NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board’s Standing Advisory Group meeting on November 9, 2011 that relates to the Board’s proposal on improving transparency through disclosure of engagement partner and certain other participants in audits. The other topics discussed during the November 9, 2011 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

STANDING ADVISORY GROUP MEETING

Public Company Accounting Oversight Board
1666 K Street, N.W.
Suite 800
Washington, D.C. 20006

November 9, 2011
9:00 a.m.
PARTICIPANTS

Moderators:

MARTIN BAUMANN

Participants:

JENNIFER RAND    KIKO HARVEY
BRIAN SIPES      STEVE RAFFERTY
JOE CARCELLO     ANTHONY KENDALL
STEPHEN HOMZA    MICHAEL AUERBACH
KURT SCHACHT     BOB DUCEY
ARCH ARCHAMBAULT LARRY SMITH
JAY HANSON
MARY HARTMAN MORRIS BRIAN CROUTEAU
DOUG CARMICHAEL  JIM KROEKER
KEVIN REILLY     ARNOLD SCHILDER
BARBARA ROPER    MEGAN ZEITSMAN
WAYNE KOLINS     HARRISON GREENE
ARNOLD HANISH    GAIL HANSON
SUE HARRIS       LYNN TURNER
DAMON SILVERS    LIZ GANTNIER
BILL PLATT       LEW FERGUSON
Participants (continued):

- SCOTT SHOWALTER
- JOHN WHITE
- JEFF MAHONEY
- JIM DOTY
- GAYLEN HANSEN
- NERI BUCKSPAN
- MIKE GALLAGHER
- DAN SLACK
- DAN GOELZER
- DENNY BERESFORD
- LISA LINDSLEY
- SAM RANZILLA
- MICHAEL GURBUTT
- KEITH WILSON
- BRIAN DEGANO
- GREG SCATES
- GREG FLETCHER
- DMYTRO ANDRIYENKO
- DOMINICA TARASZKIEWICZ
- KANNAS RAGHUNANDAN
- LISA CALANDRIELLO
MS. RAND: All right. We’re at the last discussion of the day, improving transparency of audits. Our agenda says today that we would end at 5:15. Most SAG members are required to be here until tomorrow. So with that consideration, we thought we might go all night.

Just kidding.

[Laughter.]

MS. RAND: But we’d like to have the discussion go until 5:30. If that’s a problem for anyone, certainly leave if you need to, leave at 5:15, but we do plan to go to 5:30. We very much are interested in your comments. So if we need to continue any discussion tomorrow morning, we will do that.

But with that, we’ll get started. And Lew Ferguson, our Board member, is opening -- providing some opening remarks.

Lew?

MR. FERGUSON: On October 11th of this year, the Board issued proposed amendments to the Board’s Standards and Rules aimed at improving the transparency of audits. Specifically, we have proposed two
additional requirements: one, a requirement to
identify the audit engagement partner in the auditor’s
report; and two, a requirement to disclose in the audit
report other independent public accounting firms and
other persons who took part in the audit.

This is an issue -- the identification of the
audit engagement partner specifically is a matter that
has been discussed repeatedly at the Standing Advisory
Group and in the Board’s Investor Advisory Group, and
we’ve had different views expressed on it.

On the one hand, with respect to disclosure of the
audit engagement partner, or the signature of the
report by the audit engagement partner, proponents of
disclosure have argued that such disclosure would
increase the transparency of the audit process, as well
as potentially increase the accountability of the audit
engagement partner if he was forced to have his name
identified or put his name on the report.

Skeptics, on the other hand, have argued that
identification of an individual auditor in the report
is actually misleading. It would be misleading to
investors because the audit is, in fact, a collective
enterprise and requires the resources of many, many
different people in the firm.

They’ve also made a second argument. Skeptics
have also made a second argument, that by requiring
that the individual partner either be named or sign the
report, it could potentially increase his individual
liability in the event of securities litigation arising
out of the audit.

We’ve looked at both of those things, and this is
speaking sort of primarily for myself in this case, but
I think one of the factors that influenced me, but I
think influenced the Board as a whole on this, was that
the audit engagement partner I think is in a unique
position with respect to the audit. He is the firm’s
primary interface with the client. He is the person
that the board of directors, the audit committee, and
the management of the firm interacts with most of all.

The audit committee does not call up -- the
chairman of the audit committee doesn’t call up the
firm when he has a question. He calls up the primary
audit partner. And many, many audit committees also
are extremely interested in the process of selecting a
successor audit engagement partner when there is rotation, that who the audit engagement partner is, is a very important matter to clients.

So I think we thought that this is something, because of that, and because of the unique role of the audit engagement partner, that this is something that probably would be of use to investors to know who that is. We heard the arguments and we were familiar with the arguments that if you really want to find out who an audit engagement partner is, you can go to the shareholders meeting, where the audit engagement partner will probably be there and will probably get up and identify himself.

That’s not realistic for most investors. Most investors don’t go to the shareholders meetings. Perhaps the largest ones do, but most don’t.

We also seriously considered the question of whether identification of the audit engagement partner would increase liability. I think the answer to that is not clear at this point. We looked carefully and were aware of, obviously, the developments in the Janus case in the Supreme Court and its rather ambiguous
progeny.

But I think we thought that -- and this is something that we would like to hear much more on from other people, but we thought that, in our view, that in general we did not think that by identifying, merely naming the person, not requiring him to sign the report, that this would increase dramatically liability, and that’s the reason we chose the course we did in these proposed rules of identifying but not requiring the audit engagement partner to sign the report.

