NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board’s Standing Advisory Group meeting on October 14, 2009 that related to the Board’s proposed auditing standards related to the auditor's assessment of and response to risk. The other topics discussed during the October 14, 2009 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
( PCAOB )

STANDING ADVISORY GROUP MEETING

9:03 a.m.
Wednesday, October 14, 2009

National Association of Home Builders
1201 15th Street, N.W.
Washington, D.C.
Now, what I want to try and do for these next couple slides is talk about just some of the general themes that came through in the comment letter process, and to do that and help set the stage for that, I’d like to back up and give you just a few minutes of background. When this proposal was issued, the Board outlined and identified a list of objectives that they wanted to try and accomplish through this project.

The first one of those was to update the Board’s standards relating to risk assessment to -- in light of the changes and the audit methodologies that are risk based that have been implemented and are prevalent in practice.

The second one is to further the integration of the standards relating to risk assessment with the standard for the audit of an internal control over financial reporting, AS Number 5.

And the third was to try to incorporate into these standards the general principles for identifying, assessing, and responding to the risk of material misstatement due to fraud that have existed in the Board’s interim standard on fraud, but to make the fraud responsibilities a more central part of the risk assessment process.

And as part of the development process for these standards, the Board did look carefully at the related risk assessment standards of the International Auditing and Assurance Standards Board, particularly looking at the objectives and the requirements of those standards and trying to determine whether they were appropriate for audits of issuers, which is our area of responsibility.

So, as you can see now from this slide, we received a lot of comments in those -- in each of those areas. First of all, there was general support. Almost everyone who commented, in a comprehensive way at least, supported the idea of updating these standards to speak more directly to the risk-based audit.

There was also pretty broad support for enhancing the integration of these risk assessment standards with the standard for internal control over financial reporting. And in fact, we received a number of comments that would seek to improve that integration.
When it comes to the fraud-related aspects, the views were a bit mixed. We had 15 people specifically comment on the topic of integrating these standards more closely with fraud, and 8 of the 15 were supportive of the Board's approach. There were 4 who were not as supportive of the Board’s approach or expressed some concerns about it, and then the remaining 3 were somewhat neutral or ambivalent about it.

An example of that would be, yes, we could see doing that, but our methodology already integrates the consideration of fraud into our core methodology. So we don’t think it would have any effect on practice one way or the other. So more of a neutral stance with respect to that.

Then in terms of perhaps more technical or specific comments, we received a number of comments related to the extent and nature of the requirements in the standards, comments such as there were a comparison proposed standards had a slightly different format from some of the previously issued standards of the Board. For example, there was a specific section that outlined the objective of each of these proposed standards. And the commenters were supportive of having an objective in each standard, certainly. They did indicate some not necessarily reservations about the format we used but, basically, came down to you need to develop a standard template for your standards, a standard style, and just implement that and follow it from now on. So we received a fair number of comments related to that.

And then, finally, there was a comment -- there were a series of comments about the effective date of the standards. We hadn’t specifically mentioned or proposed an effective date for the standards, and we received some -- a number of comments, a lot of them were related to guidelines on how the Board should determine its effective date for the standards along the lines of please allow us enough time to change our methodologies and to be able to have enough time to train the staff and those kinds of things.

And the important point that was also made by a number of those commenters was that the Board should propose a specific effective date and seek comment on that prior to actually adopting the standards. So those are some of the most common comments that we received on the standards, comments such as there were a comparison of these standards to the IAASB standards or the ASB standards, and they may observe that our proposal had more requirements than the -- than a comparable IAASB standard.

There were also cases where they commented on the specific language of a requirement. For example, saying that we really needed to explicitly build into the language of a requirement the -- qualify it based on the auditor's use of professional judgment. There were a host of other comments related to what I’ll call the use of terms to describe the auditor’s responsibilities, and here, we’re actually talking about verbs. So we may have a requirement for the auditor to “evaluate” or “assess” a matter, we’ve received some comments that to use a different choice of words, such as the auditor should “consider” a given matter.

So, and usually, those were, again, in comparison to either the Board’s interim standard or the related standards of the IAASB or ASB. We received a number of comments about the organization and style of these standards. These
view that as not a good idea, not neutral, but some
were negative on that.

Could you expand more on the ones who were
negative on that?

