requested by
16 FASB, and we have incorporated those, so people should see
17 those. We will discuss that.

18 We will then go through and discuss each of the
19 chapters in order and bring to the floor any issues that are
20 remaining.

21 We will have a break at lunch and then come back
22 and finish up whatever we have left.

23 I think that all the subcommittees are to be
24 congratulated. There has been a huge amount of hard work. I
25 do think that the sort of wordsmithing we are involved with

1 now is important because we surely do not want to be
2 vulnerable or criticized for something that really was an
3 inadvertent phrase here or there.

4 I think the gist of most of the recommendations are
5 very solid. We want to make sure that if there are concerns,
6 that they get met.

7 We will also be putting out in the Federal
8 Register, Jim, today or very soon, requests for comments, so
9 that if anyone in the public has comments on this July 11th
10 document, they will have, I think, until July 22nd.

11 Nili, is that correct?

12 MS. SHAH: Yes. We are going to get the Federal
13 Register Notice out for the July 31st meeting and inviting
14 the public to send comments to it.

15 CHAIRMAN POZEN: The Federal Register Notice --
16 thank you for clarification -- will be for the July 31st
17 meeting, which will just be a phone meeting. We will ask for
18 public comments on this draft, July 11th draft, to be
19 submitted. Everyone should be on notice, I think, by July
20 22nd, so that we would have time to absorb any more comments.

21 I think in fairness to us as a committee, we have
22 been very transparent. We have shown at every point what our
23 proposals are and what our concepts are.

24 I do not believe that there is anything in this
25 July 11th draft that should be surprising to people. On the

1 other hand, if people do have comments, we want to get them
2 and try to integrate them into the final report as soon as we
3 can.

4 That is our agenda for today. I guess I would ask
5 that Jim begin by consideration of the comment letters.

6 CONSIDERATION OF COMMENT LETTERS RECEIVED

7 MR. KROEKER: Your discussion of comments and
8 comment letters is an opportunity to continue to comment and
9 is a good segway to highlight what Nili Shah -- among the
10 tremendous things she's done for the committee, she put
11 together an excellent summary of the comments that have been
12 received to date and has been posted to the website. It is
13 in a memo to the full committee dated July 7th.

14 It summarizes the approximately 100 comment letters
15 that the committee has received, approximately 80 different
16 respondents. Some have sent multiple letters. It is about
17 80 different individuals or organizations.

18 I know the subcommittees throughout their process
19 have either reached out directly or indirectly to members of
20 the public to help do research and inform the subcommittees so
21 the subcommittees can provide recommendations to the full
22 committee.

23 The subcommittees have also considered both the
24 summary that Nili has provided as well as summaries that
25 staff of the subcommittees have provided to the various

1 subcommittee chairs as well.

2 That memorandum again is on the website, and it
3 also has an index of all comment letters received.

4 I'd open it up to whether there are any questions
5 on comments. Obviously, Bob, as you talk about the
6 recommendations today, we will get into some of the areas
7 where commentors have provided thoughts and that the
8 committee has either incorporated those thoughts or how they
9 have dealt with them.

10 CHAIRMAN POZEN: Yes. I've asked the staff to look
11 at all comment letters and by subcommittee to see whether we
12 have been responsive to the comment, or if not, we have made
13 an express decision that we are not going to take this into
14 account.

15 I think there has been a real effort systematically
16 to be responsive to all the comments. If there is anyone who
17 wants to raise an issue about the comment letters, now is the
18 time to do it.

19 MR. LIDDELL: Bob, I would just say that I thought
20 Nili did a wonderful job in terms of summarizing those
21 comments and putting them in a useable format. I think the
22 process worked very well.

23 CHAIRMAN POZEN: Thank you. Thanks again to Nili
24 who I know has spent a lot of late nights here. We apologize
25 for her having to do that.

1 Before getting into each of the subcommittees, I'd
2 like to just quickly explain the executive overview, where we
3 are on that, and just reflect that this executive overview
4 has already been through a number of different drafts, and
5 you were sent out those.

6 One of the difficulties we have, and this does
7 relate to the comment letters, a lot of comment letters
8 wanted us to get very involved in the IFRS issue, which we
9 basically declined to do.

10 If you look at the change that is on page three of
11 the executive overview, and this document will be -- I think
12 you all have it -- this is a change that was requested by
13 FASB and it is really to relate what we are doing through the
14 process of going from U.S. GAAP to IFRS, really saying that
15 we are not sure how that process is going to go, but some of
16 the significance of our proposals will be dependent on how
17 fast we move to IFRS.

18 That is on page three. On page five, there was
19 some more discussion about exactly the financial reporting
20 forum and what should be said there about who is coordinating
21 with whom. I guess I think we still probably need to do a
22 little wordsmithing on the last sentence on page five, the
23 last sentence of III.B, to make sure that we don't have an
24 advisory committee.

25 I will look to Jeff to give us some sense of that

1 issue.

2 MR. MINTON: Yes. The draft, I think the principle
3 is clear and understandable on the financial reporting forum.
4 I know the draft currently does have a footnote that
5 identifies that we would have to consider any Federal
6 Advisory Committee Act issues.

7 The Federal Advisory Committee Act, for lack of a
8 legal term, is very broad.

9 CHAIRMAN POZEN: We have all come to realize that.

10 MR. MINTON: I think there are a couple of
11 different ways, obviously, if a Federal Advisory Committee
12 was intended, that probably would require an effort to
13 get legislation.

14 CHAIRMAN POZEN: We would like to avoid that.

15 MR. MINTON: The real stumbling block for an
16 advisory committee is if there is a group that is providing
17 recommendations or policy coordination with a Federal
18 Government agency.

19 I think the idea is to discuss and raise issues. I
20 think there are structuring things we can do.

21 CHAIRMAN POZEN: Right now, we say "To evaluate the
22 current pressures, to discuss priorities and coordinate
23 appropriate actions." I'm taking that to mean that
24 "coordinate" is probably too strong a word there.

25 MR. MINTON: I think if the "discuss priorities and

1 coordinate appropriate actions" is directed to the SEC, then
2 we would have to think about how that would be structured.

3 CHAIRMAN POZEN: If we said "To review priorities
4 and discuss appropriate actions," would that be more in the
5 ball park there?

6 MR. MINTON: Perhaps "Evaluate the current
7 pressures and discuss potential solutions" or something. We
8 need to get away from the idea that there is a discussion of
9 prioritizing or coordinating the agency's policies.

10 CHAIRMAN POZEN: Maybe we will just go with that
11 language for this purpose, since we have something to shoot
12 at, "To evaluate the current pressures on the financial
13 systems, and to discuss" -- what was the language you just
14 said? "To discuss potential solutions."

15 MR. SIDWELL: Why wouldn't we use the wording that
16 is in the detailed recommendation, which I thought you were
17 comfortable with, Jeff.

18 MR. MINTON: Right. I think there would be a
19 couple of minor word suggestions there. You are right. That
20 has a much more detailed description, I think, of the
21 principle.

22 MS. GRIGGS: I actually thought the chapter was
23 problematic. I recommend you look at the chapter language
24 again. I thought maybe it would be problematic.

25 I have a question for you, too, Jeff. Would it be

1 better if you described the SEC's role on that organization
2 as an observer?

3 MR. MINTON: That would be helpful.

4 CHAIRMAN POZEN: I think that does go to the
5 substance, and we will get to that in Subcommittee 2. I
6 think for purposes here, another thing we were trying to do,
7 we do want to conform it, but we were also trying to have the
8 overview be a more readable sort of document.

9 Why don't we just at the moment say "To evaluate
10 the current pressures on the financial reporting system and
11 to discuss potential solutions" and just leave it at that.
12 When we get to Subcommittee 2, we will come back.

13 There was one more point or two more points on the
14 executive overview, on page six. We wanted to say that we
15 support the objectives of FASB's project on financial
16 presentation. Since that has evolved somewhat and we haven't
17 really studied it, we wanted to say we supported the general
18 principle rather than the particulars.

19 There was a footnote dropped because as Denny
20 pointed out, people might not know what "proportionate
21 recognition" is.

22 I think the only other thing is we changed "nine to
23 ten percent" to "approximately nine percent" on page seven,
24 and on page nine, and again that is the language about
25 principles.

1 I know as we go through this, we may come back to
2 the executive summary. We tried to conform the executive
3 summary to the chapters with an effort to make it as readable
4 as possible. This is only eight pages long. We are hoping
5 that people will find it readable.

6 I was going to move onto Subcommittee 1. Are there
7 any more comments about the executive overview?

8 MS. GRIGGS: Bob, I had a question. In Chairman
9 Cox's June 23rd speech, he described our mission as to
10 examine the financial reporting system with a view of
11 increasing its usefulness to investors and directors. We
12 have not made any reference to directors anywhere in our
13 report. I wondered if we should.

14 CHAIRMAN POZEN: We have talked about preparers and
15 audit committees as a part of that. I'm not sure "directors"
16 was in our charter, original charter. Perhaps Chairman Cox
17 took a little artistic liberty with that.

18 John?

19 MR. WHITE: It was a speech at the Stamford
20 Directors Institute.

21 [Laughter.]

22 CHAIRMAN POZEN: Need we say anything more.

23 MR. WHITE: Sponsored by a member of the committee,
24 Joseph Grundfest.

25 CHAIRMAN POZEN: I do think we have tried very much

1 to be sensitive to audit committees, but I don't think our
2 mandate goes to directors.

3 Any other questions on the executive overview?

4 [No response.]

5 CHAIRMAN POZEN: Let's move to Subcommittee 1. I
6 think Susan will give a brief summary of where we are. We do
7 have some questions on language that has been raised by Tom
8 Linsmeier. We want to deal with those.

9 Thank you. Susan?

10 SUBCOMMITTEE 1 - SUBSTANTIVE COMPLEXITY

11 MS. BIES: Thanks, Bob. I think all of you have
12 been through this chapter with us at prior meetings and
13 discussions. I think as all of us went through the final,
14 again, we were trying to look at this final or close to final
15 draft, and really focus on did we really deal with
16 complexity.

17 Again, from our subcommittee's perspective, we were
18 thinking about complexity both in terms of preparers as well
19 as users and auditors.

20 The issue of complexity is very difficult because
21 what could be simple for a user could create tremendous
22 complexity for preparers and vice versa. We tried to keep
23 that in balance.

24 I think probably the easiest thing, Bob, did we
25 want to sort of take the major themes and take questions

1 along the way?

2 CHAIRMAN POZEN: I think it might be useful just to
3 go through each of the major recommendations and then ask
4 whether there are any questions or if we have suggestions.

5 MS. BIES: Okay. The first major concept we
6 wrestled with is the mixed attribute model which starts on
7 page 28. We came up with some recommendations on the mixed
8 attribute model.

9 I think part of what we were thinking about here is
10 we don't fundamentally have a real problem with a mixed
11 attribute model per se because one of the things that is
12 underlying what we have here is that we think accounting
13 should really reflect the business activities of an
14 organization as opposed to the underlying assets or
15 liabilities. A given asset could be used in different ways
16 depending on what the enterprise is trying to do.

17 I think that is something that is sort of
18 consistent throughout our views on several of these issues.

19 We have gotten one comment that I think we do want
20 to try to clarify. There is estimation issues both in
21 historic costs as well as fair value. We clearly do not want
22 to dismiss that as an issue.

23 I think one of the other issues that you will see
24 is a flavor through here, that as we get into fair value, we
25 talk about it more, the notion that the difference between

1 risk and uncertainty came into our mind, that it is one thing
2 in a fair value model to use statistics to try to come up
3 with a fair value based on some risk model, but especially
4 with what has been going on in the recent environment, it's
5 the uncertainty.

6 It's the fact that models don't contain the ability
7 to derive outcomes that really reflect what is going on.
8 They were beyond historic experience or they dealt with
9 systemic issues that are beyond individual firms.

10 I think we focused more on fair value just because
11 being newer in concept and the world we are living in today,
12 we think there are a lot more challenges around the fair
13 value application than some of the historic costs that have
14 been around for quite a bit of time.

15 CHAIRMAN POZEN: Susan, I think this recommendation
16 is actually quite an important step forward because it's not
17 possible for our group to resolve the whole debate on fair
18 value versus historical costs.

19 I think what has been proposed here, which is
20 consistent with where FASB is going, is a real delineation of
21 what are the quality earnings and which bucket of various
22 earnings go into it, and I think that is a big step forward
23 to help both investors understand how much of earnings are
24 coming out of fair value fluctuations and how much are coming
25 out of other sorts of core earnings.

1 I do think in my personal dealings with a lot of
2 management who have struggled with the volatility of
3 earnings, that this will give them, if we move toward this
4 sort of thing, a way to talk about volatility earnings that
5 will be more useful. I think it is an important step
6 forward.

7 The point that you mentioned that is not here that
8 we can definitely drop a footnote or make it clearer, the
9 point that there are estimation issues in historical costs as
10 well as fair value.

11 MS. BIES: Yes, we need to add that.

12 CHAIRMAN POZEN: Unless there would be an objection
13 to that, I think we will add that. Denny?

14 MR. BERESFORD: Are we dealing with the totality of
15 recommendation 1.1 now?

16 CHAIRMAN POZEN: Yes. We're dealing with the
17 totality.

18 MR. BERESFORD: I have two concerns. One, I think
19 is the other side of what you just mentioned, Bob, the next
20 to last bullet point, "Aggregate business activities into
21 operating, investing and financing sections," I simply don't
22 know enough about where the FASB is heading on that.

23 We have a footnote. It was referred to in the
24 summary a few minutes ago about supporting the objective of
25 this project. It sounds okay, but it's obviously going to

1 add complexity. I just feel uncomfortable in voting in favor
2 of that.

3 I have a similar reservation about the last bullet
4 point, about adding the new primary financial statement to
5 reconcile the statements of income and cash flows that
6 basically back out the accrual adjustments, I guess, is what
7 it amounts to.

8 Let me back up for a second. The next to last
9 footnote, next to last bullet point, isn't clear as to what
10 we are trying to achieve there. I corresponded by e-mail
11 with Bob, and he indicated it was just the income statement
12 that we were talking about, but Bob then clarified that we are
13 talking about all the financial statements.

14 At the minimum, we need to clarify that.

15 MS. BIES: We meant to say all.

16 MR. BERESFORD: I just express reservation. This
17 is not a "fall on the sword" type thing with respect to the
18 whole report, but I would disagree with that as a specific
19 recommendation.

20 I also disagree, I think, with the last bullet
21 point simply because I think it's going to add a lot more
22 details. The simple example we have is way too simple in
23 terms of even the average company, what they would present,
24 and to be honest, in thinking about it a little bit, not a
25 lot, I don't see there would be a whole lot more information

1 than is provided by the indirect method of reporting
2 operating cash flows right now.

3 Again, it's not that I'm strongly opposed to both
4 of these ideas, but I just don't think we have developed them
5 enough. I recognize we defer to the subcommittees on a lot
6 of these different issues, but as a committee member, we have
7 to vote on each of the individual recommendations.

8 At this point, I would have reservations about the
9 last two bullet points.

10 MR. McCLAMMY: I saw your e-mail and it actually
11 got me thinking as well, that I think we do this more as a
12 conceptual direction and certainly didn't have the time to
13 get into the practicalities. I guess I even as a
14 subcommittee member would take note that we should have some
15 language in here that expresses that.

16 CHAIRMAN POZEN: Maybe the question is in those two
17 bullets, rather than saying, if I understand "Aggregate
18 business activities" into these three specific buckets, maybe
19 say something like "Aggregate business activities into
20 appropriate segments" or "appropriate sections," so that we
21 are talking more on an conceptual level than locking
22 ourselves into these three particular ones.

23 I think that might be responsive to what you are
24 saying.

25 MR. McCLAMMY: To part of it, but Denny had a

1 thought on the practicality of doing this as well.

2 CHAIRMAN POZEN: The question on the last bullet,
3 whether we might again make it more general and say
4 "Reconcile the statements of income and cash flow by major
5 classes of measurement attribution to the maximum extent
6 feasible" rather than propose a separate financial statement.

7 Those would be two changes in the wording that
8 would really get us to a more conceptual level rather than
9 this very specific recommendation.

10 MR. McCLAMMY: This is a different one than the
11 lead in to that last measurable point, you could say the SEC
12 should recommend that the FASB consider the merits of, and
13 leave it more to the FASB to determine and address it all,
14 and then I know it's been kicked around before, and I'm not
15 sure that we need to make the call, should it be a primary
16 financial statement or a footnote, so we can leave that up to
17 the FASB.

18 Then we could have a footnote right before the
19 table, the very last paragraph on page 33, that says before
20 adopting this reconciliation, the FASB should conduct in
21 depth field studies to fully understand the benefits provided
22 to users and the practicality and added burden to preparers
23 and auditors, just to get the point across that we have not
24 addressed that.

25 MR. BERESFORD: To be clear, I think these are good

1 things to explore. I know the FASB has been exploring the
2 first of those for quite some time. The second, I assume, is
3 on at least the list of considerations and so forth.

4 I think we have just sort of advanced them to a
5 little bit more definitive characterization than I feel
6 comfortable with at this point.

7 CHAIRMAN POZEN: I think those are all good
8 suggestions. Susan, we are suggesting in the recommendation
9 that FASB consider these things, and then we are suggesting
10 in the second and third bullets a more general statement
11 rather than the specific cubby holes of operating, investing
12 and financing, and sort of shying away from whether we
13 actually need a new primary financial statement.

14 I do not know how you feel about that.

15 MS. BIES: I think, again, remember, this is all
16 written in the context that we are moving toward more fair
17 value, at least for some activity. One of the problems for
18 users, and I'm going to wear my bank regulator hat, that's
19 why I'm sitting here on this committee, and I look at what
20 has happened in recent events, when you had the mortgage
21 market going crazy. When you had credit for very, very
22 subprime corporate debt trading at very thin credit spreads.

23 That led to gains recognition that flowed through
24 the income statement that was never recognized. Everybody
25 felt financial firms were over capitalized. They really

1 weren't. It was unrealized fair value.

2 I think this reconciliation, whether it's a
3 footnote or primary statement, I don't have a strong feeling
4 about, but I think it is very important that users know what
5 is just a fleeting moment in time, end of the quarter mark
6 based on best information around an estimate that also has
7 this uncertainty out there that is not in any of these
8 models.

9 That requires us to really understand what's going
10 through operations, especially since when you look at the way
11 businesses operate today, they operate in services more on a
12 cash flow what's coming in our operating margins as opposed
13 to what is sitting on the balance sheet, because so much
14 flows through the balance sheet.

15 When operating income is really the driver and the
16 accounting standard in a fair value sense is balance sheet
17 driven, it also creates this dichotomy.

18 I feel strongly that we need some kind of
19 reconcilment so someone could judge the quality of what's
20 going through the income statement. It doesn't reconcile
21 easily now with cash flow or the balance sheet, and it makes
22 it very, very difficult.

23 The more we go toward these -- I'll try to be
24 diplomatic here -- greater use of fair value for some
25 activities that some of us see just as noise because the

1 asset or liability will be held to maturity or until it's
2 paid off, that noise creates, I think, quality of earnings
3 reviews that may not be reliable for the investor to use to
4 make decisions.

5 I feel strongly we need a reconciliation of some
6 form if we are going in this direction. That is why it is
7 there.

8 CHAIRMAN POZEN: Bob?

9 MR. HERZ: I am fine with the suggestions you have
10 made. Just a couple of points. This is a user-driven
11 project. I think the users would tell you that all those
12 elements are very important, including the fair value
13 elements or other elements that are based on historic cost
14 estimates, which are probably even less reliable and less
15 useful. That is just what we hear from people.

16 I agree with you that the reconciling schedule is
17 critical to understanding the components of what the results
18 for the year were, the period were, whether they be cash,
19 whether they be working capital accruals, whether they be
20 historic cost type estimates or impairments, or whether they
21 be fair value adjustments.

22 I think the point I'm trying to make and again
23 saying that I'm fine with the edits, I think the report and
24 particularly subchapter two makes the point about the
25 preeminence of the investor point of view.

1 I can tell you this is a project that has been
2 largely driven from the investor point of view. There will
3 be practicality issues. There will be a need for system
4 changes, and we are going to go out and field test all that.
5 We are going to go re-cast financials in a number of
6 companies.

7 I think it is important to not lose sight that this
8 is clearly an investor driven type of project.

9 CHAIRMAN POZEN: Scott, and then Greg.

10 MR. EVANS: I completely agree with what Bob just
11 said. I think there is a growing consensus in the user
12 community that they want to look at the noise. I think the
13 suggestions that you have here in the reconciling statements
14 improved transparency on what's noise and what is historical
15 based accounting, what is cash flow and what is not cash
16 flow.

17 I would support it, whether we are overly
18 proscriptive here or let Bob and his group do it.

19 I think this whole recommendation in terms of the
20 substance has moved in a very good direction that is very
21 workable. I think it meets everyone's needs.

22 However, the tone of it, I think, needs a little
23 shaping because of the fact that Bob just brought out. Users
24 should see this as forward progress. However, the tone that
25 is used here is a little defensive. We need to make the

1 point that it's not just that fair value is inevitable and we
2 are going to have to cope with it, because it's being forced
3 on us, it furthers transparency. It's a good thing. It's a
4 desired outcome on behalf of users.

5 We need to get that context into it in a more
6 proactive sense so that users will see it for what it is, a
7 step forward towards transparency.

8 CHAIRMAN POZEN: Greg?

9 MR. JONAS: I serve on the group that advises the
10 IASB and the FASB on the project that includes this area.
11 Just to echo what Bob is saying and Scott as well, this is a
12 user-driven idea. On FASAC, on which I also serve, this
13 project has now over the last couple of years been ranked
14 higher and higher in importance.

15 I think there is just a growing consensus that the
16 information that is embodied here is some of the most
17 analytically powerful improvement we can make in no small
18 part because standard setters have never really focused on
19 the display and the orientation of information on the face of
20 the financials in a very long time.

21 I think this is low hanging fruit. I think it is
22 incredibly powerful. I know no one is suggesting we drop
23 this recommendation, but I really think pointing to the user
24 driven nature of this and the power of it is important.

25 CHAIRMAN POZEN: Jeff?

1 MR. DIERMEIER: I want to support the last several
2 comments. I would go so far, Denny, to say I think the
3 reconciliation aspect of this should be included in the
4 recommendation because it is a powerful element that I think
5 takes us forward. I also want to support Scott's statements
6 about the tone.

7 Susan, you said in your opening comments that
8 actually complexity can go both ways, and Bob mentioned there
9 was no doubt about it, some historical cost estimates create
10 great complexity for all users as they try to figure out what
11 reality is like.

12 Like on page 28 and page 31, there are some spots
13 there that it just kind of makes it assume it's a one way
14 street, and I think that would be helpful as well.

15 CHAIRMAN POZEN: I think that we are unlikely to
16 resolve the debate here on fair value, and to just summarize
17 where the consensus is. I do think this is a big step
18 forward to clarifying for both investors and management where
19 this is.

20 Jeff?

21 MR. DIERMEIER: I'm sorry. It sounded like you
22 were kind of wrapping up.

23 CHAIRMAN POZEN: I was trying to wrap up.

24 MR. DIERMEIER: Susan, I have a question for you
25 and it really just has to do with the intent. On page 29, in

1 the bolded type, it mentions the SEC should recommend that
2 the FASB be judicious, and then later on it says " Until the
3 FASB completes the measurement framework."

4 Right now, the FASB is working on a pension
5 accounting project. They are working on leases. Both those
6 projects have elements of fair value.

7 Are we basically saying or was it the intent that
8 we are saying they should stop working on those projects
9 until we have a measurement framework worked out?

10 CHAIRMAN POZEN: Susan, do you want to answer that?

11 MS. BIES: Again, I think our subcommittee did not
12 intend to really want to prioritize all the work that the
13 FASB has, but we wanted to say look, as you move forward, be
14 cognizant as you try to add in individual projects more fair
15 value concepts, if you don't have the framework laid out,
16 because this is so costly to implement and it can be
17 difficult for users to adapt to, that we just want to make
18 sure that you can move on all of these but you need to make
19 sure in moving forward, not only consistently in the new
20 standards but to identify where you are creating
21 inconsistencies with the framework of existing standards.

22 That's really all we are trying to say. We weren't
23 trying to prioritize.

24 CHAIRMAN POZEN: Am I correct that the subcommittee
25 was trying to say if there is an element of fair value in

1 something like leasing, that was an issue.

2 MS. BIES: But they should at least be reflecting
3 in that say new leasing standard what the framework is, their
4 state of thought now on what is likely to come out in the
5 fair value framework. That is all we are trying to say.

6 MR. DIERMEIER: When we asked the panel in Chicago,
7 when Bob Bruce talked, it was pretty clear that nobody there
8 really wanted the FASB to stop doing and being as judicious
9 as they have been all along, so the language here, as you
10 might imagine, a lot of people have commented to me that it
11 seems to give an indication or a license for the FASB to stop
12 and say look, this committee is recommending we be judicious
13 and until, so we are going to wait until we complete a
14 framework, and I don't think that's what our intent was at
15 all.

16 MR. McCLAMMY: I think at the -- I can't remember
17 who suggested it, it may have been the FASB's suggestion, we
18 came up with that language because the first language did
19 sound much more like a moratorium. We think that was the
20 word originally.

21 We did decide to change to what the suggested
22 language was, to say there needs to be a balance between
23 let's not go so rapidly that we get ahead of the system.

24 MR. DIERMEIER: Even if you change the word
25 "judicious" to "consideration," it would be possibly better.

1 It clearly says until a framework is completed. It's strong.

2 MS. BIES: I think it just gets back to sort of
3 going back to times on all the issues on revenue recognition
4 that we have struggled with over the years. If we had a
5 revenue recognition standard, it would have eliminated a lot
6 of minor projects along the way.

7 I think we are just trying to say as the FASB
8 prioritizes work, to balance these issues out. We did not
9 want to make the call on prioritizations.

10 MR. DIERMEIER: "Balance" is a good word.

11 CHAIRMAN POZEN: I'm getting down to language here,
12 Susan, as to whether -- one place says "judicious" and
13 "cautious." I thought "cautious" sounded stronger than even
14 "judicious."

15 I just observed this is kind of one of those areas
16 of clear tension between at least some investors and
17 preparers and auditors.

18 Let me make the following specific suggestions,
19 which I hope summarizes a number of points here. If we look
20 on page 29, we would drop a footnote from "judicious" that
21 would make clear that we weren't trying to stop the pension
22 and leasing projects and other things like that.

23 Second of all, we should use the word "judicious,"
24 and if there is another place where we use "cautious," we
25 should substitute "judicious."

1 More importantly perhaps in the financial statement
2 presentation following Denny's lead, we would say the FASB
3 should consider, and in the bullet "Aggregate business
4 activities," we would say something like "into appropriate
5 sections" or "segments," and then in the last one, we would
6 say something like "Consider appropriate methods or means to
7 reconcile to the extent feasible" rather than this particular
8 method.

9 On page 30, where we would be having a footnote
10 that would talk about the fact that historic costs also have
11 estimates and have some reliability and complexity issues.

12 On page 31, we would be adding something that
13 talked about fair value was a user-driven project, so we
14 would want to get that point in.

15 On page 33, in footnote 56, something along the
16 lines that Ed suggested, that we would say before adopting
17 this, we would have field testing.

18 That is my summary of what I would call
19 refinements.

20 David?

21 MR. SIDWELL: I think it would be useful to provide
22 some balance on the historic cost issues, if we specifically
23 address the issues around impairment. I think some of the
24 current debate around financial instruments obviously has if
25 they weren't at fair value, there would be a discussion about

1 how to measure impairment.

2 I would say to get some symmetry, if you are going
3 to introduce that element of issues with estimation and
4 historical cost, I think the very specific one is around how
5 you measure impairment.

6 CHAIRMAN POZEN: You are saying if we are going to
7 say -- I think the footnote here, David, was going to be more
8 sort of general, just saying that historical costs has a
9 measurement approach, involves necessarily estimates and
10 complexities.

11 I guess I was sort of hoping we would not get into
12 impairment in this, but I'm not sure exactly where you are
13 going on that.

14 MR. SIDWELL: I thought what you were suggesting,
15 which I agree with, is to create a bit more balance in this,
16 so it isn't just fair value that has a lot of issues, it is
17 the historic cost model has issues, and I think specifically
18 there is not a section around impairment, and that is one of
19 the huge judgment issues.

20 If you want to use loans as a continuation of the
21 example --

22 CHAIRMAN POZEN: I see. That is sort of an example
23 of that. Let's add that on page 30 where we have this
24 footnote on historic costs, that you ought to use impairment
25 as an example.

1 Jim, do you happen -- Adam, did we use the word
2 "cautious" instead of "judicious?" Do you know what page
3 that is

4 MR. BROWN: I believe it's in the executive
5 overview as opposed to the chapter.

6 CHAIRMAN POZEN: Oh! What page would that be?

7 MR. BROWN: Top of page six.

8 CHAIRMAN POZEN: We need to change that. We have
9 those two changes from the executive overview, the one on the
10 advisory committee and the other is "cautious" to
11 "judicious."

12 We have the four changes on page 29. Page 30, now
13 I think we understand the historic costs' footnote with an
14 example of impairment. Page 31, at the point of user driven
15 for the fair value, and page 33, footnote 56, the point that
16 Ed was suggesting in terms of field testing.

17 With that, I was hoping we might move onto 1.2.

18 Susan?

19 MR. EVANS: Bob, just a procedural point, are we
20 going to have a tentative vote on these issues today or is
21 that going to be reserved until the final meeting on July
22 31st or whatever it is?

23 MR. KROEKER: Bob, I think we should vote on the
24 recommendations today. You can do it at the end of each
25 chapter. You can do it after each recommendation, or frankly

1 you could do it at the end of discussing all the
2 recommendations. I think the objective is to vote actually
3 on the recommendations today. July 31st would be a vote to
4 approve a final report.

5 CHAIRMAN POZEN: I don't think we should do it --
6 let's do it chapter by chapter. We will get to the end of
7 the chapter and then take a vote.

8 MS. BIES: In the disclosure framework, again, I
9 think our major emphasis here is that as we move more toward
10 fair value, it's more and more important that disclosure be
11 seen as an integral part of the financial statements because
12 they describe the range of outcomes somebody could get in a
13 fair value, and rather than just relying on the point
14 estimates that appear in the recognition.

15 This is going to require, I think, not only for
16 users and preparers to learn more about how estimation is
17 done and to be able to understand these and prepare them in a
18 clear way, but we also felt here, this is where the SEC and
19 FASB together need to work.

20 We already have so many footnote disclosures. We
21 will probably end up having a whole lot more. There is
22 inconsistency with the FASB in different standards where
23 there is overlap of disclosures, and then the SEC has got its
24 own range of disclosures, some of which are inconsistent with
25 the FASB's.

1 I guess our wish here is for simplification,
2 avoiding complexity, that there be a concerted effort to try
3 and reduce the number of disclosures and make them more
4 coherent, and especially within the SEC and the FASB.

5 I think a lot of us feel that the SEC is low
6 hanging fruit here in the sense it hasn't had as much
7 attention, but we know the process may be more complicated.

8 There are differences in legal risk to the
9 preparers, depending if it's an SEC versus a FASB, and that
10 is something that needs to be thought through.

11 We are very concerned about just the burden on both
12 users and preparers around disclosure, which we think is just
13 so much more important going forward. That is the main thing
14 we are trying to get across in here.

15 CHAIRMAN POZEN: Can I just ask a point of
16 clarification? I would assume and I think we referenced
17 this, this 21st disclosure project would be broad enough that
18 some of this would be pursued as part of that. Am I right
19 about that?

20 MR. HEWITT: Yes, I'll explain that to the
21 committee at lunch. I think the 21st Century is focused on
22 two main areas, moving from a transactional framework within
23 the SEC to a company-wide framework for everything, not just
24 disclosure, but any other matters affecting that company, and
25 then also moving from a paper base to more of an electronic

1 base for users and filers to work with. I think it would
2 help.

3 CHAIRMAN POZEN: We probably ought to somewhere,
4 maybe in a footnote on page 36, reference that this is
5 complimentary to what we understand of the 21st Century.
6 That is a long time, so hopefully it won't take quite the
7 whole century to finish that project.

8 MR. HEWITT: I must say the project is envisioned
9 to take three to five years.

10 MR. KROEKER: Bob, we have it in footnote 70, page
11 40.

12 CHAIRMAN POZEN: Footnote 70, page 40. Thank you.

13 MS. GRIGGS: Bob, I had a comment on the first
14 bullet of that recommendation. I think that is an extremely
15 important recommendation, particularly as we move to the XBRL
16 format. I guess I would like to sort of add a reference to
17 the fact that the format of disclosure becomes even more
18 critical in an XBRL world because XBRL suggests a degree of
19 precision to numbers that will be lost if we can't improve
20 the disclosure.

21 MS. BIES: Good point. I think we agree that needs
22 to change. Good point.

23 CHAIRMAN POZEN: We will find an appropriate place
24 to add that thought, the format of disclosure in relationship
25 to XBRL. Good point.

1 Any other comments or suggestions?

2 [No response.]

3 CHAIRMAN POZEN: Then I think we can move onto --
4 that is 1.2 and 1.3.

5 MS. GRIGGS: Bob, I thought that was just the first
6 bullet.

7 CHAIRMAN POZEN: Excuse me. Now we move to 1.3.

8 MS. GRIGGS: I have a comment on the second bullet.
9 I would like this second bullet to be revised to delete the
10 reference to litigation and regulatory developments. It
11 sounds like perhaps we are weighing in on the FASB's proposal
12 to expand the disclosure requirements in FAS-5.

13 I can tell you that the Bar is extremely concerned
14 about that proposal because we are concerned that the
15 additional quantitative disclosures that would be required
16 would adversely affect the attorney/client privilege, and
17 would change the dynamics of the litigation system in our
18 country.

19 I don't think we want to get into that, but rather
20 just delete those words.

21 CHAIRMAN POZEN: Just to be clear, you are
22 suggesting at the top of page 36 that we just end that at
23 "recorded?"

24 MS. GRIGGS: Right.

25 CHAIRMAN POZEN: I don't know. Susan?

1 MS. BIES: We are fine.

2 CHAIRMAN POZEN: We are trying to look at 1.2 and
3 1.3 in totality. If there are other questions on those
4 disclosure related recommendations, now is the time.

5 MR. HERZ: It kind of gets to Susan's opening
6 remarks. The way we see it is this requires not just us to
7 do something but it requires us working with the SEC. We
8 have in this country, in my view, a kind of vulcanized
9 approach to disclosure, and that may be what the SEC's
10 project in part is getting at.

11 Us just providing a disclosure framework for the
12 financial statements I don't think is going to achieve your
13 overall objective for corporate disclosure, and considering
14 the overlap with the SEC stuff and the contradictions and
15 where the boundaries are, you know, what goes in and out of
16 financial's, what goes in other places.

17 It has been, to use the word again, a little bit
18 vulcanized over the years perhaps because of the different
19 legal requirements. Those have been constraints on the
20 process of disclosure.

21 I think that needs to be looked at more
22 holistically.

23 CHAIRMAN POZEN: I think we tried to capture some
24 of that in establishing a process of coordination of FASB and
25 SEC.

1 MR. HERZ: Yes. I think if you take 1.2 and then
2 1.3 sequentially, it kind of says FASB, you develop a
3 disclosure framework and then also by the way, SEC, could you
4 update and clean up your stuff. I think it is a broader
5 effort than that to get to where I understood Susan was
6 saying.

7 MS. BIES: It wasn't our intent. I agree with
8 Bob's comments. We thought we could maybe start 1.2 a little
9 differently and say something like "The SEC should work with
10 the FASB to develop a disclosure framework to integrate
11 existing SEC and FASB disclosure requirements." We have both
12 of them working independently but also coordinating.

13 CHAIRMAN POZEN: Okay. Anything else on 1.2 or
14 1.3?

15 [No response.]

16 CHAIRMAN POZEN: I have the following three changes
17 there. We will add something about the format disclosure in
18 relation to XBRL. We will make the changes in 1.2 that Susan
19 just suggested. On page 36, we will delete the "such as"
20 clause of 1.3.

21 MR. GOLDEN: And 21st Century project.

22 CHAIRMAN POZEN: And the 21st Century project, as
23 Russ just pointed out, is already in footnote 70, page 40.
24 Some of us have not quite memorized all the footnotes here
25 yet. Russ is on top of us on that one.

1 Moving now to 1.4 and 1.5 on page 41. Susan?

2 MS. BIES: The rest of this now gets into more
3 specific kind of issues as opposed to the broad brush which
4 the first ones were.

5 The first one is bright lines. We were concerned
6 that the presence of bright lines leads on the one hand to a
7 lot of sort of on and off switches and doesn't show the
8 proportionate kind of exposure you can have when situations
9 change dramatically like we have just had.

10 I know sometimes people think bright lines are
11 useful in simplifying preparation, but as we looked at this
12 issue more broadly, we came out that we felt bright lines
13 should be even more of an exception than they are. The goal
14 should be not to have bright lines, to write a standard that
15 would be clear enough to implement without the use of bright
16 lines.

17 That is basically what recommendations 1.4 and 1.5
18 are designed to say. We clearly understand in
19 recommendation 1.5 that education is very important here,
20 especially as we get into more sophisticated instruments,
21 both on the part of preparers and auditors and users.

22 As part of emphasis here, we added the need for
23 education as we move forward in some of these complex areas
24 where bright lines have historically been used.

25 CHAIRMAN POZEN: I think also we did get quite a

1 few comments on this and we massaged some of the language.

2 MS. BIES: Right.

3 CHAIRMAN POZEN: Are there comments or suggestions
4 on 1.4 and 1.5?

5 [No response.]

6 CHAIRMAN POZEN: Let's move onto page 47, industry
7 specific guidance.

8 MS. BIES: The goal here is to say over the years,
9 because we have had multiple standard setters, we have had
10 industry protocols sort of developed which are not consistent
11 for the same activity. Going forward, what we would like to
12 do is to say if it is the same activity, then there should be
13 the same accounting for it, no matter what the industry is.

14 This again is part of what the subcommittee felt
15 strongly about, if you focus on the activities as opposed to
16 the title of a company or its major business lines, we could
17 eliminate a lot of inconsistent accounting around industries.

18 What we would like to do here is basically say that
19 should be looked at as part of a clean up of a lot of the old
20 standards.

21 The one thing we like is that the IASB does not
22 have a lot of historic standards. They have a lot less
23 industry specific accounting, and we would hope that we move
24 more toward the IASB in that way and not keep the framework
25 that we have inherited over the years.

1 MR. SIDWELL: Just one question. We had used the
2 words "business activity" in 1.1. We are intending its usage
3 in this recommendation to be exactly the same as you had
4 intended in 1.1?

5 MS. BIES: I think we were trying to finesse that a
6 little, David, just from the point of view that we don't know
7 where the FASB project is going to come up, so the activities
8 of operating and investing, we think, need to be clarified.
9 We didn't try to do that.

10 I think to give you an example of what we are
11 talking about here, it isn't clear why oil and gas
12 exploration should have separate accounting from other
13 extractive industries. Why couldn't it be one accounting
14 framework for all extractive natural resources industries.

15 We didn't try to finesse that, but that is the idea
16 we are trying to get at, look at the activity, not titles of
17 assets or titles of companies.

18 CHAIRMAN POZEN: Any other questions on that? I
19 think we can move pretty quickly along here with 1.7. Why
20 don't we just do 1.7 and then we can also -- I don't know
21 whether you want to do 1.7 and 1.8 and 1.9 together, Susan.
22 How do you want to do that?

23 MS. BIES: We can do that. I think these are more
24 narrowly defined kind of topics. We can take them in any
25 order. I don't know if they need any real comments from us.

1 CHAIRMAN POZEN: Are there any comments or
2 suggestions on these? Denny?

3 MR. BERESFORD: I have one very minor editorial,
4 but it might be viewed by some people as more substantive.

5 On page 52, footnote 95, it talks about
6 complexities of hedge accounting. At the very end it says
7 "We are also aware of the FASB's derivatives project in this
8 area and are generally supportive of its progress."

9 I don't see the need for us to include those last
10 several words, similar to the comment that was made before
11 about the litigation issue on the exposure draft. It seems
12 to me we haven't as a committee looked at that in any detail.
13 I know there are some controversial issues involved in it,
14 and I would just propose that we end with "area."

15 CHAIRMAN POZEN: Any objection to that?

16 MS. BIES: No.

17 CHAIRMAN POZEN: What page is that?

18 MS. BIES: 52.

19 CHAIRMAN POZEN: Footnote 95.

20 MS. GRIGGS: Sue, I just had a question. Would
21 this proposal be understood as meaning that we would be
22 opposed to the choice in FAS-159? I guess I wouldn't want to
23 come out saying I'm opposed to FAS-159 as long as 133 works
24 the way it does.

25 FAS-159 gives companies the options of using fair

1 value in certain circumstances. Many companies have used
2 that, back in the days when a lot of banks had problems with
3 their hedge accounting and whether they appropriately
4 complied with hedge accounting requirements.

5 What many of them have done is chosen to use 159 so
6 their swaps and their instruments are both at fair value.

7 I wouldn't want to eliminate that option.

8 MS. BIES: No. I think what we would say is if we
9 had fixed the hedging criteria and modernized it in 133, we
10 wouldn't need 159. That would be the redundancy that we
11 would like to get away with.

12 MR. HERZ: The way I read the recommendation of the
13 subcommittee is that they are recommending that the FASB not
14 take on new projects that allow for optionality, so 159 would
15 be okay, but maybe phase two of 159 would not be something
16 the Board should focus their resources on.

17 Also, there is the "except in rare circumstances,"
18 so because of the stated objective that you articulated
19 related to 159, maybe in the Board's view that would be a
20 reason to do something like that. That is the way I
21 interpreted the recommendation.

22 MS. BIES: I do think we would say we would like to
23 fix 133. If the ineffectiveness goes through earnings and
24 you get the noise and the volatility, if you're saying it's a
25 hedge, then you are recognizing you are going to take that

1 ineffectiveness through earnings all the time. Isn't that
2 stronger and the framework more robust than the 133 criteria
3 which really hasn't been effective for risk management
4 programs for a couple of decades.

5 CHAIRMAN POZEN: Are we okay without changing the
6 language then?

7 MS. GRIGGS: Yes.

8 CHAIRMAN POZEN: Were there other questions on 1.7,
9 1.8 or 1.9?

10 [No response.]

11 V O T E

12 CHAIRMAN POZEN: With that footnote change on page
13 52, I think we are pretty much through chapter one. I would
14 like to see if we can have a vote of the committee as to all
15 these changes.

16 All those in favor, please say aye.

17 [Chorus of ayes.]

18 CHAIRMAN POZEN: Anyone opposed?

19 [No response.]

20 CHAIRMAN POZEN: Thank you very much.

21 MS. BIES: Bob, I just would like to take a moment
22 to thank Adam and Nili for the tremendous asset and resources
23 they were to our subcommittee. We went back and forth over a
24 lot of these issues and made them produce a lot of examples
25 for us. I just want to thank them so much for their help.

1 CHAIRMAN POZEN: I would echo that. David, if you
2 are prepared, we will go to chapter two.

3 MR. SIDWELL: I am. We are. We were a team.

4 CHAIRMAN POZEN: Why don't you take it away?

5 SUBCOMMITTEE 2 - STANDARDS SETTING PROCESS

6 MR. SIDWELL: Let me start with just one overall
7 remark, which I think we as a subcommittee really benefitted
8 from the attendance at pretty much all of our meetings. We
9 had a lot of meetings of John and Con and Jim Kroeker,
10 Shelley, Wayne, Mark Olson, Bob Herz, and a number of the
11 Board members and staff, Russ included.

12 I think we took to heart your observation that we
13 needed to come up with recommendations that reflected
14 something that was practical and doable, and we took that
15 also to mean something that the people we were making these
16 recommendations to were willing to take on.

17 I think at this point we have support for these
18 recommendations. We have based our recommendations into five
19 buckets. You can see these on page 59, around firstly how do
20 we increase the level of investor perspectives in standard
21 setting, what are some things we might do to enhance
22 governance and oversight. How might we improve the standard
23 setting process. How may we clarify the role of
24 interpretive implementation guidance and then finally what
25 about the design of standards going forward.

1 The first of these areas is one that we spent a lot
2 of time debating. I think the discussion that we have had
3 with this full committee in addition to the meeting that we
4 had in Chicago, I think the substance of what we have tried
5 to do here hasn't changed. I think the words around it have.

6 We believed that it is very important as we heard
7 from the discussion that we had earlier that the user
8 perspective, the investor perspective, be given preeminence,
9 that we spent a lot of time discussing exactly what does that
10 mean.

11 We had some comments from the letters which I think
12 show some of the active dialogue between those people who
13 believe that the investor should be given preeminence and
14 those commentators who believed that getting a balance of
15 views between preparers, academics, auditors, as well as
16 users are important.

17 In considering that feedback, we still believed it
18 is appropriate that the investor perspective be given that
19 preeminence. They are the primary consumer of the financial
20 statements. We believe it is important to give them that
21 preeminence.

22 One of the areas that we focused a lot on, and I
23 think you see this in recommendation 2.1, is it can be
24 sometimes difficult to get that involvement. Bob and the
25 team spent a huge amount of time trying to increase the level

1 of participation and I think we received good feedback from
2 many of the investors that we had communication with, that
3 there has been a lot of progress.

4 We still think there are a number of steps that we
5 can take to do that, whether it is more representation of
6 investors on the FAF, whether it's more representation,
7 however difficult to get, at the board level, at the staff
8 level, and then also making more focused use to the extent
9 possible of the various investor groups that are already in
10 place.

11 Those are really the principal ingredients in this
12 first recommendation 2.1.

13 CHAIRMAN POZEN: Are there any questions or
14 comments on that? Ed?

15 MR. McCLAMMY: Around the term of "investor
16 preeminence," I've seen that now for a while and I was very
17 comfortable with it. Over the last couple of meetings, and
18 in particular, we have had some debate over some of the
19 items, I think it's being given more prominence than may have
20 been intended.

21 I think it is starting to come across as if a user
22 group says I want this, that no matter what, we should
23 provide it. Forget the difficulty in the auditability and
24 the other factors. It's almost like they have been relegated
25 extremely far down the spectrum and just saying if the user

1 wants it, we should give it to them.

2 I think it's being interpreted certainly
3 differently than I first thought it was meant. I thought it
4 was we were trying to give the investor perspective
5 significant weight, and certainly more than it currently has,
6 but my concern is it is going to be used to say here's the
7 argument and the whole reason behind the argument is users
8 want it, so let's give it to them.

9 MR. EVANS: Ed, as you articulated it, I think we
10 were not intending to go that far. However, I think there is
11 a recognition that the investors, as we define investors
12 here, is the customer of financial statements.

13 Financial statements are a means of management
14 communicating with the investor about the activities of the
15 business and the idea is to put the investor in the same
16 position as management in terms of understanding the affairs.

17 To the extent there is some piece of information
18 that investors desire in financial statements, it certainly
19 should be debated, given serious consideration, because of
20 their preeminent role as the customer of financial
21 statements.

22 It doesn't mean we should throw all obstacles and
23 legalities and issues out of the way, but the fact that
24 investors are interested in it is by itself a reason to give
25 it serious consideration.

1 CHAIRMAN POZEN: I guess we have tried to have
2 balance here. I'm not sure that the interpretation, Ed, that
3 you're giving it is quite there.

4 MR. McCLAMMY: Again, Bob, I wasn't giving it that.
5 I'm just saying over the last couple of sessions and some
6 feedback on particular issues, it seems to be starting to be
7 used in that way. That is my concern, that after this
8 committee is gone, there is one term that is heard and
9 probably takes it too far, and I think it's that term that we
10 are going to hear back over time.

11 MS. GRIGGS: Maybe there is room for a footnote to
12 say obviously there has to be a balancing of practicalities
13 and relevance of information while meeting users' needs for
14 information.

15 MR. SIDWELL: I think you actually see it, if I may
16 point you to the first paragraph on page 61 dealing with
17 background, where I think we are trying to get this balance
18 idea across.

19 I think we are serious that we want everyone who
20 comes to the table to have a mindset of who the customer is.
21 I think that is as important as anything. We had a huge
22 debate between user and investor, and I think that
23 terminology in and of itself has proven a little bit
24 difficult.

25 MR. McCLAMMY: I agree. Don't take me wrong. I'm

1 just concerned it has gone too far. I would agree with
2 Linda's suggestion. I think sometimes the background
3 discussion, give us a sense of various people's views, it is
4 not saying we recognize any of those views.

5 I would be comfortable if we had a footnote along
6 the lines that Linda mentioned that was a footnote to the
7 proposal itself.

8 CHAIRMAN POZEN: Jeff?

9 MR. DIERMEIER: I think this is an excellent
10 section. I love the push a little bit back to the FASB to
11 see if you can source investors. I have been trying to do
12 that myself. I know the difficulty involved.

13 In terms of a footnote, maybe we can work this, my
14 take on this is a little different. I have noticed some of
15 the comments that seem to describe what you do.

16 I view the investor as sitting in the role of an
17 owner. Owners do not want their companies engaging in
18 frivolous activities, wasting time and doing things that are
19 silly. From that standpoint, I'm not sure I'd use the word
20 "frivolous" because I'd have about 100,000 people crawling up
21 my back, but the fact of the matter is the investor view does
22 not want to waste management's time engaging in activities
23 that takes them away from running the business.

24 Maybe we can reinforce that somewhere and maybe
25 that would cover your point.

1 CHAIRMAN POZEN: Let's see if we can work out an
2 appropriate footnote. I'm not sure between the two views
3 that I exactly see the wording right now. Maybe Linda will
4 give us a little help on that, somewhere in relationship to
5 page 61 we can add a footnote there.

6 MR. SIDWELL: On page 63, the bottom --

7 MS. GRIGGS: David, can I ask a question first?

8 MR. SIDWELL: Sure.

9 MS. GRIGGS: I notice that you define on page 62
10 the kind of investor that you believe should be recommended
11 for membership on the board. It's an investor whose primary
12 professional experience is as an investor and is also well
13 versed in the conceptual foundations of accounting.

14 Is that the definition that you intend for investor
15 in the rest of the recommendation or is that only for the
16 board member?

17 MR. SIDWELL: This was primarily for the board
18 member. We actually had a huge debate on this point in the
19 sense that I think we were trying to get what is somebody's
20 primary background. Where do they really spend their time.

21 We were very concerned that it would be very easy
22 to have somebody who had been a preparer for 20 years and
23 they are now one year in the role of working for a fund, not
24 as an investor but as some type of other role. We didn't
25 want that to be the characterization of the type of person.

1 CHAIRMAN POZEN: I don't think we are using -- that
2 is a very specialized definition, and it is not the general
3 definition of an investor.

4 MR. EVANS: That was simply a definition of the
5 type of investor we would want to put up for the FASB Board.
6 They would need special accounting knowledge that most
7 investors who are the customers of financials wouldn't
8 necessarily have.

9 There is a definition of investor in one of the
10 footnotes here which is much broader.

11 MS. GRIGGS: Right, it is. I just wanted to make
12 sure.

13 CHAIRMAN POZEN: This also says ideally. Should we
14 move to 2.2 now?

15 MR. SIDWELL: We would like volunteers for board
16 members.

17 MR. HERZ: From investor organizations, we have
18 tried, not very successfully. You have to give people
19 training, CFA training, all that kind of stuff.

20 CHAIRMAN POZEN: I'm sure once this report comes
21 out, you will just be flooded with people who will want to do
22 this.

23 MR. HERZ: Given the state of the market, we might
24 be just fine.

25 MR. SIDWELL: 2.2 starts at the bottom of page 63.

1 Again, just to provide you a little bit of a context for
2 this, our first work on this was back in the winter, the same
3 time that the FAF was coming out with a number of
4 recommendations. We were broadly supportive of those
5 recommendations.

6 There were a couple of areas where we felt there
7 could be enhancements. One was in the area of just
8 explicitly putting into the mission statement of the FASB an
9 additional goal that that should be a goal of minimizing
10 avoidable complexity and again the choice of words there was
11 "avoidable" linked with "complexity," recognizing that
12 complex things sometimes need complex solutions.

13 The second aspect, obviously, as we think about the
14 process of setting standards, many of these projects last a
15 long period of time, as the FAF has stated that it is going
16 to increase its level of governance over the FASB, we believe
17 that should include introducing performance measures over
18 many of the processes.

19 We think this is actually very important because
20 one of the pieces of feedback that we have received is are
21 our recommendations going to slow down the process. We
22 actually don't think they should, and obviously one way of
23 assuring they don't is through having well designed
24 performance metrics to make sure that the process is working
25 effectively in compliance with the objectives that the FASB

1 has laid out.

2 That is the body of 2.2.

3 CHAIRMAN POZEN: Do we have any questions or
4 comments or suggestions on 2.2?

5 [No response.]

6 CHAIRMAN POZEN: Let's move onto 2.3.

7 MR. SIDWELL: 2.3., which is at the bottom of page
8 65, we had a lot of discussion in this area. These are
9 really the process improvements around actually how the
10 process itself works.

11 Let me deal with the least controversial of these,
12 which is we have a recommendation here which is that the FASB
13 continue its efforts around ensuring the consistency and
14 transparency of what we are terming "field work," which
15 includes things like cost/benefit analysis, field visits,
16 field testing.

17 I think we received a lot of positive comments
18 through the letter process and through the various meetings
19 we have, that there has been an improvement in these areas,
20 but obviously these are things that can continue to be
21 enhanced over time.

22 The area where we probably have had the most debate
23 and have actually changed the name, not as subterfuge, but to
24 make it clear about what the goal is, if you remember, we had
25 a lengthy discussion about something called the "agenda

1 committee." We have now changed that to be more
2 comprehensive, into something called the "financial reporting
3 forum." We talked a little bit about this at the beginning
4 of the meeting.

5 We think there is a huge opportunity to create an
6 active dialogue, to formalize, if you like, many of the
7 informal discussions that go on between many participants in
8 the financial reporting system, not just the FASB. I think
9 it is important to see this broadly, where there can be a
10 real discussion about what are the issues that are current.
11 How should those issues be resolved. Let's have an active
12 dialogue. Let's also think through the priorities that the
13 FASB is dealing with and give advice to Bob on those
14 priorities.

15 We think this is very complimentary to the changes
16 that the FAF introduced, to make the agenda more under the
17 control of the FASB chairman. We think this creates a good
18 ability to have an active discussion amongst what I call the
19 principals in the financial reporting system, whether it's
20 members of the SEC, whether it's Mark and the PCAOB, users,
21 investors. We think this plays an important role.

22 We did receive a fair amount of commentary on this.
23 One of the elements of the commentary was -- we did not
24 intend this -- there was some confusion in what is the role
25 of this group compared with the role of say FASAC. We see

1 these roles very differently.

2 We see this as a group that has to meet frequently,
3 may have to meet on the spur of a moment if a large issue
4 emerges, and we think again, it's very much principle to
5 principle in how issues should be discussed and how they
6 should be resolved.

7 I don't know if anyone else on the committee wants
8 to add to that.

9 CHAIRMAN POZEN: There is also the other parts of
10 this.

11 MR. SIDWELL: I wanted to pause it at that point.

12 CHAIRMAN POZEN: I guess the only thing I ask Jeff
13 again, you probably have to scrub a little of the language
14 here on page 68, to avoid an advisory committee; is that
15 correct?

16 MR. MINTON: That's correct. We'd had to scrub
17 that. The SEC, we can and we do along with FASB and the
18 PCAOB meet with people to get information, but to the extent
19 that it relates to getting consensus advice or
20 recommendations from the group to the agency, we have a
21 provision for that under the law to maintain the transparency
22 and that it is fair and balanced, and that is the Advisory
23 Committee Act. We would have to make sure if that isn't what
24 is intended, that the SEC's role is probably going to need to
25 be more limited as far as just receiving information.

1 Of course, we can't take consensus recommendations
2 on perceived issues from any group outside of kind of the
3 formal comment process.

4 MS. GRIGGS: David, the way you described this
5 group, it sounded like it would be to make recommendations to
6 the FASB, perhaps the PCAOB. You didn't say make
7 recommendations to the SEC. Perhaps I misunderstood and
8 there isn't an issue, as long as the group is really focused
9 on the FASB and the PCAOB and not the SEC, then --

10 MR. SIDWELL: I viewed this in a way as operating
11 in the way the EITFs do. I want to be careful about using
12 that as a model because I don't mean it other than the SEC is
13 at the table, and if there is something that the SEC should
14 be dealing with, I think they, the EITFs, can express that
15 view.

16 I just don't want to get caught up, and we should
17 work out the logistics of how we phrase this. I think it is
18 saying they are a very important partner in this. We, for
19 instance, and there is wording later on, that this can play a
20 very important role just making sure that if there's an issue
21 that the SEC wants to deal with, we can have that discussion
22 including Bob, to make sure it's appropriate, that isn't
23 something that the FASB should take on.

24 I think we feel that the responsibility for GAAP
25 should lay with the standard setter. We want to make sure

1 that to the extent possible a lot of the implementation
2 guidance, interpretive guidance, comes out of the FASB.

3 Part of this is how do we create authoritative
4 accounting guidance in the way that the codification does
5 that. We think again this reporting forum can provide the
6 body to do that.

7 CHAIRMAN POZEN: Bob Herz.

8 MR. HERZ: This is something I believe in pretty
9 strongly. Again, if you look at certain other countries'
10 financial reporting systems, they have what is called like a
11 financial reporting council or something like that, that
12 includes --

13 CHAIRMAN POZEN: I'm sure they will want to change
14 it now to "financial reporting forum."

15 MR. HERZ: Yes, but it has been structured that way
16 purposely and mindfully whereas it includes the accounting
17 standard setter, representatives of users, preparers, the
18 regulators, the auditing standard setter/inspector, and the
19 like. That is a model in a lot of other countries. I think
20 it probably may work better than our model which again is a
21 little bit -- it's kind of a patchwork over time of
22 organizations that arose.

23 We have what we have. We have to kind of deal with
24 it in the bounds of the existing requirements and to a
25 certain extent the vulcanization of our system, and we have

1 put into place kind of patchwork communications, you know,
2 where the SEC, us, and the PCAOB will get together and do
3 this kind of thing.

4 We don't have -- individually, we have our advisory
5 groups, and in the PCAOB, although there is a lot of overlap
6 of those people as well.

7 This is just intended to be a mechanism to say we
8 have kind of an issue in the system, there may be different
9 ways to take care of it or maybe users don't even care about
10 the issue, before we kind of run and do something and add
11 regulations or disclosure requirements or whatever, in an
12 area where users/investors say they don't really care about.
13 It's more about a dispute between two accounting firms or
14 accounting firms and the SEC or whatever.

15 It's trying to create a little bit more of an
16 organized mechanism for the system to deal with system
17 issues.

18 MR. OLSON: Let me just agree with Bob on this. We
19 see real value. I think Bob referred to it as a "patchwork."
20 I think "patchwork" or "informal" would describe it, useful
21 but informal. "Patchwork" is a communication network. To
22 formalize the arrangement makes a lot of sense.

23 I would, however, try to avoid adding granularity
24 or specificity to it because I think as David just pointed
25 out, it ought to react to whatever the circumstances and the

1 issues of the day are, and not try to define at the front end
2 of the process exactly with precision what the group's role
3 is.

4 CHAIRMAN POZEN: Jim, did you want to add
5 something?

6 MR. KROEKER: We also agree with the objective of
7 the group. Jeff's comments aren't indicating somehow a
8 resistance to the notion. It is really if it is intended to
9 provide advice to the SEC, that's a whole different animal
10 than a body that would talk about issues and people would be
11 informed and then the SEC would walk away making its own
12 decision as opposed to consensus advice which would be a
13 factor.

14 CHAIRMAN POZEN: I think we have all been
15 sensitized to the breadth of the Advisory Committee Act
16 through this process.

17 David, do you want to continue?

18 MR. SIDWELL: Yes, just one other aspect I just
19 wanted to draw people's attention to which is the bullet at
20 the top of page 66. We had discussions, I think, when the
21 committee met before, and that is to deal with this question
22 of option reviews. We have just clarified in our language
23 that this was not meant to be a forbearance period where
24 people were allowed a free pass on doing whatever they
25 wanted, and that was something that clearly was not our

1 intent in the original language that we had used.

2 We did receive a lot of comment on this in the
3 comment process, as you can see on page 13 of the comments.
4 I think we have tightened that up satisfactorily in the
5 wording we now have.

6 CHAIRMAN POZEN: David, did you want to say
7 anything more about pages 69 through 72?

8 MR. COOK: Bob, can I ask a question before we
9 leave that section?

10 CHAIRMAN POZEN: Yes.

11 MR. COOK: This is sort of a question for David but
12 it is also a question back to page 36 in recommendation 1.3
13 from the first chapter, which I happen to agree with, the
14 notion, but it is directly solely at page 36 to the SEC, to
15 periodically review its disclosures and take them out when
16 they are no longer necessary because the FASB has done
17 something and so on.

18 I realized the last bullet on page 66, formalized
19 periodic assessment of existing standards, could comprehend
20 disclosure as well as accounting. There is a great deal of
21 complexity because of voluminous disclosure.

22 It isn't by any means a residential property only
23 of the SEC.

24 When you read the narrative supporting that last
25 bullet, at least I come away with the notion that we are

1 talking about challenging the accounting. I just wonder if a
2 little bit of additional wording or something that clearly
3 says that what we mean here is the FASB ought to look at all
4 of its disclosure requirements as well in existing standards,
5 and maybe keep them fresh means get rid of the ones that are
6 no longer relevant, but the volume of disclosures is just
7 overwhelming, and I think one of the real sources of
8 complexity because people look at 40 pages of footnotes and
9 throw their hands up and don't even try, because they can't
10 find what is really important, and yet our only specific
11 recommendation is addressed to the SEC as opposed to the
12 FASB.

13 David, I would just ask that you look at that.

14 MR. SIDWELL: We have actually incorporated that.
15 Maybe it's a placement issue. If you would go to page 75.

16 MR. COOK: Okay. I may have missed it.

17 MR. SIDWELL: It doesn't jump off the page. If you
18 look under "second phrase of codification," I think we are
19 obviously very mindful in a lot of this journey that
20 priorities are going to depend on the decisions about the
21 international standards for domestic issuers.

22 We, however, are saying here that we would think
23 that depending on the timing and whatever action the SEC
24 takes with respect to any move if any to using IFRS as
25 opposed to FASB, that we were saying here -- this is in six

1 and seven -- that there should be attention given to the
2 question of disclosures.

3 We recognized that it was important. We didn't
4 want to over emphasize it as a priority until the question of
5 whose standards we are using is clarified.

6 MR. COOK: I think it will get you there. I think
7 what I was thinking more about was a free standing charge to
8 periodically take a look at the disclosures that are required
9 and challenge whether they continue to be relevant without
10 regard to hitching it to the wagon of convergence or anything
11 else, pretty much like we have the recommendation in the
12 first chapter about the SEC doing it. It isn't do it as a
13 part of the convergence process but do it.

14 I'd like to see us give the same sort of guidance.
15 I don't want a big deal, just a little bit more specific
16 about disclosures.

17 CHAIRMAN POZEN: I think this is what we have in
18 disclosures, and we have now broadened it on page 36 to
19 include FASB, the SEC and FASB, to regularly update as
20 appropriate disclosure requirements.

21 MR. COOK: That is for the Commissioners.

22 Do we have a recommendation like that for the FASB
23 rather than for the Commission?

24 CHAIRMAN POZEN: Susan?

25 MS. BIES: Yes, I think Mike has a great point. I

1 think we just say "after coordination" for the Commission, we
2 ought to insert "FASB." We want FASB to update these, too,
3 but I want to reflect some of this other dialogue about
4 looking at it for relevancy going forward.

5 I think we could wordsmith this because what you
6 are expressing is what we intended. It would make us more
7 consistent with David's point.

8 CHAIRMAN POZEN: I also think that if we look at
9 page 36 that we only talk about new standards and that we
10 ought to talk about existing standards. I think we can
11 broaden this recommendation on 36, I think, and then maybe
12 have a cross reference.

13 MR. HEWITT: On 66, could it be helped simply by
14 that last bullet, say "Formalize a periodic assessment of
15 existing standards to keep the standards including
16 disclosures current?"

17 MR. GOLDEN: I interpret "current" as consistent
18 reporting and disclosure based on current economics, whereas
19 1.3 was making sure the SEC and the FASB's requirements are
20 aligned.

21 When we issue a new standard at the FASB, we will
22 update the existing disclosure requirements. You see that as
23 we black line, but I thought 1.3 was make sure there is
24 coordination between the FASB change and any current SEC
25 disclosure requirements.

1 For example, right now, the SEC has put out or is
2 about to put out proposing changing oil and gas. That may
3 impact something that is the FASB standard. We would want to
4 make sure that as you complete that requirement, as you
5 change oil and gas, we also make a consistent change in GAAP
6 literature so that it is aligned.

7 That is what I thought 1.3 was, or as 2.3 was,
8 after a period of time, every two or three years, we should
9 go back and make sure that all of the prior standards have
10 kept current with changes in the economic environment, which
11 would include disclosures.

12 MR. SIDWELL: I think we were clearly contemplating
13 and maybe it's not reflected well in the focus that we are
14 giving it, but I think we were clearly contemplating a
15 rationalization of disclosures, both FASB and SEC, as a
16 project. We just pushed it back given all the other
17 priorities around convergence.

18 We can easily add that as a bullet.

19 MR. HERZ: I think the recommendation, the re-
20 worded recommendation in Susan's subcommittee's chapter about
21 the disclosure framework is really the starting point.
22 Unless you have a framework, you don't know to eliminate,
23 reorganize, how to add things, whatever.

24 I think the starting point is the framework and the
25 framework in my view needs to include not just financial

1 statement disclosures but also the whole package of
2 disclosures, what goes where, those kinds of things.

3 I think that's very important whether we stay with
4 U.S. GAAP and SEC reporting in this country or we move to
5 IFRS plus some SEC reporting.