On the second issue, with respect to naming other firms and other individuals who participated in the preparation of an audit, as we talked to people we were surprised to learn how many investors really were not familiar with the fact that oftentimes an audit, particularly of a large multinational firm, is oftentimes conducted by many, many different firms around the world, many of which are not the same legal entity as the firm signing the report.

We thought that it would actually -- I think the Board believed that it would actually increase
investors’ knowledge about the audit by having other firms that are participating in the audit be identified. For one thing, it would give investors knowledge of or transparency into those firms that have conducted part of the audit which are not subject to PCAOB inspections, and there are a number of firms around the world, for example even in some major countries, that as of yet we are unable to inspect, and that this would be information that could be of interest to investors.

We were aware -- we heard the arguments. We were aware of the arguments that, in fact, the principal auditor is the one who is responsible ultimately for the audit, and that he’s actually supervising the audit, and the question was why do you need to disclose the names of the other firms that are involved. Nonetheless, I think under the theory that more information is probably better and people can understand and are able to evaluate that information for what it’s worth, we have proposed to go ahead and identify those firms.

So that’s the proposal or the proposals we took.
Obviously, the comment period is still open. We’re waiting for people. We’re very interested in what people’s views on these issues are. Jennifer?

MS. RAND: Okay. Thank you, Lew. I’d now like to walk you through the requirements or the proposed requirements in our proposal. While the concepts I think are pretty straightforward, which is providing identification of the engagement partner and the other firms, there’s some very technical aspects we found as a project team going through this project as far as who exactly is required to be disclosed, who isn’t, and to what extent.

So I want to provide you with an overview of that, and the proposal is asking questions about the proposed amendments, as well as certain exceptions that may be provided, et cetera. And we’re also interested in any discussion you all may have about it.

Before I get into it, I just want to mention that I’m joined up here at the table by Dima Andriyenko and Lisa Calandriello. They’re my colleagues on this project, so I may turn it to them if they have any
other thoughts in responding to any of your comments.

So moving on, the proposal was issued a month ago, October 11th, for a 90-day comment period. So we have two months to go. The comment period deadline is January 9th, 2012. It essentially is requiring disclosure in the audit report, and also Form 2, but in the audit report of the engagement partner, the name of the engagement partner, and other accounting firms or persons that took part in the audit.

It is also proposing an amendment to the Board’s annual report, which is called Form 2, and our registered public accounting firms are required to submit a form to the Board on their annual report providing information about the issuers they audit. So this would require, in addition to the issuers, the name of the engagement partner.

I keep hitting my microphone instead of the advance-the-slide button, so you’ll have to forgive me for turning my microphone on and off. Marty will do it for me. There we go.

The disclosure of the engagement partner, as Lew was talking about, it does build on the concept release
the Board issued a couple of years ago that was seeking comment on whether or not the engagement partner, there should be engagement partner signature in addition to the firm’s signature in the audit report.

We received 23 comment letters on that concept release. Some of the concerns were that the signature of the engagement partner would have the appearance or could otherwise minimize the firm’s overall responsibility for the audit. The opinion, the audit opinion is the opinion of the firm, and it’s the signature of the firm that’s in that. So several comments raised concern about that is a partner’s opinion or a firm’s opinion, minimizing the firm’s role. So clearly some concerns on that end, as well as concerns about liability, and Lew talked about that.

The Board in its approach modified the approach from the concept release. So this would not require the engagement partner’s signature. It would, however, require disclosure of the engagement partner in the firm’s opinion, and that disclosure would essentially say the name of the engagement partner for the most recent audit was -- insert individual’s name.
It would be, then, the specifics, the engagement partner’s name. It would be for the most recent period. We received several comments about would it be for multiple years, and we recognized that with the partner rotation requirements, there would be changes in partners, which we would expect. There could also be other situations such as dual dating, or in an IPO situation, maybe several years, three years of financial statements may be audited at one time.

This proposed disclosure would require for the most part reporting on the most recent period under audit. That would be the situation we expect to see most often. The proposal does deal with those special situations such as dual dating and if three years are audited at once in an IPO, for example, in which case, if that was the case, if it’s the IPO situation, the disclosure would say the engagement partner for the three years or two years under audit was X; or if it was dual dated and they just did a portion of the audit covering the second date, then that would just disclose that individual.

So we recognized that there were some different
scenarios that could come up, that do come up in reporting, and so the proposal is intended to reflect that. And then, as I said, the proposal would require disclosure in the Board’s annual report Form 2, so the names of the engagement partners.

Advance me.

All right. So next, moving on to the other participants in the audit, so that would be the other firms or could be other individuals or other type of companies, we have seen in inspections and recognize through our standards that essentially other firms or other participants could and often do participate in performing the audit. In our standards, that really falls under one of two situations. One is AU-543. So that would be when another firm performs an audit of a company’s subsidiary, division, office, and then the principal auditor may assume responsibility for that work.

Another situation is under our Auditing Standard Number 10 on supervision. And so firms or other persons, and I’ll describe persons in a minute, but those would be supervised by the firm issuing the
report, just like they supervise people within their own firm, within their own office. So that would fall under that standard. So it’s one of those. Either it’s under AU-543 or AS-10, and in a practice alert the staff issued a year ago, we talked about these two scenarios, and our Inspections Division had seen certain issues or observations, deficiencies in connection with that. So we issued a practice alert to provide some additional guidance and point out what our standards say under those scenarios.

But this would essentially capture the universe of who would be required to be disclosed in the firm’s audit report.

There are certain exceptions, and so they’re listed on this slide. The exceptions that we have, I’ll go through each one. The reasons may be a little bit different for each.

