American Federation of Labor and Congress of Industrial Organizations

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June 23, 2008

Via Electronic & U.S. Mail

Nancy M. Morris
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F St., N.E.,
Washington, D.C. 20549-1090

Re: File No. 265-24 (Advisory Committee on Improvements to Financial Reporting)

Dear Ms. Morris:

On behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), I appreciate the opportunity to provide input to the Securities and Exchange Commission ("SEC") Advisory Committee on Improvements to Financial Reporting ("Committee") on the four subcommittee reports of May 15, 2008.

Union-sponsored pension funds hold more than $450 billion in assets, and union members participate in benefit funds with more than $5 trillion in assets. Collectively, union members and their pension funds have suffered hundreds of billions of dollars in losses as a result of accounting-related scandals in the last decade — including those involving corporations such as Enron, WorldCom, Global Crossing and AIG, the stock options backdating scandal, and the ongoing mortgage crisis.

The AFL-CIO and other investor advocates were troubled by several of the recommendations of the Committee in its February 11 progress report. In our initial comment letter of February 10 we expressed concerns about:

- **Materiality**
- **Professional Judgment Framework &**
- **Mark-to Market Accounting**

Since the Committee's progress report, a number of studies and reports have been published that support our comments.[1]

In our initial comment letter, we also briefly referred to the Committee's recommendation of letting quantitatively material errors go uncorrected in public company financial statements if the issuer and its auditor judge them to be qualitatively immaterial. Since then, we had extensive discussions with the Committee about this issue. We felt those discussions were very productive, but because it appears from the Committee's May 15 report that none of the discussions or comments were taken into account, we are amplifying our concerns here:

Currently, quantitatively immaterial errors are required to be corrected if they are qualitatively material, but qualitative immateriality cannot be the basis for leaving a quantitatively material error uncorrected. This asymmetry is vital to preserving the integrity of the financial reporting system because it prevents internal company finance staff and the external auditor from being pressured to treat large errors in the financial statements as "qualitatively immaterial." It will always be possible to make such an argument, and it will be difficult for either internal or external auditors to resist the political pressure to ignore large errors if the SEC were to adopt this concept. This idea is fundamentally reckless and should be removed from the Committee's report.

Also, the Committee's recommendation that immaterial errors in annual financial statements that accumulate over time to become material errors can be corrected in a single charge will damage the financial reporting system. The current practice requires prior financial statements to be restated to correct errors that occurred during that period. The idea of taking a single large charge is a mistake because it significantly reduces the incentives for company financial management to identify and correct initially immaterial errors ex ante.

While the first idea is an invitation to suppress material errors, the damage to the financial reporting system through the second recommendation will likely be less serious than the first idea because, unlike the first, it applies to mistakes which are at least initially quantitatively immaterial. Nonetheless, the damage to the financial reporting system through the second recommendation will not be inconsequential.

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[1] "Restatements: Out of Sight, Out of Mind," report by Glass Lewis & Co., May 30, 2008;
"An Analysis of the Underlying Causes of Restatements," study by Marlene Plumee, University of Utah, and Terri Lombardi Yohn, Indiana University, March 2008 and "The Changing Nature and Consequences of Public Company Financial Restatements 1997-2006," by Susan Scholz, Associate Professor of Accounting, University of Kansas School of Business."

We are also troubled by some contradictory recommendations in the May 15 report. Subcommittee I endorses minimizing exceptions to accounting rules.[2] At the same time, Subcommittee III undercuts that recommendation by encouraging the SEC "to seek to accept a range of alternative judgments when preparers make good faith attempts to reach a reasonable judgment."[3]

We whole-heartedly support the recommendations of Subcommittee I. In order for accounting rules to aid in disclosure, accounting standard-setters should not allow exceptions, giving issuers the latitude to pick and choose how they report information to investors. The recommendation of Subcommittee III is not only incorrect; it gives no direction to regulators. As we discussed in our attached comment of February 10, the committee's recommendation blurs the distinction between what is reasonable and thus should not give rise to liability, and what is correct or incorrect and thus should require a restatement. These are two distinct concepts, and Subcommittee III's insistence on blurring the concepts makes it very difficult to even assess what its statement means.

We appreciate the opportunity to present our views on this important matter. If the AFL-CIO can be of further assistance, please do not hesitate to contact me at (202) 637-3953.

Sincerely,

Damon A. Silvers
Associate General Counsel

DAS/mg
Attachment

[2] "Subcommittee I preliminarily believes that scope exceptions should be minimized to the extent feasible," Exhibit A, Substantive Complexity Subcommittee Update, page 3, Securities and Exchange Commission Release Nos.33-8918; 34-57819, May 15, 2008.