6 CHAIRMAN POZEN: Mike?

7 MR. COOK: If that is said here somewhere, what I
8 was trying to get to is something -- that we have sort of a
9 sense of a review concept, but it seems to be focused on the
10 accounting and in conjunction with new standards.

11 Some of our most voluminous standards are not new
12 at all. They have been there forever. I don't want you to
13 do a new standard on segment reporting, but I really would
14 like you to go back and take a look about the effectiveness
15 of the present disclosures required with respect to segments,
16 in view of all the other things that have been added on.

17 That is what I was getting at. Don't do a new
18 standard as the reason to go back and look or don't wait for
19 the SEC to do something. Somebody do a sunset review from a
20 disclosure perspective.

21 MR. HERZ: If we had a framework, we could then go
22 and say okay, let's look at the whole thing, and how do we
23 fit it into that framework.

24 MR. COOK: I just want that notion --

25 MR. HERZ: It may be past my term though.

1 MR. QUIGLEY: The only point I was going to make,
2 Bob, was just endorsing Jim's suggestion in the last bullet
3 on page 66 of the recommendation, if we just simply inserted
4 the words "keep the standards and disclosure requirements
5 current," I think that would pick up Mike's point.

6 That is definitely consistent with the tone of our
7 discussions as a committee, I believe.

8 CHAIRMAN POZEN: Yes. I think that is a good
9 specific suggestion. The last bullet on page 66, we would
10 say "Periodic assessment of existing standards along with
11 related disclosures" or something like that.

12 On 1.3, we can just -- Susan, if you want to
13 broaden that a little. I think it is probably useful -- this
14 is the existing, keep that in 2.3 -- we can fool around with
15 the language.

16 Mr. HEWITT: The last bullet point there on page
17 66, I think the suggestions are very good. I'd like to see
18 something added that these standards are kept current based
19 on changing economic conditions or something to that effect.

20 CHAIRMAN POZEN: Let's see what we can do with page
21 66, that bullet.

22 MR. SIDWELL: Bob, I think we will just need to
23 make sure as we amend chapter one, there is a reference on
24 that page, in the paragraph on page 75, right at the back,
25 where we reference this disclosure framework that Bob was

1 talking about.

2 We just need as we change chapter one to make sure
3 whoever has the pen makes conforming changes.

4 CHAIRMAN POZEN: I think on chapter one, we do have
5 a cross reference in footnote 57, so on page 75, we will have
6 another cross reference, just to tie it altogether. I think
7 we will have achieved Mike's very good point here.

8 MR. WHITE: If we do end up back in chapter one on
9 1.3 working on this and we make some references to the oil
10 and gas example --

11 CHAIRMAN POZEN: I don't think we are going to do
12 that. We are definitely not going to do that.

13 I think what we are really talking about is 1.3, if
14 I understand this, just to say the SEC and FASB should also
15 establish a process of coordination for the Commission and
16 FASB to regularly update. We are just going to add the words
17 "and FASB."

18 Here, page 66, add disclosure and on page 75, a
19 cross reference. We are going to try to stay away from that
20 particular controversy.

21 Thank you, Mike. Jeff?

22 MR. DIERMEIER: David, in some of the comments,
23 their concern is in an environment of standard setting where
24 sometimes a decade is kind of termed the short term, the
25 concern is this looks like it adds bureaucracy.

1 I wonder if you should include a statement
2 something to the effect that this may look to some like it
3 adds the bureaucracy but that we believe in fact this will
4 increase efficiency and effectiveness, which are the major
5 objectives, and go directly at it, and if you can actually
6 describe that a little bit better for the rest of us that
7 haven't been so involved.

8 We listened to Bob say we think this helps. I
9 don't know if the FRF has been viewed as more efficient, so
10 to speak.

11 MR. SIDWELL: We do say somewhere, in fact, I can't
12 actually point you to it, but we will make sure we highlight
13 that. I know we say it somewhere. We will make sure we
14 highlight it.

15 CHAIRMAN POZEN: I think we are at 72.

16 MR. SIDWELL: This recommendation is directed at
17 saying that when we think about interpretative implementation
18 guidance, that we want to emphasize there should be a single
19 standard set of authoritative accounting standards and
20 interpretative guidance, and obviously for U.S. GAAP, we view
21 that as the FASB, and the SEC should only issue broadly
22 applicable guidance in limited situations.

23 We think the FRF can be a good focal point for a
24 discussion of what is the FASB doing to address an issue and
25 the SEC might well say that's not fast enough, et cetera, so

1 guidance is very appropriate. We are not trying to cut that
2 off.

3 I think this whole question of authoritative versus
4 not authoritative is aided by the codification which the FASB
5 has issued, which again we received very positive feedback
6 on, and does create the definition of "authoritative
7 guidance."

8 I think what is important, we are not trying to cut
9 off other guidance being issued. Again, I think that was
10 some of the feedback that we have had. We just want that to
11 be viewed as non-authoritative and that does not -- should
12 not be viewed as creating de facto GAAP. It should be
13 considered by registrants but it doesn't necessarily mean
14 other well reasoned documents, documented arguments, are
15 necessarily as equally valid.

16 Finally, this recommendation has an aspect that the
17 FRF can provide advice to the FASB on the prioritization of
18 its agenda, to make sure it's staying very current with the
19 issues, and probably just as importantly, providing Bob and
20 the rest of the FASB Board with an ability to say, you know,
21 you're not going to be able to get all these things done,
22 here are the three priorities that we would re-emphasize.

23 This is very much directed at trying to create an
24 environment where it's very clear that authoritative guidance
25 comes out of the FASB, that the SEC will do it periodically

1 when necessary, and that one body of non-authoritative
2 guidance has no greater credibility than another in forming a
3 rational judgment as to an accounting matter.

4 CHAIRMAN POZEN: You're encompassing -- you also
5 were talking about 2.5 as well as 2.4; is that correct?

6 MR. SIDWELL: Yes.

7 CHAIRMAN POZEN: We're also talking about trying to
8 re-emphasize the registrant specific aspects of certain
9 comment letters.

10 I now open the discussion for 2.4 and 2.5.

11 MR. McCLAMMY: I have one suggestion on 2.5, on the
12 recommendation language. It is close to the bottom. It says
13 "By changing their accounting only after concluding it is
14 appropriate to do so," on page 77, there was that same
15 concept and it had added in there, after "concluding," it
16 said "on their own, that."

17 "By changing their accounting only after
18 concluding, on their own, that it is appropriate to do so."
19 I thought that more clearly got the point across. Again,
20 I'll pulling that language straight from page 77.

21 CHAIRMAN POZEN: I see. That is in the next to
22 last paragraph on page 77, "Unless the registrant concludes,
23 on its own, that it is appropriate to do so."

24 Does anyone object to that?

25 [No response.]

1 CHAIRMAN POZEN: Okay. We will add that.

2 MR. SIDWELL: The final section --

3 MS. GRIGGS: I just had some questions on 2.4. I
4 thought the executive summary and some of the text was a bit
5 inconsistent with the way the second bullet read as to the
6 SEC trying to get its authoritative literature integrated
7 into the FASB codification. I wasn't quite sure what we meant.
8 We seem to be saying it different ways different places.

9 CHAIRMAN POZEN: This is a bit of an arcane point.
10 I understand the SEC can't be directly into the codification.
11 What exactly is it?

12 MR. MINTON: Right. At a base level, the
13 codification is a private sector publication. The SEC, to
14 make sure there is full free access to information, we have
15 to put out our authoritative literature in certain ways
16 including through the Federal Register and into the CFR.

17 There are consistent requirements across agencies
18 so that whenever somebody is looking to the Federal
19 Government, they can follow the same format.

20 We have been working with the FASB in an attempt to
21 improve the usefulness of the codification, that they do
22 include some SEC literature in there, and we have worked with
23 them in including some things, that you need to realize that
24 the authoritative literature still comes out of the SEC and
25 this is to improve the usefulness.

1 CHAIRMAN POZEN: Maybe I'm being too simplistic
2 here. It would seem that although it's a private document
3 codification and the SEC has to go through its process, that
4 once the SEC has adopted these interpretations or rules, that
5 it could be then incorporated into the codification.

6 MR. MINTON: Absolutely. I think one of the things
7 at least as I understand was being discussed is the
8 codification uses very specific types of topic references and
9 paragraph references that may be a little different from what
10 we are required to do as a Federal Government agency, as far
11 as paragraph numbering.

12 It is a little more, I think, on the technical side
13 than whether the FASB can include copies of the literature.

14 CHAIRMAN POZEN: Bob?

15 MR. HERZ: Codification, think about it. Think
16 about a balance sheet such as inventory. Then for each
17 subject, it has scope definitions, initial recognition,
18 subsequent recognition, measurement, disclosures, things like
19 that. It's in a standardized format that we use.

20 The Commission's documents are not organized that
21 way, and since they were official Commission documents, they
22 can't just chop them up into those kind of pieces and slot
23 them in.

24 What happens is each topic, and sometimes by sub-
25 topic, will be able to take their documents and just put them

1 in the right place but verbatim, without doing all the
2 chopping up that we have done of the existing accounting
3 literature.

4 It's just because they are official documents and
5 they can't be changed without official processes.

6 MR. SIDWELL: So, it's a pragmatic wording around
7 look, ideally, this stuff would just be all put together. I
8 think the wording is trying to just deal with the
9 practicality of the situation.

10 MS. GRIGGS: I just suggest conforming the wording.

11 CHAIRMAN POZEN: Which wording are we talking about
12 here exactly?

13 MS. GRIGGS: It's the language, "The SEC should
14 ensure that the literature it deems to be authoritative is
15 integrated into the FASB codification to the extent
16 practicable or separately codified as necessary."

17 That wording, I think, should be in the executive
18 summary, and should be later on in this chapter.

19 CHAIRMAN POZEN: I don't actually like the phrase
20 "or separately codified."

21 MS. GRIGGS: Of course, it is already separately
22 codified anyway.

23 CHAIRMAN POZEN: Yes. I think we should just end
24 it "to the maximum extent practical" or something like that.

25 MS. GRIGGS: But the executive summary needs to be

1 conformed to that.

2 MR. MINTON: The executive overview?

3 MS. GRIGGS: I mean the overview.

4 CHAIRMAN POZEN: Okay.

5 MS. GRIGGS: I just had a request that Jeff, you
6 look at the last sentence of the second paragraph on page 77,
7 because of the Advisory Committee Act.

8 MR. MINTON: I'm sorry.

9 MS. GRIGGS: It is the last sentence of the second
10 paragraph on page 77. "SEC staff should seek at a minimum
11 the views of the FASB Chairman and the proposed FRF before
12 issuing broadly applicable interpretive implementation
13 guidance." I don't think you can say it that way.

14 MR. MINTON: We will take a look at that along with
15 the other language to make sure we are all kosher.

16 MR. SIDWELL: I want to make sure we don't lose the
17 essence of that, because I think to be maybe politically
18 incorrect, what we are trying to address here is the fact
19 that in the absence of some type of exposure period, how do
20 we make sure that guidance at least gets a quick review to
21 make sure that the FASB or any other body, there isn't
22 something they are doing or some other answer that should be
23 considered.

24 This was trying to address that. I think whatever
25 words we choose, I think the substance is to try and make

1 sure in the absence of a formal exposure period, that
2 anything that's substantive, to use a word I'm really not
3 defining, gets some type of review by Bob.

4 I think we just need to be careful in choosing the
5 words not to remove what we were really trying to say.

6 MR. MINTON: Linda, I think your point is not so
7 much the FASB Chair, but the financial reporting forum,
8 whether in some way the financial reporting forum is being
9 given materials that are not being broadly exposed and they
10 are providing input and advice to the SEC staff on what they
11 should do, which is a select body under the Advisory
12 Committee Act type thing.

13 MS. GRIGGS: I just thought seeking the views of
14 either of them, you might not want to write it that way. It
15 sounds like you're getting their input.

16 CHAIRMAN POZEN: Linda is bringing up a separate
17 issue, Jeff. Any more comment on that?

18 MR. COOK: A different item. I just want to ask a
19 question. John, is it your expectation or have you ever
20 stated an expectation that registrants will monitor comments
21 issued to other registrants and respond to them? "Respond to
22 them" is a troubling notion here. It sounds like you have to
23 respond to somebody else's comments.

24 Is that expected? I don't think it is and I don't
25 think it's commonly done. I just don't know.

1 MR. WHITE: Maybe we don't have the right word in
2 here, but no, that is certainly not expected.

3 MR. COOK: The notion here, I think it conveys the
4 notion that somebody is going to be aware of other people's
5 comments and respond to them. I think that's not common
6 practice nor should we suggest that would be a requirement.

7 People might monitor comments for others in their
8 industry, you know, there might be specific companies that
9 they follow, but generally speaking, unless somebody brought
10 it to the company's attention that somebody else had gotten a
11 comment and by the way, you do the same thing they were told
12 they can't do any more, I would think this responding to
13 comments' notion would be a bit troubling.

14 MR. SIDWELL: The issue that we were trying to
15 address, and we can work on the wording, is company A in an
16 industry is aware that company B has a comment letter on
17 something that is also a business activity, to use Sue's
18 comment, that they are also involved in, and they say because
19 company A has received that comment, I need to change my
20 accounting.

21 A comment letter does not in and of itself create a
22 requirement that another company changes its accounting.
23 That was the scenario.

24 MR. COOK: I was trying to take it just one step
25 further and say I don't think there is any requirement nor

1 should we suggest one for companies to even be aware of
2 comments that are being received by other companies because
3 that's a huge undertaking and maybe big, big companies with
4 big, big staffs can do that, but most people can't do that.

5 I would have been happy if this sentence stopped
6 after "specific." "And that other registrants should respond
7 to comments" is a notion I don't think we --

8 MR. McCLAMMY: You could really probably get the
9 message across or the intended message, I think, by reversing
10 that and say "should not react to those comments." I think
11 that's what we are saying.

12 The example came from public accounting firms who
13 are aware of them, going out to other clients and saying
14 here's the comment, so we think you should apply it, but in
15 most cases when you dig into it, they don't have the facts
16 about the specific underlying reason for it or whether it was
17 just for expediency sake, that there was a question, and to
18 get a filing completed, the person just said, well, we aren't
19 going to even respond, we are just going to do it.

20 CHAIRMAN POZEN: I think the problem is not that
21 there is any obligation but there is a sort of informal
22 network where people get this. Maybe we could just change
23 this language to say that "One registrant should not change
24 its accounting if it becomes aware of a comment issued to
25 another registrant" or something like that.

1 MS. GRIGGS: "Simply because."

2 MR. COOK: I can certainly see a circumstance where
3 the firm would come to the financial management or the audit
4 committee and say we understand that so and so got a comment
5 that you can't use this depreciation method any longer in
6 this industry. You say, wow, we're in that industry, and we
7 use that depreciation method, we better take a look.

8 I understand that could happen, but I sure wouldn't
9 like to suggest responding to comments that go to other
10 people is somehow something that a company has any obligation
11 to do as opposed to being responsive to things that are
12 brought to their attention.

13 CHAIRMAN POZEN: We are saying it should not change
14 its accounting simply because it becomes aware of a comment
15 issued to another registrant, something like that.

16 MR. WHITE: Yes, I think that works.

17 MR. SIDWELL: Design of standards which is on page
18 78, recommendation 2.6. This is a little bit motherhood and
19 apple pie. We are trying to avoid this being -- principle
20 based is not something that means a whole lot in terms of
21 actually how you do it. I think we were just trying to be a
22 bit more pragmatic saying there are steps in trying to do
23 this that the FASB is doing. There has been a lot of
24 research done by a number of people including the accounting
25 firms and we encourage the FASB to continue to pursue using

1 clearly stated objectives, outcomes and principles as the
2 basis for standards.

3 MR. COOK: Linda has pointed out to me one of my --
4 what page is that? I missed that completely.

5 MS. GRIGGS: 78.

6 MR. COOK: Thank you. Where there is a suggestion
7 in this particular recommendation, and I don't know why I
8 didn't comment on this before, that accounting --

9 CHAIRMAN POZEN: Which page are we on?

10 MR. COOK: I'm on recommendation 2.6. Linda has
11 helped refresh my memory. I just went right by this.

12 Accounting should result in the faithful
13 representation of the economics of transactions, where we
14 have worked very hard to say that accounting doesn't do that,
15 and lots and lots of accounting results are not related to
16 the economics of a transaction, and we even have a section in
17 our chapter which says we're not going to be able to make
18 accounting do that. People can change standards but at the
19 present time accounting doesn't necessarily reflect
20 economics. Lease accounting doesn't reflect economics.
21 Pension accounting doesn't reflect, pick your favorite one
22 you want to debate about.

23 CHAIRMAN POZEN: I don't know if it's necessary for
24 this recommendation, David.

25 MR. SIDWELL: I guess the question is when we think

1 about the future and designing standards in the future, isn't
2 this the standard we want?

3 MR. COOK: Maybe why I went by it. This ia bug-a-
4 boo for me and I didn't even pick up on it until Linda just
5 pointed it out.

6 MR. SIDWELL: Do you accept it as a forward looking
7 aspiration? I think that was our intent.

8 MR. EVANS: We should attempt to faithfully
9 represent economic transactions wherever possible. It may be
10 something that's tough to achieve, but this is aspirational,
11 the whole thing.

12 CHAIRMAN POZEN: We probably need to change the
13 language to make clear that -- maybe we should say primarily
14 by increasing the use of clearly stated objective outcomes
15 and principles and being responsive to investor and other
16 user needs while in the future, you know, trying to
17 capture --

18 MR. COOK: Seeking to reflect the --

19 CHAIRMAN POZEN: If we take that and put it at the
20 end, we can make it more future oriented. We will just make
21 it even clearer that it is future oriented.

22 MR. SIDWELL: With that, I'm glad to end chapter
23 two.

24 CHAIRMAN POZEN: Just to tie up one little piece
25 here, on page six of the executive overview, we want to say

1 something like "Further, the SEC should _____ its guidance on
2 accounting matters in a format consistent with one used by
3 FASB to maximize the integration of the SEC's within the
4 codification."

5 MR. SIDWELL: I think the suggestion, Bob, was a
6 proactive one of saying the SEC guidance similar to FASB's is
7 in many different places. This was to say that if the FASB
8 effort is being useful, which I think it has been, we should
9 be encouraging the SEC to undertake a similar effort to pull
10 together its guidance in some type of subject matter way.

11 I don't think you want to necessarily lose that
12 element.

13 MS. GRIGGS: But the SEC does have a codification
14 of its guidance. Maybe it has two codifications but it has
15 the financial reporting release codification and then it has
16 the staff accounting bulletin codification.

17 MR. HERZ: Codification, the SEC's financial
18 reporting, by the title of the document, it is not
19 necessarily kind of integrated by --

20 MS. GRIGGS: No.

21 MR. MINTON: It has a topic list.

22 MR. HERZ: It has a topic list but it's not kind of
23 -- accounting stuff is not organized by accounting kind of
24 logic.

25 MR. MINTON: It's not organized by the codification

1 topics. There is a section on accounting for annual
2 statements, accounting for interim statements, independence
3 of auditors. It uses a system that was developed way before
4 the codification and way before computers actually.

5 MR. SIDWELL: The spirit of this was to suggest
6 that we are trying to go for ease of access, not the fact
7 that a codification exists. That is not what we are saying.
8 This is to create something which facilitates people being
9 able to find information easily and quickly.

10 Whatever words we want to put, but that's the
11 spirit that this recommendation has.

12 CHAIRMAN POZEN: We're really saying to help
13 integrate SEC accounting guidance into the private
14 codification, we are urging the SEC to try to the extent
15 feasible to keep its -- to construct its interpretations in a
16 manner that would fit in.

17 MS. GRIGGS: Like the language in 2.4, the way we
18 changed it.

19 CHAIRMAN POZEN: Okay. I just need to capture
20 that.

21 V O T E

22 CHAIRMAN POZEN: i think we are now at the end of
23 chapter two, and we can take a vote. All those in favor.

24 [Chorus of ayes.]

25 CHAIRMAN POZEN: Any opposed?

1 [No response.]

2 CHAIRMAN POZEN: John?

3 MR. WHITE: Just because of the amount of
4 interaction there was between the members in subcommittee two
5 and the SEC staff, I guess I just wanted to particularly
6 thank Jim and Scott and Denny and David for being so patient
7 and spending so much time with all of us on this side of the
8 table to understand how we work here and reflecting that in
9 the recommendations. Thank you.

10 CHAIRMAN POZEN: Thank you, John.

11 I think we should try to make a start on chapter
12 three. We are going to break just before 12:00 for lunch. I
13 think maybe we can start. Mike?

14 SUBCOMMITTEE 3 - AUDIT PROCESS AND COMPLIANCE

15 MR. COOK: Happy to do that. Chapter three is
16 related to the audit process and compliance. The members of
17 the subcommittee are Greg and Linda and myself and Ed Nusbaum
18 who is not here today. Our staff efforts were led by Bert
19 Fox, very, very well and very effectively, and we appreciate
20 that greatly, and we had lots of other folks who observed us
21 and gave us ideas and gave us input. As somebody said, you
22 know who you are, so I won't try to go through the list of
23 names.

24 We are humbled to be in the midst of this document
25 with all these brilliant recommendations in chapter one and

1 all these brilliant recommendations in chapter two, and all
2 of this really forward looking neat stuff that Jeff has
3 coming up in chapter four, and we just have a couple of
4 little things here.

5 We had a lot of brilliant stuff, but whenever we
6 got wound up about the audit process, we were told that
7 Kristen and the Treasury group would take care of that stuff.
8 I hope they will do as good a job in these areas as we would
9 have done had we carried on from some suggestions made to us
10 about that process.

11 On a serious note, we do have some two principal
12 topics, actually three under two headings. One is
13 materiality and that's principally in the context of error
14 correction and restatements, and then we have the subject of
15 judgment. It is no longer the judgment framework. We will
16 come to that.

17 We have those two headings. They are not
18 substantially changed in substance from what we had in
19 February. We had some very good feedback from the session
20 that we had in San Francisco. We have some written comments
21 that we have also been able to take into consideration. We
22 have clarified a number of items since that time.

23 I think you would say while the form and delivery
24 has changed some, the basic content of these recommendations
25 is pretty close to what it was at that time.

1 The first of those relates to materiality and
2 restatements and error corrections, and they are in
3 recommendations 3.1 to 3.4.

4 Key issue with respect to materiality is just a
5 reinforcement of the notion that materiality should be judged
6 from the perspective of the investor and in the context of
7 the total mix of information that is available to that
8 investor. That is consistent with where we have been and we
9 believe essential to effective implementation of our
10 recommendation.

11 We continue to have a recommendation for expansion
12 of the guidance in SAB-99 or topic 1-M, whichever you prefer.
13 We got a lot of comments back that said gee, you know, don't
14 get rid of SAB-99. SAB-99 has good stuff in it. Our
15 recommendation was read to be a suggestion that it be tossed
16 out or substantially revised.

17 We have said in trying to describe what we think
18 needs to be done here is we have a very excellent one way
19 street that we would like to see converted into an equally
20 excellent two way street by the addition of a lane that goes
21 in the opposite direction of the lane that's already there.

22 We are not suggesting there isn't very good
23 guidance in SAB-99 as it relates to thinking about things
24 that are quantitatively large as potentially being material,
25 but we want to have some thought given to the notion that

1 things which are quantitatively large are not by definition
2 material.

3 This is a bit difficult to wrestle with and
4 communicate particularly when people told us we can't use
5 bright lines, so we abandoned bright lines. We moved over to
6 sliding scales and they said no, you can't do that either, no
7 bright lines, no sliding scales.

8 Well, then it gets kind of hard. We put a notion
9 in here of not inconsequential or inconsequential and large.
10 That didn't quite get us off the hook because some folks came
11 back and said well, what's "large." We did add a footnote
12 which probably is not the most illuminating of all in this
13 document, that says "large" is bigger than inconsequential
14 and as large gets larger, it's more likely that people are
15 going to reach conclusions that something is material.

16 We didn't say when four turns into eight or five
17 turns into 12 or something gets over 33, it's all of a sudden
18 material. It just says start with large and it might not be
19 material, but the larger large gets, the more likelihood that
20 financial management and consulting with their audit
21 committees and everybody taking a responsible look, the
22 bigger it gets, the more likely you are going to conclude
23 that it's material.

24 I hope that's helpful.

25 CHAIRMAN POZEN: Just so people know where we are

1 talking about, it is footnote 138 on page 85, "large" is
2 anything more than insignificant, and footnote 141 on page 86
3 says that if the error is quantitatively large, quite large,
4 it is unlikely the quantitative considerations are going to
5 make it not material.

6 MR. COOK: If you keep looking for what "quite
7 large" is, you will be disappointed. "Quite larger" is just
8 bigger than large, which is bigger than "inconsequential."
9 That's about as far as that is going to take you, but that's
10 about the best we can do and should do in the absence of any
11 intent to try to say X percent of this or Y percent of that,
12 which has lots and lots of difficulties associated with it.

13 I'm being a bit facetious because I point out
14 that's where we and I think that's where we should come out.
15 I don't think we should try to articulate here the bright
16 lines or the scale or what have you.

17 Beyond that, the notions about materiality are
18 pretty much what they were in the original document, that
19 materiality should be judged by the investor perspective.
20 Things that get bigger and bigger are more likely to get
21 material. Things that are small can be material for other
22 reasons including qualitative considerations, and that is the
23 notion that is here.

24 We then moved to the issue of errors.

25 CHAIRMAN POZEN: Can I suggest, Mike, in the

1 interest of focusing discussion, maybe we should just discuss
2 that first recommendation on materiality. Some people may
3 have comments on that.

4 MR. COOK: Okay.

5 CHAIRMAN POZEN: Peter?

6 MR. WALLISON: Mike, was this intended to address
7 SAB-99?

8 MR. COOK: Was it intended to?

9 MR. WALLISON: Yes.

10 MR. COOK: Yes.

11 MR. WALLISON: The idea is we would like the SEC to
12 eliminate the SAB-99 guidance?

13 MR. COOK: No. The idea is the SAB-99 guidance is
14 fine, maybe it could be fine tuned a bit, but it's fine as it
15 relates to the evaluation of things that are quantitatively
16 small but have characteristics, qualitative characteristics
17 that could be material, not intending to change that or
18 suggest that be changed at all.

19 A suggestion to add to that guidance the notion
20 that things are not necessarily material just because they
21 are quantitatively large.

22 MR. WALLISON: You're leaving SAB-99 in place here?

23 CHAIRMAN POZEN: Can I just get a clarification?
24 On page 86, it says SAB topic 1-M. Is that now SAB-99?

25 MR. COOK: That is.

1 MR. WALLISON: We're back where we started, aren't
2 we? In effect, because the problem people have in
3 interpreting the materiality of something goes right to the
4 question of whether the size of it, whether it's large or
5 small, has some qualitative value associated with it; right?

6 You're saying if it has a qualitative value, well
7 then, we're not expecting to eliminate it at all; right?

8 CHAIRMAN POZEN: I think what the subcommittee is
9 saying is that SAB-99 now restated topic 1-M says if you have
10 something that's quantitatively small, you can become
11 material by virtue of qualitative, and what the subcommittee
12 is saying is adding to this, saying you can also have
13 something that was quantitatively, say over five percent, but
14 that might be not material because of qualitative factors.

15 MR. WALLISON: It's not entirely clear but I think
16 we ought to leave it that way.

17 MR. COOK: That is what we intend, which is to say
18 there's nothing wrong with what we have but it only goes this
19 way. We need some guidance that has us thinking in two
20 directions, not about the same item perhaps, but about items,
21 as to whether or not they are material and the perspective of
22 the investor, the total mix of information, where was it in
23 the business, how long ago was it, might cause you to think
24 about things that might otherwise be large as not being
25 material.

1 CHAIRMAN POZEN: One thing just to note here, on
2 page 86, I think there are a very limited number of people
3 who associate SAB topic 1-M with SAB-99, that we might refer
4 that this is the old SAB-99. Maybe we could just do that.

5 Jeff?

6 MR. DIERMEIER: Mike, we know a lot of users
7 responded quite negatively to this. We state here that the
8 likelihood in the footnote is this ever really being used is
9 remote. I think everybody is comfortable with the notion
10 that qualitative and quantitative elements have to be taken
11 into consideration.

12 Is this really worth putting this forward? Will it
13 really have any influence that doesn't already exist?

14 MR. COOK: I don't know that I can be specific but
15 we have a pretty good indication, there are a lot of things
16 that are being defined as material today because they are
17 being restated that are not having any significant influence
18 in the marketplace.

19 We point out the difficulty of making a direct
20 correlation between marketplace behavior and restatements,
21 but there is a lot of evidence in what we have looked at and
22 the research we have done that says people are making a lot
23 of almost mechanical restatements of prior financial
24 statements that are really not in our judgment material in
25 the sense of being important to an investor.

1 How many of these will change in the future is
2 pretty speculative, but we would tend to think there are
3 unnecessary restatements that will be eliminated.

4 MR. DIERMEIER: Maybe not so remote.

5 CHAIRMAN POZEN: Here's the problem we struggled
6 with. We thought of couching this footnote in terms of if
7 you're modestly above five percent, whether then the
8 qualitative factors could come into play. I guess I
9 personally thought that's what we were talking about, I think
10 if something was 40 percent.

11 I guess the desire of the subcommittee was not to
12 draw such a hard and fast bright line in the general approach
13 to encouraging judgments, that this footnote was sort of
14 brought into play as sort of a more general statement.

15 MR. DIERMEIER: For example, modestly above five
16 percent conveys a much better message. Maybe 40 percent is
17 okay but it's likely to be remote.

18 MR. COOK: Jeff, what we heard is you really need
19 to sit down and look at these things individually. It might
20 be 25 percent in a discontinued operation that hasn't been
21 part of your company or your financial statements for the
22 last two years, but it's still you found out that somehow you
23 accounted for something wrong when you accounted for the
24 disposition. That isn't of any consequence to anybody today,
25 which shouldn't cause you to go back and amend the prior

1 financial statements of the ongoing enterprise.

2 That is a pretty remote example, I would agree.
3 Just the notion that starting to try to write what it is and
4 how big it is and what it applies to takes you down a path
5 that you really can't satisfy.

6 MR. MINTON: If I could just pipe in as well.
7 We're going to be limited a little bit, and I think this is a
8 lot of the discussion with the numbers, because we do have
9 the Supreme Court that came out when they did articulate
10 materiality and there was a discussion. It was specifically
11 raised in the briefs about there should be a bright line
12 test.

13 The court actually addressed it and said well, a
14 bright line test would indeed be easier to implement, but it
15 is not appropriate for a judgmental standard such as
16 materiality, and actually footnoted and quoted -- interesting
17 -- a prior advisory committee from the SEC that said the same
18 thing back in the late 1970s.

19 So we are in kind of a little difficult situation as
20 far as being able to bring up something which has been
21 established by the Supreme Court.

22 MR. GOLDEN: I think that's key. I think
23 originally it was designed to be a judgment basis and what
24 happened in practice is is a bright line has been created. I
25 think what the subcommittee is trying to say is there is not

1 a bright line.

2 MR. JONAS: I think Jeff has called a very valid
3 question when he observed that the user comments on this
4 proposal were negative. It isn't lightly that I associate
5 myself with a recommendation that has not a strong user
6 support. In fact, users seem to oppose it. I think you have
7 called the right question here.

8 After a lot of reflection on this, I have at least
9 convinced myself that there is a benefit to the user of this
10 recommendation, and it comes in two forms. First, we are
11 trying to reduce the unnecessary restatements, the ones that
12 don't matter, and there is always a cost of putting noise in
13 the users' face that causes them to have to sort out and
14 ultimately conclude that it doesn't matter. That is not a
15 costless exercise.

16 The other benefit to the user is if we can reduce
17 unnecessary restatements, I think it will significantly speed
18 the timeliness with which companies can deal with errors
19 through disclosure.

20 There are a whole bunch of cases where companies go
21 into restatement mode and they don't come out for a long
22 time. That dark period is a tragedy for users because it's a
23 big black hole dark period. I've become convinced that the
24 number of unnecessary restatements is quite large based on
25 the data I've seen, and users disagree that fair values,

1 market value reaction is a good surrogate for -- that is the
2 user saying it doesn't matter.

3 I happen to believe it is an important piece of
4 information, and when we graph it, and we have all seen the
5 graphs of this, it's pretty overwhelming.

6 I think we are going to talk in a few minutes about
7 some great disclosures that this committee has come up with
8 that are going to help the users, but on this particular
9 point, Jeff, I've become convinced that getting rid of
10 unnecessary restatements is in fact in the users' interest as
11 well as in the interest of others.

12 MR. GOLDEN: I thought those were great comments.
13 The only thing I would add is recommendation 3.2, the first
14 bullet, I think you need to have that in mind and that is
15 that the subcommittee is recommending that all errors be
16 corrected.

17 I think some users felt this was a license to not
18 recognize errors, known errors.

19 MR. COOK: You really have to take this in context
20 when we are looking ahead. Greg is commenting and Russ on
21 important points that are part of the overall recommendation.

22 Let's take the questions about the materiality
23 issues.

24 CHAIRMAN POZEN: Scott?

25 MR. EVANS: I wanted to make a comment on 3.1. I

1 agree with Greg, we want to move forward in a productive way
2 and I also agree that users don't like the language that we
3 have used here, particularly with regard to large errors.

4 It seems to me the language distorts the attempt.
5 Your attempt here in the second bullet is to say that
6 materiality should be based on the total mix of information,
7 both qualitative and quantitative, available to the investor.
8 That's what you are trying to say.

9 Why don't you just say that and leave out the
10 differentiation of large and small. When you suggest that a
11 large error could be non-material, people begin to be
12 concerned that you are talking about a 40 percent item and
13 not something that is slightly above five, and all of the
14 cross referencing that you do here just adds confusion to
15 what's productive and a fairly straightforward assertion that
16 you're making.

17 CHAIRMAN POZEN: I think if we did that, then we
18 shouldn't have a recommendation because that's the change. I
19 think what we struggled with is having established the
20 principle that qualitative could work both ways. We then
21 were concerned by all the comments we had that people were
22 going to say exactly what you're saying, well, there will be
23 a 50 percent income change, current income, so that's what
24 the footnote was responsive to.

25 I think in talking to various people that it would

1 be helpful -- we're not going to solve this but on footnote
2 141, it just might be helpful since people might take that
3 out of context to say something like moreover, we are going
4 to say in 3.2, all these errors would have to be corrected
5 and disclosed in any event, so that would at least sort of --
6 otherwise, I'm concerned people would take that footnote out
7 of context. Maybe we can just add that.

8 I think, Mike, unless there is more discussion on
9 this point, I think we are going to take a break. Where are
10 we going exactly for lunch?

11 MR. KROEKER: Room 6000.

12 CHAIRMAN POZEN: We will come back and pick up.

13 (A luncheon recess was taken.)

14

1 A F T E R N O O N S E S S I O N [1:04 p.m.]

2 CHAIRMAN POZEN: I think we still haven't quite
3 completed our discussion of recommendation 3.1. I think
4 there have been some various recommendations. I don't know
5 whether Jeff or Scott you want to talk.

6 MR. EVANS: I can just repeat what I had said,
7 which is if you strike the sentence that begins "Just as
8 qualitative factors," and up on the second bullet that begins
9 with "material should be judged," just add at the end of that
10 "including both qualitative and quantitative factors."

11 Then take the point on large errors down to a
12 footnote like 138, and make it clear right at the outset of
13 that footnote that you're talking about a very unusual
14 circumstance, but it is theoretically possible that an error
15 that is large quantitatively might not be material, that it
16 depends on the circumstances of the case and on the totality
17 of the total mix of information, which is what you are trying
18 to say.

19 By taking the large error might not be material out
20 of the headline, both here and importantly in the executive
21 overview, I think you will avoid a lot of the concern that
22 users have over this and put it in its proper context.

23 Jeff, I don't know if you agree with that.

24 MR. DIERMEIER: I not only agree with that, I think
25 the problem is the word "large" sounds large. The fact of

1 the matter is, as we have had discussions here, what we are
2 talking about are errors that people would not -- any of us
3 would think are large in the context of any kind of
4 meaningful element to decisions.

5 For example, if somebody were to use a percent of
6 income for a company that's close to breaking even, and of
7 course, to some of our investor friends, break even is
8 relative to expectation, a penny up or down, which is just
9 absolutely folly that you would necessarily interpret those
10 things as large, but if somebody is using a mechanical
11 percentage rule based on a number that is a derivative of
12 pluses or minuses, they could call that large, but I don't
13 think any reasonable person in the room would say some of
14 those things are large.

15 There is a lot of execution issues, but I do think
16 use of the word "large" is very difficult. I think if the
17 purpose of this is to say we need greater guidance in terms
18 of how to interpret materiality, I'm not sure it's coming
19 through the way it is currently flavored, and the fact that
20 there are statements here about things should be corrected
21 and they need to be disclosed, those are important elements
22 that I think are getting lost in the "large" debate.

23 MR. COOK: Bob, in response, having had a side
24 conversation with both Scott and Jeff, we need to get this
25 input into this drafting. There is just no purpose in

1 attracting the kind of negative reaction to the extent we can
2 mitigate that.

3 We do need to make a basic point. We can't just
4 take out the point and not get across the notion that we want
5 people to think like investors. We want them to take the
6 total mix of information and we want them to assess
7 qualitative and quantitative factors.

8 We have to retain that. If we lose that, then we
9 lose the whole objective here which is to get the unnecessary
10 restatements out of the process, and we have to emphasize as
11 well the other aspect of this, which is errors are going to
12 be disclosed. They are going to be corrected. We have other
13 things.

14 This is not a "hide it" process, which is what
15 everybody quickly jumps to and saying oh, what you're doing
16 is taking people off the hook and then you're going to find a
17 way for them to hide it so nobody will ever know that a big
18 mistake was made.

19 This is not what this is. We have to be sure we
20 get that point clearly brought across as well.

21 We are going to thank you for your input by
22 engaging you in the drafting process. No good deed goes
23 unpunished. We will seek your input, Jeff, your input, Bert.
24 We will expand that horizon for us and let you help us get
25 the words closer to what we need to say without creating the

1 response that we are getting.

2 I think that is about as far as we can take it
3 unless -- we will move to the next section. If there are any
4 additional questions, we should hear them.

5 MR. HERZ: This probably is a good segway to the
6 judgment framework. A lot of emphasis, I think absolutely
7 correctly, is put in the document on the need for us as
8 standard setters to take an investor perspective, be more
9 investor oriented, have more investor representation and the
10 like.

11 Listening to this discussion about materiality and
12 restatements, I think we all agree that what needs to happen
13 is that the preparer and the auditor and the audit committee
14 also need to put themselves in an investor perspective.

15 How does that occur? The judgment framework kind
16 of gets there. It's more on accounting decisions, not at
17 like a restatement decision. I'm just kind of questioning
18 how do we get that kind of perspective into the rest of these
19 very important aspects of the reporting system.

20 MS. GRIGGS: Footnote 141 points out that
21 management is going to be consulting with their audit
22 committee and independent auditors in reaching a conclusion
23 on materiality, but we could maybe make your point a little
24 stronger. That was one way we did it.

25 You are absolutely right. It's the company, its

1 auditors, the board of directors, all of them are involved in
2 those materiality decisions.

3 MR. QUIGLEY: Isn't that point quite effectively
4 made in the middle of the paragraph that follows your
5 recommendation, the sentence that starts "One must step into
6 the shoes?"

7 MR. COOK: That's the idea. We're not going to
8 have investors firsthand making these decisions, but the
9 people who are making them, we want them to think as we
10 believe an investor would believe in analyzing the mix of
11 information and so on. That's the objective. That would be
12 the preparer, the auditor and we have put in the notion of
13 the audit committee because we think that's a helpful part of
14 the overall discussion.

15 CHAIRMAN POZEN: Just so we are all talking on the
16 same page, so we are really talking about deleting on
17 recommendation 3.1 on page 85 the last three sentences,
18 keeping the top of 86 and turning -- really, it's the second
19 half of 86, keeping the more general statement about
20 qualitative factors, but lightening up on this large error.

21 I guess we will just have to work through that and
22 see how that goes.

23 Let's go to 3.2.

24 MR. COOK: 3.2 deals with the issue of how to
25 correct errors. It's stated here, if it's not strong enough,

1 tell us, because we think it is an important point, which is
2 first and foremost, we would like to see fewer errors. We're
3 not in the game of encouraging errors or even condoning
4 errors.

5 We have added a section to this also, which I think
6 is a useful section, principally based on input that Greg
7 gave us based on some work that had been done at Moody's and
8 that he had taken a look at, which talks about the importance
9 of internal control and the effort to prevent errors from
10 taking place.

11 We don't have a specific recommendation but it's
12 like the observation about a lot of things we have in here
13 will reduce the frequency of errors. This talks about the
14 importance of effective controls in a preventative way,
15 because the data that we have looked at seems to say that
16 most often a material weakness is the result of an error, not
17 necessarily the other way around, and they are not good
18 predictors of financial reporting problems, and believing
19 that's not the right sequence of that.

20 The key points in 3.2, one, which is a departure
21 from existing practice, is a suggestion that there be a
22 requirement that all errors be corrected.

23 Today, we have immaterial errors. We have rolling
24 errors. We have things that we have always done it that way
25 kinds of errors.

1 The suggestion here is we require that errors be
2 corrected and errors, even if not material, even if not
3 causing a restatement, be corrected on a timely basis in
4 every instance. I believe that is a positive statement and a
5 change from existing practice.

6 Beyond that, if you have a material error, define
7 "material error." You have a restatement, and that is done
8 the way it is done today. If you have an item that is not
9 deemed to be material and not deemed to require restatement
10 but nonetheless is for the moment a large error, and we are
11 going to correct the terminology, it is required to be fixed
12 and it is required to be disclosed.

13 There is a disclosure component to this, again,
14 partially in response to the people who have said, well,
15 you're trying to give people a pass and they don't have to do
16 a restatement and then they get to hide the fact that they
17 have had an error. That is not the case. If that doesn't
18 come through loud and clear, we need to make it louder and
19 clearer because the point here is errors will be fixed and
20 you will disclose the correction of an error even if it does
21 not lead to a restatement of prior financial statements.

22 We have coupled with that by the addition of a
23 bullet or the elevation of one of our footnotes to a bullet,
24 the idea also that there should be no more stealth
25 restatements. That is just not the way it should be. The 8-

1 K rules should be changed to the extent they need to be
2 changed so that when there is a restatement, it is disclosed
3 and it is prominently disclosed not just something that
4 people can't find or don't hear about.

5 That's the principal notion of 3.2, which is how
6 you correct errors, how you disclose the errors that have
7 been corrected, and errors must be corrected. Those are the
8 three sort of essential points of 3.2.

9 Let me stop there and ask if there are questions or
10 comments about that. Greg?

11 MR. JONAS: Just very briefly. The second to last
12 bullet under 3.2, I wanted to point out is a recent insertion
13 that we did in response to what we heard from users.

14 We thought that the users made valid points about
15 the importance -- what they like about restatements is the
16 discipline that it imposes on preparers and auditors. The
17 pain of restatement they believe is an important incentive to
18 get the books and records right.

19 We had sympathy for that observation, but we didn't
20 think you had to have the pain of restatement to accomplish
21 the objective. You could also have the pain of disclosure.

22 The notion was that if you had a large error that
23 you deemed immaterial, the debate we had a little while ago,
24 if you had that circumstance, you needed to disclose the fact
25 that you had a large error that you deemed was immaterial,

1 and that would put the bright light of public scrutiny on
2 your judgment about that particular error.

3 That was the incentive that we thought took the
4 place of what otherwise would be the pain of restatement.

5 MR. QUIGLEY: Mike, the language in the
6 recommendation, I'm comfortable with and I think this will
7 help us improve practice and it will help reduce the number
8 of restatements, and I think that will improve financial
9 reporting. I'm very supportive of the direction.

10 The two sentences that follow the recommendation in
11 the paragraph at the top of page 88, I wonder if we need
12 those sentences and if we couldn't just start that paragraph
13 with the word "Companies." We are introducing this notion of
14 errors that are clearly insignificant, contrasting those with
15 errors that are not material, and then we are talking about
16 correcting them but not using any language about restatement
17 there.

18 I just think those two sentences out of context
19 conflict with the recommendation that precedes, that you make
20 very clear you can deal with a correction without a
21 restatement, and I think if you just killed those two
22 sentences, we don't lose anything, and I think we avoid a
23 whole bunch of confusion that those two sentences introduce.

24 MR. COOK: Good. I think that's good. It does
25 appear redundant when you look at it. Good. Scott?

1 MR. EVANS: I just wanted to make sure I clearly
2 understand what you're recommending here. I'm still not
3 positive. I think what you're saying is you have three
4 different types of errors. There are material errors, which
5 you are going to continue to restate and you go through the
6 pain of restatement. No debate about that.

7 There are immaterial errors which you are going to
8 say we are going to fix them. If you fix them and then in
9 between important errors that aren't material that we are
10 going to disclose through the 8-K process and so forth, my
11 question is I'm an analyst. We are in 2008. You have
12 discovered a problem in 2006. It's in one of these
13 intermediate categories. It's not material but it's going to
14 go through the 8-K process.

15 We roll the tape forward to 2010. How do we treat
16 2006 with regard to the item of this error? Do you have the
17 corrected information shown for 2006 or is there any
18 reference to the fact that you have filed an 8-K in 2007?
19 How do I know when I pick up a financial statement in 2010
20 that I'm looking at a number in 2006 that was subsequently
21 corrected?

22 MR. COOK: It won't be corrected in 2006. We're
23 not going to go back and change 2006. It will be corrected
24 in the 2008 financial statements, and presumably as long as
25 they are displayed, you're going to disclose the fact that

1 included in 2008 is a correction of an error that was made in
2 2006, and it was corrected in 2008 by changing this number or
3 that number. That would continue.

4 MR. EVANS: Now we are in 2010. I'm looking at the
5 2006 financials in the historic portion of the disclosure.
6 Do I have the corrected numbers or do I have the original
7 numbers?

8 MR. COOK: If it's not material, you'll have the
9 original numbers.

10 MR. EVANS: Except for the material errors where
11 there is a formal restatement, the analyst is left with
12 immaterial errors that were corrected but never disclosed to
13 the investor and important errors, I'll call them, that are
14 in between, that they need to be able to navigate through the
15 various footnotes back to the 8-K that was filed for every
16 item that went through this.

17 This becomes, I would think, an unworkable problem
18 for the investor, and what you have done is you have taken
19 the costs from the preparer and burdened the investor with
20 them, because analyzing financial statements is now going to
21 become a much more cumbersome process.

22 MR. GOLDEN: I thought the subcommittee's view was
23 that in order to determine if it was material, you had to
24 also look at the trend, and whether it was material to a
25 current investment decision today in 2008 when you discover

1 it, and one of the qualitative factors is the trend that is
2 occurring, which to me would be would it be relevant if it
3 was in the 2006 financial statements.

4 What you described, I think, is you as a user have
5 concluded that this error from 2006 would have been relevant
6 today, to see the trend in 2006, 2007 and 2008, so what you
7 may be describing may be considered material under the
8 proposal.

9 MR. EVANS: As a user, and I am a former analyst
10 myself and we had analysts testify in San Francisco, they
11 want to see the right numbers. They would like management to
12 give them the right numbers, the right historic numbers, to
13 the best of their ability.

14 This process that you're describing confounds that,
15 and puts a rather large burden on the part of investors to
16 ferret out what the corrected numbers are, as I understand
17 it.

18 MR. JONAS: I interpret, Scott, your observation
19 that you really believe as an analyst, in your example, the
20 2006 error is important to your analysis. That's implicit in
21 your comments.

22 If you felt it wasn't important, you wouldn't care.
23 You do care, you're arguing. It must be that you're troubled
24 because you heard the words "it's large," "it's significant,"
25 but "not material." You're not buying it's not material.

1 That's what I hear you saying, and I'm inclined to agree that
2 if I thought it was important to analysis, then absolutely
3 the numbers need to be recast.

4 In this example, you have made a judgment it is not
5 important to your analysis, so why do you want this road map?

6 MR. HERZ: That's kind of why I asked the question
7 about who is going to -- the judgment is going to be made by
8 the preparer and affirmed by the auditor and the audit
9 committee. This presumes reliance on their judgments and
10 ability to step into the investor shoes there.

11 My only question was are there mechanisms to
12 promote that happening in a better way like should audit
13 committees have experienced investors, just like we have a
14 financially literate person. Should the auditors be given
15 investor training. Why is it only the FASB given investor
16 training, have investor people in setting the standards.

17 There is all these other aspects of the system that
18 if you want it to work in the investor interest, those key
19 points, they have to be brought to bear, I think.

20 MR. QUIGLEY: Mike, just in terms of also getting
21 on the record the notion that we also heard from other
22 investors and what they said was immaterial restatements are
23 an annoyance to them. They have to go back and re-run their
24 models and they re-run them and say why am I doing this.
25 They come to the conclusion that in financial reporting, we

1 are restating for a whole bunch of things we shouldn't be
2 restating for.

3 At least, Scott, the voice of those investors were
4 also in my head when I read this recommendation and thought
5 this is very responsive to what the investors said to us at
6 least when they were testifying when they said 80 percent of
7 the restatements we see are just simply an annoyance.

8 MR. EVANS: To me, Jim, these investors, the
9 context they were speaking in was with regard to the dark
10 period that results from the restatement process. I think
11 there is no doubt about the fact that's problematic for
12 investors. It's problematic for everyone.

13 I think you all have some outstanding suggestions
14 on how to confront the uncertainty there. That is the thing
15 investors really don't like about the restatement process.

16 Analysts want to be able to look at the corrected
17 numbers to the extent that the company is aware of them, and
18 if you have things that are important --

19 MR. QUIGLEY: That are material.

20 MR. EVANS: I understand. You have something that
21 is important enough that you are going to file an 8-K on it.

22 MS. GRIGGS: I don't understand your comment about
23 the 8-K, Scott. There is no 8-K required unless you reach a
24 conclusion that the financial statements do have an error and
25 you'd have to restate them. There is no 8-K filed unless you

1 are restating.

2 MR. EVANS: I misunderstood your recommendation.

3 MR. COOK: This would presumably be a footnote.

4 MR. EVANS: Disclosure. I misstated -- I think why
5 you are getting the big reaction to this, and we certainly
6 saw it in San Francisco by the woman from the capital group
7 that testified and she talked about polling all of the
8 analysts that they had in the shop and they were universal in
9 their desire to continue restating, continue giving me the
10 numbers, and I will decide whether they are material or not
11 to my judgments as an investor.

12 I think that is the attitude of investors and why
13 they are leaning on the side of more disclosure. The trick
14 would be to find some way to restate the numbers without
15 creating this huge dark period that we end up getting. I
16 don't know the answer to that.

17 CHAIRMAN POZEN: I think what we are saying is you
18 correct the error, you disclose it, and you make an
19 evaluation about whether it's material to current investors.
20 If you decide that it's not material to current investors,
21 then you don't do a whole scale restatement.

22 That means all the information is there but it does
23 mean two years later you haven't conformed all the financial
24 statements. I guess partly it's a tradeoff. You can't have
25 a restatement without a dark period because nobody in their

1 right mind would publish a lot of stuff while they were in
2 the process of trying to do it. It's sort of like there's
3 just too much risk involved. You want to wait until you
4 complete the process.

5 I think it's a nice idealistic objective, but I
6 don't think it's possible to get. What we are really doing
7 is saying that little extra work for the analysts is worth
8 the positive of not having a dark period in those situations
9 where the information is what I would call borderline
10 material.

11 MR. McCLAMMY: I think another thing to keep in
12 mind is there clearly will be oversight from the SEC of what
13 kinds of things are not being restated. If they think
14 someone is stretching this too far to something that
15 investors would be concerned about, I'm sure there is going
16 to be comment letters back as to why did you deal with this
17 this way versus restatement. Why is this not material.

18 I don't think it's going to be solely in the
19 judgment of the management and the audit committees. There
20 will be oversight. Management and audit committees will know
21 there's going to be that oversight.

22 MR. DIERMEIER: In fact, maybe Ed's comment, if
23 it's not included in the write up. Going back to Scott's
24 example, 2010, when I look at the 2008 numbers, where will I
25 find this?

1 MR. COOK: In the footnotes.

2 MR. DIERMEIER: In the footnotes.

3 MR. COOK: I don't know what the heading is going
4 to be, but it's going to say something, that in the current
5 financial statements, an item has been recorded which
6 pertains to the financial statements for 2006. Here's how
7 it's been recorded, whether it's been recorded to retained
8 earnings, if that was an acceptable manner of recording it,
9 whether it's been taken as a charge in the current income
10 statement, whatever it might be, that will be disclosed and
11 the impact on the prior financial statements.

12 Again, we are speculating because the rules haven't
13 been written. That's based on the discussions we have had.
14 That's about what you would expect to find. That would stay
15 with those financial statements.

16 MR. DIERMEIER: It wouldn't be in the statements
17 themselves but in the footnotes.

18 MR. COOK: Right.

19 MR. DIERMEIER: What will happen here is detail
20 analysts will handle this the same way they handle write-offs
21 and a lot of these non-continuing things, which is perfectly
22 fine because we don't have to do all of that for the analysts
23 themselves.

24 Most of us when we see a write-off, the first thing
25 we do is we spread it out over the past five years and say

1 the past was over stated. You just want to provide enough
2 information for the analysts so they can say, well, in fact I
3 don't like this notion of every once in a while we lose a
4 little money and we just forget about it, so I build that
5 back in, because these things do have a way of creeping up
6 for some companies, but we just want to make sure it's easy
7 for that person in 2010 to find in the 2008 number that there
8 was something in 2006.

9 MR. EVANS: It would be in the 2010 financial
10 statement, that footnote would continue until such time as it
11 was outside of the purview of the historic statements?

12 MR. COOK: Until the year drops out.

13 MR. EVANS: Until the year drops out of the
14 historic results.

15 CHAIRMAN POZEN: Could I just ask for
16 clarification, Jim? You wanted to cut out these two
17 sentences on page 88. You realize that right now we say you
18 have to correct all errors excluding clearly insignificant
19 errors. We would have taken out that phrase. Now, you would
20 be required to correct all errors. Is that what you wanted
21 to do? I think it might be more precise to say companies
22 should be required to correct promptly all errors, excluding
23 clearly insignificant errors.

24 Otherwise, that would be a little too broad.

25 MR. EVANS: If you put in a little language

1 relative to what Jeff was asking about, it makes it clear
2 that you are going to continue that disclosure.

3 CHAIRMAN POZEN: Good. Linda, where would that be?

4 MS. GRIGGS: Yes, that could go into the second to
5 last bullet of 3.2, corrections of large errors in previously
6 issued financial statements should always be disclosed in the
7 notes to the financial statements for that year, even if the
8 error is determined not to be material.

9 CHAIRMAN POZEN: That will make it automatically --

10 MS. GRIGGS: Right.

11 MR. COOK: We talked about 3.3, which is the
12 recommendation that the FASB and/or the SEC is appropriate to
13 issue guidance, seeking here to have some continuous flow of
14 information during what is referred to as the black out
15 period.

16 What we were told was one of the most troublesome
17 aspects of what we have today is everybody -- somebody says
18 we've discovered a problem with respect to so and so and that
19 is really the last you hear for an extended period of time
20 while the company figures out what it is, how big it is, what
21 periods are affected, and the analyst community very
22 frustrated, professionally frustrated, by the fact that they
23 just don't know what the magnitude is, where it is, and any
24 information that can be provided on a continuous basis and a
25 feeling not only that it is not giving any information about

1 the problem, but it is shutting out the flow of information
2 on a current basis until this problem is fully understood,
3 and that is harmful to the investor community.

4 This is one of the things more than anything we
5 heard about that we really would like to see fixed from the
6 perspective of the investor community.

7 MR. McCLAMMY: I've gotten a lot of feedback from
8 both preparers and users along that line of we desperately
9 need information during this period of time, and it's harmful
10 to both the users and the companies' preparers as well.

11 I think it gets lost somewhat in generalizing 3.3,
12 because it starts by saying give us more information, but
13 then it qualifies that by saying give more information about
14 the need for a restatement and about the restatement itself.

15 It doesn't say give me other reasonable information
16 that is available. On another page, I think it was the next
17 page, it talks more to the point of companies should be
18 encouraged to provide reasonable reliable financial
19 information during that period. The way I read this
20 literally, that's not covered in the recommendation.

21 MR. COOK: You are saying the sentence on page 91
22 in that first full paragraph that begins "Consequently," is
23 it the suggestion that we pull that up into the bullet
24 itself?

25 MR. McCLAMMY: Yes, make it clear you are wanting

1 to provide more than just we have a restatement and give
2 information about the restatement.

3 MR. COOK: Okay. No disagreement with that.
4 That's a good point. We are all nodding that's a good idea.

5 3.4 pertains to interim periods and how to measure
6 materiality and how to correct errors. We have had a fair
7 amount of discussion about APB Opinion No. 28 in paragraph
8 29.

9 Essentially, what we are saying is the same
10 principles that apply on an annual basis are the principles
11 that should be applied to interim periods, that an interim
12 period doesn't necessarily lead to a restatement of an annual
13 period and you make judgments about trends. You make
14 judgments about the total mix of information. Essentially,
15 just saying when you do your guidance on the annual, we
16 should have some more guidance on the interim periods, but
17 the principles and the outcomes should be the same.

18 Is that a fair recap? That is 3.4. That ends the
19 recommendations pertaining to materiality and restatements.

20 Questions or comments before I move to judgment?

21 MR. GOLDEN: I have one question that I don't know
22 the answer to on recommendation 3.3. We use the term
23 "restatement" but should we use the term "error" under the
24 thought that if a company is still in the process of
25 determining the total magnitude of the error, they may not

1 have yet concluded its material and therefore concluded it's
2 a restatement, but you still want that disclosure?

3 MS. GRIGGS: That's a good clarification.

4 MR. COOK: Good; like that.

5 CHAIRMAN POZEN: Could you say that again?

6 MR. GOLDEN: Rather than use the word "restatement"
7 in 3.3 we use "error." The company might not have yet
8 determined if the error they have discovered is material.

9 MR. COOK: Would lead to a restatement.

10 CHAIRMAN POZEN: That's in 3.3.

11 MR. COOK: 3.5 and all related to it has to do with
12 the issue of judgment. We have moved in large part because
13 of what we heard but also sensitivity to the fact that we
14 have discussed whether or not we should seek to have a
15 judgment framework which would be the subject of a safe
16 harbor. We didn't recommend that.

17 We merely said in our first iteration of this that
18 was one possible way of doing this along with the possibility
19 of a statement of policy and the more we heard, the more we
20 talked, the more we looked at different ways of communicating
21 this judgment framework, we came to the conclusion that the
22 best way to do this was for an SEC communication to be issued
23 in the form of a policy statement that would indicate how the
24 SEC goes about evaluating the reasonableness of judgments
25 that are made.

1 With the belief, and there is a companion
2 recommendation as it relates to the PCAOB and the inspection
3 and enforcement proceedings there as it relates to auditing
4 judgments that are made, judgments about how to apply the
5 auditing standards as opposed to the accounting principles
6 and standards.

7 The judgment here was that this is the most
8 workable. This is the least difficult for a lot of reasons.
9 It should have essentially the same impact, which is if it's
10 saying to people that the principal regulator who oversees
11 and evaluates judgments that are being made in the area of
12 accounting principles and estimates and judgments, all the
13 things that go into the preparation of financial statements,
14 these are the things they are going to look at, and this is
15 the approach that they are going to take in terms of
16 evaluating whether an appropriate process has been followed
17 on a timely basis, properly documented, that that is
18 effectively the guidance that would be relevant to preparers
19 and auditors in going about making these judgments, and in
20 the case of the auditors, challenging those judgments as part
21 of the audit process.

22 It's a different formulation of how it will be
23 articulated, but the idea is that it will be essentially what
24 we had recommended earlier in what was then called the
25 judgment framework. It is no longer a framework. It is now

1 an evaluative process that the regulators will be following.

2 We have the six types of judgments that are being
3 made. I don't think we changed that at all. We have a dozen
4 or so factors to be considered, which I think we added a few,
5 didn't we, Greg, to what we had previously based on some
6 comments that we had received.

7 Those are essentially to help guide those who are
8 going to prepare this guidance in terms of what should be
9 taken into account and the types of judgments that are being
10 made.

11 In the end, there is no safe harbor. This is not
12 even discussed. It is strictly a recommendation for a
13 statement of policy. It is no longer called a framework
14 because it is now evaluative criteria for the regulators as
15 opposed to a framework, and taking those two things out
16 probably makes you feel that it's a little less than what it
17 was previously, but still come to the conclusion that this is
18 valuable guidance and it will hopefully accomplish our
19 overall objective which was to try to change the environment
20 in which judgments are being made and being evaluated from
21 one that is an environment of second guessing and
22 defensiveness and a lack of respect for the judgments that
23 are being made in an effort to take this to a point where
24 judgments will be respected, provided they are made in a
25 reasonable fashion, with full consideration of all relevant

1 factors, and done so on a timely basis.

2 Hopefully, that will have a positive impact on both
3 the people making those judgments and the people who are
4 evaluating them, and maybe even the people who ultimately at
5 some point would like to challenge those judgments in one
6 forum or another, but that's not the primary purpose of this.

7 That's what recommendation 3.5 is all about.

8 CHAIRMAN POZEN: I marked up 3.1, just to give
9 people a sense of what that might look like.

10 I think we should take comments on the judgment
11 framework, any suggestions, any reactions.

12 MR. COOK: If I could just add a couple of
13 footnotes before we go to that. Important points that we
14 hope we have made clearly without overemphasizing them is
15 that the following of this judgment process, we will call it,
16 is not anything which mitigates or reduces the auditors'
17 responsibility to challenge judgments that have been made.
18 It does not preclude the auditor in any way from challenging
19 a judgment just because somebody would say we did A, B, C, D,
20 and E, and therefore, the judgment is bulletproof even though
21 it is the wrong answer.

22 It is not going to lead to that circumstance, and
23 similarly, the regulators will challenge judgments. They
24 will have the same prerogatives they have today to challenge
25 judgments. Hopefully, they will accept more of them,

1 challenge fewer of them, respect them more than they might if
2 this type of a process were not followed.

3 At the end of the day, the regulators will have all
4 the same authorities they have today if they disagree with
5 the conclusion, regardless of the steps that have been
6 followed or the care that's been taken or the documentation
7 that's been prepared, if the answer is wrong, the answer is
8 going to be deemed to be wrong.

9 It's important that we not take away from the
10 process as it relates to auditing and the regulatory
11 oversight, but hopefully the outcome of this will be more
12 good judgments by more thoughtful, complete, timely
13 consideration of the important factors.

14 That is what we are striving to achieve here. We
15 welcome your comments on this. We had two other
16 subcommittees that told us this was important to them because
17 this kind of underlies some of the things we are trying to do
18 in terms of eliminating complexity.

19 It certainly is a consideration to the extent that
20 we are encouraging a move to a more principles based approach
21 than a rules based approach, bright lines based approach
22 because if judgments are going to be made as part of that
23 regular process on a principles based approach, the
24 environment in which those judgments are made is going to be
25 important.

1 We believe this is supportive of what we heard from
2 our colleagues on other subcommittees that urged us to move
3 in this direction.

4 CHAIRMAN POZEN: Anyone want to -- Sue?

5 MS. BIES: Yes. I like the changes that you all
6 made in this section. I think it very much supports the
7 concept that we were wrestling with in subcommittee one's
8 issues that we dealt with.

9 I like particularly after the list of all the
10 things that should be considered the paragraph that says when
11 you consider these factors, you go back to your materiality
12 again, that if it's an one off transaction that is likely to
13 never reoccur and there is less need to do a lot of this
14 stuff then if it is part of a core business that is
15 significant and ongoing.

16 I think overall you blended them well and I really
17 like the way you have approached it.

18 MR. COOK: Good. Thank you.

19 CHAIRMAN POZEN: Other comments? Scott?

20 MR. EVANS: Those who are skeptical of this
21 movement towards reasonable judgment and towards principles
22 based standards are going to argue that comparability will be
23 sacrificed as we move in this direction.

24 How do we dissuade those fears and how do we build
25 some calming thoughts into this recommendation? I know when

1 we attempted to deal with this issue, we went to
2 comparability.

3 MR. JONAS: I think what we have managed to
4 convince ourselves of at least at the subcommittee level is
5 that the consequence of thinking about these factors gets you
6 a better judgment, an better judgments gets you certainly no
7 worse comparability and probably better comparability.

8 Most importantly, we are getting a better judgment
9 out of this. Either we have judgments with discipline like
10 this in them or we have judgments without discipline, but any
11 way you go, you are going to have these judgments. If they
12 don't have discipline, it seems to me that creates more non-
13 comparability, not less.

14 CHAIRMAN POZEN: Scott, I just want to point out,
15 on page 101, the eighth factor is the diversity of practice.
16 Maybe we could emphasize that a little more. We could even
17 break it out to a separate paragraph.

18 I think a lot of the people who are concerned about
19 this are implicitly assuming that there is not judgment being
20 made now. There is judgment being made all over the place.

21 The question is how do you discipline it, how do
22 you constrain it. I do think this eighth factor, and maybe
23 you believe we ought to elaborate, tries to be responsive,
24 that that is one of the things that people need to consider.

25 MR. HERZ: I think also it's not an immediate catch

1 on this, but in chapter two, the post-implementation review
2 would include the extent to which there is a diversity of
3 reasonable judgments being made in an area, and if it's too
4 wide, then presumably somebody would say FASB or SEC or
5 whatever, you need to change something so that the range of
6 reasonable judgments under the principles is more
7 constrained. There might be a two or three year lag for that
8 though.

9 CHAIRMAN POZEN: I think that is a relevant factor
10 that we did take into account when we looked at the post-
11 review. I guess we could clearly reference that.

12 I don't know, Scott, whether you think that we
13 should break this out as a separate paragraph and make that
14 point, how you feel about it.