The first is the engagement quality reviewer. In the previous slide I talked about the two scenarios, 543 and AS-10. The engagement quality reviewer is a person that under the Board standard is intended to provide an objective review of the audit that was done
by the engagement team. The engagement quality
reviewer does not perform procedures to help the firm
obtain sufficient competent evidence to issue the
opinion. Rather, that reviewer is intended to provide
an objective look in order to provide concurring
approval of issuance that the audit was done
appropriately and the report is appropriately stated
and can be issued.

So we are excluding the EQR. It does not fall
under the 543 or AS-10 model. It would be separate.
So that is an exception as far as other firms or
individuals that would be disclosed.

Appendix K reviews, to some that may be very
familiar; to others, maybe not so familiar. Appendix K
refers to a requirement the Board adopted back in 2003
from the AICPA’s SEC Practice Section. Essentially
what that Appendix K requirement is, is that for firms
within a global network, it requires the U.S. firm to
perform a review or have those that have knowledge of
U.S. accounting and auditing and independence
requirements to perform a review of the SEC filing of
foreign-affiliated firms.
So in a global network, if there was a firm in another country as part of that network issuing a report on a U.S. public company, then the Appendix K review would come in to perform that U.S. review of that filing, or someone with expertise in U.S. accounting and auditing and independence requirements before that report is filed with the SEC.

So those reviews, we saw those as somewhat similar, at least in nature, to an engagement quality review. It’s intended to provide a review, an outside review so the firm itself does not take responsibility or supervise the work of the Appendix K review. So we are excluding that from disclosure.

We are also excluding specialists. Specialists can be used by auditors, and specialists are individuals with expertise in subjects other than accounting or auditing. We are not requiring those individuals or companies to be disclosed in the audit report. Principally the reason is that based on our standards, that doesn’t fall under the categories of supervision, AS-10 or 543, the work of another firm. The standard is specifically an AU-336, which has
specific procedures. So we saw that as somewhat different and different issues, so we have an exception for specialists.

And internal auditors and others within a company who may provide assistance to the auditor, we’re excluding that work. And really the reason is there we saw internal audit, for example, internal audit has their own procedures they may perform. Part of their work may be assisting the auditor, but we saw that as somewhat impractical to pull out the amount of time that they’re spending exactly helping the auditor versus other work they may naturally do. So we just saw some challenges and didn’t think it was necessary to include them. So we have excluded them from disclosure.

I just realized that I didn’t describe what I meant on person, which is one of the aspects of it. We recognized that individuals or companies, other than accountants per se, could be involved in providing assistance in the audit, to the auditor. It could be, for example, the auditor may feel they want some forensic help and may engage a company with forensic
type experience -- it’s not an accounting firm -- to
help them in doing fraud risk assessments and develop
their responses to fraud risk.

So an auditor may engage an external company which
isn’t a registered public accounting firm to help them
in connection with their fraud risk assessment and
audit procedures, fraud-related type audit procedures.

We think that work is also important. And so our
use of the term “person” comes from PCAOB Rule 1001,
which would include individuals, other companies. So
it was intended to be broader than just accounting
firms or accountants. That’s why we’ve used the work
of person, because we recognize that there are others
other than accountants that may perform work in
connection with the audit.

All right. So, if you could move on? Oh, you
did. Okay. Sorry.

As far as what the disclosure looks like, then, in
the report, it would require the name, location, and
headquarters' office of the other firm or other person.
It would also require disclosure of the extent of
participation. And as far as extent of participation,
the proposal would require that be measured in terms of percentage of overall audit hours.

We considered a variety of thresholds such as should it be percentage of revenues or assets or some other number. In thinking through that, we recognized that other firms or other participants may perform a variety of work. For instance, you could think of an inventory observation. Another firm may do a count of inventory in a different country. But in addition to just count how much is there, there is valuation associated with that. So it could be that the other firm in the other country is counting, but the firm issuing the report is doing the work associated with the valuation, is it valued appropriately. So just describing, then, percentage of assets didn’t make sense because both firms are involved to a significant extent in connection with just the inventory work, for example.

We recognized that firms routinely as part of their practice record their hours they reflect on the audit. And so we felt recording hours and measuring percentage of audit hours and total of audit effort
would be a measure that firms currently do and could be able to calculate. And our threshold, we came up with a threshold. We considered none, 1 percent, 10 percent, something else. We thought 3 percent was a reasonable threshold, certainly looking for any feedback on that.

But the requirement for individual disclosure would be at 3 percent of more or of the total audit hours. So you would individually disclose that. So if you think through the math, the total amount of firms that would be disclosed, could be disclosed in the report is 33. Thirty-three times 3 is 99 percent, and the 1 percent would fall out, and we would imagine it would be less than 33 because we would hope that the auditor issuing the report would do more than just 3 percent of the work. But that would be -- we initially had some questions about are we going to have pages and pages and pages. So we envisioned it would not be that, unless the font is incredibly huge I guess.

If the participation is below 3 percent, we’re just requiring that that be disclosed in the aggregate, or the option could be that firms could disclose that
individually if they wanted, but that would be up to their discretion. It would be one or the other, in the aggregate, so other participants at 2.8 percent, or it could even be larger than 3 percent as long as each individually is 3 percent.

The presentation is an explanatory paragraph following the opinion, and we also provide that if firms used 15 other firms that were at 3 percent or more of the total audit effort, they may want to disclose that in an appendix. So they just have a list of firms in an appendix. That’s an option as well.

The other aspect of the proposal is in addition to when you assume responsibility or supervise other auditors, there are situations today where auditors divide responsibility for the audit with another auditor. So one auditor may audit 75 percent of total assets, and the other one audits 25.

