SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-8836; 34-56293; File No. 265-24]

Discussion Paper for Consideration by the SEC Advisory Committee on Improvements to Financial Reporting.

AGENCY: Securities and Exchange Commission.

ACTION: Request for comments.

SUMMARY: The Advisory Committee is soliciting public comment on a discussion paper prepared by the Committee Chairman, Robert Pozen. The discussion paper provides a working outline, including a discussion of issues, views and potential consideration points that the Committee may evaluate.

DATES: Comments should be received on or before September 24, 2007.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

• Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or

• Send an e-mail message to rule-comments@sec.gov. Please include File Number 265-24 on the subject line.

Paper Comments

• Send paper comments in triplicate to Nancy M. Morris, Federal Advisory Committee Management Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549–1090.

All submissions should refer to File No. 265-24. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on its Web site (http://www.sec.gov/rules/other.shtml). Comments also will be available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Questions about this release should be referred to James L. Kroeker, Deputy Chief Accountant, or Shelly C. Luisi, Senior Associate Chief Accountant, at (202) 551-5300, Office of the Chief Accountant, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6561.

SUPPLEMENTARY INFORMATION: At the request of the SEC Advisory Committee on Improvements to Financial Reporting, the Commission is publishing this release soliciting public comments on the issues that the Committee proposes to consider. The Commission announced the establishment of the Advisory Committee on June 27, 2007.

The Committee was officially established on July 17, 2007 with the filing of its Charter with Congress. The Charter provides that the Committee's objective is to examine the U.S. financial reporting system, with a view to providing specific recommendations as to how unnecessary complexity in that system could be reduced and how that system could be made more useful to investors. The Charter directs the Committee to consider the following areas of inquiry:

- the current approach to setting financial accounting and reporting standards, including (a) principles-based vs. rules-based standards, (b) the inclusion within standards of exceptions, bright lines, and safe harbors, and (c) the processes for providing timely guidance on implementation issues and emerging issues;
- the current process of regulating compliance by registrants and financial professionals with accounting and reporting standards;
- the current systems for delivering financial information to investors and accessing that information;
- other environmental factors that may drive unnecessary complexity, including the possibility of being second-guessed, the structuring of transactions to achieve an accounting result, and whether there is a hesitance of professionals to exercise judgment in the absence of detailed rules;
- whether there are current accounting and reporting standards that do not result in useful information to investors, or impose costs that outweigh the resulting benefits (the Committee could use one or two existing accounting standards as a "test case," both to assist in formulating recommendations and to test the application of proposed recommendations by commenting on the manner in which such standards could be improved); and

- whether the growing use of international accounting standards has an impact on the relevant issues relating to the complexity of U.S. accounting standards and the usefulness of the U.S. financial reporting system.

The charter also directs the Committee to conduct its work with a view to enhancing financial reporting for the benefit of investors, with an understanding that unnecessary complexity in financial reporting can be harmful to investors by reducing transparency and increasing the cost of preparing and analyzing financial reports.

Committee Chair Robert Pozen has drafted the discussion paper for consideration by the Committee. The Committee considered the discussion paper at its first public meeting held on August 2, 2007 and agreed to publish the discussion paper for public comment at that meeting. The full text of the discussion paper is attached as an Appendix and also may be found on the Committee's Web page at http://www.sec.gov/about/offices/oca/acifr.shtml. The discussion paper identifies in general terms the issues, views and consideration points that the Committee may evaluate. All interested parties are invited to submit their views, in writing, on any or all of the subjects identified, whether some subjects identified should not be considered for any reason (such as to conserve resources, to focus resources on other, more critical subjects, or because of the limited length of the Committee's term) or on any other matter relating to the current U.S. financial reporting system that the Committee should consider addressing.

GENERAL REQUEST FOR COMMENT: Any interested person wishing to submit written comments on any aspect of the discussion paper, as well as on other matters relating to the Committee's work, is requested to do so.

AUTHORITY: In accordance with Section 10(a) of the Federal Advisory Committee Act, 5 U.S.C. App. 1, § 10(a), James L. Kroeker, Designated Federal Officer of the Committee, has approved publication of this release at the request of the Committee. The solicitation of comments is being made solely by the Committee and not by the Commission. The Commission is merely providing its facilities to assist the Committee in soliciting public comment from the widest possible audience.

