THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

UNOFFICIAL TRANSCRIPT

OPEN MEETING

MEETING THE COMPETITIVE CHALLENGES OF THE GLOBAL MARKETPLACE

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WE HAVE A GREAT DEAL OF WORK TODAY. TODAY'S MEETING IS GOING TO COVER THREE VITALLY IMPORTANT TOPICS FOR THE FUTURE OF OUR CAPITAL MARKETS.

WE'LL BEGIN WITH RATIONALIZING THE IMPLEMENTATION OF SECTION 404 OF THE SARBANES-OXLEY ACT. WE'LL MOVE ON TO CONSIDERATION OF THE ROLE THAT INTERNATIONAL FINANCIAL REPORTING STANDARDS WILL PLAY IN AMERICA'S FUTURE.

AND FINALLY, WE'LL CONSIDER TWO PROPOSALS TO ADDRESS THE QUESTION OF HOW THE FEDERAL PROXY RULES CAN BE BETTER ALIGNED WITH THE STATE LAW RIGHTS OF SHAREHOLDERS.

THESE TOPICS ARE VERY MUCH RELATED TO ONE ANOTHER.

AS THE WORLD'S CAPITAL MARKETS CONVERGE AND COMPETITION AMONG BOTH MARKETS AND FINANCIAL PRODUCTS BECOMES BROADLY INTERNATIONAL, INVESTORS WILL DEMAND MORE AND MORE DIFFERENT THINGS FROM SECURITIES REGULATION, THAT IS, AFTER ALL, INTENDED TO SERVE THEIR INTERESTS.

THEY'LL WANT TO KNOW THAT THE COSTS OF REGULATION ARE ALIGNED WITH THE BENEFITS IT PRODUCES, WHICH IS WHY WE'RE CONSIDERING A COMPLETELY REWRITTEN AUDIT STANDARD TO IMPLEMENT SOX 404.

THEY'LL DEMAND BETTER COMPARABILITY AMONG FINANCIAL
statements from issuers in America and around the world, which is why we're considering a Concept Release on the relationship between International Financial Reporting Standards and U.S. Generally Accepted Accounting Principles. And shareholders of U.S. companies will insist that their property rights as owners and investors, which include above all else the right to choose the board of directors, be respected by the federal proxy rules.

As was pointed out recently by the Committee on Capital Markets Regulation, shareholders of U.S. companies have fewer rights in a number of important areas than do their foreign competitors, giving foreign firms a competitive advantage.

For that reason, the Committee on Capital Markets Regulation urged the SEC to address and resolve appropriate access by shareholders to the director nomination process. We'll consider two very different approaches to that issue today.

So let's turn to the first item on the agenda, which is rationalizing the implementation of Section 404 of the Sarbanes-Oxley Act of 2002.

The first item consists of two parts; first, approval of the PCAOB's Auditing Standard No. 5, "An Audit of Internal Control Over Financial Reporting that is Integrated with An Audit of Financial Statements," a related
independence rule and conforming amendments. And second, the adoption of a definition of the term "significant deficiency."

Next Monday, July 30th, will mark the five-year anniversary of the Sarbanes-Oxley Act. Section 404 has posed the single biggest challenge to companies under the entire act, without question has imposed the greatest costs, but it has also contributed significantly to more reliable financial information and more reliable financial reporting as companies improve their internal controls to meet Section 404's requirements.

For the past two years, the Commission, the PCAOB and our respective staffs have been hard at work to improve the implementation of Section 404 while maintaining Section 404's benefits and protections to investors.

Over this two-year period we've held two roundtables in 2005 and 2006 to listen to issuers' first- and second-year experiences with the PCAOB Auditing Standard No. 2.

We also issued a Concept Release Concerning Management's Report on Internal Control Over Financial Reporting. We proposed and adopted additional extensions of time for non-accelerated filers, certain foreign private issuers and newly public companies.

We provided the Staff Guidance. We convened the
Advisory Committee on Smaller Public Companies to study, among other things, the impact of Section 404 on smaller companies, and we proposed and adopted guidance for management to follow in conducting their evaluations of internal control over financial reporting.

With respect to the PCAOB and the internal control auditing standard, last fall and winter we worked closely with the PCAOB and its staff as they developed their proposed new internal control auditing standard, and we convened an open meeting of the Commission on April 4th to discuss with our staff their approach to the PCAOB's proposed new standard and the alignment of that standard with our own management guidance.

Along the way we carefully considered all of the public comments that we and the PCAOB received on Section 404 implementation. Many companies and their auditors are now entering their fourth year of reporting on internal control over financial reporting.

Throughout this period, management, auditors, investors and other interested parties have provided ongoing, extensive and enormously helpful feedback to both the Commission and the PCAOB about what has worked well and what could be improved.

On May 24th, the PCAOB voted to replace the auditing standard under SOX 404 that had led to excessive
costs and serious implementation problems. They voted to
replace it with a top-down, risk-based approach focused on
internal controls that are material to a company's financial
statements and scalable for companies of varying size and
complexity.

This new standard, Auditing Standard No. 5, can
take effect only if it is approved as final by the SEC. On
June 12th, the Commission published the new standard for
public comment, and the comments have been overwhelmingly
favorable.

This morning, we consider whether to grant final
approval to Auditing Standard No. 5. As we approach the
five-year anniversary of Sarbanes-Oxley, we can be proud that
confidence in our markets is restored, that compliance costs
are coming down and that today the final approval of the
PCAOB's Auditing Standard No. 5 will make a giant step
forward in facilitating a more effective and efficient
approach to the implementation of Section 404 by refocusing
resources on what truly matters to the integrity of financial
statements.

This is an exceptionally positive step for investors and for
America's capital markets.

Although the new auditing standard and the
Commission's guidance to management should enable
cost-effective compliance with Section 404 for companies of
all sizes, smaller public companies -- as defined by the report of the Advisory Committee on Smaller Public Companies, which is specifically referred to in AS 5 -- should particularly benefit from the scalability built into the PCAOB's new auditing standard and the SEC's interpretive guidance.

In addition, because we deferred Section 404's external audit requirement for the category of smaller companies that are non-accelerated filers until the filing of their 2008 annual reports, management of these smaller companies will have additional time to develop an evaluation approach specific to their facts and circumstances and to coordinate their approach with a cost-effective external audit.

We're confident that Auditing Standard No. 5 will improve effectiveness and efficiency and will reduce inventory compliance costs, and we're committed to ensuring that its implementation is consistent with our expectations.

To that end, we'll analyze real-world information to determine that the costs and benefits of implementing Section 404 are in line with our expectations.

In addition, through our oversight of the PCAOB's inspection program we'll monitor whether audit firms are implementing Audit Standard No. 5 in a manner designed to achieve the intended results of audit efficiency and cost
reduction and whether the PCAOB is inspecting audit firms in
a manner consistent with our expectations.

With a significantly improved audit standard that enables auditors to deliver the most cost-effective audit services, the SEC and the PCAOB expect a change in the behavior of the individuals who are responsible for conducting internal control audits.

I want to once again thank our staffs, in particular the Office of the Chief Accountant, the Division of Corporation Finance and the General Counsel's Office for all of their work. Your tireless efforts over the past year will benefit investors in our capital markets for many years to come.

Specifically from the Office of the Chief Accountant, I'd like to recognize Zoe-Vonna Palmrose, Brian Croteau, Josh Jones, Amy Hargrett, Esmerelia Rodriguez, Jeff Ellis and Kevin Stout.

From the Division of Corporation Finance I'd like to recognize Betsy Murphy and Sean Harrison. And, from the Office of General Counsel, David Frederickson. I'd also like to recognize the work of the PCAOB board and their staff for their efforts.

Finally, I'd like to take this opportunity to express once again the Commission's appreciation to our own Advisory Committee on Smaller Public Companies and the
hundreds of investors, companies, auditors, professional organizations and others who responded to the Commission's and the PCAOB's various requests for comments regarding audits of internal control over financial reporting.

The Commission's efforts in improving Section 404 implementation were considerably aided by their helpful insights and suggestions.

So I'll now recognize John White, Conrad Hewitt and Zoe-Vonna Palmrose for a presentation of the staff's recommendation.

MR. WHITE: Thank you, and good morning. Chairman Cox and members of the Commission, as Chairman Cox has explained, we are here today to recommend that you approve the PCAOB's Auditing Standard No. 5, a related PCAOB independence rule, and conforming amendments to the PCAOB standards. Additionally, we're recommending that the Commission adopt a definition of the term "significant deficiency."

The PCAOB's Auditing Standard No. 5, if approved by the Commission today, will replace the current Auditing Standard No. 2. The Independence Rule 3525 will require auditors to obtain audit committee pre-approval of non-audit services related to internal control over financial reporting. As you may recall, Auditing Standard No. 2 contains a pre-approval requirement, but the PCAOB has
determined that it was more appropriate to include this
requirement in its ethics and independence rules rather than
to continue to include it within its internal control
auditing standard.

In addition, we are recommending that you approve
for the first time a definition of the term "significant
deficiency." We believe it is appropriate to include the
definition of "significant deficiency" within the
Commission's rules given the communications requirements in
the rules implementing Section 404 of Sarbanes-Oxley as well
as the certification requirements of Section 302 of
Sarbanes-Oxley.

Including a definition of "significant deficiency"
in Commission rules in combination with the definition of
"material weakness," which was adopted by the Commission this
past May, will enable management, appropriately and
conveniently, to refer to Commission rules and guidance for
the meanings of these terms rather than referring to auditing
standards, which it does today.

Conrad and Zoe-Vonna will describe the proposed
rule amendment to adopt the definition of "significant
deficiency" and the comment letters received by the
Commission on Auditing Standard No. 5 in more detail in a
moment.

Before we move to that, I wanted to take a moment
to reflect on the journey that we have taken to arrive at
today's recommendations to the Commission, a journey that
started soon after I arrived on the staff just a little over
a year ago.

   Addressing the implementation of SOX 404 has been a
significant priority of the Commission over past several
years. As you know, the Commission and the PCAOB have been
working closely together during this period to improve the
implementation of Section 404.

   Going back to May 10, 2006, many of us were here in
this very auditorium as the Commission and the PCAOB hosted a
roundtable on second-year experiences with Section 404.

   The roundtable was followed one week later with
press releases in which the Commission and the PCAOB each
announced a series of steps they planned to take to improve
the implementation of Section 404.

   In the Commission's press release, it outlined four
actions that it was undertaking to improve the implementation
of Section 404.

   These actions were: One, issuing for the first
time guidance for management in performing its assessment.
Two, working with the PCAOB in revising Audit Standard No. 2.
Third, providing extensions of the compliance deadline for
non-accelerated filers; and 4, providing SEC oversight of the
PCAOB inspection process which was designed last year to
focus on the efficiency of Section 404 implementation.

So I'm happy to say that with its actions today the Commission will have affirmatively acted on three of these four steps by providing extensions to non-accelerated filers at the end of last year, through its approval of interpretive guidance for management this past May, and now today with its consideration of Auditing Standard No. 5 to replace Auditing Standard No. 2.

And that's not to say we haven't been working very diligently on the fourth item, our oversight of the PCAOB inspection process, but I'm going to leave that item to Conrad Hewitt to expand on in a moment.

So since the May 2006 announcements, the PCAOB, in coordination with the SEC staff has been working to provide a new auditing standard, one that makes clear that the auditor's primary focus during an integrated audit is on areas that pose the highest risk of material misstatement to the financial statements and that does not require procedures unnecessary to an effective audit of internal controls.

The PCAOB released its proposed new auditing standard in December of last year. Over 175 Comment Letters were received. In addition, as part of the Commission's process of issuing its interpretive guidance for management, we received over 200 Comment Letters many of which focused on the interplay between our interpretive guidance and the
PCAOB's auditing standard.

As a result of the comments received on both proposals, the Commission held an open meeting on April 4, which you alluded to, to discuss its views on the comments received with respect to the auditing standard.

The Commission directed the staff to focus on four areas when working with the PCAOB staff. The PCAOB and its staff considered the comments received and the Commission's guidance carefully and, as a result, made significant changes from its proposal in December.

So the end result of their hard work is an auditing standard that is shorter, less prescriptive, focused on the areas of highest risk and clearly scalable to fit any company's size and complexity.

Zoe-Vonna will speak in more detail about those changes, but I am very happy to report to you today that the staff of the Commission believes that you have a very much improved auditing standard for your consideration due to the PCAOB's and the Commission's coordinated efforts, and we in the staff are very pleased and very proud to make our recommendation to you here today.

Before I turn it over to Conrad I'd like to acknowledge the cooperative efforts within the SEC staff as well as with the staff of the PCAOB.

Investors in our capital markets deserve and they
are relying on our hard work and our teamwork to improve the
implementation of Section 404, and I believe the public has
been well served by an abundance of each.

Chairman Cox, you've already thanked the many staff
members who have worked on these releases as well as the
PCAOB staff and the PCAOB who have worked with us. I just
want to echo those thanks, and I say that with great
sincerity.

I'm very, very appreciative to everybody who has
worked on this project, now for all the time that I've been
on the Commission staff. With that I'll turn it over to you,
Conrad.

MR. HEWITT: Thank you, John, Chairman Cox and
members of the Commission. The increased focus on companies' internal controls over financial reporting under Section 404 of the Sarbanes-Oxley Act and the Commission rules has led to an improved investors' confidence in our financial markets.

This improved confidence is a result of improved public disclosures related to ICFR. Also, the increased focus on internal controls has helped many companies to establish and maintain more effective internal controls.

However, as you know, these benefits have come with costs that were significantly greater than expected. Of particular concern has been indications of audit and compliance costs for smaller companies.
Concerns for Section 404, of course, are not new. Efforts by the Commission and the PCAOB have been underway for some time to meet the challenge of providing new guidance and revising the prior requirements to better balance the implementation costs with the benefits.

The proposed auditing standard that you are considering today to replace AS 2 is intended to address the specific concerns of smaller public companies by enabling and encouraging auditors to effectively tailor and scale their audits according to the relevant facts and circumstances of each company.

If adopted, the new standard will become effective for audits fiscal years ended on or after November 15, 2007. That's this year. However, it is important to note that early adoption of the new standard would be permitted.

In fact, the staff would encourage early adoption by auditors so that issuers and then investors can begin to benefit from the improvements that have been made relative to the effectiveness and efficiency in the conduct of internal control audits.

Although Zoe-Vonna Palmrose will discuss the comment letters in more detail I want to highlight one additional matter.

Some commenters expressed concern that there was not sufficient incentive for auditors to modify their methods
of performing the audit of internal controls. Therefore, they were concerned that the benefits afforded by AS 5 would not be fully implemented and realized.

These commenters noted that it was important for the PCAOB to adjust its inspection program to align it with the many changes in the new audit standard and to respect the auditor's use of professional judgment in conducting the audit. Now, this has been an area that both the Commission and the PCAOB recognize and continue to focus on.

For example, the inspection process was an area specifically identified in the Commission's and the PCAOB 2006 Announcement of Actions following the Commission's second roundtable on Section 404 implementation.

The PCAOB has incorporated procedures to evaluate the efficiency and effectiveness of ICFR audits in their inspection process.

Further, as directed by the Commission, the staff is examining whether the PCAOB inspection program has been designed to be effective encouraging changes in the conduct of integrated audits to again to improve both efficiency and effectiveness of attestations on ICFR.

The staff recognizes that even with the adoption of a new standard the hard work is not over. Appropriate implementation will be just as important as having an improved auditing standard in place.
If approved, we will work closely with the PCAOB, management, auditors and others to monitor the implementation of this new standard. I believe that it is also important for audit committees to be involved with the implementation to enable the success of Auditing Standard No. 5.

The successful implementation of Auditing Standard No. 5 will depend on several participants in the financial reporting process.

For example, the PCAOB has indicated that it will retrain its inspection team and adjust its inspection program. External auditing firms will need to retrain their staffs and change their audit programs for a more integrated audit.

The management of each company can challenge its own evaluations of internal controls based upon our interpretive guidance. And just as important, audit committees should play a more active and direct role with particular attention to their Management Guidance implementation and the scope of the external auditor's year-end audits on an integrated basis in accordance with Auditing Standard No. 5.

Now, if above are implemented properly, costs should become more in line with the benefits for investors and particularly for smaller, including micro cap, companies.

Lastly, the staff believes it is appropriate for
the Commission to include a definition of a term "significant
deficiency" in the Commission rules.

The staff recommends that you adopt the definition
which the Commission published for additional public comment
in June. As you know, the definition of "significant
deficiency" is used in the context of evaluating the minimum
required communications under both Section 302 and 404 of
SOX.

That is, "A significant deficiency is a deficiency
or a combination of deficiencies in internal control over
financial reporting that is less severe than a material
weakness, yet important enough to merit attention by those
responsible for the oversight of a registrant’s financial
reporting."

We received 22 comment letters on this proposed
definition, and the majority of the commenters expressed
their support for it. In addition, the commenters noted that
a consistent definition of "significant deficiency" in our
Commission rules and the PCAOB standards was important.

The staff believes that the definition
appropriately emphasizes the communication requirements
between management, the audit committee and the independent
auditors on those matters that are important enough to merit
attention.

And the definition will allow management to use its
At this point, I would like to reiterate the chairman's thanks to all the staff who worked tirelessly on our efforts to improve the implementation of Section 404. During this process, we worked closely with the PCAOB. And I would like to add my thanks to the board and staff of the PCAOB. We'd also like to thank the Commissioners and their staffs for all the hours they have worked together with us on this topic, a very important topic, over the past several months providing their input and guidance.

At this time, I'd like to turn it over to my deputy, Zoe-Vonna Palmrose, who will discuss the Comment Letters of AS 5 in more detail. Zoe-Vonna.

MS. PALMROSE: Thank you, Conrad. Let me begin by looking back a few months and reviewing. First, as John mentioned, the PCAOB received 175 letters when it exposed a draft of Auditing Standard No. 5 for public comment in December.

Then, as has been noted, at this year's April 4th open Commission meeting, the Commission and staff discussed the comments received by the PCAOB along with those received by the Commission in connection with its proposed interpretive guidance for management.
At the 404 meeting, the Commission directed us to focus on four areas when working with the PCAOB staff. Those areas were, first, aligning the proposed auditing standard with the Commission's proposed interpretive guidance for management, particularly with regard to prescriptive requirements, definitions and terms.

Two, scaling the audit to account for the particular facts and circumstances of companies, particularly in smaller companies. Three, encouraging auditors to use professional judgment, particularly in using risk assessment. And four, following a principles based approach to determining when and to what extent the auditor can use the work of others.

We're very pleased to be able to report to you today that the PCAOB has addressed each of these areas in addition to the other matters raised by commenters in the version of AS 5 they adopted in May and that you're now considering.

While I won't detail all of the improvements, suffice it to say this standard is much less prescriptive, appropriately allows for auditor judgment, eliminates unnecessary procedures from the audit and directs the auditor to focus on what matters most.

These improvements are significant, and they are responsive to the comments received by the PCAOB, including
those discussed at our April 4th open meeting.

Now let me turn to the comments in response to the Commission's June 7th request for comment on the standard you have before you.

The Commission received 27 comment letters. These comment letters came from issuers, registered public accounting firms, professional associations, investors and others. Overall, many commenters expressed support for the proposed standard and recommended that the Commission approve the standard and the related conforming amendments.

Some of these commenters requested that this approval be done on an expedited basis to enable auditors to implement the provisions of AS 5 prior to the required effective date.

A number of commenters noted that AS 5 includes appropriate investor safeguards, that it will facilitate a more effective and efficient approach to the ICFR audit and that the PCAOB appropriately responded to concerns raised by issuers, auditors, investors and others.

Specifically, some commenters noted that the standard's focus on principles rather than prescriptive requirements expands the opportunities for auditors to apply well-reasoned professional judgment.

Still, a few commenters expressed their continuing concern that in reducing the number of ICFR related audit
opinions from two to one, the Commission and the PCAOB retain the wrong opinion.

These few commenters indicated their belief that auditors should opine on the assessment made by management in order to comply with Section 404(b) of the Sarbanes-Oxley Act, which some go on to equate to opining on management's evaluation process.