The way the report is reflected today if that’s the case, it just makes reference that other auditors audited 25 percent. It doesn’t say the name. However, in an SEC filing, both audit reports are required to be filed with the Commission. We felt it was appropriate
that the report disclose the name of who that other auditor is. That would be publicly available anyway. So it has a similar requirement when you’re assuming responsibility, that when you’re dividing responsibility it would disclose the name of the other firm and the location of that firm.

I think that’s it.

I will now open it up for any comments you may have on the proposal, including questions that we’ve raised in the proposing release. Interested in your feedback.

It looks like I have a couple, tent cards down towards the end, so I’ll start with Lynn Turner, and then I think it’s Gail Hanson. Is that right?

Lynn?

MR. TURNER: I think the proposal to bring greater transparency to others participating in the audit is a great advancement. I think it’s long overdue and very good, and I applaud you on that, as well as identifying who the audit partner is. I think that’s very good as well.

I do have a couple of questions, though, for you.
I found the release somewhat confusing in one aspect. Where it talks about and explains why you disclose but don’t have the partner sign, you bring up the Janus case. And in the Janus case, the advisor, Janus itself, did not sign the actual filing document. It was signed by the trustees of the mutual fund. And yet you seem to imply in your proposal that the Janus case would apply to an audit partner. That audit partner, as long as he signed a firm’s name but not his name, might be very well excluded from liability.

And my question was, was that your intent? Was that your interpretation of Janus, that in fact Janus would apply to an audit partner, and that Janus would, in fact, exclude that audit partner from liability? And if so, did you have any discussions with the SEC, and did the SEC staff have a view on that? That was the first question. Maybe it’s for Lew, because I think Lew mentioned Janus.

The second --

MS. RAND: I think Chairman Doty is an attorney, and I --

MR. DOTY: If Lew is willing to let it go, that’s
fine.

MS. RAND: In any event, I’m happy for any of our Board members that are attorneys to address that question.

MR. TURNER: There was a second piece of the question, then back to you guys after they get done. And that is, on the FRY-9 annual reports that banks file with the Federal Reserve, they obviously do disclose the name of the audit partner in those filings. So for all those banks, we do have a precedent here. Have you had any discussion with the Federal banking regulators about that? And if so, did you get any feedback as far as whether that worked or not, whether it increased liability or not? I’d be interested in knowing about that.

MR. DOTY: First, good questions all, Lynn. First, we have tried to take care in this proposal not to attempt to define and offer interpretations of the Federal securities laws as to which we are entitled to know, Chevron deference, whatever. So we have attempted rather in the proposing release to draw attention to the areas where there has been judicial
development since Central Bank and judicial development
in this complex area and invite the comment of members
of the bar, many of whom have been here and are members
of the SAG, on where they think these issues lead.

Yes, we have had discussions with the SEC. We
absolutely have. They have been very helpful in
informing the release. We do not comment on the
deliberative process of our discussions with the SEC,
and I wouldn’t want to try to draw them in or suggest
that they have any obligation to comment here.

I do think we are all looking forward to seeing
what the bar says about their position on liability. I
would be -- I will tell you, speaking again for me and
not for the Board or for any other agency, let alone
the SEC, I would be surprised if the bar took the
position that this changed the law or changed the
liability of an engagement partner in some fundamental
respect, but that is the question. And if the bar
takes a different view, we’ll be very interested in
hearing it. And it’s the reason why the question is
asked.

MR. TURNER: So, by the language in there, your
intent was not to imply any conclusion one way or the other.

MR. DOTY: Our intent is not to affect the law of aiding and abetting, the recourse and remedies the SEC enjoys as an administrative agency, or any other Federal regulatory authority under the Federal banking statutes, for example.

MR. BAUMANN: I guess with respect to your other question, I will certainly be interested in any insights the banking regulators want to share with us as part of our proposal process. This may be a different scenario of being identified in the audit opinion versus being identified in a bank filing, but we haven’t had a lot of analysis and discussion of that to date so far.

MS. RAND: Okay. I think Liz Gantnierz. Oh, Harrison, did you want to comment on that, Harrison Greene?

MR. GREENE: I don’t know that we have fully vetted this concept release throughout the agencies, but -- and I don’t have any information to address Lynn’s questions about whether or not the disclosure
and the auditors, or the engagement partner’s name in the FRY-9 reports, whether or not that increased their liability. I made a note down here that maybe I can check to see if we had any anecdotal evidence to that, but I can’t really address that.

But my personal view would be I think it would serve investors and everybody else to disclose the name of the engagement partner in the report that’s the public report, and I think that would just aid a lot more. It might induce the engagement partner to be more conscientious, but I think it would also help everybody to see if the audit partner rotation rules are being complied with because we get some of those. I just think that it would be a good thing.

MS. RAND: Thanks, Harrison.

Okay, Liz Gantnier.

MS. GANTNIER: Yeah, I think Harrison started to answer mine. I just simply have a question. Harrison, you started to answer it. You mentioned in the opening remarks that not all investors have access or the ability to attend the shareholder meeting where the engagement partner might actually be physically
present. And so, therefore, those that couldn’t, the naming of the partner would provide them benefits. And I would just like somebody to articulate for me what we think those benefits are.

MS. RAND: I didn’t particularly say those comments. Lew, did you want to address that?