Nancy M. Morris
Committee Management Officer

Dated: August 21, 2007

APPENDIX

Discussion Paper for Consideration by the SEC Advisory Committee on Improvements to Financial Reporting

By Committee Chair Robert Pozen[1]

Draft dated July 31, 2007

Introduction

This white paper is provided as an outline for consideration and discussion by the Securities and Exchange Commission's Advisory Committee on Improvements to Financial Reporting (CIFiR). The purpose of the document is to provide a working outline, including a discussion of issues, views and potential consideration points that the Committee could evaluate. Additionally, the outline is structured in 5 key areas that could serve as a model for organizing the work of the Committee into subcommittees.

Background

The U.S. capital markets are the deepest and most liquid in the world. The acknowledged success of the U.S. capital markets, and their contribution to the nation's economic vitality, has been due in no small measure to the availability of relevant, reliable, readily understandable, and timely financial information. However, while the U.S. financial reporting system has become the most complete and well developed in the world, some parts of the system may not be fully aligned with changes in the economy, business operations, technology and investor needs, leaving room for improvement.

The strength of the U.S. financial reporting system lies in no small part in its inherent checks and balances, including the different perspectives of participants in the

[1] This draft discussion paper was prepared by Committee Chair Robert Pozen. It does not necessarily reflect any position or regulatory agenda of the Commission or its staff.

markets — direct participants (e.g., companies and investors), regulators, independent standard setters, and other third parties (e.g., attorneys, accountants and auditors). But these different and sometimes conflicting perspectives have contributed to some of the problems in the system, including its extreme complexity and the resulting need to consider how the usefulness of reported financial information can be improved.

The SEC has charged the Committee with examining the U.S. financial reporting system to identify ways to improve the system of financial reporting. In considering this mandate, the Committee will consider ways to both reduce unnecessary complexity and make information more useful and understandable for investors. More specifically, the Committee's charter identifies the following as areas of inquiry for the Committee:

- The current approach to setting financial accounting and reporting standards, including (a) the principles-based vs. rules-based standards, (b) the inclusion within standards of exceptions, bright lines, and safe harbors, and (c) the process for providing timely guidance on implementation issues and emerging issues;
- The current process of regulating compliance with accounting and reporting standards;
- The current system for delivering financial information to investors and accessing that information;
- Other environmental factors that drive unnecessary complexity, including the possibility of being second-guessed, the structuring of transactions to achieve an accounting result, and whether there is a hesitance by professionals to exercise professional judgment in the absence of detailed rules;

- Whether there are current accounting and reporting standards that do not result in useful information to investors, or impose costs that outweigh the resulting benefits; and
- Whether the growing use of international accounting standards has an impact on the relevant issues relating to complexity of U.S. accounting and reporting standards and the usefulness of the U.S. financial reporting system.

As the Committee proceeds with its evaluation, it may wish to consider the financial reporting system in light of the needs of two primary groups – those who prepare the financial information and those who use the information – while taking into account the overall environmental impact of two secondary groups – those who opine on the information being presented and those who regulate our financial reporting system.

Those who prepare financial information generally want:

- Clear instructions on what subjects to cover in financial reports;
- Not to be later second guessed by regulators, litigants, etc. in situations where reasonable/good faith judgments were made;
- Financial reports to reflect the economic realities of the business, with enough flexibility to reflect the special situation of both the company and the industry;
- To reduce period-to-period volatility of earnings to the extent feasible (for example, in situations where the volatility is driven by changes in estimates but where such volatility has not resulted in a “realized” gain or loss); and
- To prepare required financial information at a reasonable cost, in terms of dollars and management time.

Those who are users of financial information generally want:

- To understand the financial reports, at the level of detail that is desired by each type of user;
- To be able to rely on the integrity of the financial reports (and not be told later they were incomplete, misleading or actually wrong);
- The financial reports to reflect the economic substance of the business, regardless of technical rules;
- Financial reports to reflect, to the extent feasible, actual changes in market values from period to period; and
- The reports to be delivered in a format that makes it easy to compare one company to another.