These commenters expressed their belief that auditors opining directly on ICFR, as opposed to management's assessment, entails unnecessary and duplicative work. The staff has carefully considered this comment and continues to believe that consistent with Sections 103 and 404 of the Sarbanes-Oxley Act and the Commission's recent rule amendments AS 5 requires the appropriate opinion to be expressed by the auditor.

Further, the staff believes that an auditing process that's restricted to evaluating what management has done would not necessarily provide the auditor with a sufficient level of assurance to render an independent opinion as to whether management's assessment about the effectiveness of ICFR is correct.

Finally, the staff believes that the expression of a single opinion directly on the effectiveness of ICFR is not only important from an investor protection standpoint but provides clear communication to investors that the auditor is
not responsible for issuing an opinion on management's process for evaluating ICFR.

In the staff's view, an opinion on the latter may not only have the unintended consequence of hindering management's ability to apply appropriate judgment in designing their evaluation approach but also may have the effect of increasing audit costs without commensurate benefits to issuers and investors.

As you know, the Commission sought comments on seven specific questions in a supplemental June release as part of its request for public comment. I'll touch on the responses we received to each of these seven questions, and then we'd be pleased to discuss in issues in greater detail and answer any questions that you might have.

On the first question with respect to whether materiality is appropriately defined throughout AS 5 to provide sufficient guidance for auditors, the majority of commenters who expressed a view on this question said yes.

Some commenters elaborated that while application of materiality concepts in the context of planning and performing an audit requires the use of judgment. AS 5 appropriately specifies the basis on which those judgments should be made.

The staff agrees that AS 5 adequately addresses materiality throughout the standard. Even so, a few
commenters expressed a view that some auditors may need further and clearer guidance than is provided about materiality generally for integrated audits of both ICFR and the financial statements.

However, the staff does not believe that AS 5 is the appropriate forum to address broader questions about materiality as the concept of materiality is fundamental to the federal securities laws. Nonetheless, this is an area the staff continues to focus on in the broader context.

With respect to the second question as to whether the communication requirement regarding significant deficiencies will divert auditors attention away from material weaknesses, commenters who expressed a view on this matter overwhelmingly said no.

They said, for example, that AS 5 clearly directs the auditor to scope the audit to identify material weaknesses to be disclosed to investors, and the staff agrees.

With respect to the third question whether AS 5 is sufficiently clear that multiple control deficiencies should only be looked at in combination if they are related to one another, most of those commenting on this question said yes, that AS 5 is sufficiently clear in this regard although a couple of commenters disagreed, stating that the auditor is expressing an opinion on the effectiveness of internal
control as a whole.

Again here the staff agrees that AS 5 is sufficiently clear and notes that it's aligned with the Commission's interpretive guidance for management in this regard.

With respect to the fourth question whether the definition of "material weakness" appropriately describes the deficiencies that should prevent the auditor from finding that ICFR is effective, the majority of those commenting on this topic responded affirmatively. And the staff agrees.

On the fifth question related to the auditor's use of the work of others, the majority of those who commented expressed their view that AS 5 is clear about the extent to which auditors can use the work of others to gain efficiencies in the audit with some noting that AS 5 provides substantial flexibility in the application of auditor judgment when determining whether and to what extent to use the work of others.

The staff agrees that AS 5 is sufficiently clear about the extent to which the auditor can use the work of others. However, two commenters recommended that if the work of others is found to be competent and reliable, then the standard should require the auditor to utilize it.

But while we anticipate auditors would use the work of others under appropriate circumstances, including when the
approach results in greater efficiency, we do not believe that it's necessary or appropriate to preclude the auditor from utilizing his or her judgment in determining whether or not to use the work of others based on the particular facts and circumstances of the engagement.

As to the sixth question on whether AS 5 will reduce costs and result in cost-effective integrated audits, a number of commenters stated their view that AS 5 as approved by the PCAOB together with the Commission's guidance for management will result in a reduction of the total Section 404 compliance effort.

Some commenters agreed that a cost reduction would occur but also noted that the amount of reduced effort and cost associated with the ICFR audit will vary by company depending on factors such as the size, complexity, the degree of change from year to year, the quality of their internal control systems and documentation and the extent to which management appropriately applies the Commission's interpretive guidance for management.

None of the commenters suggested that costs would increase. Even so, so commenters noted that while AS 5 may curtail excess of testing of controls and reduce some of the unnecessary documentation currently required for Section 404 audits they still have concerns about the extent to which it will reduce costs for smaller companies.
A number of commenters urged the Commission and the PCAOB to closely monitor the extent to which the standard is implemented and achieves a reduction in costs and to take action if there's not an appropriate reduction.

In a minute, I'll say more about this issue, but first and relatedly let me cover the seventh question as to whether AS 5 inappropriately discourages or restricts auditors from scaling audits, particularly for smaller companies.

Most commenters who responded to this question said no. They noted that the standard appropriately discusses the concept of scalability based on size and complexity without including inappropriate restrictions on the auditor's ability to scale the audit.

The staff agrees that AS 5 appropriately recognizes scaling and tailoring of all audits to fit the relevant facts and circumstances so that ICFR audits will fit the size and complexity of the company being audited rather than the company's control system being made to fit the auditing standard.

The staff also agrees with the statement made by the board in its release to AS 5 that scaling will be most effective if it's a natural extension of the risk-based approach and applicable to all companies.

Before leaving question seven I'd also like to
respond to the observation by some commenters that where feasible AS 5 should provide additional guidance on how to effectively plan an integrated audit for smaller companies along with some discussion of related best practices to enhance broader understanding of risk-based auditing.

First, let me mention that the COSO guidance issued a year ago and directed to smaller companies should be helpful to both those companies whose COSO as their framework for evaluating their controls and their auditors in effectively and efficiently implementing 404.

In addition, COSO currently is conducted a project to develop guidance intended to help organizations better understand the monitoring component of the framework and comply with Section 404 in a cost-effective manner.

Further and importantly, for responding to the concerns of some commenters, the PCAOB has underway a separate project to develop guidance and education for auditors of smaller companies.

We're monitoring this project. The staff recognizes its importance as part of getting a good implementation of AS 5 for non-accelerated filers on their first ICFR audits with their filings in 2009.

Moreover, in addition to this project, the staff is working in a number of other ways as we go forward to monitor the implementation of the Commission's new guidance for
As selected examples, the staff will continue its ongoing participation in public forums and events to discuss the significant improvements made by the Commission and the PCAOB.

As just one illustration, the staff participates in the PCAOB's forums on auditing in the small business environment. These forums are held throughout the country and designed to help share important information concerning the PCAOB with respect to registered public accounting firms and public companies operating in the small business community.

Presentation materials from past events are available on the PCAOB's web site. These forums along with our speaking engagements provide for excellent two-way communication so that questions that arise can be dealt with on a real-time basis.

Further, as Conrad noted, we expect a change in the behavior of the individuals who are responsible for following these new procedures. To that end, the PCAOB's inspection program will monitor whether audit firms are complementing the new auditing standard in a way that is designed to achieve the intended results.

And it's noteworthy that the PCAOB's Office of the Chief Auditor, which drafted the standard, helps train PCAOB
inspectors on AS 5. Moreover, in our oversight capacity, the
staff, at the Commission's direction, will monitor the
effectiveness of the PCAOB's inspection process.

So these are among the activities that illustrate
going forward both the SEC and PCAOB will be focused on
whether audit firms are achieving an effective and efficient
implementation of the new 404 guidance.

In closing, I'd like to reinforce the appreciation
expressed by others to the Commission, including for your
guidance to the staff throughout the year and especially at
the April 4th open Commission meeting, to the PCAOB board and
staff and to the Office and Division staff that have worked
so hard on this project, including my staff, in particular,
Brian Croteau, Josh Jones, Amy Hargrett, Esmerelda Rodriguez,
Jeff Ellis and Kevin Stout.

Brian Croteau and Josh Jones, who have played key
roles in our efforts to rationalize the implementation of 404
are at the table to help answer your questions. That
concludes our opening remarks.

Chairman Cox, staffs of the OCA and Division of
Corp Fin would be happy to discuss any questions that you and
the Commissioners might have. Thank you.

CHAIRMAN COX: Thank you for that very complete
presentation. This is a lot of work. We've covered a lot of
ground, and I think everyone has a lot to be proud of.
At our April 4th open meeting, we discussed the need for AS 5 to make clear that the audit is scalable to account for the fact that companies come in different shapes and sizes and different complexities, and we were particularly focused on smaller companies.

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

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

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

Third, the Board made an important change from their December proposal. Not only did they have a special section that talked about scaling, but what they did is they imbedded scaling concepts that can apply in particular to small companies throughout the standard to help illustrate and provide a little bit more context and guidance in that setting.
And fourth, I should note that consistent with the
discussion and plans there is the build-out of this guidance
that is expected to come from the additional guidance that
the board and staff are working on for smaller companies.

And that project is progressing nicely, will be
available for public comment in the not to distant future and
will be able to be applied by auditors of small firms well
before the implementation for the filings in 2009.

CHAIRMAN COX: Thank you for that. We, of course,
have published guidance for managements in meeting their
obligations under Section 404(a). I seem to recall that the
PCAOB is planning its own guidance for audits of smaller
companies. How is that going?

MS. PALMROSE: That's going well. Actually, that
was part of just, sort of, what I briefly ended on. As you
know, the staff is an observer on that project. We've been
working with them.

This project also has the advantage of having a
task force that's made up of representatives from the public
accounting firms, in particular the public accounting firms
that are auditing smaller companies so not just the largest
firms and their audits of smaller companies but the smaller
firms, too.

So that task force has been working with the PCAOB.
We've been working as observers, and that guidance will, as I
said, be available for exposure in the not too distant
future. But we are reviewing drafts of that as it goes along
as are the task force. So it's going well.

MR. WHITE: I might also mention that we're working
on a brochure for smaller companies that will be, basically,
a plain English explanation of how to use management guidance
and to, kind of, lead companies through this that we think
will be helpful to them.

CHAIRMAN COX: And that's something, of course,
that smaller companies have asked for, so that will be very
responsive.

MR. WHITE: Yes. It is something that they have
asked for, and it was discussed in your congressional
testimony a few weeks ago.

CHAIRMAN COX: Excellent. John, you mentioned a
number of ways in which the staff are going to monitor the
implementation of AS 5 as well as Management Guidance.

I note that we received a number of recommendations
that we perform a cost study of AS 5. Could you describe
what plans you have to study -- what plans the Agency has to
study the costs of AS 5 and Management Guidance and when you
might be in a position to report to us on these costs?

MR. WHITE: We'd be glad to, but I think I'm going
to let Zoe-Vonna do that because she has done most of the
planning for this.
MS. PALMROSE: Well, I think that's overstated, but I certainly would be glad to provide some comments here. And the answer is yes, at the direction of the Commission.

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

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

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

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

So the answer is yes. We're working in a number of ways to move this project along, and we recognize its importance. And it's really part of our over-arching activities in a number of ways to work on the implementation of 404.
MR. HEWITT: I might just add on that point, if I may, KPMG, there are other organizations also that do studies on these costs and benefits. And KPMG just came out with their third annual benchmark study of 404, and it will be interesting to see next year's.

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

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

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

MS. PALMROSE: Let me start off, and others can jump in here. First of all, there's a big change. AS 2 had what was known as the 40s paragraphs, which, essentially, required that the auditor evaluate management's process. Those are no longer in the standard. So there is no requirement in the standard for the auditor to explicitly evaluate management's process.
Second of all, there was no interpretive guidance for management. In other words, management actually looked to the auditing standard for guidance on doing their evaluation, and that's, of course, now changed with the guidance that we have provided for management.

Again, it's important to recognize we've worked to align that so it will work together with the auditing standard. So management can look to our rules for guidance, and the auditors can look to the auditing standard.

Management does not have to look to the auditing standard.

Third of all, the auditor's report that I talked about briefly in my opening remarks we're down to one opinion, which makes sense, and that opinion is on the effectiveness of ICFR.

So there's no notion because of the auditor's second opinion that that would equate to evaluating management's process.

So all three of those are very helpful in responding in just big ways to this concern that management was constrained through their evaluation.

MR. WHITE: I kind of like to say it the short way, that no longer does management have to follow the audit standard, but instead the auditors have to adjust their procedures to follow what management does.

MS. PALMROSE: But let me just reinforce they are
aligned so that they can work effectively and efficiently together.

CHAIRMAN COX: Well, that's good news. I just have one final question. I'm sorry. Do you have further comment, John, on that?

MR. WHITE: No.

CHAIRMAN COX: Okay. Just one final question about the range of comments that we received on AS 5. If you want to characterize the types of comments we received and in particular the comments that were received on significant deficiency and how we addressed those comments.

MS. PALMROSE: I can start out, and others can chime in. I think it's important to recognize, first of all, we very much appreciate, we understand how time-consuming it is to write us, and we've asked for comment in a number of ways a number of times.

But notice that the number of comments is much lower to AS 5 that was exposed for comment in June than it has been before. So it's less than a fourth of the people in terms of number.

More importantly -- which provides some inferences that the larger marketplace is very happy with where it ended up, and also that's reinforced by the comment letters themselves.

The comment letters are very supportive of this
standard and where it ended up, and that's also in terms of
the "significant deficiency" definition, too.

So there is contentment would maybe be the word I
would choose with those standards and the proposed definition
that will be in our rule as well as in AS 5. Overwhelming
support I would characterize what we're hearing.

MR. WHITE: The other thing, and I pointed it out
earlier, we think it is a very good thing if nothing more
than just good housekeeping that we now have the definition
of "significant deficiency" and "material weakness" in our
rules.

We do, after all, ask CEOs and CFOs to certify with
respect to those matters every quarter, and I think it's very
nice to -- it's a good idea to have our own definitions there
instead of having to look over at the auditing literature.

CHAIRMAN COX: Well, thank you. I haven't any
further questions. I just want to add since I thank the
Office of the General Counsel, Office of the Chief Accountant
and the Division of Corporation Finance but I didn't thank
the people who run them, I want to thank particularly John
White, Conrad Hewitt and Brian Cartwright for all of your
work on this over a very long period of time.

Since I haven't any further questions, it is up to
Commissioner Atkins to carry the ball forward.

COMMISSIONER ATKINS: Okay. Thank you very much,
Mr. Chairman. I, too, would like to commend the hard work of
the Public Company Accounting Oversight Board and the staff
here at the SEC and the Office of the Chief Accountant,
Division of Corporation Finance and Office of Economic
Analysis and the General Counsel’s Office for all of your
hard work.

The audit standard that we're considering today is
intended to enable auditors to conduct top-down audits that
are focused on matters that they believe give rise to the
greatest risk of material misstatements.

Despite all of the public attention that’s paid to
other items on our agenda today, this matter is the most
important that we consider today. I hope that today marks
the start of a new phase of the life of Section 404 of the
Sarbanes-Oxley Act.

The infant years of Section 404 have been, to say
the least, unpleasant. I had better caveat that. At least
audit firms have been trumpeting record earnings. A couple
months ago I ran across a full page advertisement by one of
the Big 4 that boasted about, "five straight years of double
digit growth."

Now, this year, of course, just happens to be the
fifth anniversary of the Sarbanes-Oxley Act. Implementation
costs and efforts soared far above anyone’s expectations.
Accounting firms driven by pecuniary interest, a poorly
written rule and risk mitigation had every incentive to engage in make-work efforts. Managers and auditors engaged in check the box compliance exercises at direct cost to shareholders.

Money and time spent on these exercises were diverted from other important areas. The magnitude of the troubles that arose under Audit Standard 2 made it clear to virtually everyone that mere modifications to the existing standard would not have been enough. A completely new approach was needed.

As the old Chinese proverb says, rotten wood cannot be carved. I'm happy today to be able to vote for the replacement of Audit Standard 2 with Audit Standard 5. The old standard is not being laid to rest a day too soon.

That said, we need to be cautious with respect to Audit Standard 5. Even under this less prescriptive leaner standard, success is not guaranteed. If this standard is implemented incorrectly, then we will not experience the clean break with the past that AS 5 is intended to bring to pass.

Many commenters warned us that we and the PCAOB cannot simply sit back and relax now that AS 5 is in place. It's incumbent upon auditors to take the new guidance to heart.

As part of this they will need to abandon the
notion that AS 5 governs management and instead allow
management to follow the top-down risk-based approach that we
set forth in the management guidance that we adopted last
month.

As the PCAOB itself has acknowledged, it must
monitor the manner in which auditors implement the new
standard. Likewise, the SEC, in fulfillment of its statutory
responsibilities, must monitor how the PCAOB is overseeing
the audit profession's implementation of AS 5.

We need to be prepared to make changes if AS 5
fails to deliver on its promises of reshaping internal
control audits.

Until we know whether AS 5 works, a further
extension for non-accelerated filers I think is necessary.
Let us give these small public companies an additional year
to observe how their larger counterparts implement AS 5.

I advocate not requiring them to file Section 404
audit reports until they file financial statements for their
fiscal year ending on or after December 15, 2009. Congress,
of course, is considering delaying all internal control
reviews.

In the interim, I'm also looking forward to seeing
the guidance that the PCAOB develops for audits of smaller
companies, as we discussed earlier. I hope that this will go
a long way towards addressing some of the concerns that small
companies raised about the standard.

We're also considering, of course, the "significant deficiency" definition that's before us today, and I'm happy to support it as well. It's important both that we have a definition in our rules and that the definition matches the definition in Audit Standard 5.

Significant deficiencies have been a continuing source of concern for me, but I hope that the new definition will help to alleviate those concerns. As the new definition appropriately acknowledges, a significant deficiency is less severe than a material weakness.

Management and auditors are to concentrate their efforts on identifying material weaknesses. Accordingly, they should not scope or test for significant deficiencies. If attention is diverted to hunting for significant deficiencies, then internal control reviews will be derailed from their intended focus.

It is in no one's interest, least of all the shareholders, who pay for internal control work, if management and auditors get tripped up in trying to identify issues that are not material.

I approve also of the definition's pragmatic consideration of whether deficiencies are "important" enough to merit attention by those responsible for oversight of a registrant's financial reporting.
We should be clear this standard is consistent with the definition of "reportable condition," which is very well understood in the accounting literature.

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

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

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

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

In other words, what it is directing is for the auditor to think about the likely sources of potential misstatements that would cause the financial statement to be materially misstated. So materiality, what matters, what's important, bounds that discussion.
And it asks the auditor to think about what might be the likely sources of potential misstatement, and that's the "what could go wrong." It's not intended for them to consider every possible risk regardless of how insignificant. Instead, it's really intended to help focus on what matters most and the risks that could result in a material misstatement, and, under a risk-based approach, obviously, this is the important question, so it is the essential question.

I also should add there's also a subtlety here that this question is actually one of alignment between management guidance and AS 5.

Management guidance does not require that -- our guidance for management does not require management identify significant accounts and relevant assertions. It's actually imbedded in the COSO framework, but our guidance doesn't say you must walk through that gate per se.

We say focus on the risk of material misstatement to the financial statements, and one of the subtle linkages here between what the auditor and management is doing is we included "what could go wrong" as the question that management would want to think about, too, in identifying those financial reporting risks, the risks of material misstatement.

So both the auditor and management, even if they
don't use quite the same process or approach, are asking the
same fundamental question, and both are taking a risk-based
approach. And that's what is demonstrated by that question.

COMMISSIONER ATKINS: Okay. As we're talking about
materiality, then, if you look just up from paragraph 30 up
to the earlier one, paragraph 29, there it refers to the
evaluation of qualitative and quantitative risk factors in
identifying significant accounts and disclosures in their
relevant assertions.

To get back to the point of materiality, then, what
sort of qualitative factors are we talking about here?

MS. PALMROSE: That paragraph does provide some
enumeration of what would be qualitative risk considerations
Let me ask Brian to, sort of, jump in here.

MR. CROTEAU: As Zoe-Vonna said, actually, I think
they're really listed there as examples of things you would
want to think about.

Some of those are quantitative, and others are
qualitative but making the point that clearly it's not just a
quantitative analysis when considering significant accounts
and that the auditors qualitative assessments can impact and,
in fact, remove a significant account, if you will, or add a
significant account.

So we think that's important so that it's not just
a quantitative analysis that's done in considering scoping.
MR. HEWITT: A good example of that would where the estimates, the broad estimates in the accounting records and transactions and they end up in the financial statements whether it be warranty reserves, or those types of things. And those are all qualitative and not quantitative in nature, and that's where the risk is.