MR. FERGUSON: Yeah, I said it, and I actually believe that’s the case, partly in the notion that more information is better, and you can -- I mean, to the extent that over time this information becomes public, people who want to over time, if they look at the career of an auditor, you can go back and look at what other -- given auditor rotation, they’ll be able to look at what other audits this person has been involved with, if they’ve been involved as the lead auditor of other public companies, and I think this is the kind of information that, again, over time particularly investors may find useful. You could see if these people have had industry experience. You could look up their public records in a way that, if they’ve been involved in other public matters, that can be easily searched through public sites that you can find things.
It’s not easily transparent today to investors, and I think that’s --

MS. GANTNIER: Thank you for that. I would only be concerned that if my name were, let’s just say, David Duncan, that I might be confused with another David Duncan. And so I would want to be sure that there was a good control mechanism that, if you’re going to start tracking engagement partners and their competency, that we have a way to be sure that the information is not misunderstood or, for example, Joe, your comments earlier on the going concern, that you said it didn’t have an impact and the other guy said it did have an impact, and then you proved to him that it didn’t have an impact, that we don’t have sort of statistical anomalies that the data is being misinterpreted in some way. Thank you.

MR. BAUMANN: Liz, I think there is some other -- in the proposal, I believe it also indicates some academic research that’s on the behavioral side of the benefits of being identified or signing, if you will, and increased accountability from the behavioral studies. So I think that’s partially the view of the
investors as well, that they believe that increased accountability could improve the quality of audits. So this potentially has some audit quality improvement also.

MS. RAND: Okay. I have 10 minutes left according to my watch, to 5:30, and four cards up. So we’ll go in the order of Gaylen, Denny, Joe, and Arch.

So, Gaylen, you’re up.

MR. HANSEN: Yeah, thanks. Overall, I think it’s great to see this moving along. While I would have preferred to see an actual signature in the report by the audit partner, I think that might address Liz’s comment that she just brought up in a David Duncan signature that is different from David Duncan’s signature. But regardless, good to see that we’re going to have something on that.

And then I wondered if the Board considered some sort of de minimis rule. I mean, really independent contractors that are less than 3 percent, we’re going to list their names anyway, and if you have interns and that kind of stuff? Really? What do you mean by --

MS. RAND: No. It was intended not -- no, it
would exclude --

MR. HANSEN: It excludes independent contractors?

MS. RAND: Well, it excludes -- if it’s de

minimis, as far as our proposal, that would be less

than 3 percent, that they would not be individually

named. You just would say “other participants.” Let’s

just say you had one other person that did 1 percent of

the work. It would just say “other participants at 1

percent.” It doesn’t say the name.

MR. HANSEN: It just seems to me like that --

MS. RAND: We are asking questions about the

threshold and other considerations.

MR. HANSEN: I would suggest the de minimis stuff.

It’s not going to make any difference to anyone.

MS. RAND: Well, our thought was there could be

several firms involved that did less than 3 percent of

the work, but then in the aggregate it could be

material. It could be 15 percent or greater. So this

proposal would not require the disclosure of everybody

that did less than 3 percent of the work individually,

but it would say you’ve got to aggregate that amount of

work. So the investors have an understanding of how
much is done by other people, because it could be
significant.

Okay, Denny Beresford.

MR. BERESFORD: First, just for the record, Marty
made reference to the research that indicates that
somehow people will become more accountable or
conscientious. Notwithstanding whatever research there
is, I would say that that would be very difficult for
most audit partners to say that having their name named
versus signing the report, signing the material that
they must sign before the audit report is issued, will
cause them to become any more conscientious than they
are right now I think is a ludicrous argument. That’s
my personal opinion in having signed a few of those in
the past myself. That’s my view.

The comment I wanted to make, though, has to do
with the second part. When I read the proposal, I’m
not an aficionado of Appendix K, so I first thought
that the exception meant that Appendix K reviewers
meant that you were accepting all of the international
firm’s foreign affiliates. And then when I asked more
specific questions, I was told, no, that wasn’t the
case, that all the foreign affiliate firms have to be named.

And then when I thought about it some more I was thinking, well, wait a minute now, if you’re accepting the reviewers for those, the people who actually have to go through and make sure that the work of the foreign firm was done properly and in accordance with U.S. accounting and auditing standards and independence and so forth, and those firms have already done their work according to U.S. standards and in accordance with firm international guidelines and so forth, I was kind of wondering why it’s appropriate to name them now. What is it that we’re trying to accomplish? So that’s kind of question 1. But that kind of gets --

MR. BAUMANN: Can we get to question 1 first, rather than --

MR. BERESFORD: Well, let me just finish, because I think this will be my -- this kind of is my point. It seems to me -- and I know this is in your proposal. It seems to me that there is a question that you raise, and that is whether it really is necessary and appropriate to disclose all of the separate firms
within an international organization, or perhaps just
to disclose the couple or whatever it might be that are
not subject to PCAOB inspection, for example, what it
is that would be an additional improvement or insight
you might say to an investor that there is a subsidiary
in the UK or a subsidiary in Mexico or a subsidiary in
Canada or whatever it might be that might be 3 percent
or 5 percent or whatever. I can understand why maybe
having information about China, perhaps, at this point
in time might be important. Anyway, that’s the point I
was going to make.

MR. BAUMANN: I think there are two different
points, so let me comment on the first one first.

So in the case of a foreign private issuer that
may be audited by XYZ accounting firm in the UK, and
maybe there’s five other accounting firms affiliated or
not affiliated but separate legal entities from XYZ --
it could be XYZ Germany and XYZ Brazil -- if they
performed more than 3 percent, they’d be named. If
they performed less than 3 percent, they didn’t have to
be named. They could be aggregated.

The Appendix K reviewer is an individual typically
in the United States who is reviewing that foreign
private issuer filing, not under the supervision of the
auditor of the foreign private issuer. He’s an
individual of the affiliated U.S. firm who is reviewing
that. So the same as the EQR person, not under AU-543,
not under AS-10. It’s an individual outside of the
engagement team. So we felt that individual, those
hours need not be included. It’s a pretty small point.