Those who opine on the specific financial information presented generally want:

- Clear instructions on what subjects to cover in financial reports;
- Not to be later second guessed by regulators, litigants, etc. in situations where reasonable/good faith judgments were made;
- The financial reports to reflect the economic substance of the business; and
- To make a reasonable profit opining on financial information at a reasonable cost.

Those who regulate the system generally want:

- A financial reporting system that provides protection to investors, promotes market efficiency and facilitates capital formation
- Clear instructions on what subjects to cover in financial reports;
- To be able to rely on the integrity of the financial reports;
- The financial reports to reflect the economic substance of the business; and

- All of the above to be accomplished at a reasonable cost to society in relation to the benefits to be achieved.

While the list of objectives above is only illustrative and certainly not all inclusive, one can observe that the objectives of those involved in our financial reporting system are consistent in many respects. All participants want clear guidelines that allow financial reports to be prepared and presented in a straightforward fashion, do not want financial reports to be subsequently deemed to be incorrect, want the financial reports to reflect the economic substance of the business, and do not want companies to spend too much money and management time on preparing financial reports.

However, the Committee should recognize that some of the goals of participants within our financial reporting system may conflict. For example, preparers often want less volatility in earnings implying less fair value measures, while users generally prefer that more assets and liability reflect their current values. This places tension on the desire to have financial reports that reflect the economic substance of the entity. Further, users may prefer a uniform format that makes comparisons easy, while preparers may want special rules that allow them to present what they believe are the unique aspects of their industry or company.

Upon conclusion of the Committee's work, the Committee will provide written recommendations to the Chairman of the SEC on how to improve the financial reporting system in the U.S. These recommendations may cover many aspects of the financial reporting system for the Commission to consider, including recommendations that involve the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), and other appropriate organizations. In order to facilitate the Committee in forming these recommendations, the Committee will create subcommittees. The subcommittees will report their recommendations and advice to the Committee for full discussion and deliberation. The proposed subcommittees are listed below. Follow that listing of proposed subcommittees is a proposal regarding their objectives and some preliminary topics the subcommittees may wish to consider.

I. Substantive Complexity

II. Standard Setting Process

III. Audit Process and Compliance

IV. Delivering Financial Information

V. International Coordination

I. Substantive Complexity

This subcommittee will study the causes and impact of complexity on financial accounting and reporting standards, including: (1) principles-based vs. rules-based standards; (2) inclusion within standards of exceptions, bright lines and safe harbors; and (3) the concerns of fair value measurement attributes and related earnings volatility. This subcommittee may wish to consider the following:

Principles-Based Standards

Some commentators have suggested that the US should adopt more principles than detailed rules as a way to reduce complexity. However, other commentators have argued that both preparers and users may prefer bright line rules to avoid second guessing in the U.S. regulatory and litigation environment. In considering the need for principles and rules, the subcommittee may wish to evaluate the recent efforts of the FASB to move to a more principles-based approach while retaining implementation guidance. As a reference point, the subcommittee may wish to begin with the SEC staff's 2003 report to Congress mandated by the Sarbanes-Oxley Act of 2002 on a principles-based approach to standard setting in the U.S., and the FASB's related response.

Competing Principles

Complexity may be created not by the adoption of principles versus rules, but rather as a result of competing principles. For example, U.S. GAAP is not consistent on the appropriate measurement attribute to use for valuing financial assets and liabilities. In areas like financial assets and liabilities, there are two basic principles: lower of cost or market, and fair value. The appropriate method to use in U.S. GAAP may be based on a specific industry, a specific transaction, a registrant expectation, or a registrant choice. To many it would be less complex to choose one approach, but many disagree which approach is most appropriate considering both relevance and reliability. More and more compromises are made, and these compromises lead to greater complexity as lines are drawn or judgments are made to delineate when one approach applies and the other does not. This subcommittee may wish to consider to what extent mixed measurement attributes (fair value versus historical cost) have increased complexity and reduced transparency, and what changes should be made within our capital markets to allow for more consistent measurement attributes.