COMMISSIONER ATKINS: Right. But this is still bounded ultimately by materiality at the consolidated level as we talked about at the proposing?

MS. PALMROSE: Yes.

COMMISSIONER ATKINS: Okay. So of course, this, basically, comes to the crucial problem of materiality and how one is supposed to divine what that might be especially in a prospective sense.

And that has been particularly thorny, of course, in the internal control context and throughout financial reporting that we struggle with enforcement cases, and everything else.

So what steps are we taking to try to provide more clarity with respect to materiality in general?

MS. PALMROSE: Let me just start off by saying that you're absolutely right. The issues around materiality are really over-arching with respect to the financial statement audit that bleed into the ICFR audit.

So they're much broader issues here. So the staff
is cognizant of that, and we do have in process work to
examine the issues surrounding materiality both interim
materiality and materiality in general.

So the staff is working that issue and would hope
to have some recommendations going forward at some point.

COMMISSIONER ATKINS: Great. I would encourage
that, because the last time the Commission -- actually, it
was the staff, I guess, that addressed that was now eight
years ago. I think it's high time that the Commission itself
consider that.

So I would encourage the chairman and the staff to
push this forward as fast as possible, because that is the
thing that's eating away at a lot of these things that people
have to deal with.

I guess sort of a related point is what material
weaknesses are about and how they are defined. In paragraphs
69 and 70 of AS 5, they set forth indicators of material
weakness.

Now, are these indicators which include, for
example, restatements, are they definitive evidence of
material weakness?

MS. PALMROSE: No. Again, notice one change
between AS 2 and AS 5 is the term "strong" has been deleted.
So they are indicators. And, in fact, the discussion around
those both in the standard itself and in guidance, the
released text as well as in management guidance are that these are judgmentally determined. So they're based on the facts and circumstances, and these are just considerations. They are not determinative of a material weakness.

I might just add that the empirical evidence seems to support that. In other words, if we look at the material weaknesses, we find that the percentage of those that are reflected or are in conjunction with a restatement have dropped off significantly.

So it does appear that auditors and management and audit committees, issuers are sorting through this and understand that it is based on the facts and circumstances and a judgment determination.

MR. CROTEAU: And I might just add to Zoe-Vonna's comment to note that there's discussion of this in the PCAOB's release and our release that makes these points clear or at least interpretive guidance.

COMMISSIONER ATKINS: Okay. Good. Now, the definition of "material weakness" refers to interim financial statements. So I was wondering how do we square that with our emphasis on consolidated annual type outlook.

MS. PALMROSE: We actually did receive two comments. As you say, it does include in the definition of "material weakness" interim financials. We only had two
comments on this issue.

So it doesn't appear that it's cause for much concern. Again, part of the angst around -- I should mention that one of commenters said, please, for heaven's sakes, don't hold anything up over this issue, too.

But let me just retrace my steps and say that our discussion around the issues with respect to materiality also relate to interim materiality, too. And the staff, again, is cognizant of that in the context of the broader project. So we understand that.

Anyway, from the standpoint of the ICFR audit, it's clear that scoping is based on annual materiality considerations. It's clear from the audit standard. It's clear from the release text. It's clear from our management guidance. There appears to be no confusion around that.

Now, "interim" is still in the definition, because we think that interim financial reporting is important to investors. And even though you don't scope around interim materiality, controls over interim financial reporting are, essentially, one aspect that has to be considered.

So those controls are something that needs to be considered. And also, and maybe most importantly, even though you don't scope to find, if you identify a material weakness, those -- excuse me.

If you identify a control deficiency, those
controls deficiencies need to be evaluated as to whether
they'll have a material impact on the interim financial
statements, and that's all that this is asking to do here.

The staff believes that investors have a right to
know whether the control deficiencies identified would have
an impact on the interim financials, and it's a disclosure of
that that's being asked for here.

COMMISSIONER ATKINS: I just wanted to bring that
nuance out, because I think that's an important one from the
scoping perspective. But of course, Qs are important also,
as we know, for investors as far as the information that's
disclosed.

The Biotechnology Industry Association objected to
the removal of the definition of "small company" from AS 5 in
our management guidance. Why was no objective definition
included?

MS. PALMROSE: Well, actually, in both management
guidance and in AS 5 there's still a footnote that recognizes
the work of the Small Business Advisory Committee. That work
is important. We very much appreciate it, informs the
process, and there is that acknowledgment.

There's not a quantitative bright line that's
specified that if you're on one side of it you're large and
the other side that you're small.

That's actually an impediment to scaling. In other
words, it wouldn't make sense for a company that had two
companies, one just slightly over a bright line and one
slightly under a bright line, but something different would
happen to them.

That's not the way the standard is written. This
is written so it's scaled based on facts and circumstances
for companies based on their size and complexity, and those
have to be determined within the context of each company.

Also, it would make no sense to have companies on
the lower end of a bright line that had very different facts
and circumstances and expect the auditor to treat them the
same. So, essentially, the scaling is important here, and
bright lines would be an impediment to that.

That's not to say that it isn't important to
recognize that smaller -- the notion of a smaller company in
conjunction with the complexity, and that's what is
acknowledged with the footnote.

COMMISSIONER ATKINS: I agree generally with that.
I just worry that auditors who might be free to exercise
their judgment about whether scaling is appropriate might
simply hide behind complexity and then refuse to scale audits
of small companies.

MS. PALMROSE: I mean, it's unlikely that that
would be the case, again, because that goes back to a
risk-based approach. You'd have to identify what's higher
risk.

So it's within that context. And again, that's what makes the scaling work for everyone.

COMMISSIONER ATKINS: I think, in general, I'm happy to support the adoption of AS 5. We might not be completely happy with it.

I'm at least happy to put AS 2 out of its misery or, more importantly, out of the shareholders' misery of paying for it. The secret will be in the implementation and how we monitor that. So thank you very much.

CHAIRMAN COX: Thank you. Commissioner Campos

COMMISSIONER CAMPOS: Thank you, Chairman Cox.

Well, it has taken a long time to get here, but we've finally arrived. As promised, today marks the culmination of a tremendous amount of hard work and determination on the part of many people here at the SEC and at the PCAOB.

I won't go again and list the names, but I think all of you know who you are, and the chairman and your division directors have mentioned all of you.

Generally, first, I want to congratulate the PCAOB and their staff for responding to public comments and for crafting this excellent standard.

Second, I also want to thank the staff of our Office of Chief Accountant for all the efforts in the process. I know that the General Counsel, the Office of
Economic Analysis and other offices also participated.

I know that AS 5 is the product of intensive hard work and tremendous cooperation on the part of the staff of the SEC and the PCAOB. The adoption of AS 5 is evidence that we and the PCAOB have developed a framework to work on complex accounting issues and to resolve them in a professional manner.

I think it is an important milestone, and I think that we have overcome certain growing pains and that we have, hopefully, established a framework to deal with tough issues, good faith differences of opinion and still come out with a joint position on guidance and rule-making.

At this point, the SEC and the PCAOB, it seems to me, have done everything that we promised. After granting numerous extensions over the years to companies, particularly non-accelerated filers, we and the PCAOB have finally adopted standards and guidance for both auditors and management that should promote more effective and more efficient audits of internal control over financial reporting.

I'm confident that AS 5 and the management guidance will greatly help companies of all sizes but particularly smaller companies comply with Section 404 in a cost-effective manner that seeks to minimize the possibility of a material misstatement in the financial statements.

AS 5, as has been noted, is rational, right-sized
and principles based, an approach that should enable auditors
to properly scale the audit for smaller or less complex
companies.

I'm confident that once auditors and companies
begin to comply with and implement the new standard costs
will be rational and appropriate for smaller public
companies. From this point forward, issuers should have
nothing to fear from Section 404 of the Sarbanes-Oxley Act.

Certainly, investors both domestic and foreign have
always appreciated the protections offered by SOX 404. Now
they will still have the protections offered by SOX 404, but
they will also benefit by getting these protections in a more
efficient and cost-effective manner.

As I repeatedly emphasized, the rigorous disclosure
regime in the United States which protects the recent
protections offered by Sarbanes-Oxley is a great protector of
capital and, in my view, attracts capital from all over the
globe.

Let me focus on a few discreet aspects of AS 5 that
I think deserve mentioning. First, much has been made by
making the standard more principles based and top-down
focused.

This is entirely appropriate and necessary, but we
can't lose sight of the fact that the passage of the
Sarbanes-Oxley Act was due, in large part, to the massive
financial frauds of a few years ago; that is, intentional fraud by senior management who managed to override internal controls.

In this respect, I think and hope that AS 5 has done an even better job of trying to focus auditors on the risk of fraud. Specifically, I know that addressing the risk of fraud has been moved into the "Planning the Audit" section of the standard.

The focus on fraud risk during the planning stage of the audit should put fraud risk in the minds of auditors from the very beginning of the process.

I also think it's appropriate that AS 5 provides examples of controls that might address fraud risks. This, too, should focus auditors on the biggest risk of a massive financial misstatement.

I'm also pleased with respect to the definitions of "material weakness" and "significant deficiency." I know that we specifically asked the question about material weaknesses when we voted to put AS 5 out for public comment.

I note that a majority of commenters believe that the definition appropriately describes the deficiencies that should prevent the auditor from concluding that internal controls over financial reporting are effective.

Further, it is entirely appropriate for the definition to reference interim financial statements. It
makes perfect sense to me that if auditors uncover a
deficiency that poses a reasonable possibility of a material
misstatement in a company's Form 10-Q that deficiency should
be disclosed to investors.

I also think AS 5 has done a much better job with
respect to scaling the audit. In particular, I appreciate
the fact that the standard emphasizes that scaling should be
based on both size and complexity of the company.

As AS 5 notes, "Even a larger, less complex company
might achieve its control objectives differently than a more
complex company." Notably, however, the notion of scaling
the audit should not result in a less rigorous audit, nor
does it exempt smaller or less complex companies from any of
the principles set forth in AS 5.

In general, what makes AS 5 an appropriate and
consistent standard is that all of the parts seem to fit
together in a way that, hopefully, will produce a more
effective yet more efficient audit.

It allows companies to scale the audit to eliminate
unnecessary procedures and to use more principles based
approaches. In this way, auditors should focus on what
matters most. Instead of checking the box auditors should
focus on the big picture.

With that said, let me just ask a few questions.
I've focused on fraud controls and the fact that auditors
must consider the risk of fraud when planning the audit.

Zoe-Vonna, do you think that AS 5 has done enough to focus on the risk of fraud?

MS. PALMROSE: Yes. Actually, this is one of the areas that is a change between the exposure draft and the final standard, and the board and staff have taken it very seriously and, as you said, have moved up the fraud discussion to the Planning section.

So the optics around it are important, too. That's part of emphasizing its importance. And as you said, there are now some examples of anti-fraud controls. And then the third thing is that the standard does discuss the expectation that fraud would be an area of high risk, and thus the auditor's efforts would respond to that higher risk.

And so all of those are important elements in bringing this focus on fraud to the forefront, and we're very supportive of that, yes.

COMMISSIONER CAMPOS: Given the significance of the improvements from AS 2, both auditors and management hopefully are very anxious for the new standard to be implemented. How soon can auditors begin using AS 5?

MS. PALMROSE: Well, actually, AS 5 is effective for years ending on or after November 15, 2007, but it's important to note that early adoption is encouraged by the PCAOB, and we very much support that.
We really encourage auditors to take advantage of this ability, and we've heard that a number of audit firms have already started updating and integrating AS 5 into their audit programs, their materials and their training. So it looks like that is happening.

Maybe I could use this as an opportunity to just cover something that's a little bit more technical here, too, and that's that the Commission's amendment to Regulation SX related to the required auditors attestation report -- that's the auditor's opinion on the effectiveness on internal control -- we adopted that in May. And it will become effective on August 27, 2007.

So companies can begin filing the new single ICFR opinions proscribed in accordance with AS 5 in timely filings received starting on August 27th. So this means that auditors can begin using AS 5 today and can actually report on it as long as the reports will be filed by their client on or after August 27th.

COMMISSIONER CAMPOS: Do you expect that to happen?

MS. PALMROSE: Yes.

COMMISSIONER CAMPOS: There has been much talk in various circles about the potential need of the small business community to get yet another extension.

Now, we all know that we have a year for the management guidance and the management assessment to be done
before the second year and the second stage of full
implementation for the smaller accelerated filers.

In your technical view, is that enough time?

MR. WHITE: Why don't I start on that.

COMMISSIONER CAMPOS: Sure.

MR. WHITE: I won't give the technical accounting
view. I'm a lawyer, as you know.

COMMISSIONER CAMPOS: I won't hold that against
you.

MR. WHITE: You probably should, actually, but
never mind. Just to, kind of, break up the two pieces of it,
the management assessment, of course, is due next spring, in
March for the end of this year.

I think that at least listening to the advice of
the accountants around me we are pretty confident that
companies will be able to follow the new management guidance
and comply with the requirement in that time frame.

Zoe-Vonna went through a fair amount of detail of
how we had designed this and scaled it for smaller companies.
We talked a lot about this back in May, actually.

And we were, obviously, thinking about at the time
that this was in time and would work for smaller companies in
terms of the management assessment that's due next March, the
reports that are due next March.

In terms of the extension -- so the answer is we do
not believe there are any extensions needed with respect to 404(a), because I think we were, basically, giving that advice back in May.

With respect to 404(b), in effect, that's more than a year and a half from now before those reports are due. We are, obviously, going to be monitoring how things are going with AS 5. As Zoe-Vonna just described, we anticipate that companies that are already subject to AS 5 will be complying with it I will just say this season.

So we will have kind of a season in which companies can -- we will see how it's working with larger companies. This is not something that you necessarily have to address at this stage. This can wait, basically. It is not a current topic, I would say.

MR. HEWITT: I would like to add some information on this point, because we're talking about micro cap companies, those with a floating market cap of under 75 million.

These companies operate in a completely different environment. Their internal control system environment is completely different than anything else. The auditors have to approach the audit in a different approach because of the size and characteristics of these micro cap companies.

So we believe hopefully that this year, when they address their management assessment of their internal control
system that it will be very important if they do that, and

they should do that.

They should also do it next year, because I think they'll gain some benefit by doing it, which they have never focused on before, especially as it pertains to any internal controls which they may have within these very micro cap companies.

Now, as AS 5 replaces AS 2, AS 2 was never scalable. It was a large portion testing standard that auditors converted into a percentage of assets and revenues. A very high percentage, almost 80 percent, had to be covered. Micro cap companies could not afford that type of an audit, and neither could a lot of small companies towards that lower end of the scale. So I think we really need later this year to see those smaller companies, say around $100 million of micro cap, to see how they are implementing AS 5.

PCAOB really has to pay attention to these micro cap auditors. These are not the Big 4 auditing firms. The Big 4 auditing firms do a very small percentage of these micro cap companies.

So you have a small CPA firm that's going to be auditing internal control systems. They do not have the training or the resources to get their people up to speed. But hopefully, they will be able to do that by the end of this year.
And I would think that the external auditing firms of these micro cap companies will work with the management and their accounting and financial people to help guide them and to prepare them for an audit of their internal control system.

Personally, I want to wait and see to the end of this year to see how PCAOB does with the small CPA firms and how well they're trained, how well they understand AS 5 and scalability and then how well the small micro cap companies implement their management assessment of the internal control system.

MS. PALMROSE: Maybe I can just provide a little bit of an elaboration, too, to build on what Conrad has said. We've talked a bit about the project that the PCAOB is working on, on guidance for auditors of smaller companies, and that guidance will actually address the concerns that Conrad has raised in terms of auditing in a small company context.

That guidance will be in place in plenty of time to meet the audit requirements for the filings in 2009. The other point that we've talked about that's in place -- so all the components will be in place in order to do the audit in the small company context.

But there's something that we also haven't talked about that is a change from AS 2 to AS 5, and that's that AS
5 also focuses on an integrated audit. And this will be something that will be important in this context.

In other words, evidence from the financial statement audit informs the ICFR audit. Evidence from the ICFR audit informs the financial statement audit. And this is particularly important -- I mean, it's important in all companies, but it's also very important in this context in that these audits have tended to be substantive audits in the past.

And so there is now this mechanism that's explicit that's it's an integrated audit, and evidence from each informs the other. And so that should help the implementation of ICFR audits in this context, too.

COMMISSIONER CAMPOS: Well, in the smaller company context, can't we conclude that many of these companies have far fewer internal controls than what we ran into with the larger companies?

And if you envision that you have small internal staffs, whether it's one or two or even three, there aren't that many moving parts in terms of internal controls. It puzzles me why it should be so difficult to do everything that we, essentially, designed together with the PCAOB, with AS 5 and management guidance.

MS. PALMROSE: Yes. I think that's an important point. We talk about non-accelerated filers, but there's
really a distribution here. It should not -- with management
guidance and the auditing standard, it should not be that
difficult.

COMMISSIONER CAMPOS: Okay. I'm going to stop it
here. I'd like to thank everyone on our staffs, the PCAOB
for all this time and all this effort and all this dedication
to get AS 5 right and, of course, before then our management
guidance. And I'm very, very pleased to support the
finalization of AS 5.

CHAIRMAN COX: Thank you. Commissioner Nazareth.

COMMISSIONER NAZARETH: Thank you. As others have
expressed, I would like to thank the PCAOB and their staff as
well as our staff in the Office of the Chief Accountant for
bringing this much improved auditing standard to us today.

I'd also like to thank the Division of Corporation
Finance for their work along with OCA in crafting the
proposed definition of "significant deficiency." And I'm
happy to support approving the PCAOB's proposed AS 5 as well
as the proposed definition.

With these actions today, we will address the most
problematic implementation issues concerns the Sarbanes-Oxley
Act. It is indeed a credit to the hard work of all concerned
that the comment letters strongly support the new Auditing
Standard No. 5. I believe that it is a tremendous
improvement over AS 2, which is currently in place.
To the extent that the recent comment letters raised issues concerning the standard, most, if not all, such issues had already been raised and considered by the PCAOB in the course of its comment process.

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

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

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

At an open meeting on April 4, 2007, the Commission provided our staff with direction to work with the PCAOB in four particular areas -- alignment of AS 5 with the Commission's management guidance, improving the discussion of scalability within the standard, clarifying the auditor's ability to exercise judgment and following a principles based approach to determining when and to what extent auditors can use the work of others.
I'm pleased that AS 5 responds to these concerns that we raised at that meeting, and I'm optimistic that our interpretive guidance and the PCAOB's AS 5 will provide a useful coordinated framework for both management and auditors.

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

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

While I certainly agree with the criticism that the costs and burdens of implementing Section 404 of Sarbanes-Oxley have been far too high it is important to remember that there are real benefits to both companies and shareholders when issuers comply with Section 404, including management's renewed sense of ownership over controls, innovative ways to make controls more efficient, better financial reporting and disclosure and the detection of problems before they become more serious.
All of these benefits improve investor confidence and the integrity of our markets. By focusing on the areas of highest risk, we can best achieve meaningful investor protection without excessive costs.

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

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

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

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

COMMISSIONER NAZARETH: But again, even as to the inspection process are there particular things that we intend to look at as we inspect the inspection process?
MS. PALMROSE: Yes. Let me just step back for a second here and say that our inspection of the inspection process is at, sort of, an odd place from the standpoint of AS 5 in that what is currently being done doesn't cover AS 5.

And so part of what we're doing here is also dialoguing with the PCAOB in terms of how they are implementing AS 5 through their inspection process going forward. So we're actually working in terms of our oversight with them on that.

There's multiple component to the inspection process. One is somewhat historical, but what we learn from that historical also informs how we think about the inspection for efficiency going forward.

And then there's an explicit component in terms of what they're doing going forward with AS 5, which has included the training that the Office of Chief Accountant is giving their inspection teams in terms of the standard itself. So that's one component.

The study that the Commission has directed under the leadership of the Office of Economic Analysis is another component of that, and here we're not only cognizant of what has been done -- we want to be cognizant of what has and is being done by others including, as Conrad said, surveys and evidence that's gathered by others.

And that's informing our, sort of, design here and
methodology going forward. And again, that involves data
that is both publicly available and there may be other
components to that.

So that's what we're working on now. So it's a
little premature to give actually a methodology and
milestones on that. Then, again, working in terms of public
speaking and outreach with the -- we actually work with the
PCAOB and present as part of their forum. So those are
scheduled.