15 MR. EVANS: I'm just thinking you might -- as Greg
16 articulates, you thought a lot about the comparability issue.
17 It might strengthen the paper to make some of those points in
18 the body of the text, so you can show comparability is
19 important. You have thought about it. You think that
20 actually good execution of reasonable judgment will ensure
21 better comparability. You have dealt with the difference in
22 practice issue in number eight.

23 It just has more of a tone of this being a central
24 aspect of the --

25 CHAIRMAN POZEN: Let's see if we can take your

1 point and Bob's point and get a paragraph on that. I think
2 it's well taken.

3 MR. HERZ: In chapter one, having lots of rules,
4 that people don't need to apply judgment, there is the kind
5 of false comparability that results out of it. Unless you
6 get a system where you re-inject some judgment, you are going
7 to keep on perpetuating that kind of problem. You might be
8 able to reference also chapter one in that.

9 CHAIRMAN POZEN: I think that would be in a
10 different point. I think we have tried, without being
11 disrespectful, to say people are using judgment all over the
12 place and that there is no way of getting around it. You
13 want to say that judgment is better than that.

14 I think if we are going to say that, we probably
15 ought to say it somewhere on page 99 or 100, and relate it to
16 chapter one.

17 MR. DIERMEIER: I'm wondering if it wouldn't be a
18 good idea to state as a first principle here that beneath
19 this recommendation is a belief that preparers and auditors
20 should be aggressively working to abide by the principles
21 that underlie the accounting standards.

22 Start right off early on when you're talking about
23 this judgment framework to say, hey, look, first off, this
24 section, the reason we are putting this forward is we expect
25 people will aggressively basically try to abide by the

1 principles that underlie the accounting standards, and then
2 use that as a basis to launch off.

3 Right now, it doesn't quite jump out at you, and
4 how are people going to try to work it to their advantage.

5 CHAIRMAN POZEN: I don't know.

6 MR. COOK: Yes, that's a good suggestion.

7 CHAIRMAN POZEN: Before we have a vote, can I go
8 back to two points here? One, Russ, I'm confused the more I
9 look at -- I thought 3.3 dealt with the situation where we
10 had already determined that this was material to current
11 investors and we were talking about disclosure during the
12 dark period, and 3.2 dealt with the period --

13 MR. GOLDEN: My concern is I think there's a lot of
14 evidence a company has discovered a problem, but they don't
15 know the magnitude of the problem yet, so they may be unable
16 to conclude -- they know they have an error but they may be
17 unable to conclude if it is a material error and therefore a
18 restatement is required, but they would still be in the dark
19 period.

20 CHAIRMAN POZEN: Just the way we have this
21 structured, that sort of disclosure, I think, ought to go in
22 3.2. 3.3 is trying to deal with during the dark period. I
23 don't have any problem with adding that language in 3.2, but
24 I think it's confusing to be in 3.3.

25 MS. GRIGGS: Bob, I think we can define the dark

1 period as the period once a company decides they can't make
2 their filings until they actually renew their filings. It is
3 just a different way of defining it.

4 CHAIRMAN POZEN: Okay. I'm going to leave you guys
5 the chance to do that. The other thing I'd like to do just
6 for a second is I did take the liberty just to try to mock up
7 quickly a shortened version of 3.1.

8 This is not meant to be a definitive, but just to
9 give people a sense of how we would delete on page 85 the
10 last two sentences and we would make the second paragraph on
11 86 more general, and attached to footnote 141, a reference to
12 the correction of errors and disclosures, and we would take
13 out the specifics on page 87.

14 What's going to happen here is we are going to have
15 to do some drafting. I just would like some reaction of
16 whether this is in the ballpark of where people want to be.
17 Do they want to be even more general than this. I would just
18 like some sense of reaction to it.

19 MS. GRIGGS: The only thing that I think I would
20 still like to do is react to Jeff's concern about the word
21 "large" and maybe use the error represents a high percentage
22 of net income or something like that instead.

23 CHAIRMAN POZEN: If we say the error represents a
24 high percentage of income, people are going to say that
25 should always be material. I'm not sure where that would get

1 us.

2 MR. HERZ: Evaluated solely on quantitative
3 criteria would be material, however, taking into account the
4 qualitative.

5 MR. KROEKER: I think we have taken the position
6 that you can't have something that is material and then
7 somehow made immaterial. You can't call it quantitatively
8 -- qualitatively material and quantitatively not material.
9 It is either material or it isn't.

10 CHAIRMAN POZEN: When I was trying to re-write
11 this, I don't know whether you can totally avoid the word
12 "large" or "small." It is sort of a little difficult to
13 explain what you are talking about if you don't ever use the
14 word "large" or "small."

15 MR. DIERMEIER: We might only use it once and it
16 might be in small print not bold.

17 CHAIRMAN POZEN: That's what I tried to do.

18 MR. QUIGLEY: The thing that I think we have to be
19 very careful of is trying to define these terms in the
20 context of income. When you're using a word like "large,"
21 you can be talking about a classification on the income
22 statement or a classification on the balance sheet. The
23 number might be large but it isn't significant or material to
24 the analysts and their models and their projections, and
25 therefore, you might conclude that does not require a

1 restatement, even though the number itself looks like a big
2 number. It's just a classification issue. You're not re-
3 measuring income.

4 I think everybody gets stuck when you talk about a
5 large re-measurement of income and then try to explain that's
6 not material.

7 CHAIRMAN POZEN: We can have the staff -- this
8 seems to me a reasonable starting place. I'm sure we will
9 have many insightful comments about the particular words.

10 Just to summarize before we vote on chapter three,
11 we would have something like this on 3.1. We would change --
12 we would delete the top two sentences on page 88 and do a
13 little re-working to put "clearly insignificant" in.

14 On page 88, the text of the second bullet, refer to
15 notes to the financial statements. We would broaden 3.3 to
16 include other reliable information. We would also do
17 something to 3.3 about the dark period and errors which Russ
18 and Linda will reveal to me, and then pages 99 through 100,
19 we will try to have some relationship to the false sense of
20 consistency and bright lines in chapter one, and then on page
21 101, we will try to beef up a little the diversity practice
22 in relationship to post-adoption review.

23 That is what I have. Susan?

24 MS. BIES: Bob, just clarify, I guess I didn't
25 catch this, why are we deleting on page 87 of your handout

1 the examples?

2 CHAIRMAN POZEN: I'm only trying to respond that
3 people wanted less detail and the question of a large error.
4 Those people don't even want to say "large." This is saying
5 it again, but it's a reasonable question.

6 MS. GRIGGS: I would leave that in.

7 CHAIRMAN POZEN: Okay. Let's head back page 87.

8 MS. GRIGGS: The only other thing that I heard that
9 I thought we were going to do is on page 86, the word "one,"
10 "One must step into the shoes," I thought we were going to
11 say preparers, audit committees, auditors should, just to
12 pick up Jim's comments.

13 CHAIRMAN POZEN: "One" is going to be preparers,
14 auditors and who else?

15 MS. GRIGGS: Audit committees. Bob's point that we
16 should have all of them trained in understanding investors'
17 interests. I think that's a good point.

18 It's at the top of page 86. We could expand that.
19 That talks about preparers and auditors.

20 CHAIRMAN POZEN: You want to add audit committees?

21 MS. GRIGGS: Sure.

22 MR. HERZ: Lower our standards.

23 [Laughter.]

24 CHAIRMAN POZEN: I think we are going to side step
25 this particular issue. I think we have a pretty good sense

1 here of what these changes are. Ed?

2 MR. McCLAMMY: One other comment on 3.1, on the
3 sentence that has been deleted.

4 CHAIRMAN POZEN: Which one?

5 MR. McCLAMMY: On 3.1.

6 CHAIRMAN POZEN: Which sentence?

7 MR. McCLAMMY: The last sentence that you
8 scratched, page 85. I do think it is important to have in
9 the recommendation the concept of quantitative and
10 qualitative and stay away from all the "large" and "small"
11 and just say those two factors should be considered.

12 CHAIRMAN POZEN: Maybe we should say materiality
13 should be judged based on total mix of information available
14 to reasonable investors including qualitative and
15 quantitative factors.

16 MR. McCLAMMY: Good.

17 CHAIRMAN POZEN: Okay. I think we have actually
18 gone a long way toward something which by e-mail would
19 probably take a week.

20 Just to clarify, we are putting at the end of the
21 second bullet on page 85, including qualitative and
22 quantitative. We are on page 86, preparers, auditors and
23 audit committees instead of "one," and we are putting back in
24 the paragraph on page 87 that I had deleted.

25 With those changes --

1 ahead with their interactive data proposal. If any of you
2 want to read it, I have a copy in my briefcase. In fact, the
3 comments are due on that on August 1.

4 I am hopeful and in fact I've heard Chairman Cox
5 mention that the work of this committee in this regard has
6 been helpful in terms of what was put forward. I don't think
7 we need to take any more time of this committee on this
8 subject.

9 CHAIRMAN POZEN: I would agree with that one. I
10 think XBRL, for what it is, it is beyond us.

11 MR. DIERMEIER: On page 114, recommendation for
12 corporate website use. Remember, the importance of this is a
13 recommendation to the SEC to give clear, cohesive and
14 comprehensive guidance so that preparers do not feel that
15 they are inappropriately constrained with use of the web.

16 Really, there is no change from this from the prior
17 meeting, but you will see that on the appendix, Appendix H-1,
18 we do have an example of a Microsoft corporate website use,
19 which I think was taken off the same presentation we made to
20 all of you.

21 CHAIRMAN POZEN: Do we have any questions on the
22 websites?

23 [No response.]

24 MR. DIERMEIER: Page 116, recommendation on KPIs
25 and other metric disclosures. The reason this is important,

1 I think we all know, the GAAP financials are important but
2 it's just one piece of the overall puzzle. In fact, most of
3 us in the investment business are trying to understand the
4 underlying drivers of a business, the associated metrics and
5 trying to make forward looking statements, particularly for
6 long term investors, and we also know that managers are
7 managing their businesses not based off their balance sheet
8 and income statement but off a whole host of metrics and
9 variables and in fact we would like to be able to be closer
10 to the seat of the CEO and the managers that are running the
11 company itself.

12 Recommendations here relate to generating
13 consistent KPI terminology, suggesting that a private sector
14 initiative be encouraged by the SEC, and that the SEC also
15 encourage companies to use consistently and with consistency
16 KPIs on a voluntary basis as they communicate with investors.

17 A potential controversy around this could involve
18 things like the release of competitive information but I
19 think we were careful here in our words to make sure that we
20 are not seeking information that would be competitive. We
21 would rather have the marketplace if company ABC in my
22 industry decides to disclose certain information about their
23 KPIs and I'm the only firm that might not do that, I think we
24 would be better off with the marketplace to impose
25 discipline.

1 Other than that, I don't think there is a great
2 deal of change from the prior material that was presented to
3 the committee.

4 CHAIRMAN POZEN: I think the main change is just to
5 make clear this is a voluntary encouragement and we are not
6 trying to set up a new regime.

7 Any questions on KPIs?

8 [No response.]

9 MR. DIERMEIER: Page 121, improved quarterly press
10 releases. We have all discussed in this group that a
11 quarterly press release is very important by nature of its
12 timing and may be one of the most if not the most important
13 informational event for a company.

14 With some exceptions, very little is mandated in
15 terms of what has to be in that quarterly press release.
16 Here we are recommending that private sector best practices
17 are sought to encourage a better press release, considering
18 things like having all three financial statements, the
19 location of information.

20 In particular, we were disappointed that some
21 companies were not keeping their earnings call and related
22 information for more than a quarter after the call, which
23 makes it very difficult to make comparisons and do analysis,
24 which seems to be in opposition to SEC guidance.

25 We did discuss the timing of the release of the

1 quarterly press release with the Q, but we are making no
2 recommendation here. Basically, to allow the private sector
3 to consider it in terms of their discussions.

4 In addition, as Bob Herz suggested at our meeting
5 in Chicago, the largest driver of financial complexity may be
6 short termism, but we felt this topic was beyond the dual
7 mandate of this committee and is in the hands of a group that
8 is grappling with this issue as we speak.

9 MR. BERESFORD: A question, I think just for
10 clarification. The term both in the recommendation and in
11 the text, "income statement, balance sheet and cash flow
12 tables," and I don't really know what you have in mind there,
13 whether you are talking about just selective information from
14 those statements, whether you're talking about condensed or
15 abbreviated ones.

16 MR. DIERMEIER: It could be abbreviated. Some
17 companies narrowly provided some data, and I think that data
18 showed that 80 plus percent in quarterly press releases show
19 some abbreviated income statement, something like a balance
20 sheet, and then the number dropped off to about 56 percent in
21 terms of providing some kind of a cash flow like statement.

22 MR. BERESFORD: I think it might be helpful by
23 footnote or example or something to clarify what it is that
24 you have in mind by the use of the word "tables."

25 MR. DIERMEIER: That's a very good idea. Thank

1 you.

2 CHAIRMAN POZEN: That's on page 121. Is there
3 discussion? We will work that in. Very good point.

4 [No response.]

5 CHAIRMAN POZEN: Any more questions about 4.4?

6 [No response.]

7 CHAIRMAN POZEN: Okay. Now we move to 4.5.

8 MR. DIERMEIER: Potentially, certainly an item that
9 historically has been somewhat controversial, although I
10 think given advances in technology and the ability to drill
11 down, the discussion we had earlier today, the importance for
12 executive summaries rise from a real strong desire to engage
13 more investors somehow into the investment process.

14 I think we all understand that the official filed
15 reports that are put out there for many investors are way too
16 daunting, and I know that we are not going to be able to
17 reach every person who has a financial interest in a company
18 around the world, but there certainly are individuals that we
19 would like to pull in that if you talk to some of the
20 organizations that represent individual investors, they are
21 having a hard time even getting those folks to spend much
22 time looking at some of the financial data that gets put
23 forward.

24 To engage more investors, to possibly provide a
25 starting point or some kind of a road map for understanding

1 the company's business, and then to take advantage of the
2 technology that exists that we saw in the Microsoft
3 demonstration that Chris' group put together, the ability to
4 drill down so that regardless of the degree of sophistication
5 on the part of the investor, starting off in the executive
6 summary and eventually drilling down to the area that you
7 might be interested in, could be quite helpful.

8 We are proposing here that this would be an
9 executive summary to the annual and also to the quarterly's.

10 You will see in brackets in the write up, the
11 brackets are there because some people have suggested that
12 maybe there ought to be a phase in. One thing we did not
13 include in the write up but is something that we certainly
14 could give consideration to is a stronger statement, that if
15 an organization were to in fact include the information that
16 typically would be included in their MD&A overview, they
17 could move that up to the executive summary if they felt that
18 would somehow help them in terms of their preparation. That
19 would be something we would be happy to give consideration to
20 as well.

21 There's an example in the appendix on page H-10.
22 The group feels despite the fact that in years past,
23 summaries haven't gone very far, that this is the time for us
24 to move forward and in terms of being able to put forth the
25 document as a whole and show indication that we have done

1 something here to basically improve the useability of this
2 information format, I think this is a good lead horse.

3 CHAIRMAN POZEN: Denny?

4 MR. BERESFORD: At the last meeting, I think I
5 expressed some significant concern about this. Mainly, I'm
6 concerned that this would be more boilerplate. With the
7 different things that are suggested, the four bullet points,
8 it's going to be very hard to express them, I think, in no
9 more than two pages. I have some reservations.

10 I have to say after reading Appendix H, the
11 Microsoft example is outstanding. At a minimum, I would urge
12 you to cross reference that example in the text on page 124
13 to 126. I don't think it is right now. It's buried so
14 deeply in the report that few people will ever see it, I
15 think, if there is not at least a cross reference given.

16 Beyond that, I guess my personal preference would
17 be to make this an encouragement as opposed to even a
18 quarterly requirement. Again, I don't feel this is a fall on
19 the sword type thing. I know all we are doing is making a
20 recommendation and the SEC would have to study it and then
21 get comments and so forth. This is far from a completed task
22 at this point.

23 I am concerned that the average company is not
24 going to have the resources as a Microsoft to be able to do
25 this in such a well stated fashion. The lawyers will get a

1 hold of it, of course, and it will become very problematic
2 very quickly, I'm afraid.

3 CHAIRMAN POZEN: Jim?

4 MR. QUIGLEY: I just wanted to ask whether or not
5 the parenthetical with the recommended length of up to two
6 pages really adds anything. The example that you are showing
7 is 12 pages, if you think of that whole appendix as being
8 that so-called executive summary.

9 I just think we are being too proscriptive and let
10 the marketplace decide. Earlier, you said let's let the
11 market discipline decide how many KPIs you have. Why don't
12 we let the marketplace decide what an executive summary is.

13 I'm not sure that two pages adds much to it.

14 CHAIRMAN POZEN: Jim, I think you mixed together
15 the appendix related to the website with the summary. The
16 summary starts on H-10. I think it goes for three pages.

17 MR. BERESFORD: Yes, it is three pages rather than
18 a maximum of two.

19 [Laughter.]

20 CHAIRMAN POZEN: I think it's a reasonable comment.
21 I was the one who put in two pages, just to give a sense of
22 that. I think it's a good comment. There is no reason for
23 us to be quite as proscriptive. If somebody did a great job
24 in two and a half pages or three pages, we wouldn't be
25 against that. I think we can take out the two pages.

1 MR. SIDWELL: The one question I have is I think
2 when you look at filings today, there is a huge amount of
3 duplication from section to section. It seems to me this is
4 adding without necessarily saying try to focus what is
5 already there. I would be concerned that you end up with
6 another however many pages on top of already having said
7 those things in MD&A and probably two places elsewhere, risk
8 factors and in the footnotes. Is that something we really
9 want to be doing.

10 MR. DIERMEIER: We were thinking that rather than
11 duplicate the MD&A, if you wanted to pull that information up
12 into the summary, that you could do that, so as to not
13 duplicate. In fact, if you did the executive summary well,
14 you could potentially avoid duplication elsewhere because you
15 could use the summary as a road map in terms of telling
16 people -- you can provide in the summary the opportunity for
17 potential links and drill down into other areas and should in
18 fact help avoid duplication.

19 I understand that most people would say Microsoft
20 can do that easier than others.

21 MR. SIDWELL: Just using extensive cross
22 referencing in the past has not been encouraged.

23 CHAIRMAN POZEN: I think maybe Amy, this is a point
24 that a number of people have raised, what would be the
25 relationship of the executive summary to the overview, and

1 how that would work, and to what extent can we coordinate and
2 reduce overlap of these sorts of things.

3 MS. STARR: As you all probably know, the MD&A
4 overview is not mandatory at this point in time. The idea is
5 that the MD&A overview currently would be more expansive than
6 what would otherwise be suggested or recommended as part of
7 the executive summary, which would be in the periodic report.

8 To the extent that the executive summary takes the
9 place of the MD&A overview by containing the same type of
10 information that otherwise would be in the MD&A overview, the
11 concept would be there would be potentially a cross reference
12 in the MD&A section to the overview, so that people could
13 understand the MD&A in the context of what's laid out in the
14 executive summary.

15 CHAIRMAN POZEN: I think that's a very helpful
16 point. I think we don't want to create a second overlapping
17 repetitive document. To the extent that we can -- just to
18 put a very harsh question, since the MD&A overview is
19 voluntary, that means if somebody does the executive summary,
20 that can serve both purposes?

21 MS. STARR: Again, the purpose behind the MD&A
22 overview is to give insight into the company's business and
23 its operations. If that same disclosure is located
24 elsewhere, then you again are providing the level of
25 information that will help investors understand the MD&A and

1 the company's financials.

2 MR. COOK: I don't have a lot of enthusiasm for
3 this because I'm concerned as Denny is that this becomes
4 boilerplate. I have a hard time believing more is good when
5 we are trying to reduce complexity and my concern about
6 volume and that being a deterrent to people understanding a
7 lot of things.

8 Could you tell us not so much who is the advocate
9 for this but where did this come from? Who really thinks we
10 need this and it's really a good idea? I'd like to be
11 convinced. I'll support whatever you conclude. I'm not
12 getting the why this is an important thing to do.

13 MR. MANN: I think probably my constituency is
14 individual investors. I've seen statistics that fewer than a
15 third ever manage to make it through a financial document at
16 all for companies they hold. What is it that we are trying
17 to get at here with this committee, trying to find a way to
18 make these documents more useful for what we have described
19 as reasonably diligent consumers of financial statements.

20 I think that is who we are going for here. The
21 people I've spoken with have been pretty supportive.

22 MR. DIERMEIER: -- he thinks it is the best hope
23 for his folks to actually spend a little more time and the
24 expectation is if they spend a little bit of time and
25 actually learn how to navigate, we might get ourselves a

1 growth variable here.

2 We are only talking about, I think, the smarter end
3 of the retail environment.

4 MS. GRIGGS: Jeff, I have a question for you. Go
5 ahead, Chris.

6 MR. LIDDELL: The whole concept here is that you
7 don't have to wade your way through the whole 10-K or 10-Q,
8 that you have one place and two/three pages, where you can
9 get an overview of what's going on, which is for most people
10 about the level of detail they want and it's all in one
11 place, than trying to navigate their way around a 120 page
12 document or whatever.

13 MS. GRIGGS: My question relates to the summary for
14 the 10-Q. If it's supposed to be a road map to the 10-Q, the
15 10-Q always has the financials and the MD&A. Often, that's
16 all it has. It may have some risk factors. It may have
17 other disclosures. There really isn't much else in a 10-Q.

18 I'm wondering do you really mean a road map to the
19 10-Q or do you mean sort of an update to your prior executive
20 summary in your 10-K? What do you want in a Q?

21 MR. DIERMEIER: I think that's an excellent
22 question. The way you put it, Linda, it sounds like the MD&A
23 overview basically would suffice and you wouldn't need an
24 additional although you could position it as an executive
25 summary, but you might want to make reference to statements

1 that were made in prior executive summaries as well, so as to
2 give a more founded picture.

3 CHAIRMAN POZEN: Amy will correct me, I think there
4 is some precedent of having just the material changes going
5 in the 10-Q.

6 MS. STARR: In the context of risk factor
7 disclosures, it's mandated in the 10-Q, and to the extent
8 there are changes from what had been disclosed, that would
9 have to be included in the 10-Q.

10 CHAIRMAN POZEN: That is a sort of possible
11 response, Linda, that in the 10-Q, one would sort of start
12 from the 10-K and then add if there were material changes,
13 and if there were no material changes, presumably you would
14 just say that.

15 MS. GRIGGS: Then I wouldn't call it a road map to
16 the 10-Q. I'd say it's an update to the executive summary in
17 the 10-K. I think it's described wrong.

18 MR. COOK: It sounds like there's a pretty high
19 level of enthusiasm on this in the subcommittee that has
20 really taken a look at it, and you are all pretty supportive.

21 MR. DIERMEIER: The group is really very strongly
22 supportive of it.

23 MR. MANN: We share your concern, we don't want
24 this to become boilerplate in any way, shape or form, but in
25 terms of an improvement, we think this is something that is

1 very positive.

2 MR. LIDDELL: I think the idea of being able to
3 substitute the MD&A overview with the executive summary
4 addresses a lot of concerns people had in terms of
5 replicating information.

6 MR. JONAS: Let me follow on with support for this
7 idea. We have most of the rated companies that we do of any
8 size come in and speak to us usually at least once, maybe
9 twice a year. Management has a total of an hour to make the
10 points they want to make.

11 I see management, particularly well prepared
12 management, doing exactly this at the front of those
13 presentations. They give you the elevator speech. Let me
14 tell you my main points and then I'm going to go deep in
15 those points, but first understand my big picture before I go
16 deep so I don't lose you.

17 It's remarkably well done. Were it not done, we
18 would be lost at sea in a lot of these presentations.

19 I think done well, this is just an outstanding
20 idea. I share Denny's concern and the concerns of others. I
21 think it is hard as heck to write a good elevator speech. I
22 don't know that many companies, particularly smaller ones,
23 are going to take the time and agonize over the elevator
24 speech, but done well, this is of enormous value in my
25 experience.

1 MR. EVANS: I would throw my support behind it as
2 well. I think it's a good practical suggestion that broadens
3 the audience for financial statements and reaches a part of
4 the investing public that is just not bothering with the
5 complexity that we are dealing with. I think it's a very
6 powerful idea.

7 CHAIRMAN POZEN: John?

8 MR. WHITE: I was thinking you might want to add
9 some language that linked this into the website proposal. As
10 you might have guessed, I'm deep into implementing the
11 website proposal.

12 When you get to the summary provision of that and
13 talking about using links off a summary description down into
14 the other information, that's very much what you're talking
15 about here, if you have this in an interactive format.

16 I realize 10-Ks are different than the website
17 presentations, but ultimately, this is all going to link
18 together. I'd be inclined to get something into this piece
19 that tied those two recommendations together.

20 CHAIRMAN POZEN: Just to show you that I tried to
21 compete with Russ Golden, in footnote 202 on page 125, it
22 probably isn't as developed as it could be.

23 MS. STARR: I think we could probably pull that up
24 to the body to make it stronger.

25 CHAIRMAN POZEN: I'm just kidding.

1 MR. WHITE: I was going to say I read the whole
2 document but I didn't get to --

3 [Laughter.]

4 CHAIRMAN POZEN: Footnote 202, it's a real
5 headliner.

6 MR. WHITE: I can tell you that I'm deep into the
7 websites.

8 CHAIRMAN POZEN: Let me see if I can --

9 MR. KROEKER: Bob, Tom Weatherford couldn't be here
10 today but he also had -- I don't think the recommendation is
11 proscriptive -- he had some concerns about whether there
12 should be an extra year for smaller companies to learn from
13 larger companies on this. Again, I don't think the
14 recommendation is proscriptive. I think he would appreciate
15 a note about smaller companies being able to learn from
16 larger companies.

17 CHAIRMAN POZEN: I should ask how do you guys feel
18 about that, smaller companies? Realistically, that's where
19 you are going to get some push back.

20 MR. LIDDELL: A year, it's fine by me.

21 MR. McCLAMMY: I agree with Denny's observations on
22 concern about the duplication, but do understand what people
23 are saying, although I do think if you have a sophisticated
24 retail investor, at a minimum, they should be reading the
25 MD&A. It's the one place where they get -- to be telling

1 them forget reading the MD&A, just go to that two page
2 summary, I think it is probably doing an injustice to them.

3 If someone is making an investment decision off a
4 two page summary, I guess I'd be concerned about that as
5 well, without at least having the knowledge of the MD&A.

6 Those are the broad comments. If I get into the
7 specifics, even if I buy into the overall concept, I think
8 the recommendation is probably too much detail of what should
9 be included and what shouldn't be included, and maybe it
10 should be a broader recommendation to the SEC and leave that
11 up to them.

12 I get into things like where we are talking about
13 the most important information. There's nothing that's going
14 to turn this into more of a lawyer written document than
15 saying one, I focused on the most important pieces, because
16 they are going to then say you need to talk about everything,
17 so no one can second guess you on what is the most important.

18 Second, when you get into a summary of business
19 outlook, to me, it takes further than the MD&A currently
20 takes it about adverse trends and risks.

21 I think it may be better just to have the initial
22 like one-third of this and cut it off where it says "As with
23 the MD&A, the executive summary should be required to use a
24 layered approach," and just get the major concept across that
25 there should be an executive summary.

1 CHAIRMAN POZEN: I think if I get the group's
2 consensus here, I think people are prepared to support it,
3 but just to capture the massaging here, I see seven different
4 points here.

5 One is there should be a cross reference to the
6 Microsoft screens. Second is my silly idea of two pages
7 should be deleted, also from the executive summary. Third, I
8 think we do need a better clarification of the relationship
9 to the MD&A. I guess we need to just think through which
10 side people do, and if they look at executive summaries, to
11 refer them to the MD&A. I think we wouldn't want a chopped
12 up thing. We just need to think through that better, sort of
13 considering people who are going to want to do most of it in
14 the executive summary and a little in the MD&A versus vice
15 versa, to make that work.

16 Fifth, I think we should think of the 10-Q as an
17 updated executive summary and people can use that, and just
18 put the material changes.

19 Six, we should try to be less proscriptive here,
20 and then say develop a little more the website and then just
21 have some acknowledgement, let the big companies go first and
22 then the small companies will then see how it's done and they
23 will get a little more comfortable with it.

24 I think those are all actually good suggestions. I
25 think it will make it a more workable proposal. With Amy's

1 help, we will revise this.

2 MS. GRIGGS: Bob, I echo your suggestion that it
3 not be so proscriptive because the suggestion there be a
4 digest of companies, GAAP, non-GAAP, and non-financial KPIs,
5 just made me worry about the non-GAAP financial measures,
6 which is a topic we didn't even get to in our exercise. That
7 just opens things up.

8 CHAIRMAN POZEN: I actually was a little concerned
9 about that myself, since I would sort of be discouraging
10 people to use KPIs and then if they had to do this, but I
11 think we can figure out a way to state this in a broader,
12 more general way, and there is no one size fits all.

13 I think my concern was if the executive summary had
14 to include all the KPIs, that might be a reason for some
15 people not to use KPIs, and we don't want to do that.

16 I think we will put that down, too. I think that
17 all goes to not being as proscriptive and trying to make this
18 a document that -- I agree strongly with whoever said if we
19 use "important," then some lawyer is going to decide if you
20 don't put the right thing in there, somebody will sue you.
21 We don't want to do that either.

22 PARTICIPANT: "Less important."

23 [Laughter.]

24 PARTICIPANT: "Large."

25 CHAIRMAN POZEN: Then someone would say but that

1 really was important.

2 I think those are all very good suggestions. I
3 think this will make it a much more workable thing.

4 The only other change I have here is follow up on
5 Denny's suggestion on pages 121 and 122, to clarify exactly
6 which tables or what we are suggesting here.

7 V O T E

8 CHAIRMAN POZEN: I think that's pretty much
9 concludes everything. Are we ready to take a vote? All
10 those in favor?

11 [Chorus of ayes.]

12 CHAIRMAN POZEN: All those opposed?

13 [No response.]

14 CHAIRMAN POZEN: We have an unanimous vote.

15 Jim, I think Chairman Cox wanted to come by for a
16 minute here. He does want to. We are trying to get him down
17 here.

18 MR. KROEKER: He does.

19 CHAIRMAN POZEN: We will have a chance for a few
20 more questions.

21 MR. BERESFORD: Bob, before we close, I know
22 several people today have given credit to the staff and other
23 people, but I think we all owe a great deal to you as the
24 leader of this group that we wouldn't have gotten anywhere
25 close to being where we are today and certainly in making, I

1 think, a lot of great recommendations, without the terrific
2 oversight and leadership that you have shown us, and we
3 really thank you a great deal.

4 [Applause.]

5 CHAIRMAN POZEN: Thank you. I want to thank Jim
6 and Russ for co-executive heading or half time, given some
7 rule that I don't quite fully understand, and the chief
8 people on the staff, Jeff, Amy, Bert and Adam, and of course,
9 Brett and Nili. Can't forget Nili for staying up.

10 MR. KROEKER: He's supposed to be on his way down
11 right now. If people want to give him a minute or two, that
12 would be most appreciated.

13 The one person I would like to thank as well who
14 goes unrecognized often is Dana Swain, who has done a
15 tremendous job of providing support. I want to make sure she
16 gets recognized as well.

17 CHAIRMAN POZEN: Let me just ask a factual point.
18 Is there anyone else other than Jeff who wants to join us in
19 some of these briefings? We will have Mark and then somebody
20 from FASB when we announce the actual report.

21 MR. COOK: I had a thought just as I was listening
22 to the discussion about this over lunch and particularly
23 sensitive to it since we seem to be the lightning rod for
24 all the things that are not so happy, but do we want to reach
25 out -- I was just thinking, somebody will have a relationship

1 with -- I would have a relationship with a Chris Dodd or a
2 Jon Corzine, people who are on important committees and are
3 likely to be engaged with this and maybe try to get them
4 engaged a little earlier by sending them a copy and saying I
5 thought you might find this to be interesting, happy to have
6 somebody come by and chat.

7 Do we want to have an outreach of some kind or is
8 that more risk than benefit? I realize this time of year, an
9 election year, this probably isn't going to get to the top of
10 anybody's hit parade. Is that a good idea or bad idea?

11 CHAIRMAN POZEN: I would say it can't hurt if you
12 know somebody to have them focus a little, especially if we
13 can get some staff support.

14 The difference is since we aren't making any
15 legislative proposals, whether we really -- how important the
16 congressional situation is.

17 I think we are now privileged to have Chairman Cox.

18 COMMENTS BY CHAIRMAN COX

19 CHAIRMAN COX: Thank you very much. I can't tell
20 you how grateful I am personally to each of you for the
21 enormous amount of time, energy and leadership you have
22 devoted to this enterprise. You are getting close to the
23 finish line on July 31st. We will have a news conference on
24 August 1.

25 What has already gone into this with all the public

1 meetings that you have, with all the hard work and the
2 productivity, with your interim recommendations, there is
3 just a great deal here to be grateful for, and I want to
4 thank each of you very much for making yourselves available
5 for this purpose.

6 As I look around here and see the talent that we
7 have assembled, it's pretty remarkable with all that's going
8 on in public today, in a room with no windows, in the
9 basement, in a building in Washington, so much fire power be
10 assembled and focused on what is really going to help
11 investors in the days and months ahead.

12 The focus of this group all along has been on
13 making financial reporting useful to investors and useful to
14 the broader markets. Lord knows, we need that more than ever
15 right now, when a great deal of the turmoil in the markets is
16 a function of people not understanding where the risk lies,
17 not understanding what it is exactly they are looking at.

18 Each of us brings to this job a slightly different
19 perspective based on our experience and where we are coming
20 from, but what we all have in common is a thorough commitment
21 to making sure that information which drives markets is
22 presented in the most useful, accurate, understandable and
23 clear fashion.

24 I want to thank each of you for your leadership in
25 this. As you know, we have already moved forward on your

1 XBRL recommendation. We are close to doing something on your
2 corporate website recommendation. We have a handful of
3 others, including judgment, that we hope to be able to move
4 forward on.

5 You have some 25 recommendations that we are
6 looking forward to receiving and hopefully moving forward
7 with in real time.

8 This has been a really productive effort. I don't
9 want to contrast you with any other advisory committees
10 around town, but this is really news that you can use. There
11 is a lot of take away here, a lot of practical value, and I
12 know the advice is coming not just to the SEC, but also the
13 FASB, the PCAOB, and the fact that we have all three chairmen
14 here gives you an idea of just how seriously these
15 recommendations are going to be taken.

16 I just can't thank you enough. This is a stellar
17 effort. I look forward to being able to say similar things in
18 public and more importantly, being able to act on these
19 recommendations.

20 Thanks.

21 CHAIRMAN POZEN: We appreciate very much the
22 support that you have given us by giving us such great staff
23 people who have really done a lot of work and also I want to
24 say that Bob Herz and Mark Olson have been extremely
25 cooperative, so this has really been a constructive effort.

1 We have guaranteed that nothing we are giving you
2 requires legislative action. That's one of our theme songs.
3 We want to make sure and we hope that working closely
4 together with the staff and really trying to be practical
5 that we will have recommendations that you can really act on
6 and get done in a reasonable amount of time.

7 CHAIRMAN COX: Your organization, by the way, also
8 deserves credit. There is a lot of horsepower here, as I've
9 remarked. The way you have set out your work plan, the way
10 you have divided your work and your responsibilities has
11 produced a great result.

12 Purely from a management standpoint, I also want to
13 congratulate you, Mr. Chairman, for the way that you and the
14 other subcommittee chairmen have run things.

15 CHAIRMAN POZEN: Thank you very much for that very
16 good subcommittee leadership and also help from Russ and Jim
17 and Con, John, so it has been a real team effort. Hopefully,
18 the proof is in the pudding. We are pretty far along on this
19 and today has been mainly I would say fine tuning. We have
20 pretty strong agreement on this. We are going to get an
21 unanimous report, get it to you on time, on budget.

22 I think all of us really hope this will actually
23 lead to some changes. We are not trying to revolutionize the
24 accounting system, but there are a number of steps that will
25 make it better. We hope they will get adopted.

1 We like the fact that there is already action and
2 we hope there will be some more.

3 CHAIRMAN COX: Good. The objective is shared far
4 beyond this advisory committee. I think there is no
5 objection that I've heard anywhere to making financial
6 reporting better. When I say that, I don't mean it
7 trivially, I mean I think everybody recognizes the
8 opportunities, real opportunities at hand to do this. It
9 isn't just pie in the sky.

10 We fully expect to take advantage of the
11 opportunity that you have given us at the Commission.

12 I'm reminded that because this is a Federal
13 advisory committee, even though it doesn't look public, we
14 are being webcast here. I have had a chance to praise you
15 publicly already. I look forward to doing it maybe even with
16 a t.v. camera as opposed to just an audio webcast.

17 Between now and the 31st of August, there is still
18 more work to be done.

19 CHAIRMAN POZEN: The 31st of July.

20 CHAIRMAN COX: Excuse me, of July, and then August
21 1, we will unveil the whole package. Wonderful. I will
22 leave it to you, Mr. Chairman.

23 CHAIRMAN POZEN: Thanks very much for coming. We
24 really appreciate your personal support and personal
25 interest.

1 Jim, can you wrap us up here so people can go home?

2 MR. KROEKER: Thanks again and meeting adjourned.

3 CHAIRMAN POZEN: Thank you very much.

4 [Whereupon, at 2:40 p.m., the meeting was

5 adjourned.]

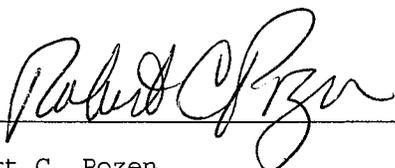
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CERTIFICATION

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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

**Multipurpose Room, Room L006, SEC Headquarters
Washington, D.C.**

Friday, July 11, 2008, Beginning at 9:30 A.M.

AGENDA

- I. Introductory Remarks – Robert Pozen, Committee Chairman
- II. Consideration of Comment Letters Received
- III. Discussion of Developments since May Meeting
 - A. Subcommittee 1 – Substantive Complexity
 - B. Subcommittee 2 – Standards-Setting Process
 - C. Subcommittee 3 – Audit Process and Compliance
 - D. Subcommittee 4 – Delivering Financial Information
- IV. Discussion of Significant Drafting Comments
- V. Vote on Draft Recommendations
- VI. Planning for July 31, 2008 Teleconference
- VII. Adjournment (expected no later than 3:30 pm)

Exhibit B

DRAFT
FINAL REPORT
of the
ADVISORY COMMITTEE
on IMPROVEMENTS to
FINANCIAL REPORTING
to the
UNITED STATES SECURITIES and
EXCHANGE COMMISSION

August [x], 2008

DRAFT - JULY 11

Draft Final Report
of the
Advisory Committee
on Improvements to Financial Reporting
to the
United States Securities and Exchange Commission

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E. Committee By-Laws	
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G. Examples of Substantive Complexity	
H. Examples of Corporate Website Use	
I. Committee Members, Official Observers, and Staff	

This report has been prepared for discussion and deliberation by the full Committee at a July 11, 2008 open meeting. Pending any further action on this report by the Committee, it does not necessarily reflect either the views of the Committee or other members of the Committee. It also does not necessarily reflect the views or regulatory agenda of the Commission or its staff.

**SEC ADVISORY COMMITTEE ON
IMPROVEMENTS TO FINANCIAL REPORTING**

Washington, DC 20549

August [x], 2008

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1070

Dear Chairman Cox:

[It is my pleasure and privilege to present to you, and the other Commissioners, on behalf of the Advisory Committee on Improvements to Financial Reporting, our final report of recommendations to increase the usefulness of financial information to investors, while reducing the complexity of the financial reporting system to investors, preparers, and auditors.

Our Committee has worked diligently to provide this final report to you. This report reflects our final recommendations, which update the matters presented to you in our progress report dated February 14, 2008, based on additional deliberations and consideration of subsequent testimony and comment letters received. We believe the recommendations in our final report could be implemented by the Commission, the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), or their respective staff, as appropriate, without legislation. These 25 recommendations are summarized in the executive overview of our final report.

We commend the Commission for its initiative in creating the Committee. You have been generous in furnishing staff and other resources. In particular, we would like to thank the staff members whose participation was invaluable during the Committee's work. These include from the Commission staff:

Conrad Hewitt
John W. White
Wayne Carnall
Paul Beswick
Bert Fox
Stephanie Hunsaker

James Kroeker
Shelley Parratt
James Daly
Adam Brown
Todd E. Hardiman
Shelly Luisi

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K. Ramesh
Amy Starr
Brett Williams

Nili Shah
Dana Swain

These also include Russell Golden, Holly Barker, and Christopher Roberge from the FASB staff, and Sharon Virag from the PCAOB staff.

We also want to thank our Official Observers whose participation and counsel have been so helpful to the Committee during this time:

Robert Herz, FASB
Charles Holm, Federal Reserve Board
Kristen Jaconi, U.S. Department of the Treasury
Phil Laskawy, International Accounting Standards Committee Foundation
Mark Olson, PCAOB

The members of the Committee, the Official Observers, and the staff are deeply grieved by the premature death of Brett Williams, who made such a great contribution to the Committee's work. We extend our sincere sympathies to Brett's family.

Respectfully submitted on behalf of the Committee,

Robert C. Pozen
Committee Chairman

cc: [Current Commissioners - to be updated]
Members and Official Observers of the Committee
Conrad Hewitt
John White
James L. Kroeker
Florence E. Harmon]

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EXECUTIVE OVERVIEW

I. Introduction

In July 2007, the U.S. Securities and Exchange Commission (SEC or Commission) chartered the Advisory Committee on Improvements to Financial Reporting (Committee). The Committee's dual mandate is to examine the U.S. financial reporting system in order to make recommendations intended to increase the usefulness of financial information to investors,¹ while reducing the complexity of the financial reporting system to investors, preparers, and auditors. Reflecting this dual mandate, the Committee included 17 members representing key constituencies in our capital markets.² The diverse backgrounds and experiences of the members included five important users of financial statements, four former regulators (of whom one is a full-time academic), three chief financial officers from companies of different sizes, the chief executive officers of a large- and medium-sized audit firm, and three members of audit committees.³

At the start of our work, the Committee agreed to issue focused recommendations, addressing acknowledged problem areas, that we believe can be adopted in a reasonable time period by the SEC, the FASB, or the Public Company Accounting Oversight Board (PCAOB). We agreed to avoid recommendations requiring legislative action or attempting to address all perceived shortcomings in the financial reporting system. In doing our work, we were guided by the principle that the primary purpose of financial statements is to help investors make well-informed decisions.

[At our July 11, 2008 meeting, we unanimously adopted all of the recommendations in this report. At our July 31, 2008 meeting, we voted unanimously to issue to the Chairman of the SEC this final report of the Committee's recommendations to the SEC to improve financial reporting.⁴ This report is the culmination of our work, which has included eight public meetings where these topics were deliberated by the full

¹ [We define] "investors" as all providers of capital, including current and potential providers of equity capital and creditors. We recognize there are other important users of financial statements, such as credit rating agencies.

² Each member's representative capacity is identified in appendix D.

³ One of these audit committee members is also a former chairman and chief executive officer of a large audit firm. Another audit committee member is also a full-time academic and a former chairman of the Financial Accounting Standards Board (FASB).

⁴ In our role as an advisory committee to the SEC, we have addressed most of our recommendations to the SEC, while noting the need for involvement of other bodies, such as the FASB and the PCAOB. We also note that some of our recommendations may require SEC action, while others may be implemented by SEC staff. We have, however, generally adopted a convention of addressing these areas to the SEC for convenience. We leave the determination of whether the proposals require SEC or SEC staff action to the discretion of the SEC and its staff. This report does not necessarily reflect the views or regulatory agenda of the SEC or its staff.

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Committee. In addition, to facilitate the development of our recommendations, our four subcommittees researched, deliberated, and sought views from various constituents, in order to prepare proposals for consideration by the full Committee. In generating this report, we also considered all of the public comment letters received on our work and public testimony received in March and May 2008.^{5]}

This final report is organized by the topics considered by our four subcommittees. Thus, chapter 1 is on substantive complexity, chapter 2 on the standards-setting process, chapter 3 on audit process and compliance, and chapter 4 on delivering financial information.

II. Scope of Our Report

We have limited our deliberations to matters involving SEC registrants. While financial reporting matters and, more specifically, generally accepted accounting principles in the U.S. (U.S. GAAP), also apply to private companies and non-profit entities, our focus is consistent with our role as an advisory committee to the SEC.

We have also limited our scope as it relates to international matters. [We broadly support] the continued move to a single set of high-quality global accounting standards, coupled with enhanced international coordination to foster their consistent interpretation and to avoid jurisdictional variants. Further, [we encourage] the development of a roadmap to identify issues and milestones to transition to this end state in the U.S., with sufficient time to minimize disruptions, resource constraints, and the complexity arising from such a significant change.^{6]}

[We note] that the SEC and the FASB are now engaged deeply in efforts with many parties across the world on a variety of complex issues related to the convergence^{7]} of U.S. GAAP with international financial reporting standards (IFRS). Accordingly, the Committee has decided not to focus directly on convergence issues. However, we recognize that there are various paths to convergence, and that a full transition may take

⁵ Comments to the Committee are available at <http://www.sec.gov/comments/265-24/265-24.shtml>. Verbal testimony is available via archived webcasts and records of proceedings at <http://www.sec.gov/about/offices/oca/acifr.shtml>.

⁶ Chairman Christopher Cox, *Making Disclosure More Useful for Public Company Directors*, Keynote Address to the Stanford Law School Directors' College, Palo Alto, CA, (June 23, 2008).

⁷ Some constituents understand "transition" or "convergence" to mean that U.S. GAAP and IFRS (as issued by the International Accounting Standards Board (IASB)) will eventually be harmonized, at which point no substantive differences will exist between the two bodies of accounting literature. Others understand it to mean a discrete transition from U.S. GAAP to IFRS at a specified date without respect to whether the two bodies of literature are substantially harmonized at the date of transition. We use these terms broadly and interchangeably to refer to the movement from the current financial reporting system in the U.S. to its ultimate end state, without endorsement of the specific approach to do so.

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years to achieve. Therefore, [we believe] it is quite fruitful to recommend enhancements to the current financial reporting system in the U.S.

In specific, [we believe] that the principles underlying our recommendations are relevant, regardless of the end state of convergence. For example, [we believe] our recommendations to improve the standards-setting process would be relevant to any accounting standards-setter. Furthermore, to the extent feasible, we point out how our recommendations can be coordinated with the work of the IASB and the development of IFRS, with the objective of promoting convergence. For example, [we note] that the guidance contained in IFRS is generally less encumbered by detailed rules than U.S. GAAP; accordingly, U.S. GAAP will probably need to become less rules-based in order to promote the goal of global convergence. [We also note] that IFRS has less industry-specific guidance, and [we encourage] the IASB to continue in this manner, consistent with our recommendation that the FASB issue activity-based standards rather than industry-specific accounting standards. On the other hand, IFRS contains a number of alternative accounting policies for the same activity, and there are political pressures to add exceptions in certain countries. As part of the effort to promote global convergence, [we urge] the IASB to continue to reduce the number of alternative accounting policies currently available.

III. Key Recommendations

This executive overview highlights the key aspects of the Committee's recommendations, with a few examples,⁸ linking these recommendations with the Committee's dual mandate of improving usefulness and reducing complexity in financial reporting. A compendium of the Committee's final recommendations is included at the end of this executive overview. This section of the executive overview outlines five themes underlying the Committee's recommendations in this final report:

- A. Increasing the usefulness of information in SEC reports
- B. Enhancing the accounting standards-setting process
- C. Improving the substantive design of new accounting standards
- D. Delineating authoritative interpretive guidance
- E. Clarifying guidance on financial restatements and accounting judgments

III.A. Increasing the Usefulness of Information in SEC Reports

One of our primary objectives is to make financial information more useful to investors, both individuals and institutions, while minimizing additional burdens on preparers. As part of this effort, [we are recommending] a short summary at the beginning of a company's annual and quarterly reports [alternatively, initially in the annual report and

⁸ The examples we use are illustrative only; we do not mean to imply any order of priority.

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phased-in to quarterly reports]. Many individual investors may find a company's periodic reports overly complex and detailed. A summary would describe in no more than two pages the company's main business units, key metrics for its past performance, and an outline of its business outlook, along with a page index showing where investors could find more detailed information on particular subjects.

These executive summaries would appear in the forepart of these financial reports, whether on company websites or in hard copies of the reports. In addition, in [our view,] summary information on corporate websites allows investors to obtain an overview of the company's financial performance, with hyperlinks to allow more detailed reviews of any particular area. To promote greater use of corporate websites, [we urge] the SEC to provide additional guidance on certain legal issues through an updated interpretive release.

[We support] the SEC's long-term efforts to transform financial reports into XBRL, so that particular items across companies can be easily sorted and analyzed by investors. Similarly, [we support] the gradual phase-in of XBRL, which was generally included in the SEC's recent proposal. The SEC proposal further follows generally [our recommendation] to have XBRL tags initially furnished (rather than filed) by companies, without a separate attestation report on these tags by the auditors.

[We are] also encouraging the private sector to develop key performance indicators (KPIs), on an activity and industry basis, that would capture important aspects of a company's activities that may not be fully reflected in its financial statements or may be non-financial measures. [In our view,] KPIs are likely to provide investors with an enhanced understanding of company performance so this is a fruitful area for encouraging further uniformity and disclosure. While we recognize that the most appropriate KPIs may be dependent on the activities of the particular company, we would like the private sector to develop consistent definitions and methodologies for KPIs by activity and industry, as appropriate, in order to facilitate comparisons across companies and through time.

III.B. Enhancing the Accounting Standards-Setting Process

Although the FASB's processes work well and it recently made significant improvements to these processes, further refinements could enhance the effectiveness and efficiency of standards-setting. Most importantly, [we believe] that the financial reporting system would be best served by recognizing the pre-eminence of the perspective of investors because they are the primary users of financial reports. To promote this perspective, we support increased investor representation on the FASB and the Financial Accounting Foundation (FAF). In addition, we believe that other participants in standards-setting should either be investors or those with some investing experience, to the maximum

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extent feasible. Increasing their direct and indirect representation in the process is the best way to assure that financial reports will be useful to investors.

While the FASB has an extensive process for soliciting feedback from investors and other interested parties on proposed standards, this process would be improved by increasing the field work for proposed standards and formalizing post-adoption reviews of new standards, as well as periodic assessments of existing standards. These measures are designed to provide the FASB with better input during and after the standards-setting process, which should enhance the effectiveness of the process and make the end product more useful to investors.

To be responsive to the ever-changing financial landscape, the FASB needs to coordinate its efforts with those of the SEC and the PCAOB, as well as the needs of investors, preparers, auditors, and other interested parties. To promote such coordination, we [recommend] the creation of a Financial Reporting Forum (FRF), on which all of these public and private parties would be represented. The FRF would meet regularly to evaluate the current pressures on the financial reporting system, set priorities for projects, and discuss how to carry out these projects.

III.C. Improving the Substantive Design of New Accounting Standards

Certain accounting standards do not clearly articulate their underlying objectives and principles; these are sometimes obscured by dense language, detailed rules, and numerous exemptions. In response, [we are] suggesting a different approach to the design of standards in a few important areas.

[We strongly support] the FASB's efforts to divide the income statement into two or more sections. [We recognize] the current mixed attribute system of historic cost and fair value is likely to continue, although [we urge] a cautious approach to further expansions of fair value. Within this mixed attribute system, it would be very helpful to portray for investors the different sources of changes in a company's income – for example, by clearly distinguishing cash receipts from unrealized changes in fair value. [In our view,] this distinction would also help companies explain better to investors earnings volatility each period.

[We generally oppose] all-or-nothing bright-line tests since some of them may result in very different accounting for transactions with quite similar economics. A number of these tests are also susceptible to manipulation, which the leasing rules well illustrate. Instead, [we advocate] intermediate approaches such as proportionate recognition, consideration of qualitative factors, and enhanced disclosures to more fairly present a company's financial condition and operating results. Each of these approaches might be fruitfully considered, for example, as part of the accounting reforms under discussion for off-balance-sheet financing vehicles.

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To decrease complexity and increase comparability, [we are generally advocating] a move away from industry-specific guidance in authoritative literature – unless justified by strong conceptual arguments. A better approach would be to focus on the nature of the business activity itself, since the same activities, such as lending, may be carried out by companies from different industries. [In our view,] the FASB should begin by addressing industry-specific guidance that conflicts with the general principles in U.S. GAAP. [We also recommend] that the FASB eliminate alternative accounting methods for the same transaction, unless the alternative has a compelling rationale.

III.D. Delineating Authoritative Interpretive Guidance

Historically, interpretive guidance on implementing accounting standards proliferated from many public and private sources, thus increasing the volume of U.S. GAAP. To reduce the avoidable complexity associated with the proliferation of U.S. GAAP, [we strongly support] the FASB's efforts to complete the codification of all U.S. GAAP in one document, which would clearly delineate authoritative from non-authoritative literature. Further, the SEC should codify its guidance on accounting matters in a format consistent with the one used by the FASB. While [we recognize] that non-authoritative interpretive implementation guidance will continue to be promulgated by various sources and to play a useful role, [we recommend] that such guidance be prominently labeled as non-authoritative to avoid confusion. If the convergence of U.S. GAAP and IFRS does not occur within a few years, the FASB and the SEC should consider a systematic rethinking of U.S. GAAP in a second phase of the codification project.

[We believe] that there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance of general significance. The FASB should perform this function for U.S. GAAP, while the SEC should focus on registrant-specific guidance as explained below. If the SEC staff identifies accounting issues of relatively broad significance in the process of reviewing filings by registrants, the SEC staff should refer such issues to the FASB through the proposed FRF. In those rare instances when the SEC believes it is necessary to quickly announce an accounting interpretation of broad significance, [we strongly encourage] the SEC to consult in advance with the FASB and the FRF.

[We support] the efforts of the SEC staff in its Division of Corporation Finance to publish its comment letters on financial reports filed by registrants. However, [we urge] the SEC staff to re-emphasize that those comment letters are registrant-specific and do not represent binding precedent on other registrants. Similarly, [we urge] the Division of Corporation Finance and the Office of the Chief Accountant to emphasize that their “pre-clearance” processes are registrant-specific and are not binding on other registrants. [We also support] a number of steps that we understand the SEC staff is planning to take to increase the consistency of its accounting guidance to registrants.

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III.E. Clarifying Guidance on Financial Restatements and Accounting Judgment

In 2006 and 2007, 9% to 10% of all U.S. public companies restated their financial statements because of accounting errors, although the number may be beginning to decline. Moreover, there is considerable evidence that the accounting errors leading to financial restatements were less significant in the last few years than in the period before 2002. The restatement process, which may take longer than 12 months, imposes significant costs on investors as well as preparers. During that process, companies normally go into a “dark period” and issue very little financial information to the public.

Therefore, [we recommend] that the determination of whether an accounting error is material be separated from the decision on how to correct the error. [In our view], a company should promptly correct and prominently disclose any accounting error unless clearly insignificant. In addition, the instructions to the SEC’s Form 8-K should make clear that it must be filed for all determinations of non-reliance on prior financial statements to limit the possibility of “stealth” restatements. On the other hand, the correction and disclosure of any accounting error should not automatically result in the amendment of prior financial statements; rather, past financial statements should be restated only if the restatement would be material to investors making current investment decisions.

The preparation and audit of financial statements have always required the exercise of judgment. The recent trend in accounting entails a move away from prescriptive guidance toward greater use of judgment – for example, the more frequent use of fair value involves estimates of value that may be less objectively determined than historical cost measures. Similarly, the revised auditing standards recently issued by the PCAOB emphasize the need for professional judgment in taking a risk-based approach to performing internal control audits. Moreover, international accounting standards generally contain less prescriptive guidance and more reliance on general principles than U.S. GAAP.

In recognition of the increasing exercise of accounting and audit judgments, [we recommend] that the SEC and PCAOB adopt policy statements on this subject. These policy statements would provide more transparency into how these regulators evaluate the reasonableness of a judgment. [We have offered] factors that [we believe] are important in this evaluation process, including the available alternatives a company identified; the robustness of a company’s analysis of the relevant literature and review of the pertinent facts; and how a company’s conclusions meet investors’ information needs. [We also believe] that the statement of policy should emphasize that judgments be documented contemporaneously to ensure that the evaluation of the judgment is based on the same facts that were reasonably available at the time the judgment was made. [We

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believe] adoption of these policy statements would not only provide more transparency into how the SEC and the PCAOB evaluate the reasonableness of a judgment, but also encourage preparers and auditors to follow a disciplined process in making judgments. As a result, investors should have more confidence in the ways in which accounting and auditing judgments are being exercised.

IV. Compendium of Recommendations

In this final report, the Committee makes the following recommendations – organized according to the four chapters of the report. Each recommendation is discussed in more detail in the body of this report.

Chapter 1 – Substantive Complexity

1. **Recommendation 1.1:** Avoidable complexity caused by the mixed attribute model should be reduced in the following 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 required⁹ until:
 - The FASB completes a measurement framework to systematically assign measurement attributes to different types of business activities
 - The SEC, the FASB, and other regulators and standards-setters develop and implement a plan to strengthen the infrastructure that supports fair value reporting.
 - Financial statement presentation¹⁰ – The SEC should recommend that the FASB:
 - Assign a single measurement attribute within each business activity to the maximum extent feasible, which is consistent across the financial statements¹¹
 - Aggregate business activities into operating, investing, and financing sections

⁹ For instance, improvements to certain existing, particularly complex standards, such as SFAS No. 133 and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, may be warranted in the near-term.

¹⁰ [We are aware] of the FASB and IASB's joint financial statement presentation project and [are generally supportive] of its direction.

¹¹ To make this approach operational, the FASB might establish a rebuttable presumption in favor of a single measurement attribute within the operating, investing, and financing sections of the financial statements. 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.

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- Add a new primary financial statement to reconcile the statements of income and cash flows by major classes of measurement attributes.¹²
2. Recommendation 1.2: The SEC should recommend that the FASB develop a disclosure framework to:
 - Integrate existing disclosure requirements into a cohesive whole to ensure meaningful communication and logical presentation of disclosures, based on consistent objectives and principles. This would eliminate redundancies and provide a single source of disclosure guidance across all financial reporting standards.
 - 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.
 3. Recommendation 1.3: 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.¹³
 4. Recommendation 1.4: Recognition guidance in U.S. GAAP should be based on a presumption that bright lines should not exist. As such, the SEC should recommend that the recognition guidance in new projects undertaken jointly or separately by the FASB avoid the use of bright lines, in favor of proportionate recognition.¹⁴ Where proportionate recognition is not feasible or applicable, the FASB should provide qualitative factors in its recognition guidance. 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 the recognition guidance of relevant areas to the extent feasible as a specific objective of those projects, in favor of the two approaches above.

5. Recommendation 1.5: 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 recommend that the FASB, academics, and

¹² An example of this presentation is included in chapter 1.

¹³ We consider coordination between the SEC and the FASB in chapter 2.

¹⁴ We define proportionate recognition to mean accounting for the rights and obligations in a contract, as discussed in chapter 1.

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professional organizations, better educate students, investors, preparers, auditors, and regulators in this respect.

6. Recommendation 1.6: U.S. GAAP should be presumptively based on business activities, rather than industries. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB be scoped on the basis of business activities, except in rare circumstances. Any new projects should include the elimination of existing industry-specific guidance—particularly that which conflicts with generalized U.S. GAAP—in relevant areas as a specific objective of those projects, except in rare circumstances.

Considering the pace of convergence efforts, the SEC should also recommend that in conjunction with its current codification project, the FASB add a project to its agenda to eliminate existing industry-specific guidance which conflicts with generalized U.S. GAAP, except in rare circumstances.

7. Recommendation 1.7: U.S. GAAP should be based on a presumption that formally promulgated alternative accounting policies should not exist. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB not provide additional optionality, except in rare circumstances. Any new projects should also include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects, except in rare circumstances.
8. Recommendation 1.8: U.S. GAAP should be scoped with sufficient precision to minimize the use of scope exceptions. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB should be carefully scoped to minimize the use of exceptions. Any new projects should also seek to refine the scope of existing standards in relevant areas as a specific objective of those projects to minimize existing scope exceptions.
9. Recommendation 1.9: U.S. 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 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 those projects, except in rare circumstances.

Chapter 2 – Standards-Setting Process

10. Recommendation 2.1: Investor perspectives are critical to effective standards-setting, as investors are the primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the

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needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting. Although it is more challenging to obtain investor perspectives than those of other constituents involved in the standards-setting process, additional investor representation would facilitate increased consideration of investor perspectives in the standards-setting process. Specifically, the SEC should recommend that the FAF and the FASB do the following:

- Add investors to the FAF to give more weight to the views of different types of investors, both large and small
- Give more representation on both the FASB and the FASB staff to experienced investors to improve consideration of the usefulness of financial reports
- Re-evaluate the manner, timing, and quality of investor input received throughout standards-setting to determine whether changes would be warranted to make investor involvement more efficient and effective.

11. Recommendation 2.2: The SEC should continue to recommend that the FAF enhance governance of the FASB, as follows:

- Recommend that the FAF amend the FASB's mission statement, stated objectives, and precepts to emphasize that an additional goal should be to minimize avoidable complexity
- Recommend that the FAF develop performance metrics to ensure that key aspects of the standards-setting process are effective, efficient, and compliant with the goals in the FASB's mission statement, objectives, and precepts.

12. Recommendation 2.3: The SEC should recommend that the FAF, the FASB, and other participants in the financial reporting system continue to improve the effectiveness, efficiency, and timeliness of standards-setting, as follows:

- Create a formal FRF that includes key decision makers in the U.S. financial reporting system, including representatives from the SEC,¹⁵ the FASB, and the PCAOB, as well as the preparer, auditor, and investor and other user communities, to make recommendations for responding to immediate needs and longer-term priorities in the financial reporting system overall. This may require the FASB to re-evaluate the roles and composition of other advisory groups or agenda committees.
- Enhance the consistency and transparency of key aspects of the FASB's field work, including cost-benefit analyses, field visits, and field tests.
- Formalize post-adoption reviews of each significant new standard to address interpretive questions and reduce the diversity of practice in applying the standard, if needed.

¹⁵ The extent of advice able to be given to the SEC would need to consider the constraints imposed by the Federal Advisory Committee Act.

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- Formalize periodic assessments of existing standards to keep the standards current.
13. Recommendation 2.4: The SEC should coordinate with the FASB to clarify roles and responsibilities regarding the issuance of interpretive implementation guidance, as follows:
- To the extent practicable, going forward, there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance that are applicable to a particular set of accounting standards, such as U.S. GAAP or IFRS. For U.S. GAAP, the FASB serves this function. To that end, the SEC should only issue broadly applicable interpretive implementation guidance in limited situations (see recommendation 2.5).
 - The FASB Codification, a draft of which was released for verification on January 16, 2008, should be completed in a timely manner. In order to fully realize the benefits of the FASB’s codification efforts, the SEC should ensure that the literature it deems to be authoritative is integrated into the FASB Codification to the extent practicable, or separately codified, as necessary.
 - All other sources of interpretive implementation guidance should be considered non-authoritative and should not be required to be given more credence than any other non-authoritative sources that are evaluated using reasonable judgments made in good faith that are supportable under U.S. GAAP.
 - The proposed FRF should advise the FASB on re-prioritizing its agenda in a way that balances the need for international convergence (which is highly dependent on possible future actions of the SEC), improvements to the conceptual framework and maintaining existing U.S. GAAP. If U.S. GAAP will continue to be in use for an extended period of time, such a re-prioritization of standards-setting should consider the possibility of a second phase of the codification project to systematically revisit U.S. GAAP.
14. Recommendation 2.5: As a general matter, the SEC staff should refrain from issuing broadly applicable interpretive implementation guidance that would change U.S. GAAP and instead should refer such matters to the FASB, such as through the proposed Financial Reporting Forum. The SEC staff should re-emphasize that its comment letter and “pre-clearance” processes are registrant-specific and that other registrants should respond to those comments by changing their accounting only after concluding it is appropriate to do so. Furthermore, the SEC staff is taking a number of steps to improve the consistency of its interpretive implementation guidance associated with U.S. GAAP and the Commission should take appropriate steps to monitor the outcome of those actions.
15. Recommendation 2.6: The SEC should recommend that the FASB build upon recent improvements made to the design of accounting standards as part of its Understandability initiative – primarily by increasing the use of clearly-stated

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objectives, outcomes, and principles, and emphasizing the importance in financial reporting of the faithful representation of the economics of transactions and being responsive to investor and other user needs for clarity, transparency, and comparability.

Chapter 3 – Audit Process and Compliance

16. Recommendation 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 large¹⁶ 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.

17. Recommendation 3.2: The FASB or the SEC, as appropriate, should issue guidance on how to correct an error consistent with the principles outlined below:

- Companies should be required to correct all errors promptly and should not have the option to defer correction of errors until future financial statements. All material errors in previously issued financial statements 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 investors making current investment decisions. For example, a material error that is not important to a current investment decision would not require restatement of the financial statements in which the error occurred, but would need to be promptly corrected and prominently 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.

¹⁶ In this recommendation, the term “large” refers to any error that is more than insignificant. We understand that this is a broad definition and that the larger an error is, the more likely that the error will be deemed material regardless of any qualitative factors.

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- Restatements of interim periods do not necessarily need to result in a restatement of an annual period.
 - Corrections of large errors in previously issued financial statements should always be disclosed in the filing, even if the error is determined not to be material.
 - To limit the likelihood of “stealth restatements,” the SEC should revise the instructions to Form 8-K to state clearly that the form needs to be filed for all determinations of non-reliance on prior financial statements.
18. Recommendation 3.3: The FASB or the SEC, as appropriate, should issue guidance on disclosure of financial information 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.
19. Recommendation 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 recommendation 3.2.
20. Recommendation 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 recommendation to cover judgments made by auditors based on the application of PCAOB auditing standards would be beneficial to auditors. Therefore, we recommend 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’s 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.