Preparers vs. Users

Complexity also may result from conflicts between the objectives of preparers and users. From the perspective of sophisticated users, financial reports would be more useful if they contained more segment information in multi-line businesses. However, most companies are reluctant to have more reporting segments because this may involve the disclosure of competitively sensitive information. This subcommittee may wish to consider whether enhanced information would improve the usefulness of financial reporting in our capital markets.

Industry Specific Exceptions

Many industries have successfully obtained special treatment or exemptions from general accounting standards from the FASB or the SEC. While such exemptions or special treatment increase complexity, they, in many cases, may help preparers within these industries present their financial reports in ways that, in their view, better reflect the economic substance of their businesses than the general standards. This subcommittee may wish to consider whether industry specific accounting or disclosure is useful to our capital markets.

Alternative Accounting Policies

Currently, GAAP allows for entities to elect alternative accounting treatment for various transactions that may be economically similar. Most recently, the FASB issued SFAS 159, Fair Value Option, that allows companies to irrevocably elect to record certain types of assets and liabilities at fair value. This election is an instrument by instrument election. Other explicit options are currently present in U.S. GAAP. Providing companies with options may be a useful compromise when there are acceptable alternatives, but it makes it more difficult for users to compare companies. The subcommittee may wish to consider whether alternative accounting policies are useful to our capital markets.

Sensitivity Analysis

Financial reports are currently presented in a way that may over-simplify an issue with a complex range of results. In certain areas of accounting, the assumptions drive the results – for example, accounting for unfunded liabilities of defined benefit funds. Yet the range of permissible assumptions – for example, discount rates and mortality experience – is quite large. While sensitivity analyses are utilized to some degree, the subcommittee may wish to consider whether further sensitivity analyses would reduce complexity.

II. Standard Setting Process

This subcommittee will study the standard setting process and may wish to consider the following:

U.S. GAAP Hierarchy

Presently, all U.S. public companies must follow U.S. GAAP to be in compliance with applicable securities laws and regulations. Over the years, U.S. GAAP has been developed by many different recognized and unrecognized organizations. In the most recent past, these recognized organizations have included the SEC, the FASB, the Emerging Issues Task Force (EITF), and the American Institute of Certified Public Accountants (AICPA) Accounting Standards Executive Committee (AcSEC). For public companies, the authority to set GAAP resides with the SEC. The SEC has historically looked to private sector bodies to provide standards for financial reporting by public companies, and since 1973 the FASB has been recognized by the Commission for this role, absent any contrary determination by the Commission. In addition, the SEC at times will develop interpretive application and disclosure guidance for public companies.

The FASB also allows for the EITF, which is subject to its own oversight by the FASB and the SEC, to develop interpretive application guidance to existing U.S. GAAP.

The FASB has undertaken a significant project to develop a comprehensive and integrated codification of all existing accounting literature organized by subject matter that would become an easily retrievable single source for all of U.S. GAAP. This project may provide a useful roadmap for identifying those areas in U.S. GAAP that could be simplified.

Characteristics of the FASB

Currently in the U.S., accounting standards for public companies are established by the FASB, absent any contrary determination by the Commission, and the FASB is subject to oversight by the SEC. The Board consists of three members from public accounting, two from preparers, one from academia, and one user. While each member of the Board brings different experiences and perspectives, they are selected based on their expertise in financial reporting and are expected to make decisions based on what they believe will improve financial reporting rather than representing any one constituent group. All members of the Board must sever all ties and remain independent. The subcommittee may wish to consider the characteristics of Board members and the Board selection process.

FASB Standard Setting Process

The FASB has an open due process through which the Board obtains input from many constituents, issues proposals and receives extensive further input in the format of comment letters and holds public meetings with constituents. The Board makes all decisions on its accounting standards in public through open debate prior to reaching conclusion. This process can take many years, but was designed to provide constituents maximum input into the decisions of the Board. Currently, a simple majority vote is needed to complete projects. The Board publishes all decisions via board minutes on its website and as a basis for conclusions within all significant standards.