And we have a number of speaking engagements and
outreach activities scheduled to help educate as well as
listen to the implementation of both management guidance and
AS 5 and then working explicitly as an observer on auditing
in a small business context project.

So that has relatively -- it's very important, but
it has a relatively more recent time schedule. And
hopefully, that will be out for exposure in the near future.

MR. HEWITT: I might just add to that point on how
we can assure ourselves that the implementation will be
completed as it should be when AS 2 was never completed.

For example, we'll be looking at the PCAOB's
training manual and looking at their training program of
their inspection teams to ensure that they stick to the
concept of AS 5 in terms of scalability, in terms of
principles based and not have items in their training program
that may relate to, say, significant deficiencies, which do not belong in there.

So that will be our starting point. And as they perform their inspection and write their reports, we'll be looking in their reports and their working papers to see if there's something that does not jive with the intent of AS 5 in terms of implementing that standard.

So there will be a lot of work for us at the end of this year and next year in that regard to make sure that AS 5 is being implemented properly.

COMMISSIONER NAZARETH: Thank you. I think that's a good plan. Obviously, you've done a lot of thinking about it. It is, obviously, a very important part of this whole process in order to achieve the goals that were intended.

Thank you.

CHAIRMAN COX: Thank you. Commissioner Casey.

COMMISSIONER CASEY: Thank you, Mr. Chairman. I also want to commend the staff for their extensive work on the significant deficiency rule change release and the AS 5 audit standard release. And I also want to extend my gratitude to the board and staff of the PCAOB for their work as well.

I believe that the SEC and PCAOB have made great strides in retooling the audit standard and aligning it with Management Guidance.
The Commission's consideration and anticipated adoption of AS 5 today is an important milestone in our efforts to achieve greater efficiency and cost savings under 404, but it is certainly not the final chapter, and we cannot simply close the book, claim success and move on.

We have made necessary changes. It is now incumbent upon us to ensure they are sufficient. Indeed, as everyone has worked thus far to undue the unnecessarily burdensome management and audit practices that have developed from 404 I think there is also a strong recognition that much work lies ahead to ensure these changes are implemented effectively and achieve their purported benefits.

Our recent release of management guidance and today's anticipated release of the new audit standard for internal controls are designed to help undo much of the burdensome consequences of 404 compliance; namely, they should drop costs down and are targeted to give the most relief to smaller issuers.

With the new guidance and standard, managements and auditors are empowered and encouraged to approach internal controls assessments and audits in a principled risk-based manner.

Our efforts have been focused on changing existing incentives and behavior so that mechanical and unnecessary box checking becomes a thing of the past and rational
If this change happens, we should see the worst of SOX 404 disappear and the best of it -- investor confidence in financial statements -- apply to all companies. As we have no doubt learned from our work in this area over the last year among some of the key contributors to the 404 problems were the definition of "material weakness" and "significant deficiencies."

I am hopefully that our recent guidance, today's "significant deficiency" rule change and the new audit standard fix these problems by focusing the audit on identifying material weaknesses and ensuring that audits are not scoped to look for all deficiencies however insignificant or immaterial.

I have carefully reviewed comments about these definitions, and while no one can be sure it appears that those who most closely work with assessing the strength of internal controls believe that cost savings can be achieved but that in no event should these changes result in increased cost.

Another key problem was the undue cost burden expected to be borne by smaller companies when they are required to comply with 404. We have received many comments on AS 5, and while most are favorable in this regard believing that the new standard allows sufficient flexibility
and risk-based judgment to scale audits to smaller companies.

Several commenters remain concerned that scalability remains an unproven concept in the absence of clear definitions and guidance.

Indeed, this remains a central challenge that runs throughout our management guidance and is embraced in AS 5, attempting to infuse greater judgment and flexibility through a principles-based approach and avoiding detail checklists or rigid guidelines to become the de facto rule.

I believe there is great value in a principles-based approach and that we should resist returning to the prescriptiveness of the AS 2 approach despite the greater clarity that some commenters legitimately seek.

That being said, we must gain confidence that scalability works before subjecting smaller companies to the costs of 404 and most particularly the audit requirement under 404B.

In the course of considering our efforts and the comments we have received on management guidance and on AS 5, I have become convinced that further delaying implementation of the 404 audit requirement at least for smaller companies is necessary and appropriate.

Delaying the audit requirement would be the most deliberate approach to ensuring that scalability and alignment are met for smaller companies before requiring them...
to bear the cost burdens of compliance.

Such a delay will ensure that the Commission and the PCAOB will be able to monitor how larger companies are faring under the new standard before subjecting smaller companies to the specter of 404 that may or may not work for them.

Indeed, it may not be possible to have a firm grasp on how the changes of both the guidance and AS 5 at least for larger issuers are affecting 404 implementation until summer of next year at the earliest.

Many of the comments we have received have called for "field testing," active monitoring and examination before proceeding with at least the audit requirement for smaller companies.

I believe these comments are consistent with how the Commission has suggested we intend to monitor implementation. The only question is what is a realistic time frame to do so.

Accordingly, the Commission and PCAOB need to remain engaged with this process to help users of this new standard and our management guidance achieve the benefits that we seek, and we must remain nimble and responsive so that if we find that costs are not coming down and that the unnecessary burdens of 404 are not lifting we can discover the causes and provide a remedy.
This means that we must also be willing to consider further revisions to this or related audit standards and further guidance for management. Along those same lines we must develop a plan for monitoring implementation of management guidance and AS 5 so that we know whether we are achieving our goals. We should consider how we will measure success, when and how we should take those measurements.

Likewise, we should be mindful of how we influence implementation of 404 through our inspections of the PCAOB and through our Examination, Compliance and Enforcement programs.

We do no greater harm than to ask the management and auditors to use greater professional judgment and then undermine that request by second-guessing that judgment if it is reasonable. So I look forward very much to monitoring our work in this area.

I would also note -- and actually, I have a question on this point that I'll direct, but I think it is worth noting that some commenters continue to believe that we have eliminated the wrong opinion and that in order to fix 404 we should require management to conduct an assessment of its internal controls and require the auditors to review that assessment rather than perform an audit of internal controls themselves.

These commenters argue it is the audit requirement
itself that imposes undue cost not necessary to ensuring an
adequate internal control regime. I believe that the
Commission has sought to faithfully interpret and implement
congressional intent on 404, and our approach reflects that.

Ultimately, only time will tell whether that
opinion that we have eliminated will assist in driving costs
down. I am hopeful that it will and committed to taking
necessary steps to do so.

So with that I would like to ask the question on
getting to some of the comments regarding eliminating the
wrong opinion. Can the staff respond to the rationale behind
it and why we're confident that the approach that we're
taking is the right one?

MS. PALMROSE: Yes. Let me review some of the
points I was trying to make in my opening remarks. This has
been an issue that we've closely considered, and the PCAOB
has, too. So there have been long and deep deliberations
over this issue, and we're quite confident that we have
selected the right opinion.

First of all, I think everybody agrees that it
makes no sense to have two and that that was contributing to
the problems and ambiguity. In fact, I will confess I taught
it wrong. So I was part of the problem, and it's nice to be
part of the solution.

But having said that, in all seriousness, we
believe that the report on the effectiveness of ICFR satisfies the requirements of the Act, is what's necessary from an investor protection standpoint for the auditors to reach an opinion about the management's assessment and that this serves important investor protection and that it also has the side benefit of making very clear that the auditor is not opining on management's process. So the auditor is not driving management's evaluation process.

So it's a win/win from the standpoint of costs. It's a win/win from efficiency. It's a win/win from the standpoint of investor protection.

MR. HEWITT: I'd just like to add to that it's very difficult to audit management's process as such. Every company management will have a different process in terms of trying to establish their internal control system, and to audit that is not important.

What is important in the audit of internal controls is for the auditor to look and find the high-risk key internal control points within the system and test those controls to see that they're functioning properly.

It has nothing to do with the process or evaluation. So that's why the opinion is as we think it should be so the focus is where it's important and what is not important.

COMMISSIONER CASEY: As we monitor the
implementation, if we were to find that the cost savings and
the efficiencies that we were expecting were not being
achieved, would the staff make recommendations to the
Commission on any changes that need to be made?

And have we had discussions or have we spoken to
the PCAOB about having that kind of openness and ensuring
that the standard and the management guidance are working
effectively?

MS. PALMROSE: Well, at this stage, we're committed
to going forward with the implementation and acquiring the
evidence. So I don't think there has been any conclusion or
prejudgment about what that evidence would be or how one
would react to it.

I mean, one really has to see the evidence before
one comes up with proposals to respond to it, but we're very
optimistic, as I said, that with the guidance and with AS 5
that all the pieces are in place and we've rationalized this
process.

COMMISSIONER CASEY: One further question. Some of
the commenters raised concerns with management guidance or
for smaller companies understanding what's required under
management guidance. Clearly, it's voluntary, and we provide
a safe harbor if they follow it.

There has been some discussion here about their
ability to get input on how they should apply management
guidance and COSO also providing a framework.

There has also been the notion of providing greater
direction from the Commission or being able to be more
responsive in providing answers to questions that they might
have. There was some discussion about an ombudsman.

What challenges should we give consideration to in
providing additional guidance?

MS. PALMROSE: Well, first, as you did say, in
terms of more specificity about what an evaluation could
consist of, COSO has actually provided that in the guidance
that is available for small companies that came out I think
it was last June or July. And so that is available, and that
can be applied.

The staff does take calls in OCA, so we actually
are responding to any requests for additional information and
insights. So far the only request we've got is where is it,
and we were able to respond to those. So far we haven't had
questions develop, but we certainly are prepared to respond.

COMMISSIONER CASEY: Thank you very much.

MR. WHITE: As I mentioned, the Office of Small
Business in Corp Fin is working on this brochure that will at
least provide kind of a guide, I guess you would say. But of
course the real place to look is in management guidance
itself. I mean, it was written in a plain English workable
way so that you can --
COMMISSIONER CASEY: Can you speak a little bit more about the guide again, about how it's going to work for smaller companies that you're drafting?

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

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

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

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

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

COMMISSIONER ATKINS: Aye.

COMMISSIONER CASEY: Yes.

COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.

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

COMMISSIONER ATKINS: Yes.

COMMISSIONER CAMPOS: Yes.

COMMISSIONER CASEY: Yes.

COMMISSIONER NAZARETH: Yes.

CHAIRMAN COX: And that matter stands approved.

Thank you all once again for outstanding work, and I want to take this opportunity also to thank the chairman of the PCAOB, Mark Olson, the entire Board and their staff once again. This was very much a collaborative work over a long period of time, and I think we all have a lot to be proud of.

(A brief recess was taken.)

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

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

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

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

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

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

Global accounting standards benefit investors by allowing better comparisons among investment options and increased access to foreign investment opportunities. They reduce costs for issuers who no longer have to incur the expense of preparing financial statements using different sets of accounting standards.
And lower costs facilitate cross-border capital formation as well as benefit shareholders who ultimately bear the burden of the entire cost of the financial reporting system.

Five years ago with the Commission's express support the Financial Accounting Standards Board and the International Accounting Standards Board formalized their commitment to the convergence of U.S. and international accounting standards.

More than two years ago we endorsed a roadmap that will commit us to eliminating the U.S. GAAP reconciliation requirement for foreign private issuers with the result that eligible firms listing on U.S. exchanges could choose whether to report under IFRS or U.S. GAAP.

Once the U.S. GAAP reconciliation requirement is eliminated, if an issuer chose IFRS, it wouldn't be required to reconcile the differences with U.S. GAAP just as today issuers reporting under U.S. GAAP are not required to reconcile the differences with IFRS.

In supporting convergence between IFRS and U.S. GAAP, the Commission has recognized that progress could result in IFRS and U.S. GAAP co-existing and even freely competing in U.S. capital markets.

This commitment to convergence has meant that issuers, markets and investors will some day have a choice,
because they, not the government, will decide between IFRS and U.S. GAAP. It has also meant that the SEC was seriously contemplating a system in which both foreign and domestic issuers would someday have that choice.

In March, the Commission held a roundtable on IFRS to assess the impact of the co-existence of two sets of accounting standards on the U.S. markets, on the decisions that investors make and on the Commission's program of investor protection.

We heard from key participants in the capital-raising process -- issuers, accountants, investors, credit rating agencies, investment bankers and, of course, lawyers -- on whether the benefits of eliminating the U.S. GAAP reconciliation requirement for foreign private issuers are, in fact, achievable in practice, and their responses were resoundingly positive.

Today, nearly 100 countries require or allow the use of International Financial Reporting Standards. Since 2005, when the European Union mandated the use of IFRS for public companies in all of its member states, the Commission has received a significant volume of financial statement filings using IFRS from foreign private issuers.

Likewise, U.S. investors, analysts and others who rely on these issuers' financial statements are becoming increasingly familiar with IFRS.
In light of these developments and our roundtable, the Commission last month proposed to eliminate the requirement that foreign private issuers who submit financial statements prepared using IFRS also submit a reconciliation of those financial statements to U.S. GAAP.

This proposal, if adopted, would result in the co-existence of two different sets of accounting standards in the U.S. capital markets.

This morning we're considering publishing a staff Concept Release that solicits public comment on the future role of IFRS in U.S. markets and asks whether U.S. issuers should be permitted to use IFRS for purposes of complying with our rules and regulations.

In some respects, this is a mirror image of allowing foreign private issuers to file IFRS financial statements without reconciling their financial statements to U.S. GAAP, because it would give U.S. issuers the same choice that foreign private issuers would have.

This concept would also touch potentially every aspect of the U.S. capital markets from how U.S. accountants are educated and trained to how U.S. issuers prepare their financial statements, to how U.S. investors understand financial statements and to how accounting standards are developed and interpreted to apply to U.S. companies.

The purpose, then, of this concept release is to
solicit views from a broad range of investors, issuers and other market participants on the benefits and the costs and the advantages and the disadvantages of allowing U.S. issuers to report using IFRS.

This public feedback will be enormously valuable to the Commission. In addition, many countries have already made the change from their home country GAAP to IFRS, and we would be particularly interested in hearing from issuers and regulators and other affected parties in these jurisdictions to understand and learn from their experience.

Before I recognize Conrad Hewitt and John White to lead the discussion of the staff's recommendation for soliciting that feedback through the proposed concept release I want to thank the staffs of the Office of the Chief Accountant and of the Division of Corporation Finance for your excellent work, in particular, Julie Erhardt, Jim Kroeker, Katrina Kimpel, Joe Ucuzoglu, Jeff Ellis, Stephen Brown, Mark Barton, Craig Olinger, Paul Dudek, Michael Coco and Sondra Stokes.

I also want to thank Ethiopis Tafara and Sarah Otte from the Office of International Affairs, Richard Sennett from the Division of Investment Management and David Fredrickson and Zachary May from the Office of the General Counsel.

So now I will turn it over to Conrad Hewitt and
John White.

MR. HEWITT: Thank you, Chairman Cox and members of the Commission. It is truly amazing for an accountant that has been in the business for as long as I have to present to you today a proposed concept release to allow U.S. issuers to prepare their financial statements in accordance with IFRS instead of U.S. GAAP.

When I began my career, it was a big deal during the course of any international work just to communicate with or visit others around the world. There was no thought of there being a practical way to work with the same set of accounting standards across borders.

I am pleased that not only are we considering it, but many others are as well throughout the world. I realize this is the case only by virtue of the work you cited of both the Commission and many other parties over the years.

All of these efforts have put me in a position where I, as Chief Accountant, think that it's appropriate at this time to recommend that the Commission ask investors, issuers, auditors and other market participants to help the Commission's exploration work by providing their views on the possibility of an IFRS option for use by U.S. issuers in preparing their financial statements for the purpose of complying with the rules and regulations of the Commission.

The draft Concept Release that you have before you
is the document by which I recommend that the Commission seek
this input over approximately the next 90 days.

Please let me emphasize that I see this Concept
Release as just that, an information-seeking document, and it
does not conclude that U.S. issuers should be permitted to
report under IFRS much less provide a timeline.

Rather, among other things, the Concept Release
describes and asks several questions about, A, the
convergence work that has been underway for the past five
years to align the content of IFRS and U.S. GAAP;

B, the appropriateness of exploring the possibility
for U.S. issuers to have that option to report under IFRS
while the convergence work continues and;

C, lastly, the effects on the obvious parties,
investors and issuers, but also on other parties such as
educators, auditors, specialists such as actuaries,
regulators that are not security regulators and other market
participants whose work would be impacted by implementing
such an IFRS option.

It does not take very long in thinking about each
of these aspects of this policy matter for many questions to
come to mind since the U.S. capital markets have not
previously experienced the wide use of two different sets of
accounting standards by issuers.

The Concept Release would pose all those questions,
and I am sure commenters will let us know if we forgot one or two.

Now, before I turn it over to John White, Director of the Division of Corporation Finance, I certainly want to express my thanks to all the members of our staff who have worked hard to think about these matters and prepare this Concept Release.

And I would like to especially mention to my left here Rick Sennett, Chief Accountant for the Division of Investment Management who is here with me at the table, for the contributions of his group with respect to working to make this Concept Release inclusive of the interests of the possible use of IFRS by investment companies.

I will now turn it over to John.

MR. WHITE: Thank you, Conrad. Good afternoon, Chairman Cox, Commissioners. As Conrad discussed, the purpose of this Concept Release is to raise a series of questions to solicit public input on the possibility of allowing U.S. issuers to present their financial statements prepared in accordance with IFRS as published by the IASB instead of in U.S. GAAP in their filings with the Commission.

Last month we were before you, and the Commission approved a proposal that we made for providing for specific rule changes which would allow foreign private issuers to present in their filings with the Commission financial
That proposal was a critical and dramatic step towards the regulatory framework that we're looking out towards of a single set of high-quality comprehensive global accounting standards.

And as I guess I've said many times, consistent and faithfully applied comprehensive global accounting standards will provide investors with an enhanced ability to compare companies and will serve to improve confidence in our markets.

So, all of this that I've described was the primary focus of a staff roundtable on IFRS that we held last March where I think most of us that are here today were at that roundtable.

What we're presenting to you today in the form of a Concept Release is, I think it's really fair to say, is an even more dramatic step than what you did last month, because last month what you did related to certain foreign private issuers.

Today we are talking about the possible choice to use IFRS by any U.S. issuer. We're talking about tenfold the number of companies that this would be available to.

If the Commission were to provide U.S. issuers with a choice to include financial statements prepared in
accordance with either U.S. GAAP or IFRS, issuers would need
to carefully consider that choice.

We recognize that not all U.S. issuers would choose
to use IFRS. Some, including those that do not have a
significant customer base or operations outside the United
States, would likely continue to present their financial
statements prepared in accordance with U.S. GAAP in their
filings with us.

I think many of those companies are likely to be
the smaller companies that would continue to stay with U.S.
GAAP.

We recognize that providing U.S. issuers with this
choice would allow them to use one of two different sets of
accounting standards, and while this is a necessary step
along the road to global accounting standards, it does mean
that we would have two sets of accounting standards out there
that would have equal standing, that would be co-existing in
our capital markets.

Now, we recognize that this ability to use IFRS
could benefit U.S. issuers in our ever increasing global
capital marketplace, but we also recognize that investors and
other market participants would need to understand and work
with both IFRS and U.S. GAAP while comparing U.S. issuers,
particularly since we expect many U.S. issuers would
continue, as I said, to elect to stay with U.S. GAAP.
We need public input and believe this is the appropriate time to go out and seek that input, and that is why we're recommending this Concept Release to you.

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

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

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

And in the Division of Corporation Finance, Craig Olinger, Sondra Stokes, Paul Dudek and Michael Coco and of course Rick Sennett in IM all for their invaluable contributions and I guess I would even say for their global vision in presenting this matter to you.
I guess I'd actually have to say that almost every one of the people that I've named has spent a lot of personal time with me teaching this topic to me and helping me understand it, and I really want to say thank you to everyone who has helped me with this process.

With that I'll turn it over to Katrina.

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

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

The Concept Release describes the Commission's past consideration with respect to reducing disparity between the accounting and disclosure practices of the United States and other countries as a means to facilitate cross-border capital formation while providing adequate disclosure for the protection of investors and the promotion of fair, orderly and efficient markets.
Accounting standard-setters have been encouraged to do the same as demonstrated by the Financial Accounting Standards Board and the IASB being committed for the last several years to the convergence of U.S. GAAP and IFRS.