MR. BERESFORD: I must still misunderstand it.
I’m thinking of Eli Lilly, for example. Eli Lilly has
operations in --

MR. BAUMANN: It doesn’t apply. Appendix K
doesn’t apply to Eli Lilly.

MR. BERESFORD: Okay. But does Eli Lilly have to
report in their auditor’s report, assuming this goes
through, that they have operations in 86 different
countries, and at least in some of those Ernst & Young
is going to have more than 3 percent of their total
audit?

MR. BAUMANN: So the second question is -- I think
Jennifer has already gone through that -- whether the
firm is in a network or not, they are separate legal
entities, and there is a misconception on the part of many people that it is one firm that is signing the report. This would put some clarity, transparency to the fact that who is the principal auditor and who are the other firms, and they could be part of the network or not. But they are separate legal entities. They are separately inspected by the PCAOB.

One part of the network could have very few comments in Part 1 of their report. Another firm could have many comments in Part 1 of their report and would look quite different. This would shed light onto who the different players were in that, and it would also shed light on some of those firms that have not yet been subject to inspection, or not even registered with the PCAOB.

So that’s the rationale behind that.

MS. RAND: Lew Ferguson.

MR. FERGUSON: It’s also important to understand that the relationship between these firms, even though they’re separate legal entities, they’re not parent and subsidiary. They’re corporations that are not commonly controlled. They’re entirely separate entities joined
together in an affiliate, in a network most often. They voluntarily agreed to be part of this network. So it’s not -- you don’t have the kind of legal control that you would have in a parent-subsidiary or commonly controlled holding company structure, and I think that’s important for investors to understand.

MS. RAND: Okay. One more card went up after I thought I was down to two, I think. So, Jeff, I’ll let you have the last word. But please, no more other cards.

I know, Joe is next.

MR. CARCELLO: Thanks, Jennifer.

Two really questions, I guess, so let me do them one at a time, if I could, because they’re not exactly related.

When you talk about disclosing the location of other participants in the audit, and my understanding of how you would have them do that, how the auditor would do that, it would be a disclosure of the country, of the headquarters' office location. So assuming my understanding is correct, could a firm be established in another safe jurisdiction, let’s say Australia, but
where all the staff of this firm are located in a risky jurisdiction? And I’ll let you use your imagination for what a risky jurisdiction is.

So the disclosure is designed to highlight for investors. We are using this firm for X percent of the audit, and it’s in this country, and if you think this country is risky either because of whatever reasons or because the PCAOB can’t inspect there, whatever reason, forewarned is forearmed. So I try to drive around that rule by establishing a firm in a jurisdiction, in a country where investors would say, well, that’s fine, that’s a safe jurisdiction, but yet all of my staff is out of and sourced from a country that is potentially problematic. Do you understand the question? It’s kind of subtle.

MS. RAND: Well, you said Australia, so let’s say they’re using it from another country, all their staff are essentially from another country.

MR. CARCELLO: Yeah, yes.

MS. RAND: So I guess technically then you would list Australia.

MR. CARCELLO: Yeah, that’s the way this law is
written.

MS. RAND: But then that Australia firm would have
to be able to meet the standards that they’re able to
effectively supervise them as employees if they’re in
another country. I mean, so we’ve seen situations in
the practice alert issued a year ago talking about the
use of other auditors or firms taking responsibility,
or using people in another country as assistants where
we’ve had inspections -- where we’ve written up
deficiencies in connection with that. We’ve raised
concern about they really weren’t being supervised as
employees. So I would expect that that scenario that
you described could be, but the firm has to meet a high
bar that the Australia firm, for example, to make sure
that they can effectively do that.

MR. CARCELLO: Just to make sure you guys, if you
haven’t thought about it, think through that.

And then the second issue -- and Lew really teed
this up, I thought, very nicely in the public meeting,
and you didn’t have a chance to hit everything in your
presentation, Jennifer -- but the issue of offshoring.

You didn’t mention that because you didn’t have
enough time, but I want to highlight that. In your
concept release you say, “An accounting firm could
establish an office in a country with a relatively low
cost of labor and employ local personnel to perform
certain audit procedures on audits of companies located
in the country of the accounting firm’s headquarters or
in a third country.”

So again, let me articulate this. So a U.S. firm
could open an office of the U.S. firm in a country that
has low cost of labor, and they could do 5, 10, 15, 20
percent of the audit work. Under this proposal it’s
not highlighted. I think that’s why Lew said he wanted
comments on this.

Now you would say when you inspect that U.S. firm,
you inspect that, and you may inspect their quality
control procedures, but if it’s in a country that
doesn’t let you in, you’re still not getting in.
You’re not allowed on the ground. And some of these
countries have very, very different cultures than the
United States, completely different cultures in terms
of investor protection and skepticism and so forth,
completely different education systems, dramatically
different.
And so I don’t know if it’s really a question.
It’s really more of a comment for the group,
particularly for investors, to make sure you don’t
overlook that.

MS. RAND: Well, I’m glad you raised the point of
offshoring because it is something that we described or
discussed in the proposal and do have questions around
it. The situation, the issue about education,
training, culture, all of that, it’s an issue broader
than just offshoring. It’s kind of use of other firms
and other countries, and the quality associated with
the work.