The FASB develops major standards based on a conceptual framework. This conceptual framework was designed by previous Boards to act as fundamentals on which future financial accounting and reporting would be based. The conceptual framework, however, is not complete and is not consistent with all of existing U.S. GAAP. To address these issues, the FASB currently has a major project on its agenda jointly with the International Accounting Standards Board (IASB) to improve the conceptual framework and to readdress some major accounting standards where the application is not consistent with the conceptual framework or does not provide sufficiently transparent financial reporting. Areas being considered in this joint project include pensions, leasing, liabilities and equity, revenue recognition, and financial statement presentation.

Accounting standards resulting from the FASB process often leave open many questions of interpretation. The underlying reason for the need for interpretation generally results from either a misunderstanding of the stated principle or rule, or a concern that others will express a different view of the application of the principle or rule within the standard. The FASB staff offers a service to respond to inquiries, but exercises caution in answering some inquiries due to the establishment of precedent. Sometimes the FASB or FASB staff is asked to formally amplify or clarify a set of interpretive issues within an accounting standard. These interpretations were previously published as FASB staff question and answer documents with little Board oversight and no public comment period. Currently, these interpretations are primarily done through FSPs (FASB staff positions), which are discussed and debated with Board members at a public meeting and exposed for comment.

The subcommittee may wish to consider the process for setting standards and developing interpretations, including the FASB's voting procedures and the methods used by the FASB or the FASB staff to: (1) set their agenda, (2) set their priorities, (3) deliberate, (4) communicate, and (5) respond to technical inquiries.

Interpretive Guidance - EITF

In the mid 1980s, the FASB formed the EITF. The original charter of the EITF was to act as an advisory group to the Board to educate the Board on emerging issues so that the Board could decide whether interpretive guidance was necessary. Shortly after its creation, the EITF's charter was revised to allow for members of the EITF to develop authoritative interpretive guidance. The types of issues addressed by the EITF range from very specific to very broad, but are expected to be completed by the Task Force within one year. The EITF may only interpret existing standards and does not have the authority to amend or replace existing standards. Members of the EITF represent all significant constituents and include large and small preparers, large and small audit firms, and users. These members are volunteers and do not sever ties with their current employers or firms. The Chairman of the EITF is a member of the FASB staff and all documents produced for the EITF are developed by the FASB staff. A conclusion by the EITF is reached if not more than 3 members object. Currently, all conclusions by the EITF are exposed for public comment and are ratified by the FASB. This subcommittee may wish to consider the role of the EITF and whether that role should be changed to one of an advisory group.

Interpretive Guidance – SEC

The Commission itself sometimes addresses accounting issues directly. In addition, SEC staff primarily through the Office of the Chief Accountant (OCA) communicates to the public in various forms about accounting issues, including staff accounting bulletins, letters to industry, speeches, and other educational material. These sources of information often are viewed by the SEC staff as confirmations of existing accounting standards, but have led to restatements by public registrants. The OCA also receives requests from specific registrants for pre-review of accounting issues. These requests are often considered by others in determining their own accounting policies.

The SEC’s Division of Corporation Finance reviews and comments on financial reports filed by public issuers that are not investment companies. The Division has a process for making its comment letters public upon completion of the review process. Through the Division’s filing review process and its now more transparent process making comment letters publicly available on the SEC’s website, the staff of Corporation Finance can have a significant influence on how accounting standards are interpreted.

The SEC's Division of Enforcement, in the course of its investigatory and settlement negotiation processes, often explains the staff’s views of a registrant’s accounting conclusion. The Division’s communications in this regard have been viewed by some as representing views applicable to all companies and not just with respect to the individual facts and circumstances involving the party involved in the particular enforcement investigation.

This subcommittee may wish to consider the extent to which the SEC should publish interpretive guidance, as well as the communication methods used to describe the activities of the SEC or the SEC staff.

Interpretive Guidance – Other

Many organizations, including large accounting firms and the AICPA, publish detailed educational material regarding accounting. These publications are widely used and presumed to be correct by their readers, but may turn out to be not always consistent or accurate. When an inconsistency or inaccuracy is discovered, the authors of the education material often seek clarity from the FASB or SEC staffs. This subcommittee may wish to consider whether the FASB or SEC should be involved reviewing or providing this type of guidance.