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Chapter 4 – Delivering Financial Information

21. Recommendation 4.1: The SEC should, over the long-term, mandate the filing of interactive data-tagged financial statements after the satisfaction of certain preconditions relating to: (1) successful XBRL U.S. GAAP Taxonomy testing, (2) the capacity of reporting companies to file interactive data-tagged financial statements using the new XBRL U.S. GAAP Taxonomy on the SEC's EDGAR system, and (3) the ability of the EDGAR system to provide an accurately rendered version of all such tagged information. The SEC should phase-in interactive data-tagged financial statements as follows:

- The largest 500 domestic public reporting companies based on unaffiliated market capitalization (public float) should be required to furnish to the SEC, as is the case in the voluntary program today, a document prepared separately from the reporting companies' financial statements that are filed as part of their periodic Exchange Act reports. This document would contain the following:
 - Interactive data-tagged face of the financial statements¹⁷
 - Block-tagged footnotes to the financial statements.¹⁸
- Domestic large accelerated filers (as defined in SEC rules, which would include the initial 500 domestic public reporting companies) should be added to the category of companies, beginning one year after the start of the first phase, required to furnish interactive data-tagged financial statements to the SEC.

Once the preconditions noted above have been satisfied and the second phase-in period has been implemented, the SEC should evaluate whether and when to move from furnishing to the SEC to the official filing of interactive data-tagged financial statements with the SEC for the domestic large accelerated filers, as well as the inclusion of all other reporting companies, as part of a company's Exchange Act periodic reports.¹⁹

22. Recommendation 4.2: The SEC should issue a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate

¹⁷ To allow this first phase, the SEC EDGAR system must permit submissions using the new XBRL U.S. GAAP Taxonomy.

¹⁸ We understand that tagging beyond the face of the financial statements and block-tagging of footnotes, such as granular tagging of footnotes and non-financial data, may require significant effort and would involve a significant number of tags. See, e.g., comment letter from Medtronic, Inc. (March 31, 2008).

¹⁹ [A dissenting vote on developed proposal 4.1 was cast by Peter Wallison in February 2008].

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information, which addresses issues such as liability for information presented in a summary format, treatment of hyperlinked information from within or outside a company's website, treatment of non-GAAP disclosures and GAAP reconciliations, and clarification of the public availability of information disclosed on a reporting company's website.

Industry participants, including investors, should coordinate among themselves to develop uniform best practices on uses of corporate websites for delivering corporate information to investors and the market.

23. Recommendation 4.3. The SEC should encourage private sector initiatives targeted at best practice development of company use of KPIs in their business reports. The SEC should encourage private sector dialogue, involving preparers, investors (including analysts), and other interested industry participants, such as consortia that have long supported KPI-like concepts, to generate understandable, consistent, relevant and comparable KPIs on relevant activity and, as appropriate, industry-specific, bases. 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 management discussion and analysis (MD&A) and other company disclosures.
24. Recommendation 4.4. Industry groups, including the National Investor Relations Institute, Financial Executives International, 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 restating 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.

25. Recommendation 4.5: The SEC should mandate the inclusion of an executive summary in the forepart of a reporting company's filed annual and quarterly reports [or, alternatively, annual reports initially with a phase-in for quarterly reports] that will provide a roadmap to the fuller discussion in the reports. The executive summary should provide summary information, in plain English, in a narrative and

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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 periodic report. To the extent a similar summary is included elsewhere in the report, the disclosure could cross-reference such summary. The requirement for the executive summary, with a recommended length of up to two pages, should build on, but not replicate, 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 key aspects of company performance;
- A digest of the company's GAAP, non-GAAP, and non-financial KPIs (to the extent disclosed in the company's Form 10-Q or 10-K [or, alternatively, to the extent disclosed in the company's Form 10-K]);
- A summary of business outlook; and
- Page number references to more detailed information contained in the document (which, if the report is provided electronically, could be hyperlinks).

* * * * *

[We believe] publication of this report will increase the likelihood of our recommendations being implemented. We have made great efforts to solicit public input at every stage of the Committee's deliberations, and to work closely with the staff of the SEC, the FASB, and the PCAOB. We are hopeful that, through the cooperation of all relevant parties, this report will expeditiously and significantly improve the state of financial reporting in the U.S.

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INTRODUCTION

I. Our Formation

On June 27, 2007, U.S. Securities and Exchange Commission (SEC or Commission) Chairman Christopher Cox announced the Commission's intent to establish the SEC Advisory Committee on Improvements to Financial Reporting (Committee).²⁰ At the same time, Robert C. Pozen was named Chairman of the Committee. The official notice of our establishment was published in the Federal Register five days later.²¹ The Committee's charter was filed with the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services on July 17, 2007, initiating our 12 ½-month existence.²² The Committee's membership was completed on July 31, 2007, with members drawn from a wide range of professions, backgrounds, and experiences.²³ On August 2, 2007, we adopted our by-laws.²⁴

II. Our Objectives

The Committee's dual mandate is to examine the U.S. financial reporting system in order to make recommendations intended to increase the usefulness of financial information to investors, while reducing the complexity of the financial reporting system to investors, preparers, and auditors.

More specifically, our charter identifies the following areas of inquiry:

- The current approach to setting financial accounting and reporting standards, including: (1) the principles-based versus rules-based standards, (2) the inclusion within standards of exceptions, bright lines, and safe harbors, and (3) the process for providing timely guidance on implementation issues and emerging issues
- The current process of regulating compliance with accounting and reporting standards
- The current system for delivering financial information to investors and accessing that information
- Other environmental factors that drive avoidable complexity, including the possibility of being "second-guessed," the structuring of transactions to achieve an accounting

²⁰ See, SEC, *SEC Establishes Advisory Committee to Make U.S. Financial Reporting System More User-Friendly for Investors*, SEC Press Release No. 2007-123 (June 27, 2007) (included as appendix A).

²¹ See, SEC, *Advisory Committee on Improvements to Financial Reporting*, SEC Release No. 33-8817 (July 2, 2007) [72 FR 36077] (included as appendix B).

²² See, Committee charter (included as appendix C).

²³ See, SEC, *SEC Chairman Cox Announces Members of Advisory Committee on Improvements to Financial Reporting*, SEC Press Release No. 2007-154 (July 31, 2007) (included as appendix D). This press release describes the diverse backgrounds of the Committee members.

²⁴ See, Committee by-laws (included as appendix E).

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result, and whether there is a hesitance by professionals to exercise professional judgment in the absence of detailed rules

- Whether there are current accounting and reporting standards that do not result in useful information to investors, or impose costs that outweigh the resulting benefits
- Whether the growing use of international accounting standards has an impact on the relevant issues relating to the complexity of U.S. accounting and reporting standards and the usefulness of the U.S. financial reporting system.

At the start of our work, the Committee agreed to issue focused recommendations, addressing acknowledged problem areas, that we believe can be adopted in a reasonable time period by the SEC, the Financial Accounting Standards Board (FASB or Board), or the Public Company Accounting Oversight Board (PCAOB). We agreed to avoid recommendations requiring legislative action or attempting to address all perceived shortcomings in the financial reporting system.

III. Our Guiding Principles

[We believe] that financial reporting should provide information that aids investors in making investment, credit, and similar resource allocation decisions.²⁵ Of paramount importance are investors, defined as all providers of capital, including current and potential providers of equity capital and creditors.²⁶

Some argue that, over time, financial reporting has become a burdensome compliance exercise with decreasing relevance to investors. This effect can be attributed, in part, to: (1) the evolution of new business strategies and financing techniques that stretch the limits of what the traditional reporting framework can effectively convey, and (2) an overly litigious culture that, arguably, results in financial reporting designed as much to protect against liability as to inform investors. As a result, we believe the disconnect between current financial reporting and the information necessary to make sound investment decisions has become more pronounced.

A key factor often cited as driving this disconnect is complexity, which has rarely been defined in the context of financial reporting. We developed and applied the following definition of complexity in this context to guide our deliberations:

²⁵ Adapted from the FASB and IASB exposure draft, *Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information* (May 29, 2008), which states, “The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers. Information that is decision useful to capital providers may also be useful to other users of financial reporting who are not capital providers.”

²⁶ We recognize there are other important users of financial statements, such as credit rating agencies.

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Definition of Complexity

The state of being difficult to understand and apply. Complexity in financial reporting refers primarily to the difficulty for:

1. Investors to understand the economic substance of a transaction or event and the overall financial position and results of a company
2. Preparers to properly apply generally accepted accounting principles in the U.S. (U.S. GAAP) and communicate the economic substance of a transaction or event and the overall financial position and results of a company
3. Other constituents to audit, analyze, and regulate a company's financial reporting.

Complexity can impede effective communication through financial reporting between a company and its stakeholders. It also creates inefficiencies in the marketplace (e.g., increased investor, preparer, audit, and regulatory costs) and suboptimal allocation of capital.

Causes of Complexity

The causes of complexity are many and varied. We have identified the following significant causes of complexity:

1. Complex activities – The increasingly sophisticated nature of business transactions can be difficult to understand, particularly with respect to the growing scale and scope of companies with operations that cross international boundaries and financial reporting regimes.
2. Incomparability and inconsistency – Incomparable reporting of activities within and across entities arises because of factors such as the mixed attribute model, bright lines, and exceptions to general principles. Some of this guidance permits the structuring of transactions in order to achieve particular financial reporting results. Further, to the extent new pronouncements are adopted prospectively, past and present periods of operating results are not comparable. This is compounded by the rapid pace at which new accounting pronouncements are being adopted, which hinders the ability of all constituents to understand and apply new guidance in relatively short timeframes.
3. Nature of financial reporting standards – Standards can be difficult to understand and apply for several reasons, including:
 - The existence of opposing points of view that were taken into account when developing standards – most importantly, the attempts by public companies to smooth amounts that vary from period to period, versus the requests from those who want such amounts marked to market each period
 - The challenge of describing accounting principles in simple terms (i.e., plain English) for highly sophisticated transactions
 - The presence of detailed guidance for numerous specific fact patterns

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- The impact of multiple bodies setting standards
 - The development of such standards on the basis of an incomplete and inconsistent conceptual framework.
4. Volume – The vast number of formal and informal accounting standards, regulations, and interpretations, including redundant requirements, make finding and evaluating the appropriate standards and interpretations challenging for particular fact patterns.
 5. Audit and regulatory systems that complicate the use of professional judgment – The risk of litigation and the fear of being “second-guessed” result in: (1) a greater demand for detailed rules on how to apply accounting standards to an ever increasing set of specific situations, (2) unnecessary restatements that are not meaningful to investors, and (3) legalistic disclosures that are difficult to understand.
 6. Educational shortcomings – Undergraduate and graduate education in accounting has traditionally emphasized the mechanics of double-entry bookkeeping, which favors the use of detailed rules rather than the full understanding of relevant principles. The same approach is evident in the certified public accountant (CPA) exam, as well as continuing professional education requirements.
 7. Information delivery – The need for information varies by investor type and is often driven by legal risk, rather than investor needs. In addition, the lack of a holistic approach to disclosures, the amount and timing of information, and the method by which it is transmitted, may result in complex and hard-to-navigate disclosures that cause investors to sort through material that they may not find relevant in order to identify pieces that are. These factors make it difficult to distinguish the sustaining elements of an entity from non-operating or other influences.

We observe that two types of substantive complexity exist: (1) unavoidable complexity, which is a function of the underlying transaction or item being accounted for, such as the first cause of complexity noted above, and (2) avoidable complexity, which is introduced from other sources. Our focus is on avoidable complexity, with an emphasis on improvements that are feasible in the near-term.

IV. Our Scope

IV.A. Public Company Focus

We have limited our deliberations to matters involving SEC registrants. While financial reporting matters and, more specifically, U.S. GAAP, also apply to private companies and non-profit entities, our focus is consistent with our role as an advisory committee to the SEC.

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IV.B. International Matters

The global financial reporting environment has changed dramatically over the past six years. Specifically, in 2002, the European Union adopted a regulation requiring its listed companies to report under international financial reporting standards (IFRS) by 2005. Also in 2002, the FASB and the International Accounting Standards Board (IASB) agreed to work together to converge U.S. GAAP and IFRS over time.²⁷ In 2007, the SEC amended its rules to eliminate the requirement for a U.S. GAAP reconciliation for foreign private issuers reporting under IFRS as issued by the IASB,²⁸ and issued a concept release²⁹ to explore a more far-reaching prospect – the possibility of giving domestic issuers the alternative to report using IFRS.

These events have heightened the debates regarding the future of the financial reporting system in the U.S. These debates involve both the end state (i.e., whether to support a single set of high-quality global accounting standards) and the best way to accomplish that end state in the U.S. (i.e., the transition).³⁰ [We broadly support] the continued move to a single set of high-quality global accounting standards, coupled with enhanced international coordination to foster their consistent interpretation and to avoid jurisdictional variants. Further, [we encourage] the development of a roadmap to identify issues and milestones to transition to this end state in the U.S., with sufficient time to minimize disruptions, resource constraints, and the complexity arising from such a significant change.³¹

Notwithstanding the above, throughout the remainder of this report, we have focused our scope on the U.S. financial reporting environment for two reasons. First, as the Commission has already received extensive public input regarding the expanded use of IFRS in the U.S., our deliberations would likely add little new information to the debate. Second, [we believe] that full transition may take years to achieve, so that U.S. GAAP

²⁷ FASB and IASB memorandum of understanding, *The Norwalk Agreement* (September 18, 2002).

²⁸ SEC, *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP*, SEC Release No. 33-8879 (December 21, 2007).

²⁹ SEC, *Concept Release On Allowing U.S. Issuers To Prepare Financial Statements In Accordance with International Financial Reporting Standards*, SEC Release No. 33-8831 (August 7, 2007).

³⁰ Some constituents understand “transition” or “convergence” to mean that U.S. GAAP and IFRS (as issued by the IASB) will eventually be harmonized, at which point no substantive differences will exist between the two bodies of accounting literature. Others understand it to mean a discrete transition from U.S. GAAP to IFRS at a specified date without respect to whether the two bodies of literature are substantially harmonized at the date of transition. We use these terms broadly and interchangeably to refer to the movement from the current financial reporting system in the U.S. to its ultimate end state, without endorsement of the specific approach to do so.

³¹ Chairman Christopher Cox, *Making Disclosure More Useful for Public Company Directors*, Keynote Address to the Stanford Law School Directors’ College, Palo Alto, CA, (June 23, 2008).

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will continue to be utilized by many U.S. public companies for a number of years. Therefore, [we believe] it is quite fruitful to recommend enhancements to the current financial reporting system in the U.S.

Despite this focus on U.S. GAAP, [we believe] that the principles underlying our recommendations are relevant, regardless of the end state of convergence. For example, [we believe] our recommendations to improve the standards-setting process would be relevant to any accounting standards-setter. Furthermore, to the extent feasible, we point out how our recommendations can be coordinated with the work of the IASB and the development of IFRS, with the objective of promoting convergence.

V. Our Approach

V.A. Subcommittee Structure

To facilitate the development of these recommendations, at our first open meeting on August 2, 2007,³² we adopted a subcommittee structure proposed by the Committee Chairman in a discussion paper that provided a working outline and potential considerations for the Committee.³³ Our subcommittees were as follows:

1. Substantive Complexity
2. Standards-Setting Process
3. Audit Process and Compliance
4. Delivering Financial Information

The July 31, 2007 discussion paper initially contemplated the establishment of an International Coordination subcommittee in 2008. However, for the reasons mentioned above, this additional subcommittee was not established.

V.B. Committee and Subcommittee Meetings

Each of these four subcommittees researched, deliberated, sought views from various constituents, and considered comment letters received, in order to prepare proposals for consideration by the full Committee. At our open meeting on November 2, 2007, in Washington D.C., each subcommittee provided the full Committee with an update of its deliberations to date, as well as any preliminary hypotheses regarding matters it intended,

³² This and all of our subsequent full Committee meetings were open to the public and conducted in accordance with the requirements of the Federal Advisory Committee Act (5 USC-App. 2 §1). All meetings of the full Committee were also webcast or audiocast over the internet.

³³ Committee Chairman Robert C. Pozen, *Discussion Paper for Consideration by the SEC Advisory Committee on Improvements to Financial Reporting* (July 31, 2007), available at http://www.sec.gov/about/offices/oca/acifr/acifr_discussion.htm.

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subject to further discussion, to ultimately recommend to the full Committee for consideration in developing its final report of recommendations to the Chairman of the SEC.

Subsequent to the November 11, 2007, open meeting, each subcommittee continued its fact-finding and deliberations to refine its preliminary hypotheses into: (1) developed proposals, (2) conceptual approaches, or (3) future considerations. Developed proposals were proposals that we believed could be implemented by the Commission, its staff, or other bodies, as appropriate. Conceptual approaches represented our initial views at the time, which were based on discussions on a particular subject, but which still required additional vetting before formalization into a developed proposal. Matters for future consideration were areas in which deliberations and research had not yet begun. At the Committee's open meeting on January 11, 2008, in Washington D.C., the full Committee received further updates from each subcommittee since the previous open meeting; further deliberated each of the developed proposals; and adopted all developed proposals, conceptual approaches, and matters for future consideration.³⁴

At our open teleconference on February 11, 2008, we reviewed a draft progress report discussing the Committee's developed proposals, conceptual approaches, and future considerations. All Committee members present at our February 11, 2008 meeting voted unanimously to issue this progress report to the Chairman of the SEC and to publish the progress report in order to encourage public feedback. This progress report was issued in final form on February 14, 2008 (Progress Report).³⁵

Subsequent to the issuance of the Progress Report, each subcommittee continued its refinement of its developed proposals and its work on its conceptual approaches and future considerations, through consideration of further research, deliberations, testimony, and comment letters. In addition, at our open meeting on March 13 and 14, 2008, in San Francisco, and our open meeting on May 2, 2008, in Chicago, we received public testimony from a total of five panels, each consisting of seven witnesses from various constituencies, in the areas of materiality, judgment, XBRL, substantive complexity, and the standards-setting process.³⁶

These efforts culminated in the preparation of a draft final report, reflecting draft recommendations proposed by each of the subcommittees for consideration by the full

³⁴ The Committee's vote to adopt the developed proposals, conceptual approaches, and matters for future consideration was unanimous, except for one dissenting vote from Mr. Peter Wallison regarding the timing of adoption of XBRL-tagged financial statements and the need for auditor assurance on the tagging process. See separate statement regarding this dissenting vote in appendix A of the Progress Report, available at <http://www.sec.gov/rules/other/2008/33-8896.pdf>.

³⁵ Our Progress Report is available at <http://www.sec.gov/rules/other/2008/33-8896.pdf>.

³⁶ Refer to appendix F for a list of witnesses on these panels.

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Committee. This draft final report was published on the Commission's website on July [7], 2008. [We discussed this draft final report at our open meeting on July 11, 2008, in Washington D.C., and voted unanimously in favor of each draft recommendation.]

[At the Committee's open teleconference on July 31, 2008, we reviewed an updated draft final report. All Committee members present voted unanimously to issue to the Chairman of the SEC this final report of the Committee's recommendations to the SEC³⁷ to improve financial reporting.]

V.C. Comment Letters

In developing this final report, we carefully considered all comment letters received.³⁸ We made, through the Commission, three formal requests for comments on issues we were considering. Specifically, on August 24, 2007, we published a release in the Federal Register formally seeking public comment on Chairman Pozen's discussion paper dated July 31, 2007.³⁹ On February 28, 2008, we formally requested comment on our Progress Report.⁴⁰ Finally, on May 22, 2008, we formally requested comment on each subcommittee's update report dated May 2, 2008.⁴¹ In addition, each of our meetings was announced by formal notice in a Federal Register release, and each such notice included an invitation to submit written statements to be considered in connection with the meeting. We also welcomed feedback at any time from investors, preparers, auditors, and others on the Committee's work, and maintained an open comment box via our dedicated page on the Commission's website.

VI. Organization of this Report

This final report is organized by the topics considered by our four subcommittees. Thus, chapter 1 is on substantive complexity, chapter 2 on the standards-setting process, chapter 3 on audit process and compliance, and chapter 4 on delivering financial information.

³⁷ In our role as an advisory committee to the SEC, we have addressed most of our recommendations to the SEC, while noting the need for involvement of other bodies, such as the FASB and the PCAOB. We also note that some of our recommendations may require SEC action, while others may be implemented by SEC staff. We have, however, generally adopted a convention of addressing these areas to the SEC for convenience. We leave the determination of whether the proposals require SEC or SEC staff action to the discretion of the SEC and its staff. This report does not necessarily reflect the views or regulatory agenda of the SEC or its staff.

³⁸ Comments to the Committee are available at <http://www.sec.gov/comments/265-24/265-24.shtml>.

³⁹ See, *Request for Comments on Discussion Paper for Consideration by the SEC Advisory Committee on Improvements to Financial Reporting*, SEC Release No. 33-8836, (August 24, 2007) [72 FR 48700].

⁴⁰ See, *Request for Comments on Progress Report of the SEC Advisory Committee on Improvements to Financial Reporting*, SEC Release No. 33-8896 (February 28, 2008) [73 FR 10898].

⁴¹ See, *Request for Comments on Subcommittee Reports of the SEC Advisory Committee on Improvements to Financial Reporting*, SEC Release No. 33-8918 (May 22, 2008) [73 FR 29808].

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CHAPTER 1: SUBSTANTIVE COMPLEXITY

I. Introduction

Public companies in the U.S. submit financial statements to the SEC so investors can monitor their financial performance and make decisions about capital allocation. Traditionally, those financial statements are prepared using a common framework referred to as U.S. GAAP. A casual review of audited financial statements might create a perception that amounts reported in a balance sheet or income statement are mechanical and precise, when they, in fact, reflect a great deal of choice, estimation, and judgment.

While, ideally, U.S. GAAP should provide clear and consistent guidance for preparing financial statements, this is not always true. A number of factors undermine this ideal, including the causes of complexity enumerated in the introduction to this report. As a result, certain parts of U.S. GAAP may actually hinder effective comparison of financial performance between companies. For instance, a large company may purchase a smaller company to acquire a newly-developed patent that the smaller company obtained to protect a promising new product. In that scenario, the purchasing company would value the patent and record it as an asset under U.S. GAAP. However, if the smaller company was not purchased, but continued developing the product on its own, it would be prohibited by U.S. GAAP from recording an asset to reflect the patent on its balance sheet.

This example is just one illustration of the avoidable complexity currently embedded in U.S. GAAP. We have identified what we consider to be the four most pressing forms of avoidable substantive complexity that currently exist in financial reporting: (1) the mixed attribute model that blends the use of fair value and historical cost, (2) the lack of a holistic approach to disclosures, (3) certain bright lines, and (4) exceptions to general principles.

The mixed attribute model results in amounts that are a blend of accounting conventions. Some assets and liabilities are measured at historic cost, others at lower of cost or market, and still others at fair value. Some advocate using fair value for the entire balance sheet as a solution to this blending effect. However, this approach would compound existing questions about the relevance and reliability of certain valuation modeling techniques, including considerable subjectivity in the valuation of thinly-traded assets and liabilities.

Disclosure provides important context for the estimates and judgments reflected in the financial statements. It also highlights risks and uncertainties outside of the statements that could impact financial performance in the future. Historically, disclosure standards have developed in a piecemeal manner, resulting in redundancies, confusion, and disorganized presentations in financial reports. These factors make complete and meaningful communication between companies and investors challenging.

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Bright lines can create arbitrary borders along a continuous spectrum of transactions. More problematic, certain reporting standards require drastically different accounting treatments on either side of a bright line that may not be warranted based on the underlying economics. Lease accounting is often cited as an illustration of bright lines. Consider, for example, a lessee's accounting for a piece of machinery. Under current requirements, a very small difference in quantitative tests can lead to totally opposite accounting results – the leased asset is fully reflected on the lessee's balance sheet, or it is not captured on the balance sheet at all.⁴²

Exceptions to general principles can also create complexity because they deviate from established standards that are applicable to most companies. In effect, investors and preparers no longer speak a uniform language to communicate financial information; they must learn new dialects. Other constituents in that communication process are similarly impacted. We have identified four types of these exceptions that contribute to complexity. First, some areas of industry-specific guidance conflict with generalized U.S. GAAP that applies across most industries.⁴³ Second, alternative accounting policies give preparers options among acceptable practices, such as whether or not to apply hedge accounting,⁴⁴ which reduce comparability across companies. Third, scope exceptions⁴⁵ represent departures from a principle and require detailed analyses to determine whether they apply. Fourth, competing models create requirements to apply different accounting treatments to similar types of transactions or events, depending on the balance sheet or income statement items involved. This diversity requires all constituents to understand assorted implementation methods, even though they are based on similar fundamental principles.

The remainder of this chapter discusses how these areas contribute to complexity in greater depth and, more importantly, provides recommendations to reduce their effects in a reasonable time period, to the extent feasible.

Lastly, while our deliberations have been conducted primarily in the context of the current U.S. environment, [we believe] our observations and recommendations will remain relevant if the international financial reporting environment changes. As it relates to IFRS itself, we point out how some problems in U.S. GAAP might be avoided in IFRS

⁴² See discussion of bright lines in section IV of this chapter below for further details.

⁴³ See comparison of Statement of Financial Accounting Standard (SFAS) No. 51, *Financial Reporting by Cable Television Companies*, with SEC Staff Accounting Bulletin (SAB) 104, *Revenue Recognition* (as codified in SAB Topic 13), later in this chapter.

⁴⁴ Hedge accounting guidance is provided in SFAS No. 133, *Accounting for Derivatives and Hedging Activities*.

⁴⁵ Throughout this chapter, the term “scope exceptions” refers to scope exceptions other than industry-specific guidance.

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as it matures, whereas we affirm other efforts of the IASB that we believe are headed in the right direction. More broadly, with respect to matters of convergence, we believe the principles underlying our recommendations will benefit financial reporting regardless of the approach ultimately taken in the U.S.

II. Mixed Attribute Model

As previously noted, 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. Complexity arising from the mixed attribute model 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 (in particular, it should address whether and when fair value should be used).⁴⁶ While we are aware the FASB has a long-term project to develop such an approach, known as the measurement framework, [we advocate] a number of steps in the near-term to improve the clarity of financial statements for investors.

First, [we 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, [we recommend] a consistent presentation of amounts in the financial statements based on their distinct measurement attributes, grouped by operating, investing, and financing sections. This will make subtotals of individual line items in the statements more meaningful. Third, [we recommend] a new financial statement to reconcile the statements of income and cash flows by major classes of measurement attributes to help investors analyze earnings. Fourth, [we recommend] the development of a disclosure framework, which would enable investors to better understand the key risks and uncertainties associated with different measurement attributes (refer to section III of this chapter).

Recommendation 1.1: Avoidable complexity caused by the mixed attribute model should be reduced in the following respects:

⁴⁶ See, e.g., comment letter from Fitch Ratings, Inc. (April 2, 2008), which states the measurement framework would be part of a “foundation for improved financial reporting.”

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- ***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 required⁴⁷ until:***
 - *The FASB completes a measurement framework to systematically assign measurement attributes to different types of business activities*
 - *The SEC, the FASB, and other regulators and standards-setters develop and implement a plan to strengthen the infrastructure that supports fair value reporting.*

- ***Financial statement presentation⁴⁸ – The SEC should recommend that the FASB:***
 - *Assign a single measurement attribute within each business activity to the maximum extent feasible, which is consistent across the financial statements⁴⁹*
 - *Aggregate business activities into operating, investing, and financing sections*
 - *Add a new primary financial statement to reconcile the statements of income and cash flows by major classes of measurement attributes.⁵⁰*

Background

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.

⁴⁷ For instance, improvements to certain existing, particularly complex standards, such as SFAS No. 133 and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, may be warranted in the near-term.

⁴⁸ [We are aware] of the FASB and IASB's joint financial statement presentation project and [are generally supportive] of its direction.

⁴⁹ To make this approach operational, the FASB might establish a rebuttable presumption in favor of a single measurement attribute within the operating, investing, and financing sections of the financial statements. 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.

⁵⁰ An example of this presentation is included later in this section.

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In practice, costs associated with the use of (potentially uncertain) fair value estimates can be considerable. Some preparers' knowledge of valuation methodology is limited, often 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 (and ultimately, the investor). In addition, there are recurring concerns about "second-guessing" by auditors, regulators, and courts in light of the many judgments and imprecision involved with some fair value estimates. Regardless of whether such estimates are prepared internally or by valuation specialists, the effort and 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,⁵¹ 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.⁵² 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 fair value reporting for all assets and liabilities simpler and more meaningful than the current mixed attribute model. On the other hand, a full fair value approach would diminish the reliability of some reported amounts (while increasing the effort required to prepare them) because they cannot be valued based on observable prices. Further, some estimates depend on model inputs that are also unobservable. These amounts would have to be estimated by preparers and certified by auditors, as discussed above. Such estimates are often 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.⁵³

Therefore, [we assume] 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

⁵¹ For instance, additional training for field auditors may be necessary to lessen dependency on valuation experts.

⁵² See, e.g., comment letter from the CFA Institute Centre for Financial Market Integrity (March 31, 2008).

⁵³ See, e.g., comment letter from the AFL-CIO (February 10, 2008), which states its "longstanding concerns about the adoption of mark-to-market or fair value accounting as the *predominant* conceptual model by the FASB" (emphasis added).

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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 investors, information delivery is made more challenging by fair value. The uncertainty associated with some fair value measurements (i.e., some 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, may not be apparent. 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 caused by changes in interest rates. The derivative instrument is required to be recognized at fair value, but the debt would generally be measured at amortized cost. This results in a measurement mismatch for accounting purposes, despite the offsetting changes that occur from an economic perspective. 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 was 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 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. Management intent is subjective and, thus, can be difficult to audit. However, the use of fair value would generally make management intent of much less relevance in assessing the value of an investment.

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Finally, we note concerns about the reliability of fair value estimates may be lessened in the future to the extent firms and regulators strengthen their risk management policies and related infrastructures. As some have noted, reduced trading activity for financial products makes price discovery based on observable market prices difficult.⁵⁴ Therefore, as market participants and regulators improve the way they assimilate fair value information to identify and respond to current risk exposures, market liquidity and observable prices should be enhanced. In turn, this may diminish the need to develop estimates of fair value.

Discussion

[We acknowledge] the view that a complete transition to fair value would alleviate avoidable complexity resulting from the mixed attribute model. However, [we also recognize] that expanded use of fair value would increase avoidable complexity unless numerous implementation questions are addressed (as discussed above), which extend beyond the scope of our work. Therefore, before expanding the role of fair value in financial reporting, [we believe] standards-setters and regulators should develop and implement a plan to strengthen the infrastructure that supports its use. Specifically, educational seminars may be necessary to better inform investors about the characteristics of fair value reporting. Likewise, preparers and auditors would benefit from ongoing training in basic valuation matters to reduce dependence on valuation specialists. Finally, the curricula in undergraduate and graduate accounting programs, as well as the CPA exam, will need to incorporate concepts of valuation theory and practice. [We recognize] a plan like this (as well as its execution) will require a coordinated effort among all constituents because each party shares an interest in accurate and reliable financial reports. In other words, standards-setters, preparers, auditors, regulators, and investors all have a role in fair value reporting. As each party gains experience with fair value information, it should be shared and considered by others in the educational effort to facilitate system-wide improvement.

At present, [we believe] fair value should not be the only measurement attribute in U.S. GAAP. [We advise] caution about expanding the use of fair value until a systematic measurement framework is developed. In this regard, [we also believe] that phase two of the FASB's fair value option project, which may permit a choice to use fair value measurement for certain nonfinancial assets and liabilities, should not be finalized before a measurement framework is completed.

At that point, the FASB should determine measurement attributes based on considerations such as business activity, the relevance and reliability of fair value inputs,

⁵⁴ Financial Stability Forum, *Enhancing Market and Institutional Resilience* (April 7, 2008).

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and other considerations vetted during the measurement phase of its conceptual framework project. While [we prefer] an activity-based approach to assigning measurement attributes, [we are] sympathetic to an approach based on the type of asset or liability in question, such as financial instruments vs. non-financial instruments.⁵⁵ This is a natural tension that the FASB should address as part of the measurement framework. For example, in one scenario, the FASB may determine amortized cost is the presumptive measurement attribute within the operating section of a company's financial statements. Nevertheless, the FASB 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, [we believe] the grouping of individual business activities (and related measurement attributes) by operating, investing, and financing sections would alleviate some of the concerns about fair value in particular. It would also reduce confusion caused by the commingling of all measurement attributes, as well as facilitate earnings analyses based on the natural elements of most profit-driven entities. For instance, operating income could be 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 consolidated statements of income and cash flows – would disaggregate changes in assets and liabilities based on cash, accruals, and changes in fair value, among others. This presentation should be more useful to investors, particularly because it would delineate the nature of changes in income (e.g., fair value volatility, changes in estimate) and allow investors to assess the degree to which management controls each one. A visual example of this statement might include the following:⁵⁶

⁵⁵ See, e.g., comment letter from PricewaterhouseCoopers LLP (March 31, 2008).

⁵⁶ [We have adapted] and modified this table from a similar schedule in the FASB's financial statement presentation project.

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Reconciliation of the Statements of Income and Cash Flows

	A Cash Flow Statement	B Cash flows Not Affecting Income	C D E Non-cash items affecting income			F Income Statement (A+B+C+D+E)	
			Accounting Accruals Other Than Remeasurements	Recurring Fair Value Changes	Remeasurements Other Than Recurring Fair Value Changes		
Operating							
Cash received from sales	2,700,000		75,000			2,775,000	Sales
	0			(1,000,000)		(1,000,000)	Loss on trading securities
	0		(9,000)			(9,000)	Depreciation expense
	0				(15,000)	(15,000)	Impairment expense
Investing							
Capital expenditures	(500,000)	500,000				0	
Financing							
Interest paid	(125,000)		(100,000)			(225,000)	Interest expense

[We believe] the relationship of rows and columns in this schedule will help investors assess different elements of financial performance. Said differently, the cash and non-cash components of earnings are presented more clearly under this presentation (F = A+B+C+D+E) than they are today. The following comments explain the items in the illustration above:

- Column A – Cash received (\$2.7 million) by the company represents the majority of sales recorded in the income statement this period.
- Column B – Cash spent to purchase equipment (i.e., \$500,000 of capital expenditures) is recorded as an asset under U.S. GAAP; it is not treated as an immediate expense, and therefore does not affect current income.
- Column C – Accounting accruals reflect routine bookkeeping entries. For instance, sales made on credit (\$75,000) near the end of the period represent revenue in the income statement, even though they will not be collected until a later date. Depreciation expense (\$9,000) is recorded to allocate part of a previously-acquired asset’s original cost to the current period. Lastly, the company reduced earnings by 100% of the interest expense it incurred under a lending arrangement this period (\$225,000). Note it only paid a portion of its obligation in cash (\$125,000), leaving the remainder to be paid at a later date.
- Column D – Recurring fair value changes describes items measured at fair value every period (quarterly and annually). In this case, the company recorded a loss (\$1 million) on its actively-traded investment securities due to a market downturn. U.S. GAAP requires adjusting these securities to fair value each period even if they are not sold.

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- Column E – Remeasurements other than recurring fair value changes identify adjustments recorded only after a triggering event happens or when management decides that a decrease in value is other-than-temporary. For example, due to unforeseen events, the company recorded a goodwill impairment charge (\$15,000).

Recognizing companies will use different titles for income statement line items, [we believe] the predominant value of this schedule is the columnar depiction of measurement attributes and the context it provides for earnings analysis. For example, investors 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.

The mixed attribute model also exists under IFRS. As such, [we believe] the concepts in this recommendation apply equally to IFRS, particularly as the IASB works with the FASB on the joint financial statement presentation project.

III. Disclosure Framework

Disclosure provides important context for the estimates and judgments reflected in the financial statements. It also highlights risks and uncertainties outside of the statements that could impact financial performance in the future.

[We believe] 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. Equally important, the presentation of disclosures in SEC filings could be restructured to make them more meaningful. Our recommendation advocates a joint process between these two institutions to achieve these goals.

Recommendation 1.2: The SEC should recommend that the FASB develop a disclosure framework to:

- ***Integrate existing disclosure requirements into a cohesive whole to ensure meaningful communication and logical presentation of disclosures, based on consistent objectives and principles. This would eliminate redundancies and provide a single source of disclosure guidance across all financial reporting standards.***
- ***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***

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measured in the financial statements, as well as events and uncertainties that are not recorded, such as certain litigation and regulatory developments.

Recommendation 1.3: *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.*⁵⁷

Background

Historically, disclosure standards have developed in a piecemeal manner (i.e., standard-by-standard).⁵⁸ The lack of an underlying framework has contributed to: (1) repetitive disclosures that may disproportionately emphasize certain risks, (2) excessively detailed disclosures that may confuse rather than inform, and (3) disorganized presentations in financial reports. These factors make complete 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, [we acknowledge] the perception that amounts recognized in financial statements are generally subject to more refined calculations by preparers and higher degrees of scrutiny by investors 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.

In order for a disclosure framework to facilitate such a dialogue between preparers and investors over the long-run, it should establish broad objectives, the specific application of which will vary. For example, in one case, a broad objective to disclose key sensitivities may result in a company disclosing alternative useful lives for the depreciation of its fixed assets. In another situation, a company might disclose different estimates of volatility in the valuation of certain option contracts. However, neither disclosure would be specified in the framework itself. Rather, a framework would identify the more fundamental principle of disclosing sensitivities. Otherwise, disclosure standards will degenerate into myriad rules because standards-setters cannot 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).⁵⁹ Recently, certain sponsoring banks have

⁵⁷ We consider coordination between the SEC and the FASB in chapter 2.

⁵⁸ See, e.g., comment letter from the Ohio Society of CPAs (March 31, 2008).

⁵⁹ From a review of SEC filed documents, [we have] identified seven SEC filers that sponsored SIVs

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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. (FIN) 46(R), *Consolidation of Variable Interest Entities*, 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).⁶⁰ 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 investors because it would have amounted to "disclosure overload." For instance, at the time the decision not to consolidate was 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 between a detailed, prescriptive approach to disclosure guidance compared a more principled style. In any event, [we agree] with observers such as the Financial Stability Forum⁶¹ who have encouraged the FASB and the IASB to expedite their efforts in this particular area of the accounting standards to more clearly portray the risk exposures and potential losses associated with off-balance-sheet entities.⁶²

Discussion

At a minimum, [we believe] 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

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, we note 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.

⁶⁰ FIN 46(R) requires the disclosure of involvement with certain off-balance-sheet entities, including the nature, purpose, size, and activities of the off-balance-sheet vehicle, as well as the reporting enterprise's maximum exposure to loss in such arrangements. While some observers believe these requirements may have been insufficient, others counter that preparers could have applied them more diligently and that additional investor scrutiny may have been warranted.

⁶¹ The Financial Stability Forum's recommendation on off-balance-sheet entities is contained in its report, *Enhancing Market and Institutional Resilience* (April 7, 2008).

⁶² Beyond disclosure, [we provide] suggestions for how the FASB might consider improving the accounting requirements related to consolidation policy in section IV (bright lines) of this chapter.

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key supporting judgments, risks, and uncertainties.⁶³ In the following commentary, we focus largely on the third element.

The elements of the framework noted here are not necessarily new. For instance, the SEC's *Cautionary Advice Regarding Disclosure about Critical Accounting Policies* encourages disclosure of sensitivity analyses similar to what we describe below. The incremental value of our recommendation is its intent to rationalize the current patchwork state of disclosure standards in financial reports. By way of example, a basic description of the sale of a company's goods and services is usually provided in the first or second footnote to the audited financial statements, together with an identification of the relevant U.S. GAAP literature. An analysis of recent sales activity and known trends is typically presented in management discussion and analysis (MD&A) – and depending on the preparer⁶⁴ – with a quantification of key sensitivities in the application of U.S. GAAP. Pending lawsuits, competitive threats and other environmental factors relevant to future sales may be sprinkled across company's disclosure of risk factors and legal contingencies in different parts of the annual report. To the extent this information is organized more logically in a single location – eliminating redundancies where possible – [we believe] our framework will enhance an investor's understanding of the business.

[We recognize] our disclosure recommendation 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. We are also aware there are important considerations regarding audit assurance, legal safe harbors, and other liability 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 these factors are considered, and so that the Commission amends its guidance where appropriate. For instance, Regulations S-K and S-X may need to be amended. Further, the way registrants present information could be restructured, as outlined above in the example of a company's selling effort.

With respect to amounts recorded in the financial statements, a disclosure framework should more effectively signal to investors the level of imprecision associated with

⁶³ We acknowledge the work of the FASB's Investors Technical Advisory Committee (ITAC) on the topic of a disclosure framework. We also agree with the need to move towards a more principles-based approach for future disclosure standards and have adapted certain elements of ITAC's thinking in this discussion. Further, much of what we recommend is consistent the disclosure framework proposed in the SEC staff's *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (June 2005).

⁶⁴ We note the SEC's guidance on critical accounting policies was not adopted as a final rule, resulting in mixed practice in the disclosure of sensitivities.

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significant estimates and assumptions,⁶⁵ 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, [we note] that in certain cases, there is no "right" number in a probability distribution of figures that represents fair value more accurately than others. While SFAS No. 157, *Fair Value Measurements*, established disclosure requirements that provide insight into Level 2 and 3 fair value estimates,⁶⁶ it may not be sufficient in all cases. Many investors might find information related to a valuation model helpful. This might encompass key risks associated with certain assumptions⁶⁷ and related sensitivity analyses, including a range of possible outcomes predicted by the model and a discussion of the reliability of the model itself.

Outside of amounts recorded in 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, certain 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.

[We acknowledge] disclosure guidance generally establishes a "floor" for communication between companies and investors, rather than a "ceiling."⁶⁸ Our recommendation offers a cohesive structure for the narrative that supports and explains the financial statements, but [we believe] preparers should take the initiative in tailoring financial reports for investors so they can make fully-informed decisions about capital allocation.

⁶⁵ See, e.g., comment letter from the Center for Audit Quality (March 31, 2008).

⁶⁶ SFAS No. 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).

⁶⁷ For example, if a valuation model relies on historical assumptions for a period of time that excludes economic downturns, that fact and its implications may need to be disclosed.

⁶⁸ We note companies are not precluded from providing disclosure of the type proposed here. Indeed, certain existing guidance is largely consistent with our views, such as Accounting Principles Board (APB) Opinion No. 22, *Disclosure of Accounting Policies*; Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*; Item 303(a) of Regulation S-K related to MD&A; and SEC, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*, SEC Release No. 33-8040 (December 12, 2001).

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Moving forward, the SEC or its staff should update, and as needed, remove portions of public company disclosure guidance that are impacted by new FASB standards. [We are aware] of efforts in the past conducted to identify overlaps of this type. In particular, the FASB report on “GAAP-SEC Disclosure Requirements,” which was a part of a larger Business Reporting Research Project, identified a number of duplicative requirements between FASB standards and SEC guidance. Indeed, several areas of overlap identified in that 2001 report were never addressed.⁶⁹ Unless the SEC or its staff establishes a monitoring process to update disclosure requirements, similar problems will persist and may confuse investors. Further, if recommendation 1.7 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.⁷⁰

From an international perspective, [we note] IAS 1, *Presentation of Financial Statements*, includes some of the elements that [we 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, [we believe] that our recommendation in this area would also result in improvements to IFRS, particularly as financial statements prepared on that basis become more common in SEC filings.

IV. Bright Lines

At a high level, bright lines refer to arbitrary thresholds in U.S. GAAP, which, in many cases, can lead to questionable accounting results. However, some clearly marked boundaries are, in fact, useful to reduce confusion and promote comparability.

⁶⁹ These include:

- Income taxes - Regulation S-X, Rule 4-08(h)(1) is redundant with paragraph 45 of SFAS No. 109, *Accounting for Income Taxes*, because both require disclosure of the significant components of income tax expense for the period.
- Major customers - The disclosure about major customers required by Regulation S-K is largely redundant with the disclosure required by paragraph 39 of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.
- Contingencies – The disclosures required by Item 103 of Regulation S-K are largely redundant with the basic disclosure requirements of: (1) SFAS No. 5, *Accounting for Contingencies*, (e.g., the requirement to disclose any material pending legal proceedings) and (2) as they pertain to environmental liabilities, with SoP 96-1, *Environmental Remediation Liabilities*.

Beyond these particular redundancies (which are only illustrative), we deemed a separate project to comprehensively identify and resolve overlaps between U.S. GAAP and SEC requirements outside the scope of our work, particularly in light of the significant number of standards that have been issued or amended since the FASB’s report was first issued in 2001.

⁷⁰ We note the SEC’s recent announcement regarding its “21st Century Disclosure Initiative,” which involves an internal study to improve the usefulness and timeliness of disclosures and the formation of a follow-on advisory committee. [We understand] that one area of focus will be needless redundancy in SEC forms and reporting requirements. [We believe] these efforts will complement [our recommendation] to reduce redundancies between FASB and SEC disclosure requirements.

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Generally speaking, we believe a number of bright lines currently used in recognition guidance could be replaced with other approaches or, at a minimum, improved upon. Recognition establishes if and when to record an asset, liability, revenue, or expense in the primary financial statements (e.g., whether a leased asset would be recorded on the balance sheet). In contrast, other bright lines exist in measurement and presentation guidance that [we believe] are helpful. Measurement involves choosing the right attribute or characteristic as a basis for quantifying a recognized item. For instance, the original cost and current fair value of a building are likely different numbers. One of them must be selected, depending on the reason for presenting this figure in the financial statements or footnotes. Presentation relates to how an item is portrayed on the face of the financial statements, such as whether an asset is classified as current or long term.

Our comments in this area are designed to assist standards-setters and regulators to better capture the substance of transactions in financial reporting standards, recognizing a limited number of bright lines support this goal.

Recommendation 1.4: Recognition guidance in U.S. GAAP should be based on a presumption that bright lines should not exist. As such, the SEC should recommend that the recognition guidance in new projects undertaken jointly or separately by the FASB avoid the use of bright lines, in favor of proportionate recognition.⁷¹ Where proportionate recognition is not feasible or applicable, the FASB should provide qualitative factors in its recognition guidance. 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 the recognition guidance of relevant areas to the extent feasible as a specific objective of those projects, in favor of the two approaches above.

Recommendation 1.5: 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 recommend that the FASB, academics, and professional organizations, better educate students, investors, preparers, auditors, and regulators in this respect.

⁷¹ We define proportionate recognition to mean accounting for the rights and obligations in a contract, as discussed later in this section.

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Background

As they relate to financial statement recognition, bright lines refer to two main areas: quantified thresholds and pass/fail tests (discussed below).⁷² They also address how amounts are measured and presented in the financial statements, such as the current value of an investment and whether it is classified as short-term or long-term.

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,⁷³ where a mere 1% difference in the test results leads to very different accounting.

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 quantified thresholds. 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 fourth element, revenue cannot be recognized until such evidence does exist or *all* four elements are delivered.

These types of 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). 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" or to inject a level of "conservatism" by establishing precise rules to avoid problems that have occurred in the past.

⁷² Refer to appendix G for additional examples of bright lines.

⁷³ 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.

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Bright lines can also 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 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 more timely. 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

We [believe] bright lines may be justified in some parts of U.S. GAAP, but not in others. Specifically, [we believe] bright lines should be minimized in recognition guidance, but may serve an important role in the areas of measurement and presentation. We elaborate on these thoughts below.

Recognition

Within the context of recognition guidance, we [believe] bright lines should be minimized in favor of proportionate recognition. As a secondary approach, where proportionate recognition is not feasible or applicable, we [recommend] that U.S. GAAP be based on qualitative factors, supported by presumptions, as necessary. We also [believe] that disclosure may be used as a supplement or alternative to the approaches above.

We use 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 U.S. GAAP, we [believe] that recognition of rights and obligations would be appropriate in areas such as lease accounting – in effect, an entity would fully recognize its *rights to*

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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, a lessee would recognize an asset for its right to use the machine (rather than for a proportion of the asset) at approximately \$35⁷⁴ 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, we acknowledge 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.⁷⁵ In situations like these, the FASB should consider providing recognition guidance based on qualitative factors, supported by presumptions, to guide the selection of a single appropriate recognition model by preparers. We [believe] 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.

We use 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.⁷⁶ There are situations in which selling shareholders of a target company

⁷⁴For 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.

⁷⁵ 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.

⁷⁶ Emerging Issues Task Force (EITF) 95-8, *Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination*. We note 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 U.S. GAAP.

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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). U.S. 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. However, it is possible this presumption may be overcome depending on the circumstances.

Finally, we note that disclosure is critical to communicating with investors, either by supplementing financial statement recognition (proportionate or otherwise) or by discussing events and uncertainties outside of the financial statements. We [believe] 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. We discuss examples of this situation in our consideration of a disclosure framework in section III of this chapter.

We acknowledge historically, practitioners have often gravitated to bright lines to resolve debates and achieve consistency.⁷⁷ As such, in order for our recommendations related to bright lines to be operational, we recognize the need for a cultural shift towards the acceptance of more judgment. In this regard, we [believe] the exercise of reasonable judgment discussed in recommendation 3.5 is essential to their success. We further note 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. In this regard, we [believe] that recommendation 2.4 regarding the delineation of authoritative interpretive guidance is helpful, particularly its emphasis that non-authoritative literature has no more standing in U.S. GAAP than its name indicates.

In summary, we believe the FASB should establish recognition guidance using the progression outlined above. That is, it should favor proportionate recognition, moving to the use of qualitative factors and presumptions, only when necessary. Enhanced disclosure should supplement both approaches, and there may be some cases where disclosure is the only effective method of reporting information to investors. The accounting treatment for consolidation policy can be used to illustrate this sequence. For example, the FASB might first consider whether those who invest in an off-balance-sheet

⁷⁷ See, e.g., comment letter from BDO Seidman, LLP (March 31, 2008).

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entity should record their respective rights and obligations, with no single investor consolidating the entire entity. If the FASB rejected that approach, it might explore whether qualitative factors could be used to identify a single investor with a controlling financial interest that should consolidate.⁷⁸ In any event, the FASB should require each investor to disclose the nature and magnitude of its involvement with the entity to provide background for the amounts recorded in the financial statements, as outlined in our consideration of a disclosure framework in section III of this chapter.

Measurement and Presentation

With respect to the measurement of amounts in the financial statements, we [believe] bright lines may be justified. Specifically, measurement guidance legitimately represents an all-or-nothing approach, as it would be a non sequitur to suggest a single asset should be measured on the basis of fair value and amortized cost at the same time (refer to section II of this chapter for further discussion of the mixed attribute model).

Similarly, the continued use of bright lines may be justified in presentation guidance.⁷⁹ For example, only investments with original maturities of three months or less qualify for presentation as cash equivalents on the balance sheet.⁸⁰ This avoids each company establishing its own definition of a cash equivalent. Some might have picked, for example, 30 days, others 60, and still others 180 days, creating needless diversity. The number of years to be presented in the financial statements is also effectively a bright line with positive results (two years of balance sheets, three years for the statements of income and cash flows).

We [believe] financial reports benefit from the enhanced comparability these types of bright lines create. In addition, we note the risk of misrepresentation and structuring opportunities in this context is minimal.

Other Considerations

From an international perspective, we note IFRS currently has fewer bright lines than U.S. GAAP. We [encourage] the SEC to affirm the IASB's efforts on this path.

With respect to training and educational efforts, we note the U.S. Treasury Department's Advisory Committee on the Auditing Profession has offered a number of preliminary recommendations on this topic. We [agree] with those who support their direction,⁸¹ and

⁷⁸ We are aware of the FASB's current efforts to revise FIN 46(R), which appear consistent with the use of qualitative factors envisioned here.

⁷⁹ See, e.g., testimony from John Stewart (May 2, 2008).

⁸⁰ See SFAS No. 95, *Statement of Cash Flows*.

⁸¹ See, e.g., comment letter from Fitch Ratings, Inc. (April 2, 2008).

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encourage the SEC to monitor these developments as the Commission takes steps, in coordination with the FASB, to promote the ongoing education of all financial reporting constituents (see also recommendation 1.1 for educational efforts related to fair value measurements).

V. Exceptions to General Principles

On balance, we [recommend] the elimination of exceptions to general principles because we [believe] similar activities ought to be accounted for similarly. In the context of the remainder of this chapter, we refer to “activities” in a broad sense. For example, we question whether oil and gas exploration activities are sufficiently different from research and development efforts to justify an accounting model which treats costs that would otherwise be expensed as an asset.⁸²

Further, we do not express a view on the role of management intent in defining and distinguishing between business activities.⁸³ For instance, we do not express a view on whether investing for the short-term versus the long-term are separate activities (e.g., trading bonds on price differences in the secondary market, as opposed to holding them until maturity).

V.A. Industry-Specific Guidance

Recommendation 1.6: U.S. GAAP should be presumptively based on business activities, rather than industries. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB be scoped on the basis of business activities, except in rare circumstances. Any new projects should include the elimination of existing industry-specific guidance—particularly that which conflicts with generalized U.S. GAAP—in relevant areas as a specific objective of those projects, except in rare circumstances.

Considering the pace of convergence efforts, the SEC should also recommend that in conjunction with its current codification project, the FASB add a project to its agenda to eliminate existing industry-specific guidance which conflicts with generalized U.S. GAAP, except in rare circumstances.

⁸² Some believe an inconsistency of this sort exists between the full cost method of accounting for oil and gas producing activities in Regulation S-X, Rule 4-10 and SFAS No. 2, *Accounting for Research and Development Costs*.

⁸³ Management intent is a present assertion about management’s plans for future courses of action, as noted in the FASB’s *Special Report: Future Events: A Conceptual Study of Their Significance for Recognition and Measurement* (1994). Due to the varying levels of management intent throughout U.S. GAAP and the merits of the arguments both for and against its use, we have determined that accounting based on management intent is too dependent on facts and circumstances to feasibly address within our timeframe.

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Background⁸⁴

Industry-specific guidance refers to: (1) exceptions to general accounting standards for certain industries, (2) industry-specific guidance created in the absence of a single underlying standard or principle, and (3) industry practices not specifically addressed or based in U.S. GAAP. Industries covered by this guidance include, but are not limited to the insurance, utilities, oil and gas, mining, cable television, financial, real estate, casino, broadcasting, and film industries.⁸⁵

Industry-specific guidance has developed for a number of reasons. These include multiple standards-setters issuing guidance without consistently coordinating their efforts, a desire to enhance uniformity throughout an industry, and efforts to customize accounting standards for allegedly “special” transactions or investor needs. In some cases, industries have developed their own practices in the absence of applicable authoritative literature.

Industry-specific guidance contributes to avoidable complexity by making financial reports less comparable.⁸⁶ This is evident across industries, when conflicting accounting models are used for similar or identical transactions. It may also be used as an improper analogy to achieve desired results or to require more conservative accounting treatments (e.g., by auditors).⁸⁷ In addition, the use of an industry to define an accounting treatment raises serious questions about which companies are within the scope of specific guidance. This issue is especially pronounced for diversified companies, which may be involved in a number of different industries.

⁸⁴ This background section focuses largely on authoritative, industry-specific U.S. GAAP, as opposed to various forms of non-authoritative accounting guidance.

⁸⁵ Refer to appendix G for additional examples.

⁸⁶ As noted previously in the SEC staff’s *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):

The proliferation of specialized industry standards creates two problems that can hinder standard setters’ efforts to issue subsequent standards using a more objectives-oriented regime:

- The existence of specialized industry practices may make it more difficult for standard setters to eliminate scope exceptions in subsequent standards (e.g., many standards contain exceptions for insurance arrangements subject to specialized industry accounting)
- The specialized standards may create conflicting GAAP, which makes it more difficult for accounting professionals to determine the appropriate accounting.

⁸⁷ For instance, some auditors may use concepts in revenue recognition from the software industry (SoP 97-2, *Software Revenue Recognition*) as a basis for postponing the revenue recognition of companies in other industries without on-point literature. Opponents of this practice argue such revenue deferral is too conservative and does not adequately portray the extent to which a company may have satisfied its product or service obligations in a long-term or multiple-element contract.

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Further, industry-specific guidance unnecessarily increases the volume of accounting literature. This, in turn, adds to the costs of implementing such literature and maintaining it (e.g., monitoring it for interaction with other new and existing standards and expanding the size and scope of technical resources and databases). Industry-specific guidance also increases the cost of training accountants and retaining industry experts, while compounding the complexity that investors experience in understanding the present variety of accounting and disclosure standards. Lastly, it hinders more widespread use of XBRL by increasing the number of data tags that need to be created, maintained, and properly used to deliver financial information.

On the other hand, industry-specific guidance may, in some cases, alleviate complexity by allowing industry reporting to better meet the specific investor needs in that industry and enhancing comparability across entities within an industry. Further, it may depict important differences in the economics of an industry, particularly where application of a generalized principle may not result in accounting that is faithful to a transaction's substance. We also note that historically, some industry-specific guidance has filled a need where U.S. GAAP is otherwise lacking, and simplified or reduced the amount of guidance a preparer in an industry would need to consider (even though it might increase complexity across industries generally). Finally, specialized guidance has been able to address prevalent industry issues quickly because it was written for a narrower audience than generalized U.S. GAAP.

Industry-specific guidance can be broken into three categories. First, some industry-specific guidance is explanatory in nature and consistent with generalized U.S. GAAP, such as portions of AICPA Accounting and Auditing Guides that assist preparers interpret and apply existing, generalized U.S. GAAP. Second, other industry-specific guidance is inconsistent with generalized U.S. GAAP. For example, SFAS No. 51 requires that initial hookup revenue (a type of nonrefundable upfront fee) is recorded to the extent of direct selling costs incurred; the remainder is deferred and recorded in income over the estimated average period that subscribers are expected to remain connected to the system. However, generalized guidance indicates this practice is inappropriate unless it is specifically prescribed elsewhere (such as SFAS No. 51).⁸⁸ Therefore, similar activities like upfront fees for gym memberships are not afforded equal treatment. Third, still other industry-specific guidance was created in the absence of a general principle that applies across industries. For instance, while there is no comprehensive revenue recognition standard, SoP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, discusses revenue and cost recognition in areas such as the construction industry.

⁸⁸ SAB Topic 13.

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Discussion

We generally [believe] industry-specific guidance should be eliminated to reduce avoidable complexity. We acknowledge that the elimination of existing industry-specific guidance may result in more complexity over the short-term, particularly for the industries losing special treatment. Nonetheless, we [believe] it is an acceptable cost for a long-term reduction in avoidable complexity.

However, to mitigate the transitional complexity that may arise from the implementation of this recommendation, we emphasize the following points, which are discussed further below:

- The FASB's initial focus should be the elimination of industry-specific guidance that conflicts with generalized U.S. GAAP
- As such, industry-specific guidance should not be eliminated until generalized guidance is available
- Industry-specific guidance may be justified in the short term due to cost-benefit considerations
- The scope of this recommendation relates to authoritative, rather than non-authoritative, guidance.

First, we [believe] the FASB's initial focus should be the elimination of industry-specific guidance that conflicts with generalized U.S. GAAP.⁸⁹ To that end, the FASB's codification project should facilitate this effort, as it may be used to sort existing industry-specific guidance into one of the three categories identified above (consistent with U.S. GAAP, inconsistent with U.S. GAAP, or there is no comparable U.S. GAAP). But, industry-specific guidance should not be eliminated until generalized guidance is available. This approach will help ensure that industry-specific guidance that fills a void in U.S. GAAP is not prematurely eliminated, leaving preparers with no relevant guidance and possibly resulting in otherwise avoidable diversity. Subsequently, as the FASB develops new generalized guidance in areas like revenue recognition, it should eliminate industry-specific guidance to the maximum extent feasible. Similarly, the SEC should eliminate its industry-specific guidance in related areas, if any.

Second, we [believe] that industry-specific guidance may be justified in the short-term when cost-benefit considerations indicate that the enhanced information investors would receive under generalized U.S. GAAP is not justified by the direct costs to preparers and the indirect costs to investors to account for activities in that manner. In such cases, the SEC should encourage the FASB to work with the relevant industry participants to identify long-term ways to improve the benefits and mitigate the costs of the general standard. After making these changes, the related industry-specific guidance should be

⁸⁹ See, e.g., comment letter from Ernst & Young LLP (March 31, 2008).

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phased out as efficiently as possible. Towards that end, the SEC should encourage the FASB to provide sufficient time to allow companies to adopt generalized U.S. GAAP with minimal transition costs.

Third, the scope of this recommendation relates to authoritative guidance. This recommendation is not intended to (nor can it) curtail or eliminate non-authoritative guidance. We recognize the benefits of and the demand for guidance that identifies and interprets general U.S. GAAP for a specific industry.⁹⁰ We are also aware that constituents, such as the AICPA, have historically addressed this demand by issuing industry-specific implementation guidance. Due to this demand, industry-specific guidance will continue to be developed by parties other than the FASB. However, we stress that such guidance should not be considered authoritative. Rather, this recommendation is addressed to the designated standards-setters, such as the FASB in the U.S., as discussed in chapter 2 of this report. If a designated standards-setter issues guidance for activities that are prevalent in particular industries, we [believe] it should be applicable to all transactions of the type in question, regardless of the industry in which a company operates.

From an international perspective, we note that IFRS currently contains less industry-specific guidance than U.S. GAAP. For example, there is extensive revenue recognition guidance under U.S. GAAP spread across more than 140 pieces of literature,⁹¹ including specific guidance for software revenue and sales of real estate. Conversely, a single IFRS standard provides general principles and illustrative examples to address virtually all revenue-generating activities, which contains only 57 paragraphs (including the appendix).⁹²

Nonetheless, the SEC should encourage the IASB to be mindful of this recommendation as it continues to develop a more comprehensive body of standards. The SEC should also encourage the IASB to limit future industry-specific guidance to activities whose economics are legitimately different from other business activities. Otherwise, we [believe] specialized accounting for only certain subsets of similar activities will create avoidable complexity.

V.B. Alternative Accounting Policies

Recommendation 1.7: U.S. GAAP should be based on a presumption that formally promulgated alternative accounting policies should not exist. As such, the SEC should recommend that any new projects undertaken jointly or separately by the

⁹⁰ See, e.g., comment letter from KPMG LLP (March 31, 2008).

⁹¹ See the *FASB Report* (December 24, 2002).

⁹² International Accounting Standard 18, *Revenue*.

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FASB not provide additional optionality, except in rare circumstances. Any new projects should also include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects, except in rare circumstances.

Background

Alternative accounting policies refer to optionality in U.S. GAAP. The following discussion addresses formally-promulgated options in U.S. GAAP, but does not address choices available to preparers at more of a practice or implementation level.⁹³ Examples of optionality in U.S. GAAP include:⁹⁴

- The indirect versus the direct method of presenting operating cash flows on the statement of cash flows
- The application of hedge accounting⁹⁵
- The option to measure certain financial assets and liabilities at fair value
- The immediate or delayed recognition of gains/losses associated with defined benefit pension and other post-retirement employee benefit plans
- The successful efforts or full cost accounting method followed by oil and gas producers.

Alternative accounting policies arise for a number of reasons. These include circumstances in which the pros and cons of competing policies may be balanced and thus do not result in a single, clearly preferable approach. Other causes encompass political pressure that results in standards-setters providing for a preferred and an alternative accounting method, high administrative costs of the preferred alternative to preparers (e.g., cost-benefit considerations), and a portrayal of differences in management intent.

Alternative accounting policies contribute to avoidable complexity by making financial reports less comparable. This is evident across companies when identical activities are accounted for differently. Such alternatives may permit accounting that is less reflective of economic substance to the extent that they are based on political pressure, and facilitate differences in accounting policies selected by preparers to achieve the most

⁹³ For example, companies are free to choose from among several depreciation methods – straight-line, double-declining balance, etc.

⁹⁴ Refer to appendix G for additional examples.

⁹⁵ We have noted complexities arising from the application of hedge accounting, which allows entities to mitigate reported volatility over the life of the hedge relationship. In this regard, we generally feel that instead of assessing hedge effectiveness to determine whether companies qualify for this alternative accounting treatment, a better policy would be to simply record the ineffective portion of a hedge in earnings (i.e., a proportionate approach versus an all-or-nothing approach). We are also aware of the FASB's derivatives project in this area and are generally supportive of its progress.

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favorable treatment. The unnecessary proliferation of accounting literature to codify these alternatives also adds to avoidable complexity.

On the other hand, alternative accounting policies may alleviate complexity by allowing preparers to determine the best accounting for particular activities based on cost and economic substance, to the extent that more than one accounting policy is conceptually sound. In addition, certain alternative policies may be developed more quickly than a final “perfect” standard to minimize the effect of other unacceptable practices. In other words, they may function as a short-term fix on the road to ideal accounting.

Discussion

We [believe] alternative accounting policies should be eliminated, except when: (1) multiple accounting alternatives exist that are consistent with the conceptual framework, and none portray economic substance more accurately than others, or (2) an alternative or interim treatment can be developed more quickly than a final “perfect” standard to minimize the effect of other unacceptable practices.

If one or both of the justifications above apply, we [believe] that the provision of alternative accounting principles should be coupled with a long-term plan by the FASB to eliminate the alternative(s) through the use of sunset provisions. In addition, the effect of applying the alternative policy not selected by preparers should be clearly and succinctly communicated to investors (e.g., through footnote disclosure).

Further, as new guidance is issued, including that which is issued through the convergence process, the SEC should eliminate its alternative accounting policies in related areas, if any.

For the sake of clarity, we distinguish our recommendation to minimize alternative accounting policies here from the application of reasonable judgments discussed in chapter 3. In that context, differences may result from the absence of on-point guidance for certain transactions when companies apply U.S. GAAP by analogy. Similarly, differences may stem from the application of a single standard.⁹⁶ In contrast, our recommendation advises against expanding the number of free choices included in U.S. GAAP, such as whether or not to apply pension smoothing. This minimizes diversity at the outset of the financial reporting process, while recognizing some diversity in practice is unavoidable. It also reflects our belief that investors are better served by favoring consistency over diversity in the professional standards themselves.