KEITH WILSON: I guess the way I would
categorize the most -- most of those concerns were
around the lines of they tended to prefer having a
separate standard that was focused specifically on
fraud. They thought it was helpful to have all of the
auditor’s responsibilities related to fraud summarized
in one place and preferred that to the approach of
incorporating the key aspects into the core standards
for risk assessment.

MALE VOICE: Keith, might I ask -- it’s been
some time since I’ve read these, and so when you ask do
we have any comments, I wasn’t really expecting it.

What’s the timetable now? Could we give you any
comments by email on the specific standards? What’s
doable here? Because I feel like I’m maybe not quite
as prepared as I could have been.

KEITH WILSON: Well, actually, I think the
comment period is closed, and we are in the process now
of revising the proposed standards and putting them
before the Board. I think I indicated earlier that our
target was to issue proposed standards and revised --
repropose these standards in December is our target.

We wanted to present today generally in
keeping with the theme of updating the SAG in terms of
developments what was the nature of the comments we
received. And as long as we were doing that, we just
thought we would take the opportunity today, if anybody
wanted to react to the comments we received or had
something else to say, to do that.

But other than that, I would say that
essentially the comment period is closed. So, thank
you.

Damon Silvers?

DAMON SILVERS: I mean, I spoke earlier today
about the fraud standard, which I guess some of the
commenters felt was a better place to address these
issues than in the -- sort of in risk assessment and
sort of throughout the standard, the bodies of the
auditing standards.

I mean, I think the Board ought to be wary of
a catch-22 here, right? You know, there have been
plenty of instances in Washington of people who don’t
want to do anything always pointing you somewhere else.

Wherever you are, wherever you’re actually acting, they
will all go, “No, that’s not the right place to act.

Go over here.” When you get over there, then they’re,
“Oh, no. That’s not the right place. Now come back
here.”

The Board should be wary of that kind of
ting thing.

My own view is, is that I think you need to
do both. I think that there needs to be a clear,
overarching set of obligations on auditors in relation
to fraud, and then I think there needs to be an
understanding -- and then those, that basic framework
needs to be embedded in areas such as risk assessment,
where it’s clearly, I think, part of what the investing
public thinks is happening here is that auditors are
keeping an eye out for circumstances that would appear
to increase the probability that fraud may be
occurring.

I also see fraud as a continuum, as one end
of a continuum of potential problems with a financial
statement, and that in setting standards for risk
assessment, I’m not sure how you -- I think you have to
-- you have to give guidance and more than guidance for
looking for mistakes, looking for conduct, which I
think is somewhere -- I’m not sure of
the term ofar
but there is something between a mistake and a fraud.
To me, it’s little bit more intentional than a mistake.

And that but for the insistence of an
auditor, that principles of financial accounting have
to be complied with, would go forward. But it’s not
somebody forgetting how to add. I don’t see how you
give the -- I don’t see how you set a set of standards
around risk assessment, taking into account that range
of human behavior, and not embody in it some attitude
toward assessing the risk of fraud. And so, like I
said, I think both is the right answer.

KEITH WILSON: Okay. Thank you.

Just before we move on to Gary, let me just
mention that as a point of clarification, we are
intending that there continue to be a separate standard
related to fraud. But we do feel like there is some
important principles that need to be captured in there, too. So --

DAMON SILVERS: I was suggesting that the overall fraud standard needs to be strengthened at the same time as you're undertaking this exercise. So I'm sort of the opposite of the person who says do nothing, you know? I say do everything.

[Laughter.]

KEITH WILSON: All right. Very good.

GARY KAURECK: Yes. Thanks.

Actually, I think Damon said a lot of what I was going to say because I think, Mar, in your opening comments, you had said these standards, these seven things, they can become foundational audit standards as opposed to tactical. And if they're foundational, I think the possible existence of fraud or the auditor's inspection for it is one of the central things auditors do work on, and I think it should be in there.

I think, again, maybe you want a separate fraud standard of how to deploy audit procedures. But

I would think in the risk standards, you would want to come up with an answer to questions is fraud a primary or a secondary audit objective? And do you automatically assume fraud or is it only when evidence of possible fraud emerges, and are you looking for positive or negative evidence?

I think that should be in the risk standard.