The issue in the proposing release that we were
teeing up on offshoring is it’s our understanding firms
are offshoring work to areas and places where there is
a lower cost of labor, for example, and some of that
work is being described as just doing compiling files,
not really significant judgment type of work.
The way the structures, though, are being
organized can vary by firm. So they could be setting
up an office in another country, but it might as well
be Dallas. They’re saying it’s still part of the U.S. firm even though it’s overseas in Country X. So in that situation, the way this proposal would not pick that up if a firm had set up an office in some other country because it’s technically being part of the U.S. firm. But there are situations where firms, where that offshore work is part of a separate firm.

MR. CARCELLO: And then it’s picked up.

MS. RAND: And then it would be picked up.

MR. CARCELLO: Exactly.

MS. RAND: So we are asking questions about the nature of that work and kind of how this disclosure works.

MR. BAUMANN: I think that issue of the offshoring is evolving, and as we gain more understanding about that, we may think about that differently in the disclosure. But right now in the proposal we describe it and ask comment and would investors want to know more about that in the disclosures we’re requiring here. So it’s a good point, Joe.

MS. RAND: I appreciate everyone continuing to stay past 5:30, but we just have two left, Arch, and
then Jeff Mahoney.

So, Arch?

MR. ARCHAMBAULT: Thanks, Jennifer. Just a few points I’d like to make.

First of all, like Denny, I really have to reject the notion that the disclosure of the name somehow is going to incent a partner to perform better. I simply wouldn’t want someone as a partner whose behavior in some way would change simply because his or her name was in the audit report.

Another thing is I do find it disturbing that the public statements around this issue in the release often seem to be directed at investors being able to search for publicly available disciplinary action against the partners, which strikes me as negative, very negative, quite frankly. And so if there is some negative reaction to this, I wouldn’t be surprised at all.

But having made those points, I really don’t have any objection to naming the partner in the audit report. Investors, if they want to, can find out the name, and this is simply going to make it easier for
them to have that name.

Lew mentioned the liability side of things. I’m certainly not an attorney, but I don’t suspect under 10B that it’s going to actually increase the liability for a partner. I think what will happen, though, is that you’ll probably see more partners named in litigation that comes up. Plaintiffs will use that as a tool. The name is there. In the current situation, the name is not there. They always have the ability to amend a complaint and add the name, and they sometimes do that. But I think we’ll see more partners named.

A question, though, in my mind comes up with Section 11 and whether or not having the partner’s name in there is going to in some way require the partner to sign consents, which is something possibly the SEC is considering.

I’ll mention quickly Form 3. We didn’t talk about it much, but changes in the partner other than on the rotation. I think that can be problematic because there could be reasons for a change that, quite frankly, other laws would preclude you from disclosing, like HIPAA, and we’ve had situations like that, health
reasons. So what do you do in those circumstances? Do you just disclose that a change was made but you don’t say the reason? That would raise a lot of confusion if you have to disclose other changes where you did explain the reason. So a consideration there.

The disclosure of the other participants. Again, I don’t have a real objection to that, but I’m really wondering what we’re trying to do. What I’ve heard many, many times is that the investors want to know the other firms, including network firms that have participated in the engagement, so that they can see whether those firms have been inspected. In other words, they’re registered and have been inspected.

So it seems to me that we ought to try and keep consistent with other requirements of the PCAOB in terms of the threshold, because otherwise you can end up with a long list of names which I’m not sure what useful information is being provided if they are looking for those firms that have been inspected.

In the release itself, the examples of the disclosure you give, 60 percent of the engagement was done by firms other than the ones signing the report is
how I read that. Well, without explaining, in effect,
why the signing firm feels they have the ability to
sign that report when 60 percent was done by someone
else, and those percentages could actually go up, I
think it could raise a lot of confusion there as well.

Form 2, again, I don’t really object to the
disclosure in Form 2. It seems quite duplicative. It
seems like there could be confusion between a name
reported in Form 2 but then a different partner
actually comes out and is named in the audit report.
So I’d try and search for a way to maybe do it in one
place so there would be consistency. And while there
would be a lag because of the Form 2 timing, I’m not
sure that would be that critical.

So just some thoughts to throw out for your
consideration.

MS. RAND: I’d like to comment on a few of them.
You had several thoughts, but there are three I wanted
to touch on.

One, you talked about the engagement partner, and
I guess just talking about you didn’t really see that
it would -- I forget the exact word you used, but
really go into improving their accountability or sense of accountability.

I think the main aspect of the proposal is to improve transparency. We’ve been hearing a lot from investors. Potential -- the release talks about there could be an effect of increasing a sense of accountability, but the significant reason is increasing transparency to investors.

As far as reasons, you talked about there could be a change in engagement partner for reasons other than rotation. The proposal is not requiring that any reason be described. It doesn’t have that at all. We’re asking questions about should other information be provided, but we’re just saying you just disclose the name of the engagement partner. So it’s not stating that you would have to provide a reason.

And as far as registration and inspection, there is an aspect -that I want to highlight you talked about, having them be consistent thresholds. As far as the Board’s registration and inspection threshold is the Board requires firms to be registered with us, and therefore inspected. If they audit an issuer, so
they’re signing the report, or they play a substantial role, and substantial role is defined as 20 percent of the audit hours or 20 percent of revenues, et cetera, of their metrics.

In considering this proposal for providing transparency to investors of the other participants in the audit, we considered that registration threshold and inspection of the 20 percent, for example, and felt that several -- if we just went with that threshold, that other firms would not be disclosed, and kind of thinking would you just disclose those that had been inspected or highlight those that have not, there’s a lot of considerations that come into that. We haven’t gotten access into certain countries, but maybe today we get access. So do we not include them on the list if we didn’t have them today, or even if they’d been inspected, there could be significant Part 1 findings in the inspection. So just the fact that they’re inspected doesn’t mean that there aren’t issues with the firm.

