Investors Technical Advisory Committee
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Via Email

December 13, 2007

Mr. Mike Cook, Chairman
SEC Advisory Subcommittee III: Audit Process and Compliance
SEC Advisory Committee on Improvements to Financial Reporting

Dear Mr. Cook,

The Investors Technical Advisory Committee (ITAC) welcomes the opportunity to provide input on the Subcommittee's preliminary findings. Our input is from our perceptions as users of financial statements with the goal of improving the financial reporting process[1].

The following are ITAC's comments pertaining to the Subcommittee's preliminary findings discussed in its report dated November 2, 2007 regarding financial statement restatements. We hope these comments will be considered during your next scheduled meeting.

In general, ITAC believes:

- A material error in either annual or quarterly financial statements should be corrected in a timely manner.
- The current guidance provided by the courts, Securities and Exchange Commission (SEC) and American Institute of Certified Public Accountants Auditing Standards Board regarding assessment of materiality is appropriate. Materiality has been and should remain a function of the application of judgment based on the specific facts involved.
- A material transaction from a quantitative perspective should typically not be determined to be immaterial from a qualitative perspective, unless such a calculation should produce a numerically non-meaningful result (such as when the comparison is to an insignificant amount of earnings.) . Additional guidance on such determinations while helpful, would likely further contribute to a "rules" oriented mentality when applying such judgments.
- When an error has been determined to have occurred, it should be promptly reported to investors along with available pertinent information regarding the following:
    - the nature and magnitude of the error;

[1] This letter represents the views of the ITAC and does not necessarily represent the views of its individual members, the organizations by which they are employed. ITAC views are developed by the members of the Committee independent of the views of the FASB and its staff. For more information about the ITAC, including a listing of the current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml

- the items in the financial statements impacted;
- the impact (or potential impact) on liquidity, results of operations, financial condition and cash flows[2];
- whether a material weakness in internal controls exists; and
- the expected timetable for restatement of financial statements and remediation of internal controls matters.

- To the extent the above information is forward looking, a safe harbor consistent with that currently provided for disclosure of forward looking information in Management's Discussion and Analysis could be provided. However, a safe harbor should not be provided for historical information that is factually incorrect.
- When a material error is corrected, it is important investors be provided corrected financial statements that present all periods in a consistent and comparable manner. Investors should not be required to "adjust" prior period financial statements to make them comparable.
- A safe harbor for judgments should not be established. That would result in a check the box mentality with respect to judgments and negatively impact the professional judgment required in making such assessments. It should also be noted that many of the judgments that were made in many of the recent corporate scandals have been appropriately questioned. In addition, any safe harbor for judgments would have to take into effect that the judgments being made by preparers and auditors are those considered to be "experts" within the SEC reporting system.

More specific comments on the above items follow.

Restatement Process:

ITAC agrees with the Subcommittee's belief that often, but not always, current disclosures surrounding restatements are not adequate and could be improved both from the perspective of completeness and timeliness. In particular, the announcement of a pending restatement creates an uncertainty in the marketplace that may result in a drop in securities' value that may ultimately drop further or rise when the uncertainty is removed. Disclosures that would help in reducing or eliminating this uncertainty would be beneficial for investors. For example, ITAC would support company's disclosing additional information as it becomes known during the restatement process.

Realizing disclosure of specific amounts related to errors and pending restatements may not initially be possible, investors would benefit from the following information as soon as the information becomes known including:

- Items in each of the financial statements and their captions which are the subject of the errors and pending restatement.
- For each of the items identified, the nature of the issue giving rise to the error and pending restatement, and the amount (or potential range) of the error.