And again, maybe in different standards, maybe if we got different goals for them, then in a separate fraud standard, okay, if I have to assume fraud exists as a primary audit objective, how do I actually go about doing that? And what is the standards of a detailed audit performance?

So I think if these are truly foundational standards, these seven, I don't know how fraud can't be inside of it.

KEITH WILSON: Thank you.

Vin Colman?

VINCENT COLMAN: Damon, I know you're a lawyer and not an auditor, and I'm an auditor. I do this for a living. Do you mind, I'm just trying to understand, make sure I fully understand what you're saying. And can you just, perhaps for me, if you start at a forensic audit, right, and then you work your way along the continuum, what -- the vision you're articulating that either came from Treasury or where you want to go -- I'm just trying to understand where you want to go -- where do you put yourself along that continuum?

So I understand when, you know -- because when you're saying both a separate standard and vetting it on the standards, and we're going to talk about this this afternoon because it's certain in some of the other materials that we got. I'm just trying to understand the vision of where you're -- what you're articulating. Could you do that along the continuum?

DAMON SILVERS: Well, I mean, I'm like Gaylen in that I don't actually have the text of the fraud standard in front of me, but I will give you -- but I think it's a very fair question because I think we definitely should not be expecting that every audit is a forensic audit. I think that's -- there is a risk of that in this way of thinking.

I think in the risk standards, you would want to come up with an answer to questions is fraud a primary or a secondary audit objective? And do you automatically assume fraud or is it only when evidence of possible fraud emerges, and are you looking for positive or negative evidence?

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So I think if these are truly foundational standards, these seven, I don't know how fraud can't be inside of it.

KEITH WILSON: Thank you.

VINCENT COLMAN: Right. Because that's what I hear. When you're articulating it, that's what I kind of hear you saying.

DAMON SILVERS: Yes, that's --

VINCENT COLMAN: That's why I'm looking for the clarification.

DAMON SILVERS: Right. And that's absolutely not what I'm saying. What I'm saying is I think that we need to move the dial a bit on the overall audit standard so that there is an overall obligation on the auditor to be -- and I'm sorry. The IT guys tell me there's something wrong with my BlackBerry. That we need to move the overall dial on the audit standard to create -- oh, it's my BlackBerry in my pocket.

[Laughter.]

DAMON SILVERS: See? I just got one. I just gave in and got one of these things, and I don't know how they -- they're evil. That's what Sam and I have been discussing, the various pernicious qualities of BlackBerrys, both recognizing that neither of us would part with it any more than we'd part with our right arms.
Anyway, no, and I think this is why the sort of the risk assessment area is one where it's particularly good -- would be a particularly good idea to have integrated approach that then embodied this approach elsewhere. So I think that they need to move the dial a little bit in terms of auditors having some obligation to -- some greater obligation than is currently embodied in the fraud -- in the current fraud standard to be, to act in a context where there's essentially a reasonable suspicion.

And that then -- and I think you then need to embody that in areas such as this, that approach in areas such as this. I don't think that we can create -- I mean, this was a subject of some extensive discussion in the Treasury Committee. Some people -- and I think Lynn may feel that my basic approach is not tough enough. Unfortunately, he's not here at the moment. Maybe he'll chime in later.

Some people felt that we ought to be moving very much toward a kind of absolute liability standard, right? You don't find fraud, it's the auditor's fault.

That's -- that is not my view. I think that there are

1 percent would be I'm going to change everything I proposed before, where are you on that continuum, would you guess, roughly? A 10 percent course correction?

KEITH WILSON: That's a very interesting question, and I don't know that I've really thought of it in terms of a specific percentage. Let me try and say that some of the things that we're contemplating now and that we're looking at doing with these standards tend to be more in the areas of refinements, not major structural changes, if that helps in terms of the way we're looking at the standards.

GREGORY JONAS: So, Marty, help me out, with a little percentage. If, you know, 0 percent would be a re-exposure of exactly what you had before and 100 percent would be I'm going to change everything I proposed before, where are you on that continuum, would you guess, roughly? A 10 percent course correction?

KEITH WILSON: That's a very interesting question, and I don't know that I've really thought of it in terms of a specific percentage. Let me try and say that some of the things that we're contemplating now and that we're looking at doing with these standards tend to be more in the areas of refinements, not major structural changes, if that helps in terms of the way we're looking at the standards.