The Use of Cost-Benefit Analysis in Standard Setting

Determining the costs and benefits of a new accounting standard or rule involves difficult predictions. Often, the true costs and benefits may not be able to be fully known or understood until after the new standard or rule is fully implemented. The processes and practices both pre- and post-issuance may differ among organizations that set accounting standards and rules. The subcommittee may wish to review the existing cost-benefit analysis practices of appropriate organizations to determine if changes should be recommended.

Existing Standards

This subcommittee also may wish to consider whether to review two or three previously issued standards or rules to understand both the cost-benefit analysis that was utilized prior to the standard or rule's exposure to public comment and the cost-benefit analysis that was utilized prior to adoption of the standard or rule. This subcommittee may wish to review whether any changes by the standard setter as a result of a given cost-benefit analysis or for ease of implementation actually reduced the costs of application or increased the benefits. Finally, the subcommittee may wish to consider two or three existing standards and determine whether any changes might be made to the standards to reduce the actual costs of application or improve the benefit to users.

III. Audit Process and Compliance

This subcommittee will study the current process of regulating compliance with the accounting and reporting standards and other environmental factors that drive unnecessary complexity, including the possibility of being second-guessed, the structuring of transactions to achieve an accounting result, and whether there is a hesitance on the part of professionals to exercise professional judgment in the absence of detailed rules. This subcommittee may wish to consider the following:

Financial Restatements

A significant number of restatements have occurred in the U.S. financial markets over the past few years. Some have attributed these restatements to more rigorous interpretations of accounting and reporting standards by preparers, outside auditors, the SEC, and the PCAOB, while others believe the concept of materiality (and discussions regarding materiality in SEC Staff Accounting Bulletins 99 and 108) is applied too broadly. Many believe that this increased volume of restatements makes it more difficult for securities analysts and other users of financial information to determine the significance of a restatement. Further, some have expressed concern that the high volume of restatements could lead to an environment where users of financial reports begin discounting the importance of restatements (for example, if restatements are viewed to be routine).

The U.S. Treasury has announced it is commissioning a study to determine why the volume of financial restatements has risen so sharply, and this subcommittee should monitor the U.S. Treasury's work in this regard. This subcommittee also may wish to consider the reasons for an increase in restatements. For example, the subcommittee might consider whether the increase is a result of: (1) a broad application of the definition of materiality (including the application of materiality guidance in situations where errors do not impact the "bottom line"); (2) more rigorous auditing or enforcement; (3) second guessing by the SEC, the PCAOB, or outside auditors; (4) increasingly detailed accounting standards; or (5) inappropriate application of standards by preparers/auditors. Further, the subcommittee may wish to consider whether there are alternative methods to communicate with the capital markets for certain types of accounting errors (including consideration of the potential for prospective methods to deal with making changes to historical accounting practices).

Use of Judgment

Any move toward reducing complexity and increasing transparency should consider the role of preparer and auditor judgment as it relates to the reduction of prescriptive application guidance. For example, one approach to consider could be whether to expand the use of accounting and auditing standards that allow for more judgment in application. The subcommittee should also consider the role of disclosure in such an environment. For example, some have suggested that more latitude should be provided in standards, with the caveat that more disclosure is provided about the alternative(s) that were considered and why the selected alternative was applied. This subcommittee may wish to consider whether an increase in the use of judgment (elimination of bright lines and detailed application guidance) would result in increased usefulness of financial reports, including the potential impact on comparability. Furthermore, the subcommittee may wish to consider whether an increase in judgment on the part of preparers and auditors is impacted by not knowing or understanding how these groups will be judged by the SEC, the PCAOB or others.

PCAOB

The PCAOB is required to inspect annually all registered public accounting firms that provide audit reports for more than 100 public companies, and at least triennially registered public accounting firms that provide audit reports for fewer than 100 issuers. Reports on these inspections have been produced in many cases more than one year after the completion of the inspections. Pursuant to the Sarbanes-Oxley Act, a portion of the results of the inspections are made available publicly, and certain nonpublic portions of the reports may remain nonpublic if the firm responds to the criticisms to the Board's satisfaction within a given time period.