⁹⁶ For instance, competing views as to whether a transfer of mortgages to a separate entity represents a sale or secured borrowing arrangement under Statement 140.

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From an international perspective, we note that IFRS currently permits numerous alternative accounting policies. While we acknowledge the IASB's efforts in reducing some of these alternative treatments, we nonetheless [believe] the SEC should encourage the IASB to be mindful of this recommendation, and seek to eliminate alternatives as part of its standards-setting projects. Further, [we believe] it is not helpful for particular countries or regional compacts to adopt jurisdictional variants of IFRS as issued by the IASB, but recognize these matters are beyond the control of the IASB.

V.C. Scope Exceptions

Recommendation 1.8: U.S. GAAP should be scoped with sufficient precision to minimize the use of scope exceptions. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB should be carefully scoped to minimize the use of exceptions. Any new projects should also seek to refine the scope of existing standards in relevant areas as a specific objective of those projects to minimize existing scope exceptions.

Background

Scope exceptions represent departures from the application of a principle to certain transactions. For example:⁹⁷

- SFAS No. 133 excludes certain financial guarantee contracts, employee share-based payments, and contingent consideration from a business combination, among others
- SFAS No. 157 excludes employee share-based payments and lease classification and measurement, among others
- FIN 46(R) excludes employee benefit plans, qualifying special-purpose entities,⁹⁸ certain entities for which the company is unable to obtain the information necessary to apply FIN 46(R), and certain businesses, among others.

Similar to other exceptions to general principles, scope exceptions arise for a number of reasons. These include: (1) the issuance of guidance that imprecisely articulates the scope of a standard, resulting in unintended consequences, (2) cost-benefit considerations, (3) the need for temporary measures to quickly minimize the effect of unacceptable practices, rather than waiting for a final "perfect" standard to be developed, (4) avoidance of conflicts with standards that would otherwise overlap, and (5) political pressure.

⁹⁷ Refer to appendix G for additional examples.

⁹⁸ We note that the FASB has tentatively decided to remove the qualifying special-purpose entity concept from U.S. GAAP and its exception from consolidation.

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Scope exceptions contribute to avoidable complexity in several ways. First, where accounting standards specify the treatment of transactions that would otherwise be within the scope, exceptions may result in different accounting for similar activities (refer to the discussion on competing models in section V.D. of this chapter). Second, scope exceptions may contribute to avoidable complexity because of difficulty in defining the bounds of the 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. 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. 133.⁹⁹ [We recognize] the benefit of “practical cuts” such as these, some of which are identified during the development of a standard, and others that become apparent after the standard is put into practice.

Discussion

We [believe] complexity resulting from scope exceptions may be minimized through more careful consideration of the scope of new projects.¹⁰⁰ In this regard, we [believe] improvements to the standards-setting process that are discussed in chapter 2 will be helpful, such as more effective cost-benefit analyses, field tests, and field visits. Even with more precise project scoping, we still expect continued demand for exceptions.

We [believe] these demands should be resisted, particularly when they represent political pressure. Nonetheless, we also acknowledge their practical merit in circumstances such as: (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 U.S. GAAP. But in cases where scope exceptions are provided as a temporary measure, they should be coupled with a long-term plan by the FASB to phase them out through the use of sunset provisions.

We also note 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

⁹⁹ See, e.g., comment letter from Institute of Management Accountants (October 3, 2007).

¹⁰⁰ See, e.g., testimony from Ben Neuhausen (May 2, 2008).

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the balance sheet classification of redeemable preferred stock not covered by SFAS No. 150).¹⁰¹ Accordingly, as the FASB develops standards to address these transactions, the SEC should eliminate its related guidance.

From an international perspective, we note that IFRS currently has fewer scope exceptions than U.S. GAAP. We encourage the SEC to affirm the IASB's efforts in this regard. However, we also note 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, where IFRS provides scope exceptions, the SEC should encourage the IASB to 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 its standards.

V.D. Competing Models

Recommendation 1.9: U.S. 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 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 those projects, except in rare circumstances.

Background

Competing models are distinguished here from alternative accounting policies. Alternative accounting policies refer to different accounting treatments that preparers are *allowed to choose* under existing U.S. 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 models include:¹⁰²

- Different *methods* of impairment testing for assets such as inventory, goodwill, and deferred tax assets¹⁰³

¹⁰¹ *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.*

¹⁰² Refer to appendix G for additional examples.

¹⁰³ 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

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- Different *levels of asset aggregation* to conduct impairment tests and comply with disclosure requirements, such as asset groups, reporting units, operating segments, and reportable segments¹⁰⁴
- Different methods of revenue recognition in the absence of a general principle, and
- 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

We [believe] similar activities should be accounted for in a similar manner. Nonetheless, we acknowledge that competing models may be justified in two circumstances: (1) where the costs of applying a certain model to a subset of activities exceed the benefits and (2)

determine the amount of any loss, the fair value of a “reporting unit” (as defined in U.S. 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 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.

¹⁰⁴ Asset groups are defined in SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to test long-lived assets (e.g., property, plant, and equipment) for impairment. Reporting units are defined in SFAS No. 142, *Goodwill and Other Intangible Assets*, to test goodwill for impairment. Operating segments and reportable segments are defined in SFAS No. 131 for purposes of disclosure; they are also used to define reporting units in SFAS No. 142.

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as temporary measures (that are eventually phased out) to minimize the effect of unacceptable practices quickly, rather than waiting for a final “perfect” standard to be developed. To the extent a competing model meets one or more of the justifications above, scope exceptions could be used 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).

We recognize that the FASB and IASB’s joint project on the conceptual framework will alleviate some of the avoidable complexity caused by competing models. However, we would encourage the implementation of this recommendation prior to the completion of conceptual framework, where practical because: (1) the conceptual framework is a long-term project and (2) current practice issues encountered in the standards-setting process will inform 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.

We note IFRS also contains competing models. Accordingly, we [believe] the SEC should encourage the IASB to be mindful of this recommendation, particularly as it works with the FASB on the joint conceptual framework.

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CHAPTER 2: STANDARDS-SETTING PROCESS

I. Introduction

A robust accounting standards-setting process (standards-setting) is the foundation of an efficient system of financial accounting and reporting, on which capital providers may rely to make investment decisions. Although the U.S. approach to financial reporting has been quite effective in achieving that overarching objective, U.S. GAAP has evolved over many years to a point where some of its basic principles are obfuscated by detailed rules, interpretations, exceptions, and alternatives that collectively reduce the usefulness of the resulting financial reporting. Historically, interpretive rules on how to implement U.S. GAAP (interpretive implementation guidance) have proliferated from a variety of sources and, intentionally or not, have often become perceived as additional U.S. GAAP. This increases the complexity of the financial reporting system and reduces its transparency, especially when questions exist about the authoritative nature of such guidance or conflicts exist between interpretations.

This chapter advances recommendations intended to alleviate some of these concerns. Specifically, after examining the U.S. standards-setting process, [we recommend] changes to:

- Increase the consideration of investor perspectives in standards-setting
- Enhance governance and oversight
- Improve the process of setting standards
- Clarify the role of interpretive implementation guidance
- Improve the design of standards going forward.

In general, [we believe] the design of the U.S. standards-setting process, including the process of issuing authoritative interpretive implementation guidance, and the role played by each participant are appropriate. However, refinements may be made to existing processes that may significantly influence behaviors and thereby help financial reporting better serve the needs of investors. As investors are the primary consumers of financial reports, standards-setting would be greatly improved if their perspectives were better integrated into standards-setting through increased investor involvement throughout the process.

Some of [our recommendations] may be partially or substantially addressed by actions recently taken, or in the process of being taken, by the Financial Accounting Foundation (FAF), the FASB, and the SEC, the impacts of which may not yet be fully realized or apparent. We reference these impacts where applicable. Other aspects of [our recommendations] may occur in practice, but may not be well understood or consistently applied. [Our recommendations] are designed to increase the transparency and effectiveness of these processes.

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II. International Considerations

As noted earlier in our report, [we do not] advance detailed recommendations regarding the best means for accomplishing the convergence of international accounting standards. Rather, recognizing that there are various paths to convergence and that it may take years to achieve, [our recommendations] presume that U.S. GAAP will exist for a number of years. However, if the SEC were to act to move domestic registrants in the U.S. to IFRS in the near-term, by necessity either the prioritization of many of [our recommendations] would be different or they would require reconsideration. As such, this chapter comments on how some of [our standards-setting recommendations] may be impacted by efforts for convergence of international accounting standards currently being considered in the U.S.

Regarding the standards-setting process itself, our mandate focuses on recommending improvements to U.S. processes, which may be informed by best practices internationally. An explicit analysis of how international standards-setting could be improved was not in our purview. Nevertheless, [we believe] the principles underpinning [our recommendations] may be equally applicable in any high-quality standards-setting regime.

III. Investor Perspectives

Recommendation 2.1: Investor perspectives are critical to effective standards-setting, as investors are the primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting. Although it is more challenging to obtain investor perspectives than those of other constituents involved in the standards-setting process, additional investor representation would facilitate increased consideration of investor perspectives in the standards-setting process. Specifically, the SEC should recommend that the FAF and the FASB do the following:

- ***Add investors to the FAF to give more weight to the views of different types of investors, both large and small***
- ***Give more representation on both the FASB and the FASB staff to experienced investors to improve consideration of the usefulness of financial reports***
- ***Re-evaluate the manner, timing, and quality of investor input received throughout standards-setting to determine whether changes would be warranted to make investor involvement more efficient and effective.***

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Background

Consideration of investor perspectives throughout standards-setting is critical. The current standards-setting process does attempt to balance the views of different stakeholders, but investor perspectives are often under-represented, because the intricacy of standards-setting often makes it difficult to elicit continued investor participation as compared to other constituents. In recent years, the FASB has undertaken significant efforts to increase investor participation in standards-setting. Specifically, the FASB created a number of new investor advisory groups, added investors to existing advisory and other groups, made greater use of project-specific resource groups, and engaged in more focused constituent outreach at all stages of standards-setting. [Our recommendation] is intended to supplement those recent efforts to provide the FASB with more formal, efficient, and timely feedback from investors, both large and small.

Contemporaneous with our review of the standards-setting process in the U.S., the FAF engaged in a similar review.¹⁰⁵ Our Progress Report advanced draft proposals that the FAF considered, along with comment letters received from its constituents, in reaching its final conclusions.¹⁰⁶ Specific to recommendation 2.1, the FAF expanded the sources of FAF Trustee nominations (subject to the need to consider implementation issues), reduced the size of the FASB from seven to five members effective July 1, 2008, and affirmed the need for investor participation on the FASB by amending its by-laws to require that all FASB members “have knowledge of and experience in investing, accounting, finance, business, accounting education and research and a concern for the investor and the public interest in matters of investing, financial accounting and reporting.” Notwithstanding [our general support] for these resolutions, [our final recommendation] is reflective of areas [we believe] warrant further consideration.

Discussion

[We believe] the financial reporting system would best be served by recognizing that the perspectives of investors should be pre-eminent because all stakeholders benefit from a system that allocates capital more efficiently. Some disagree with the notion of one constituent group having pre-eminence, because doing so might create an imbalance in standards-setting.¹⁰⁷ [Our recommendation] is intended to promote the appropriate balance of constituent views by underscoring that all participants in standards-setting

¹⁰⁵ FAF, *Request for Comments on Proposed Changes to Oversight, Structure and Operations of the FAF, FASB and GASB* (December 18, 2007).

¹⁰⁶ FAF, *Corporate Governance Changes to Oversight, Structure, and Operations of the FAF, FASB and GASB: Recitals and Resolutions Adopted by the FAF Board of Trustees on 02-26-08*.

¹⁰⁷ See, e.g., comment letters from BDO Seidman, LLP (March 31, 2008); the Center for Audit Quality (March 31, 2008); Deloitte & Touche LLP (March 31, 2008); Ernst & Young LLP (March 31, 2008); KPMG LLP (March 31, 2008); and PricewaterhouseCoopers LLP (March 31, 2008).

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should have an investor focus in developing and administering a well-designed and effective system of financial reporting. This notion was captured by the FAF in its recent changes to the FASB by-laws. [We also believe] increasing investor representation in standards-setting will enhance their participation and consideration of investor perspectives, thereby improving the overall investor focus of financial reporting.

FAF

[Our recommendation] complements the FAF's recent governance reforms, but [we believe] additional investor representation on the FAF should be emphasized. Such representation should strive to consider differing perspectives in the investor community.

FASB and FASB Staff

Given the FAF's reduction in the size of the FASB from seven to five members, [we support] the current composition of the Board, which includes members whose primary professional experience is as investors, preparers, auditors, and academics. Board members should be selected from the most qualified individuals who possess a breadth of experiences that will ensure that the perspectives of investors are carefully considered and given pre-eminence when attempting to balance the perspectives of other constituents. However, increasing direct investor involvement on the Board would bring investor perspectives to the forefront of standards-setting and the process of issuing interpretive implementation guidance. We encourage the FAF to increase the representation of investors as future Board positions become available. Specifically, [we recommend] that the composition of the Board include no fewer than one, and ideally more than one, member whose primary professional experience is as an investor and who is also well-versed in the conceptual foundations of accounting.

[We recognize] that a reduction in the size of the Board may create a workload capacity concern, but [we understand] the FASB is already taking steps to mitigate this concern, by, for example, being more selective when accepting Board member speaking engagements and by making greater use of webcasts to ensure maximum outreach. [We believe] that this concern may be further allayed by delegating more responsibilities to senior staff members and by possibly increasing the size of the FASB staff. In addition, the FAF and FASB should consider staffing alternatives that make use of part-time senior staff for particular projects or purposes.

There may be opportunities to increase investor representation on the FASB staff, as well. The FASB has permanent staff with professional investing experience and has had a fellowship program for many years, although fellows usually come from the auditor and preparer communities. The FASB has approached investors and investor groups about the possibility of sponsoring fellows, but thus far has had limited success. The FASB's

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effectiveness may be enhanced by fellows sponsored by the investor community, and we encourage continued efforts to identify qualified candidates to serve in this capacity.

Other Investor Involvement

As noted above, the FASB has greatly improved its investor outreach in the past few years. However, there may be opportunities to further increase the involvement of and more effectively utilize investors so that they know when and how to engage the FASB and its staff to assist in standards-setting. Specifically, the FASB should re-evaluate its advisory and other groups to determine whether investor involvement is efficient and effective. By reconsidering which investors should participate in each group, the FASB may better attract advice or detailed technical assistance, as the situation requires, from investors with the right background and experience at the right time. Similarly, clarifying which investor groups the FASB should consult on different types of issues and with what frequency would likely increase the efficiency and effectiveness of investor participation in standards-setting for all involved parties.

In addition, the FASB should incorporate into its standards-setting process a formal mechanism to obtain high-level investor feedback on new standards before they are exposed for public comment. To achieve that objective, the FASB could re-evaluate the role and composition of its User Advisory Council (UAC). A reconstituted UAC could serve as a pre-committed panel of diverse investors who could conduct pre-issuance reviews of proposed standards. The objective of such formalized investor reviews would be to timely assess and provide feedback on perceived investor benefits associated with a proposed new standard in its entirety (including whether investors believe that the proposed new standard would provide better information than what is currently available) and propose alternative or less costly solutions, when appropriate. However, such a formalized review should not inhibit the frequent and ongoing dialogue between the standards-setter and its advisory or other groups throughout the standards-setting process.

IV. FAF and FASB Governance

Recommendation 2.2: The SEC should continue to recommend that the FAF enhance governance of the FASB, as follows:

- ***Recommend that the FAF amend the FASB's mission statement, stated objectives, and precepts to emphasize that an additional goal should be to minimize avoidable complexity***
- ***Recommend that the FAF develop performance metrics to ensure that key aspects of the standards-setting process are effective, efficient, and compliant with the goals in the FASB's mission statement, objectives, and precepts.***

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Background

The FAF is responsible for the oversight and appointment of Board members of the FASB and the GASB. While the FAF does not direct the standards-setting activities of the FASB, it does have a responsibility to periodically review the FASB's structure and governance to assess its effectiveness and efficiency. The FAF has always maintained oversight of the FASB as one of its main priorities. [Our recommendation] is designed to promote more active FAF oversight of the FASB – in order to improve the efficiency and effectiveness of standards-setting.

As noted above, the FAF recently implemented various changes in its oversight of the FASB. Specific to recommendation 2.2, the FAF changed the terms of service of Trustees, created flexibility in the size of the FAF itself, retained FASB simple majority voting, and assumed a more active oversight role that includes monitoring the efficiency and effectiveness of standards-setting. Notwithstanding [our general support] for these resolutions, [our final recommendation] is reflective of areas [we believe] warrant further consideration.

Discussion

Mission and Objectives

The FASB's mission statement, objectives, and precepts acknowledge that efficient capital markets rely on credible, concise, and understandable financial information. They also recognize the importance of the following:

- Improving the usefulness of financial information by focusing on relevance, reliability, comparability, and consistency
- Keeping standards current
- Considering promptly significant areas of deficiency that need improvement
- Promoting international convergence
- Improving the understanding of the nature and purpose of information in financial reports
- Being objective in decision-making and promoting neutrality of information
- Weighing carefully the views of constituents
- Satisfying the cost-benefit constraint
- Minimizing disruption by providing reasonable effective dates and transition provisions
- Reviewing the effects of past decisions in a timely fashion to interpret, amend, or replace standards, when necessary
- Following an open, orderly process for standards-setting.

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[We believe] minimizing avoidable complexity should be added to this list. Although [we do not believe] the FASB sets out to issue complex standards, amending the mission statement, stated objectives, and precepts may promote more explicit consideration of less complex accounting alternatives by all participants in standards-setting.

Performance Metrics

The recent FAF changes seek to increase its active oversight of the FASB. [We support] these improvements, but [we note] that the FAF has not described how it intends to implement them. Many of the recommendations in this chapter provide input regarding how and in what areas to strengthen such oversight. The FAF should develop performance metrics to assess the FASB's adherence to the goals in its mission statement, objectives, and precepts. These metrics should track the timeliness and effectiveness of the FASB's standards-setting process, including, but not limited to, the efficiency and effectiveness of cost-benefit analyses, field visits, field testing, and Board consideration of public comments.

The FAF and FASB are best positioned to agree on what performance metrics would be appropriate to implement. A number of not-for-profit organizations have implemented service effort performance metrics that the FAF and FASB may consider when designing their own metrics. The active monitoring of such metrics would not have a detrimental impact on the FASB's independence; rather, they are intended to improve accountability associated with the process of standards-setting.

V. Standards-Setting Process Improvements

Recommendation 2.3: *The SEC should recommend that the FAF, the FASB, and other participants in the financial reporting system continue to improve the effectiveness, efficiency, and timeliness of standards-setting, as follows:*

- *Create a formal Financial Reporting Forum (FRF) that includes key decision makers in the U.S. financial reporting system, including representatives from the SEC,¹⁰⁸ the FASB, and the PCAOB, as well as the preparer, auditor, and investor and other user communities, to make recommendations for responding to immediate needs and longer-term priorities in the financial reporting system overall. This may require the FASB to re-evaluate the roles and composition of other advisory groups or agenda committees.*
- *Enhance the consistency and transparency of key aspects of the FASB's field work, including cost-benefit analyses, field visits, and field tests.*

¹⁰⁸ The extent of advice able to be given to the SEC would need to consider the constraints imposed by the Federal Advisory Committee Act.

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- *Formalize post-adoption reviews of each significant new standard to address interpretive questions and reduce the diversity of practice in applying the standard, if needed.*
- *Formalize periodic assessments of existing standards to keep the standards current.*

Background

U.S. standards-setting involves significant due process. The FASB's activities are open to public participation and observation, and the FASB actively solicits the views of its various constituents on accounting issues. [We believe] the FASB's approach to obtaining significant input through its open due process is appropriate, although there is a difficult trade-off between a transparent due process and expediency. Although [we believe] the FASB's processes function well and [we acknowledge] the significant improvements made recently, further refinements to existing processes could improve the effectiveness, efficiency, and timeliness of standards-setting.

Agenda

Some assert that it may take too long for the issuance of new accounting standards or interpretive implementation guidance in response to changes in business practices or the economic environment.¹⁰⁹ As noted above, the FAF recently implemented various changes in its oversight of the FASB. Specific to agenda-setting, the FAF instituted a leadership agenda at the FASB, whereby the FASB Chairman, following appropriate consultation and subject to oversight from the FAF, sets the FASB's agenda and the priority of projects. [We understand] that through the new leadership agenda, the FASB has recently taken steps to re-align its agenda to more effectively meet its dual (and potentially competing) standards-setting goals of international convergence and of maintaining, improving, and simplifying U.S. GAAP. For example, the FASB has removed less active projects from its agenda to redirect its resources to current projects that are meant to address immediate practice issues. [We support] continued and ongoing efforts in that regard. Notwithstanding [our support] for these efforts, [our final recommendation] is reflective of areas [we believe] warrant further consideration.

¹⁰⁹ See, e.g., comment letters from the Center for Audit Quality (November 20, 2007); the Equipment Leasing and Finance Association (October 10, 2007); Ernst & Young LLP (March 31, 2008); FirstEnergy Corp. (March 31, 2008); KPMG LLP (March 31, 2008); Medtronic, Inc. (March 31, 2008); and UBS AG (March 31, 2008).

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Standards-setting Process

Due to its practice of being very open to constituent input, the FASB often receives conflicting advice. Further, even though the FASB has a transparent due process, new standards are often met with requests for interpretive implementation guidance, implementation deferral, or amendment. Some assert that new standards are not always internally consistent or may be more complex to apply than is necessary to achieve the desired objective.¹¹⁰ [We acknowledge] that various factors impact the development of new standards, including the lack of a completed conceptual framework, competing priorities placed on the Board, opposing views expressed by different constituents, the desire for detailed guidance that answers every implementation issue, and the evolutionary nature of standards-setting in the U.S. At the same time, [we note] that while some of these factors are not in the Board's control, others are.

As noted above, the FAF recently implemented various changes in its oversight of the FASB. Specific to other aspects of standards-setting, the FAF assumed a more active oversight role (including the possibility of the FASB formalizing a post-implementation standards review process and the FAF monitoring the efficiency and effectiveness of standards-setting). Notwithstanding [our general support] for this resolution, [our final recommendation] is reflective of areas [we believe] warrant further consideration.

Discussion

Financial Reporting Forum (FRF)

Some express concern that the responsibilities of the proposed FRF would overlap with those of FASB advisory and other groups.¹¹¹ [We acknowledge] that the creation of the FRF may necessitate the FAF and the FASB re-evaluating the composition and responsibilities of other FASB advisory groups and agenda committees, as well as when and what input is requested of them, to avoid overlapping responsibilities. For example, involvement of preparers, auditors, and investors and other users could be effectuated by

¹¹⁰ See, e.g., comment letters from BDO Seidman, LLP (March 31, 2008); the Center for Audit Quality (November 20, 2007); Ernst & Young LLP (March 31, 2008); Financial Executives International – Committee on Corporate Reporting (September 26, 2007 and April 4, 2008); Financial Executives International – Committees on Small and Mid-Sized Public Companies and on Finance & Information Technology (March 31, 2008); and the Institute of Management Accountants (October 3, 2007).

¹¹¹ See, e.g., comment letters from the Center for Audit Quality (March 31, 2008); the CFA Institute Centre for Financial Market Integrity (March 31, 2008); Ernst & Young LLP (March 31, 2008); Financial Accounting Standards Advisory Council (March 31, 2008); Financial Executives International – Committee on Corporate Reporting (April 4, 2008); Fitch Ratings, Inc. (April 2, 2008); KPMG LLP (March 31, 2008); PricewaterhouseCoopers LLP (March 31, 2008); UBS AG (March 31, 2008); and Terry D. Warfield, University of Wisconsin (February 4, 2008).

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leveraging members or executive committees from existing FASB or PCAOB advisory groups and agenda committees.¹¹²

Further, [we would not limit] the proposed FRF's purview solely to the work of the FASB. Rather, key decision-makers in the U.S. financial reporting system, including representatives from the SEC, the FASB, and the PCAOB would participate on the FRF with preparers, auditors, and investors and other users to confer on immediate financial reporting needs and priorities system-wide. By identifying emerging issues and discussing which group is best positioned to deal with them (e.g., the FASB, the EITF, the SEC, the PCAOB, or others) and in what form, the FRF would give timely input on how best to handle urgent matters versus longer-term needs in the financial reporting system overall.

[Our recommendation] complements the FAF's recent decision to change the FASB's agenda-setting process by establishing a leadership agenda. [We believe] instilling more decision-making authority in the FASB Chairman, combined with a requirement to consult with the proposed FRF, would be a positive step toward increasing the efficiency and effectiveness of the financial reporting system at large. If the SEC acts to move domestic issuers to IFRS in the future, the FRF could also serve as a useful mechanism to identify and debate U.S. financial reporting issues that may need consideration for international standards-setting.

In creating such a proposed FRF, the SEC, the FAF, the FASB, and the PCAOB should consider ways to implement the following objectives:

- Timeliness and transparency – Urgent matters in the U.S. financial reporting system should be dealt with in a timely fashion, which may require the FRF to be convened both on a regular schedule and on short notice, as necessary. The meeting process should allow interested parties to raise issues and track decisions reached by the FRF in a transparent fashion.
- Active participation – One or more key decision-makers from the SEC, the FASB, and the PCAOB should sit on the FRF, which would allow coordination of how and by whom guidance should be issued, thereby reducing the impetus for the SEC to issue interpretive implementation guidance separately from the codified version of U.S. GAAP (see section VI of this chapter). Representation from preparers, auditors, and investors and other users could be effectuated by leveraging members or executive committees from existing FASB or PCAOB advisory groups and agenda committees, but all parties should maintain an appropriate focus on investor and other user needs.

¹¹² See, e.g., comment letters from the Center for Audit Quality (March 31, 2008); Ernst & Young LLP (March 31, 2008); and PricewaterhouseCoopers LLP (March 31, 2008).

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Field Work

The FASB has an extensive process for developing and soliciting investor and other feedback on new standards. Field work generally includes performing cost-benefit analyses, field visits, and other outreach before the standard is exposed for public comment and may include field tests, during which the implementation of a new standard is beta tested. With respect to cost-benefit analyses, participants in standards-setting have long acknowledged that reliable, quantitative cost-benefit calculations are seldom feasible, in large part because of the difficulty of quantifying the benefits and estimating costs prior to implementation. As a result, cost-benefit analyses are sometimes based largely on non-quantitative input received in various ways throughout standards-setting, including field visits, field tests, public comments, and other constituent outreach. To varying degrees, the process for obtaining the input and the extent to which the cost-benefit analyses are documented and communicated in the standards differs across projects.

To enhance the effectiveness of field work, the FASB should implement improvements so that the approach for performing field work is more consistent and transparent across all projects. The work performed should be reasonable in relation to the difficulty and length of time required to implement the proposed standard and the magnitude of its potential impact, should leverage the resources and subject matter expertise available through FASB advisory and other groups, and should consider the work performed by others. Whenever practicable, all aspects of field work should occur concurrently, to improve the efficiency of the process used to obtain and evaluate constituent input. To enhance transparency around that process, the FASB should also improve its documentation of field work (for example, in the basis for conclusions of both exposure drafts and final standards).

Some express concern that introducing enhanced field work processes may impede the timeliness of standards-setting.¹¹³ By increasing the effectiveness and efficiency of field work, [we believe] improved timeliness will result. Further, although enhanced processes may be time consuming, [we believe] by identifying and addressing implementation issues prior to issuing new standards, the FASB would reduce the amount of time spent considering possible interpretive implementation guidance, implementation deferrals, or amendments to standards.

[We acknowledge] the significant amount of time required to perform field work, but [we understand] the FASB is currently considering improvements to the consistency and

¹¹³ See, e.g., comment letters from the CFA Institute Centre for Financial Market Integrity (March 31, 2008); the Council of Institutional Investors (March 31, 2008); Fitch Ratings, Inc. (April 2, 2008); and UBS AG (March 31, 2008).

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transparency of its cost-benefit procedures that will not significantly increase the level of effort involved. [We also understand] that the FASB plans to make greater use of roundtables, surveys, and other research, which together may satisfy [our recommendation]. Roundtables have an advantage over traditional field work, because they provide an ideal opportunity to vet issues raised in comment letters through active debate between and among various constituents, promoting balanced standards-setting in an efficient manner with maximum Board involvement. [We support] these efforts and [recommend] that the FASB give further consideration to these and other improvements when assessing whether a compromise between doing no field testing and full-scale beta adoptions of new standards would be possible. The success of these efforts will in large part be determined by the willingness of participants in the financial reporting community to provide appropriate information and assistance to the standards-setter.

As noted in section IV of this chapter, the FAF should also develop key performance metrics to track the timeliness and effectiveness of the FASB's standards-setting process, including, but not limited to, the effectiveness and efficiency of field work.

Post-Adoption Reviews of New Standards

[We acknowledge] that it is impossible to identify and address all implementation issues in a new standard prior to it being issued and adopted. Issues and questions are often identified during the initial implementation phase as preparers and auditors begin to apply a new standard in practice. Preparers, auditors, and others often monitor and take measures to reduce diversity in practice when implementing a new standard by conferring among themselves and issuing non-authoritative interpretive implementation guidance. During this initial period, requests are often made of the FASB, the EITF, and the SEC to provide interpretive implementation guidance for new standards.

In the current financial reporting environment, preparers and auditors are sometimes viewed as being penalized for implementing their understanding of new accounting standards immediately after adoption. This is because any ambiguity or substantial gaps identified in the implementation period may lead the regulators to issue interpretive implementation guidance that differs from conclusions originally reached by the preparers and auditors.

The FASB has a process in place to timely identify and respond to implementation issues for new accounting standards, including through the EITF and ongoing constituent outreach involving FASB advisory groups and others. To enhance its effectiveness, the FASB should formalize post-adoption reviews so that they are performed for each significant new standard within a reasonable period following its effective date in a transparent fashion. The review objective should be to assess whether the standard is accomplishing its intended purpose (or whether there are unintended consequences that need to be resolved through standards-setting or in other ways). [We do not believe] that

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a specified time period for conducting post-adoption effectiveness reviews should be prescribed, as [we believe] the standards-setter and its advisory groups should evaluate the facts and circumstances surrounding each major project when making such determinations.

[We believe] that, when necessary, interpretive implementation guidance for new standards that may result from these reviews is best given by the FASB using:

- A transparent due process with public comment
- Appropriate transition guidance, timing, and required disclosures that will provide investors and other users with useful information regarding possible changes in accounting
- The codified version of U.S. GAAP.

Understandably, some interpretive implementation guidance may be of such an urgent nature that a transparent due process would not be responsive to the needs of investors and other users. Therefore, [we envision] that the SEC or other parties, through representation on the proposed FRF, could agree to assist by issuing interpretive implementation guidance in limited situations (see section VI of this chapter).

Our recommendation does not contemplate that preparers would have the flexibility to implement new standards at different times or have the ability to adopt early or late. Following the recent policy decision by the FASB that discourages early adoption of new standards for comparability reasons, [our recommendation] contemplates transition guidance for a new standard with a stated, required implementation date. Similarly, this recommendation is not a safe harbor. Nor does it constitute a policy to forebear on enforcing new accounting standards. Violations of U.S. GAAP will continue to be dealt with by the SEC through the review, comment, restatement, and enforcement processes. However, the SEC should give appropriate consideration to situations in which there are ambiguities or gaps in a new standard that could be subject to more than one reasonable interpretation. For example, it may be inappropriate for the SEC to bring an enforcement proceeding based on a new accounting standard if, after careful analysis performed in good faith, the registrant took a reasonable and supportable view of that standard, which was subsequently changed by formal amendment or published interpretation. On the other hand, a registrant that fails to follow well-defined aspects of a new accounting standard should not be able to defend such actions by arguing that the standard was new and subject to possible revision.

Periodic Assessment of Existing Standards

After an accounting standard has been in place for a reasonable period, more data is likely to be available to evaluate its benefits and costs. Further, economic conditions and business practices may change over time, such that older accounting standards may lose their relevance and effectiveness. Some note that numerous accounting standards or

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models need immediate re-evaluation.¹¹⁴ For example, in today's economic environment, the accounting for securitizations and structured products with off-balance-sheet risk is cited as needing re-evaluation.¹¹⁵ The accounting for convertible debt and derivatives and hedging activities is also frequently cited areas for improvement.

Having current accounting standards in place is critical to the proper functioning of the U.S. capital markets. The FASB has a process in place to timely identify and respond to questions that arise for existing standards, including through the EITF and ongoing constituent outreach involving FASB advisory groups and others. To enhance its effectiveness, the FASB should formalize its reviews of existing standards so that they continue to be useful in the current economic and business environment. Such assessments should be systematic and incorporate procedures to periodically request feedback from a broad range of constituents, including the SEC, about U.S. GAAP requirements that create practice problems or are unnecessarily complex in the current environment.

VI. Interpretive Implementation Guidance

Recommendation 2.4: The SEC should coordinate with the FASB to clarify roles and responsibilities regarding the issuance of interpretive implementation guidance, as follows:

- ***To the extent practicable, going forward, there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance that are applicable to a particular set of accounting standards, such as U.S. GAAP or IFRS. For U.S. GAAP, the FASB serves this function. To that end, the SEC should only issue broadly applicable interpretive implementation guidance in limited situations (see recommendation 2.5).***
- ***The FASB Codification, a draft of which was released for verification on January 16, 2008, should be completed in a timely manner. In order to fully realize the benefits of the FASB's codification efforts, the SEC should ensure that the literature it deems to be authoritative is integrated into the FASB Codification to the extent practicable, or separately codified, as necessary.***
- ***All other sources of interpretive implementation guidance should be considered non-authoritative and should not be required to be given more credence than***

¹¹⁴ See, e.g., comment letters from BDO Seidman, LLP (March 31, 2008); the Center for Audit Quality (November 20, 2007); the Council of Institutional Investors (March 31, 2008); the Institute of Management Accountants (October 3, 2007); and Sherman L. Rosenfield (October 13, 2007).

¹¹⁵ SEC staff, *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (June 2005).

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any other non-authoritative sources that are evaluated using reasonable judgments made in good faith that are supportable under U.S. GAAP.

- *The proposed FRF should advise the FASB on re-prioritizing its agenda in a way that balances the need for international convergence (which is highly dependent on possible future actions of the SEC), improvements to the conceptual framework and maintaining existing U.S. GAAP. If U.S. GAAP will continue to be in use for an extended period of time, such a re-prioritization of standards-setting should consider the possibility of a second phase of the codification project to systematically revisit U.S. GAAP.*

Background

Non-authoritative interpretive implementation guidance has proliferated over time from a variety of sources, which intentionally or not, has been viewed as additional authoritative U.S. GAAP. In other words, interpretive implementation guidance that is not formally authoritative often is erroneously perceived by participants in the financial reporting and legal communities to be quasi-authoritative. The key risks associated with a proliferation of interpretive implementation guidance are that: (1) the appropriate rule may not be identified and considered and (2) it may conflict with authoritative or other non-authoritative guidance, causing uncertainty in application and legal risk.

Over the past few years, the FASB and the SEC have taken steps intended to reduce the proliferation of interpretive implementation guidance from different authoritative bodies. For example, the SEC recognized the standards of the FASB as “generally-accepted,” and the FASB limited the ability of other bodies (e.g., the EITF,¹¹⁶ the FASB staff, and others) to create authoritative guidance without FASB ratification. Nevertheless, the SEC staff continues to be a source of interpretive implementation guidance in its own right, through such vehicles as comment letters, staff speeches, SABs, and other forms of exchange that, although non-authoritative, are perceived as quasi-authoritative.

[Our recommendation], which should be read in conjunction with [recommendation 2.5], is designed to recognize recent accomplishments in this area, clarify what guidance is authoritative and non-authoritative, and further influence the behaviors that have led to the desire for more guidance.

¹¹⁶ Historically, the process of issuing authoritative interpretive implementation guidance in the U.S. rested primarily with the EITF. Formed and overseen by the FASB, the mission of the EITF is to reduce diversity in the application of U.S. GAAP by promulgating interpretive implementation guidance on a timely basis. The EITF was designed to minimize the need for the FASB to spend time and effort addressing narrow implementation, application, or other emerging issues that can be analyzed within existing U.S. GAAP.

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Discussion

FASB Codification

The FASB has undertaken a significant project to develop a comprehensive, integrated Codification of existing accounting literature organized by subject matter that is intended to become an easily retrievable single source of U.S. GAAP. To that end, on January 16, 2008, the FASB released a draft of the FASB Codification that will be subject to a one-year verification period. [We support] the FASB's initiation of this project and recognize the significant effort it has entailed. The FASB Codification:

- Brings together all U.S. GAAP from all authoritative sources and classifies it by topic into a single, searchable database so that it may be more easily researched
- Clarifies what guidance is authoritative versus non-authoritative
- Puts accounting standards into a consistent format, to the extent practicable.

Although the FASB Codification does not change the substance of U.S. GAAP, it should make its application easier. However, SEC literature, which has developed through different mechanisms, is not as easily integrated into the FASB Codification.¹¹⁷ Similarly, the FASB Codification does not deal with either the root causes of the proliferation of interpretive implementation guidance or the behavior of participants in the U.S. financial reporting community that caused the complexity. Notwithstanding these concerns, [we support] the FASB's efforts to verify the Codification. To further promote the benefits of the Codification, the SEC should codify its interpretive implementation guidance using a consistent format. If U.S. GAAP will continue to be in use for an extended period of time, the FASB and the SEC should consider systematically revisiting U.S. GAAP in a second phase of the codification project.

Non-Authoritative Guidance

Although the FASB Codification will help clarify the roles of authoritative and non-authoritative guidance, meaningful improvements in financial reporting will be difficult if non-authoritative interpretive implementation guidance continues to be perceived, as it is today, as having quasi-authority in the marketplace. [Our recommendation] is intended to foster acceptance of reasonable judgments made in good faith when they are supportable under U.S. GAAP. Specifically, non-authoritative interpretive implementation guidance should be clearly labeled as such and should not be used as the

¹¹⁷ Two of the benefits of the FASB Codification are its search feature and decimal system, which consistently organizes topics and subtopics in U.S. GAAP. To improve its usability in the future, the Codification includes authoritative content issued by the SEC, as well as selected SEC staff interpretations. However, the inclusion of SEC guidance is for administrative convenience and will not supersede such guidance in its current form. Further, the SEC guidance does not follow the same organizational structure as the rest of U.S. GAAP in the Codification.

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sole basis for forcing accounting treatments when other reasonable interpretations exist that are supportable under U.S. GAAP and are made in good faith.

Priorities

We acknowledge that the FASB contends with competing priorities and that its agenda over the next few years will be dominated by international convergence efforts. Therefore, [we believe] the financial reporting system would benefit from continuous input from the FRF proposed in section V of this chapter regarding both urgent matters and longer-term priorities in the financial reporting system overall.

Second Phase of Codification

As noted above, the Codification does not change the substance of U.S. GAAP, which continues to be encumbered by detailed rules, bright lines, scope exceptions, industry guidance, accounting alternatives, and other forms of complexity. Further, because of the evolutionary nature of U.S. standards-setting, the Codification does not read consistently in all parts. Even after the proposed re-codification of SEC literature, there will be opportunities to remove redundancies between SEC and FASB disclosure requirements and make other simplifications. Therefore, subject to the recommendation above that the FRF should advise the FASB on re-prioritizing its agenda given international convergence and other priorities, [we believe] the FASB and the SEC should perform a second phase of the codification project, which would involve a comprehensive assessment of existing accounting standards recommended in section V of this chapter. Specifically, the FASB should research opportunities to: (1) amend, replace, or remove outdated standards, (2) re-address frequent practice problems (as identified by restatement volumes, input from the SEC, implementation guidance issued, or frequently asked questions), (3) design standards more optimally (see section VII of this chapter), (4) rewrite the Codification to be less complex and more coherent after codification, where practicable, (5) remove conflicts between standards or with the conceptual framework, (6) remove redundancies between SEC disclosure requirements and other sources of U.S. GAAP (see chapter 1), and (7) require disclosures based on a coherent disclosure framework (see chapter 1) that should be added to the conceptual framework.

Recommendation 2.5: *As a general matter, the SEC staff should refrain from issuing broadly applicable interpretive implementation guidance that would change U.S. GAAP and instead should refer such matters to the FASB, such as through the proposed Financial Reporting Forum. The SEC staff should re-emphasize that its comment letter and “pre-clearance” processes are registrant-specific and that other registrants should respond to those comments by changing their accounting only after concluding it is appropriate to do so. Furthermore, the SEC staff is taking a number of steps to improve the consistency of its interpretive*

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implementation guidance associated with U.S. GAAP and the Commission should take appropriate steps to monitor the outcome of those actions.

Background

When the FASB issues new accounting standards or interpretive implementation guidance, it follows a rigorous notice and comment process. When the Commission adopts rules, including those that would comprise part of authoritative U.S. GAAP, its approval of those rules generally follows a similar public comment process.

Some express concern that the SEC staff may, at times, take actions that serve to interpret, revise, or add to U.S. GAAP without opportunities for public comment that should be associated with such actions.¹¹⁸ In fact, the SEC staff usually does not engage in a public comment process before it issues interpretive implementation guidance. The SEC staff provides interpretive implementation guidance in at least three ways. First, the SEC staff has historically provided interpretive implementation guidance that is intended to be applicable to all registrants, such as in SABs, Letters to Industry, Frequently Asked Questions, and *Current Issues* outlines. Second, the SEC staff may provide interpretive implementation guidance to select audiences in speeches and in other public remarks, some of which are published on the SEC website. Finally, the SEC staff provides interpretive implementation guidance to individual registrants in two ways – in its comments to registrants during filing reviews and in response to registrant requests that the SEC staff not object to a specific interpretive implementation issue in what is commonly referred to in the private sector as the “pre-clearance” process. Although guidance provided to individual registrants is based on each registrant’s specific facts and circumstances, other registrants may independently conclude that it is appropriate to apply the guidance to their own facts and circumstances. Their advisors and auditors often encourage them to do so.

[We noted] several areas where the SEC staff could improve the consistency of the interpretive implementation guidance it provides in its filing reviews. Although the SEC staff has procedures in place for registrants to request reconsideration of SEC staff conclusions in comment letters or pre-clearance matters, registrants may choose not to avail themselves of these processes because they may be concerned about missing market opportunities to raise capital, the potential risk of re-opening other issues to reconsideration or their fear of possible retribution (misguided or not).

¹¹⁸ See, e.g., comment letters from the Center for Audit Quality (November 20, 2007); the Council of Institutional Investors (March 31, 2008); Ernst & Young LLP (March 31, 2008); Financial Executives International – Committee on Corporate Reporting (April 4, 2008); Financial Executives International – Committees on Small and Mid-Sized Public Companies and on Finance & Information Technology (March 31, 2008); and KPMG LLP (March 31, 2008).

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Discussion

While the Commission has the ultimate authority to establish accounting standards for public companies, it has historically indicated, and in 2003 reaffirmed as a result of the Sarbanes-Oxley Act of 2002, that pronouncements of the FASB are recognized as “generally accepted” for purposes of the federal securities laws. However, the distinction between the roles of the Commission and the FASB can become blurred when it comes to SEC staff actions that may be perceived as providing broadly applicable interpretive implementation guidance. To the extent issues arise in SEC staff filing reviews or in the pre-clearance process that may indicate a need to consider interpreting, revising, or adding to U.S. GAAP, [we believe] it is appropriate for the SEC staff to refer those matters to the FASB for its consideration, such as through the proposed Financial Reporting Forum.

[We believe] that the SEC staff should generally refrain from issuing interpretive implementation guidance that changes the application of U.S. GAAP because the SEC staff does not usually solicit public comment before issuing such guidance. [We recognize] there are times when it would nevertheless be necessary and appropriate for the SEC staff to issue broadly applicable interpretive implementation guidance, such as when a critical, time-sensitive need exists and the FASB has not had the opportunity to deliberate the matter. However, [we believe] the SEC staff should seek, at a minimum, the views of the FASB Chairman and the proposed Financial Reporting Forum before issuing broadly applicable interpretive implementation guidance, such as what it provides in SABs, Letters to Industry, and Frequently Asked Questions.

With regard to SEC staff comments to individual registrants in the filing review and the pre-clearance processes, financial reporting participants may misconstrue registrant-specific accounting outcomes as quasi-authoritative and apply these outcomes to similar fact patterns of other registrants. The SEC staff’s efforts to increase the transparency of its filing review process through the posting of comment and response letters may inadvertently increase this practice. [We support] the SEC staff’s public statements that its comments to an individual registrant are based on that registrant’s facts and circumstances and that one registrant should not change its accounting in response to comments issued to another registrant unless that registrant concludes, on its own, that it is appropriate to do so. The SEC staff should re-emphasize that its comment letter and pre-clearance processes are registrant-specific and take steps necessary to improve their transparency.

[We understand] that the SEC staff has recently implemented or plans to implement various changes designed to increase the consistency of SEC staff comments and outcomes of the filing review process. In addition, [we understand] that the SEC staff is developing procedures to improve the consistency of the interpretive implementation guidance it provides in its speeches and other public remarks by supplementing the

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existing practice of reviews of such remarks by SEC senior staff members from various Divisions and Offices. These reviews help ensure that SEC staff speeches are not used to informally communicate broadly applicable interpretive implementation guidance. Rather, speeches should be used to highlight authoritative interpretive implementation guidance that has already been issued or U.S. GAAP compliance issues observed during the filing review and comment process that are clearly indicative of trends. [We understand] that the Commission plans to establish a disclosure standards function within the Division of Corporation Finance to monitor the consistency of SEC staff comments and review outcomes over time. [We understand] that the SEC staff is also in the process of consolidating all interpretive implementation guidance and other information intended for accountants into a single location on the SEC website. In an effort to increase registrant awareness of available reconsideration processes, [we understand] that this enhanced web page will include a recently-released, detailed description of the Division of Corporation Finance review and comment process that identifies the appropriate SEC staff members to contact when seeking reconsideration of SEC staff comments or views.¹¹⁹ Although [we cannot tell] if this will diminish concerns about using these reconsideration processes, [we support] the SEC staff's efforts to improve transparency in this regard.

Although these planned improvements will take time to achieve their intended goals, [we support] these efforts and recommend that the Commission undertake an internal periodic review of their effectiveness. Specifically, [we recommend] that the Commission direct the appropriate SEC senior staff members to continually monitor whether these revised internal staff procedures are successful.

VII. Design of Standards

Recommendation 2.6: The SEC should recommend that the FASB build upon recent improvements made to the design of accounting standards as part of its Understandability initiative – primarily by increasing the use of clearly-stated objectives, outcomes, and principles, and emphasizing the importance in financial reporting of the faithful representation of the economics of transactions and being responsive to investor and other user needs for clarity, transparency, and comparability.

Background

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, and exceptions. This can create uncertainty in the application of

¹¹⁹ See <http://www.sec.gov/divisions/corpfin/cffilingreview.htm>.

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U.S. GAAP and produce confusing results for investors. Further, the proliferation of detailed rules fosters accounting-motivated structured transactions, as rules cannot cover all outcomes. As discussed in chapter 1, 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 and other users, 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 and other users rely.

Discussion

[We recognize] 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.¹²⁰ Rather than engage in such a debate, [we prefer] to think of the design of accounting standards in terms of the characteristics they should possess. There are many publications on this topic written by well-known commenters 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.¹²¹ 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 and structures accounting standards as part of its Understandability initiative and the Codification project. [We support] the increased use of clearly-stated objectives, outcomes, and principles in accounting standards to build upon these improvements. [We believe] the highest goal for accounting standards in the future is that they should faithfully represent the economics of transactions and be responsive to investor and other user needs for clarity, transparency, and comparability. Standards that meet these criteria, when applied in

¹²⁰ 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.

¹²¹ CEOs of the World's Six Largest Audit Networks, *A Proposed Framework for Establishing Principles-Based Accounting Standards*, Global Public Policy Symposium (January 2008).

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good faith in a financial reporting system that employs [our other recommendations], will foster enhanced comparability and help to increase investor confidence in financial reporting.

Although [we support] 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 spectrum new accounting standards should be written over time. This would assist the standards-setter in determining the volume of rules that may be necessary under 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 and other users, it would be reasonable to provide prescriptive guidance in addition to objectives, outcomes, and principles.

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CHAPTER 3: AUDIT PROCESS AND COMPLIANCE

I. Introduction

In this chapter, we concentrate on the subjects of financial restatements, including the potential benefits from providing guidance with respect to the materiality¹²² 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

Background

Likely Causes of Restatements

The number of financial restatements¹²³ in the U.S. financial markets has been increasing significantly over recent years, reaching approximately 1,600 companies in 2006.¹²⁴ Restatements generally occur because errors that are determined to be material are found in financial statements 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 of 2002; 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*

¹²² 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).

¹²³ 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 when they are to be presented in a subsequent filing with the SEC.

¹²⁴ 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).

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(as codified in SAB Topic 1M).¹²⁵ SAB Topic 1M was written primarily to 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 broad application of SAB Topic 1M, errors may have been deemed to be material when an investor may not consider them to be important.

When material errors occur, 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 best means to achieve those goals when previously filed financial statements contain errors that are material to investors making current investment decisions.

Furthermore, we [believe] that public companies should focus on reducing errors in financial statements. In this regard, we [believe] that some of our recommendations in other chapters will be helpful in reducing the frequency of errors in financial statements. These include recommendations to reduce complexity, such as the recommendations to limit scope exceptions, alternative accounting policies and bright lines, and the recommendation to have the FASB complete and adopt a measurement framework, discussed in chapter 1, recommendations to improve the standards-setting process and to delineate authoritative interpretive guidance discussed in chapter 2, the recommendation on judgment discussed in section III of this chapter, and the recommendation on XBRL discussed in chapter 4.

An important factor in reducing errors in financial reporting is the presence of an effective system of internal control over financial reporting. Efforts to improve company controls and audit quality in recent years should reduce errors, and there is evidence this is currently occurring.¹²⁶ We are fully supportive of the many benefits that have resulted from the implementation of section 404 of the Sarbanes-Oxley Act and the related standards issued by the SEC and the PCAOB. While internal control over financial reporting has been strengthened in recent years, there is evidence indicating that material weaknesses in internal control are often identified after a financial reporting problem has arisen, and perhaps only as a result of the event itself.¹²⁷ Financial reporting would clearly be improved if there was more timely identification of material weaknesses, and

¹²⁵ See, e.g., comment letters from the Bar Association of the City of New York (April 18, 2008) and John J. Huber, Latham and Watkins LLP (March 13, 2008).

¹²⁶ 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.

¹²⁷ A Moody's Investors Service's report, *The Third Year of Section 404 Reporting on Internal Control, Controls Problems are decreasing, but reporting can be improved* (May 2007), an Audit Analytics report, *404 Dashboard, Year 3 Update* (December 2007) and a Glass Lewis & Co. report, *Restatements: Out of Sight, Out of Mind* (May 30, 2008), all indicate that there is a very high percentage of material weaknesses that are first reported in connection with either a restatement of prior period financial statements or a material audit adjustment.

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remediation of these weaknesses to prevent errors from occurring in the first place. Therefore, we encourage the SEC and the PCAOB to continue to stress the timely identification and correction of weaknesses, with appropriate emphasis on tone at the top and corporate governance as key factors that will lead to early identification and timely action, particularly as they relate to the potential for fraudulent financial reporting.

While reducing errors in financial reporting 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 recommendations regarding: (1) additional guidance on the concept and application regarding materiality, and (2) the process for, and disclosure of, the correction of errors.

Our Research

We considered several publicly-available studies¹²⁸ on restatements. The restatement studies we have reviewed all indicate that the total number of restatements increased over the last decade, through they appear to have declined in 2007.¹²⁹ The studies also indicate that there are many different types of errors that result in the need for restatements. Based on these studies, it appears to us that there may be restatements that may not be important to investors making current investment decisions.¹³⁰ 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 expenses.¹³¹ While there are limitations¹³² to using

¹²⁸ Studies considered include the study commissioned by the Department of the Treasury: Susan Scholz, *The Changing Nature and Consequences of Public Company Financial Restatements 1997-2006* (April 2008); Marlene Plumlee and Teri Yohn, *An Analysis of the Underlying Causes of Restatements* (March 2008); GAO study, *Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Updates* (March 2007); two Glass Lewis & Co. studies, *The Errors of Their Ways* (February 2007) and *Restatements: Out of Sight, Out of Mind* (May 30, 2008); 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.

¹²⁹ 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.

¹³⁰ See, e.g., comment letter from Financial Executives International – Committee on Corporate Reporting (April 4, 2008).

¹³¹ Susan 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

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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 statement, and the trend toward restatements in cases where there is no evidence of fraud or intentional wrongdoing. A recent study also indicated that restatements related to non-core expenses increased from approximately 20% of total restatements in 1997 to 39% in 2006, and that the sum of such restatements in 2005 and 2006 (1,086) is nearly equal to the sum over all the other eight years of the study (1,116).¹³³ Despite recent evidence that the number of restatements 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 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.¹³⁴ 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, disclosures often do not provide enough information about the nature and impact of the error, and the resulting actions the company is taking.

loss recognition, inter-company investments, contingency and commitments, fixed and intangible asset valuation or impairment and income taxes.

¹³² 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.

¹³³ These trends are addressed in Susan Scholz's study. Susan Scholz's study also indicates that the relative frequency of revenue-related restatements has declined from approximately 40% of total restatements in 1997 to approximately 11% of total restatements in 2007, with the caveat that the ending of the technology bubble (technology firms tend to disproportionately restate revenue) and the introduction of SEC Staff Accounting Bulletin No. 101 on revenue recognition would explain a decrease in revenue restatements.

¹³⁴ See, e.g., comment letters the CFA Institute Centre for Financial Market Integrity (March 31, 2008) and ITAC (December 13, 2007).

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- Interim periods should be viewed as more than just a component of an annual financial statement for purposes of making materiality judgments.

Recommendations

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.¹³⁵ 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.¹³⁶

With this context, we recommend the following regarding the assessment of the materiality of errors to financial statements and the correction of financial statements for errors.¹³⁷

Recommendation 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 large¹³⁸ error is not material.

¹³⁵ See, e.g., comment letters from PricewaterhouseCoopers LLP (March 31, 2008); Steven E. Bochner, Wilson Sonsini Goodrich & Rosati LLP (March 13, 2008); and the Bar Association of the City of New York (April 18, 2008).

¹³⁶ See, e.g., comment letters from the CFA Institute Centre for Financial Market Integrity (March 31, 2008) and Elizabeth F. Mooney, The Capital Group Companies (March 13, 2008).

¹³⁷ We recommend principles that we believe will be helpful in addressing financial statement errors. In recommending these principles, we have not determined if the principles are inconsistent with existing U.S. 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 recommendations would require a change to U.S. GAAP, the SEC should work with the FASB to revise U.S. GAAP.

¹³⁸ In this chapter, the term “large” refers to any error that is more than insignificant. We understand that this is a broad definition and that the larger an error is, the more likely that the error will be deemed material regardless of any qualitative factors.

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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.”¹³⁹ 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.¹⁴⁰

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 material.¹⁴¹ 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

¹³⁹ See supra note 122.

¹⁴⁰ See, e.g., comment letter from CALPERS (March 13, 2008).

¹⁴¹ Some have argued that this view could result in a very large error affecting financial statement metrics meaningful to investors being deemed to be immaterial by virtue of qualitative factors. The Committee believes that the probability of management, after consultation with their audit committee and independent auditors, reaching such a conclusion is remote.

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and not a 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 should be considered when evaluating the materiality of a large error. (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.

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.¹⁴²

Recommendation 3.2: The FASB or the SEC, as appropriate, should issue guidance on how to correct an error consistent with the principles outlined below:

- ***Companies should be required to correct all errors promptly and should not have the option to defer correction of errors until future financial statements. All material errors in previously issued financial statements 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 investors making current investment decisions. For example, a material error that is not important to a current investment decision would not require restatement of the financial statements in which the error occurred, but would need to be promptly corrected and prominently 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.***

¹⁴² See, e.g., comment letter from the Center for Audit Quality (March 31, 2008).

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- *Restatements of interim periods do not necessarily need to result in a restatement of an annual period.*
- *Corrections of large errors in previously issued financial statements should always be disclosed in the filing, even if the error is determined not to be material.*
- *To limit the likelihood of “stealth restatements,” the SEC should revise the instructions to Form 8-K to state clearly that the form needs to be filed for all determinations of non-reliance on prior financial statements.*

We [believe] that all errors, excluding clearly insignificant errors, should be promptly corrected. 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 correction of errors until future financial statements. By correcting small errors when they are identified, a company substantially reduces the likelihood 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. 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.¹⁴³

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. 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 period with appropriate disclosure at the time the current annual period financial statements are filed with the SEC. Regardless of how these errors are corrected,¹⁴⁴ we [believe] there should be prominent disclosure

¹⁴³ 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.

¹⁴⁴ 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

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showing the impact on the financial statements of correcting errors from prior financial statements.

More generally, 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 not to be important 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 impacted. This approach would 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 restate prior financial statements, as relevant, but to report this 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. The SEC should consider inclusion of this option in the overall guidance on how to correct errors after evaluating the likelihood of abuse.¹⁴⁵ As part of a response, the SEC might confirm [our view] that while no amendment would be required of a report filed with the SEC, we [believe] a company would still be required to file a current report on Form 8-K under Item 4.02, "Non Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review," in order to alert investors to the existence of a material error.

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.

accomplished through an adjustment to equity or to current period income with either appropriate disclosure or separate classification of the adjustment. These approaches might potentially require an amendment to U.S. GAAP. We believe that there are merits in these approaches and that the FASB and the SEC, as appropriate, should carefully weigh these approaches before determining the actual approach to utilize.

¹⁴⁵ See, e.g., comment letter from the Consumer Federation of America (January 16, 2008).

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- 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 management, after consultation with their audit committee and independent auditors, concludes that a large error is not material because of qualitative factors, there should be appropriate disclosure about the error in the period in which the error is corrected.¹⁴⁶

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 recommendation 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. Stealth restatements would also be reduced if, as the GAO recommended to the SEC, the SEC amends the instructions to the Form 8-K and other relevant periodic filings to clearly state that an Item 4.02 disclosure on Form 8-K is required for all determinations of non-reliance on previously issued financial statements irrespective of whether such information has been disclosed in a periodic report or elsewhere.¹⁴⁷

Recommendation 3.3: The FASB or the SEC, as appropriate, should issue guidance on disclosure of financial information 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:

¹⁴⁶ See, e.g., comment letter from BDO Seidman, LLP (March 31, 2008).

¹⁴⁷ GAO study, *Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Updates* (March 2007).

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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.¹⁴⁸ 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

¹⁴⁸ See, e.g., comment letters from ITAC (December 13, 2007) and CALPERS (March 13, 2008).

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- 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.

Recommendation 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 recommendation 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*.¹⁴⁹ 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.¹⁵⁰

¹⁴⁹ 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.

¹⁵⁰ See, e.g., comment letters from Ernst and Young LLP (March 31, 2008) and John J. Huber, Latham and Watkins LLP (March 13, 2008).

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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 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 recommendations 3.1 and 3.2 above, would provide useful guidance in assessing and correcting interim period errors.

We [believe] that the determination of whether an interim period error is material should be made based on the perspective of a reasonable investor,¹⁵¹ 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.¹⁵² As one example, a reasonable investor would use interim financial statements to assess the sustainability of a company's operations and cash flows so that an error that did impact the sustainability of a company's operations and cash flows may very well be material. However, 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.

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.

¹⁵¹ See, e.g., comment letter from CALPERS (March 13, 2008).

¹⁵² 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.

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III Judgment

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, more use of fair value estimates, and a focus on more principles-based 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.¹⁵³ 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 how regulators evaluate judgments 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.

¹⁵³ See, e.g., comment letters from Financial Executives International – Committee on Corporate Reporting (April 4, 2008) and Deloitte and Touche LLP (March 31, 2008).

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- 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 U.S. 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

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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 U.S. 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.

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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. Guidance should not suggest that those who evaluate a judgment must 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.¹⁵⁴ Determining at what point the relevant facts were known to management, *or should have been known*,¹⁵⁵ can be difficult, particularly for regulators who are often evaluating these circumstances after substantial time has passed. Therefore, hindsight should be based only on the facts reasonably available at the time the relevant 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.¹⁵⁶

A preferred 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 SEC to articulate 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

¹⁵⁴ See, e.g., comment letter from Deloitte and Touche LLP (March 31, 2008).

¹⁵⁵ 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.

¹⁵⁶ See, e.g., comment letters from CALPERS (March 13, 2008) and Medtronic, Inc. (March 31, 2008).

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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 approach 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 policy¹⁵⁷ 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 U.S. GAAP

Some have suggested that a factor for evaluating judgments be a requirement to reflect the “economic substance” of a transaction. 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 U.S. GAAP judgments reflect economic substance. However, reasonable people disagree on what economic substance actually is, and many would conclude that significant parts of current U.S. 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 U.S. GAAP that would not meet many reasonable definitions of economic substance).

Similarly, some have suggested that a factor for evaluating judgments be a requirement to reflect the “high road” – 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 U.S. GAAP (e.g., costing inventory, measuring depreciation, and electing to apply hedge accounting are just some of the many varied methods allowed by U.S. 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 agree that qualitative standards for U.S. 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 U.S. GAAP – a change that would be beyond our purview and one that would not be doable in the near- or

¹⁵⁷ See, e.g., comment letter from CALPERS (March 13, 2008).

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intermediate-term. Our recommendation that the SEC issue a statement of policy relating to its evaluation of judgments could and we [believe] would enhance adherence to U.S. GAAP, but it cannot be expected to correct inherent weaknesses in the standards to which it would be applied.

Recommendation

We recommend the following:

Recommendation 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 recommendation to cover judgments made by auditors based on the application of PCAOB auditing standards would be beneficial to auditors. Therefore, we recommend 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's 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 to 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.

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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 helping the SEC and preparers more efficiently resolve potential differences during the SEC's review of preparer's filings. However, 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. 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 are likely to be addressed in 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

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

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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 expertise¹⁵⁸
8. The preparer's consideration of known diversity in practice regarding the alternatives or estimates¹⁵⁹
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.

Material issues or transactions should be disclosed appropriately. We note that existing disclosure requirements should be sufficient to generate 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.¹⁶⁰

¹⁵⁸ 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.

¹⁵⁹ If there is not diversity in practice, it would be significantly harder to select a different alternative.

¹⁶⁰ Existing disclosure requirements include the guidance on critical accounting estimates in the SEC's *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, SEC Release No. 33-8350 (December 19, 2003) (2003 MD&A Interpretive Release); the SEC's *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*, SEC Release No. 33-8040 (December 12, 2001); 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.

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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.

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CHAPTER 4: DELIVERING FINANCIAL INFORMATION

I. Introduction

We evaluated the information needs of investors, methods by which financial information is provided to investors, and means to improve delivery of financial information to all market constituencies. In evaluating the information needs of investors, we recognized that the information needs of different types of investors are not always the same. We agreed that information provision must be accomplished in a manner that is efficient, reliable, and cost-effective for each of the relevant investor groups and will not significantly increase burdens on reporting companies.

In this chapter, we focus our efforts on financial information provided by reporting companies in their periodic and current reports under the Securities Exchange Act of 1934 (“Exchange Act”) and other ongoing disclosures provided by reporting companies to investors and the market.¹⁶¹ We [believe] that our recommendations will enhance ongoing reporting that will enable investors to better understand reporting companies.

Based on the above, we analyzed a number of ways to improve the delivery of financial information to investors and the market. These are:

- Tagging of financial information (XBRL or interactive data)
- Improving corporate website use
- Disclosures of key performance indicators (KPIs) and other metrics to enhance business reporting
- Improved quarterly press release disclosures and timing
- Use of executive summaries as an integral part of Exchange Act periodic reports

We received [21] comment letters and heard oral statements from 7 persons regarding these topics.¹⁶²

¹⁶¹ We determined that we would not address information delivery in registered offerings under the Securities Act of 1933 for two primary reasons. First, the SEC already has addressed information delivery in registered securities offerings when it adopted new communication rules in 2005 for registered offerings by issuers other than registered investment companies. Second, we view information delivery relating to ongoing company reporting by public companies as the area needing greater focus.

¹⁶² See, e.g., comment letters from ADVENTRX Pharmaceuticals, Inc. (March 14, 2008); American Accounting Association (April 30, 2008); Bar Association of the City of New York (April 18, 2008); BDO Seidman, LLP (March 31, 2008); Business Wire (February 4, 2008); Center for Audit Quality (March 31, 2008); CFA Institute Centre for Financial Market Integrity (March 31, 2008); EDGAR Online, Inc. (February 7, 2008); Enhanced Business Reporting Consortium (October 24, 2007 and March 31, 2008); Ernst & Young LLP (March 31, 2008); Financial Executives International – Committee on Corporate Reporting (April 4, 2008); FirstEnergy Corp. (March 31, 2008); Fitch Ratings, Inc. (April 2, 2008); Institute of Public Auditors in Germany (March 26, 2008); KPMG LLP (March 31, 2008); Medtronic, Inc. (March 31, 2008); Ohio Society of CPAs (March 31, 2008); PricewaterhouseCoopers LLP (March 31, 2008); PR Newswire (September 21, 2007); and Steven E. Bochner, Wilson Sonsini Goodrich & Rosati

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II. Tagging of Financial Information (Interactive Data)

We would like to make [recommendations] that increase the certainty that interactive data will be a significant part of the reporting landscape so that preparers, investors, auditors, software developers, and regulators make the needed investment in interactive data.