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

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

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

Additionally, we are interested in what issuers believe the cost of converting from U.S. GAAP to IFRS would be. We are recommending that this Concept Release be open to public comment for a period of 90 days after its publication in the Federal Register.
Thank you, and we are prepared to answer any questions that you may have.

CHAIRMAN COX: Thank you very much. And thank you especially, Joe Ucuzoglu. I can say it often and proudly.

MR. WHITE: I've never been able to say it.

CHAIRMAN COX: Thank you, Katrina. Thanks to everyone who presented. Let me just start by jumping on a point that you began to discuss about who might be interested in a voluntary system in electing the use of IFRS.

For most of America's public companies, particularly smaller public companies, almost any change in regulation is viewed as a cost. They're not leaping to move from Windows XP to Vista, and I don't imagine them all lining up to be early adopters to completely change over their entire accounting system.

So why would any mid-cap or small cap company volunteer to use IFRS? And to put it the other way, will any U.S. issuers want to prepare their financial statements in accordance with IFRS, and why?

MR. WHITE: Why don't I at least start with some of my experiences at least. And I guess I will have to say that companies that have talked to me have been largely the large multinational companies, and there seems to be a great deal of interest among them in this possibility.

The two reasons that they cite are that they
believe it will be a lower cost and lower burden in preparing their financial statements because they're already following IFRS in their foreign operations, their foreign subsidiaries and that they think it will be much more efficient for them to be able to just prepare their financials in one standard. The other obvious benefit is in terms of access to capital. If other companies in their industry are also reporting in IFRS, then they may well want to be able to report in the same method, basically, as their competitors. And so particularly if they're competing internationally, at least listening to the larger companies they would like that benefit. I can't say I really heard it from the smaller companies. At least in my experience, they have not been at our door in the same way. Conrad, and Julie, you may have talked to smaller companies as well.

MR. HEWITT: And I'll just add on to what John has said. We do know there is large multi-global U.S. companies that have adopted IFRS throughout the world because it's easier to consolidate their financial statements monthly and quarterly and annually. And it would make a lot of sense for those companies to certainly look at this option and adopt it if they're using it worldwide already and not in the U.S. In essence, they're maintaining two sets of very expensive
accounting records.

Moving on down the chain to the mid-caps and small companies there's a large number of them that operate throughout the world and have operations and divisions and subsidiaries and plants, and so forth.

These are not just sales offices, but these companies will have a more difficult time to move to this option, because you have to have a CFO, you need a controller, you need accounting staff in the U.S. that understands IFRS and how to apply them. And that does not exist today.

So it will take a while for those companies, and these companies, by the way, are using U.S. GAAP throughout the world as much as they can get by with. They'll be required by statutory -- requirements of audit companies to provide statutory audits, but they're still using U.S. GAAP worldwide.

CHAIRMAN COX: On the subject of two systems co-existing, which would be a prospect of a voluntary choice between one or the other systems, isn't it essentially the case we've already got that?

Once we lift the reconciliation requirement you've got every foreign private issuer with the choice, and we can imagine what that choice will be for foreign issuers, to use either IFRS or U.S. GAAP.
They file with us their financial statements that investors get to consume are prepared using IFRS. So investors and analysts and we are already in the position of looking at both operating already in our markets; isn't that right?

MR. HEWITT: That's very true. IFRS is becoming very popular throughout the world. Right now there is over 100 countries that have adopted IASB standards, and there's more moving towards that direction.

We know Canada is moving towards that direction. We met with them last month on this subject. Korea, which their GAAP is very similar to our U.S. GAAP, they have told us that they are moving to IFRS.

So the analysts and investors here in the U.S. and throughout the world are becoming more and more accustomed and understand IFRS as being used in the financial statement reporting process.

And that's important, because I think it will be -- it's already widely accepted, as you say, and I think it will be easy for the more sophisticated investors to accept IFRS financial statements. Maybe the retail investors, the small ones who never understand U.S. GAAP anyway because it's so complicated in certain areas, won't care.

So I think it's here, and there will be some -- it
will take a while for everybody to get used to these types of standards in the U.S.

MS. ERHARDT: I was just going to add I think the point of your question is, in essence, what brings us here today, which is if we, the staff, did nothing about U.S. issuers using IFRS, in substance, doing nothing is doing something, and it's precluding the use.

And as a result, if the proposal goes forward for foreign issuers, we are indeed having a dividing line in our market where the two GAAPs co-exist based on country of incorporation outside the U.S., and they don't co-exist for U.S. issuers.

So really, I think what's behind the staff's thinking is by doing nothing you're making that dividing line, and how do we know that dividing line is the right one? How do we know that the co-existence dividing line should be foreign choice, U.S. not?

So we don't know, and so this Concept Release, in essence, elicits comment to say maybe that doesn't make sense. Maybe it does, but we'd like to know. As opposed to just continuing business as usual and by default having that dividing line.

CHAIRMAN COX: If the dividing line is as you describe, a choice of accounting systems based on your jurisdiction of incorporation and that would be the regime
administered in the United States, might that, in fact, not be an incentive for people to pick up and reincorporate, leave America and come back as a foreign company?

MS. ERHARDT: Yes, and hence we're here today to solicit input.

CHAIRMAN COX: Just one last question. We recently announced the creation of a committee on improvements to financial reporting. Are they going to look at some of these questions, too?

MR. HEWITT: Yes. There will be, basically, five segments that they'll be looking at, the five working groups. And one of them is on the international convergence, and is that model better than some of the the models that we're using in the U.S.

They will have an observer present from IASB. They've already named that observer. We're hoping that what we do in this improvement to the financial reporting process that they'll take it back and also do the same thing over in Europe.

CHAIRMAN COX: Thank you. I don't have any further questions. Commissioner Atkins.

COMMISSIONER ATKINS: Thank you, Mr. Chairman.

Just over a month ago we voted to propose that foreign private issuers be permitted to file their financial statements with us using IFRS without reconciling to U.S.
At that meeting, I asked Julie Erhardt when we would see a Concept Release on whether U.S. issuers should be able to file their financial statements using IFRS. Julie promised to turn to that task as soon as possible, and so here we are. That's great.

I congratulate you, Julie and Katrina Kimpel, Craig Olinger, Sondra Stokes and others who have worked so hard to make it possible for us to consider this release today.

Once we start down the road of considering whether foreign private issuers can file in IFRS without reconciliation, the natural question, as you were just talking about, arises of whether U.S. issuers should be able to do the same.

Some have even taken it one step further and suggested that we mandate the use of IFRS by U.S. issuers. Indeed, one of the panelists at our IFRS roundtable last March suggested just that, a former chief accountant.

As more and more countries switch to IFRS the pressure is likely to build on the U.S. to do the same or, at a minimum, to permit it as an alternative. If IFRS becomes the dominant standard, it may not be in our best interests to try to swim against the tide.

Of course, if IFRS is not applied consistently across the countries in which it's adopted, there will be
less of an appetite here for moving to such a standard.

Before taking any definitive steps, however, I think it's important to look at all of the considerations that apply uniquely to U.S. companies. We also must thoroughly consider the direct and indirect costs of opening the door to the use of IFRS by U.S. issuers.

The comments that we receive in response to our Concept Release will assist us in determining whether to go forward and, if so, how and when to do so.

We also will gain useful information by observing how IFRS is used in practice and by participating in international efforts to achieve consistency.

So I look forward to hearing from a wide range of commenters in response to the many questions in the Concept Release. One thing I should note is that input from the Office of Economic Analysis will be important as we decide how to proceed.

We will not have the benefit, unfortunately, of Chester Spatt's insights. Today marks Chester's final open meeting. So thank you, Chester, for all of your contributions to the work of the SEC during your tenure here.

I just have a few questions. One, are there certain types of U.S. companies for which you believe there to be particular pressure to shift to IFRS?

MR. HEWITT: I'll go ahead. John mentioned a
couple items on that point. Yes. There are particular industries, such as the financial institution industry, where IFRS is very prevalent throughout the world.

U.S. large banks like J.P. Morgan, investment companies will agree to have to look at it and say, you know, "The rest of our competitors are using it, and it's difficult not for us to use it and be competitive in the capital markets throughout the world." So those types of companies certainly.

And then, as I said before, the large multi-global companies are using it now throughout the world and not in the U.S., but they definitely would want to consider it.

COMMISSIONER ATKINS: Are there any industries or sub-industries where you think it's already a competitive issue for us, or is it too new?

MR. WHITE: I thought it was mentioned at the roundtable that the airline industry was an industry that U.S. companies would be quite likely to migrate to IFRS. Were there other industries mentioned, Julie? That's the one I remember.

MS. ERHARDT: No, not by name. But I think generically, think of any industries where maybe the larger players are domiciled outside the U.S. They would probably be the first to coalesce, if you will, because they're the furthest where the industry players would have moved along to
IFRS from other countries.

Whereas, in industries where the larger players perhaps are more concentrated in the U.S., perhaps less of the industry has moved due to developments overseas, so maybe that would be a little slower to have an interest.

MR. WHITE: One of the things that the securities analyst and the rating agency participant at the roundtable said was that in industries where they analyze in IFRS they take the U.S. GAAP numbers and, basically, convert them over to IFRS in their analysis, in any event, today or as best they can. Don't always have all the information you need.

COMMISSIONER ATKINS: Right. One aspect of it, too, is to build competency here. So are U.S. universities starting to go down that line of teaching the differences between GAAP and IFRS? Obviously, discussions like this will help encourage that, I suppose.

MR. HEWITT: No, they have not. I gave a speech at the University of Washington about two month ago, and I indicated that the international convergence, for example, is moving along, and it was going to be possible some day in the world there might be just one global standard-setter some day many years away.

I urged them to start teaching IFRS in their classroom. One of the problems is there's not even a textbook as such yet. I'm sure they are being developed now,
but it takes a long time to get all this stuff moving.

And then the final end of this whole process is in the U.S. here it has to be on our uniform CPA examination in the 50 states. There are no questions on the exam today concerning IFRS.

COMMISSIONER ATKINS: Right.

MR. HEWITT: There has to be in the future.

MS. ERHARDT: I was just going to say on a practical level in two weeks Jim Kroeker and I are speaking before the annual meeting of all the accounting professors in the United States. So we will definitely cover this matter and encourage them.

MR. WHITE: One group that I do think is moving forward are the large accounting firms. I mean, in discussions with them they are working quite hard on this.

COMMISSIONER ATKINS: That's good. Okay. Thank you very much.

CHAIRMAN COX: Thank you. Commissioner Campos.

COMMISSIONER CAMPOS: Thank you. I'm also pleased to support the Concept Release. I'd like to thank the Office of Chief Accountant, the Division of Corporate Finance, the Office of International Affairs and all the individuals that are mentioned for all of their hard work.

Obviously, this Concept Release follows on the heels of our release in which we propose to eliminate the
U.S. GAAP reconciliation requirement for foreign private issuers who file financial statements prepared in accordance with IFRS as published by the IASB.

Given that we have proposed allowing foreign issuers to use IFRS without reconciliation this at least raises a question of whether we should also, to provide symmetry, allow U.S. issuers to also use IFRS.

That said, I don't want to minimize the fact that allowing domestic U.S. issuers to use IFRS would be a very significant policy decision. There are many theoretical and practical issues that must be addressed before we actually take such a step.

It does, however, seem appropriate to at least present the issue for public comment in such a Concept Release.

Over the past few years there has been increased focus on the use of IFRS around the world and in particular in Europe. In just a few years, the Commission has seen a substantial increase in the number of filings containing financial statements prepared in accordance with IFRS from just a few in 2005 to over 100 in 2006.

That said, it is not clear how much thought and attention issuers, investors and other interested parties in the United States have given IFRS. Indeed, even the Commission's recent proposal to allow foreign private issuers
to file financial statements prepared in accordance with IFRS without a reconciliation is tailored to the needs of foreign issuers.

The importance of today's Concept Release, therefore, is that it seeks to highlight the use or the potential use of IFRS in the United States. As with the proposed release we issued last month, though, we need to make sure that there are no unintended consequences of our actions.

For example, it is important that allowing U.S. issuers to use IFRS would not remove the incentive for convergence between IFRS and U.S. GAAP. As I stated previously, I hope that this would not occur because there are huge benefits for convergence.

So it is imperative that we continue to be vigilant with respect to the ongoing IASB and FASB convergence project and ensure that it continues to move forward.

Protection of U.S. investors is also paramount. We need to ensure that allowing U.S. issuers to prepare financial statements in accordance with IFRS serves this goal. There has been a great deal of talk about the fact that IFRS is more principles based as compared to U.S. GAAP, which is supposedly more rules based.

While I think this is an over simplification, the critical issue is ensuring that accounting standards, be they
principle based or rule based, are specific enough to help
guide conduct in a way that protects investors yet promotes
and facilitates capital formation.

In my opinion, at least some degree of specificity
is required if one wants to hold people accountable for their
actions.

I have just a few questions. We've already
proposed to eliminate the reconciliation requirement for
foreign issuers, so presumably in one short year or so we
will be tasked with evaluating the disclosures pursuant to
IFRS by foreign issuers who are listed here in the U.S. and
judge the reporting under IFRS.

I take it that our agency is making arrangements to
have expertise to do this and to understand whether
enforcement -- hopefully, that's the very, very few
situations -- is needed. Is that correct?

MR. WHITE: Well, without speaking to the
enforcement part, in terms of the internal efforts, I mean,
we've already done that.

We went through starting the summer of a year ago
training, basically, I think everybody across OCA and across
Corp Fin, I mean, all the accountants within the agency,
because we started a really significant review process of all
of the first-time IFRS filers where their 20-Fs came in a
summer a year ago.
And that review project was, basically, completed in June, and there is actually posted on the web site -- I guess it came out after the meeting in June -- of a short, I'll call it a summary, report from OCA and Corp Fin laying out what we found in those reviews plus, by the way, links to all of the Comment Letter correspondence that has now been posted.

We've had a lot of people working first trained and taught and spent a year on this project. We're, obviously, now, in some cases, looking at the second year of filings that have come in from these companies.

We're probably well ahead of most everybody else.

Is that fair to say, Julie, or not?

MS. ERHARDT: Well, I'm not exactly sure who everybody else is. I can speak, perhaps, with respect to our interactions with securities regulators who have jobs like we have in other jurisdictions through IOSCO, the International Organization of Securities Commissions, which the Commission is a member.

In particular, they have a subcommittee on Accounting and Auditing Disclosure which I happen to chair, and certainly through the meetings all over the world face-to-face, four-day meetings with our counterparts we certainly have a very good sense from those who are from jurisdictions that are further down the path in implementing
IFRS as to what they've been through, what issues they're facing, how they are handling them.

So we sort of have an insider's view through our interaction with other regulators as to what's in store and where the rough spots might be. So that has certainly helped form the work that John described, and I envision those relationships and what we can take away and contribute to them will certainly guide our work going forward.

MR. HEWITT: I just might add finally on that question that after the first round of filings that we've only had two real difficult issues of differences in understanding how they applied IFRS out of a couple hundred.

And we have good experience in doing that, so I think we won't be doing anything differently when the U.S. firms and everybody else starts using IFRS.

COMMISSIONER CAMPOS: Well, I'm sure investors will be very reassured that we are on top of our game and that we seem to have all of the experts in the U.S. on IFRS within the particular agency, seeing as no one else has really gotten to it.

Let me ask another question, and that is that we've recently been asked or at least the question has been posed that the U.S. insisting, our agency insisting that IFRS in terms of foreign issuers be the IFRS that's issued or
promulgated by the IASB and not what may be adjusted by
different jurisdictions such as the EU that by so requiring
we are meddling in sovereign concerns.

And I am wondering if that is an issue over time.

What does it mean to domestic issuers in terms of what
version of IFRS they will use? If they want to get the
benefit of IFRS and they use the version that we find
acceptable on our shores, which is what is being published by
the IASB, but Europe has something different and has
carve-outs and Australia has carve-outs and Asia has
carve-outs, how are we going to reconcile that, and why is
that an advantage?

It seems like we will then have various versions of
IFRS and possibly various versions of standards yet again.

MR. WHITE: Well, we won't have various versions in
the U.S. reporting, because foreign private issuers will be
required to follow the IASB version, and U.S. issuers would
be following the IASB version. So at least at that level you
wouldn't have different standards.

MS. ERHARDT: I think it's a little better than
that in the sense that, to my knowledge, the countries that
have moved to IFRS, while they may have carved out and
created options locally, at the same time they have not
precluded use of IFRS in the form issued by the IASB.

So what we're proposing, which is to have issuers
prepare under IFRS as issued by the IASB, in essence,
dovetails with the same type of approach other countries have
gone, to allow it.

The step that they've taken that you refer to is
after some experience under their belt they've, for various
reasons, found the need to make certain provisions optional
but not preclude use of IFRS as published by the IASB.

I have no way of knowing what those pressures are
and if they have any analogy to what we experience in the
U.S. and if we were to get to the point of accepting IFRS for
U.S. issuers whether we might feel the same. That's a
question I can't possibly predict.

I think in pursuit of the idea that a company and
their investors can work with one set of standards globally
the same content, and, in essence, your financial statements
can serve as a passport to various markets, and your
investors will see the financial statements whether they buy
your shares, you know, in London or in the U.S., that is
coalescing, we think, around IFRS as published by the IASB.

So the national versions, while they may serve
national purposes, doesn't shut out the idea that the global
passport would coalesce around the version that the IASB
issues, and, in essence, that's the aspect of the policy
matter that we're pursuing.

COMMISSIONER CAMPOS: So we don't need to worry
about that?

MS. ERHARDT: I'm not stressed.

COMMISSIONER CAMPOS: Okay. I'm sleeping well at night, too. All right. These are interesting issues, and I guess, if there are concerns, we'll certainly hear from commenters on this.

Again, I think it's a worthwhile release. It's timely. It's not often that we get a chance to think ahead and anticipate issues. Certainly, regulators are always accused of not anticipating.

I think this is one case where we are, and we're actually asking, at least domestic players, to get involved and to give us their thoughts about this, which I think is a very, very good move. Thanks.

CHAIRMAN COX: Thank you. Commissioner Nazareth.

COMMISSIONER NAZARETH: Thank you. I'd like to thank the Office of Chief Accountant and the Division of Corporation Finance whose staffs have worked extremely hard in crafting this release.

This topic was part of a discussion at our March 2007 roundtable, and I'm interesting in hearing from a wider pool of commenters about the idea and especially about the timing of any possible proposal.

While I think that the idea of allowing U.S. issuers to file using IFRS is appealing and may be
appropriate at some point in the future, we must carefully think through all of the implementation issues and all the implications before making a proposal in this area.

In particular, we might want to wait until we have gained greater experience with foreign issuers using IFRS before proposing it as an option for U.S. issuers.

As I said at our open meeting last month, investors need high-quality comparable financial information to make informed investment decisions.

Allowing U.S. issuers to file using IFRS, as with last month's proposal to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers filing using IFRS would mean that investors would need to be familiar with two sets of accounting standards, U.S. GAAP and IFRS as published by the IASB.

I'm interested in hearing from commenters about whether this is a significant burden for investors or not. The IASB is a standard-setter that is outside of the Commission's regulatory jurisdiction. I'm interested in learning what impact commenters think this should have on whether the Commission should accept IFRS filings from U.S. issuers.

I'm also very interested in what commenters expect the impact of such a proposal on the convergence process between U.S. GAAP and IFRS. Would there still be an
incentive to continue convergence if U.S. filers are allowed
to file using IFRS?

What would be the impact on U.S. GAAP? Is the
convergence process far enough along to allow U.S. issuers to
file using IFRS?

I would hope that our actions would not slow or
halt the convergence process, because I think that investors
would greatly benefit if we can achieve a high-quality global
set of standards used consistently throughout the world.

So again, thank you for your continued hard work,
and I look very forward to hearing from all parties about how
they think that the Commission should proceed in this area
and on what time frame.

Again, I do think that it's a very fulsome release,
a huge amount of questions, very, really, ideal way frame the
dialogue so that we can get significant input.

I just have one or two questions some of which
relate to those that I've, hopefully, inspired some of the
public to respond to.