Similar to the FASB, the PCAOB receives requests for guidance on how audits should be carried out. In the case of internal control reviews, the PCAOB issued a series of questions and answers, which were generally well received. Nevertheless, these questions and answers were issued without advance notice or public comment, despite the fact they were intended to have general applicability.

This subcommittee may wish to consider the PCAOB's inspection process and how the process impacts registrant and auditor behavior. The subcommittee may also want to consider whether this creates the need for additional auditing and accounting interpretive guidance, as well as the process on how such guidance is issued.

SEC – Corporation Finance

The SEC is required to review filings by listed public issuers on a regular and systemic basis, as well as review all public companies required to file reports at least once every three years. These reviews may be time consuming and are conducted by the SEC Division of Corporation Finance. A perception may exist that consultation with the OCA does not generally occur unless the registrant requests such consultation. This subcommittee may wish to understand the process the SEC uses to review registrants' public filings, including the process for providing comments and the level of review and coordination with the various departments of the SEC. Furthermore, the subcommittee may wish to consider whether and how the process impacts registrant and auditor behavior and creates the need for additional auditing and accounting interpretive guidance.

SEC – Division of Enforcement

The Division of Enforcement has broad authority to open an informal inquiry into a registrant's financial reporting or an auditor's application of professional standards with respect to registrant reporting. Formal investigations that provide subpoena authority are made only after approval by the Commission. The OCA is generally consulted before consideration by the Commission of a recommendation by the Division of Enforcement involving financial reporting or auditor misconduct. This subcommittee may wish to understand the process the SEC uses to open an enforcement investigation, including the level and timing of coordination with the various departments of the SEC. Furthermore, the subcommittee may wish to consider how the process impacts registrant and auditor behavior and affects the need for additional auditing and accounting interpretive guidance.

Audit Firms

This subcommittee may wish to consider whether the behavior of audit firms creates or results in unnecessary complexity. For example, to promote efficient and effective audits, audit firms have created various tools and controls so that a uniform policy is applied throughout their organizations. These include checklists, audit programs, training, and networks of subject matter experts. These subject matter experts tend to view their particular issue as very important and may insist on a uniform national policy, even if the recommended approach is not applied uniformly in practice by others outside the firm. This subcommittee may wish to consider the impact that these practices have on promoting judgment and transparent reporting in the capital markets.

Sustainability of the Audit Profession

Legal risks faced by audit firms and registrants clearly influence their behavior in preparing and auditing financial reports, including their willingness to exercise judgment and to show flexibility in applying accounting rules. With respect to audit firms, the U.S. Treasury has announced its intention to establish an advisory committee to study the sustainability of a strong and vibrant public company auditing profession. Treasury has announced that the committee is to study, among other things, the ability to attract and retain the human capital necessary to meet developments in the business and financial reporting environment; audit market competition and concentration; and the financial resources of the auditing profession, including the effect of existing limitations on auditing firms' structure. This subcommittee should be aware of how litigation and potential litigation influence behavior and may wish to consider the work of the Treasury's committee, but should not attempt to develop proposals that duplicate the work of that committee.

IV. Delivering Financial Information

This subcommittee will study the current system for delivering financial information to investors and accessing that information. This subcommittee may wish to consider the following:

Tiering of Information

Different groups of investors exist in our capital markets and may have different needs for information from financial reports. The individual investor may be interested mainly in a journalistic outline of the key points about the progress of the business. By contrast, a sophisticated investor may be interested in a full discussion of management's choice of assumptions underlying the financial reports as well as a comparative analysis of particular financial indicators versus a peer universe. Many have suggested tiering the information with a journalistic summary at the beginning and more detailed analyses as the reader continues to read. Within the context of the Internet, this could mean a summary page, together with hyperlinks to more detailed information on particular topics.

