The Advisory Group met in the Academy Hall within the offices of FHI 360, located at 1825 Connecticut Avenue, Northwest, Washington, D.C., at 8:30 a.m., James R. Doty, Chairman, presiding.

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MR. KROLL: Thank you, Marty. Good morning. My name is Steve Kroll and I'm a member of the AQI Project Team. The team is especially happy to have this opportunity to meet with the Standing Advisory Group, because of the Group's background with AQIs. It worked through the initial set of about 70 potential AQIs and really helped us shape the project, in May 2013, and considered other aspects of the project in depth at its November 2013 and June 2014 meetings. Like most things, these issues don't go away. They're still relevant today.

The discussions that we've planned for today and tomorrow come at a very important time for the project. The Board has issued its Concept Release and subsequently received the comments summarized in your materials. Interest in AQIs in various forms has continued to grow, both here and abroad. And I'd have to give a nod to the IAASB in that context. The challenge though is deciding what to do next.

Moving the project forward involves hard questions. Some were raised in the Concept Release itself and others were raised in the comments. Most go to the
possibility of achieving the release's stated purpose, which was: "creating a potential portfolio of quantitative measures that may provide new insights about how to evaluate the quality of audits and how high-quality audits are achieved." At margin the topics posed for the breakout groups later this morning try to focus these critical questions and we are eager, given the group's experience, to hear its views about those questions and about the project's future direction.

The next speaker is my friend George Wilfert, a Deputy Director of ORA, who will talk in greater detail about the plans for the discussions. After that, Greg Jonas, whom I think all of you know, the Director of ORA and the leader of the AQI project, will give you an overview of the broad areas of agreement and controversy that we extracted from the comments. Finally, Jane Hutchens, to my left, also a team member, will review the assignments and location for the breakout groups. Thank you.

MR. WILFERT: Thanks, Steve. First, I'd like to acknowledge that we found the SAG's counsel very helpful in developing our Concept Release. The comment period ended in September and the Board received 47 comments,
which, as Steve noted, the staff has summarized in the exhibits to your handouts for your reference during the breakout sessions. We thought it might be beneficial to briefly discuss both the format and the goals of the breakout sessions, which will help set the stage and provide context for the discussion.

The format we have planned for you today consists of three breakout sessions addressing different aspects of the Concept Release. Each breakout session has been assigned specific topic and series of questions for discussion. The goals we would like to achieve include identifying the areas of general agreement with respect to the topic and questions assigned to each group, obtaining an understanding of the areas of controversy. So in this regard, we would very much appreciate SAG members sharing their insights with us so we can help discern the underlying rationale for differing views. In addition, we always greatly value new ideas and recommendations.

Tomorrow morning's debrief session will be presented in two parts. First, we will present a summary of the views from the breakout sessions. The Concept
Release acknowledged a wide range of ways forward using AQIs to inform and promote audit quality. We would like to devote the second half of tomorrow's discussion to the topic of next steps and request each SAG member to offer a summary recommendation about how the Board should move forward.

Next, I'd like to turn to Greg, who would like to share the staff's observations regarding the areas of broad agreement and the issues that may be perceived as controversial in the comment letters received to date.

MR. JONAS: Great, George, thank you. And good morning, everyone. You know, it's always dangerous to try to summarize the themes from comment letters because they're full of detail, they're full of nuance. To really understand them, you need to read all of them. So at the risk of generalizing, let me lead with my chin and summarize what the staff believes to be the central areas, starting with agreement.

First of all, we perceive, not exactly unanimous, but an overwhelming majority of folks continue to believe that discussion about AQIs, the AQI project, is a useful thing to be doing and that potentially AQIs could be very
useful to informing discussions about audit quality. The second area of the, we perceived to be, strong consensus, relates to an area of the Concept Release where we kind of led with our chin.

And that was, we described what we believe to be the characteristics of a useful AQI. That it's quantitative. That they operate in packs as a portfolio, so we can triangulate on quality. That they require context to be understood, that is, the metric plus context equals insight; the metric alone is unlikely to yield insight. That their purpose is to inform discussion and help people ask the right question rather than answering questions themselves. And then, importantly, they are not scorecards, they're not safe harbors, they're not benchmarks. That description of what we think a useful AQI is seemed to get a lot of applause in the comment letters.

A third area of broad agreement is that audit committees are a key user. That doesn't mean that others may not be key users, but a strong consensus that at least the audit committee is a key user of AQIs. And that in their discussions, the most informative AQIs are likely
to be at the engagement level rather than at, say, the firm level, industry level, office level, some other type of AQI. So engagement-level AQIs are the focus of audit committee discussions.