One is that the Commission's relationship with
IASB, obviously, is quite different from our relationship
with FASB. How do you think that should impact our
consideration on whether U.S. filers should be able to file
using IFRS?

MS. ERHARDT: I think it's a relevant
consideration. In other words, in the end of the day, the
Commission has responsibility for the accounting and
disclosure practices that registrants use.

Certainly, in carrying out that responsibility in
the U.S. for many, many years, we have looked to the private
sector to help us execute that.

But helping us execute does not change the fact
that ultimately we are responsible, and therefore we can't
help but make very relevant to our considerations what our
relationship is with the private sector body that's doing the
work, whether it be the Financial Accounting Standards Board
or, under this idea, the International Accounting Standards
Board.

So it certainly is a matter that we are
considering. It's certainly a topic that we propose the
Concept Release solicit some feedback on.

But having said that, I'd also like to say that the
International Accounting Standards Board is not an unknown
commodity to us.

Certainly, through the Commission's work for many
years on promoting reducing disparity in accounting standards
the staff have worked with the International Accounting
Standards Board, its predecessor the committee to develop the
standards.

And the Concept Release describes the nature of our
interactions and our service on their advisory council,
participation at their interpretation committee meetings, our
monitoring their projects in the same manner that we do those
of the Financial Accounting Standards Board, our work through
IOSCO with whom they do consult in some of their selections
of trustees, et cetera.

So there is a large degree of interaction, but that
does not change the fact that, as you acknowledge, it is
different, and it's certainly something that we are
considering.

COMMISSIONER NAZARETH: And again, those
differences go to also investors' ability to understand the
financial statements since they have no experience with IFRS.
Again that would, I assume, be another important
consideration.

MS. ERHARDT: Very much so. Education, when people
say that, maybe immediately they tumble to thinking
accounting classrooms and accounting professors and future
accountants.

The release tries to put first order of business
investors understanding of IFRS, because if they have
concerns about their level or their ability to understand,
that's first and foremost what we want to know about.

Then, certainly, it's not unimportant whether those
accountants preparing the financial statements understand it
as well. If investors see rough spots in working with the product, that's first and foremost what we'd like to understand.

COMMISSIONER NAZARETH: Okay. Thank you.

CHAIRMAN COX: Thank you. Commissioner Casey.

COMMISSIONER CASEY: I'm also very pleased to support the issuance of this Concept Release. Last month we published a proposal to eliminate the reconciliation requirement to U.S. GAAP for foreign private issuers that file financial statements in the U.S. prepared on the basis of the IASB version of IFRS.

Given that proposal, issuing a Concept Release to solicit broad comment on whether U.S. issuers should be offered a similar choice is a logical and appropriate next step.

The purpose of such a Concept Release would be to seek comment on whether U.S. issuers should be afforded the choice of preparing their financial statements under U.S. GAAP or IFRS, and, if so, what the implications would be for investors, issuers and our markets.

Clearly, our consideration of whether to permit U.S. issuers to prepare financial statements using IFRS is taking place in the context of other important developments. The growing acceptance of IFRS in jurisdictions around the world, the progress of convergence efforts by the FASB and
the IASB, the increasingly international scope of many U.S. issuers' business operations and our own proposal to eliminate the reconciliation requirement are chief among the factors that compel the Commission to begin consideration of whether U.S. issuers should be permitted to use IFRS in preparing their financial statements.

The Concept Release raises numerous questions about the use of IFRS by U.S. issuers, some theoretical, some more practical.

For example, there are numerous questions designed to elicit information on the degree to which U.S. issuers would have an interest in filing in IFRS, how investors and market participants would react to a marketplace in which some companies would file in U.S. GAAP and others using IFRS and what the effect would be on the ongoing convergence process of permitting U.S. issuers to file in IFRS.

On the more practical side, the Concept Release asks for input on the critical steps that would be needed in terms of investor education and auditor training to prepare for U.S. issuers' financial statements.

I think no one underestimates the significance of such a move or the challenges that it might entail, but the more informed we are about the advantages, disadvantages and ramifications of such a change the better prepared we will be to respond appropriately given our statutory mandates of
investor protection, capital formation and fair and efficient markets.

For this reason, I urge issuers, investors, market participants and other affected parties to assist the Commission in this important area by responding to the questions raised in the Concept Release.

I am pleased to see that we have allowed for a 90-day comment period to provide sufficient time for commenters to prepare their comments. I'd also like to thank the Office of the Chief Accountant and the Division of Corporate Finance for their excellent work, and I'm very pleased to support this Concept Release. I have no additional questions.

CHAIRMAN COX: Thank you very much. Does any Commissioner have any additional questions? If not, we'll move to the vote.

Does the Commission vote to publish a Concept Release to solicit public comment on allowing U.S. issuers, including investment companies, to prepare financial statements in accordance with International Financial Reporting Standards, as published in English by the International Accounting Standards Board for purposes of complying with the Commission's rules and regulations?

COMMISSIONER ATKINS: Aye.

COMMISSIONER CAMPOS: Yes.
COMMISSIONER CASEY: Yes.

COMMISSIONER NAZARETH: Yes.

CHAIRMAN COX: And the matter is approved. I want to thank everyone once again. And before you rise, because the Office of Economic Analysis was a significant contributor to this and because this is going to be Chester Spatt's last open meeting, I want to take this opportunity to thank on behalf of all of us our chief economist, Chester Spatt for your outstanding service.

The SEC was very fortunate to attract you in the first place from Carnegie Mellon. We were doubly fortunate when you re-upped for a second tour of duty.

You have distinguished this Agency with your own outstanding academic and professional reputation. You've added to the reputation of the SEC with your own luster. You've been an outstanding leader, a valued colleague and a giant in the ranks of investor protection.

So on behalf of all of us on the Commission and on behalf of all the professional staff here in the home office and the thousands of us across the country not to mention America's investors and everyone who depends upon free and efficient capital markets, thank you very much for your outstanding service for a job well done. And we wish you God speed on your return to academia.

MR. SPATT: It has been a privilege to serve at the
Agency. Thank you, Chairman Cox, for your very kind words.

CHAIRMAN COX: Well, thank you very much.

(Applause)

CHAIRMAN COX: Thanks again.

(A brief recess was taken.)

CHAIRMAN COX: The final item is a recommendation from the Division of Corporation Finance concerning amendments to the federal proxy rules governing shareholder proposals and shareholder communications.

The most significant of the proposed amendments concern the question of a shareholder's ability to propose procedures in a company's bylaws for the nomination of directors.

Current Exchange Act Rule 14a-8(i)(8) provides that a company may exclude from its proxy materials a proposal that relates to an election for membership on the company's board of directors.

The purpose of this provision is to prevent the circumvention of other proxy rules designed to ensure that shareholders receive adequate disclosure and that they have an opportunity to make informed voting decisions in election contests.

In applying this provision, the Commission staff has determined that companies may exclude from their proxy statements proposals that would establish a process for
conducting contested elections outside of the Commission's
detailed disclosure and regulatory regime governing contested
elections.

Last September, the U.S. Court of Appeals for the
Second Circuit invalidated the SEC staff's long-standing
interpretation of Rule 14a-8(i)(8). That interpretation had
been applied since 1990, but the Court found it inconsistent
with a prior interpretation.

The Court said that it would, "take no side in the
policy debate regarding shareholder access to the corporate
ballot," noting that "such issues are appropriately the
province of the SEC."

Since the effect of the decision is to create
uncertainty about the application of Rule 14a-8 in the Second
Circuit on the one hand and in the 11 other judicial circuits
in America on the other hand, the Commission is required to
act.

Moreover, the effect of applying the Court's
decision as a rule of general application would be to permit
director election contests without the disclosures required
by the election contest rules.

In light of this opinion and the paramount
importance of meaningful disclosure to investors in election
contests, we've undertaken a careful and extensive review of
the proxy process, including the provisions of Rule 14a-8.
This review included three roundtables this past May that focused on the relationship between the federal proxy rules and state corporation law, on proxy voting mechanics, and on shareholder proposals.

Today we're formally considering two different proposed resolutions to this question so that as we continue to evaluate the legal, economic and policy aspects of all that's involved here we will continue to have choices.

I've stated previously and will repeat again today that it's my intention as chairman to have a clear, unambiguous rule in place in time for the next proxy season.

The Government in the Sunshine Act requires that whenever more than two commissioners are gathered to discuss policy-making on a matter such as this it must be at a public meeting. So unfortunately, the obvious way to work through tough technical and policy issues is off limits to us.

That is, as commissioners, we can't get together, roll up our sleeves, sit around a table and brainstorm about potential ideas. Still, that's what this issue calls for, and so we'll be doing some of that work right here during this open meeting just as the Government in the Sunshine Act would have us do it.

As you'll hear, we don't all agree. And when the dust settles today, we won't be finished. We won't be making any fateful decisions just yet, but instead we'll open up
these topics for formal comment from the entire country.

By advancing two very different proposals, we'll have the benefit of the full breadth of commentary about different ways of attacking the issue. By considering serious alternatives, we'll have the benefit of a thorough analysis of a variety of ways to accomplish our intended objectives.

This approach will also give us a richer context in which to evaluate public comment concerning the potential costs and benefits of any new rule, and exposing both of these proposals to public comment will enable us to better understand the impact that any new rule would have on competition, an analysis that we're required to undertake pursuant to Section 23(a)(2) of the Exchange Act.

For all of these reasons, it's my intention to support both releases at the proposing stage. Having said that, the Commission's analysis of shareholder participation in the nomination and election of directors hardly begins with our proposals today.

This issue and its several offshoots have a long and storied history, and many previous chairmen and commissioners have attempted to tackle them. As Chairman John Shad put it during the Reagan Administration, "The Commission has always encouraged shareholder participation in the corporate electoral process," and he added, "The SEC's
responsibilities for regulating proxy solicitation have been premised on a need to assure "fair corporate suffrage" for every security holder."

He advanced an idea to use the Commission's jurisdiction over the Self-Regulatory Organizations to standardize listing standards regarding shareholder voting.

We have a different approach before us today, but the objective remains the same.

Fair corporate suffrage is just as important now as it was in the 1980s, and several commentators from all across the spectrum have recently been making the case.

The distinguished group of securities experts, market professionals and academics that comprise the Committee on Capital Markets under the direction of Professor Hal Scott of Harvard Law School and the co-chairmanship of Glenn Hubbard, President Bush's former Chairman of the Council of Economic Advisors and John Thornton, the former president of Goldman Sachs, devoted an entire section of their recent report to shareholder rights.

They did so because of the same reasons that the SEC today just approved our reforms of Sarbanes-Oxley and our Concept Release on IFRS, because in the committee's words, "the strength of shareholder rights in publicly-traded firms directly affects the health and efficient functioning of U.S. capital markets."
The Committee on Capital Markets observed that, "Overall, shareholders of U.S. companies have fewer rights in a number of important areas than do their foreign competitors." And they added that, "This difference creates an important potential competitive problem for U.S. companies."

As one way of addressing that need, the committee recommended to the SEC that we take the opportunity of the Court's decision in the AIG case to ensure "appropriate access by shareholders to the director nomination process."

But we enter upon this discussion today with the full benefit of recent experience that ended badly. Four years ago under Chairman Donaldson, the Commission proposed a rule that would have established a mandated procedure under which companies would be required to include shareholder nominees in their proxy materials. That rule generated enormous controversy and was ultimately unsuccessful.

There are several lessons to infer from that experience. First, the federal proxy process must be respectful of the preeminent role of state law in determining shareholder rights.

Second, as we heard repeatedly at our three May roundtables on the proxy process, changes to the existing system, even changes that everyone agrees are improvements, should be measured and incremental to ensure that, first, we do no harm.
Third, the federal proxy rules should not embellish shareholders' state law rights or create new ones but, rather, vindicate their existing rights under state law, the company's charter and its bylaws.

And finally, the federal interest is preeminent when it comes to disclosure. Ensuring that shareholders get full and fair disclosure in connection with proxy contests is a fundamental concern of the Exchange Act and of this Agency.

So neither of the proposals that we're considering today takes the approach of the aborted rule 14a-11, which for all intents and purposes would have imposed a national bylaw on every public corporation in America.

Instead, today we're considering whether, if shareholders in companies wish to propose their own bylaws, should those proposals be allowed in the company's proxy materials and, if so, under what circumstances.

And just as the many roundtable participants advised us to do, we will conduct this analysis on a foundation of respect for state law and for the fundamental principles of shareholder choice and private ordering that are the genius of our free enterprise system.

At bottom, a share of stock is private property, and the law's enforcement of private property rights is what gives it its value. America's investors currently entrust over $20 trillion of their assets in exchange for these
property rights as holders of equity securities, and yet a
common stockholder has precious few specific rights that
under-gird this fantastic investment.

And so it's of the utmost importance that what the
stockholder does have is jealously guarded by our legal
system. The stockholder is said to own the company, but he
or she cannot direct management or the board to do anything.
Indeed even 100 percent of the shareholders acting
in concert couldn't do so. Instead, they must rely on the
directors. Only after every unsecured creditor is taken care
of does the common shareholder receive a penny in assets upon
liquidation.

A common stockholder can receive dividends, but
only if the company decides to declare them. But the
shareholders do have the ironclad legal right to do one thing
for themselves, and that's to choose the company's directors.

And yet some say the company's proxy materials,
which are produced at the shareholders' expense, should under
all circumstances be inaccessible to the shareholder when it
comes to nominating directors.

That would seem to stand the principle of fair
corporate suffrage on its head, and that harsh conclusion
would seem especially warranted if what's being considered is
not the shareholder's opportunity to use the company's proxy
to nominate a director but, rather, only to propose a bylaw
that would set up a procedure by which that could happen, but
that would itself have to first be approved by a majority of
the company's shareholders.

Beyond all of this, as so many participants at our
roundtable described, it's an irony that the federal proxy
rules force many other things onto the corporate proxy that
are at the periphery of the shareholder's rights, if they are
within the scope of their state law rights at all.

If a proposal has nothing to do with the ordinary
business of the company, if it's nonbinding and even
superfluous, then the proxy rules might well require its
inclusion on the company's proxy.

But if the proposal concerns the most fundamental
of shareholder rights, the most unqualified, unbridled right
that the shareholder has, then in the current system the
answer is no and indeed no under all circumstances.

As Chairman Shad observed in 1984, "under our
corporate form of enterprise, more not less equity capital is
essential to growth and development. The disenfranchisement
of shareholders poses a present and real issue that must be
debated and addressed." And I would add protecting the
private property rights of America's shareholders is the only
way to ensure that boards of directors remain accountable to
the interests of investors. It's the check and balance on
boards and management that's built into the corporate form
under state law, and its proper functioning is essential to
our free enterprise system.

Still some would say that any incremental
improvement in the way the proxy system vindicates the
shareholder's state law right to choose the directors will
threaten capitalism.

To that I would reply by all means we should be
cautious and measured when we adjust the workings of our
proxy system, and this process of soliciting public comment
we're embarking upon today will ensure that.

But we should also keep first principles firmly in
mind. We cannot have capitalism without capital. There
could be nothing more central to our mission of promoting
healthy capital formation than defending the rights of
capital and the property interests of shareholders.

Ensuring that the proxy system respects the state
law rights of shareholders is essential to maintaining the
balance of federalism, and upholding the rights of ownership
is fundamental to the maintenance of investor confidence and
the workings of our entire free enterprise system.

At this point, let me thank and congratulate my
fellow commissioners for their diligent, professional and
responsible investigation into these issues for the better
part of a year.

While the proposals we're considering today only
begin a process of public comment that will consume several
more months they also mark the culmination of ten months of
sustained work.

Commissioners faithfully attended each of the
roundtables on these subjects and devoted countless hours to
study, to meetings, to research and to collaborative learning
with our professional staff and many other participants in
our capital markets.

And during the last month since the Division’s
initial draft of its recommended release was circulated to
all commissioners, they've contributed many useful comments
and shepherded through many changes. I have no doubt that
this process will continue during the weeks and months ahead.

It’s been a hallmark of our work over the last
two years on many, many difficult subjects that we've sought
whenever possible to reach a unanimous result, because we
knew that by first considering one another's viewpoints we
would inevitably improve our own understanding and the final
result even if in the end we didn't agree.

Today, despite the difficulty that the Commission
has had in wrestling with this issue over several decades all
of us -- Commissioner Atkins, Commissioner Campos,
Commissioner Nazareth, Commissioner Casey and I -- agree
unanimously that the objective of this rule-making is to
protect investors' interests and to promote capital formation
for the benefit of the entire nation.

I hope and expect that all of us will continue to work to get it right. So before I turn it over to John White for a detailed explanation of the two alternatives, let me offer a very brief summary.

The first proposal would amend Rule 14a-8(i)8) to codify the interpretation of the election exclusion since 1990. That approach would ensure that in all proxy contests shareholders would receive the disclosures currently required under the other proxy rules, and it would permit the exclusion from the company's proxy materials of all shareholder-proposed bylaws concerning director nominations.

The second approach would expressly permit the inclusion of such shareholder-proposed bylaws in the company's proxy materials. This approach would also ensure that shareholders received the disclosures currently required under the other proxy rules, and it would require important new disclosures about the shareholder or shareholders who are proposing the bylaw.

The disclosures would be made under the schedule 13D/G regime, which requires that shareholders who own more than 5 percent of the company's shares provide certain information about themselves.

The shareholder proponent would have complete freedom to structure the bylaw so long as the procedure for
director nominations that it sets out complies with applicable state law and the company's charter and bylaws.

This reflects the decision not to impose a federal one-size-fits-all approach, but rather to promote shareholder choice and private ordering. For this reason, the current proposal differs sharply from what the Commission proposed in 2003.

In addition, the second approach includes important new features to facilitate greater online interaction among shareholders and between shareholders and management. It would amend the proxy rules to remove obstacles to electronic shareholder communications.

It would clarify that a company or shareholder who maintains an electronic shareholder forum is not liable for statements by any other participant in the forum, and it would also eliminate any ambiguity concerning whether participation in an electronic shareholder forum could constitute a proxy solicitation.

I'd like now to thank the Division of Corporation Finance and the staff for your excellent work on these proposals. In particular, I want to thank John White, Marty Dunn, Lily Brown, Tamara Brightwell, Steve Hearne and Ted Yu. I also want to thank Brian Cartwright and the Office of General Counsel as well as Chester Spatt and the Office of Economic Analysis for your excellent work.
And now I'll turn it over to John White to explain the two proposals in more detail.

MR. WHITE: Thank you again, Chairman Cox. As you've described, we are recommending this afternoon that the Commission publish two releases related to Rule 14a-8, the Shareholder Proposal Rule.

In a moment, I'll turn this over to Lily Brown to describe the details of the two releases, but first just a comment. I'm going to be reiterating some of the things you just said in terms of the long process that we've gone through.

The staff and the Commission has been studying and discussing this topic in a lot of detail since last September. We've looked at -- discussed many of the alternatives in a quite arduous process.

And as you know, last May we had three roundtables that were attended by all of the Commissioners in which we heard a wide variety of views expressed by the participants. I should also mention that transcripts and video archives of those roundtables are available on the SEC web site for anyone who would like to see them.

There has really just been a great deal of study, discussion and thought by everyone at this table and by the five of you.

So after engaging in this process, as I say,
for almost a year now, we have decided to recommend that you publish for comment two releases which contain, as you describe, alternative and different approaches.

This should allow a full range of public comment while still permitting the Commission to adopt a new final rule before the next proxy season, which you quite forcefully stated a few moments ago as your goal.

So that's kind of where we're at in terms of what we've done here. Before I turn it over to Lily let me just thank the team, because it has really been an incredible effort by them during this long period not just getting these releases ready for you today but just the whole idea of putting on three roundtables in a single month.

Some people don't realize what it is to put a roundtable on. I don't think anybody has ever put on three of them in one month on one topic. So it really is an incredible job the team has done here.

Just to go through the key players, in Corporation Finance, Lily Brown, Tamara Brightwell, Ted Yu, Steve Hearne, and I left to last Marty Dunn, who I think has pretty much spent - he’s been involved with this topic all of his professional career or most of it.

MR. DUNN: Five or six years flew by.

MR. WHITE: A long part of his professional career.

I mention that because you're going to hear from Marty as
we're answering the questions today.