Tagging of Information

The SEC is engaged in a major project to introduce interactive data tagging technology for the informational content of financial reports, such as through the use of XBRL, so that users have the ability to quickly and easily focus on the important information they desire in these reports. Moreover, tagging of information may allow investors to customize their needs based on their desired level of detail. The tagging of information can be focused on performance metrics for carrying out the strategy of a specific company and could be designed along the lines of a balanced scorecard. The tagging of information can be organized into a variety of standard formats for key performance indicators (KPIs) organized by industry. An existing project for the development of these KPIs is being undertaken by a non-profit consortium on enhanced business reporting (originally started under the AICPA). The subcommittee may wish to study these developments and consider whether additional recommendations can be made to improve the usefulness of financial reporting in these areas.

Press Releases and Website Disclosure

Press releases and corporate websites have become important forms of communication for many public companies. For example, some companies post or issue press releases to report interim and annual results and in doing so often release non-GAAP financial measures. These operating results are often issued well before the formal operating results and disclosure are required to be filed with the SEC, and they may contain additional information that is not required to be filed. Recently as a result of implementing the Sarbanes-Oxley Act, the SEC revised its rules and regulations concerning the public disclosure of non-GAAP financial measures, including in press releases and earnings webcasts, and whether press releases also must be filed versus furnished with the SEC. This subcommittee may wish to consider the underlying reasons why press releases and web disclosures—and the information contained in them—are used by our capital markets in order to determine if additional performance indicators would be useful for our capital markets. In addition, the subcommittee may wish to consider the experience of issuers with disclosure of non-GAAP information and the use of press releases and corporate websites in connection with their financial reports. The continued demand for these disclosures by issuers may suggest that the required formats for reporting financial information are not serving all the needs of preparers and users.

Legal Issues

To provide various forms of communications that meet the needs of different investor groups, there may be a need to consider the legal liabilities for different types of information – e.g., MD&A versus audited income statements – and for the different communication methods used to provide them. For example, this subcommittee may wish to look at the experience with "free writing" in public offerings whereby issuers can communicate new developments or pieces of information that may not be included in the formal prospectus. Further, this subcommittee may wish to look at the various attempts to provide a summary prospectus in the mutual fund industry.

V. International Coordination

This subcommittee should consider whether the growing use of international accounting standards has an impact on the relevant issues relating to complexity of U.S. accounting standards and the usefulness of the U.S. financial reporting system (for example, by identifying best practice employed internationally). As it relates to the acceptance of International Financial Reporting Standards, or IFRS, in the U.S. capital markets, the SEC has issued a proposing release to permit the use of IFRS by foreign private issuers without a U.S. GAAP reconciliation. In addition, the SEC has voted to issue a concept release on whether U.S. issuers should be allowed the choice to use IFRS to satisfy their SEC reporting requirements. The SEC expects to receive important feedback on these initiatives that could be considered by this subcommittee. Each of the four other subcommittees should consider whether there are areas or international best practice that should be evaluated by the international subcommittee for implementation in the U.S. financial reporting system. Given the timing of the expected comment letter process on the Commission’s initiatives, and in order of the other subcommittees to identify areas of focus, the substantive research and analysis of this subcommittee will not begin until early 2008. While the nature of the items considered by this committee has not been fully developed, the subcommittee may wish to consider the following:

Standard Setting Approach

This committee should consider whether there are “best practices” employed by the IASB in the standard setting process. For example, many believe the IASB takes an approach based more on principles rather than detailed rules, but the IASB, like the FASB, nevertheless does have conflicting principles and controversies based on volatility and the increased use of fair value. Many have observed that the accounting standards promulgated by the FASB are too lengthy. This is partly because the FASB includes in its standards not only the text, but also its history and the responses to significant comments on the initial proposal and implementation guidance. By contrast, IFRS generally include only the text in its accounting standards. The FASB has already started to work together with the IASB in formulating new accounting standards or revising existing standards in the hopes that future standards will be converged. The subcommittee may wish to consider a few examples where the FASB and the IASB are working together to determine if the process is effective and efficient to meet the needs of our capital markets.

Regulation

The enforcement of accounting standards outside the U.S. may be quite different depending on the particular jurisdiction from the enforcement policies and practices within the U.S. The subcommittee may wish to consider these differences and determine whether the U.S. system could benefit from any lessons from the foreign experience.