[3] Exhibit C, Audit Process and Compliance Subcommittee Update, page 23.

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February 10, 2008

Via Electronic Mail and Messenger

Ms. Nancy M. Morris
Federal Advisory Committee Management Officer
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. 265-24 (Advisory Committee on Improvements to Financial Reporting)

Dear Ms. Morris:

On behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), I appreciate the opportunity to provide input to the Securities and Exchange Commission ("SEC") Advisory Committee on Improvements to Financial Reporting ("Committee") regarding efforts to reduce complexity and make corporate U.S. financial reports more transparent and useful for investors.

Union-sponsored pension funds have more than $450 billion in assets, and union members participate in benefit funds with more than $5 trillion in assets. Collectively, union members and their pension funds have suffered billions of dollars in losses in accounting related scandals in the last six years—including Enron, WorldCom, Global Crossing, AIG, the stock options backdating scandal and, most recently, the subprime crisis.

We are troubled by the Committee's initial direction as laid out in its Progress Report dated February 11, 2008, in the areas of materiality, professional judgment, and the relationship between the Financial Accounting Standards Board ("FASB") and the SEC. We believe these issues would benefit from a more lengthy and less single-minded process.

PROCEDURAL CONCERNS

The issues associated with the preparation and auditing of financial statements are both complex and of great importance—including what the proper balance should be between rules and principles, what degree of professional care auditors should take in the performance of their work, and what steps should be taken by companies when an accounting or auditing error is discovered.

The AFL-CIO is deeply concerned about the Committee's eagerness to adopt a set of recommendations that could provide companies and auditors the ability to hide material financial information from investors and regulators. To date, the Committee seems unaware or uninterested in the recent history of catastrophic audit failures and the role of auditing and accounting issues in the current financial crisis. We think the Committee should give the complex and serious issues it faces more consideration by seeking additional outside testimony on draft recommendations both from a wider range of experts and from investors.

It should also be kept in mind that the Committee's recommendations should be given due consideration by a full SEC and should not be rushed through while two of the five seats are still vacant.

SUBSTANTIVE CONCERNS

Materiality

Currently, SEC Accounting Bulletin No. 99 defines materiality as follows: "Materiality concerns the significance of an item to users of a registrant's financial statements. A matter is 'material' if there is a substantial likelihood that a reasonable person would consider it important.'"

The Committee seems to feel that Bulletin No. 99's approach is too simple a standard. We cannot tell whether the Committee is suggesting this standard be changed, or merely extensively reinterpreted. In any case, we would strongly oppose weakening the standard. In the absence of a clear discussion of the Committee's views of the existing materiality standard, the use of phrases such as "the total mix of information," "the sliding scale," and "qualitative factors also may lead to a conclusion that a quantitatively large error is not material" are each designed to give issuers and their auditors safe harbors for hiding material information from the investing public.

We fear in particular the sort of fact pattern that occurred in the stock options scandal where the Chief Accountant of the SEC advised issuers that they did not need to restate financials when they or their auditors discovered they had engaged in the "spring-loading" of stock options, conduct which was later found to be a per se breach of fiduciary duty by the Delaware Chancery Court. One might think that accounting errors intertwined with breaches of duty to the corporation and its shareholders were the sort of financial errors that on a qualitative basis should be material, but it appears not to be so. We oppose any rulemaking that would extend the scope of that sort of thinking.

Our concerns about the weakening of the materiality standard are broadly shared by investor advocates. The Investors Technical Advisory Committee to the FASB suggested in its letter to the Committee that companies should promptly report errors to investors, along with information about the nature and magnitude of errors.[1] The ITAC expressed concern that the Committee's approach would let companies sweep errors under the rug and not disclose them to investors, even if a series of small errors over time cumulatively result in material misstatements.[2] The Consumer Federation of America has commented that the Committee's proposal would let companies omit errors necessitating restatements and would make financial statements opaque and less useful.[3]

While the Committee has some significant positive ideas about developing the information disclosed to investors when a restatement does occur, these will not be of much use if the basic materiality standard is weakened.

Professional Judgment Framework

Again, this is an area where the Committee appears to not have given sufficient thought to the relationship among its ideas. The Committee outlines a detailed set of considerations that would appear to be the basis a regulator could use to determine whether an auditor engaged in professional judgment. But what exactly does the Committee have in mind for this framework, since it suggests the use of the framework should not impede accountability by auditors and issuers to regulators and investors?

It is true that rebuilding the strength of the auditing profession should be an important policy goal of the SEC and the PCAOB. However, the single worst thing that could be done in relation to that question would be to immunize auditors' judgments. That would effectively leave no countervailing pressures to the social and economic pressures that auditors face from issuers, which were the subject of extensive testimony at recent hearings of the Treasury Department's Advisory Committee on the Audit Profession.