Others that are here at the table, in some cases behind us, in General Counsel's Office, David Fredrickson, Alex Cohen and Meredith Mitchell. In the Office of Investment Management, Susan Nash, Brent Fields, Tara Buckley. In the Office of Economic Analysis, Cindy Alexander.

And I won't read through all the individual Commissioner's counsels, but there have been tremendous effort put in by the counsels of all five of you in inputting on this process. All of us in Corporation Finance and elsewhere on the staff are very appreciative of all their efforts.

So with that I will turn it over to Lily to go through more details than I guess you did a moment ago.

MS. BROWN: Thank you. Good afternoon. Today we are recommending that the Commission publish two releases related to Exchange Act Rule 14a-8, the shareholder proposal rule.

The first release would propose amendments to Rule 14a-8 that would enable shareholders to include shareholder nomination bylaw proposals in the company proxy materials where the proposal relates to a change in the company's bylaws that would be binding on the company if approved, the proposal is submitted by a shareholder or a group of
shareholders that has continuously held more than 5 percent of the company's securities for at least one year, and the shareholder or group of shareholders is eligible to and has filed a Schedule 13G that contains all required information. There would be no limitations in our rules as to the content of those proposals. They would need only to comply with applicable state law and governing corporate documents.

However, critical to allowing this access to the company's proxy materials would be comprehensive disclosure regarding the shareholder proponent and the shareholder proponent's relationship and prior interactions with the company.

As proposed, Regulation 14A and Schedule 13G would be amended to provide shareholders with additional information about the proponents of shareholder nomination bylaw proposals. These additional disclosures would be required by the shareholder proponents as well as by the company.

The proposals also would assure that the existing disclosure requirements for solicitations in opposition would apply to nominating shareholders and their nominees under any such shareholder nomination procedure with the nominating shareholder being liable for any false or misleading statements in that disclosure.
Nominating shareholders and their nominees as well as the company would be subject to the additional Regulation 14A and Schedule 13G disclosures as well.

We also recommend that this release propose revisions to the proxy rules to promote greater online interaction among shareholders by removing obstacles in the current rules to the use of electronic shareholder forums and clarify the application of the liability provisions of the federal securities laws to statements or information on such a forum.

The release also asks for public comment on a range of questions related to the shareholder proposals process under Rule 14a-8.

Finally, we recommend that the Commission approve a second release in which it would propose amendments to the text of Rule 14a-8(i)(8) regarding proposals that relate to an election. These amendments are designed to clarify the operation of the exclusion in Rule 14a-8(i)(8) in a manner that is consistent with the Agency's prior interpretation of that exclusion.

Under that interpretation, companies may permit the exclusion of proposals that would result in an immediate election contest or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the
Thank you. We would be happy to answer any questions you may have on the two releases.

CHAIRMAN COX: Well, thank you. Because of, obviously, the way this works with respect to shareholder bylaws is the center of discussion, I want to ask about something that might otherwise not get quite as much attention.

In one of the two alternatives there is the proposal that you just described to open up the space that we're roughly describing as electronic shareholder fora. I wonder if you could help describe what it is that we're doing and what we're not doing with this proposal.

For example, would the federal proxy rules mandate a particular kind of online forum, or would this be, essentially, a free form opportunity for shareholders and companies to try out new ideas and be creative?

MR. DUNN: Okay. I'll start with that. The key to it is that what we're making clear here is that folks can do it and that there's no particular way that we would say you can run a forum.

The goal is to not inhibit how they develop. The purpose for this is to look through the proxy rules and try to think of things in there that careful people might look to to find ways not to that might inhibit them and to eliminate
those concerns; for example, the concern that there might be liability for one person for the statements of another on such a forum. And we provide clarity regarding liability is on the speaker.

Questions about whether participation there might be deemed a solicitation under the proxy rules. In the proposals, very basically it would say that if it's 60 days before the meeting -- and there's a little bit if you announce later than that -- but, basically, 60 days before the meeting and you're not soliciting a proxy, then you'd be out of that definition. So folks don't have to worry about that part of it.

Similarly, there would just be a statement in there saying that companies are allowed to do this. Shareholders are allowed to do this, which I think is very useful for folks to know.

So the goal would be simply to get out of the way and let whatever technology, whatever ability folks have to come up with any way to interact, do petitions, look amongst each other, figure out ways to interact amongst each other and with the company. We'd let that flourish.

CHAIRMAN COX: Existing federal law provides broad protections from liability for online access providers generally for statements of others on internet forums of various kinds.
So I take it what we're doing is we are adding to those liability protections specific coverage that in addition to not violating any other federal laws you're not violating the federal proxy rules.

MS. DUNN: Yeah. I'm not sure who was in Congress at the time they got passed, so I don't know anybody who knows anything about that. But that is very clear with respect to other things, and because folks tend to be very cautious when the securities laws liability come around we're trying to take the same approach here. Exactly.

CHAIRMAN COX: Just quickly, if you would -- we've discussed a lot at the three roundtables, which really were superb -- how do the Division's recommendations reflect or respond to the participants' statements at those roundtables?

MR. DUNN: The three main things that I took away from those discussions were the need to make sure that the federal securities laws and particularly the proxy rules are aligned with state law rights. The other was to make sure that no matter what you do disclosure has got to be paramount. And the third thing I saw was that, really, technology needs to be taken into account.

So what we believe these do is do all three of those, actually. The proposals would definitely look more to the state law ability of folks to raise bylaw provisions. It would in conjunction with that recognize the overriding need
for disclosure, regardless.

And the forum part definitely looks at technology, and the Commission has taken some other recent actions that go that direction as well, the e-proxy and the various things there.

So to my mind, a lot of what we learned at the roundtables goes into this. I think we learned more at that than is done here, but what we do here I think fits within those areas.

CHAIRMAN COX: All right. Thank you. I haven't any further questions, and so I'll recognize Commissioner Atkins.

COMMISSIONER ATKINS: Ok. Thank you very much, Mr. Chairman. The topic before us today is one that’s long vexed many of our predecessors. It seems that at least once a decade we engage in a significant review of the proxy rules.

Just look at what we did in 1976, 1982, 1992 and 1998. I had a personal and intimate experience with the 1992 changes, as did Marty Dunn, when I worked here with Marty. And now, during the first decade of the 21st Century this is already the second time that we've engaged in an extensive review and discussion of our proxy rules.

The key question is how do we address the competing problems of collective action versus the tyranny of the
minority? How do we permit shareholders to effectively exercise their state corporate franchise rights without allowing a shareholder who may have only a nominal economic interest to highjack the agenda of all shareholders?

We've tried to bridge this problem with Rule 14a-8, a rule that while far from being perfect has at least created a framework for dealing with this problem.

Today we have proposed a couple of actions on this issue. The need to address this issue has been precipitated by the Second Circuit's decision last year in AFSCME v AIG. That decision has created an air of uncertainty as to what is the current state of our regulations with respect to the election exclusion of Rule 14a-8.

This uncertainty must be cleared up. It is unfair to both companies and shareholders alike to keep the current murky situation in place. By doing nothing, we invite costly and fruitless litigation.

It’s further unfair to create an environment where contested elections could occur for seats on the boards of directors outside of the disclosure regimen imposed by our own Rule 14a-12. Thus, the current situation is simply not acceptable.

So as to the two proposals to be published for comment today, one I can support, and the other I cannot. There are aspects of the latter that I can support, but
overall I have significant questions regarding our authority to take some of the steps proposed to be taken. In particular, while I agree with the statements in the release emphasizing that it is substantive state law that governs shareholder rights I have concerns whether some of the proposals may conflict with that principle. I also worry about the slippery slope of some of the provisions in the proposal. Moreover, I do not believe that the second proposal takes into account all of the recent changes in corporate governance generally. It does not consider more measured steps that we can take to continue to drive down the costs and improve the efficiency of running a short slates of directors, even a short slate of one that may lead to the attaining of the goals of responsible long-term shareholders concerned with the financial performance of their companies. Nevertheless, I look forward to the debate that certainly lies ahead.

As the Chairman said, a lot of discussion and thought has transpired among the Commissioners and the staff on this issue, especially during the past couple of weeks leading up to this meeting.

I want to recognize especially the efforts of the staff who have literally sacrificed their weekends and their nights during this period in order to respond to the various ideas and suggestions being put forth by the Commissioners.
So your efforts are really tremendously appreciated by I'm sure all of us up here on the table. Thank you very much.

I just have one question, and that's for our General Counsel. Just exactly what are we voting on now? I just want to make sure that it's a draft as to the interpretation and proposal with respect to 14a-8(i)(8) that I guess I received last night about 11 p.m. give or take a few minutes.

And then as to the longer one, again it's a draft dated last night. I got it about midnight, and it's marked from changes from the 11th of July.

MR. WHITE: I'll let Brian finish the answer, but you received an action memo, as you described, last night around 11:50 that had attached to it both of the releases. And those are the two releases you'd be voting on.

MR. CARTWRIGHT: Just to complete the answer, I think, as in all matters that are brought before the Commission, the draft that is most recently before the Commission at the time of the vote is the draft on which the Commission is voting.

And I believe, if I understand, and I think my colleagues in the Division agree the drafts that you refer to are the drafts before the Commission.

COMMISSIONER ATKINS: Okay. I just wanted to make sure. Okay. With that, thanks. I look forward to hearing
the comments of my fellow Commissioners.

CHAIRMAN COX: Thank you. Commissioner Campos.

COMMISSIONER CAMPOS: Thank you very much. Let me also add my thanks to the staff and in particular Corp Fin and all the individuals who have participated and worked long hours on these two proposals. It’s been a mighty chore, and tremendous labor has been put into it. Let me echo my appreciation as well.

These issues have been around since I joined the Commission five years ago, and it's incredible how, as time goes by, how we keep reflecting and dealing with the same issues in many respects.

I do think the world has moved, and I do think the latest three roundtables have added to the record and the investigation that the Commission has done in this particular area.

Essentially, it seems to me that all of this effort, essentially, boils down to a situation that exists in America that is very different than any other developed market in the world. That is, only in the United States – as compared to other developed markets – are shareholders who hold a voting class of shares, prevented from voting yes or no for directors.

As we all know, shareholders can only vote yes or withhold their votes. Some have called this system -- we've
often heard this – “Soviet-style voting.”

As the Chairman said, this system seems to fly in the face of basic ownership rights under our capitalist system for property. Do shareholders have a right to vote and influence the selection of directors, or is that simply an illusion?

Under our laws, shareholders are not entitled to manage the day-to-day operations of a corporation. That is clear. Instead, however, they rely on management efforts of the board of directors who owe them fiduciary duties.

So again it would seem logical and rational that shareholders who owned voting stock have the right to vote for directors or influence their selection in a meaningful way.

It seems that there are greater issues and problems with the opponents who fear shareholder access. I think part of it is philosophical. Part of it is a view that shareholders are not really owners, which I think flies in the face of our corporate law. That view, sort of, maintains that shareholders are free riders who can, essentially, use the Wall Street rule and simply walk when they don't like what's going on.

Of course, what this particular proposition ignores is that the time to walk is when the share price is at its lowest, and it seems hardly an option to sell your stock when
it's the lowest instead of trying to influence the company in a meaningful way to improve itself and have the share price go up.

Further, large institutions today are heavily invested in indexes and cannot simply move large blocks of shares. If they do, that affects the price. So this is a serious issue, and that particular view I don't think deals with reality.

Another reason that's often cited is that shareholder access will somehow disrupt the conduct of business at companies and boards. In my view, this particular argument doesn't hold water.

Essentially, shareholders, in my evaluation and in my study, don't want to do the day-to-day business of boards. They intervene only when they have to and when there is repeated failure of performance and failure to take into account shareholder suggestions.

So a company that is consistently underperforming I think quite naturally under a capitalist system should expect the attention of shareholders.

So our proxy proposal or any proposal, frankly, in this particular area would not affect any company that is responsive to shareholders, I would submit.

Finally, I hear the argument that: "There is so much to deal with with respect to SOX. Please don't add another
requirement.” Well, I think that the world today moves fast. The Commission didn't create the global economy. The Commission didn't create activist funds. The Commission didn't create all of the pressures and all of the financial competitive situations that exist. We didn't create the effort of private equity and hedge funds who are interested in this particular world. So I think it belies the issue. This is not something that a board can avoid by simply not having a rule that allows for shareholder proposals. Shareholder activism is something that occurs here today in spite of whatever the Commission may do.

So, essentially, I think it comes down to is accountability, and I think under our capitalist system boards need to be accountable. That's the way they were designed under our basic laws from the premises and from the history of Anglo-Saxon law. There needs to be accountability to shareholders. Our particular proxy proposal today, and I'm talking about the first one that has to do with the 5 percent, would be a simple and elegant way of trying to accomplish under state law the means for a proposal to be made for a framework for shareholder access.

Whatever that might be would be ultimately between the shareholders and the company and be governed by state
Having said that, I do support the -- let me be clear -- I support the proxy proposal today that involves the proposition to allow shareholder proposals to go forward, but I do have some deep reservations.

I'm aware that many investors have said very publicly that a 5 percent ownership threshold is too high. This is especially the case, they argue, in large companies, in our large accelerated filer community, and the reason for that is very simple.

If you put together the holdings of all of the major institutional investors that make up one of the large organizations, the Council of Institutional Investors, with respect to large companies, their combined holdings do not equal 1 percent. There may be some exceptions, but that's generally the rule.

So investors have posed the question: is a rule in which a 5 percent threshold is proposed useful to investors? Is this threshold, essentially, too high so that the proposal is, essentially, useless and more optical and, in fact, an illusion?

Several questions are asked in the release which I think promote or at least elicit responses from investors and commenters and academics about this particular question.

In particular, one of the questions has to do with
whether the Commission should consider some sort of
differentiated standard for large companies, which might mean
that the percentage should be substantially lower than 5
percent, maybe even 1 percent -- or lower, who knows -- or
whether it should be higher.

Also asked is whether a different set of standards
should apply in terms of a threshold for smaller companies,
mid-cap and small caps.

So I today want to encourage investors and other
commenters, academics, to make their views known and to give
us their thoughts as to this particular proposal that has
been offered.

Separately, I also have great reservations about
the question raised in this longer proposal that would allow
the opting out, my terminology, of the SEC's 14a-8 procedures
for non-binding or precatory proposals.

The question poses a situation in which either
shareholders or management through a bylaw proposal could
eliminate the non-binding proposals being considered at all
by a company. I mean, that could be the ultimate result of a
proposal that is ultimately adopted by shareholders.

I think the question is open as to whether such a
proposal would require shareholder approval if the company or
the board made it.

I'm very concerned about whether it is good policy
to eliminate a particular opportunity that nuns, rabbis, Christian sects, environmentalists and others have used for placing non-binding proposals -- I'm sure I left someone out -- for consideration by management.

As stated in the roundtables, this particular procedure under our oversight and under 14(a) often presents ideas that eventually get traction, get legs and turn into real proposals that are adopted by the company.

So I'm interested in knowing what investors and commenters think about this particular question and the possible rule that may come out of this.

Is it good policy to allow a system to take away this particular practice and force those types of activists to use other tactics? I look forward to those comments.

As to the second release, I find myself in a position of not being able to support it. The second release, to my analysis, has many problems not the least of which is that it, essentially, puts investors in a position where they can no longer make any proposals if it were followed by the letter of the law, by the letter of this proposal.

However, I find that it seems to me to be somewhat deficient in that it doesn't really answer many of the questions that the Second Circuit put.

Without doing a legal analysis here, which I think others might be interested in doing, the Second Circuit did
state that: "The SEC fails to so much as acknowledge a
changed position let alone offer a reasoned analysis of this
change. The amicus brief," referring to our submission, "is
curiousely silent on any division action prior to 1990 and
characterizes the intermittent post-1990 no-action letters
which continue to apply the pre-1990 positions as mere
mistakes."

For that and for other reasons, I believe that this
particular proposal will not change the status quo. As I
read it, there's nothing in this release apart from the
proposed rule that is really new.

Thus, the interpretation of this release without
more is, to quote the Second Circuit, "plainly at odds with
the interpretation the SEC made in 1976."

Given this, I hope and expect that the Agency will
not be taking the position in the upcoming proxy season that
this release without adopting a final release of some sort
changes the current situation.

But let me ask a couple of questions about that.

Brian, perhaps you can help me. In your opinion, does this
interpretive release have any current legal effect?

Specifically, in your view, is it sufficient to effectively
reverse the Second Circuit's decision and change our views as
respect to what we do with no-action letters?

MR. CARTWRIGHT: Well, the release, if adopted,
includes a provision that restates yet again the Agency's
position under the existing 14a-8(i)(8).

As was mentioned, 14a-8(i)(8) was adopted in 1976,
and at that time the Commission said that Rule 14a-8 was not
the proper means for effecting reforms in elections. And at
least since 1990 the Agency through the Division of
Corporation Finance in the no-action process that 14a-8
itself sets forth has on countless occasions reiterated that
position.

Perhaps the most recent and full statement of that
position was the statement the Commission made in the Second
Circuit itself in which the Commission authorized -- it was
actually under the signatures of John White and myself -- the
submission after a request for an amicus brief from the
Second Circuit of a very full explication of the
Commission's, the Agency's long-standing position.

What this proposed release would do would restate
that conclusion. I think I know that there are many who care
very much about that restatement or not.

Nonetheless, I think that the whole record of the
Agency's position going back to 1976 would be before any
court that would be considering this, or reconsidering it in
the case of the Second Circuit, and saying it one more time.

Well, one could ask the extent to which that would
have a decisive effect on any judge or panel that might
consider it. So that's, I think, what it does.

COMMISSIONER CAMPOS: So just to try to phrase it in a little bit my plainer version of English, you don't think this particular release, if adopted, the shorter release, would control any other court who is looking at this particular situation?

MR. CARTWRIGHT: Well, it's a restatement of the Commission's existing position. So we might, assuming that it's adopted this afternoon, look at the state of affairs yesterday and the state of affairs tomorrow.

What we would have tomorrow if it were adopted would be one more statement of the Agency's position, which it's had for a very long time now.

And as I say, I think can you ask how much effect that would have on a court in the Second Circuit or a court in any of the eleven other circuits. It's incremental. It's saying it again one more time, but that's all it is.

COMMISSIONER CAMPOS: And this statement was, effectively, already before the Second Circuit the first time, wasn't it?

MR. CARTWRIGHT: Yeah. The Second Circuit, of course, as everyone who has been following this is well aware, did not accept the Agency's long-standing interpretation.

So the current state of the law in the Second
Circuit is contrary to the Agency's interpretation. One would assume that another court in the Second Circuit would feel bound by that precedent. It's always possible that there would be some way to argue that it shouldn't be bound, but, presumably, it would be.

So I think saying the same thing again one more time without precluding any possibilities here is probably not highly likely to have an effect in the Second Circuit, and I think courts outside of the Second Circuit considering it have the whole record before them.

This is one more occasion, if adopted, in which the Agency would have made that statement. Perhaps that would be persuasive to a judge, but you have to look at the whole package, and it's just one more iteration.

COMMISSIONER CAMPOS: Thank you. Let me go to John or Marty, whoever wants to handle this one. So, what is, how is the Division of Corp Fin going to handle -- if we assume we adopt this second shorter release today, how is Corp Fin going to handle a request for a no-action position by the division with respect to excluding a bylaw proposal that would put a shareholder access process in place?

MR. WHITE: Let me start by saying I think that's a very hypothetical question, because as Chairman Cox has described a few minutes ago we have every expectation that prior to the upcoming proxy season one of these proposals or
the other or some combination would be adopted so we will
actually have a final rule in place. So we would not be in a
situation to ever face a proposal --

COMMISSIONER CAMPOS: So the shorter proposal is
not a final rule, in your view if adopted today? Is that
what you're saying?

MR. WHITE: It contains a rule proposal. A rule
proposal is, obviously, not being adopted today. It's a rule
proposal.

COMMISSIONER CAMPOS: On the short interpretive
release?

MR. WHITE: Both releases are rule proposals or
contain rule proposals.

COMMISSIONER CAMPOS: Okay. All right. I just
want to make clear that that was the case. So you're
saying -- you're punting a little bit, because you're saying
we'll have a final rule, and the division won't have to worry
about that?