So we’re just providing -- you know, the disclosure is providing a list of names. So at any
point in time, investors and others can go and see if
the firm was registered, inspected with us, if we’re
able to perform inspections, et cetera. So there’s a
lot of considerations behind that.

MR. ANDRIYENKO: Yeah, I just wanted to add that a
firm may be registered with the PCAOB because of its
significant participation in another audit. In this
particular one, the firm might have done less than 20
percent, let’s say 7 percent. So nonetheless, you may
have several of those even though the firm performed
less than 20 percent. That would be a registered firm.
So if you went with the 20 percent disclosure, you may
miss one or two of those firms.

MS. RAND: Okay, Jeff Mahoney, you’ve got the last
word.

MR. MAHONEY: Thank you very much.

The Council generally supports the proposal. I’ve
not issued a comment letter yet. We did issue a
comment letter, as you know, in response to the earlier
concept release.

I’ll just note a few points. This proposal with
respect to the engagement partner name, it’s generally
consistent with the recommendations of the U.S. Treasury Department’s Advisory Committee on Audit Profession. That committee was composed of a diverse group of investor, business, academic, and institutional leaders, including the CEO and chairman of one of the big-four accounting firms and some very prominent, respected corporate board members, including members of audit committees of prominent companies.

The committee concluded that mandating the signature of the engagement partner in the auditor’s report would “increase transparency and accountability.” This recommendation I recall was initially brought to the committee by a former big-four audit partner who believed that this would be a simple change that would make a significant improvement to the auditing profession, and his focus was on accountability. He thought it would improve self-policing of partners at his former firm.

I also note it was explicitly endorsed by Don Nicholiason, who co-chaired that committee, former SEC chief accountant, and who is a board member, member of the audit committee at the time of the Treasury
Department work. It was also explicitly endorsed by a number of investor and other financial statement users, including several public pension funds, capital research and management company, Hermes Equity Ownership Services, Ltd., to name a few.

For those who advocate moving to best practices in other countries, I would note that since 2006 statutory audits of annual consolidated accounts in the European member states have required audit partner signatures, and pre-dating 2006 a number of countries, including Germany, France, Luxemburg and others have required audit partner signatures as well. So it has been in place for quite a long time in other places around the world.

I’d also note that, as I mentioned earlier, a growing number of public companies consistent with Council policies now have an annual vote on the retention of auditors. There is not a lot of information for investors to make that vote, and as Lew pointed out, this would be another data point that over time could provide some relevant information to investors so that they could make a more informed vote
on that annual retention vote.

Thank you.

MR. BAUMANN: Thanks, everybody, for your incredible engagement today, your comments pro and con on various positions, but helping us think through very tough issues. So we really appreciate and value the contributions of the SAG members, and it was really demonstrated today.

Hopefully, we’ll see many of you or all of you at 6:30 at the Madison.

If not, I’ll see you tomorrow morning at 9:00 a.m.

Thank you.

[Whereupon, at 5:51 p.m., the meeting was adjourned.]
Improving the Transparency of Audits

Jennifer Rand

Deputy Chief Auditor / Deputy Division Director

Dima Andriyenko

Associate Chief Auditor
Improving the Transparency of Audits

- Proposed Amendments to PCAOB Auditing Standards and Annual Report Form
  - Issued on October 11, 2011
  - Comment period open until January 9, 2012

- Improve transparency of audits by requiring the disclosure of:
  - Engagement partner, and
  - Accounting firms and other persons that took part in the audit
Disclosure of the Engagement Partner

- Builds on the July 28, 2009 Concept Release on Engagement Partner Signature
- Modifies the approach in Concept Release
- Details of the disclosure:
  - Audit Report
    - Engagement partner’s name
    - For the most recent reporting period
    - Special situations – multiple-periods, dual-dating
  - Annual Report Form (Form 2)
    - Names of engagement partners
Disclosure of Other Accounting Firms and/or Other Persons That Took Part in the Audit

When assuming responsibility or supervising

- Applicable when the auditor:
  - Assumed responsibility for the work of another firm in accordance with AU sec. 543, *Part of Audit Performed by Other Independent Auditors*;
  - Supervised the work of another firm in accordance with Auditing Standard No. 10, *Supervision of the Audit Engagement*, or
  - Supervised a person not employed by the auditor that performed audit procedures on the audit in accordance with Auditing Standard No. 10.
Disclosure of Other Accounting Firms and/or Other Persons That Took Part in the Audit

*When assuming responsibility or supervising*

**Exceptions:**

- EQR and Appendix K reviewers
- Specialists
- Internal auditors, other company personnel, or third parties working under the direction of management or the audit committee, who provided direct assistance in the audit of internal control over financial reporting
- Internal auditors who provided direct assistance in the audit of the financial statements
Disclosure of Other Accounting Firms and/or Other Persons That Took Part in the Audit

When assuming responsibility or supervising

- Details of the disclosure:
  - Name, location of headquarters’ office or residence
  - Extent of participation:
    - As of the report date
    - 3% and more of total audit hours – separately
    - Below 3% – other participants may be aggregated or reported separately

- Presentation:
  - Explanatory paragraph, or
  - Explanatory paragraph and appendix
Disclosure of Other Accounting Firms and/or Other Persons That Took Part in the Audit

*When dividing responsibility*

- Requires disclosure of the other auditor’s name and location in the audit report
  - Existing requirement to disclose the portion audited by the other auditor is unchanged

- Removes requirement to obtain permission to disclose the other auditor’s name
SAG Member Discussion

SAG members will be invited to comment on the proposed amendments, including the questions raised in the proposing release.