SEC Advisory Committee on
Improvements to Financial Reporting:
Audit Process and Compliance - Restatements and Materiality
Testimony of Elizabeth F. Mooney, Analyst
The Capital Group Companies
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Chairman Pozen and other members of CIFiR,
Thank you for the opportunity to be here today to testify on the topics of materiality and restatements, two very important issues to investors. I am an analyst with the Capital Group Companies, which manages, through affiliates, American Funds as well as institutional, endowment and private client accounts. Capital Research and Management and Capital Guardian Trust Company buy and hold equities and fixed income securities for the long term. We actively-manage well over $1tn of assets and have over 350 analysts and portfolio managers globally throughout the organization. We conduct intense, on-the-ground company research and are "current" "reasonable" investors who are heavy users of, and rely on, financial statements.

These are my own views and I surveyed my investment colleagues with several questions and wanted to discuss the results with you.

First, we oppose a company's (and its auditors') decision not to correct its financial statements for a large, quantitatively significant error. Correcting such an error is relevant, and the restated information would likely have an effect on our valuation of the company's securities going forward. We emphatically oppose having anyone other than investors determine whether quantitatively significant errors provide relevant information to investors; that is, whether such errors are capable of making a difference in user decisions. Quantitatively large errors should not be deemed immaterial by the company and auditors.

Second, we believe a company should restate previously reported amounts for individual income and expense items on the income statement even though the previously reported net income number would not change as a result. We are very interested in the corrected individual components of the income statement and use the changes in specific income and expense items over time as part of our trend analyses. This detail information is critical for projecting a company’s future earnings and in turn, the valuation of debt or equity securities. As such, net income is merely the starting point for analyzing a company’s historic performance and should not be viewed as the **only** important amount on the income statement for assessing materiality of possible restatements.

Third, we believe that even if a material error does not affect the annual financial statements in a company's most recent 10-K filing, historical results should still be restated. Correction should not be limited to results presented in the current report being filed. Even such errors that do not affect the annual financial statements included in a company's <u>most recent</u> filing with the SEC <u>are relevant</u> to current investors.

Fourth, we believe that both interim and annual results need to be restated if affected by a material error. The same rules and principles should apply for both as we rely on both sets of results. Again, trend analysis or understanding the variance in reported amounts over time is very important. Making an adjustment for a large quantitative error in a following period (or annual statements) to avoid correcting the actual prior period or periods (interim statements) affected will result in distorting the interim current and prior reporting periods. This has a negative impact on the usefulness of trend analysis.

Fifth, we agree with the part of CIFiR's Developed Proposal 3.2 that suggests current disclosure is not consistently adequate for the needs of investors. Yes, we do <u>get "confused</u>" when a company provides <u>little or no disclosure</u> once it has announced a reporting issue and/or possible restatement until it issues its revised financial report. Disclosure is a concern, and <u>investors</u> want to be their own decision-makers on which errors [material under SAB 99] are <u>unimportant</u> in their investment theses. Companies should disclose their basis for materiality, how they assess materiality, and the amount of uncorrected errors as of each reporting period.

Overall, the analysts and portfolio managers that I surveyed place a high level of importance on having comparable, consistent and accurate historical financial statements for analyzing a company, conducting trend analysis and forecasting future results. Using a scale of 1 = not important to 5 = very important, nearly all respondents believe that having such information is <u>very important</u> (or a 5 rating), and the remaining view it as important (or a 4 rating).

If the market is "getting it wrong" by punishing a stock in reaction to a company's restatement, then the company should disclose more information. The lack of transparency is what creates any unwarranted confusion and unnecessarily penalizes valuations. If high quality information is provided, reasonable investors can quickly digest it and move forward. If restatement information is misinterpreted initially, clarity helps stocks rebound sooner. We see it time and time again.

Fortunately, the Sarbanes Oxley clean-up is mostly behind us for accelerated filers, and the number of restatements is on the decline.

In conclusion, current guidance provided by the courts and SEC for assessing materiality is appropriate. On behalf of investors, and as one reasonable investor put it to me, please don't change a word of SAB 99.