Based on the considerations discussed below, we have the following [recommendations]:

Recommendation 4.1: The SEC should, over the long-term, mandate the filing of interactive data-tagged financial statements after the satisfaction of certain preconditions relating to: (1) successful XBRL U.S. GAAP Taxonomy testing, (2) the capacity of reporting companies to file interactive data-tagged financial statements using the new XBRL U.S. GAAP Taxonomy on the SEC's EDGAR system, and (3) the ability of the EDGAR system to provide an accurately rendered version of all such tagged information. The SEC should phase-in interactive data-tagged financial statements as follows:

- ***The largest 500 domestic public reporting companies based on unaffiliated market capitalization (public float) should be required to furnish to the SEC, as is the case in the voluntary program today, a document prepared separately from the reporting companies' financial statements that are filed as part of their periodic Exchange Act reports. This document would contain the following:***
 - ***Interactive data-tagged face of the financial statements***¹⁶³
 - ***Block-tagged footnotes to the financial statements.***¹⁶⁴
- ***Domestic large accelerated filers (as defined in SEC rules, which would include the initial 500 domestic public reporting companies) should be added to the category of companies, beginning one year after the start of the first phase, required to furnish interactive data-tagged financial statements to the SEC.***

(March 13, 2008). Also see, e.g., testimony from Steven E. Bochner, Wilson Sonsini Goodrich & Rosati (March 14, 2008); Jeff M. Bodner, Intel Corporation (March 14, 2008); Mark Bolgiano, XBRL US (March 14, 2008); Randy G. Fletchall, Ernst & Young LLP (March 14, 2008); Gregory P. Hanson, ADVENTRX Pharmaceuticals (March 14, 2008); Christopher Montano, Gridstone Research (March 14, 2008); and John Turner, CoreFiling (March 14, 2008).

¹⁶³ To allow this first phase, the SEC EDGAR system must permit submissions using the new XBRL U.S. GAAP Taxonomy.

¹⁶⁴ We understand that tagging beyond the face of the financial statements and block-tagging of footnotes, such as granular tagging of footnotes and non-financial data, may require significant effort and would involve a significant number of tags. See, e.g., comment letter from Medtronic, Inc. (March 31, 2008).

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*Once the preconditions noted above have been satisfied and the second phase-in period has been implemented, the SEC should evaluate whether and when to move from furnishing to the SEC to the official filing of interactive data-tagged financial statements with the SEC for the domestic large accelerated filers, as well as the inclusion of all other reporting companies, as part of a company's Exchange Act periodic reports.*¹⁶⁵

Background

Description of Interactive Data

XBRL is an international information format standard designed to help investors and analysts find, understand, and compare financial and non-financial information by making this information machine-readable. It enables companies to better control how their financial or non-financial information is presented and disseminated and reduce reporting costs by integrating their operating data with their financial reporting disclosure. XBRL or interactive data is a computer language which uses standardized XML (eXtensible Markup Language) technology and permits the automation of what are now largely manual steps for access, validation, analysis, and reporting of disclosure. For example, an investor or analyst who wants to compare the sales of all pharmaceutical companies will be able to use software applications to take the interactive data-tagged information, extract the sales numbers and download them directly to a spreadsheet.

Interactive data uses standardized definitions of terms, like a dictionary. The standardized terms are then arranged in a logical structure called a taxonomy. A U.S. GAAP financial statement itself, in that its underlying details are summarized in the line items of a balance sheet or income statement, is a kind of taxonomy. There are taxonomies for different kinds of businesses. For example, the banking industry sector taxonomy differs from that of a software industry sector company.

Status of Interactive Data-Tagged Financial Statements in SEC Reports

The SEC has adopted a voluntary pilot program for the use of interactive data tagging in which participants submit voluntarily supplemental tagged financial information using the interactive data format as exhibits to specified EDGAR filings.¹⁶⁶ Voluntary pilot participants may use existing standard XBRL taxonomies. Over four dozen companies

¹⁶⁵ [A dissenting vote on developed proposal 4.1 was cast by Peter Wallison in February 2008].

¹⁶⁶ The SEC's voluntary interactive data rules specify the form, content, and format of interactive data submissions, description of interactive data, timing of interactive data submissions, and use of Taxonomies. For example, the rules require the tagged data to be described either as "unaudited" or, for quarterly financial statements, "unreviewed."

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are participating in the pilot program and have agreed to voluntarily submit their annual, quarterly and other reports with interactive data for a period of one year. The SEC recently expanded the voluntary filing program to include mutual funds which will file using a risk and return taxonomy developed by the Investment Company Institute.

On May 30, 2008, the SEC proposed amendments requiring certain companies to provide to the SEC financial statements in interactive data format using XBRL.¹⁶⁷ The proposed rules would apply to domestic and foreign companies using U.S. GAAP and, eventually, to foreign private issuers using IFRS as issued by the IASB.¹⁶⁸

On April 28, 2008, XBRL-US released its U.S. GAAP Taxonomy and preparer's guide. The XBRL U.S. GAAP Taxonomy includes tags for a company's financial statements and notes.

The SEC has stated that it will use the initial financial statements prepared using the new XBRL U.S. GAAP Taxonomy to help it further update its EDGAR system so that it will be able to "seamlessly accept and render the filings." We understand that the SEC's EDGAR system is being modified to accept and render financial statements with interactive data tags based on the newly-developed XBRL U.S. GAAP Taxonomy.

Time and Costs Involved in Interactive Data-Tagging

We understand that while the XBRL U.S. GAAP Taxonomy has a significant number of individual tags or elements, it contains all of the terms or concepts commonly used in financial statements prepared in accordance with U.S. GAAP. We understand that reporting companies would use only a limited number of tags or elements. For example, one large voluntary filer uses approximately 192 tags (it tags its notes as blocks rather than at a granular level) to tag its Form 10-Q. We understand that there may be the need for customized "extensions" if the XBRL U.S. GAAP Taxonomy does not include a tag for the particular item in the company's financial statements. Because the XBRL U.S. GAAP Taxonomy tracks U.S. GAAP, we [believe] that there likely will be less need for customized extension elements.

The type of information that is tagged also is relevant to understanding interactive data-tagged financial statements. Companies participating in the voluntary program have been tagging the face of their financial statements using existing taxonomies and software. As

¹⁶⁷ See, *Interactive Data to Improve Financial Reporting*, SEC Release No. 33-8924 (May 30, 2008) ("Interactive Data Release").

¹⁶⁸ Under the proposal, interactive data would be required with a company's annual and quarterly reports, transition reports, and Securities Act registration statements, and on its corporate web site, if it maintains one. The disclosure in interactive data format would supplement, but not replace or change, disclosure using the traditional electronic filing formats in ASCII or HTML. See Interactive Data Release.

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to the notes to the financial statements, additional effort may be involved. While the notes to the financial statements may easily be tagged as a block of text, unlike preparation of notes to the financial statements in a paper-based format, tagging the individual information in each note will involve additional tags and, therefore, more work than block-tagging the text.¹⁶⁹ The SEC's proposed rules would provide that the footnote disclosure be tagged using four different levels of detail.¹⁷⁰

We understand that the software industry has been engaged in developing tagging and rendering (turning the interactive data-tagged information into a human readable format) software for interactive data-tagged financial statements.¹⁷¹ Companies generally use two methods to tag their financial statements using interactive data tagging. The first method, called a "bolt-on" approach, involves developing the interactive data reports after the filed financial statements are developed – a process known as "mapping." Companies also may use interactive data as part of an integrated approach to financial reporting. In an integrated approach, companies incorporate interactive data into their internal company financial systems which allows financial reports to be created from the interactive data-tagged financial systems, without first preparing such financial statements in "human readable format." Interactive data-tagging using a "bolt-on" approach may involve somewhat more effort than using an integrated approach. Currently, there is software that allows companies to interactive data-tag their financial statements using the "bolt-on" approach.¹⁷² At this time it is unknown how many companies have begun integrating interactive data-tagging into their internal financial reporting systems and, therefore, it is not clear when a significant number of companies would move from a "bolt-on" to an integrated approach to interactive data-tagging of their financial statements.

Certain preparers participating in the SEC's voluntary program have indicated that the initial number of hours it took to tag the face of their financial statements using existing

¹⁶⁹ See Interactive Data Release. Also see, e.g., comment letters from the CFA Institute Centre for Financial Market Integrity (March 31, 2008); BDO Seidman, LLP (March 31, 2008); and the Center for Audit Quality (March 31, 2008).

¹⁷⁰ This level of detail would be:

- (i) each complete footnote tagged as a single block of text (which would be the only footnote tagging in the filer's first year of interactive data reporting);
- (ii) each significant accounting policy within the significant accounting policies footnote tagged as a single block of text;
- (iii) each table within each footnote tagged as a separate block of text; and
- (iv) within each footnote, each amount (i.e., monetary value, percentage, and number) separately tagged and each narrative disclosure required to be disclosed by U.S. GAAP (or IFRS issued by the IASB, if applicable), and Commission regulations separately tagged.

See Interactive Data Release.

¹⁷¹ See, e.g., testimony from John Turner (March 14, 2008).

¹⁷² Using the "bolt-on" method, companies can prepare their financial statements (including notes) in a number of formats, such as Adobe (pdf), Word, and HTML.

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standard taxonomies (not the new XBRL U.S. GAAP Taxonomy) and a “bolt-on” approach ranged from 80-100 hours and that the number of hours dropped significantly for subsequent reports (due to the lack of a need to replicate the tagging process for most items).¹⁷³ For preparers also tagging the notes to their financial statements using a “block” tag, the number of hours increased slightly. The costs to tag the face of the financial statements using standardized software were not significant. Additional time and cost was spent by at least one preparer to validate the tags that were used. In these cases, there was no auditor involvement in the process.¹⁷⁴

Smaller Public Company Reactions to Interactive Data-Tagging

Smaller public company representatives recognize the benefits that interactive data offers their companies over the long-term, but are concerned about initial implementation costs, which could be alleviated with the development of improved tagging and verification software. The representatives strongly support a phase-in approach in which such smaller public companies would be included at the end, once larger public companies had worked through any significant implementation issues, including use of company resources involved in tagging and verification of interactive data tags.¹⁷⁵

Potential Benefits of Interactive Data

We see a number of potential benefits of interactive data for reporting companies and investors relating to financial and non-financial information. First, interactive data-tagging could benefit reporting companies by permitting improved communications with analysts and investors. Released corporate data could be instantaneously and immediately usable by analysts in their models without the need for them to wait for third party aggregators or staff to input the data into their own format. There would be a reduction in search costs. Further, such reduced search costs could potentially increase coverage of companies, especially mid-size and smaller companies, by sell-side and buy-side analysts, and at both major brokerage and independent research firms. Interactive data-tagging also would likely improve the quality of data¹⁷⁶ and the ability of a company to control the presentation of its financial information. The elimination or

¹⁷³ For example, one S&P 500 company participating in the voluntary pilot spent 80 hours learning the tagging tool, understanding SEC requirements, creating extensions for tags, and creating a process for ongoing tagging and future submissions.

¹⁷⁴ See, e.g., comment letters from EDGAR Online (February 7, 2008) and Medtronic, Inc. (March 31, 2008). For a discussion of cost estimates relating to the SEC’s proposed interactive data rules, including based on information received from participants in the voluntary program, see the Interactive Data Release.

¹⁷⁵ See, e.g., comment letters from ADVENTRX Pharmaceuticals, Inc. (March 14, 2008) and Steven E. Bochner, Wilson Sonsini Goodrich & Rosati (March 13, 2008).

¹⁷⁶ Although XBRL is frequently called “interactive data,” the use of the term “data” should not be deemed to imply numerical data alone. XBRL also is useful for the tagging of narrative information.

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reduction of the manual input would likely reduce error rates in reporting and inputting of corporate data by aggregators.¹⁷⁷

Second, interactive data has the potential to improve the integration of company operating and reporting data. Using interactive data, operating data can be accessed in the internal enterprise applications where it is regularly stored, and thus will be used for financial reporting purposes without the necessity of downloading to paper or manual search. The same electronically accessible data can be used for other purposes beyond those of financial statements, including tax, industrial filings, audit, benchmarking, performance reporting, internal management, and sustainability. We [believe] that the full economic benefits of interactive data will most likely come when companies incorporate interactive data into their internal reporting, instead of using it as a “bolt-on” after their financial reports are prepared.

Finally, interactive data-tagged financial statements can provide a number of benefits to investors, including both retail investors and the “model builder/research analyst.” Investors can benefit from, among other things, a reduced cost of locating and inputting data into analytical frameworks, elimination of manual input thereby reducing the likelihood of input error by an investor or data aggregator, reduced investor dependence on proprietary and inconsistent data sources, increased likelihood of more investors utilizing primary data sources, and reduced cost of and improved company comparisons. The interactive data-tagged financial statements should enable investors and experienced analysts at research organizations to spend more time analyzing data than data gathering.¹⁷⁸

We recognize, however, that notwithstanding the potential benefits, many company officers may not understand how interactive data works or what improvements it could bring to both their financial reporting and their costs of reporting. In addition, there currently is limited acceptance of interactive data due, in part, to companies needing greater certainty that interactive data will be adopted before they will expend the necessary resources to understand it and its benefits. Companies may have other concerns about potential start-up costs in adopting interactive data, including purchase of software and personnel resources for data input and training. Further, analysts and software developers generally are unaware or uninformed about interactive data.¹⁷⁹

¹⁷⁷ See, e.g., comment letters from ADVENTRX Pharmaceuticals, Inc. (March 14, 2008) and the CFA Institute Centre for Financial Market Integrity (March 31, 2008).

¹⁷⁸ See, e.g., comment letter from the CFA Institute Centre for Financial Market Integrity (March 31, 2008).

¹⁷⁹ See, e.g., testimony from John Turner (March 14, 2008). Also see, e.g., comment letters from the CFA Institute Centre for Financial Market Integrity (March 31, 2008) and Financial Executives Institute (April 4, 2008).

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Implementation of Interactive Data-Tagging of Financial Statements

We [believe] that the SEC should, over the long-term, require all public reporting companies (preparing their financial statements using U.S. GAAP) to tag the financial statements (including footnotes) they are required to file with the SEC as part of their Exchange Act reports using interactive data. We [believe] that an implementation roadmap from the SEC is needed to encourage the involved parties to move beyond a wait-and-see approach and commit resources toward the necessary development of software. That software would tag financial information and enable the viewing and reading of the interactive data-tagged information, the use of interactive data-tagged data by investors such as analysts and investors, and the integration of interactive data by companies. We [believe] that full implementation of mandated interactive data-tagged financial statements will require a phase-in over a period of time, as discussed below, to enable preparers and investors to understand interactive data, to permit successful use of the new XBRL U.S. GAAP Taxonomy, and to enable the further development of tagging and rendering software. We [believe] that such a phase-in should be sensitive to the concerns of smaller public companies regarding mandated interactive data-tagged financial statements. We note that the SEC proposals regarding interactive data contain components of our developed proposals from our Progress Report, but have expanded beyond our developed proposals in a number of regards.¹⁸⁰ At the Committee meeting on March 14, 2008 held in San Francisco, the Committee received oral and written input from market participants regarding the interactive data developed proposals. We are not modifying our [recommendations] from those developed proposals.

We [believe] that mandatory implementation of interactive data will involve a number of steps leading to the ultimate goal of requiring public reporting companies to tag their financial statements using interactive data.

Full mandatory implementation may not be possible until all the following preconditions are met:

- Taxonomy development
 - The final XBRL U.S. GAAP Taxonomy and preparer guide have been released;
 - Voluntary filers have successfully used the XBRL U.S. GAAP Taxonomy and preparer guide for a period of time.

¹⁸⁰ For example, the SEC proposed rules would require certain reporting companies to file a new exhibit containing financial statements and any applicable financial statement schedules in interactive data format beginning with fiscal periods ending on or after December 15, 2008. The proposed rules also would apply to reporting companies using U.S. GAAP and the interactive data requirements would phase-in for all such reporting companies over the next two years. See the Interactive Data Proposing Release.

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- Ability of SEC EDGAR to “seamlessly” accept interactive data submissions using the new XBRL U.S. GAAP Taxonomy and other interactive data-tagged data and provide an accurate rendered version of all such tagged information.
 - Status: The SEC is currently using the initial financial statements prepared using the new XBRL U.S. GAAP Taxonomy to help it update EDGAR so that it will be able to “seamlessly accept and render the filings.” [Currently, the SEC’s EDGAR system does not accept financial statements with interactive data tags based on the newly-developed XBRL U.S. GAAP Taxonomy.]

We [believe] that, to achieve the desired acceptance of interactive data, after the XBRL U.S. GAAP Taxonomy precondition is satisfied, on an interim basis interactive data-tagged financial statements should be required to be implemented on a phase-in basis as follows:

- The largest 500 domestic public reporting companies based on unaffiliated market capitalization (public float) should be required to furnish to the SEC, as is the case in the voluntary program today, a document prepared separately from the reporting companies’ financial statements that are filed as part of their periodic Exchange Act reports. This document would contain the following:
 - Interactive data-tagged face of the financial statements¹⁸¹
 - Block-tagged footnotes to the financial statements.¹⁸²
- Domestic large accelerated filers (as defined in SEC rules, which would include the initial 500 domestic public reporting companies) should be added to the category of companies, beginning one year after the start of the first phase, required to furnish interactive data-tagged financial statements to the SEC.

We [believe] that a phase-in would provide businesses, financial planners, software developers, and investors with the impetus to move forward in building systems based on interactive data. For example, in connection with the mandatory implementation of interactive data, we are aware that, if tagging were mandated for companies, they may use a “bolt-on” solution in-house or use a service provider in the early stages before moving to a broader integrated interactive data approach. This “bolt-on” approach, for many, could be used as a means to begin to climb the learning curve in a cheap, easily managed manner. In this regard, we [believe] that companies should have the capacity to compare interactive data-tagged and rendered financial statements to avoid errors and the

¹⁸¹ To allow this first phase, the SEC EDGAR system must permit submissions using the new XBRL U.S. GAAP Taxonomy.

¹⁸² We understand that tagging beyond the face of the financial statements and block-tagging of footnotes, such as granular tagging of footnotes and non-financial data, may require significant effort and would involve a significant number of tags. See footnote 170 above regarding the SEC’s proposed rules regarding the tagging of footnotes. For cost information regarding footnote tagging, see the Interactive Data Release.

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SEC should take steps to assist in that regard. We [believe] that the SEC should encourage or contract for the development of free software to compare rendered and filed statements.¹⁸³

During the phase-in period, the SEC and PCAOB should seek input from companies, investors, and other market participants as to the experience of such persons in preparing and using interactive data-tagged financial statements using the XBRL U.S. GAAP Taxonomy, and related costs. The SEC should consider conducting or contracting for a study of the rate of errors by companies in using the appropriate interactive data tags in comparison to the financial statement items, which should be done only after filers use the final uniform Taxonomy and preparer guidance to tag their financial statements.¹⁸⁴

As mentioned above, under the phase-in approach, the interactive data-tagged financial statements would still be considered furnished to and not filed with the SEC. As part of the mandatory implementation, we [believe] that, as is the case in the voluntary program, the SEC should make clear what liability provisions the interactive data-tagged financial statements would be subject to under the federal securities laws.¹⁸⁵

Finally, at the end of the phase-in period described above, and as promptly as practicable after all the preconditions to full implementation discussed above are met, the SEC should evaluate the results from the phase-in period to determine whether and when to move from furnishing to the SEC to the official filing of interactive data-tagged financial statements with the SEC by domestic large accelerated filers, as well as whether and when to include all other reporting companies, as part of a company's Exchange Act periodic reports.¹⁸⁶

We note that there have been developments in software for interactive data, such as the use of "microformat," that would assist companies in tagging their financial statements.

¹⁸³ See, e.g., comment letter from the CFA Institute Centre for Financial Market Integrity (March 31, 2008).

¹⁸⁴ See, e.g., comment letters from the Bar Association of the City of New York (April 18, 2008) and the Center for Audit Quality (March 31, 2008).

¹⁸⁵ See, e.g., comment letters from the Center for Audit Quality (March 31, 2008) and the Ohio Society of CPAs (March 31, 2008). The SEC's proposed rules address liability issues relating to the interactive data files. For example, under the proposed rules, data in the interactive data file submitted to the SEC would be subject to the federal securities laws in a manner similar to that of the voluntary program and, as a result, would be deemed not filed for purposes of specified liability provisions; excluded from the officer certification requirements under Exchange Act Rules 13a-14 and 15d-14; and protected from liability for failure to comply with the proposed tagging and related requirements if the interactive data file either: (i) met the requirements; or (ii) failed to meet those requirements, but the failure occurred despite the issuer's good faith and reasonable effort, and the issuer corrected the failure as soon as reasonably practicable after becoming aware of it. See Interactive Data Release.

¹⁸⁶ We do note that the SEC's proposed rules would subject all reporting issuers using U.S. GAAP to the interactive data requirements.

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In a “microformat” system, some interactive data material and human readable financial statements can be integrated into the same document. As with certain other rendering software, a reader can see the relevant interactive data material by rolling a cursor over the human readable text and visa versa.

II.C. Assurance

An important issue related to tagging public company financial statements using interactive data involves whether assurance should be provided by a third party. We understand that among the primary benefits of providing independent assurance of interactive data documents is that financial statement investors could quickly build confidence in interactive data and increase their use of such data. One primary reason for not obtaining such independent assurance of interactive data documents is the concern that the cost and time incurred to obtain such assurance may significantly outweigh the benefits to preparers and investors.¹⁸⁷ We note that the SEC’s proposed rules would not require the involvement of “third parties such as auditors or consultants in the creation of the interactive data provided as an exhibit to a filer’s periodic reports or registration statements, including assurance.”¹⁸⁸

As to assurance, we understand that questions arise as to whether assurance should be provided as to matters such as:

1. The appropriate use of the proper XBRL U.S. GAAP Taxonomy and accurate tagging of financial statements
2. The reasonableness of any company extensions to the XBRL U.S. GAAP Taxonomy
3. The compliance of the interactive data-tagged document (also called the “instance document”) with SEC content and format requirements
4. The separate performance of validation checks over footings and inter-checks (for example, whether inventory is reported more than once throughout the document, determine if amounts reported are consistent) of the interactive data instance document
5. Whether the information in the interactive data instance document is the same as the information in the official filed financial statements (applicable under a “bolt-on” state).

The concept of obtaining assurance on the correct tags and matching the interactive data rendered documents to the filed statements is predicated on the belief that the incremental monetary and human resource costs to provide the assurance will be very small.

¹⁸⁷ See, e.g., comment letters from the Center for Audit Quality (March 31, 2008); Financial Executives International – Committee on Corporate Reporting (April 4, 2008); and Steven E. Bochner, Wilson Sonsini Goodrich & Rosati (March 13, 2008).

¹⁸⁸ See the Interactive Data Release.

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Reviewing the tags the first time will involve significant effort, but subsequent reviews may be limited to new or changed tags. Moreover, the costs and benefits of assurance reviews may differ depending on whether companies are using the “bolt-on” rather than the integrated tagging approach. Therefore, [we believe] that it is appropriate to study the assurance process during the phase-in period to assess the actual costs and benefits of assurance that might be provided on the interactive data-tagged financial statements.

The type, timing, and extent of assurance, if any, on a company’s interactive data-tagged financial statements and other tagged information required to be furnished to the SEC should take into account the needs of investors, and other market participants, along with the costs to reporting companies. Until a group of reporting companies has been required to furnish to the SEC interactive data-tagged financial statements and notes using the new XBRL U.S. GAAP Taxonomy for a period of time that will allow investors and other market participants to evaluate the reliability of such interactive data-tagged financial statements and notes, it is premature to make concrete suggestions regarding assurance.

Accordingly, our [recommendation] does not include any assurance proposal. During the interim phase-in period discussed above, the SEC and PCAOB should seek input from companies, investors, and other market participants as to the type, timing, and extent of desired or needed assurance, if any. This input should include the experience of such persons in preparing and using interactive data-tagged financial statements using the newly-developed XBRL U.S. GAAP Taxonomy, and related costs. Additionally, after public companies are required to tag their financial statements using interactive data, whether in accordance with our recommendations or otherwise, the SEC should consider initiating a voluntary pilot program in which companies obtain assurance on their interactive data-tagged financial statements (whether using a “bolt-on” or integrated approach) in order to evaluate fully potential costs and benefits associated with such effort.

III. Improved Corporate Website Use

Recommendation 4.2: The SEC should issue a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate information, which addresses issues such as liability for information presented in a summary format, treatment of hyperlinked information from within or outside a company’s website, treatment of non-GAAP disclosures and GAAP reconciliations, and clarification of the public availability of information disclosed on a reporting company’s website.

Industry participants, including investors, should coordinate among themselves to develop uniform best practices on uses of corporate websites for delivering corporate information to investors and the market.

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Background

The SEC has issued a series of interpretive releases and rules addressing the use of electronic media to deliver or transmit information under the federal securities laws. The SEC issued its last comprehensive interpretive release on the use of electronic media, including corporate websites, in 2000. Since 2000, significant technological advances have increased both the market's demand for more timely corporate disclosure and the ability of investors to capture, process, and disseminate this information. Recognizing this, the SEC has adopted a large number of rules that mandate, permit, or require disclosure of the use of corporate websites to provide important corporate information and developments.¹⁸⁹

Discussion

We examined the integral role that technology and corporate websites play in informing the markets and investors about important corporate information and developments, including website disclosure presentations that are under development by software vendors. A valuable element of many of such website presentations is that they present the most important general information about a company on the opening page, with embedded links that enable the reader to drill down to more detail by clicking on the links. In this way, viewers can follow a path into, and thereby obtain increasingly greater details about, the financial statements, a company's strategy and products, its management and corporate governance, and its many other areas in which investors and others may have an interest. See appendix H for screen shots from a presentation made to us by Microsoft Corporation (Microsoft) about their plans for an innovative presentation of investor-related information on their corporate website.

Improving the use of corporate websites can enable shareholders and investors to gather information about a company that is at a level they believe is satisfactory for their purposes, without requiring them to wade through large amounts of written material that may provide a level of detail beyond their particular needs.

Corporate websites offer reporting companies a cost-effective, efficient method to provide information to investors and the market. Encouraging reporting companies to increase their use of their websites, including developing a tiered approach to deliver such corporate information on their websites, would benefit investors of all types, retail and institutional. Enhanced corporate website usage could decrease the complexity of information presentation and would enhance its accessibility. In addition, through

¹⁸⁹ See, e.g., comment letters from the Bar Association of the City of New York (April 18, 2008); Business Wire (February 4, 2008); the CFA Institute Centre for Financial Market Integrity (March 31, 2008); Financial Executives Institute (April 4, 2008); and PR Newswire (September 21, 2008).

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coordination by industry participants, uniform best practices on uses of corporate websites could be developed.¹⁹⁰ Of course, the increased use of corporate websites is not intended to affect the valuable role that newswires and other news vehicles play in disseminating important company information to investors and the public.

We have been informed that there are continuing concerns about the treatment of website disclosures under the federal securities laws that some have argued may be impeding greater use of corporate websites. These concerns include liability for information presented in a summary format, the treatment of hyperlinked information from within or outside a company's website, the disclosure of non-GAAP measures and required reconciliations to GAAP, and the need for clarification of the public availability of information disclosed on a reporting company website.¹⁹¹ Consequently, we [believe] that the SEC should issue a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate information. We [believe] that SEC guidance would encourage further creative use of corporate websites by reporting companies to provide information, including website disclosure formats following industry developed best practice guidelines.

IV. Disclosures of KPIs and Other Metrics to Enhance Business Reporting

Recommendation 4.3: 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 (including analysts), and other interested industry participants, such as consortia that have long supported KPI-like concepts, to generate understandable, consistent, relevant and comparable KPIs on relevant activity and, as appropriate, industry-specific, bases. 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.

Background

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

¹⁹⁰ See, e.g., comment letters from the Enhanced Business Reporting Consortium (March 31, 2008); the CFA Institute Centre for Financial Market Integrity (March 31, 2008); and Financial Executives Institute (April 4, 2008).

¹⁹¹ See, e.g., comment letter from the Center for Audit Quality (Mar. 31, 2008).

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value. The Enhanced Business Reporting Consortium¹⁹² 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.”¹⁹³ KPIs can be non-financial measures and also can include supplemental non-GAAP financial reporting disclosures that proponents have stated can improve disclosures by public companies. 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.

We understand that investment professionals concur that investors are very interested in non-financial information as a way to better understand the businesses they invest in.¹⁹⁴ 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. 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

¹⁹² The Enhanced Business Reporting Consortium was founded by the AICPA, Grant Thornton LLP, Microsoft, and PricewaterhouseCoopers LLP in 2005 upon the recommendation of the AICPA Special Committee on Enhanced Business Reporting. The Enhanced Business Reporting Consortium 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.

¹⁹³ See, e.g., comment letter from the Enhanced Business Reporting Consortium (March 31, 2008).

¹⁹⁴ See e.g., comment letter from the Enhanced Business Reporting Consortium (June 19, 2008).

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no doubt improves market efficiency.¹⁹⁵

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 that “[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’.”¹⁹⁶ 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.” 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

Our [recommendation] extends beyond a narrow definition of financial reporting to business reporting more generally. We evaluated whether public companies should increase their voluntary disclosure of financial and non-financial performance measures or indicators, such as KPIs. We examined the current practices of public companies and note 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 same industry or engaged in the same activity so that they lend themselves to comparisons between and among companies. Therefore, we have

¹⁹⁵ See, Botosan, Christine A., *Disclosure Level and the Cost of Equity Capital*, *The Accounting Review*, Vol. 72, No. 3, 323–349 (July 1997); Botosan, Christine A., *Disclosure and the Cost of Capital: What Do We Know?*, *Accounting & Business Research*, Vol. 36 (Special Issue), 31–40 (2006); and Sumon C. Mazumdar and Partha Sengupta, *Disclosure and the Loan Spread on Private Debt*, *Financial Analysts Journal*, Vol. 61, No. 3, 83–95 (May 2005).

¹⁹⁶ 2003 MD&A Interpretive Release.

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evaluated the kinds of KPIs that companies should voluntarily make available, in what format, and whether they should be consistently defined over time. We have [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 and activity basis.

Accordingly, for KPI reporting to be most effective and improve user understanding, we [recommend] that companies should consider the following to improve voluntary KPI disclosures:¹⁹⁷

- **Understandability** – We [believe] that a given KPI term, such as "same store sales," would be most useful in evaluating the activity if it had a standard agreed definition as to the particular activity. For that reason, we [believe] that the SEC should explore ways to encourage private 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 participants, the SEC and other global regulators should work through these private initiatives to support the use of such term in voluntary disclosures in periodic and other company reports, with such modified or additional disclosures as the SEC and other global regulators deem necessary or appropriate. Companies including KPIs in their periodic and other company reports should be encouraged to use such industry or activity-defined terms and to disclose any differences in their use of terms from any industry or activity-defined and accepted definition. Companies including KPIs in their periodic and other company reports would still have the freedom to use whatever terms they wished in describing their businesses, but should make clear any differences between their definitions and those that have been industry- or activity-defined.
- **Consistency** – Any KPI that is used should be reported consistently from period-to-period, not just for the current period, but for a reasonable number of prior periods as well. Any changes in the definition of a KPI should be disclosed, along with the reasons for the change. If companies voluntarily report KPIs, they 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.

¹⁹⁷ We note 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."

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- Relevancy - KPIs 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. In many cases, particular KPIs are based on activities that span diverse industries. In some cases, however, KPIs are industry specific because of the unique nature of the way in which businesses are run in that particular industry. To the extent appropriate, we [believe] KPIs should be activity based but recognize that particular industry specific KPIs may reflect better the way in which businesses in the particular industry are run.
- Presentability – When companies voluntarily disclose KPIs in their reports and other releases, they could 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 could be useful to companies that choose to structure their KPIs along business lines. The inclusion of tabular presentations showing current and prior periods also could be useful to companies voluntarily reporting KPIs.
- Comparability – Encouraging companies to use industry or activity-defined KPIs would enable investors to compare companies within and across industries and would also be quite useful at the industry segment level. Once industry or activity-defined KPIs are available, we would hope that investor interest would encourage companies to use commonly defined KPI terms.

We understand that some companies may be hesitant about increased disclosure of KPIs because of concern that disclosure of these metrics may compromise competitive information.¹⁹⁸ Neither we nor investors want companies to give away valuable company secrets. We have heard questions about the validity of many of such competitive harm claims, particularly where information is widely known within a particular industry. We have heard that there is already so much information about companies that disclosure of unique competitive information would be rare. Nevertheless, we [believe] that if a particular KPI could result in disclosure of competitively important information, the affected company could decline to disclose it.¹⁹⁹

Our [recommendation] provides that the SEC should encourage a private, industry-driven initiative with significant investor involvement to develop best practices that companies could follow in voluntarily developing and disclosing KPIs. Just as financial reporting

¹⁹⁸ We have heard a question as to the liability treatment of KPIs. We understand that there are not unique legal liabilities associated with disclosures of KPIs. Such disclosures would be evaluated in the same manner as any other disclosures made by a public company, whether in a filing with the SEC or in an earnings release.

¹⁹⁹ See, e.g., comment letters from the Bar Association of the City of New York (April 18, 2008) and the Enhanced Business Reporting Consortium (March 31, 2008).

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standards and the recently developed interactive data taxonomy may improve business reporting by creating standardized language, we [believe] the development of a KPI dictionary, on an industry or activity basis, as appropriate, but also allowing for company-specific definitions, could provide valuable information to investors.

Thus, our [recommendation] 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 [recommendation] 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. Then companies could voluntarily disclose these commonly-defined KPIs in a company's periodic reports, as well as other disclosure formats such as earnings releases. The [recommendation] 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
- Permit cross-company and cross-industry comparisons.

We do not [believe] that the mandatory reporting of KPIs is desirable at this time. Instead, we are encouraging the SEC to promote the development of commonly recognized and defined KPIs on a relevant activity basis or by industry groups, as appropriate.

Integration with Other Recommendations

We [believe] that the formalization of KPI disclosures through commonly recognized definitions, will enhance the benefits that will come from certain of our other recommendations. For example, disclosing KPIs on company websites 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

Recommendation 4.4: 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-

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GAAP measures presented, and provide more industry and company specific key performance indicators.

The SEC should consider restating 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

The quarterly earnings release, often the first corporate communication about the results 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 SEC 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

We examined 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. We also 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. We [believe] the goal for the earnings release should be a consistent, reliable communication form that all investors can easily navigate. In view of our [recommendation] regarding key performance indicators, we also would encourage the inclusion of activity and company specific key performance indicators in earnings releases.

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We are not making a [recommendation] regarding the issuance of earnings releases at the same time that the related periodic report is filed with the SEC.²⁰⁰ We understand 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, we understand that some large companies issue their earnings release at the same time as the filing of their quarterly reports. We also understand 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 we have heard that some investors have 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 have expressed concern about the effect of delays in disclosing material non-public information about the quarter or year end. In addition, investors 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.

We 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. We note 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.²⁰¹ We are [recommending] that the SEC reiterate this suggestion.

We 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. While we understand the importance of this issue, we are not making any [recommendation] regarding the provision of quarterly earnings guidance at this time because we note that many others are evaluating the issues arising from the provision of quarterly earnings guidance.

²⁰⁰ We note that the SEC had received comments on this issue in connection with a prior request for comment to tie the filing of the quarterly report to the issuance of an earnings release. See, SEC, *Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports*, SEC Release No. 34-46464 (Sept. 5, 2002). We also note the comments received in connection with our Progress Report. See, e.g., Bar Association of the City of New York (Apr 18, 2008); Business Wire (Feb. 4, 2008).

²⁰¹ See, SEC, *Conditions for Use of Non-GAAP Measures*, SEC Release No. 34-47226 (Jan. 22, 2003).

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VI. Use of Executive Summaries in Exchange Act Periodic Reports

Recommendation 4.5: *The SEC should mandate the inclusion of an executive summary in the forepart of a reporting company's filed annual and quarterly reports [or, alternatively, annual reports initially with a phase-in for quarterly reports] that will provide a roadmap to the fuller discussion in the reports. The executive summary should 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 periodic report. To the extent a similar summary is included elsewhere in the report, the disclosure could cross-reference such summary. The requirement for the executive summary, with a recommended length of up to two pages, should build on, but not replicate, 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 key aspects of company performance;*
- *A digest of the company's GAAP, non-GAAP, and non-financial KPIs (to the extent disclosed in the company's Form 10-Q or 10-K [or, alternatively, to the extent disclosed in the company's Form 10-K]);*
- *A summary of business outlook; and*
- *Page number references to more detailed information contained in the document (which, if the report is provided electronically, could be hyperlinks).*

Background

We understand that some investors may find it difficult at times to navigate through a company's periodic reports. In fact, complexity and detail in the information presented may cause certain investors to avoid certain types of investments altogether or avoid understanding the businesses in which they have invested. We understand that some investors may have difficulty in parsing reporting company periodic reports and locating key financial and non-financial information important to an understanding of the company and its business.

We believe that the purpose of the executive summary is to capture in an easily digestible format the essence of anything that the company believes should be important to investors by way of company current performance or management's outlook. Companies should structure the summary to be equally useful to reasonably diligent retail and professional investors alike by using plain language and identifying and highlighting key issues and trends.

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We [believe] that an executive summary should encourage more investors to read and understand the key aspects of the businesses in which they invest and potentially increase participation in the capital markets. The value of an executive summary today, as compared to other summary disclosures that have been used before, is enhanced significantly by the availability of corporate websites and electronic linkages to detailed information on which such summary is based.

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. We [believe] that an executive summary in the forepart of a company's annual and quarterly Exchange Act reports [or, alternatively, a company's annual report initially with a phase-in for quarterly Exchange Act reports] will facilitate the ready delivery of important information to investors by providing them a roadmap of the disclosures contained in such reports.

Discussion

We [recommend] a requirement to include an executive summary in reporting company annual and quarterly Exchange Act reports (Forms 10-K and 10-Q) [annual report initially with a phase-in for quarterly Exchange Act reports].²⁰² We understand 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. [Our recommendation would be to begin requiring an executive summary for the annual and quarterly reports, but understand that there are those who would prefer to begin requiring an executive summary in an annual report and then, after companies have experience with such requirement, phase-in a requirement to include an executive summary in a quarterly report. We believe that, as an initial matter, an executive summary in a quarterly report could require only material changes reflected in the quarterly report from prior disclosures.]

We do understand, however, 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. 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

²⁰² 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.

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consider as it engages in a more detailed analysis of the company, its business and financial condition.

The executive summary should be as self-contained as possible and therefore should avoid unnecessary detail and "boilerplate" language. However a summary should provide navigation to parts of the document containing related information should the investor wish to see more detail. 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. To the extent a similar summary is included elsewhere in the report, the disclosure could cross-reference such summary. As with the overview or introduction in 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 reporting company and include cross-references to the location of the fuller discussion in the report.

The executive summary in a periodic report might fruitfully use as a starting point 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."²⁰³ The requirement for the executive summary, with a recommended length of no longer than two pages, could use as a starting point, but not replicate in full, disclosures in the company's MD&A overview, but have a limited number of required disclosure items such as:

- A summary of key aspects of company performance
- A digest of the company's GAAP, non-GAAP, and non-financial KPIs (to the extent disclosed in the company's Form 10-Q or 10-K)
- A summary of business outlook
- Page number references to more detailed information contained in the document (which, if the report is provided electronically, could be hyperlinks).

We [believe] that the executive summary should be required to be included in the forepart of a reporting company's annual or quarterly report [or, alternatively, annual report with a phase-in for quarterly reports] 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. We understand that the inclusion of a summary in the body of the periodic report should not give rise to additional liability implications.

²⁰³ 2003 MD&A Interpretive Release.

This report has been prepared for discussion and deliberation by the full Committee at a July 11, 2008 open meeting. Pending any further action on this report by the Committee, it does not necessarily reflect either the views of the Committee or other members of the Committee. It also does not necessarily reflect the views or regulatory agenda of the Commission or its staff.

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This report has been prepared for discussion and deliberation by the full Committee at a July 11, 2008 open meeting. Pending any further action on this report by the Committee, it does not necessarily reflect either the views of the Committee or other members of the Committee. It also does not necessarily reflect the views or regulatory agenda of the Commission or its staff.



U.S. Securities and Exchange Commission

SEC Establishes Advisory Committee to Make U.S. Financial Reporting System More User-Friendly for Investors

**FOR IMMEDIATE RELEASE
2007-123**

Washington, D.C., June 27, 2007 - Securities and Exchange Commission Chairman Christopher Cox today announced the establishment of an advisory committee that will examine the U.S. financial reporting system with the goals of reducing unnecessary complexity and making information more useful and understandable for investors.

The SEC Advisory Committee on Improvements to Financial Reporting will study the causes of complexity and recommend to the Commission how to make financial reports clearer and more beneficial to investors, reduce costs and unnecessary burdens for preparers, and better utilize advances in technology to enhance all aspects of financial reporting.

"Our current system of financial reporting has become unnecessarily complex for investors, companies, and the markets generally," Chairman Cox said. "The time is ripe to review how that system can be made less complex and more useful to investors."

Robert C. Pozen, chairman of MFS Investment Management in Boston and former vice chairman of Fidelity Investments, will chair the SEC's advisory committee. Chairman Cox said he expects between 13 and 17 additional members with varied backgrounds to be named to the advisory committee within the next few weeks.

"In addressing the complexity of the current system, our advisory committee will focus not only on offering better guidance to preparers of financial reports, but also on providing more user-friendly disclosures to meet the different needs of various types of investors," Mr. Pozen said.

SEC Chief Accountant Conrad Hewitt said, "The advisory committee will be studying the very important subject of complexity and transparency in order to help investors better understand the financial statements upon which they rely."

Chairman Cox said that the Commission will direct the advisory committee to conduct its work with a view toward removing practical and structural impediments that reduce transparency or unnecessarily increase the cost of

preparing and analyzing financial reports to the detriment of the investor. The advisory committee will focus on the following areas before making recommendations to the Commission:

- the current approach to setting financial accounting and reporting standards;
- the current process of regulating compliance by registrants and financial professionals with accounting and reporting standards;
- the current systems for delivering financial information to investors and accessing that information;
- other environmental factors that drive unnecessary complexity and reduce transparency to investors;
- whether there are current accounting and reporting standards that impose costs that outweigh the resulting benefits, and
- whether this cost-benefit analysis is likely to be impacted by the growing use of international accounting standards.

As part of its consideration of these areas, the advisory committee will focus on how technology can help address accounting complexity by making financial information more useful to a greater number of investors. Through the power of XBRL, hyperlinks, and other technological advances, the opportunity exists to redesign the financial reporting system to deliver the type and level of information that investors need to access their preferred indicators of company performance.

Chairman Cox noted that Chairman Robert Herz of the Financial Accounting Standards Board (FASB) and Chairman Mark Olson of the Public Company Accounting Oversight Board (PCAOB) have been instrumental in raising awareness about the need to increase the usefulness of the financial reporting system. The advisory committee is looking forward to the continued cooperation and support of both organizations in studying these issues.

The advisory committee will begin its work after additional members are named and the SEC staff files the committee's charter with Congress.

* * *

Biographical Notes:

ROBERT C. POZEN

Robert C. Pozen is Chairman of MFS Investment Management®, which manages more than \$200 billion in assets for more than five million investors worldwide. He was named to his current position in February 2004.

Mr. Pozen is an independent director of Medtronic and BCE (Bell Canada Enterprises). In both companies, he has served as a member of the Audit Committee. In addition, he is involved in various non-profit organizations, such as the Council on Foreign Relations and The Commonwealth Fund. He was recently elected as a fellow of the American Academy of Arts and Sciences.

Mr. Pozen was formerly vice chairman of Fidelity Investments and president of Fidelity Management & Research Company, the investment advisor to the Fidelity mutual funds. During his five years as president, Fidelity's assets under management almost doubled. While previously serving as managing director and general counsel of Fidelity Investments, he created Fidelity's Charitable Gift Fund and launched Fidelity's entry into the Japanese mutual fund business.

Prior to joining Fidelity, Mr. Pozen served as Associate General Counsel for the SEC, and taught law and economics at New York University.

During 2002 and 2003, Pozen was the John Olin Visiting Professor at Harvard Law School, teaching interdisciplinary courses focused on corporate governance and financial institutions. In 2003, he served as Secretary of Economic Affairs for Massachusetts Governor Mitt Romney, helping to close the state's large budget gap and re-organize its functions in business and technology, labor and workforce training, and consumer affairs.

Mr. Pozen also served on President Bush's Commission to Strengthen Social Security in late 2001 and 2002. He later developed a detailed proposal to restore solvency to Social Security, known as progressive indexing, that grows benefits more slowly for higher earners while maintaining scheduled benefits for low earners.

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33–8817; 34–55969; File No. 265–24]

Advisory Committee on Improvements to Financial Reporting

AGENCY: Securities and Exchange Commission.

ACTION: Notice of Federal Advisory Committee Establishment and Notice of Meeting.

SUMMARY: The Chairman of the Securities and Exchange Commission (“Commission”) intends to establish the Securities and Exchange Commission Advisory Committee on Improvements to Financial Reporting (“Committee”).

The first meeting of the Committee will be held on August 2, 2007 in the Auditorium, Room L–002, at the Commission’s main offices, 100 F Street, NE., Washington, DC beginning at 10 a.m. The meeting will be open to the public. The public is invited to submit written statements with the Committee.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Statements

- Use the Commission’s Internet submission form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail message to rule-comments@sec.gov. Please include File Number 265–24 on the subject line; or

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Federal Advisory Committee Management Officer, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File No. 265–24. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on its Web site (<http://www.sec.gov/rules/other.shtml>). Comments also will be available for public inspection and copying in the

Commission’s Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT:

James L. Kroecker at (202) 551–5360 Deputy Chief Accountant, Office of the Chief Accountant, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–6561.

SUPPLEMENTARY INFORMATION: In accordance with the requirements of the Federal Advisory Committee Act, 5 U.S.C. App. 2 §§ 1–16, as amended, the Securities and Exchange Commission (“Commission”) is publishing this notice that the Chairman of the Commission intends to establish the Securities and Exchange Commission Advisory Committee on Improvements to Financial Reporting (the “Committee”). The Committee’s objective is to examine the U.S. financial reporting system, with a view to providing specific recommendations as to how unnecessary complexity in that system could be reduced and how that system could be made more useful to investors.

To achieve the Committee’s goals, between 14 and 18 members will be appointed who can effectively represent the varied interests affected by the range of issues to be considered. The Committee’s membership may include officers of public companies; board and audit committee members of public companies; accountants and securities lawyers who provide professional services to public companies; and investors, among others. The Committee’s membership will be fairly balanced in terms of the points of view represented and the functions to be performed.

The Committee may be established 15 days after the publication of this notice by filing a charter for the Committee complying with the Federal Advisory Committee Act, with the Committee on Banking, Housing, and Urban Affairs of the United States Senate and with the Committee on Financial Services of the United States House of Representatives. A copy of the charter will be filed with the Chairman of the Commission, furnished to the Library of Congress, placed in the Public Reference Room at the Commission’s headquarters, and posted on the Commission’s Web site at <http://www.sec.gov>. The Committee’s

charter would direct it to consider the following areas:

- The current approach to setting financial accounting and reporting standards, including (a) principles-based vs. rules-based standards, (b) the inclusion within standards of exceptions, bright lines, and safe harbors, and (c) the processes for providing timely guidance on implementation issues and emerging issues;
- The current process of regulating compliance by registrants and financial professionals with accounting and reporting standards;
- The current systems for delivering financial information to investors and accessing that information;
- Other environmental factors that may drive unnecessary complexity, including the possibility of being second-guessed, the structuring of transactions to achieve an accounting result, and whether there is a hesitance of professionals to exercise judgment in the absence of detailed rules;
- Whether there are current accounting and reporting standards that do not result in useful information to investors, or impose costs that outweigh the resulting benefits (the Committee could use one or two existing accounting standards as a “test case,” both to assist in formulating recommendations and to test the application of proposed recommendations by commenting on the manner in which such standards could be improved); and
- Whether the growing use of international accounting standards has an impact on the relevant issues relating to the complexity of U.S. accounting standards and the usefulness of the U.S. financial reporting system.

The Committee would be directed to conduct its work with a view to enhancing financial reporting for the benefit of investors, with an understanding that unnecessary complexity in financial reporting can be harmful to investors by reducing transparency and increasing the cost of preparing and analyzing financial reports. Our expectation is that the advisory committee would provide specific recommendations and action steps that can be implemented both in the near term and the long term.

The Committee will operate for approximately 12 months from the date it is established, unless, before the expiration of that time period, its charter is extended or renewed in accordance with the Federal Advisory Committee Act or unless the Commission determines that the

Committee's continuance is no longer in the public interest.

The Committee will meet at such intervals as are necessary to carry out its functions. The charter will provide that meetings of the full Committee are expected to occur no more frequently than twelve times per year. Meetings of subcommittees of the full Committee may occur more frequently.

The charter will provide that the duties of the Committee are to be solely advisory. The Commission alone will make any determinations of action to be taken and policy to be expressed with respect to matters within the Commission's authority with respect to which the Committee provides advice or makes recommendations.

The Chairman of the Commission affirms that the establishment of the Committee is necessary and in the public interest.

Furthermore, upon establishment of the Committee, and in accordance with section 10(a) of the Federal Advisory Committee Act, 5 U.S.C. App. 10a, notice is hereby given that the first meeting of the Committee will be held on August 2, 2007 in the Auditorium, room L-002 at the Commission's main offices, 100 F Street, NE., Washington, DC, beginning at 10 a.m. The meeting will be open to the public. The purpose of this meeting will be to discuss general organizational matters, to plan the progression of the Committee's work, and to begin discussions about the sources of unnecessary complexity and the barriers to investor transparency in the U.S. financial reporting system.

By the Commission.

Dated: June 27, 2007.

Nancy M. Morris,

Committee Management Officer.

[FR Doc. E7-12740 Filed 6-29-07; 8:45 am]

BILLING CODE 8010-01-P

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
ADVISORY COMMITTEE ON IMPROVEMENTS TO FINANCIAL REPORTING

CHARTER

Preamble

In accordance with Section 9(c) of the Federal Advisory Committee Act, 5 U.S.C. App. 2 §§ 1-16, as amended, the Chairman of the Securities and Exchange Commission ("Commission") establishes an advisory committee and adopts the following articles to govern the advisory committee.

Articles

A. Official Designation. The official designation of the advisory committee is "Securities and Exchange Commission Advisory Committee on Improvements to Financial Reporting" (the "Committee").

B. Objective and Scope of Activity. The Committee's objective is to examine the U.S. financial reporting system, with a view to providing specific recommendations as to how unnecessary complexity in that system could be reduced and how that system could be made more useful to investors. The Committee should consider the following areas of inquiry:

- the current approach to setting financial accounting and reporting standards, including (a) principles-based vs. rules-based standards, (b) the inclusion within standards of exceptions, bright lines, and safe harbors, and (c) the processes for providing timely guidance on implementation issues and emerging issues;
- the current process of regulating compliance by registrants and financial professionals with accounting and reporting standards;
- the current systems for delivering financial information to investors and accessing that information;
- other environmental factors that may drive unnecessary complexity, including the possibility of being second-guessed, the structuring of transactions to achieve an accounting result, and whether there is a hesitance of professionals to exercise judgment in the absence of detailed rules;
- whether there are current accounting and reporting standards that do not result in useful information to investors, or impose costs that outweigh the resulting benefits (the Committee could use one or two existing accounting standards as a "test case," both to assist in formulating recommendations and to test the application of proposed recommendations by commenting on the manner in which such standards could be improved); and

- whether the growing use of international accounting standards has an impact on the relevant issues relating to the complexity of U.S. accounting standards and the usefulness of the U.S. financial reporting system.

The Committee should conduct its work with a view to enhancing financial reporting for the benefit of investors, with an understanding that unnecessary complexity in financial reporting can be harmful to investors by reducing transparency and increasing the cost of preparing and analyzing financial reports.

C. Duration. The Committee shall operate until the earlier of the termination date set forth in Article J below or the date on which the Commission determines that its continuance is no longer in the public interest.

D. Official to Whom Committee Reports. The Chairman of the Commission, or his designee, shall receive the advice of the Committee on behalf of the Commission.

E. Responsibility for Support. The Commission shall provide any necessary support services for the Committee.

F. Committee Membership. The Committee shall be composed of not more than 18 Committee Members who can effectively represent the varied interests affected by the range of issues to be considered. The Committee's membership may include officers of public companies; board and audit committee members of public companies; accountants and securities lawyers who provide professional services to public companies; and investors, among others. The Committee's membership will be fairly balanced in terms of points of view represented and the functions to be performed.

G. Duties of Committee. The Committee shall function as an advisory body according to the procedures set forth in the Federal Advisory Committee Act, 5 U.S.C. App. 2 §§ 1-16, as amended. Its duties shall be solely advisory and shall extend only to the submission of advice or recommendations to the Commission. Determinations of action to be taken and policy to be expressed with respect to matters within the Commission's authority upon which the Committee provides advice shall be made solely by the Commission.

The Chairman of the Commission will appoint the Designated Federal Officer ("DFO"). The DFO or her/his designee shall approve or call committee meetings, approve meeting agendas in consultation with the Chairperson, attend all committee or subcommittee meetings, adjourn any meeting when the DFO determines adjournment to be in the public interest, and chair meetings in the absence of the Chair or Vice Chair or as directed by the Chairman of the Commission.

H. Operating Costs. The estimated annual operating costs of the Committee in dollars and staff-years are as follows:

- (1) dollar cost: \$1,100,000 per year, for travel, per diem, miscellaneous expenses of Committee members and Commission personnel, and webcasts or other

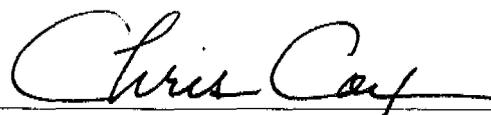
means of making meetings publicly available (this estimate does not include the cost of staff years below); and

(2) staff years: five (5) staff years per year of Commission personnel time.

I. Meetings. The Committee shall meet at the call of the Designated Federal Officer, in consultation with the Chairperson. A simple quorum is required for these meetings. The estimated number of Committee meetings is 12 per year. The Committee shall be authorized to establish subcommittees, as necessary, to fulfill its mission, and these subcommittees shall operate under the provisions of the Federal Advisory Committee Act of 1972, as amended. Such subcommittees shall report their recommendations and advice to the Committee for full deliberations and discussion. Subcommittees or working groups have no authority to make decisions on behalf of the chartered Committee nor can they report directly to the Commission or any Federal officers or employees.

J. Termination Date. The termination date of the Committee shall be August 2, 2008, which may be extended by amendment of this Article and renewal of this Charter in accordance with the Federal Advisory Committee Act before the termination date.

K. Filing of Charter. The Committee is authorized to meet and take action as of the date of the filing of this Charter on July 17, 2007 with the Chairman of the Commission, the Committee on Banking, Housing and Urban Affairs of the United States Senate, and the Committee on Financial Services of the US House of Representatives.



Christopher Cox
Chairman

July 17, 2007



U.S. Securities and Exchange Commission

SEC Chairman Cox Announces Members of Advisory Committee on Improvements to Financial Reporting

Committee to Hold First Meeting on August 2

FOR IMMEDIATE RELEASE 2007-154

Washington, D.C., July 31, 2007 - Securities and Exchange Commission Chairman Christopher Cox today announced the appointment of the following members to the SEC Advisory Committee on Improvements to Financial Reporting. The advisory committee, established last month, will hold its first meeting on Thursday, August 2, at 10 a.m. at the SEC's Washington D.C. headquarters.

Denny Beresford, Ernst & Young Executive Professor of Accounting, J.M. Tull School of Business, University of Georgia, Athens, Ga. Mr. Beresford is a member of the boards of directors and chairman of the audit committees of Fannie Mae, Kimberly-Clark Corporation and Legg Mason, Inc. He was the chairman of the Financial Accounting Standards Board from 1987 to 1997. Mr. Beresford will represent Fortune 500 audit committees.

Susan Bies, was a Federal Reserve Board Governor from 2001 to 2007. Before becoming a member of the Federal Reserve Board, Dr. Bies was Executive Vice President for Risk Management and Auditor at First Tennessee National Corporation in Memphis, Tenn. Dr. Bies will represent banking regulators.

J. Michael Cook, retired Chairman and Chief Executive Officer of Deloitte & Touche LLP. Mr. Cook is a member of the boards of directors and chairs the audit committees of Burt's Bees Inc., Comcast Corporation, and Eli Lilly and Company, and is a member of the board of directors and chairs the compensation committee of International Flavors and Fragrances. Mr. Cook will represent Fortune 500 audit committees.

Jeffrey J. Diermeier, President and Chief Executive Officer, CFA Institute, Charlottesville, Va. Prior to joining CFA Institute, Mr. Diermeier was global chief investment officer at UBS Global Asset Management. Mr. Diermeier will represent investment professionals.

Scott C. Evans, Executive Vice President, Asset Management, TIAA-CREF, New York, N.Y., and Chief Executive Officer of TIAA-CREF's investment

advisory subsidiaries Teachers Advisors, Inc. and TIAA-CREF Investment Management LLC. Mr. Evans is responsible for development of TIAA-CREF's investment products and oversight of the company's more than \$380 billion in assets under management. Mr. Evans will represent pension funds.

Linda Griggs, Partner, Morgan Lewis, Washington, D.C. Ms. Griggs will represent securities attorneys.

Joseph A. Grundfest, William A. Franke Professor of Law and Business, Stanford Law School, Stanford, Calif., and co-director of the Rock Center on Corporate Governance at Stanford University. Mr. Grundfest joined Stanford's faculty in 1990 after serving for more than four years as an SEC Commissioner. Mr. Grundfest will represent securities attorneys.

Greg Jonas, Managing Director, Moody's Investors Service, New York, N.Y. Mr. Jonas joined Moody's from Andersen, where he led the technical functions that supported Andersen's worldwide financial assurance practice. In the 1990s, Mr. Jonas served as the Executive Director of the AICPA Special Committee on Financial Reporting. Mr. Jonas will represent credit rating agencies.

Christopher Liddell, Chief Financial Officer, Microsoft Corporation, Redmond, Wash. Mr. Liddell is responsible for leading Microsoft's worldwide finance organization and overseeing accounting and reporting, strategic planning and analysis, treasury, tax, audit and investor relations. Before joining Microsoft, Mr. Liddell was Chief Financial Officer of International Paper Co. Previously, he was Chief Executive Officer of Carter Holt Harvey Ltd., New Zealand's second-largest listed company. Mr. Liddell will represent Fortune 500 technology companies.

William H. Mann, III, Senior Investment Analyst, Motley Fool, Alexandria, Va., and the lead advisor for "Motley Fool Global Gains," an investment newsletter service focused on identifying market-beating international stocks. Mr. Mann will represent individual investors.

G. Edward McClammy, Senior Vice President, Chief Financial Officer and Treasurer, Varian, Inc., a global technology company in Palo Alto, Calif., that builds leading-edge tools and solutions for diverse, high-growth applications in life science and industry. Prior to joining Varian, Mr. McClammy served in various management roles at Quantum and Lucky Stores, Inc. Mr. McClammy also has worked for Price Waterhouse and the FASB. Mr. McClammy will represent mid-size companies.

Edward E. Nusbaum, Executive Partner and Chief Executive Officer, Grant Thornton, LLP, Chicago, Ill. Before becoming CEO, Mr. Nusbaum served as the firm's National Managing Partner of Professional Services, Managing Partner of the Philadelphia Office and National Director of Assurance Services based in New York. Mr. Nusbaum will represent auditors of mid-size and smaller public companies.

James H. Quigley, Chief Executive Officer, Deloitte Touche Tohmatsu, New York, N.Y. Mr. Quigley previously served as Chief Executive Officer of Deloitte & Touche USA LLP. Mr. Quigley will represent auditors of large and multi-national public companies.

Robert C. Pozen, Chairman, MFS Investment Management, which manages more than \$200 billion in assets for more than five million investors worldwide. Mr. Pozen also is an independent director of Medtronic and serves on the audit committees. Mr. Pozen was formerly vice chairman of Fidelity Investments, sponsor of the Fidelity funds. Prior to joining Fidelity, Mr. Pozen served as Associate General Counsel for the SEC. He will represent mutual funds.

David Sidwell, Chief Financial Officer, Morgan Stanley, New York, N.Y. Prior to joining Morgan Stanley, Mr. Sidwell spent nine years at PricewaterhouseCoopers and 20 years at JPMorgan Chase & Co. Mr. Sidwell will represent securities broker-dealers.

Peter J. Wallison, Senior Fellow, American Enterprise Institute for Public Policy Research, and co-director of AEI's program on Financial Market Deregulation. Before joining AEI, he practiced banking, corporate and financial law at Gibson, Dunn & Crutcher in Washington, D.C. Mr. Wallison also has served as General Counsel of the U.S. Department of the Treasury, General Counsel to the Depository Institutions Deregulation Committee, White House counsel to President Ronald Reagan and counsel to Vice President Nelson Rockefeller. Mr. Wallison will represent proponents of interactive data for financial reporting.

Thomas Weatherford, serves on the boards of directors of Synplicity Inc., Tesco Corporation, Advanced Analogic Technologies, SMART Modular Technologies, Mellanox Technologies and several private companies. Mr. Weatherford retired in January 2003 as Executive Vice President and Chief Financial Officer of Business Objects S.A. Mr. Weatherford will represent small and mid-size company audit committees.

Chairman Cox said, "I am pleased that this exceptionally distinguished group will advise the Commission and the nation on how our increasingly complex financial reporting system can be tamed and made more useful for everyone who relies on it. The committee members each represent key constituencies in our capital markets. I know we can count on them to thoroughly study these issues and recommend improvements that will keep America's financial reporting system as the gold standard for the world."

Chairman Cox previously announced the appointment of Robert C. Pozen, chairman of MFS Investment Management and former vice chairman of Fidelity Investments, as chairman of the advisory committee. Mr. Pozen will be joined by these 16 other members representing investors, companies, and various other entities within the securities markets.

Chairman Cox also announced today that five others will serve as official

observers of the advisory committee, representing the Financial Accounting Standards Board (FASB), Public Company Accounting Oversight Board (PCAOB), Department of the Treasury, International Accounting Standards Committee Foundation, and federal banking regulators. They are:

Robert Herz, Chairman, Financial Accounting Standards Board, Norwalk, Conn.

Charles Holm, Associate Director and Chief Accountant, Banking Supervision and Regulation, Federal Reserve Board.

Phil Laskawy, Chairman of the Trustees, International Accounting Standards Committee Foundation, which oversees the International Accounting Standards Board, London, U.K.

Mark Olson, Chairman, Public Company Accounting Oversight Board, Washington, D.C.

Kristen E. Jaconi, Senior Policy Advisor to the Under Secretary for Domestic Finance, U.S. Department of the Treasury

The advisory committee will examine the U.S. financial reporting system and provide recommendations about how to improve its usefulness for investors and reduce unnecessary complexity for U.S. companies.

As financial reporting has become more complex, many investors have expressed concerns that it is often difficult to understand the financial reports of companies in which they invest. Likewise, companies have expressed concerns that it is difficult to ensure compliance with U.S. GAAP and SEC reporting rules when preparing financial reports. In fact, during 2006, almost 10 percent of U.S. public companies had to restate prior financial reports due to the discovery of errors in those reports. Restatements are costly to companies, and undermine the confidence of investors in the financial reporting system.

As part of its consideration of these areas, the advisory committee will explore ways to redesign the financial reporting system to take advantage of interactive data and the XBRL computer language for financial reporting. These new technologies, the SEC believes, can help address accounting complexity by making financial information more useful to investors and others who use it.

Further information about the advisory committee and its initial meeting is available on the SEC's Web site at: <http://www.sec.gov/about/offices/oca/acifr.shtml>.

COMMITTEE BY-LAWS

Securities and Exchange Commission Advisory Committee on Improvements to Financial Reporting

By-Laws and Operating Procedures

(As adopted on August 2, 2007)

The following By-Laws and Operating Procedures (“By-Laws”) will govern the operations of the Securities and Exchange Commission Advisory Committee on Improvements to Financial Reporting (the “Committee”).

Section I: Purpose, Organization and Operation

The purpose of the Committee is to examine the U.S. financial reporting system, with a view to providing specific recommendations as to how unnecessary complexity in that system could be reduced and how that system could be made more useful to investors. The Chairman of the Commission has determined that the establishment of the Committee is in the public interest. The Committee has been formed under the authority of the Federal Advisory Committee Act, 5 U.S.C. App. 2 §§ 1-16, as amended (“FACA”), which governs the creation and operation of advisory committees by federal government agencies, by the filing of its Charter on July 17, 2007 with the Committee on Banking, Housing, and Urban Affairs of the United States Senate and the Committee on Financial Services of the U.S. House of Representatives. Notwithstanding anything to the contrary in these By-Laws, the Committee will operate in accordance with FACA and its implementing regulations, and with its Charter, as the same may be amended from time to time.

Section II: Members and Official Observers

The Members of the Committee are appointed by and serve at the pleasure of the Chairman of the Commission as may be appropriate for the accomplishment of the Committee’s purposes and in order to balance the viewpoints required to effectively address those purposes. Membership includes the responsibility to attend Committee meetings personally. The Commission reserves the ability to replace any member who is unable to fully participate in the Committee’s meetings. Alternate members will not be permitted to represent those individuals appointed by the Commission without prior written agreement. Official Observers are invited by the Chairman to serve as official observers of the Committee; they also serve at the pleasure of the Chairman. Official

This report has been prepared for discussion and deliberation by the full Committee at a July 11, 2008 open meeting. Pending any further action on this report by the Committee, it does not necessarily reflect either the views of the Committee or other members of the Committee. It also does not necessarily reflect the views or regulatory agenda of the Commission or its staff.

Observers have all rights of Members of the Committee except the right to vote or to make a motion for a vote.

Section III: Meetings

(A) **In General.** The Committee will meet at such intervals as are necessary to carry out its duties. Meetings may be called by the Chairman of the Committee with the approval of the Designated Federal Officer of the Committee appointed in accordance with FACA (“DFO”), or by the DFO. The Chairman of the Committee will preside at all meetings of the Committee, unless the Chairman of the Commission directs the DFO to preside in accordance with FACA. The presiding officer may specify the use of rules of parliamentary procedure consistent with these By-Laws. Subject to such reasonable guidelines and procedures as the presiding officer of the Committee may adopt, Members and Official Observers may participate in a meeting by means of conference telephone or similar communications equipment if all Members and Official Observers can hear one another at the same time and member of the public entitled to hear them can do so.