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[1] Draft Memo of the Advisory Committee on Improvements to Financial Reporting: "Prior period financial statements should only be restated for errors that are material to those periods." And again, "For example, an error that does not affect the annual financial statements included within a company's most recent filing with the Commission may be determined to not be relevant to current investors." January 11, 2008.

[2] Comment letter to the SEC Advisory Committee on Improvements to Financial Reporting, December 13, 2007: "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."

[3] Consumer Federation of America comment letter, January 16, 2008: 'In the name of reducing the number of "unnecessary" restatements, the Committee has made several proposals on materiality and related issues that would decrease the information that investors get about errors...the recommendations appear to make it possible for companies to correct errors found close to the next reporting period on the next financial statement without having to restate the current erroneous reports. It doesn't take a genius to figure out that companies will try to get as many restatements as possible handled in this way."

We believe that we will always have an accounting system with both rules and principles. It is unclear to us what a professional judgment framework would change with respect to the circumstance where there may have been a material error in a financial statement. If the numbers in question are within the scope of a principle, neither the company nor its auditor have any reason to be concerned under the current approach. If the numbers in question are outside the scope of a principle, or violate a rule, it should not matter what level of professional judgment was involved—an error is an error, and it should be corrected. If professional judgment is a liability standard, it does not seem to represent a change from the current set of liability standards under the securities laws and under the state laws of professional duties.

Because it is unclear what the Committee really has in mind here, we suspect the idea of a professional standard is a rhetorical device designed to ensure that even when the Committee's weak idea of a materiality standard is violated, nothing has to be corrected and no one is held accountable, because somewhere in the chain of error someone with a CPA signed off.

In general, both recommendations on materiality and professional judgment are peculiar in light of recent statements by the Center for Audit Quality and the officers of prominent accounting firms that they cannot think of even one specific instance in recent years where auditors have been inappropriately second-guessed. [4]

MARK-TO-MARKET ACCOUNTING

The AFL-CIO has long-standing concerns about the adoption of mark-to-market or fair value accounting as the predominant conceptual model by FASB. The reasons for our concern are stated in general terms in the Committee's Progress Report, apparently as one perspective in a discussion where the Committee failed to reach consensus.

Undoubtedly, certain types of assets should be marked to market, and have been for some time under U.S. GAAP. These assets are typically those for which there is a liquid market and where the firm could likely sell those assets on that market and remain a going concern. The broadening of mark to market accounting to assets for which there is no liquid market ("mark to model"), and the booking of gains and losses where there are no transactions, have been the hallmarks of the major financial frauds and disasters of the last decade. Even so, the FASB marches further and further in this direction. The Committee appears to have discussed these issues but has not been able to come to any clear conclusions. We think this is an

[4] Question to Cynthia Fornelli, executive director of the Center for Audit Quality, by a member of the U.S. Treasury Department's Advisory Committee on the Auditing Profession, at the Feb. 4 meeting in Los Angeles: "Are you aware of any specific examples, especially of the major corporate billion dollar scandals, where the auditors were inappropriately second-guessed on those cases?" Fornelli: "I cannot provide it to you, but sometimes it is the fear of being second guessed. Or the fear of not having your judgment respected."

area where the Committee could be very helpful if the concerns that are in this report in this area are linked to recommendations for action—and in particular for a rethinking of mark to market or fair value accounting outside of liquid assets and liabilities, readily marketable by the firm.

OTHER SUBSTANTIVE CONCERNS

The Committee appears to want to bring FASB more under the control of the SEC and to lessen the finality of its rulemaking. Although we have our differences with FASB, we do not believe an increased politicization of FASB is in the public interest, and we urge caution in this area. Finally, a recommendation by the Committee that the FASB's new rules be road-tested for two years before they can be relied upon would create uncertainty in the marketplace and make it more difficult for investors to rely upon financial statements.

CONCLUSION

While there are many thoughtful items in the Committee report, the dominant features of the report are the apparent desire to complicate and weaken the financial reporting structure, which is of course the opposite of the Committee's charge. We urge the Committee to give further thought and seek a wider range of input through more hearings, especially where it appears to be urging a weakening of auditing and accounting standards. In general, most investors and observers living through the subprime crisis are looking for more protection from false financial statements in the future, not less.

We appreciate the opportunity to present our views on this important matter. If the AFL-CIO can be of further assistance, please do not hesitate to contact me at (202) 637-3953.

Sincerely,

Damon A. Silvers
Associate General Counsel

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