GREGORY JONAS: That's an 11 perceT!t comment.

[Laughter.]

KEITH WILSON: Okay. You're much more comfortable with percentages than I am.

MARTIN BAUMANN: Given that Keith wasn't willing to throw out a percentage, I do think it's closer to the 11 percent than it is to the 100, though.

So, but again, notwithstanding that, given their importance, we feel let's repropose them and get one changes in response to those comments. In some places, we decided not to make changes.

But because they -- as I said, we think they're important enough and so important to the foundation of the entire audit, the risk assessment process, planning -- with planning the audit, considering the impacts of materiality and judgments, that we want to put it out one more time, let everybody see how we've amended the proposals, and then just get comments back and then go final.

GREGORY JONAS: So, Marty, help me out, with a little percentage. If, you know, 0 percent would be a re-exposure of exactly what you had before and 100 percent would be I'm going to change everything I proposed before, where are you on that continuum, would you guess, roughly? A 10 percent course correction?

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So, but again, notwithstanding that, given their importance, we feel let's repropose them and get one more set of comments and then go final.

Thank you.
KEITH WILSON: Joe Carcello?

JOSEPH CARCELLO: I wanted to talk a little bit about the fraud question, Marty. And first of all, I agree with Damon, first of all, on I think an absolute liability standard would be a big mistake. As someone who has spent a lot of my professional career studying fraud, a lot of these frauds are very elaborate, and I don't know if the right answer is to embed the fraud guidance throughout all the standards or keep it separate. So I'm not going to really -- I don't have a strong opinion on that.

But I did want to, as some of you in the room know, that we are working -- me and three other people are working with COSO to update the study on fraud that we did in 1999. And although we're not done, we do have some preliminary information that I think is important.

First of all, fraud continues to be a big problem. There is well over 300 fraud companies between 1998 and 2007. There is well over 1,000 enforcement releases related to those 300 fraud companies. In the '99 study that we did for COSO, the size of the companies was very, very small. And so, someone could say, well, this is only a problem of very tiny companies.

Although, by and large, fraud companies do tend to be smaller, the size of the companies has increased by over a factor of 6. That's not due to inflation, guys. You can do the math.

The stock price decline is approximately 20 percent at the first disclosure, not necessarily a fraud, the first disclosure that there may be an accounting problem. And bankruptcy, delisting, material asset sales, and other adverse consequences to the firm and their shareholders is significantly more likely than a matched sample of no fraud companies.

So this is just, you know, tidbits from my memory, and we're still doing a lot of additional work.

But the reason I mention this is just for the Board to understand, for the SEC representatives to understand, since this study comes from your enforcement actions, that this continues to be a major problem in the capital markets.

MARTIN BAUMANN: Good. Thanks, Joe, for that input. And Damon, thanks also for the commentary on fraud.

Let's move along to the second topic where we have issued a concept release on confirmations, and Dee Mirando-Gould is going to give you a summary of the comments received there.

Thanks, Dee.
Meeting of the Standing Advisory Group

October 14, 2009
9:00 a.m. – 2:30 p.m.
Update on Proposed Standards and Concept Release Issued

Keith Wilson, Dee Mirando-Gould, and Bella Rivshin

*Associate Chief Auditors, Office of the Chief Auditor*
Update on Proposed Standards and Concept Releases

- Proposed standards on risk assessment
- Audit confirmations concept release
- Signing the auditor’s report concept release
Proposed Standards on Risk Assessment

- Comment Letters Received
  - Firms and association of accountants 18
  - Academics and associations of academics 4
  - Issuers, business groups, and internal auditors 3
  - Investor representatives 1
  - Other standards-setters 2
  - Other individuals 5
  - Total 33
Proposed Standards on Risk Assessment

Key Themes of Comment Letters

- Support for improving standards for risk-based audits
- Support for integration of the proposed standards for assessing and responding to risk with the standard for audit of internal control over financial reporting
- Divergent views on integrating the auditor’s consideration of fraud into the proposed standards
- Suggestions for greater alignment with standards of the IAASB and ASB
Proposed Standards on Risk Assessment

Key Themes of Comment Letters (cont’d)

- Other general topics
  - Extent and nature of requirements
  - Use of terms to describe the auditor’s responsibilities
  - Organization and style of the proposed standards
  - Effective date of standards