[2] Impacts on current period results and impacts on trends should be reported

- If the errors involve estimates or judgments, identification of changes, and their magnitude, when they become known.
- Effect(s) on past and future liquidity and cash flows as well as ability to access resources.
- Business units/locations/segments/countries/subsidiaries that are affected by the error and pending restatement.
- Event(s) that caused the restatement to surface, what are the expected remediation activities the company is implementing during the restatement process, and the estimated time-frame to completion.
- Period(s) that are affected and are being reviewed.
- Internal control weaknesses or deficiencies for the accounting area(s) that have been identified.
- Other business areas that could be impacted (e.g., potential loss of customers, violation of debt covenants, etc.).

To the extent any of the above disclosures change materially, we anticipate Form 8-K filings would be used to identify material changes in facts as more information becomes known.

The following outlines our input on other areas where your Subcommittee has preliminary views:

<u>Materiality:</u>

- The ITAC agrees that both quantitative and qualitative factors are necessary to evaluate whether a restatement is material. Materiality should be based (as it is currently) on whether in the light of surrounding circumstances, the magnitude of the item, or a combination of items, is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item. We believe the standard of the U.S. Supreme court based on "…a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available…" is an appropriate test.
- We believe the materiality of errors in both quarterly as well as annual financial statements should be assessed. The assessment of materiality of errors in quarterly financial statements should not be based on the expected results for the annual period. Rather they should follow the general guidance noted above when making a judgment regarding whether an error is material.
- The ITAC encourages further consideration of assessments of errors related solely to the balance sheet and the cash flows, often characterized as "reclassifications" but which are errors nonetheless. We emphasize that while such errors do not impact earnings, to the extent that these errors impact metrics investors use to evaluate the operational and financial prospects of a company, these errors are material.

We do not believe the Subcommittee's proposed consultation with an independent valuation expert during the restatement process would add value in evaluating the potential impact of an error. We think that valuation experts should be consulted during a restatement process in the same fashion they are consulted during the "normal" financial statement presentation process. The proposed approach would also add additional time, and thus cost, to the restatement process.

Judgments:

Sound professional judgments based upon appropriately selected assumptions are a key ingredient to the preparation of financial statements. Unfortunately, judgments made in many of the recent corporate scandals were not considered appropriate and were questioned not only by regulators but by investors as well.

The U.S. auditing literature currently provides useful guidance for auditors in making estimates. Similar and consistent guidance for preparers of financial statements, issued by the FASB or SEC may also be useful.

Some have recommended a framework consistent with the business judgment rule applicable to directors of a company. However, the business judgment rule is predicated on directors who are not considered experts as opposed to the financial management of a company and its auditors who are considered experts and relied upon as such by investors. Any framework adopted would have to take into account this fundamental difference and the level of reliance investors place on those experts involved in the preparation and auditing of financial statements; financial statements investors receive and rely upon for making informed investment decisions.

Instead, we believe it would be most useful for investors if more robust disclosures were required regarding those estimates and judgments that have a material impact on the financial statements. Disclosures that would be useful to investors include:

- Principal estimates and key assumptions and data used in making estimates;
- Possible ranges of outcomes;
- Comparison of actual results with original estimates;
- Changes in key assumptions when they occur and the reason for such changes;
- A roll forward of activity in accounts involving significant judgments such as allowances for inventory obsolescence and warranties, loan loss reserves, etc.; and
- Risks and uncertainties related to the applicable account, with an estimate of the range of the potential impact those items could have on the results of operations, financial condition or liquidity of a company in either a favorable or negative manner, unless management concludes they are either immaterial or the probability of occurrence is remote.

We recently submitted an agenda proposal to the Financial Accounting Standards Board requesting a principles-based disclosure framework that would provide essential disclosures, including those listed above.[3]

ITAC members would be happy to discuss our input on the matters discussed above and offer any additional insight to the Subcommittee. We expect to provide additional input to the Subcommittee on the areas of regulation and compliance issues as you continue to formalize your recommendations.

Sincerely,

Mike Gyure Marc A Siegel

Investors Technical Advisory Committee
By Mike Gyure and Marc Siegel, Members

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[3] For a copy of the agenda request, see http://www.fasb.org/investors_technical_advisory_committee/itac_comment_letters.shtml