And then a final area of broad agreement is that if AQIs are useful at all, they're likely to be useful to the larger engagements, the more complex work and to the larger firms. It's an open and debatable question about how useful the AQIs are to the smallest engagements and the smaller firms, the so-called scalability question.

So if those are the areas of agreement, where are the areas of controversy? Well first, a package of controversy relates to the AQIs themselves. As you recall from the Concept Release, we teed up 28 AQIs as potentially useful. And we were quite specific in what we thought those might be in order to elicit the most pointed comments during the comment process.

And not surprisingly, some of those AQIs were quite controversial. And in particular, it's the ones that kind of broke new ground, the ones that are not commonly thought of or used today. So for example, AQIs about the incentive system or the tone at the top within firms. As I
mentioned, the scalability question is controversial. How much testing needs to be done to verify an AQI is somewhat controversial. Everybody agrees testing needs to be done, but some of the letters said, doggone it, you almost need to prove empirically that an AQI is useful to be able to with confidence use it. Others believed that far less testing is needed, even though some testing is needed.

And then finally, a number of letters said, you know, all these AQIs are potentially very interesting, but what we really want to get to is the professional skepticism, objectivity, independence of the auditor. Can you help us think of some AQIs that would focus the discussion on those areas?

Another area of controversy related to the question of the extent to which investors are a key customer of AQIs. The letters we received from investors passionately argued that investors are a key customer of AQIs. And, of course, to meet that need, we would need to make AQIs public. Others argued passionately that investors should not be a key customer, direct customer of AQIs, for two broad reasons. One is understanding the AQIs requires context
and it would be very difficult to give an investor the appropriate context in which to evaluate the AQIs. And then other letters noted that investors are very busy folks, preoccupied with many, many issues in evaluating companies, and doubted whether investors would seriously pore over a portfolio of AQIs in order to evaluate audit quality.

A third broad area of controversy relates to unintended consequences. Many of the letters warned us, as you have in the past, about unintended consequences. But where the controversy resides is what to do about the unintended consequences. What actions would we take to avoid having to make them? There the letters offered a very diverse array of views.

And then the final area of controversy relates to the question of, should AQIs be mandated in some way, raising the issue of, what is the highest and best use of an audit regulator in the AQI process? And here letters offered a spectrum of views. Some argued basically, “butt out,” that these are early days, what we need is continued experimentation and right now we really don't see a major role for a regulator.
Others argued passionately that the regulator offered a key role in helping to standardize vocabulary and have consistency of AQIs and to ensure that a robust portfolio of AQIs are discussed, not only the good ones, but the ones where there's some bad and potentially some ugly that's present. And then letters were in-between, offering that perhaps a role of regulation was to encourage, to offer insight, if not coming short of mandating the use of AQIs themselves.

We offer this summary because we think these themes are going to come out in each of the breakout sessions and we look forward to hearing your views on these important issues, as well as the other ones that were raised in the materials for today's meeting. So with that, let me turn it to Jane, who will discuss a little more detail about the breakout sessions today. Jane?

MS. HUTCHENS: Thanks, Greg. Our breakout group sessions this morning will all concern the content and possible uses of a group of potential Audit Quality Indicators. On the back of everyone's name tag includes a number: 1, 2, or 3, so that everyone is aware of which breakout session they will be participating in. The rooms
are located upstairs, up the stairs to the right here.

Group 1 will meet in Room C, so in case it says Room C or Room 1, that will be our Group 1. Group 2 will meet in Room D and will discuss the use of AQIs specifically by audit committee members. Group 1, I don't think I mentioned, will also discuss the AQIs and the content themselves. Group 3 will meet in Room E and will discuss the use of AQIs by investors.

And then as George mentioned earlier, tomorrow morning we will have an 8:30 a.m. debrief discussion. The first part of that discussion will include review of what was discussed during the breakout sessions and we will seek comment from the other groups on each topic. We will also go round-robin around the table and provide every member an opportunity to provide us a brief comment regarding what you believe the next step should be for the project.

On each of the breakout groups, there will be a facilitator to moderate the discussion, as listed in the top row of the line there, Eugene, Greg and Marty. The bottom line there, George, Steve and myself, will serve as an AQI team member in each of the breakout sessions. We will also have in each of the breakout sessions at least
one Board member participating in the discussions.

Since we reordered the format this morning, Jim will speak after us, before the breakout sessions. There will be a 30-minute break before the breakout sessions begin. The breakout sessions are scheduled to begin promptly at 10:30 and then will end at 12:15 for lunch. Does anyone have questions about the format or any observations on the breakout sessions that they'd like to ask? Okay. We'll turn it over to the Chairman now.

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