(B) **Notice.** The Committee will publish a notice of each meeting in the Federal Register at least 15 calendar days before the meeting. The notice will include (1) the name of the Committee; (2) the time, date, place and purpose of the meeting; (3) a copy or summary of the agenda; (4) a statement as to whether all or part of the meeting will be open to the public and, if any part is closed, a statement as to why, citing the specific statutory provisions that serve as a basis for closure; (5) any notice required by Section III(F) if oral public comment is to be excluded; and (6) the name and telephone number of the DFO or other Commission official who may be contacted for additional information concerning the meeting.

(C) **Agenda.** The Chairman of the Committee will draft an agenda for each meeting of the Committee sufficiently in advance of the meeting to permit a copy or summary of the agenda to be published with the notice of the meeting, if required. The DFO must approve the agenda before publication, if required. The Commission staff will distribute the agenda to the Members and Official Observers before each meeting. Items for the agenda may be submitted to the Chairman through the DFO by any Member or Official Observer of the Committee or by any member of the public.

(D) **Voting.** A Member must be participating in a meeting personally, in person or by telephone, to cast a vote. When a decision or recommendation of the Committee is required, the presiding officer will request a motion for a vote. Any Member may make a motion for a vote and vote. No second after a proper motion will be required to bring any issue or recommendation to vote. Committee action based on a vote requires a simple majority of the votes cast at a meeting at which there is a quorum.

This report has been prepared for discussion and deliberation by the full Committee at a July 11, 2008 open meeting. Pending any further action on this report by the Committee, it does not necessarily reflect either the views of the Committee or other members of the Committee. It also does not necessarily reflect the views or regulatory agenda of the Commission or its staff.

(E) **Quorum.** A quorum will consist of a simple majority of the Members, not including Official Observers.

(F) **Open Meetings.** Unless otherwise determined in advance, all meetings of the Committee will be open to the public. Once an open meeting has begun, it may not be closed for any reason. If, during the course of an open meeting, matter inappropriate for public disclosure arises during discussion, the presiding officer will order such discussion to cease and will schedule it for closed session. All materials brought before, or presented to, the Committee during an open meeting will be available to the public for review or copying at the time scheduled for the meeting. All such materials also will be available on the Commission's web site as soon as practicable afterwards. The Chairman may decide in advance to exclude oral public comment during a meeting, in which case the meeting announcement published in the *Federal Register* will note that oral comment from the public will not be permitted and will invite written comment as an alternative. Members of the public may submit written statements to the Committee at any time.

(G) **Activities Not Subject to Notice and Open Meeting Requirements.** Consistent with FACA regulations, the following activities are excluded from the procedural requirements contained in Sections III(B) and III(F): (a) Preparatory work. Meetings of two or more Committee Members convened solely to gather information, conduct research, or analyze relevant issues and facts in preparation for a meeting of the Committee, or to draft position papers for deliberation by the Committee; and (b) Administrative work. Meetings of two or more Committee Members or subcommittee members convened solely to discuss administrative matters of the Committee or to receive administrative information from a Federal officer or agency.

(H) **Closed Meetings.** All or parts of meetings of the Committee may be closed in limited circumstances in accordance with applicable law. Requests for closed meetings must be submitted by the DFO to the Chairman of the Commission under FACA, generally at least 30 days in advance of the meeting. The appropriate Commission official must determine that closing the meeting is consistent with the provisions of the Government in the Sunshine Act. Consistent with Section III(B)(4), the notice of the closed meeting published in the *Federal Register* must include information on the closure.

(I) **Hearings.** The Committee may hold hearings to receive testimony or oral comments, recommendations and expressions of concern from the public. The Committee may hold hearings at open meetings or in closed session in accordance with the standards in these By-Laws for closing meetings to the public. The Chairman or the Committee may specify reasonable guidelines and procedures for conducting orderly and efficient hearings, such as requirements for submitting requests to testify and written testimony in advance and placing limitations on the number of persons who may testify and the duration of their testimony.

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(J) Minutes. The DFO will prepare minutes of each meeting of the Committee and submit them to the Chairman of the Committee for certification of their accuracy. The DFO will distribute copies of the certified minutes to each Member and Official Observer. Minutes of open or closed meetings will be made available to the public upon request, subject to the withholding of matters about which public disclosure would be harmful to the interests of the Government, industry, or others, and which are exempt from disclosure under the Freedom of Information Act. The minutes will include a record of persons present (including the names of Committee Members and Official Observers, names of Commission and committee staff providing support services to the Committee, and names of members of the public who made written or oral presentations); a complete and accurate description of the matters discussed and conclusions reached; and copies of all reports received, issued or approved by the Committee.

Section IV: Officials

(A) Chairman. The Chairman of the Committee is appointed and serves at the pleasure of the Chairman of the Commission to perform the duties specified in these By-Laws. The Committee Chairman will work with the DFO to establish priorities, identify issues that should be addressed, determine the level and types of staff and financial support required and serve as the focal point for the Committee's membership.

(B) Designated Federal Officer. The DFO is designated by the Chairman of the Commission and serves as the Federal Government's agent for matters related to the Committee's activities. By law, the DFO must, among other things, approve or call all meetings of the Committee, approve agendas, attend all meetings, and adjourn meetings when such adjournment is in the public interest. In addition, the DFO is responsible for providing adequate staff support to the Committee, including staff to assist the DFO in the performance of the following functions: (1) notifying Members and Official Observers of the time and place for each meeting; (2) maintaining records of all meetings, including subcommittee meetings, as required by law; (3) maintaining the roll; (4) preparing the minutes of all meetings of the Committee and its subcommittees; (5) attending to official correspondence; (6) maintaining official Committee records, including subcommittee records; (7) maintaining a web site for the Committee; (8) acting as the Committee's agent to collect, validate and pay all vouchers for pre-approved expenditures; and (9) preparing and handling all reports, including the annual report of the Committee required by FACA.

(C) Support Staff. The Chairman of the Commission has agreed that staff from the Commission's Office of the Chief Accountant and other Divisions and Offices as necessary will be available to the DFO to provide adequate staff support for the

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Committee. The Committee may obtain such other staff or advisory or assistance services appropriate to the goals of the Committee.

Section V: Subcommittees

The Chairman of the Committee, with the approval of the DFO, may convene subcommittees to support the Committee's functions and may appoint Members and Official Observers to, and Chairs of, any subcommittees so convened. The Chairman will be an *ex officio* member of all subcommittees. Only Members of the Committee will have the right to vote and make a motion for a vote in a subcommittee. No subcommittee will have any authority to provide advice or recommendations (1) directly to the Commission or (2) to be adopted by the Committee without discussion or consideration at an open meeting of the Committee. All activities of the subcommittees will be in compliance with FACA.

Section VI: Records

All documents, reports and other materials prepared by or submitted to the Committee constitute official governmental records and must be maintained in accordance with FACA's policies and procedures.

Section VII: Expenses

Expenses related to the operation of the Committee will be borne by the Commission. Expenditures of any kind must be approved in advance by the DFO.

Section VIII: Amendments

These By-Laws may be amended from time to time by vote of the Members.

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LIST OF WITNESSES WHO TESTIFIED BEFORE THE COMMITTEE

March 13, 2008 Meeting

Panel on Materiality and Restatements

Jack L. Acosta – Sumtotal Systems, Inc.

Steven E. Bochner – Wilson Sonsini Goodrich & Rosati LLP

Manish Goyal – TIAA-CREF

John J. Huber – Latham & Watkins LLP

Steve Meisel – PricewaterhouseCoopers LLP

Elizabeth Mooney – The Capital Group Companies

Barbara Roper – Consumer Federation of America

Panel on Judgment

Jonathan Chadwick – Cisco

Randy Fletchall – Ernst and Young LLP

Salvatore J. Graziano – Bernstein Litowitz Berger & Grossmann LLP

John J. Huber – Latham & Watkins LLP

Dennis Johnson – CALPERS

Scott Richardson – Barclay's Global Investors

Scott Taub – Financial Reporting Advisors, LLC

March 14, 2008 Meeting

Panel on XBRL

Steven E. Bochner – Wilson Sonsini Goodrich & Rosati

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Jeff M. Bodner – Intel Corporation

Mark Bolgiano – XBRL US

Randy G. Fletchall – Ernst & Young LLP

Gregory P. Hanson – ADVENTRX Pharmaceuticals

Christopher Montano – Gridstone Research

John Turner – CoreFiling

May 2, 2008 Meeting

Panel on Substantive Complexity

Linda Bergen – Citigroup

Mark Bielstein – KPMG LLP

Kevin Conn – MFS Investments

Jeff Mahoney – Council of Institutional Investors

Ben Neuhausen – BDO Seidman, LLP

Brooke Richards – American Express

John Stewart – Financial Reporting Advisors, LLC

Panel on Standards-Setting Process

Linda Bergen – Citigroup

Mark Bielstein – KPMG LLP

Kevin Conn – MFS Investments

Jeff Mahoney – Council of Institutional Investors

Ben Neuhausen – BDO Seidman, LLP

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John Stewart – Financial Reporting Advisors, LLC

Lynn Turner – COPERA Trustee

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EXAMPLES OF SUBSTANTIVE COMPLEXITY

This appendix provides examples of avoidable substantive complexity that currently exist in U.S. GAAP; it is not an exhaustive list. As we acknowledge in chapter 1, some forms of avoidable complexity may be justifiable, for example, due to cost-benefit considerations, or to provide interim guidance while standards-setters develop more permanent literature. Our purpose here is to facilitate thoughtful consideration of the issues raised in the report, rather than to identify individual pronouncements that should be amended or rescinded.

1. Measurement Attributes

Examples of measurement attributes include the following:

- Historical cost
- Amortized historical cost
- Fair value
- Fair value less selling costs

2. Bright Lines

Examples of bright lines in the form of quantified thresholds and pass/fail models include the following:

A. Quantified thresholds

- *Lease Accounting*

Current lease accounting is based on a principle: when a lease transfers substantially all of the benefits and risks of ownership of the property, it should be accounted for as an asset and a corresponding liability by the lessee and the asset is derecognized by the lessor (capital lease); otherwise, rental expense is recognized as amounts become payable (operating lease).

However, to apply this principle, SFAS No. 13 provides the following bright lines for classifying leases as capital or operating. Meeting any one of these criteria results in capital lease treatment.

- The lease transfers ownership of the property to the lessee by the end of the lease term

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- The lease contains a bargain purchase option
 - The lease term is equal to 75% or more of the estimated economic life of the leased property
 - The present value at the beginning of the lease term of the minimum lease payments, excluding certain items, equals or exceeds 90% of the excess of the fair value of the leased property.
- *Consolidation*

For those entities that are not subject to the FIN 46(R) model, “the usual condition for a controlling financial interest is ownership of a majority voting interest, and therefore, as a general rule, ownership by one company...of over 50% of the outstanding voting shares of another company is a condition pointing toward consolidation.”²⁰⁴ Further, there is a presumption that an investment of 20% - 50% requires equity method accounting. In addition, the equity method is required for investments in limited partnerships unless the interest “is so minor that the limited partner may have virtually no influence over partnership operating and financial policies” (SoP 78-9, *Accounting for Investments in Real Estate Ventures*). In this case, practice has used a 3%-5% bright line to apply the “more than minor” provision. This practice has been acknowledged by the SEC staff in EITF Topic No. D-46, *Accounting for Limited Partnership Investments*.

- *Revenue Recognition*

Bright lines may also be found in revenue recognition literature. One example is SFAS No. 66, *Accounting for Sales of Real Estate*, which provides bright lines for determining the buyer’s minimum initial investment requirements for real estate sales.

- *Business Combinations*

When an SEC registrant undergoes a change in control, the company must reflect the new basis of accounting arising from its acquisition in its stand-alone financial statements (i.e., apply purchase accounting to its own stand-alone financial statements) if the company becomes substantially wholly-owned. “Substantially wholly-owned” is defined such that this push down accounting is prohibited if less than 80% of the company is acquired, permitted if 80% to 95% of the company is acquired, and required if 95% or more of the company is acquired.

²⁰⁴ Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements*, paragraph 2.

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In addition, SFAS No. 141 requires that the purchase price allocation period in a business combination usually not exceed one year from the consummation date.²⁰⁵

- *Pension and Other Post-Retirement Employment Benefit Accounting*

SFAS No. 87, *Employers' Accounting for Pensions*, and SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, permit the use of smoothing mechanisms that delay the recognition of the effects of changes in actuarial assumptions and differences between actual results and actuarial assumptions. However, these standards contain a bright line as to when the delayed recognition amounts should be recognized.

- *Hedge Accounting*

SFAS No. 133 requires that derivative instruments be recognized at fair value, with changes in fair value recognized in income. However, in an effort to mitigate earnings volatility, SFAS No. 133 permits the use of hedge accounting when a derivative is highly effective in achieving offsetting changes in fair value or cash flows attributable to the risk being hedged. U.S. GAAP, however, does not define "highly effective." Instead, practice has defined "highly effective" as an offset ratio of 80% to 125%.

- *Presentation*

Bright lines are also present in classification requirements. For example, SFAS No. 95 clarifies the definition of "cash equivalents" by stating that "generally, only investments with original maturities of three months or less qualify under that definition" (paragraph 8). Despite use of the word "generally," this bright line is often interpreted stringently.

In addition, SEC Regulation S-X includes bright lines for separate presentation of amounts that would otherwise be included in lines such as revenue, other current assets and liabilities, and other assets and liabilities.

²⁰⁵ We note SFAS No. 141 has been superseded by a new FASB standard, SFAS No. 141 (revised 2007), which similarly states in paragraph 51, "...the measurement period shall not exceed one year from the acquisition date."

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- *Disclosure*

Bright lines also exist with respect to the determination of related parties for the purposes of disclosing related party transactions and the identification of segments for the purposes of determining which operating segments require separate presentation.

Further, SEC Regulation S-X includes a number of bright lines regarding requirements to present stand-alone acquiree financial statements, stand-alone equity method investee financial statements, and pro forma financial information, among others. These bright lines are based on the results of certain significance tests, or calculations, defined in Regulation S-X. These significance tests compare the acquiree or investee to the registrant in the areas of assets, investments, and income.

B. Pass/fail tests

- SFAS No. 48, *Revenue Recognition When Right of Return Exists*, requires that where a right of return exists, revenue be recognized at the time of sale only if certain criteria, such as the amount of future returns can be reasonably estimated. Otherwise, revenue recognition is deferred until the right expires or the criteria are subsequently met.
- SFAS No. 133 – if critical terms do not match or if documentation does not comply with the rules, then companies are not eligible to apply hedge accounting.
- SFAS No. 140 contains requirements, all of which must be satisfied, to achieve sale accounting for a transfer of financial assets. Otherwise, the transfer is treated as a secured borrowing with a pledge of collateral.
- EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, identifies a number of criteria that must be met in order for an instrument to be classified as an equity instrument. Failure to meet any of these criteria results in classification as a liability, which is marked to market through income. The criteria do not provide for probability assessments or judgments based on the preponderance of evidence.
- SoP 97-2 related interpretations, and audit firm guidance contain the following pass/fail tests:
 - If vendor specific objective evidence (VSOE) does not exist for all of the undelivered elements of a software sales arrangement, the recognition of

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all revenue from the arrangement must be deferred until sufficient evidence exists, or until all elements have been delivered, unless certain exceptions are met.

- Extended payment terms usually result in a deferral of revenue. Specifically, when extended payment terms are present, a presumption exists that the vendor's fee is not fixed or determinable, due to the possibility that the vendor may provide a refund or concession to a customer. While there are factors to overcome this presumption, interpretive guidance sets the hurdle to overcome this presumption extremely high, generally resulting in the deferral of revenue until payment is due.

3. Qualitative Factors Supported by Presumptions

In place of bright lines in certain circumstances, [we have recommended] the use of qualitative factors, supported by presumptions. Below are examples:

- *Consolidation Accounting*

Prior to FIN 46(R), the consolidation of special purpose entities (SPEs) hinged on an analogy to guidance that required lessees to consolidate SPE lessors that lacked a substantive investment at risk from an unrelated party. "Substantive" was defined as 3%, at a minimum, with the caveat that a greater investment may be necessary in certain facts and circumstances. Despite this caveat, which would suggest the need for judgment, the presence of the 3% bright line gave rise to numerous structured transactions to achieve a specific accounting purpose.

In December 2003, the FASB issued FIN 46(R), which superseded the 3% threshold. FIN 46(R) requires consolidation in certain circumstances by the party that holds the majority of the risks and rewards of an entity, rather than equity ownership and voting rights. FIN 46(R) contains a presumption that if equity investment at risk is less than 10% of the entity's total assets, the entity is a variable interest entity subject to the FIN 46(R) model, with similar caveats that require additional analysis, judgment and consideration.

- *Contingencies*

SFAS No. 5 provides an example of qualitative factors in U.S. GAAP. SFAS No. 5 establishes recognition and disclosure requirements based on the likelihood – remote, possible, probable – that a liability has been incurred. Although U.S. GAAP does not define these terms, we note audit firms have defined them using quantified presumptions.

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4. Industry-Specific Guidance

1. Below is a list of examples of industry-specific guidance in U.S. GAAP. Note that this list does not reflect all industry-specific guidance or all industries subject to its own guidance.

Industry	Sources
Broadcasting Industry	SFAS No. 63, 139; EITF 87-10; SOP 00-2
Banking and Thrift Industries	APB Opinion No. 23; SFAS No. 72, 91, 104, 109, 114, 115, 147; Technical Bulletin 85-1; FSP 85-24-1; SOPs 90-3, 03-3; EITFs 97-3, 93-1, 92-5, 89-3, 88-25, 88-19, 87-22, 86-21, 85-44, 85-42, 85-41, 85-31, 85-24, 85-8, 84-20, 84-9, 84-4, D-Topics D-78, D-57, D-47, D-39, SEC Regulation S-X – Article 9, SEC Industry Guide; AICPA Auditing and Accounting Guide
Cable Television Industry	SFAS No. 51
Computer Software to be Sold, Leased, or Otherwise Marketed	SFAS No. 2, 86
Contractor Accounting: Construction-Type Contracts & Government Contracts	ARB 43, Chapter 11, ARB 45, SFAS No. 111; SOP 81-1
Development Stage Enterprises	Opinion 18; SFAS No. 7, 95, 154; Interpretation 7; SOP 98-5; AICPA Auditing and Accounting Guides
Finance Companies	SFAS No. 91, 111, 115; SOP 01-6; AICPA Auditing and Accounting Guide
Franchising: Accounting by Franchisors	SFAS No. 45, 141
Insurance Industry	SFAS No. 5, 60, 91, 97, 109, 113, 114, 115, 120, 124, 133, 135, 140, 144, 149, 156; Interpretation 40; FSP FAS 97-1; AICPA Auditing and Accounting Guides; EITFs 99-4, 93-6, 92-9; D-Topics D-54, D-35, D-34, SEC Regulation S-X – Article 7, SEC Industry guide
Investment Companies	SFAS No. 102; FSP AAG INV-1; SOPs 94-4-1, 93-1, 93-4, 95-2, 00-3, 01-1; AICPA Auditing and Accounting Guide; D-Topics D-76 D-74, D-11, SEC Regulation S-X – Article 6,
Mortgage Banking Activities	SFAS No. 65, 91, 114, 115, 124, 125, 133, 134, 140, 149, 156; Technical Bulletin 87-3; SOP 97-1, 03-3; EITF 95-5, 90-21, 87-34, 85-13, 84-19, D-Topics D-10, D-4, D-2
Motion Picture Industry	SFAS No. 139, SOP 00-2
Oil and Gas Producing Activities	SFAS No. 19, 25, 69, 95, 109, 131, 143, 144, 145, 153; Interpretation 33, 36, FSP FAS 19-1,

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	141/142-1, 142-2; AICPA Auditing and Accounting Guide; SEC industry guide, SEC Reg S-X Rule 4-10, SAB Topic 12, FRR Section 406; EITFs 04-6, 04-4, 04-3, 04-2, 90-22
Pension Funds: Accounting and Reporting by Defined Benefit Pension Plans	SFAS No. 35, 75, 102, 110, 135, 149; SOPs 92-6,94-4,94-6,95-1,99-2,99-3, 01-2
Real Estate: Sales & Accounting for Costs and Initial Rental Operations of Real Estate Projects	SFAS No. 13, 34, 66, 67, 91, 98, 114, 140, 144, 152; Interpretation 43; SOPs 75-2, 78-9, 92-1, 97-1, 04-2; AICPA Auditing and Accounting Guide; EITF 06-8, 05-3, 98-8, 97-11, 95-7, 95-6, 94-2, 94-1, 91-10, 91-2, 90-20, 89-14, 88-24, 88-12, 87-9, 86-7, 86-6, 85-27, 84-17, SEC Regulation S-X – Rule 3-14, SEC SAB Topic 5N, 5W
Record and Music Industry	SFAS No. 50
Regulated Operations	SFAS No. 71, 87, 90, 92, 98, 101, 106, 109, 135, 142, 144, Interpretation 40; Technical Bulletin 87-2; EITFs 97-4, 92-7; D Topics D-21, D-5; SAB Topic 10
Title Plant	SFAS No. 61, 144

2. Industry-specific exceptions in U.S. GAAP, such as the scope exception for registered investment companies and life insurance entities in FIN 46(R), and for U.S. savings and loan associations, other “qualified” thrift lenders, and stock life insurance companies in SFAS No. 109.
3. Industry practice such as accounting for certain types of inventory at fair value.
4. Industry practice from prior to March 15, 1992 that has been grandfathered under SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*.

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5. Alternative Accounting Policies

Examples of alternative accounting policies are as follows:

- SFAS No. 87 and SFAS No. 106, which permit alternatives for amortizing delayed recognition amounts and for measuring return on plan assets.
- SFAS No. 95, which permits alternative presentations of the form and content of the statement.
- SFAS No. 115 (specifically Q&A 35 of the SFAS 115 Implementation Guide), which indicates that companies are not precluded from classifying securities as trading, even if they have no intention of selling them in the near-term.
- SFAS No. 130, *Reporting Comprehensive Income*, permits a choice in presenting comprehensive income. An entity may present other comprehensive income below the total for net income in a single statement, in a separate statement that begins with net income, or in a statement of changes in equity.
- SFAS No. 133, which permits, but does not require, the use of hedge accounting, which, in certain circumstances, may mitigate earnings volatility from marking derivative instruments to market.
- SFAS No. 159, which permits, but does not require, the measurement of certain financial assets and financial liabilities at fair value.
- EITF 88-1, *Determination of Vested Benefit Obligation for a Defined Benefit Plan*, which permits vested benefit obligations to be determined as the actuarial present value of the vested benefits to which the employee is entitled if the employee separates immediately or the actuarial present value of the vested benefits to which the employee is currently entitled but based on the employee's expected date of separation or retirement.
- EITF 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)*, which permits that certain taxes, such as sales, use, and value added taxes, may be presented either on a gross or net basis.
- EITF Topic D-98, *Classification and Measurement of Redeemable Securities*, which permits a choice of methods of accreting instruments to their redemption value.

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- FIN 48, *Accounting for Uncertainty in Income Taxes*, which permits an entity to classify interest and penalties as either interest or taxes.
- FSP AUG AIR-1, *Accounting for Planned Major Maintenance Activities*, which prohibits the accrue-in-advance method, but allows for continued use of one of three other alternatives: direct expense, built-in overhaul, or deferral methods.
- Oil & gas accounting: The two accounting methods followed by oil and gas producers are the successful efforts method and the full cost method. Successful efforts accounting essentially provides for capitalizing only those costs directly related to proved properties; the costs associated with exploratory dry holes are expensed as incurred. Full cost accounting generally provides for capitalizing (within a cost center) all costs incurred in exploring for, acquiring, and developing oil and gas reserves-regardless of whether or not the results of specific costs are successful.
- SAB Topic 5H, *Accounting for Sales of Stock by a Subsidiary*, which permits gains (losses) on sales of stock by a subsidiary to be recognized in income or equity.

6. Scope Exceptions

Examples of scope exceptions include:

- SFAS No. 109 scopes out recognition of deferred taxes for undistributed earnings of certain subsidiaries and goodwill for which amortization is not deductible, among others.
- SFAS No. 133 scopes out certain financial guarantee contracts, employee share-based payments, and contingent consideration from a business combination, among others.
- SFAS No. 144 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 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.

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- 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 46(R) 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 46(R), and certain businesses, among others.
- SoP 81-1 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.

7. 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 levels of asset aggregation to conduct impairment tests and comply with disclosure requirements, such as asset groups, reporting units, operating segments, and reportable segments.
- 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.

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EXAMPLES OF CORPORATE WEBSITE USE

At our January 11, 2008 meeting, representatives from Microsoft gave a presentation about a proposed new Investor Central portion of its corporate website. The presentation highlighted one innovative way that companies could use their corporate websites to provide financial and other company information to investors. Included in this appendix are screen shots from Microsoft's presentation to us.

Microsoft has since made its Investor Central portion of its website operational. See www.microsoft.com/msft/IC/default.aspx.

DRAFT - JULY 11

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Summary Report Page-Highlights Performance, Outlook and Opportunities and allows for tiering to segment and financial performance detail

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Summary Report – Performance at a Glance

Current Results – Fiscal Year 2007

Performance

- Company revenue surpassed \$50B
- Strong customer demand for our new Windows and Office products
- Operating income and EPS both grew double digits
- Good financial results while making investments for future growth
- We used our financial strength to benefit both our shareholders and accelerate growth plans:
 - \$27B of share repurchases and dividends
 - Announced 8 acquisitions, including-\$6B for aQuantive, the largest in company history

Outlook

Opportunities

Key Performance Indicators

Key Performance Indicators	Q4 '06	Q4 '07
Booking Growth		
Total bookings	>10%	>15%
Core bookings	N/A	>20%
Unearned Revenue Balance (millions)	\$10,902	\$12,646
Contracted Not Billed (billions)	>\$9	>\$10
Product Billing Mix		
DEM	30%	30%
Multi-year licensing agreements	40%	40%
License only	15%	15%
Rest of business	15%	15%
PC Unit Growth	11-12%	11-13%

Guidance Fiscal Year 2008

Revenue	\$56.8 B		\$57.8 B
	Low	△	High
Operating Income	\$22.2 B		\$22.7 B
	Low	△	High
Diluted EPS	\$1.69		\$1.73
	Low	△	High

△ = Wall Street Analyst Expectations

Revenue

Operating Income

Earnings Per Share

Download Income Statement

[Excel \(176 kb\)](#) | [XBRL \(87 kb\)](#)

MSFT Intraday Chart

Operating Segments

- Client
- Server and Tools
- Online Services Business
- Microsoft Business Division
- Entertainment and Devices Division

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Income Statement detail page-XBRL tagged income statement allows tiering to financial and segment detail

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INCOME STATEMENTS

(In millions, except per share amounts)

	Three Months Ended June 30,		Year Ended June 30,	
	2007	2006	2007	2006
Revenue	\$13,371	\$11,804	\$51,122	\$44,282
Operating expenses:				
Cost of revenue	3,237	2,130	10,693	7,650
Research and development	1,948	1,861	7,121	6,584
Sales and marketing	3,329	2,822	11,455	9,818
General and administrative	868	1,110	3,329	3,758
Total operating expenses	9,382	7,923	32,598	27,810
Operating income	3,989	3,881	18,524	16,472
Investment income and other	295	377	1,577	1,790
Income before income taxes	4,284	4,258	20,101	18,262
Provision for income taxes	1,249	1,430	6,036	5,663
Net income	\$3,035	\$2,828	\$14,065	\$12,599
Earnings per share:				
Basic	\$0.32	\$0.28	\$1.44	\$1.21
Diluted	\$0.31	\$0.28	\$1.42	\$1.20
Weighted average shares outstanding				
Basic	9,507	10,186	9,742	10,438
Diluted	9,657	10,255	9,886	10,531
Cash dividends declared per common share	\$0.10	\$0.09	\$0.40	\$0.35

Site Actions ▾

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[Download Additional Financial Statements for Fiscal Year 2007](#) ▾

Balance Sheets	Excel (15kb)	XBRL (9kb)
Cash Flows	Excel (15kb)	XBRL (9kb)
Segment Revenue & Operating Income	Excel (15kb)	XBRL (9kb)

Client Revenue

Server & Tools Revenue

Online Services Business Revenue

Microsoft Business Division Revenue

Entertainment & Devices Division Revenue

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H-3

Revenue/Operating Income Summary –directly from XBRL tagged 10-K with hyperlink to Notes

The screenshot displays the Microsoft investor relations page for the Revenue/Operating Income Summary. The page is structured as follows:

- Header:** Microsoft logo, navigation links (Subscribe to Investor QuickAccess, Quick Links, Home, Worldwide), and a search bar.
- Left Navigation:** Investor Relations Home, Annual Reports, Earnings Releases, SEC Filings, Investments/Acquisitions, Stock Info And Analysis, Financial History, Speeches and Events, Press Releases, Corporate Information, Investor Services, and a link to the Summary Annual Report.
- Main Content Area:**
 - Revenue/Operating Income Summary:** Includes a link to the Revenue Recognition Accounting Policy and a Summary section.
 - Fiscal year 2007 compared to fiscal year 2006:** A table comparing 2007 and 2006 data for Revenue and Operating Income, showing percentage changes.
 - Notes to the Financial Statements:** A detailed section on the Revenue Recognition Policy, explaining the accounting treatment of software licensing and revenue recognition.
 - Operating Segments:** A list of segments including Client, Server and Tools, Online Services Business, Microsoft Business Division, and Entertainment and Devices Division.
- Right Sidebar:** A 'Financial Summary – FY07 Q4' box providing a quick overview of key metrics such as Revenue (\$13.4 billion), Operating Income (\$4.0 billion), and Diluted Earnings per Share (\$0.31).

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Client Operating Segment-Performance & Outlook directly from XBRL tagged 10-K with earnings call slides

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Summary Annual Report

Client Operating Segment

Performance

Fiscal year 2007 compared to fiscal year 2006

Client revenue increased primarily reflecting licensing of Windows Vista. OEM revenue increased \$1.46 billion or 13% driven by 13% growth in OEM license units while revenue from commercial and retail licensing of Windows operating systems increased \$422 million or 21%. During the year, the OEM Premium Mix increased 16 percentage points to 68%. Based on our estimates, total worldwide PC shipments from all sources grew 10% to 12% driven by demand in both emerging and mature markets.

Client operating income increased reflecting the increased revenue and decreased research and development costs, partially offset by increased Windows Vista product costs and increased sales and marketing expenses for launch-related programs. The decrease in research and development costs reflects the capitalization of certain Windows Vista software development costs and completion of product development on Windows Vista. Headcount-related costs decreased 3%, driven by a 1% decrease in headcount and a decrease in stock-based compensation expense.

Outlook

Strategy

Key Performance Indicators

Key Performance Indicators	Q4'06	Q4'07
PC unit growth	11-12%	11-13%
OEM license unit growth	19%	11%
OEM Premium mix	55%	72%
Consumer premium mix	10%	30%
Business premium mix	45%	42%

- Client
- Server and Tools
- Online Services Business
- Microsoft Business Division
- Entertainment and Devices Division

[Back to Income Statement](#)

Site Actions

(In millions)	2007	2006	Percentage Change Between 2007 and 2006
Revenue	\$14,972	\$13,089	14%
Operating Income	\$11,603	\$10,297	13%

Client Revenue

Q4 Summary

- OEM license unit growth of 11%
- OEM premium mix of 72% driven by sales of Windows Vista Home Premium
- Volume licensing unearned revenue balance grew over 25% due to strength in both renewal and new annuity attach rates

Growth driven by continued demand for Windows Vista

Revenue Guidance Fiscal Year 2008

Annual growth 9%
Low
High
 11%

▲ = Wall Street Analyst Expectations

Growth & Focus Areas For Windows Business Group

Strong PC Unit Growth

Next 3 Years: More Than Half Of Unit Growth Will Come From Emerging Markets

Upsell To Premium Within Each Segment

Deliver Premium Offerings To Business & Consumers

Reduce Usage Of Counterfeit Software

Worldwide PC Software Piracy Estimated At 35%*

Windows VL Annually Penetration Currently Only 19%

Continue Enterprise & Midmarket VL Growth

Windows Installed Base Will Reach 1B In FY08

Executive Presentations

- Presentation to Analysts
- Industry conferences

Download Segment Revenue

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Client Operating Segment - Strategy links to analyst presentation, industry conferences and hyperlinks to strategy supporting press releases

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Client Operating Segment

Performance

Outlook

Strategy

Grow window shipments by delivering a compelling value proposition with our OEM partners

- Windows Vista Starter Edition provides unique, low cost offering for emerging markets
- Continue to work with OEM partners on unique and compelling designs

Continue efforts to reduce unlicensed software

- Work with law enforcement to pursue software piracy globally

Offer customers choice among product offerings to suit their needs

- Distinct products for business or home usage
- Provide a tiered product lineup for customers based upon features and price

Drive deeper engagement with large business customers

- Enhance offering for volume licensing customers with additional benefits beyond product upgrades, such as help with manageability and deployment.

Key Performance Indicators

Key Performance Indicators	Q4'06	Q4'07
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- ▣ Client
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Hyperlinked Press Release – supports the strategy in the page above

Touching People's Lives: Two Million and Counting
Microsoft passes the 2 million mark with Windows Starter, using technology innovation to bring digital literacy to beginner PC users in all corners of the world.

BEIJING, April 19, 2007 – Learning to use a mouse in Russia. Connecting a PC to a printer in India. Empowering a small business in Namibia. Opening doors to a child's education in rural Argentina.

These are the sorts of challenges Microsoft sought to address with the introduction of Microsoft Windows XP Starter Edition in 2004 – and reinvested in with the introduction of Windows Vista Starter in January 2007. As of today, more than 2 million individuals and families have started their journey into the digital world via a PC with a Windows Starter operating system, which Microsoft designed specifically for first-time PC owners in developing countries and disadvantaged communities.

News of Windows Starter reaching the 2-million-units-shipped mark is especially timely in light of other Microsoft announcements. At the Microsoft Government Leaders Forum (GLF) Asia today, Microsoft Chairman Bill Gates launched a sweeping new effort to help close the digital divide in all parts of the globe. The company's growing commitment to advance social and economic opportunity through technology includes an expansion of Microsoft Unlimited Potential and a new Microsoft Student Innovation Suite designed to make a high-quality education affordable for young learners around the world.

The Student Innovation Suite features Microsoft Windows XP Starter Edition, along with Microsoft Office Home and Student 2007, Microsoft Math 3.0, Learning Essentials 2.0 for Microsoft Office and Windows Live Mail desktop. The suite will be available for US\$3 to governments purchasing bulk orders of computers for students through Microsoft's Partners in Learning program.

The inclusion of Windows XP Starter in the Student Innovation Suite is expected to fuel the already-rapid growth of product shipments, which have gained significant traction since Microsoft released the operating system.

"The response to Windows Starter has been amazing," says Mike Wickstrand, director of Product Management, Microsoft Market Expansion Group. "We achieved the 1 million milestone in September 2006, two years after the product's inception, but that number doubled in just six months. This growing demand drives us to constantly evolve Windows Starter to meet the needs of our customers."

Wickstrand cites the example of new Windows Vista parental controls, which Microsoft added to Windows Vista Starter upon learning how keenly parents in emerging nations want to protect their children from visiting inappropriate Web sites. Microsoft has also adapted the operating system to user needs in terms of language support. For example, when Windows Starter was first launched in India, the product was designed around the assumption that the local language is crucial to customers. User feedback, however, indicated that while the native language is crucial in some areas of the country, English is considered an aspiration language for education in other areas. That understanding led Microsoft to add multilingual capabilities and the ability to create multiple user accounts.

"It's gratifying that so many people are benefiting from Microsoft's localization investments, which increasingly allow families to use personal computers in their native language and in languages that they aspire to become more fluent in," Wickstrand says.

Meeting Entry-Level User Needs Across Borders

Microsoft views Windows Starter as a passport to a digital society. To help advance computer literacy worldwide, the operating system family is tailored to the needs and wants of first-time PC users, optimized to run on low-cost hardware and localized for various geographies. Windows XP Starter Edition was first released in Thailand in 2004 and was subsequently made available in 139 countries and 24 languages. Windows Vista Starter will be available in 139 countries and 59 languages around the world. Both versions guide PC novices through the steps of learning fundamental computer skills so new users can take the greatest possible advantage of owning their first PC.

For example, the Russian-language edition of Starter features a simple, two-minute tutorial on getting started with a mouse. Engaging visual images and a voice-over in Russian combine to teach basic skills that are critical to a beginner, such as rolling the mouse across a mouse pad and clicking the buttons to acquire on-screen targets, and how to choose items from drop-down menus.

Similarly, a version of Windows Starter available in India features a quick and easy how-to on printing from a PC for the first time. Colorful graphics, dialog boxes and on-screen menus, coupled with a voice-over in Hindi, guide the novice user through the simple steps of cable connection.

New users are finding such resources valuable. Take the case of Japhet Hellao, a small entrepreneur in Katatura Township, Windhoek, Namibia, who provides catering for the country's nine national trade unions. Before his family got its first computer, Hellao ran his business entirely by hand. He quickly learned how much a PC could do for him, even at the elementary stages, using Windows Starter. The verdict so far: No more scrutinizing the books for hours, no more writing letters by hand and then mailing them, no more standing in line everywhere, and no more frequent need to do the banking in person. Hellao reports that he's saving huge amounts of time – time that he can spend instead with his family.

Windows Starter similarly touched the lives of the Alaniz family, first-time PC owners in Niquivil, Argentina, population 700. Vanessa Yanina Alaniz, 27, takes advantage of the computer to print affordable labels for the jams, liqueurs, empanadas and breads that she and the other two single mothers in her family produce. Beyond improving their ability to make a living, the PC holds promise for the education of the young children in the Alaniz family, making up for having no books and no library nearby. When the new PC was turned on for the first time and

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Hyperlinked Analyst Presentations – Kevin Turner’s Client segment transcript from the Financial Analyst Meeting supports strategy

MSFT Financial Analyst Meetings: Kevin Turner - Microsoft Internet Explorer

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Financial Analyst Meeting 2007
July 26, 2007

Kevin Turner
Chief Operating Officer

[Biography](#)

[Download the PowerPoint presentation \(3 MB\)](#)

[Watch the webcast](#)

2007 Annual Report

KEVIN TURNER: All right. Well, good morning, and again welcome, and thanks for being here. We've certainly got a lot to cover with you, and I'm going to close out the "growing and extending the core" section that Jeff read up. As we get into it, the areas specifically I want to touch on first are the corporate desktop value area and then the Windows OSM area, and then I'll wrap it up by pulling together what you heard from Jeff and through this piece on Windows Client, and how we're going to operationalize that and land that in the field, which I think is very important being able to monetize the innovation and how do we land it out there.

And then after I talk we're going to bring up Kevin Johnson, Bob Muglia, Jeff and myself, and then we're going to do a Q&A specifically around growing our core and close this particular section out.

So as we jump into Windows Client, you know, there's a couple of things I think a year ago that was on everybody's mind—a couple of, four, questions. Number one, will it ship? Number two, will Windows Vista drive revenue? Number three, will Windows Vista deliver a great experience? And, number four, will Windows Vista, particularly for commercial customers, deliver a lower total cost of ownership? And those are the four questions that I really want to frame what I'm going to talk to you about today in the Windows Client area.

You know certainly it was the big issue we've had in Windows. And as you look at it in terms of revenue for us, which we had high expectations for Vista, but also in terms of dollar growth. So year-over-year revenue growth of 14 percent, net revenue growth dollar year-over-year was \$1.9 billion—that's the biggest net revenue growth in Windows history. And, as you look at that, 14 percent was certainly a very good number for us last year. You know, the numbers that we've given you for this next year from a guidance standpoint around GAAP and what our growth is going to be in Windows Client is around 9 to 10 percent growth—so again another healthy year we're forecasting or projecting for FY '08 in the Windows Client area.

But let's look across the customer segments and talk about how do the customer segments and where do we see kind of the results shaping up. Strong results in the consumer market driven by two things: one, certainly a healthy PC market—10 to 12 percent growth this last year. Also, for FY '08, as we look at the PC forecast, and Kevin Johnson and I and our teams collaborating on what do we think, it's going to be next year, we're forecasting 9 to 11 percent PC growth. And so when you get those two numbers, it kind of helps some of you who have the modeling how we're going to shape up as it relates to Windows Client from a revenue standpoint this next year.

Customers purchasing our premium version of Windows in FY '07, our premium mix, was 68 percent. And that's a 16-point year-over-year increase as it relates to our premium mix. It's something we feel very good about, and certainly the consumer premium SKUs are driving the majority of that growth, as they were up 19 percent. So when you think about that, that's an important thing.

On the business side, volume licensing, which you all would have seen out of our Q4 numbers, new sales and renewals is growing at the best rate we've seen in many, many years, and that's driven by customers interested in both Windows Vista Enterprise and the ability to get the Enterprise edition deployed, as well as something we affectionately call MDOP, which is the Microsoft Desktop Optimization Pack. And that is where we deliver more value beyond upgrade rights in our Software Assurance offering. So that allows us to be able again to get more value into each socket or unit that we sell into the enterprise and commercial space.

So from a modeling standpoint, FY '08 looks like, again, from a revenue standpoint, GAAP is 9 to 10 percent growth; from a PC forecast 9 to 11 percent. And then when you think about the two trends you're dealing with, with a higher percent of the PCs coming through emerging markets, which we have at lower revenue per license, as well as the opportunity that we have from the consumers outgrowing the business mix, both of those are opportunities that cause a strain on our revenue for license. So the things that we're doing to offset that we'll talk in a little bit, or at least partially offset that, are around piracy and they're also around this MDOP being able to sell more value into our commercial customers.

So when you think about the experience and feeling up the experience and the fact that it delivered the revenue, we shipped the product—Kevin Johnson and Steve have done an amazing job. We had the best launches around the world—over 400,000 customers came to our launches, and certainly something that was the best launch that we've ever had—launch wave we've ever had in the history of the company, is something that we feel very good about.

When you look at it, you know, as we designed Windows Vista, our customers told us they needed three things to make sure that we built into the product, and those are three things that I still hear today that customers tell me today that they need to be able to move to Windows Vista. The first one they told us was security and reliability, and that was the number 1 feature in the product. So how did we do? Windows Vista is the most secure operating system we've ever released. In the first 100 days we've had far fewer high-severity vulnerabilities than XP. We've had 12 in Vista. We had 25 in XP. And think about the sophistication level of the people that create the vulnerabilities today versus what it was when XP released. It's a far different opportunity today than it was then. Over that same time period, I think you should also note that Windows Vista had far fewer than Apple, as well as any major desktop Linux distributor. And that's something, again, we feel very good about from a security and reliability standpoint. But we're not resting on our laurels; that is something we're going to continue to stay focused on. This is the first operating system we've ever launched with security built in on the front end from a foundation standpoint. And, again, we're going to continue to work on that and improve it as we go forward.

When you think about reliability, Windows Vista has not the built-in tools for diagnostics, backups, self-healing capabilities. Again, it helps increase uptime and lower

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Detailed KPI schedule – XBRL delivered detailed KPI sheet for analysts to review and download

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Key Performance Indicators and Key Drivers

Indicator	Period									
	Q1'06	Q2'06	Q3'06	Q4'06	FY06	Q1'07	Q2'07	Q3'07	Q4'07	FY07
Corporate:										
<input type="checkbox"/> Booking Growth Total Bookings >15% >25% >10% >20% 20% >15% Core Bookings >20% 25% >20%										
<input type="checkbox"/> Unearned Revenues (amounts in millions) Unearned Revenue by Segment Unearned Revenue \$8,806 \$8,838 \$8,901 \$10,902 \$10,097 \$11,861 \$10,283 \$12,646 \$12,646 Unearned Revenue Components Volume Licensing Programs \$5,763 \$5,750 \$5,743 \$7,861 \$6,876 \$6,917 \$6,946 \$9,334 \$9,334 Undelivered Elements \$2,097 \$2,125 \$2,110 \$2,066 \$2,120 \$3,757 \$1,968 \$1,839 \$1,839 Other Sources \$946 \$963 \$1,048 \$1,175 \$1,101 \$1,187 \$1,369 \$1,473 \$1,473										
<input type="checkbox"/> Product billing mix (approximate) OEM 40% 35% 27% 30% 40% 30% 30% 30% Multiuser Licensing Agreements 25% 25% 35% 40% 25% 25% 25% 40% License Only 20% 20% 20% 15% 20% 20% 20% 15% Rest of Balance 15% 20% 15% 15% 15% 25% 25% 15% Enterprise agreement renewal rates - relative to historical range of 66-75% In-line In-line In-line High end High end Exceeded										
<input type="checkbox"/> Client: PC Unit Growth 15-17% 14-15% 12-13% 11-12% 12-14% 8-10% 8-10% 10-12% 11-13% 10-12% OEM License Unit Growth 18% 15% 16% 19% 17% 11% 10% 20% 11% 14% OEM Premium Mix 50% 49% 53% 55% 52% 59% 67% 70% 72% 68% Consumer Premium Mix 4% 7% 9% 10% 8% 16% 27% 30% 30% 27% Business Premium Mix 48% 42% 44% 45% 44% 43% 40% 40% 42% 41%										
<input type="checkbox"/> Online Services Business: Usage Metrics (amounts in millions) Windows Live Hotmail Accounts 215 230 241 260 263 268 285 310 Windows Live Messenger Accounts 185 205 230 243 320 255 263 278 280 Live ID's 380										
<input type="checkbox"/> Server and Tools: Server Hardware Shipments 11-13% 4-6%										
<input type="checkbox"/> Microsoft Business Division: Dynamics Billing Growth 19% 21% 20% 24% 21%										
<input type="checkbox"/> Entertainment and Devices: Xbox 360 Unit Sales (amounts in millions) 1.5 1.7 1.8 5 0.9 4.4 0.5 0.7 6.6 Xbox 360 Unit Sales (LTD) (amounts in millions) 1.5 3.2 5 5 6 10.4 10.9 11.6 11.6 Total Xbox Live Members (amounts in millions) >3 >3 >4 >5 >6 >7 >7 LTD Xbox 360 US Software Attach (source: NPD) 4.1 4.5 4.4 4.4 5.1 5.1 5.7 5.9 5.9 LTD XBOX360 US accessory attach (source: NPD) 3.1 3 2.9 2.9 2.9 2.8 3 3.2 3.2										

Download the Key Performance Indicators: [Excel \(75 kb\)](#) [XBRL \(87 kb\)](#)

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Summary Annual Report – Highlights CEO message, company financial highlights, segment highlights and CFO message along with hyperlinks to further detail

Summary Annual Report – Microsoft Corporation

Our mission is to enable people and businesses throughout the world to realize their full potential. Since our founding in 1975, we have worked to achieve our mission by creating technology that transforms the way people work, play, and communicate. We develop and market software, services, and solutions that we believe deliver new opportunities, greater convenience, and enhanced value to people's lives. We do business throughout the world and have offices in more than 100 countries.

We generate revenue by developing, manufacturing, licensing, and supporting a wide range of software products for many computing devices. Our software products include operating systems for servers, personal computers, and intelligent devices; server applications for distributed computing environments; information worker productivity applications; business solution applications; high-performance computing applications, and software development tools. We provide consulting and product support services, and we train and certify computer system integrators and developers. We sell the Xbox 360 video game console and games, the Zune digital music and entertainment device, PC games, and peripherals. Online offerings and information are delivered through our Windows Live, Office Live, and MSN portals and channels. We enable the delivery of online advertising through our proprietary adCenter® platform.

We also research and develop advanced technologies for future software products. We believe that delivering breakthrough innovation and high-value solutions through our integrated software platform is the key to meeting our customers' needs and to our future growth. We believe that we continue to lay the foundation for long-term growth by delivering new products, creating opportunities for partners, improving customer satisfaction, and improving our internal processes. Our focus is to build on this foundation through ongoing innovation in our integrated software platforms; by delivering compelling value propositions to customers; by responding effectively to customer and partner needs; and by continuing to emphasize the importance of product excellence, business efficacy, and accountability.

Message from our CEO, Steve Ballmer

Fiscal 2007 was an important and very successful year for Microsoft. Fueled by the launches of new versions of our flagship Microsoft Windows and Office products, the rollout of the biggest wave of business software in company history, and excellent momentum across a broad range of markets, we reached a significant milestone in 2007 when we surpassed \$50 billion in revenue. One essential difference between Microsoft and any other company in this industry is our willingness to enter new markets and embrace disruptive business trends.

Innovation is a key factor affecting Microsoft's growth. Our model for growth is based on broad adoption of innovation, willingness to enter new markets, and embracing and acting on disruptive trends. We continue our long-term commitment to research and development, including advanced work aimed at innovations, in a wide spectrum of technologies, tools, and platforms; communication and collaboration; information access and organization; entertainment; business and e-commerce; and devices. Increasingly, we are taking a global approach to innovation. This global approach will help us remain competitive in local markets and attract top talent wherever it resides.

Based on our broad focus on innovation and long-term approach to new markets, we see the following key opportunities for growth:

Consumer technology. To build on our strength in the consumer marketplace with Windows Vista, the 2007 Microsoft Office System, Xbox 360, Microsoft Windows Live, Windows Mobile, and Zune, we are focused on delivering products that we believe are compelling and cutting edge in terms of design as well as features and functionality. To succeed in consumer technologies, we also are working to define the next era of consumer electronics. In the past, consumer electronics was a hardware-centric business; today, the innovation in consumer electronics devices lies in the software that powers them. This is creating new opportunities for us to deliver end-to-end experiences.

Software plus services. Underlying our opportunities in consumer technologies, and in all of our businesses, is a company-wide commitment to fully embrace software plus services. The ability to combine the power of desktop and server software with the reach of the Internet represents an opportunity across every one of our businesses. As we continue to build out our services platform, we will bring a broad range of new products and service offerings to market that target the needs of large enterprises, small and medium-sized businesses, and consumers.

Expanding our presence on the desktop and server. While we enjoyed success in fiscal year 2007 with the launches of Windows Vista and the 2007 Microsoft Office System, we see potential for growth by delivering more value per customer. With the planned releases in fiscal year 2008 of Windows Server 2008, SQL Server 2008, and Visual Studio 2008, and the possibility to provide additional value in security, messaging, systems management, and collaboration, we believe we are well-positioned to build on our strength with businesses of all sizes. We will continue to pursue new opportunities in high performance computing, unified communications, healthcare, and business intelligence. Emerging markets are also an important opportunity for us. In fiscal year 2007, we announced the expansion of our Unlimited Potential program as the foundation for our efforts to reach the five billion people around the globe who do not have access to PCs and digital technology today.

This report has been prepared for discussion and deliberation by the full Committee at a July 11, 2008 open meeting. Pending any further action on this report by the Committee, it does not necessarily reflect either the views of the Committee or other members of the Committee. It also does not necessarily reflect the views or regulatory agenda of the Commission or its staff.

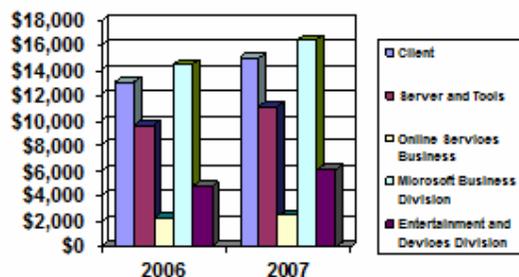
Financial Highlights
(In millions, except per share data)

Fiscal Year Ended June 30	2007	2006	2005	2004	2003
Revenue	\$51,122	\$44,282	\$39,788	\$36,835	\$32,187
Operating income	18,524	16,472	14,561	9,034	9,545
Net income	14,065	12,599	12,254	8,168	7,531
Diluted earnings per share	\$ 1.42	\$ 1.20	\$ 1.12	\$ 0.75	\$ 0.69
Cash dividends declared per share	\$ 0.40	\$ 0.35	\$ 3.40	\$ 0.16	\$ 0.08
Cash and short-term investments	23,411	34,161	37,751	60,592	49,048
Total assets	63,171	69,597	70,815	94,368	81,732
Long-term obligations	8,320	7,051	5,823	4,574	2,846
Stockholders' equity	31,097	40,104	48,115	74,825	64,912

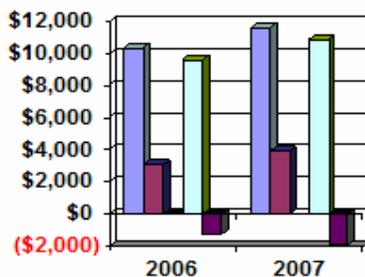
Segment Revenue/Operating Income

Microsoft has five operating segments: Client, Server and Tools, the Online Services Business, the Microsoft Business Division, and the Entertainment and Devices Division.

Segment Revenue (in millions)



Operating Income / (Loss)



Details on the types of products and services provided by each segment can be found in our [SEC Form 10-K](#).

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Message from our CFO, Christopher Liddell

Fiscal 2007 was a year of \$7 billion of revenue growth, fueled by robust customer acceptance of products in both our emerging and mature businesses, including Windows Vista, Microsoft Office 2007, SQL Server, Windows Server and Xbox 360 consoles. Our core businesses accounted for \$5 billion of absolute revenue growth, with the Business Division, Client and Server and Tools growing 13, 14 and 16% respectively for the year.

Operating income for the year also grew double digits. We were able to achieve this growth while still being able to make a number of significant investments in our businesses, such as:

- The launch of over 40 new products into the marketplace as well as a number of updates and enhancements to our online services offerings.
- Continued development of a number of upcoming products releases, such as new versions of Windows Server, SQL Server and Visual Studio
- The enhancement of our online services infrastructure by continuing to refine adCenter and increasing our datacenter capacity
- Necessary investments in Xbox customer satisfaction, and
- We also announced eight strategic acquisitions, including aQuantive, to provide the advertising industry with a world class Internet-wide advertising platform, Tellme for its voice response services, and Softricity for its application virtualization and streaming capabilities.

EPS for the year came in at \$1.42, up 18% over last year which was faster than both revenue and operating income.

Finally, during fiscal 2007 we made significant progress on our strategy of returning cash to shareholders. In July of 2006 we announced authorization for programs to repurchase up to \$40 billion worth of our stock over five years. One year after that announcement, I am happy to say we have passed the half way mark on the programs by repurchasing approximately \$25 billion worth of our stock during the 2007 fiscal year. If you combine the share repurchases we made this year with the \$3.8 billion of dividends paid, we returned about 175% of operating cash flow to shareholders over the fiscal year.



DOWNLOAD ADDITIONAL FINANCIAL STATEMENTS FOR FY 2007

MD&A

[INCOME STATEMENT](#)

[BALANCE SHEET](#)

[CASH FLOW](#)

STOCKHOLDERS' EQUITY

FOOTNOTES

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American Enterprise Institute

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(Delivering Financial Information Subcommittee)

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Senior Policy Advisor to the Under Secretary for Domestic Finance
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Office of the Chief Accountant

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Professional Accounting Fellow
Office of the Chief Accountant
U.S. Securities and Exchange Commission

DRAFT - JULY 11

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Exhibit C

MEMORANDUM

TO: Members and Official Observers
SEC Advisory Committee on Improvements to Financial Reporting
(Committee)

FROM: Nili Shah

RE: Overview of Comments Received through June 30, 2008

DATE: July 7, 2008

I. Introduction

This memorandum provides an overview of comment letters received by the Committee from July 17, 2007, the date of its charter, through June 30, 2008. While I have attempted to accurately and concisely reflect the variety of responses received, the large number of responses makes a detailed discussion of all comment letters impracticable.

This overview has been prepared for the Committee's convenience, and is intended to broadly inform Committee members regarding overall themes and comments related to matters outside the scope of their respective subcommittees. This overview is not intended to serve as a substitute for a review of the comment letters themselves. All comment letters are available on the Committee's web site at <http://www.sec.gov/comments/265-24/265-24.shtml>.

As you read this memorandum, please bear in mind that the majority of the comment letters underlying this overview only address Committee statements through its March 13-14, 2008 public meeting in San Francisco. Accordingly, of necessity, the letters discussed below generally do not reflect comments regarding developments since the San Francisco meeting, which, in some cases, already incorporate changes as a result of the comment letters discussed below. Where a comment letter addresses a Committee development subsequent to the March 13-14, 2008 public meetings, this has been separately noted.

II. General Comment Letter Statistics

The Committee received 96 comment letters, from 77 different commenters,¹ through June 30, 2008. Commenters represented all constituencies, with preparers submitting the

¹ Some commenters submitted multiple letters, varying based on: (1) the stage of the Committee's work (e.g., formation; issuance of the August 2, 2007 discussion paper; or issuance of the February 14, 2008 progress report (Progress Report)) and/or (2) the individual within the organization. Statistics in the

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most letters, followed by users. Refer to appendix A for a list of commenters, segregated by constituency.

Note that throughout this overview, constituencies have been defined as follows:

Constituency	Description
Users	Investors and other users, investor groups, investor protection agencies, and attorneys representing users
Preparers	Preparers, preparer-related professional organizations, and advisors to preparers
Auditors	Auditors and audit-related professional organizations
Standards-Setters	Standards-setters and related formal and informal advisory groups
Regulators	Regulators, former regulators, and oversight bodies
Academics	Academics
Information Providers	Providers of financial information to users and providers of technology to support financial information dissemination
Professional Organizations	Accounting and finance professional organizations with broad-based membership, as well as informal professional groups
Other	Individuals and those with unknown affiliation

III. General Observations

There were two recurring themes throughout the comment letters.

First, commenters repeatedly expressed the need for consideration of the international environment. Some requested that the Committee express support for the use of IFRS in the U.S. Others requested consideration of how convergence efforts or wholesale IFRS adoption in the U.S. would affect the Committee's recommendations. For example, one auditor² questioned whether each of the recommendations would facilitate the transition to IFRS, would be accomplished as a result of transition to IFRS, or would become irrelevant upon transition to IFRS. Specifically, commenters:

- Stated that IFRS creates another type of exception in the form of jurisdictional variants.
- Believed that bright lines should be addressed in the context of the eventual move to IFRS and principles-based standards.
- Noted that the FASB's role would change with the move towards IFRS in the U.S.
- Believed that the FASB's agenda priorities should be considered in light of international convergence.
- Noted that adoption of IFRS in the U.S. will result in the elimination of much detailed guidance in the U.S.

remainder of this overview factor out multiple submissions from the same commenter, although footnote references list all submissions, including multiple submissions from the same commenter, to the extent they relate to the matter in question.

² PricewaterhouseCoopers LLP (Mar 31, 2008)

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- Questioned how university education could best integrate the teaching of IFRS.
- Cautioned against a short-term focus that would lead to adoption of changes in U.S. GAAP, followed by additional changes upon adoption of IFRS.
- Noted that a professional judgment framework would facilitate a move towards principles-based accounting standards.
- Encouraged alignment between taxonomies developed in the U.S. and those developed based on IFRS. As one user³ stated,

...the XBRL implementation plan should be closely tied to the convergence agenda. If US implementation of XBRL were coordinated with taxonomies consistently mapped between US GAAP and IFRS, then XBRL would help foster the cause of ultimate convergence; however, as this project is now proposed, XBRL in the US would be insular and would in fact become an obstacle to eventual convergence...We believe that by not addressing convergence as part of the XBRL adoption plan, issuers could become further entrenched in US GAAP and investors may not invest in tools to utilize XBRL until the two taxonomies are aligned.

A preparer⁴ echoed this thought by encouraging

...the SEC to consider appropriate sequencing of the implementation of XBRL with the convergence with international accounting standards. We recommend appropriate sequencing of these efforts to allow companies to focus on convergence and avoid re-implementation of XBRL once international taxonomies are created that accurately [reflect] globally converged standards.

Notwithstanding the above, two auditors⁵ nonetheless urged the Committee to reconsider the existing body of U.S. GAAP, as even with the adoption of IFRS, U.S. GAAP could still influence accounting under IFRS, due to the provisions in IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.⁶ Further, one professional organization⁷ disagreed with the views of certain U.S. constituents that full-scale adoption of IFRS is the most expeditious means by which to achieve the FASB's agenda priorities, as this commenter believed that U.S. issuers should be permitted, but not required, to report under IFRS at this time.

Second, several commenters questioned the use of the term "investor," as it frequently appears in discussions regarding investor representation in the standards-setting process,

³ Fitch Ratings, Inc. (Apr 2, 2008)

⁴ Financial Executives International (Apr 4, 2008)

⁵ Center for Audit Quality (Nov 20, 2007), Ernst & Young LLP (Mar 31, 2008)

⁶ Note that the auditors made this comment in the context of industry-specific guidance, but that it is also applicable to other areas of U.S. GAAP. Specifically, IAS 8 permits use of other countries' GAAP in certain cases where IFRS is silent.

⁷ Bar Association of the City of New York (Apr 18, 2008)

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materiality, correction of errors, and professional judgment. Commenters noted that there are several types of investors. One user⁸ recommended that the Committee “adopt a single definition for “investor” that is used consistently – and in an unqualified manner – throughout the report and “distinguish ‘investors’ from ‘other users of financial reports.’”

IV. Overview of Comments

A. Substantive Complexity

The developed proposals, conceptual approaches, and future considerations related to substantive complexity seek to reduce the complexity in GAAP resulting from exceptions to general principles, bright lines, the mixed attribute model, and the lack of a holistic approach to disclosures. However, one academic⁹ noted that complexity affects constituents differently and that a task-complexity-capturing measurement system is important to systematically identify the causes and remedies of complexity.

Exceptions to General Principles

Industry-Specific Guidance

In the Progress Report, developed proposal 1.1 expressed that industry-specific guidance should be eliminated in favor of GAAP based on business activities. Seventeen commenters addressed this area in their comment letters. Six commenters¹⁰ (one user, one preparer, two auditors, and two professional organizations) were generally supportive of the developed proposal, particularly as it relates to the elimination of industry-specific guidance that conflicts with generalized GAAP. On the other hand, seven commenters¹¹ (one user, one preparer, and five auditors) believed that industry-specific guidance should be retained in certain circumstances or defined “business activities” in such a way that they effectively referred to industries. Some of these opponents also observed that if standards-setters did not issue industry-specific guidance, non-authoritative literature would fill the void.

Two significant themes emerged in this area. First, several commenters expressed confusion over or requested clarification as to the definition of “business activities.” Two

⁸ CFA Institute (Mar 31, 2008)

⁹ American Accounting Association (Apr 30, 2008)

¹⁰ User: CFA Institute (Mar 31, 2008); Preparers: Financial Executives International (Apr 4, 2008); Auditors: Center for Audit Quality (Nov 20, 2007), Ernst & Young LLP (Mar 31, 2008); Professional Organization: Institute of Public Auditors in Germany (Mar 26, 2008), Ohio Society of CPAs (Mar 31, 2008)

¹¹ User: Investment Company Institute (Mar 31, 2008); Preparer: Group of North American Insurance Enterprises (May 19, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

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commenters¹² (one user and one preparer) specifically questioned the role management intent plays in the definition of “business activities.” Second, several commenters cautioned the Committee that the significance of the change may result in transition issues and emphasized that new activities-based guidance would be necessary prior to the elimination of industry-specific guidance.

Alternative Accounting Policies

In the Progress Report, developed proposal 1.2 expressed that formally promulgated alternative accounting policies should not exist, except in rare circumstances. Eight commenters¹³ (two users, one preparer, three auditors, one professional organization, and one other) were generally supportive, while four commenters¹⁴ (two auditors and two academics) opposed this developed proposal. Those opposing this developed proposal stated that: (1) there is more evidence in favor of, rather than against, the benefits of accounting choice, (2) alternatives should be allowed if they are “more practical and cost-effective than a conceptually pure accounting requirement,”¹⁵ (3) alternatives, “supported by robust disclosures[,] enable preparers to more accurately reflect and disclose the economic realities of transactions, providing investors with more transparent and useful information that improves comparisons between companies,”¹⁶ and (4) “meaningful elimination of accounting choice would entail a rules-based approach to accounting standard setting that is in direct opposition to the [objectives-oriented] approach currently favored.”¹⁷

Commenters in this area also observed that even without formally promulgated accounting alternatives, diversity will continue to exist, in light of the movement to principles and acceptance of reasonable professional judgments. One user¹⁸ believed that this developed proposal was inconsistent with the recommendation regarding professional judgment, which would “encourage the SEC ‘to seek to accept a range of alternative judgments when preparers make good faith attempts to reach a reasonable judgment.’”

¹² User: CFA Institute (Mar 31, 2008); Preparer: Financial Executives International (Apr 4, 2008)

¹³ User: AFL-CIO (Jun 23, 2008), CFA Institute (Mar 31, 2008); Preparer: Financial Executives International (Apr 4, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008); Other: Paul H. Rosenfield (Mar 25, 2008)

¹⁴ Auditors: Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Academics: American Accounting Association (Apr 30, 2008), University of Michigan, Ross School of Business (Feb 19, 2008)

¹⁵ Ernst & Young LLP (Mar 31, 2008)

¹⁶ PricewaterhouseCoopers LLP (Mar 31, 2008)

¹⁷ American Accounting Association (Apr 30, 2008)

¹⁸ AFL-CIO (Jun 23, 2008)

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The Committee also discussed the role of management intent in accounting policies, but refrained from expressing a view. In this regard, two preparers¹⁹ believed that management intent should play a role in accounting policies, while two other commenters²⁰ (one user and one other) disagreed with this view.

Scope Exceptions other than Industry-Specific Guidance

In the Progress Report, the Committee identified a future consideration related to when, if at all, scope exceptions should be eliminated. Comments in this area were sparse, with one auditor²¹ expressing support for few exceptions; one auditor²² supporting a re-examination of scope exceptions, with change, as necessary; and one preparer²³ observing that scope exceptions do not necessarily increase complexity and, at times, reduce complexity, such as in the case of an exception to treating purchase orders to buy fungible products as derivatives.