MR. WHITE: Well, I started by saying it was
a -- as you were posing it, it was a hypothetical question or
quite likely to be hypothetical.

If we were to have a no-action letter request prior
to a final rule being adopted, based on our current thinking
and the advice of the General Counsel's Office, which you
just heard Brian's description, and remembering that any
shareholder proposal is very fact specific in terms of how you analyze it -- I mean, there are all kinds of different factors that may come into play with respect to a particular proposal -- we would be analyzing it and approaching it the same way as we did last season.

COMMISSIONER CAMPOS: The same way as we did last season, which would be that we take no view, or words to that effect? You will not issue a no-action letter?

MR. WHITE: We only put out a letter one time last season which we said we had no view. It was not a matter that was subject to the Second Circuit, or at least the company said it was not subject to the Second Circuit.

COMMISSIONER CAMPOS: So you would expect to have the same view based on your current thinking as you did last season, correct?

MR. WHITE: Based on our current thinking and based on our discussions with the General Counsel's Office, yes.

COMMISSIONER CAMPOS: Okay. Now let me push you a little bit more. This is even more hypothetical. So assume we never go to a final rule. What would be the position of Corp Fin with respect to requests for no-action positions in a shareholder access bylaw proposal given today's adoption of the short release or putting it out?

MR. DUNN: If we never adopt a rule, I'd be really disappointed in everybody. Where we are now what this says
is where we've thought -- and how is that for the dad in me
coming out -- but it is where we've been all along --

COMMISSIONER CAMPOS: We'd all be disappointed.

MR. DUNN: -- is what this says is this is the view
of the Commission which the Commission has expressed before.
That didn't hold sway in the Second Circuit in the recent
decision.

So where we are left with following this, following
the discussion Brian just had as to how this plays, while it's
an interpretation, it's a restatement of the interpretation.
It's not a final rule, because it's a rule -- it's a current
interpretation. It's not a final rule. It's a proposed
rule.

Based on what Brian just said I think we're in the
same spot whether it's a week from now or six months from now
is that we are still faced with this is the view of the
Commission. There's an opposite view of the Second Circuit.

There's not a final rule clarifying it or not
another action clarifying it for us, and so that places us in
the same spot we were last year regarding the level of
certainty we can have.

MR. CARTWRIGHT: I think that the division would be
very much in the same position it was last time, and so it
would be not inappropriate for it to take the same position.

I think it would be very disappointing if the
Commission were unable to come to some resolution here, because I think what would happen is what started to happen but didn't quite happen in the last proxy season is that we would end up with litigation by private parties. This is litigation to which the Commission is typically a party, if at all, only as an amicus -- so not technically a party -- in other circuits. We would end up with a situation where there was great uncertainty around the nation, and that I think we all agree is not desirable. From our narrow view in OGC, it's not desirable. I think it's probably not desirable more generally. So I hope that, as Marty and John said, this turns out to be hypothetical only.

COMMISSIONER CAMPOS: Well, I think we'll all be disappointed if we don't have a meaningful final rule. All right. I'm happy for those clarifications. I appreciate the thought that went into them.

And again, I really am appreciative -- I know every other Commissioner and our staffs are -- of all the hard work that Corp Fin has done and all the other divisions that have weighed in as well. Thank you.

CHAIRMAN COX: Thank you. Commissioner Nazareth.

COMMISSIONER NAZARETH: Thank you. As it was originally contemplated, the proxy access proposal, which I'll call the first proposal, was intended to recognize the
legitimate interests of shareholders in the governance of the
corporations they own.

This proposal is designed to enable a meaningful
percentage of shareholders to come together to propose a
bylaw amendment regarding the procedures for nominating
candidates to a company's board of directors.

It would facilitate shareholders' exercise of their
fundamental state law and company ownership rights to elect
the board of directors. It would largely eliminate the
artificial barriers that the federal proxy rules have erected
to the exercise of these state law rights.

The proposal would also mandate robust disclosure
regarding the background and interaction of the proposing
shareholders and the company, providing information necessary
for shareholders to determine the extent to which the
proposing shareholders may be acting in their own
self-interests.

The proposal was designed to balance the rights of
shareholders with the legitimate goal of leaving the
management of companies largely to the board and the
managers, whose primary focus should be on profit generation.

One key element of the proposal that was designed
to achieve this goal were the thresholds that were set to
trigger access; namely, that the proposing shareholder or
group of shareholders have 5 percent or more of the stock and
that they have held the stock for at least one year.

Whether these exact percentages and holding periods achieve the correct balance may well be an open question, and I would certainly encourage comment on this point, but the concept of requiring a meaningful percentage of ownership and a holding period to trigger the access to the proxy seemed very sensible to me.

Today's proposal is based on another perfectly logical economic tenet. In a free market system, a majority of the shareholders will generally behave in their economic self-interest.

When it comes to share ownership, their goals are profitability and integrity of the enterprise. In the vast majority of instances, these incentives will be consistent with those of a company's management.

Unfortunately, there are notable instances, however, in which management acts in its own economic self-interest or chooses to ignore the express will of the shareholders and is unresponsive to them.

In these instances, shareholders should have the ability to effect changes more effectively through the proxy process.

Currently, shareholders have virtually no chance to do so through access to the company ballot. Our proxy rules do not facilitate it, and shareholders are forced to solicit
proxies on their own ballot, which is more costly and much less effective.

This proposal appears to be responsive to many of the constructive comments we received at the roundtables on proxy access that were held over the past several months. We received very insightful input from a host of panelists many of whom focused on both the tension between federal proxy rules and the rights afforded shareholders under state law.

Another area of focus at the roundtables and one on which we ask a variety of questions in this release relate to precatory proposals.

In this release, we ask a number of thought-provoking questions on possible changes to Rule 14a-8 rights concerning precatory proposals, including the possibility that shareholders could vote to establish access procedures concerning precatory proposals that differ from those in our rules.

Now, unfortunately, after all this effort, I'm now concerned that all of this work towards greater shareholder democracy may not be realized and that the chances of effecting meaningful shareholder access may be minimal.

Yesterday, I received for the first time an entirely different, indeed diametrically opposite alternative, to this shareholder access proposal. That is the second proposal that we are being asked to vote on today.
This one is probably best called the shareholder non-access proposal. I was previously told verbally that we should expect to be asked to vote on proposing a confirmation of the staff’s pre-AFSCME position on proxy access.

It was expressly understood that during the pendency of the comment process on these two proposals that we would maintain the status quo and not issue any interpretation that purported to move the starting line, so to speak, back to where we started, but that is exactly what was produced yesterday.

Thus, we're being asked today to vote on two proposals, the second of which, at least on its face, purports to immediately return us back to our pre-AFSCME posture.

What concerns me more, however, is that this shareholder access proposal could in fact -- although I don't think that it was the intention, it could, in fact, be turned on its head.

There's at least a possibility given now that we have two proposals that the Commission could pick and choose from each of these diametrically opposed proposals and thus put shareholders in even a worse position than they are currently.

And let me give you an example. Although I previously supported including the Discussion and Question
section on shareholder procedures for precatory proposals in this release partly because it is consistent intellectually with state law rights and the free market concepts in the access release, and it was coupled with increased access in the access release, it could now potentially be split from the shareholder nomination access proposal and coupled with the non-access proposal, at least potentially.

So one can imagine a final rule-making in which we then are asked to consider both pre-AFSCME non-access and potentially more restrictive precatory proposal procedures. Indeed, one of the possible outcomes under this scenario could be the adoption by a board of directors without a shareholder vote at all of procedures concerning shareholder precatory proposals that are more restrictive than our current 14a-8 as long as this action was consistent with state law.

Now again, I don't think that that was anybody's intention, but because we have these two proposals that is a possibility. And so it's for that reason that I'm extremely concerned about where we find ourselves having these two proposals today.

A vote against the shareholder access proposal would make non-access a virtual certainty, but a vote for it does leave open this possibility of some problematic results.
So it's going to be very incumbent on all
commenters to firmly establish what their positions are and
how important these issues are to them as we deliberate on
these incredibly important issues.

So needless to say, this has been, I think, one of
the more challenging issues that I've worked on since I've
been here at the Commission, and I've worked on a few of them
that were a little complicated.

The challenges have undoubtedly also been extremely
taxing and challenging for our staff as well, who throughout
this process have acted with extraordinary energy and
professionalism.

And I really want to specifically recognize the
staff for their countless hours that they've devoted to this
exercise, particularly John White, Marty Dunn, Lillian Brown
who I don't even want too think about how little sleep she’s
gotten in the last week, Tamara Brightwell and Steven
Hearne and obviously our friends as well in the Office of
General Counsel.

So with that I do just want to ask Brian to address
a little bit because of my caution and concern about this
precatory discussion.

My reading of this is that the discussion was so
fulsome and the questions in the release now are, in fact, so
specific that at least as a technical matter we could move to
an adoption on the precatory section even though it's not
drafted as a proposal but as questions.
       Could you comment on that, please?
MR. CARTWRIGHT: Yeah. Let me sound like a lawyer,
since I am, at the outset and say that it, obviously, would
depend on the specifics of whatever was proposed to be
adopted in the end, and careful analysis would have to be
done there.

       The set of questions is, I think, dense. There are
a lot of questions that are asked. I think the world is
fairly on notice that the Commission could act in this area.
So I think the Commission will have a great deal of
flexibility when the time for adoption comes to take any one
of a broad range of courses. When we get to the point where
we're starting to crystallize down to one, then we'll have to
take a close look and make sure that it fits with what has
been proposed.

COMMISSIONER NAZARETH: Thank you.

CHAIRMAN COX: Thank you. Commissioner Casey.

COMMISSIONER CASEY: I would also like to start by

thanking the staff for all of your hard work. The process
leading to today's votes on two proxy related releases has
required quick work by the staff and has sought rapid
response by the Commission.

Today's larger proxy proposal that which would seek
to fundamentally change our proxy process presents a difficult
challenging issue, and you have been able to work under
extraordinary time pressure, often sacrificing much of your
personal time and turning your attention away from other
important work as you press forward with this work.

Unfortunately, despite your hard work I find that I
am only likely to be able to support one of the proposals
before us today. I remain unable to support the broader
proxy proposal offered today that would fundamentally change
our proxy process.

While I have supported the Commission's efforts to
evaluate the operation and effectiveness of our proxy rules
with an eye to considering whether changes to our rules are
advisable or warranted, I have also firmly believed since the
Second Circuit decision in the AFSCME v AIG case that the
Commission must provide clarity and certainty by first
reaffirming its long-standing interpretation that Rule 14a-8
is not the proper means to wage a contested election and that
bylaw proposals such as the AFSCME proposal are excludable
under 14a-8(i)(8).

I believe now, as I did in the months following
that decision and leading up to this past proxy season, that
that long-standing policy, a policy that we recently
confirmed just last March in our submission to the Second
Circuit, is sound and that it preserves a carefully crafted
disclosure regime for the protection of all shareholders.

    Further, recognizing the long history, sensitivity
and significant import of these issues for shareholders and
companies, I felt strongly that an open and deliberative
process was necessary to inform the Commission's
consideration and provide valuable input and context
regarding the current state of the operation of our rules and
whether they effectively serve the interests of all
shareholders.

    The roundtables held two months ago were intended
to bear these questions out and test assumptions about
whether the appropriate balance in our rules continues to be
struck appropriately.

    Unfortunately, I cannot support the broader proxy
rule release before us today because I think it fails to
adequately address both of these interests.

    I am, however, pleased -- and I want to discuss
this a little bit more in some of my questions -- that the
Commission is considering separately a release that reaffirms
our long-standing position, clarifies our long-held view and
proposes clarifying language should such language be
necessary.

    Given the fundamental changes that would be
proposed to our carefully crafted proxy regime, the
challenges presented by any alterations to this regime and
the controversial nature of proposals in the proxy area
generally, I do not think that the proposing release offering
a new bylaw approach is appropriate at this time.

The proposal suggests that the Commission believes
that the option offered by the release is the best or
preferred option, and I have no such confidence that this is
so.

Further, I do not believe that the single-option
proposal makes a sufficient effort to rationalize the
Commission's long-held positions on 14a-8 and instead offers
an abrupt change of course with little explanation.

In three weeks during May, the Commission hosted a
series of roundtables to consider the role of our proxy rules
and whether any changes to the rules should be considered. I
viewed the roundtables and all of the work conducted before,
during and after the roundtables as a fact-finding effort to
inform the Commission on whether or not additional changes
were necessary or desirable.

The schedule included a roundtable considering the
different federal and state rules in the proxy process, two
weeks later a roundtable discussing the mechanics of the
current process and the very next day a roundtable on
shareholder proposals that could vindicate state law rights.

Although this process was, in my mind, intended to
inform our judgment the aggressive schedule suggested that it
was laying the foundation potentially for a predetermined proposal, and so I fear that much of what we learned during this process is not contained in the single-option bylaw proposal before us today.

I understand that in the draft we received late last night there were additional questions added intended to elicit comments in an attempt to be responsive to these concerns, and I appreciate those changes very much, although I still believe they do not go far enough.

Instead, today's bylaw proposal approach presents an abrupt change to our long-standing proxy process and fails to meaningfully discuss or offer alternatives that could potentially achieve the same or even better results.

I have no confidence that this is the only direction that we can go, but I fear that the Commission's release of a single option proposal forces us in this one direction to the exclusion of other potentially viable alternatives.

As I noted a moment ago, proxy access issues have historically been challenging to the Commission. We've considered similar proposals in the past as recently as in 2003, as previously been noted, but the Commission has always stopped short of endorsing a fundamental change to the rules because such change alters the entire construct of our proxy rules, has the potential to skirt our careful disclosure
regime, touches fundamental notions of corporate governance and reaches the federal/state division of responsibility. This process has a 60-year history, and given the stakes, change has largely been measured and incremental. While the bylaw approach is at least theoretically intellectually appealing and compelling to me, the release's base assumption and practical implication continue to pose some real policy concerns.

One of the key failures of previous proposals in this area is that the Commission sought to establish a federal access rule that pushed the envelope, in my view, of SEC authority into more substantive state law territory and also may have been inattentive to disclosure concerns. The bylaw proposal before us today attempts to address these concerns by hewing to state substantive law and by enhancing disclosure requirements for proponents, and while I find these considerations meritorious and necessary, the release before us still remains flawed.

As I noted earlier, my view is shaped in part by the many views discussed at the roundtables. In these roundtables, participants discussed the role of the federal government in the proxy process and the important role of the states in defining shareholder rights and responsibilities. Many participants also described binding proposals as the most important shareholder rights, viewing precatory
proposals as less important. Still others asserted that
precatory proposals, though largely a creature of federal not
state law, constitute important shareholder rights.

Participants discussed that the precatory process
has evolved over the years into a process that certain
shareholders view as important to exercising their voice to
the company on a range of matters not all of which are
related to the economic value of the company.

According to many roundtable participants, it also
has created a system in many cases whereby proponents use
precatory proposals to engage management in discussions that
result in real change. In some cases, these discussions and
changes are hidden from the view of other shareholders.

I question whether our proxy rules should be
facilitating such conduct, and today's single-option proposal
does not squarely address this condition.

One over-arching theme I did take from the
roundtables, however, was the need for caution and careful
balance in considering any changes we might seek to make.
And my view is that the bylaw change today is much more of a
sea change.

Other roundtable participants also addressed the
absence of fiduciary responsibilities in non-management
proponents and the effect this condition might have on other
shareholders.
The single-option proposal, the bylaw proposal offered today, announced only today only briefly visits this question and only addresses it through disclosure. And again, there were many other topics that were discussed, including the role in the proxy process of advisory services, broker voting, majority voting, empty voting and over-voting.

The release, in my view, does not seriously address many of these considerations, nor does it speak to or take stock in some other changes that have been going on in the market, including the rise of institutional investors and their ability to effect management and the new changes on e-proxy as far as bringing down costs for proxy solicitations.

The natural next step we should be taking in light of all the considerations advanced in our fact-finding roundtable is, in my view, a release that posits several different approaches and seeks comment upon those approaches but that also invites different ideas.

As I noted earlier, I understand that some effort was made in the last few hours to elicit such comments through questions, but the clear implication of today's single-option release is that the option is the preferred choice of the Commission.

And without a more informed discussion it cannot be my preference, and I cannot support the narrow bylaw proposal in its current form.
With that said, I'd like to just further inquire from the general counsel regarding the Second Circuit's decision. Can you please articulate exactly what the Second Circuit found in terms of our need to further explain our position?

MR. CARTWRIGHT: I don't think the Second Circuit found anything that was mandatory on the Commission.

COMMISSIONER CASEY: Okay.

MR. CARTWRIGHT: The Second Circuit did not accept the Commission's long-standing interpretation of existing 14a-8(i)(8), and therefore at the present time in the Second Circuit the Commission's interpretation does not stand. That was the conclusion.

COMMISSIONER CASEY: I'm sorry. Could you repeat that? I just couldn't hear you Brian.

MR. CARTWRIGHT: I'm sorry. And that was the outcome of that case. We participated as, in the view of the Second Circuit, as an amicus.

We're not a party, as we would not normally be in these circumstances, and they did not choose to adopt the view that the Agency propounded and which was consistent with the Agency's long-standing position. We lost.

COMMISSIONER CASEY: I appreciate that. So in your view, it was incumbent upon the Commission to do what in order to clarify its approach?
MR. CARTWRIGHT: Well, that's not strictly a legal question, I guess.

COMMISSIONER CASEY: Okay.

MR. CARTWRIGHT: If you were asking me what would be needed to minimize legal uncertainty, I would say a clear Commission rule-making. There's two proposals before the Commission today. The outcome, if either of those are adopted, will be a much greater clarity than exists at the moment where we have a single circuit at variance with the position of the Agency.

And as you know, within particularly what we've around here called the long release because it has more pages there's a fulsome set of questions. So there's lots of possibilities that remain open.

I think my colleagues in the Division of Corporation Finance expressed the view that they would be disappointed if the Commission were unable to come to some conclusion.

I think the Chairman has said very forcefully that he expects that the Commission will be able to reach a rule-making outcome. And if that happens, then we will have legal clarity, and the 2008 proxy season will be less potentially chaotic than it might otherwise be.

COMMISSIONER CASEY: Thank you.

CHAIRMAN COX: Commissioner Atkins.
COMMISSIONER ATKINS: I just wanted to follow up on that. With respect to the shorter release, I'll just read the one sentence of the summary up front.

"The Commission is publishing its interpretation of and proposing amendments to Rule 14a-8(i)(8) to provide certainty regarding the meaning of exclusion in that rule."

So I think there is a significant difference. The Second Circuit -- I guess I, sort of, disagree with the sweeping conclusion that you came to, Brian.

But I think they ask for an explanation clearly. They parse carefully the deference to be given between an amicus and a rule-making. I think we're answering that question today in setting it out.

And I guess my question to the Corporation Finance Division is in administering Commission rules do you believe that you should follow Commission rules and views, or do you think you should be free to disregard those?

MR. CARTWRIGHT: Can I jump in just to respond for half a second before they answer? And that is the Second Circuit made it clear in its opinion that it considered the ultimate policy decisions in this arena to be the Commission's choice, not for the judiciary.

So that's why the Commission can adopt a new revised 14a-8, the old 14a-8. The Commission has a great deal of freedom. I didn't mean to suggest anything to the
contrary.

COMMISSIONER ATKINS: Okay. All right. And as to
the explanation that they were looking for, I think that's
being provided.

But I guess my question is in view of the action
that I guess we're going to take today, would you follow
Commission interpretation in administering our rules?

MR. WHITE: We would follow Commission
interpretations.

COMMISSIONER ATKINS: Okay. Thanks.

CHAIRMAN COX: Is there any further question or
discussion? If not, we'll move to the vote.

Having designated these to everyone's satisfaction
as the long release and the short release, the question will
occur first on the long release. All those in
favor?

(Chairman Cox and Commissioners Campos and Nazareth
voted in favor. Commissioners Atkins and Casey voted
against.)

And the recommendation is approved.

The question next is on the short release. All
those in favor?

(Chairman Cox and Commissioners Atkins and Casey
voted in favor. Commissioners Campos and Nazareth voted
against.)
And the recommendation is approved. There being no
further business to come before the meeting, the meeting is
adjourned. Thank you all for a long day.

(Whereupon, at 2:50 p.m., the meeting was
concluded.)

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