Competing Models

In the Progress Report, the Committee identified a future consideration related to when, if at all, competing models should be eliminated. Only one auditor²⁴ addressed this area, noting that U.S. GAAP has several competing models and that this area may be simplified.

The Progress Report also noted that the Committee would explore the relationship between competing models and the FASB's conceptual framework. One academic noted the lack of a coherent conceptual framework hampers faculty efforts to educate "students [on] how to analyze the economic substance of a business event consistent with the basic definitions of an asset, liability, revenue, or expense and then [to] proceed rationally [to] determine the proper handling of the item,"²⁵ sometimes resulting in the teaching of rules and exceptions, rather than concepts. Two commenters²⁶ (one preparer and one auditor) suggested that the Committee provide recommendations regarding the conceptual framework. The auditor also believed that the "conceptual framework reflects compromises among differing views of seven Board members." As such, although an existing accounting standard may be inconsistent with the conceptual framework, it should only be changed if there is a related practice problem or other compelling reason

¹⁹ Financial Executives International (Apr 4, 2008), UBS AG (Mar 31, 2008)

²⁰ User: CFA Institute (Mar 31, 2008); Other: Paul H. Rosenfield (Mar 25, 2008)

²¹ KPMG LLP (Mar 31, 2008)

²² Center for Audit Quality (Nov 20, 2007), Center for Audit Quality (Mar 31, 2008)

²³ Institute of Management Accountants (Oct 3, 2007)

²⁴ BDO Seidman, LLP (Mar 31, 2008)

²⁵ American Academic Association (Apr 30, 2008)

²⁶ Preparer: Prime Income Asset Management (Jun 17, 2008); Auditor: BDO Seidman, LLP (Oct 1, 2007)

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to change. Other commenters²⁷ (one auditor, one professional organization, and one other) were more specific, stating that the conceptual framework should emphasize simplicity, practicability, operationality, and soundness, rather than just relevance, reliability, and consistency. One academic²⁸ also asserted a need to: (1) move away from the balance sheet approach to financial reporting, towards an income statement approach and (2) renew emphasis on the principle of matching of expenses to revenues.

Bright Lines

In the Progress Report, conceptual approach 1.A listed potential alternatives to the current use of bright lines, such as proportionate recognition, additional disclosure, and rules-of-thumb or presumptions. Seven commenters addressed this area. Four commenters²⁹ (one user, two auditors, and one professional organization) generally agreed that the use of bright lines required re-examination or should generally be avoided. Four commenters³⁰ (three auditors and one professional organization) questioned this conceptual approach, in the context of: (1) why proportionate recognition, rules-of-thumb, or presumptions were preferable solutions, and (2) how the conceptual approach would apply in the determination of the economic substance of a transaction and which accounting model to apply to that transaction.

Specifically, the professional organization³¹ believed that it was unclear that proportionate recognition was better than the all-or-nothing approach currently used. One auditor³² stated, “Although bright-lines should be challenged, proportionate recognition on its own does not appear to be the simple solution.” Another auditor³³ questioned the practicability of proportionate recognition and how it would reduce complexity; this auditor also believed that bright lines should not be avoided if they are relevant to the determination of the substance of a transaction. The remaining auditor³⁴ stated

We believe that this discussion should be broadened to a discussion of how to decide whether a class of transactions has such varied economic substance that more than one accounting model is needed. Then, if the conclusion is reached

²⁷ Auditor: BDO Seidman, LLP (Oct 1, 2007), BDO Seidman, LLP (Mar 31, 2008); Professional Organization: Institute of Public Auditors in Germany (Mar 26, 2008); Other: Paul H. Rosenfield (Mar 25, 2008)

²⁸ University of Michigan, Ross School of Business (Feb 19, 2008)

²⁹ User: CFA Institute (Mar 31, 2008); Auditors: Center for Audit Quality (Nov 20, 2007), Center for Audit Quality (Mar 31, 2008), KPMG LLP (Mar 31, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008)

³⁰ Auditors: BDO Seidman, LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008)

³¹ Ohio Society of CPAs (Mar 31, 2008)

³² Ernst & Young LLP (Mar 31, 2008)

³³ KPMG LLP (Mar 31, 2008)

³⁴ BDO Seidman, LLP (Mar 31, 2008)

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that there needs to be more than one accounting model, the discussion should address the best way to provide guidance on which model applies...

For [some] classes of transactions...one model may not fit all...If the FASB concludes that the variation in economic substance supports the retention of two accounting models, we believe guidance would be necessary to help accountants identify the appropriate model for a specific transaction and achieve reasonable consistency in practice. Rules of thumb and presumptions may be a reasonable alternative to bright lines, but we note that where this approach is used in today's standards, practice has often gravitated to bright lines to resolve debates and achieve more consistency in practice. In our view, this natural tendency can only be mitigated through clearly explained standards interspersed with suitable examples.

The Progress Report also presented conceptual approach 1.B related to a possible recommendation to facilitate better training of students, investors, preparers, and auditors to understand the economic substance and business purposes of transactions, in contrast to mechanically complying with rules without sufficient context. Five commenters³⁵ (two users and three auditors) generally agreed with this developed proposal, noting that: (1) regulators should also receive training in this regard, (2) the conceptual approach may be better implemented by focusing on the training and tools available to the teaching profession, and (3) the Treasury Advisory Committee is also considering recommendations related to education. One academic³⁶ asserted that university education has moved in this direction, but has encountered difficulties due to the state of the conceptual framework (refer to the competing models section of this overview for further discussion).

Mixed Attribute Model

In the Progress Report, the Committee presented conceptual approaches 1.C, 1.D, 1.E, and 1.F regarding the mixed attribute model. Specifically, the Committee discussed potential recommendations requiring the judicious use of fair value until completion of a measurement framework, groupings in financial statement presentation, and additional disclosures.

Sixteen commenters expressed views regarding the use of fair value. Three commenters³⁷ (one user, one regulator, and one other) opposed the Committee's conceptual approach, in support of the use of fair value, with the user suggesting that the Committee's language may be interpreted as a "recommendation to slow or impede the

³⁵ Users: CFA Institute (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

³⁶ American Accounting Association (Apr 30, 2008)

³⁷ User: CFA Institute (Mar 31, 2008); Regulator: Walter P. Schuetze (Aug 1, 2007); Other: Paul H. Rosenfield (Mar 25, 2008)

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implementation of fair value reporting.” Three commenters³⁸ (two users and one other) opposed the use of fair value, noting that fair value is difficult to estimate, easy to manipulate, and difficult to audit. The remaining ten commenters expressed views in between these two extremes:

- Five commenters³⁹ (one user, two auditors, and two professional organizations) generally supported the judicious use of fair value until completion of a measurement framework, with the user recommending that the FASB prioritize the measurement framework to be better positioned to consider the use of fair value.
- One professional organization⁴⁰ recommended a study to ascertain whether fair value is both relevant and reliable before increased use.
- Two commenters⁴¹ (one user and one auditor) supported the use of fair value for financial instruments.
- One auditor⁴² supported the use of fair value for financial instruments, possibly except for an entity’s own debt.
- One auditor⁴³ supported the use of fair value for traded items.

Eight commenters addressed aspects of financial statement presentation in their comment letters. Of these, five commenters⁴⁴ (one user, one preparer, two academics, and one other) presented detailed views as to improvements that may be made to financial statement presentation, such as inclusion of a fair value statement, additional emphasis on cash flow, and recognition of internally-generated intangible assets, among others. The user, as well as three auditors,⁴⁵ generally supported the direction of the conceptual approach, particularly as it relates to segregation of fair value remeasurements from other operating results.

As it relates to disclosures, two commenters⁴⁶ (one user and one auditor) expressed support for more disclosure around fair value and non-fair value measures, as well as additional disclosure regarding variability and subjectivity, to the extent that fair value is permitted or required for assets / liabilities that are not traded in active markets.

³⁸ User: Richard Solomon (Jun 26, 2008); Gilbert F. Viets (Mar 11, 2008); Other: John S. Ferguson (Feb 19, 2008)

³⁹ User: Fitch Ratings, Inc. (Apr 2, 2008); Auditors: Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Institute of Public Auditors in Germany (Jun 16, 2008), Ohio Society of CPAs (Mar 31, 2008)

⁴⁰ New York State Society of CPAs (Sep 28, 2007)

⁴¹ User: AFL-CIO (Feb 10, 2008); Auditor: Center for Audit Quality (Nov 20, 2007)

⁴² KPMG LLP (Mar 31, 2008)

⁴³ BDO Seidman, LLP (Mar 31, 2008)

⁴⁴ User: CFA Institute (Mar 31, 2008); Preparer: Occidental Petroleum (Jul 28, 2007); Academics: Dartmouth University, Tuck School of Business (Nov 2, 2007), University of Michigan, Ross School of Business (Feb 19, 2008); Other: Next Generation Healthcare Solutions, LLC (Jan 17, 2008)

⁴⁵ Center for Audit Quality (Nov 20, 2007), Center for Audit Quality (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

⁴⁶ User: CFA Institute (Mar 31, 2008); Auditor: BDO Seidman, LLP (Mar 31, 2008)

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Disclosure Framework

In the Progress Report, conceptual approach 1.G discussed the Committee's consideration of a recommendation related to the development of a disclosure framework, improvement of the piecemeal approach to establish disclosures, and regular SEC evaluation of its disclosure requirements as new FASB standards are issued, to eliminate redundancies. The Committee received eight comment letters addressing this area, all of which were generally supportive. Two auditors⁴⁷ supported the conceptual approach, noting that a disclosure framework would facilitate the review and updating of both the FASB's and SEC's disclosure requirements. Three commenters⁴⁸ (one user and two auditors) provided specific disclosure-related recommendations, noting: (1) that disclosures about uncertainties and imprecision should be simple, straightforward, and prominent to help communicate to a broad audience, and (2) a need for increased disclosure of risks, underlying estimates and assumptions, the way those estimates and assumptions impact reported amounts, and sensitivity analyses.

In addition, two commenters⁴⁹ (one preparer and one professional organization) observed that financial statements are too voluminous to be meaningful and that there needs to be balance between investors' desire for maximum disclosures and preparer and auditor costs. One academic⁵⁰ recommended that the Committee highlight this tension between the benefits and costs of disclosure, and the important role it "must play in any conceptually based framework." Specifically, although impossible to meaningfully quantify, the academic noted benefits of a reduced cost of capital (which is still subject to debate), improved market liquidity, and reduced litigation costs, as compared to costs related to competitive disadvantages from disclosure and increased litigation costs (particularly related to forward-looking data).

One user⁵¹ asserted that the FASB should prioritize a presentation and disclosure project, as it, along with a measurement framework and the financial presentation project, form the building blocks to improved financial reporting.

Note that comments received related to disclosures associated with the mixed attribute model and the professional judgment framework are discussed in those respective sections.

⁴⁷ Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

⁴⁸ User: CFA Institute (Mar 31, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

⁴⁹ Preparer: John R. Roberts (Mar 25, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008)

⁵⁰ American Accounting Association (Apr 30, 2008)

⁵¹ Fitch Ratings, Inc. (Apr 2, 2008)

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B. Standards-Setting Process

Investor Representation

In the Progress Report, developed proposal 2.1 noted a need for additional investor representation on standards-setting bodies and stated that investor perspectives should have pre-eminence. Twenty-one commenters expressed views in this area, as follows:

- Six commenters⁵² (four users, one preparer, and one academic) generally agreed with this developed proposal.
- One preparer⁵³ believed that the current status is sufficient.
- Five commenters⁵⁴ (four academics and one other) objected to the Committee's view that academic representation should not be mandated.
- Eight commenters⁵⁵ (six auditors, one academic, and one professional organization) believed that representation should be balanced, instead of giving investor perspectives pre-eminence. In particular, the academic noted that

[s]ince investors and other users of financial statements (e.g. analysts) without an ownership position in the firm are free riders (i.e. garnering the benefits of disclosure without bearing the costs), overweighting the views of such constituents could yield suboptimal outcomes.

- One auditor⁵⁶ advocated the use of a mix of full- and part-time Board members and staff so that standards-setters will have a better appreciation of the burdens of complexity.
- One professional organization,⁵⁷ noting that there is no single type of investor, questioned how investor representation would be determined to ensure the average investor perspective is achieved.

One professional organization⁵⁸ supported the revisions related to investor perspectives in subcommittee II's May 2, 2008 update report, noting that the language appears to somewhat reflect the need for a more balanced representation.

⁵² Users: Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008), CFA Institute (Mar 31, 2008), Consumer Federation of America (Jan 16, 2008), Council of Institutional Investors (Mar 31, 2008); Preparer: FirstEnergy Corp. (Mar 31, 2008); Academic: University of Michigan, Ross School of Business (Feb 19, 2008)

⁵³ Financial Executives International (Mar 31, 2008), Financial Executives International (Apr 4, 2008)

⁵⁴ Academics: American Accounting Association (Feb 3, 2008), American Accounting Association (Apr 30, 2008), Brigham Young University (Jan 21, 2008), Rice University (Jan 22, 2008), University of Wisconsin (Feb 4, 2008); Other: Paul H. Rosenfield (Mar 25, 2008)

⁵⁵ Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Academic: American Accounting Association (Apr 30, 2008); Professional Organization: Institute of Public Auditors in Germany (Mar 26, 2008)

⁵⁶ BDO Seidman, LLP (Oct 1, 2007)

⁵⁷ Ohio Society of CPAs (Mar 31, 2008)

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FAF and FASB Governance

In the Progress Report, developed proposal 2.2 identified ways for the FAF to enhance its governance of the FASB. Six commenters⁵⁹ (one user, one preparer, three auditors, and one professional organization) specifically addressed this developed proposal, and generally agreed with its provisions.

Standards-Setting Process Improvements

In the Progress Report, developed proposal 2.3 identified a number of ways for the FASB to improve the efficiency and effectiveness of standards-setting. The Committee received twenty-four comment letters addressing this area.

With respect to the formation of an agenda advisory group, sixteen commenters expressed views, as follows:

- Five commenters⁶⁰ (three preparers and two professional organizations) supported its formation.
- Eleven commenters⁶¹ (four users, one preparer, four auditors, one standards-setter, and one academic) either opposed its formation or questioned its need, stating that: (1) FASAC and ITAC already play similar roles, such that the group would create systemic redundancies, (2) the group could be created via an executive committee of the FASAC, and (3) the group appears to bring the FASB under more of the SEC's control, further politicizing the standards-setting process. One commenter, instead, supported a system-wide group to serve as an advisor to all constituents and to facilitate a coordinated assessment of which groups should address emergency application and implementation issues in U.S. GAAP.

With respect to field tests, cost-benefit analyses, and investor pre-reviews, ten commenters⁶² (one user, four preparers, four auditors, and one professional organization)

⁵⁸ Institute of Public Auditors in Germany (Jun 16, 2008)

⁵⁹ User: CFA Institute (Mar 31, 2008); Preparer: Financial Executives International (Apr 4, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: American Academy of Actuaries (Mar 13, 2008)

⁶⁰ Preparers: Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008), Medtronic, Inc. (Mar 31, 2008); Professional Organizations: Institute of Public Auditors in Germany (Mar 26, 2008), Ohio Society of CPAs (Mar 31, 2008)

⁶¹ Users: AFL-CIO (Feb 10, 2008), CFA Institute (Mar 31, 2008), Council of Institutional Investors (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008); Preparer: UBS AG (Mar 31, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Standards-Setter: Financial Accounting Standards Advisory Council (Mar 31, 2008); Academic: University of Wisconsin (Feb 4, 2008)

⁶² User: CFA Institute (Mar 31, 2008); Preparers: Equipment Leasing and Finance Association (Oct 10, 2007), Financial Executives International (Apr 4, 2008), Institute of Management Accountants (Oct 3,

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were generally supportive, although one auditor⁶³ expressed concerns with identifying users to perform pre-reviews. Four commenters⁶⁴ (two users, one preparer, and one academic), while not openly opposing this approach, expressed concerns regarding delays and the difficulty in performing cost-benefit analyses.

Eight commenters⁶⁵ (three preparers, four auditors, and one professional organization) agreed with post-adoption reviews of new standards, while two users⁶⁶ disagreed, expressing concerns regarding the uncertainty that the post-adoption reviews would create in the market and that the leeway in those reviews would undermine the quality of financial statements. Two of the commenters who supported post-adoption reviews proposed different time frames, with one preparer⁶⁷ suggesting that post-adoption reviews begin immediately after issuance of a standard and one auditor⁶⁸ suggesting that they begin two to three years after issuance, to ensure sufficient data.

Regarding periodic assessments of existing standards, six commenters⁶⁹ (one user, three preparers, and two auditors) expressed support, although one preparer⁷⁰ suggested that reevaluations begin one year after issuance of a standard.

Separately, one auditor⁷¹ observed a number of examples where standards had been issued, only to be superseded, amended, or delayed shortly thereafter, often for reasons identified during the public comment letter process. As such, this auditor recommended that the FAF and FASB study past experiences to see how the process for evaluating public comments could be improved.

Interpretative Implementation Guidance

In the Progress Report, developed proposal 2.4 discussed proposals to reduce the number of parties that interpret GAAP and the volume of interpretative guidance. Sixteen

2007), Medtronic, Inc. (Mar 31, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008)

⁶³ Center for Audit Quality (Mar 31, 2008)

⁶⁴ Users: CFA Institute (Mar 31, 2008), Council of Institutional Investors (Mar 31, 2008); Preparer: UBS AG (Mar 31, 2008); Academic: American Accounting Association (Apr 30, 2008)

⁶⁵ Preparers: Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008), Medtronic, Inc. (Mar 31, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008)

⁶⁶ AFL-CIO (Feb 10, 2008), Consumer Federation of America (Jan 16, 2008)

⁶⁷ Financial Executives International (Apr 4, 2008)

⁶⁸ PricewaterhouseCoopers LLP (Mar 31, 2008)

⁶⁹ User: CFA Institute (Mar 31, 2008); Preparers: Equipment Leasing and Finance Association (Oct 10, 2007), Financial Executives International (Apr 4, 2008), Medtronic, Inc. (Mar 31, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008)

⁷⁰ Equipment Leasing and Finance Association (Oct 10, 2007)

⁷¹ BDO Seidman, LLP (Mar 31, 2008)

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commenters addressed this area in their comment letters. Eleven commenters⁷² (one user, three preparers, four auditors, and three professional organizations) generally agreed with this developed proposal, particularly as it relates to the FASB being the sole standards-setter, with the codification including all authoritative literature, including SEC literature. However, eight commenters⁷³ (one user, one preparer, five auditors, and one professional organization) supported continued non-authoritative interpretations, noting that: (1) the FASB and the SEC do not have the authority to restrain the expression of constituent views, (2) non-authoritative guidance fills a void, particularly given the length of time required to issue standards, and (3) in a principles-based environment, non-authoritative dialogue and interpretations will be more important.

SEC Roles and Responsibilities

In the Progress Report, conceptual approach 2.A discussed ways to further reduce interpretative implementation guidance through clarification of the SEC's role in relation to the FASB and the SEC's internal roles and responsibilities. Nine commenters addressed this conceptual approach. Four auditors⁷⁴ observed that SEC staff interpretations are of broad interest, given the SEC's statutory responsibility, and thus, do not support curtailment of the SEC staff's ability to communicate publicly. However, commenters suggested changes in SEC staff procedures, including review by the Office of the Chief Accountant of all potential restatements identified by the Division of Corporation Finance, prudence in making public comments, improved quality control in drafting and reviewing comment letters in order to avoid inappropriate inferences, and adoption of a mechanism to clearly disseminate SEC staff positions with broad implications.

Optimal Design of Standards

In the Progress Report, conceptual approach 2.B discussed consideration of a proposal to encourage improvement in the way standards are written. Sixteen commenters touched on this area. Eleven commenters⁷⁵ (one user, three preparers, four auditors, and three

⁷² User: CFA Institute (Mar 31, 2008); Preparers: Financial Executives International (Mar 31, 2008), Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008), UBS AG (Mar 31, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organizations: American Academy of Actuaries (Mar 13, 2008), Institute of Public Auditors in Germany (Mar 26, 2008), Ohio Society of CPAs (Mar 31, 2008)

⁷³ User: Fitch Ratings, Inc. (Apr 2, 2008); Preparer: Equipment Leasing and Finance Association (Oct 10, 2007); Auditor: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), Professional Organization: Bar Association of the City of New York (Apr 18, 2008)

⁷⁴ BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

⁷⁵ User: CFA Institute (Mar 31, 2008); Preparers: Financial Executives International (Mar 31, 2008), Institute of Management Accountants (Oct 3, 2007), John R. Roberts (Mar 25, 2008); Auditors: BDO

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professional organizations) generally agreed with this conceptual approach and the characteristics of optimal accounting standards, as presented at the Global Public Policy Symposium in January 2008. Some of these commenters expressly supported principles-based standards, but advocated the standards-setters giving: (1) reasons for any detailed requirements, and (2) examples to illustrate the link between the detailed requirements and the principles. Some commenters also expressly stated that accounting standards should not include anti-abuse provisions.

One academic⁷⁶ highlighted inconsistencies in the Progress Report with respect to the use of “principles-based” and “objectives-based” standards. This academic supported objectives-based standards, not solely principles-based, and believed that standards should take whatever form best allows them to achieve their objectives.

Two commenters⁷⁷ (one user and one preparer) opposed this recommendation, preferring rules over principles, noting that principles add to uncertainty and would be harmful to investors.

Certain commenters also provided specifics as to areas that should be considered in optimal standards. Specifically: (1) one professional organization⁷⁸ stated that a preparer’s ability to comply with a standard should also be considered, (2) one auditor⁷⁹ suggested that standards-setters “bunch” the implementation dates of new standards, to diminish the pace of change and to provide stability in between the implementation dates, (3) one preparer⁸⁰ expressed a need for standards-setters to better understand and include some element of the underlying mathematics in standards that require the use of probability, and (4) one preparer⁸¹ recommended consideration of tax effects, as they are important to the economics of a transaction.

FASB Agenda

In the Progress Report, conceptual approach 2.C considers a re-prioritization of the standards-setting agenda that balances international convergence, improvements to the conceptual framework, and the maintenance of existing GAAP, as well as the addition of a second phase of the codification project to the agenda. Eight commenters addressed

Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Nov 20, 2007), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008); Professional Organizations: American Academy of Actuaries (Mar 13, 2008), Institute of Public Auditors in Germany (Mar 26, 2008), Ohio Society of CPAs (Mar 31, 2008)

⁷⁶ George Washington University (Mar 2, 2008)

⁷⁷ User: Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008); Preparer: Equipment Leasing and Finance Association (Oct 10, 2007)

⁷⁸ Institute of Public Auditors in Germany (Jun 16, 2008)

⁷⁹ BDO Seidman, LLP (Oct 1, 2007)

⁸⁰ Occidental Petroleum (Jul 28, 2007)

⁸¹ Equipment Leasing and Finance Association (Oct 10, 2007)

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this area in their comment letters. Six commenters⁸² (two users, three auditors, and one other) generally agreed on aspects of this conceptual approach, such as prioritization of convergence, the conceptual framework, and the second phase of the codification project; however, one auditor⁸³ cautioned that while U.S. GAAP should be revisited after codification with the intent of simplification, changes should not be made to U.S. GAAP where there is no identified problem, as change itself causes complexity.

Four commenters proposed additional areas that should be prioritized. Three of these commenters⁸⁴ (one user and two auditors) recommended acceleration of the FASB / IASB joint financial statement presentation project. One of these auditors⁸⁵ also suggested that the FASB identify the five to ten areas with the most avoidable complexity in GAAP (such as requirements to track APIC pools in accounting for tax effects on share-based payments), and undertake short-term projects to fix these areas, even if the FASB is working on a longer-term project in that area. One user⁸⁶ suggested that the standards-setter should finally conclude on consolidation, lease, pension, and option accounting. As discussed further in section IV.A of this memorandum, some commenters also emphasized the need to complete measurement and disclosure frameworks.

C. Audit Process and Compliance

Materiality

In the Progress Report, developed proposal 3.1 proposed steps to take with respect to the definition of materiality. Developed proposal 3.3 addressed materiality in the context of interim periods. Twenty-four commenters addressed this area in their comment letters. Fourteen commenters⁸⁷ (four preparers, seven auditors, and three professional organizations) generally agreed with the Committee's direction, focusing on the need for additional guidance, emphasis on the perspective of a reasonable investor, and consideration of the total mix of information. Some of these commenters also expressly

⁸² User: CFA Institute (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Other: Paul H. Rosenfield (Mar 25, 2008)

⁸³ BDO Seidman, LLP (Mar 31, 2008)

⁸⁴ User: Fitch Ratings, Inc. (Apr 2, 2008); Auditors: Center for Audit Quality (Nov 20, 2007), Center for Audit Quality (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

⁸⁵ Center for Audit Quality (Nov 20, 2007),

⁸⁶ Gilbert F. Viets (Mar 11, 2008)

⁸⁷ Preparers: Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008), Robert F. Richter (Mar 31, 2008), Wilson Sonsini Goodrich & Rosati (Mar 13, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 13, 2008), Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), Jim Ingraham (Jun 4, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Ad Hoc Materiality Task Force (Feb 13, 2008), Bar Association of the City of New York (Apr 18, 2008), Ohio Society of CPAs (Mar 31, 2008)

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supported the view that qualitative factors may decrease the importance of a quantitatively significant error to the reasonable investor. Some commenters requested additional guidance as to the definition of a “reasonable investor” and examples of qualitative factors. In addition, some commenters believed that materiality guidance is best issued by the FASB, possibly as part of the conceptual framework.

Eight commenters⁸⁸ (seven users and one professional organization) opposed this developed proposal, generally favoring the current approach, questioning the use of a sliding scale, or opposing a “qualitative override” of a quantitatively large error. One user “emphatically oppose[s] having anyone other than investors determine whether quantitatively significant errors provide relevant information to investors.” Another user⁸⁹ expressed

The Council generally does not support the Committee’s proposal to modify “the assessment of the materiality of errors to financial statements...” We believe that investors are best served by the existing qualitative approach to assessing materiality and that the Committee has failed to provide a sufficient basis for modifying that approach.

The Committee’s proposal appears to be premised on the view that there is a growing number of unnecessary restatements and that one of the chief causes of those restatements is “an overly broad application of the concept of materiality...” We are not convinced that that premise is accurate...

...materiality does not appear to be a chief cause of restatements.

One academic⁹⁰ observed that while research suggests that qualitative factors may lead to a conclusion that a quantitatively small error is material (e.g., research shows that: (1) intent to deceive is an important factor for investors and (2) restatements of revenue and on-going operating expense accounts elicit more negative market reactions and litigation, than non-operating expenses, one-time or special items, or the reclassification of financial statement items), there is too little empirical research to reliably conclude whether a quantitatively large error could be immaterial for qualitative reasons.

⁸⁸ Users: AFL-CIO (Feb 10, 2008), AFL-CIO (Jun 23, 2008), CalPERS (Mar 13, 2008), The Capital Group Companies (Mar 13, 2008), CFA Institute (Mar 31, 2008), Council of Institutional Investors (Mar 31, 2008), Consumer Federation of America (Jan 16, 2008), Consumer Federation of America (Apr 14, 2008), Investors Technical Advisory Committee (Dec 13, 2007); Professional Organization: Institute of Public Auditors in Germany (Mar 26, 2008)

⁸⁹ Council of Institutional Investors (Mar 31, 2008)

⁹⁰ American Accounting Association (Apr 30, 2008)

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Six commenters⁹¹ (two users, three auditors, and one professional organization) supported the Committee’s developed proposal as it related to education sessions, although some believed education sessions should include investors, securities counsel, and other financial statement users.

With respect to interim considerations, six commenters⁹² (one user, four auditors, and one professional organization) agreed that interim periods should not be viewed as discrete periods, while two users⁹³ disagreed. One academic noted that “research suggests that market reaction does not differ for restatements involving interim-only financial statements compared to annual statements.”⁹⁴

One professional organization⁹⁵ noted and approved of the deletion of the term “sliding scale” in subcommittee III’s May 2, 2008 update report.

Correction of Errors

In the Progress Report, developed proposal 3.2 proposed steps to take with respect to the correction of an error. Developed proposal 3.3 addressed error correction in the context of interim periods. Twenty-four commenters addressed this area in their letters.

Thirteen commenters⁹⁶ (one user, three preparers, seven auditors, and two professional organizations) generally agreed with aspects of this developed proposal, particularly the need for additional guidance and the view that not all errors should result in restatements. Two auditors⁹⁷ expressly agreed with the “current investor” standard. One preparer⁹⁸ stated

If the threshold for when a restatement is required is too low, investors and the public interest are not being served...Not all restatements are created

⁹¹ Users: CalPERS (Mar 13, 2008), CFA Institute (Mar 31, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), Jim Ingraham (Jun 4, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Institute of Public Auditors in Germany (Mar 26, 2008)

⁹² User: CalPERS (Mar 13, 2008); Auditors: Center for Audit Quality (Mar 13, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Ad Hoc Materiality Task Force (Feb 13, 2008)

⁹³ CFA Institute (Mar 31, 2008), Investors Technical Advisory Committee (Dec 13, 2007)

⁹⁴ American Accounting Association (Apr 30, 2008)

⁹⁵ Institute of Public Auditors in Germany (Jun 16, 2008)

⁹⁶ User: CalPERS (Mar 13, 2008); Preparers: Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008), Latham and Watkins LLP (Mar 12, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 13, 2008), Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), Jim Ingraham (Jun 4, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organizations: Ad Hoc Materiality Task Force (Feb 13, 2008), Bar Association of the City of New York (Apr 18, 2008)

⁹⁷ Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008)

⁹⁸ Latham and Watkins LLP (Mar 12, 2008)

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equal...Restatements are expensive in terms of time, effort, diversion of management resources, expenses, litigation, and capital formation.

On the other hand, seven users⁹⁹ generally opposed the developed proposal. One user¹⁰⁰ stated, “The recent increase in restatements indicates to me that managers and auditors indeed have become more careful as a result of the Sarbanes-Oxley reforms.” Another user¹⁰¹ stated

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

Thirteen commenters¹⁰² (four users, four preparers, four auditors, and one professional organization) agreed that error corrections required better disclosure, especially during the dark period. Four commenters¹⁰³ (two preparers, one auditor, and one professional organization) recommended guidance regarding legal concerns and liability for disclosures during the dark period, such as a safe harbor for forward looking data.

Four commenters¹⁰⁴ (one preparer and three auditors) requested clarification regarding the application of the “dual method” under SAB 108 and suggested that the Committee request the SEC staff to amend SAB 108 so that the “iron curtain” method of quantifying errors is only applied to previously unissued financial statements.

⁹⁹ AFL-CIO (Jun 23, 2008), Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008), The Capital Group Companies (Mar 13, 2008), CFA Institute (Mar 31, 2008), Consumer Federation of America (Jan 16, 2008), Consumer Federation of America (Apr 14, 2008), Fitch Ratings, Inc. (Apr 2, 2008), Investors Technical Advisory Committee (Dec 13, 2007)

¹⁰⁰ Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008)

¹⁰¹ Investors Technical Advisory Committee (Dec 13, 2007)

¹⁰² Users: Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008), CalPERS (Mar 13, 2008), CFA Institute (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008); Preparers: Financial Executives International (Apr 4, 2008), Institute of Management Accountants (Dec 6, 2007), Institute of Management Accountants (Feb 4, 2008), Latham and Watkins LLP (Mar 12, 2008), Wilson Sonsini Goodrich & Rosati (Mar 13, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 13, 2008), Center for Audit Quality (Mar 31, 2008), Jim Ingraham (Jun 4, 2008), KPMG LLP (Mar 31, 2008); Professional Organization: Bar Association of the City of New York (Apr 18, 2008)

¹⁰³ Preparers: Financial Executives International (Apr 4, 2008), Wilson Sonsini Goodrich & Rosati (Mar 13, 2008); Auditor: KPMG LLP (Mar 31, 2008); Professional Organization: Bar Association of the City of New York (Apr 18, 2008)

¹⁰⁴ Preparer: Latham and Watkins LLP (Mar 12, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

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Five commenters¹⁰⁵ (one preparer, three auditors, and one professional organization) requested guidance or provided potential guidance regarding the correction of out-of-period errors, with two commenters suggesting that out-of-period errors that do not result in restatements be corrected through equity.

Professional Judgment

In the Progress Report, developed proposal 3.4 proposed that the SEC adopt a judgment framework for accounting judgments, with the PCAOB similarly adopting one for auditing judgments. Thirty-seven commenters addressed this area in their letters. Twenty-two commenters¹⁰⁶ (three users, nine preparers, seven auditors, and three professional organizations) generally supported the development of a professional judgment framework, noting that it will become more important with the shift to principles and fair value. One auditor¹⁰⁷ countered opponents by expressing

[W]e are aware that some investors are critical of the professional judgment framework. Specifically, these investors are concerned that the framework would foster an environment that could lead to lower quality financial statements, and possibly more fraud. We do not agree with these concerns. CIFIIR's professional judgment framework would increase the quality of financial statements because it should promote that professional judgments are reasonable, exercised in good faith and well-documented at the time the judgment is made. In fact, the framework would provide additional clarity around many of the judgments that already occur in today's environment.

Several commenters also stressed that the framework should not be a “check the box” or rules-based approach; should be coupled with additional disclosures of critical accounting policies, estimates, and the role professional judgment plays; should include consideration of concepts such as risk and materiality; and should be embedded into training such as accounting degrees, CPA exams, and continuing professional education; and should not limit auditors and regulators ability to ask appropriate questions. Finally,

¹⁰⁵ Preparer: Latham and Watkins LLP (Mar 12, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organization: Ad Hoc Materiality Task Force (Feb 13, 2008)

¹⁰⁶ Users: Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008), CalPERS (Mar 13, 2008), CFA Institute (Mar 31, 2008); Preparers: Cisco Systems (Mar 13, 2008), Financial Executives International (Apr 4, 2008), Financial Reporting Advisors, LLC (Mar 13, 2008), FirstEnergy Corp. (Mar 31, 2008), Institute of Management Accountants (Oct 3, 2007), Latham and Watkins LLP (Mar 12, 2008), Medtronic, Inc. (Mar 31, 2008), John R. Roberts (Mar 25, 2008), UBS AG (Mar 31, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), Jim Ingraham (Jun 4, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organizations: Bar Association of the City of New York (Apr 18, 2008), Institute of Public Auditors in Germany (Mar 26, 2008), Ohio Society of CPAs (Mar 31, 2008)

¹⁰⁷ Deloitte & Touche LLP (Mar 31, 2008)

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three auditors¹⁰⁸ also emphasized that the SEC and PCAOB professional judgment frameworks be developed concurrently.

Five users¹⁰⁹ questioned the need for a professional judgment framework or believed that better disclosure would be more beneficial. One user¹¹⁰ stated

It is unclear to us what a professional judgment framework would change with respect to the circumstance where there may have been a material error in a financial statement. If the numbers in question are within the scope of a principle, neither the company nor its auditor have any reason to be concerned under the current approach. If the numbers in question are outside the scope of a principle, or violate a rule, it should not matter what level of professional judgment was involved – an error is an error, and it should be corrected.

One academic¹¹¹ stated that the professional judgment framework neglects that

when preparers and auditors face judgments where there is a range of acceptable conclusions[,] their judgments tend to be biased in favor of their economic self-interest. These economic forces will continue to exist even in the presence of a well-designed judgment framework.

With respect to whether a professional judgment framework would provide a safe harbor from litigation or restatement, four preparers¹¹² favored a safe harbor in some form, whereas nine commenters¹¹³ (eight users and one preparer) opposed a safe harbor. One user¹¹⁴ opposing a safe harbor stated

The problem starts with the underlying assumptions the committee brings to this project: that the threat of litigation and enforcement over financial statement errors leads to poorer quality financial reporting, that more principles-based regulation will

¹⁰⁸ Center for Audit Quality (Mar 31, 2008), Deloitte & Touche LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008)

¹⁰⁹ AFL-CIO (Feb 10, 2008), Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008), Consumer Federation of America (Jan 16, 2008), Fitch Ratings, Inc. (Apr 2, 2008), Investors Technical Advisory Committee (Dec 13, 2007)

¹¹⁰ AFL-CIO (Feb 10, 2008)

¹¹¹ American Accounting Association (Apr 30, 2008)

¹¹² Financial Executives International (Apr 4, 2008), Financial Reporting Advisors, LLC (Mar 13, 2008), Institute of Management Accountants (Oct 3, 2007), Institute of Management Accountants (Jan 4, 2008), UBS AG (Mar 31, 2008)

¹¹³ Users: AFL-CIO (Feb 10, 2008), Bernstein Litowitz Berger & Grossmann LLP (Mar 10, 2008), CalPERS (Mar 13, 2008), Consumer Federation of America (Apr 14, 2008), Consumer Federation of America (Jan 16, 2008), Council of Institutional Investors (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008), Investors Technical Advisory Committee (Dec 13, 2007), Gilbert F. Viets (Mar 11, 2008); Preparer: Latham and Watkins LLP (Mar 12, 2008)

¹¹⁴ Consumer Federation of America (Jan 16, 2008)

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result in higher quality reports, and that less is more when it comes to financial restatements...

...We have no doubt...that were this approach adopted, the next generation of Fastows would be shameless in claiming this safe harbor as a shield. That would make the job of regulators all the more difficult and the chances of remuneration for defrauded investors even more remote.

In another letter, this user believed

...the clearly stated intent of the Committee is that reliance on its proposed professional judgment framework would result in some greater deference on the part of regulators and others for judgments made according to that framework. That, and not the legal form of any such policy, is the basis for our opposition...

...Investors want issuers and auditors to take very seriously their responsibility to get the numbers right. Sending the message that sound process excuses bad results is not the way to achieve that...In short, unless the professional judgment framework is completely divorced from any suggestion that reliance on the framework protects issuers and auditors from being second-guessed, we will continue to oppose it on the grounds that it is not in the investors' best interests.

One professional organization¹¹⁵ noted in subcommittee III's May 2, 2008 update report plans to move away from recommending issuance of a framework to recommending issuance of a policy statement. This commenter stated

...[W]e do not share the Subcommittee's view that a framework would necessarily cause preparers to adopt a checklist mentality. Likewise, we fail to appreciate how a framework...could potentially be 'used as a shield to protect unreasonable judgments.' On the contrary, if carefully thought through, we contend that such a framework would result in consideration benefits – ultimately for investors.

D. Delivering Financial Information

Tagging of Financial Information (XBRL)

In the Progress Report, developed proposal 4.1 recommended that the SEC should, over the long-term, mandate the filing of XBRL-tagged financial statements, on a phased-in basis. The Committee received twenty-four comment letters addressing aspects of this developed proposal.

¹¹⁵ Institute of Public Auditors in Germany (Jun 16, 2008)

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Commenters held a variety of views regarding the timing of XBRL adoption. Two commenters¹¹⁶ (one user and one information provider) advocated that the SEC move faster than proposed. One preparer¹¹⁷ disagreed with a phased-in approach, as it would hinder comparisons across companies. Eleven commenters¹¹⁸ (four preparers, five auditors, and two professional organizations) supported a phased-in approach in some form, with delays to ensure sufficient: (1) transition time, particularly for smaller companies, (2) understanding of costs, (3) clarity regarding assurance and liability issues, and (4) technical foundations (e.g., successful taxonomy testing, sufficient preparer guidance, altering EDGAR) are in place. One academic¹¹⁹ asserted that education issues may also pose problems, as surveys indicate the majority of CEO's and CFO's feel unprepared to adopt XBRL in the near-term, anecdotal evidence indicates faculty lack familiarity with XBRL and generally do not cover it in their classes, and research indicates that users are unlikely to use the technology without sufficient education.

Commenters similarly held a variety of views regarding the timing as to when XBRL assurance should be mandated. Three commenters¹²⁰ (one auditor, one information provider, and one professional organization) emphasized the improved quality of audited XBRL data or questioned concerns about costs, suggesting that they were in favor of near-term assurance, although they did not provide a specific timetable. Eight commenters¹²¹ (three preparers, four auditors, and one professional organization) opposed assurance during the phase-in period. Other recurring themes in this area include:

- Five¹²² (one preparer and four auditors) questioned the form / extent of XBRL assurance. One professional organization¹²³ even recommending assurance over the effectiveness of the XBRL reporting process itself.
- Two auditors¹²⁴ expressed concerns regarding liability issues associated with auditor expectations gaps, as auditors currently express an opinion on the financial statements

¹¹⁶ User: CFA Institute (Mar 31, 2008); Information Provider: EDGAR Online, Inc. (Feb 7, 2008)

¹¹⁷ Medtronic (Mar 31, 2008)

¹¹⁸ Preparers: ADVENTRX Pharmaceuticals, Inc. (Mar 14, 2008), Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008), Wilson Sonsini Goodrich & Rosati (Mar 13, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Professional Organizations: Bar Association of the City of New York (Apr 18, 2008), Ohio Society of CPAs (Mar 31, 2008)

¹¹⁹ American Accounting Association (Apr 30, 2008)

¹²⁰ Auditor: PricewaterhouseCoopers LLP (Mar 31, 2008); Information Provider: EDGAR Online, Inc. (Feb 7, 2008); Professional Organization: Institute of Public Auditors in Germany (Mar 26, 2008)

¹²¹ Preparers: Financial Executives International (Apr 4, 2008), Medtronic, Inc. (Mar 31, 2008), Wilson Sonsini Goodrich & Rosati (Mar 13, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008); Professional Organization: Ohio Society of CPAs (Mar 31, 2008)

¹²² Preparer: Medtronic, Inc. (Mar 31, 2008); Auditors: Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

¹²³ Institute of Public Auditors in Germany (Mar 26, 2008)

¹²⁴ Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008)

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“taken as a whole” and not on individual elements of those financial statements. As such, “assurance on XBRL-tagged information could be misinterpreted by investors or the courts as providing assurance...as to accuracy and completeness of each tagged item.”¹²⁵ One academic¹²⁶ pointed out another expectations gap, noting research that indicates “users tend to blend audited and unaudited information, when the two are linked via the internet. Thus, users expectations related to assurance may run counter to the proposal to furnish them without assurance.”

- Three auditors¹²⁷ also recommended that the SEC monitor error rates during the phase-in period in order to assess the reliability of XBRL submissions without independent assurance.

Seven commenters discussed preparer costs and benefits of adopting XBRL. One information provider¹²⁸ noted that its automated approach required approximately 10 hours in the first year, with declines thereafter. One preparer¹²⁹ estimated that the bolt on approach would take between 80 to 100 hours. Another preparer¹³⁰ estimated costs of \$30,000 to \$50,000 in the first year, with possible declines thereafter. Two auditors¹³¹ asserted that XBRL costs are not expected to compare to costs of implementing section 404 of the Sarbanes-Oxley Act. Two preparers¹³² did not anticipate any improvements in the time or costs of internal preparer processes, particularly under the bolt on approach. However, one preparer¹³³ observed that XBRL adoption could result in better accuracy of financial information held by data providers and users, easier access to information, and increased analyst coverage.

Five commenters¹³⁴ (two users and three auditors) advised the Committee to move beyond the block tagging of financial statement footnotes, as block tags limit the usefulness of XBRL. Commenters varied as to when tagging at a more granular level should be required. One preparer¹³⁵ noted that granular tagging of notes would be more labor intensive than estimates discussed above.

¹²⁵ Center for Audit Quality (Mar 31, 2008)

¹²⁶ American Accounting Association (Apr 30, 2008)

¹²⁷ BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008)

¹²⁸ EDGAR Online, Inc. (Feb 7, 2008)

¹²⁹ Medtronic, Inc. (Mar 31, 2008)

¹³⁰ ADVENTRX Pharmaceuticals, Inc. (Mar 14, 2008)

¹³¹ Center for Audit Quality (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008)

¹³² Financial Executives International (Apr 4, 2008), Medtronic, Inc. (Mar 31, 2008)

¹³³ ADVENTRX Pharmaceuticals, Inc. (Mar 14, 2008)

¹³⁴ Users: CFA Institute (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008)

¹³⁵ Medtronic, Inc. (Mar 31, 2008)

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Improved Corporate Website Use

In the Progress Report, developed proposal 4.2 recommended that: (1) the SEC issue a new interpretative release regarding the use of corporate websites for disclosures of corporate information, and (2) industry participants coordinate amongst themselves to develop uniform best practices in this area. Thirteen commenters expressed views in this area, with ten¹³⁶ (two users, two preparers, five auditors, and one standards-setter) of them supporting the developed proposal, particularly as it relates to the provision of SEC guidance on legal liability. One preparer¹³⁷ qualified its response by stating that while it supported the increased use of corporate websites and SEC guidance, to the extent that it improves consistency and clarity, it hesitated to support additional guidance, out of concern that guidance may become too prescriptive to allow for communication of information in a way that is most meaningful to an individual company's stakeholders. One auditor¹³⁸ supported this developed proposal, "provided that auditor assurance is not recommended over website disclosures outside the content of a full set of financial statements."

Three commenters¹³⁹ (two information providers and one professional organization) opposed this developed proposal. Both information providers supported simultaneous disclosures, such as those provided using their services, over the use of corporate websites, as web postings are "incapable of ensuring simultaneous, real-time disclosure"¹⁴⁰ and "would put the advantage back on the side of those investors who have the resources to scour the web for new postings to company websites."¹⁴¹ The professional organization¹⁴² asserted that the SEC has adequate guidance on this subject and the Committee need not address it.

Use of Executive Summaries in Exchange Act Periodic Reports

In the Progress Report, the Committee identified a future consideration related to "a requirement to include an executive summary in reporting company annual and quarterly Exchange Act reports (Forms 10-K and 10-Q)" (page 82). One information provider¹⁴³ opposed this consideration in favor of "full-text distribution [which] enables investors to

¹³⁶ Users: CFA Institute (Mar 31, 2008), Fitch Ratings, Inc. (Apr 2, 2008); Preparers: Financial Executives International (Apr 4, 2008), FirstEnergy Corp. (Mar 31, 2008); Auditors: BDO Seidman, LLP (Mar 31, 2008), Center for Audit Quality (Mar 31, 2008), Ernst & Young LLP (Mar 31, 2008), KPMG LLP (Mar 31, 2008), PricewaterhouseCoopers LLP (Mar 31, 2008); Standards-Setter: Enhanced Business Reporting Consortium (Mar 31, 2008)

¹³⁷ FirstEnergy Corp. (Mar 31, 2008)

¹³⁸ PricewaterhouseCoopers LLP (Mar 31, 2008)

¹³⁹ Information Providers: Business Wire (Feb 4, 2008), PR Newswire (Sep 21, 2007); Professional Organization: Bar Association of the City of New York (Apr 18, 2008)

¹⁴⁰ Business Wire (Feb 4, 2008)

¹⁴¹ PR Newswire (Sep 21, 2007)

¹⁴² Bar Association of the City of New York (Apr 18, 2008)

¹⁴³ Business Wire (Sep 20, 2007)

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self-select data based on their own individual needs,” noting that a “journalistic summary preamble to financial statements is inherently too restrictive to bring any real added-value to current disclosure practices...” A professional organization¹⁴⁴ believed that if executive summaries were mandated, then other financial disclosure requirements should be reduced to avoid redundancies and even lengthier disclosure documents.

Disclosures of KPIs and Other Metrics to Enhance Business Reporting

In the Progress Report, the Committee identified a future consideration related to KPIs, stating that it would explore: (1) ways to encourage industry-specific KPI disclosure, (2) who should develop standards for measuring KPIs, (3) whether XBRL should be extended to include KPIs, and (4) the interplay between the use of non-GAAP measures and KPIs. Two commenters discussed this future consideration in their letters. One standards-setter¹⁴⁵ generally agreed with the Committee’s direction, but emphasized that: (1) KPI disclosure should be voluntary, in light of the large amounts of complex information already required to be reported, and (2) while standards need to be industry-specific, companies should be able to report using a different standard. This standards-setter also provided statistics from a survey of over 475 participants, indicating that:

1. 74% of the respondents believe that companies should disclose key performance indicators, intangibles, value drivers, [and] intellectual assets in addition to financial statements and notes.
2. 74% respondents believe that standardization of key performance indicators, intangibles, value drivers, [and] intellectual assets should be pursued within industry sectors to facilitate comparability.
3. 51% believe that standardization should be done by industry groups comprised of companies, industry analysts and investors[.]

This survey also indicated 73% believe that if these metrics are reported, they should be audited. Of those who did not believe that these metrics should be disclosed, 64% cited competitive disadvantage as the basis for their view.

One professional organization¹⁴⁶ stated that mandatory KPI disclosure should only be considered after careful consideration of liability and competitive harm issues. This commenter was also against a mandated, uniform compendium of KPIs, in part because it would impose a “one size fits all” approach in an area that is registrant-specific. Further, this commenter believed that XBRL extensions for KPIs would complicate the attestation issues raised by the Committee.

¹⁴⁴ Bar Association of the City of New York (Apr 18, 2008)

¹⁴⁵ Enhanced Business Reporting Consortium (Oct 24, 2007), Enhanced Business Reporting Consortium (Mar 31, 2008), Enhanced Business Reporting Consortium (Jun 19, 2008)

¹⁴⁶ Bar Association of the City of New York (Apr 18, 2008)

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Improved Quarterly Press Release Disclosures and Timing

In the Progress Report, the Committee identified a future consideration related to a number of possible improvements related to quarterly press release disclosures and their timing. With respect to timing, the Committee stated that it

...will evaluate 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. (page 84)

Two commenters¹⁴⁷ (one information provider and one professional organization) opposed the synchronization of the issuance of the quarterly press releases and Form 10-Q. Both expressed concern that investors would be adversely impacted due to the delay of information provided to investors. The professional organization¹⁴⁸ further stated that if the issuance dates were synchronized, then “the rules regarding periodic reporting should be streamlined to enable earlier filing of periodic reports.” This commenter also noted that such a mandate would not be practical in the context of the fourth quarter press release and the filing of an annual report, given the time required to complete the annual audit.

Continued Need for Improvements in the MD&A and Other Public Company Financial Disclosures

In the Progress Report, the Committee identified a future consideration related to the continued need for improvements in the MD&A and other public company financial disclosures. One standards-setter¹⁴⁹ indicated that improvements to MD&A should include a “market driven development of a voluntary, best practices framework covering generally accepted disclosure guidelines for information about opportunities, risks, strategies and plans, and about the quality, sustainability and variability of cash flows and earnings.” One professional organization¹⁵⁰ stated that the Committee should not focus on comprehensive review or modification of MD&A, but encouraged periodic preparation of the SEC’s Fortune 500 report on common types of comments issued on the MD&A.

E. Miscellaneous

The Committee also received miscellaneous comments related to a number of other areas. For example, commenters expressed the need for:

¹⁴⁷ Information Provider: Business Wire (Feb 4, 2008); Professional Organization: Bar Association of the City of New York (Apr 18, 2008)

¹⁴⁸ Bar Association of the City of New York (Apr 18, 2008)

¹⁴⁹ Enhanced Business Reporting Consortium (Mar 31, 2008)

¹⁵⁰ Bar Association of the City of New York (Apr 18, 2008)

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- Cultural change
- Regulators to shift their emphasis from accounting to emerging financial trends and transactions based on “the supposed creativity of investment bankers, hedge funds, short sellers and speculators (who remain largely unregulated, if at all)”¹⁵¹
- Tort reform
- A reduction in bond-rating agencies’ conflicts of interest
- Improved audit firm independence by eliminating audit firm dependence on clients and lobbying
- A requirement for companies to obtain independent grades of how conservative their accounting policies are
- Defining the objective of financial reporting as being stewardship and not decision-making.
- Amendment of accounting standards such as SFAS No. 109, *Accounting for Income Taxes*, SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

¹⁵¹ John R. Roberts (Mar 25, 2008)

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LIST OF COMMENTERS

Note that in the Areas of Comment column, the following definitions have been used:

- 1 - substantive complexity
- 2 - standards-setting process
- 3 - audit process and compliance
- 4 - delivering financial information

I. Users

This constituency includes investors and other users, investor groups, investor protection agencies, and attorneys representing users.

Commenter	Subcategory	Date	Weblink	Areas of Comment
AFL-CIO	Institutional investor / analyst / pension fund	Feb 10, 2008	http://www.sec.gov/comments/265-24/26524-40.pdf	1, 2, 3
AFL-CIO	Institutional investor / analyst / pension fund	Jun 23, 2008	http://www.sec.gov/comments/265-24/26524-95.pdf	1, 3
Bernstein Litowitz Berger & Grossmann LLP	Law firm	Mar 10, 2008	http://www.sec.gov/comments/265-24/26524-54.pdf	2, 3
CalPERS	Institutional investor / analyst / pension fund	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-50.pdf	3
The Capital Group Companies	Institutional investor / analyst / pension fund	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-51.pdf	3
Chris Carvalho	Individual	Aug 23, 2007	http://www.sec.gov/comments/265-24/26524-3.htm	-
CFA Institute	Institutional investor / analyst / pension fund	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-68.pdf	1, 2, 3, 4
Consumer Federation of America	Association	Jan 16, 2008	http://www.sec.gov/comments/265-24/26524-87.pdf	2, 3
Consumer Federation of America	Association	Apr 14, 2008	http://www.sec.gov/comments/265-24/26524-84.pdf	3
Council of Institutional Investors	Institutional investor / analyst / pension fund	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-79.pdf	2, 3
Fitch Ratings, Inc.	Credit rating agency	Apr 2, 2008	http://www.sec.gov/comments/265-24/26524-82.pdf	1, 2, 3, 4
Investment Company Institute	Institutional investor / analyst / pension fund	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-71.pdf	1
Investors Technical Advisory Committee	Institutional investor / analyst / pension fund	Oct 11, 2007	http://www.sec.gov/comments/265-24/26524-17.pdf	-
Investors Technical Advisory Committee	Institutional investor / analyst / pension fund	Dec 13, 2007	http://www.sec.gov/comments/265-24/26524-27.pdf	3
Richard Solomon	Individual	Jun 26, 2008	http://www.sec.gov/comments/265-24/26524-96.htm	1
Gilbert F. Viets	Individual	Mar 11, 2008	http://www.sec.gov/comments/265-24/26524-49.htm	1, 2

II. Preparers

This constituency includes preparers, preparer-related professional organizations, and advisors to preparers.

Commenter	Subcategory	Date	Weblink	Areas of Comment
ADVENTRX Pharmaceuticals, Inc.	Corporation	Mar 14, 2008	http://www.sec.gov/comments/265-24/26524-56.pdf	4
BeaconAdvisors	Consultant and other	Aug 1, 2007	http://www.sec.gov/comments/265-24/26524-1.htm	-
Cisco Systems	Corporation	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-53.pdf	3
Edison Electric Institute	Corporation	Mar 28, 2008	http://www.sec.gov/comments/265-24/26524-64.pdf	1
Equipment Leasing and Finance Association	Association	Oct 10, 2007	http://www.sec.gov/comments/265-24/26524-18.pdf	2
Financial Executives International	Association	Sep 26, 2007	http://www.sec.gov/comments/265-24/26524-9.pdf	-
Financial Executives International	Association	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-70.pdf	2, 4
Financial Executives International	Association	Apr 4, 2008	http://www.sec.gov/comments/265-24/26524-81.pdf	1, 2, 3, 4
Financial Reporting Advisors, LLC	Consultant and other	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-59.pdf	3
Financial Security Assurance	Corporation	Jul 17, 2007	http://www.sec.gov/comments/265-24/26524-23.pdf	-
FirstEnergy Corp.	Corporation	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-65.pdf	1, 2, 3, 4
Group of North American Insurance Enterprises	Association	May 19, 2008	http://www.sec.gov/comments/265-24/26524-90.pdf	1
Institute of Management Accountants	Association	Oct 3, 2007	http://www.sec.gov/comments/265-24/26524-15.pdf	1, 2, 3
Institute of Management Accountants	Association	Dec 6, 2007	http://www.sec.gov/comments/265-24/26524-42.pdf	3
Institute of Management Accountants	Association	Jan 4, 2008	http://www.sec.gov/comments/265-24/26524-29.pdf	3
Institute of Management Accountants	Association	Feb 4, 2008	http://www.sec.gov/comments/265-24/26524-41.pdf	3
Latham and Watkins LLP	Law firm	Mar 12, 2008	http://www.sec.gov/comments/265-24/26524-57.pdf	3
Medtronic, Inc.	Corporation	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-74.pdf	2, 3, 4
Occidental Petroleum	Corporation	Jul 28, 2007	http://www.sec.gov/comments/265-24/26524-4.htm	1, 2
Prime Income Asset Management	Corporation	Jun 17, 2008	http://www.sec.gov/comments/265-24/26524-93.htm	1
Robert F. Richter	Consultant and other	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-77.pdf	3
John R. Roberts	Individual	Mar 25, 2008	http://www.sec.gov/comments/265-24/26524-83.pdf	1, 2, 3, 4
U.S. Chamber of Commerce	Association	Sep 26, 2007	http://www.sec.gov/comments/265-24/26524-11.pdf	-
UBS AG	Corporation	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-73.pdf	1, 2, 3
Wilson Sonsini Goodrich & Rosati	Law firm	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-58.pdf	3
Wilson Sonsini Goodrich & Rosati	Law firm	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-60.pdf	4

III. Auditors

This constituency includes auditors and audit-related professional organizations.

Commenter	Subcategory	Date	Weblink	Areas of Comment
BDO Seidman, LLP	Audit firm	Oct 1, 2007	http://www.sec.gov/comments/265-24/26524-12.pdf	1, 2, 3
BDO Seidman, LLP	Audit firm	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-85.pdf	1, 2, 3, 4
Center for Audit Quality	Association	Nov 20, 2007	http://www.sec.gov/comments/265-24/26524-28.pdf	1, 2
Center for Audit Quality	Association	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-50.pdf	3
Center for Audit Quality	Association	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-66.pdf	1, 2, 3, 4
Deloitte & Touche LLP	Audit firm	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-75.pdf	1, 2, 3
Ernst & Young LLP	Audit firm	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-72.pdf	1, 2, 3, 4
Jim Ingraham	Individual	Jun 4, 2008	http://www.sec.gov/comments/265-24/26524-91.htm	3
KPMG LLP	Audit firm	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-76.pdf	1, 2, 3, 4
PricewaterhouseCoopers LLP	Audit firm	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-80.pdf	1, 2, 3, 4

IV. Standards-Setters

This constituency includes standards-setters and related formal and informal advisory groups.

Commenter	Subcategory	Date	Weblink	Areas of Comment
Enhanced Business Reporting Consortium	Association	Oct 24, 2007	http://www.sec.gov/comments/265-24/26524-20.pdf	4
Enhanced Business Reporting Consortium	Association	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-69.pdf	4
Enhanced Business Reporting Consortium	Association	Jun 19, 2008	http://www.sec.gov/comments/265-24/26524-94.htm	4
Financial Accounting Standards Advisory Council	Standards-setter	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-78.pdf	2, 3

V. Regulators

This constituency includes regulators, former regulators, and oversight bodies.

Commenter	Subcategory	Date	Weblink	Areas of Comment
Canadian Public Accountability Board	Regulator	Sep 20, 2007	http://www.sec.gov/comments/265-24/26524-7.pdf	3
Walter P. Schuetze	Individual	Aug 1, 2007	http://www.sec.gov/comments/265-24/26524-7.pdf	1

VI. Academics

This constituency includes academics.

Commenter	Subcategory	Date	Weblink	Areas of Comment
American Accounting Association	Association	Feb 3, 2008	http://www.sec.gov/comments/265-24/26524-33.pdf	2
American Accounting Association	Association	Apr 30, 2008	http://www.sec.gov/comments/265-24/26524-89.pdf	1, 2, 3, 4
Brigham Young University	Academic	Jan 21, 2008	http://www.sec.gov/comments/265-24/26524-37.pdf	2
Dartmouth University, Tuck School of Business	Academic	Nov 2, 2007	http://www.sec.gov/comments/265-24/26524-26.pdf	1
George Washington University	Academic	Mar 2, 2008	http://www.sec.gov/comments/265-24/26524-47.pdf	2
Loma Linda University	Academic	Apr 28, 2008	http://www.sec.gov/comments/265-24/26524-88.pdf	-
Rice University	Academic	Jan 22, 2008	http://www.sec.gov/comments/265-24/26524-32.pdf	2
University of Michigan, Ross School of Business	Academic	Feb 19, 2008	http://www.sec.gov/comments/265-24/26524-46.htm	1, 2
University of Wisconsin	Academic	Feb 4, 2008	http://www.sec.gov/comments/265-24/26524-34.pdf	2, 4

VII. Information Providers

This constituency includes providers of financial information to users and providers of technology to support financial information dissemination.

Commenter	Subcategory	Date	Weblink	Areas of Comment
APCO Worldwide	Consultant and other	Jul 28, 2007	http://www.sec.gov/comments/265-24/26524-21.pdf	-
Business Wire	Corporation	Sep 20, 2007	http://www.sec.gov/comments/265-24/26524-6.htm	4
Business Wire	Corporation	Feb 4, 2008	http://www.sec.gov/comments/265-24/26524-36.pdf	4
EDGAR Online, Inc.	Corporation	Feb 7, 2008	http://www.sec.gov/comments/265-24/26524-39.pdf	4
EQ Metrics	Consultant and other	Sep 25, 2007	http://www.sec.gov/comments/265-24/26524-8.htm	-
EQ Metrics	Consultant and other	Oct 8, 2007	http://www.sec.gov/comments/265-24/26524-16.pdf	-
Generate Inc.	Corporation	Feb 4, 2008	http://www.sec.gov/comments/265-24/26524-35.pdf	4
PR Newswire	Corporation	Sep 21, 2007	http://www.sec.gov/comments/265-24/26524-10.pdf	4
Semansys Technologies	Corporation	Mar 3, 2008	http://www.sec.gov/comments/265-24/26524-48.htm	4
XBRL US, Inc.	Corporation	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-55.pdf	4

VIII. Professional Organizations

This constituency includes accounting and finance professional organizations with broad-based membership, as well as informal professional groups.

Commenter	Subcategory	Date	Weblink	Areas of Comment
Ad Hoc Materiality Task Force	Consultant and other	Feb 13, 2008	http://www.sec.gov/comments/265-24/26524-43.pdf	3
American Academy of Actuaries	Association	Mar 13, 2008	http://www.sec.gov/comments/265-24/26524-61.pdf	2
Association for Financial Professionals	Association	Oct 1, 2007	http://www.sec.gov/comments/265-24/26524-25.pdf	-
Bar Association of the City of New York	Association	Apr 18, 2008	http://www.sec.gov/comments/265-24/26524-86.pdf	2, 3, 4
California Society of CPAs	Association	Jan 11, 2008	http://www.sec.gov/comments/265-24/26524-44.pdf	-
Institute of Chartered Accounts in England and Wales	Association	Jul 18, 2007	http://www.sec.gov/comments/265-24/26524-24.pdf	4
Institute of Public Auditors in Germany	Association	Mar 26, 2008	http://www.sec.gov/comments/265-24/26524-63.pdf	1, 2, 3, 4
Institute of Public Auditors in Germany	Association	Jun 16, 2008	http://www.sec.gov/comments/265-24/26524-92.pdf	1, 2, 3
New York State Society of CPAs	Association	Sep 28, 2007	http://www.sec.gov/comments/265-24/26524-13.pdf	1, 3
Ohio Society of CPAs	Association	Mar 31, 2008	http://www.sec.gov/comments/265-24/26524-67.pdf	1, 2, 3, 4

IX. Other

This constituency includes individuals and those with unknown affiliation.

Commenter	Subcategory	Date	Weblink	Areas of Comment
Don Bjerke	Individual	Jun 15, 2008	http://www.sec.gov/comments/265-24/26524-97.pdf	-
Conmergence	Consultant and other	Aug 14, 2007	http://www.sec.gov/comments/265-24/26524-2.htm	-
David Erwin	Individual	Aug 29, 2007	http://www.sec.gov/comments/265-24/26524-22.pdf	3
John S. Ferguson	Individual	Feb 19, 2008	http://www.sec.gov/comments/265-24/26524-45.pdf	1
National Cooperative Business Association	Association	Oct 3, 2007	http://www.sec.gov/comments/265-24/26524-14.pdf	-
Next Generation Healthcare Solutions, LLC	Corporation	Jan 17, 2008	http://www.sec.gov/comments/265-24/26524-30.pdf	1
Paul H. Rosenfield	Individual	Mar 25, 2008	http://www.sec.gov/comments/265-24/26524-62.pdf	1, 2
Sherman L. Rosenfield	Individual	Oct 13, 2007	http://www.sec.gov/comments/265-24/26524-19.htm	-
James E. Woodward	Individual	Feb 7, 2008	http://www.sec.gov/comments/265-24/26524-38.htm	-

Exhibit D

Index of Written Statements Received

Listed below are the written statements received by the Advisory Committee between its sixth meeting on May 2, 2008 and its seventh meeting on July 11, 2008 and the dates of receipt.

Jul. 3, 2008	Jeff Mahoney, General Counsel, Council of Institutional Investors
Jul. 3, 2008	Joel Jameson, President, Silicon Economics, Inc.
Jun. 26, 2008	Richard Solomon, Self Employed Investor and Manager of Funds, Chappaqua, New York
Jun. 23, 2008	Rudolf Bless and M. Eric Smith, Credit Suisse Group
Jun. 23, 2008	Damon A. Silvers, Associate General Counsel, AFL-CIO
Jun. 19, 2008	Michael P. Krzus, Partner, Grant Thornton LLP and President, The Enhanced Business Reporting Consortium, Chicago, Illinois
Jun. 17, 2008	Roberto Viana, CPA, Director of SEC Reporting, Prime Income Asset Management, Dallas, Texas
Jun. 16, 2008	Klaus-Peter Naumann, Chief Executive Director, and Norbert Breker, Technical Director, Accounting and Auditing, Institut der Wirtschaftsprüfer in Deutschland
Jun. 15, 2008	Don Bjerke
Jun. 4, 2008	Jim Ingraham, Partner, PricewaterhouseCoopers
May 19, 2008	Jerry de St. Paer, Executive Chairman, Group of North American Insurance Enterprises