NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board’s Standing Advisory Group meeting on November 10, 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 10, 2011 meeting are not included in this transcript excerpt.

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Thursday, November 10, 2011

9:06 a.m.

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Washington, D.C.
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JOHN WHITE

DENISE WRAY

MEGAN ZIETSMAN
MR. BAUMANN: Well, good morning, everybody. Thanks for getting back here so promptly today.

From our perspective, we thought yesterday was an excellent day in terms of getting input on very important matters to us. We hope that everybody has come back with the same level of energy and excitement and enthusiasm to continue the dialogue with the same intensity we had yesterday. So that, we really appreciated that.

Before I get started on today's program, we didn't give -- allocate quite as much time at the end of the day to the transparency project as we had laid out on the agenda, given the timetable. So I just wanted to make sure if anybody had wanted to make any further statement on that and didn't have a chance, we could certainly comment on that.

Barbara?

MS. ROPER: Since I cut out early, I'd
just very quickly say I am particularly enthusiastic about the proposal to include the disclosure of the other firms that are involved in the audits. I think that will be useful, valuable information.

So, and I'll put something in writing before the comment period is up. But, thanks.

MR. BAUMANN: Thank you.

Mike Gallagher?

MR. GALLAGHER: Marty, I'm not sure I know what a better way to do it would be. But my only concern around hours is that hours can be very different in terms of the quality of the hours. We talked about offshoring and so forth, and we're going to be thinking a lot about what might an alternate measure be.

And then the other thing was just the 3 percent. We just thought that was a little bit on the low side, and we'll be thinking about that, too, in terms of alternatives and responding.

MR. BAUMANN: Those are really both good points. We picked a marker and asked people to
comment on that marker. We needed to have some
sort of a place where you'd cut it off, obviously,
but certainly looking for input on that.

And I recognize that some hours in
certain areas are higher risk and more quality
hours than other hours, but we'll look forward to
suggestions on other ways to measure participation
in the audit.

Well, this topic does have more interest.

Good. Bill Platt?

MR. PLATT: Hey, Marty, thanks.

And I agree with Mike's comments. I
guess just the other thing that we're thinking
about is that even if hours is a measure, is the
disclosure of the percentage for each firm really
something that's necessary? So, for example, in
the example, I think you have one that's 3 percent,
4 percent, and 5 percent. Does it really matter to
disclose the percentages exactly, or might there be
ways to bucket it?

For example, firms that play a
substantial role and list all of them without an
indication of where they are in severity and those
that -- others that are above a threshold, but
below substantial role. We haven't formed a view
yet, but those are some of the things we're
thinking about as we think about it.

MR. BAUMANN: Again, we're interested in
feedback on how to disclose the participation of
other firms. I think many want to see the listing
of those firms who played a role and want greater
information. And there can be other suggestions of
ways to try to combine them, but we're interested
in all views, obviously, on the proposal.

Joe Carcello?

MR. CARCELLO: Yes, I want to get maybe
some feedback from people from the firms. As we
were talking about this last night, one thought --
and I'd be interested in the firms' reaction to
this -- would be a higher threshold rather than 3
percent. Let's say 5 or 10. But a lower threshold
if the firm is in a country that's not subject to
inspection.

MR. GALLAGHER: Yes, Joe. I think that's
something to think about. I think because that
definitely gets to an issue I know is of concern to
investors. So we'll put that into our mix as we
think about the solution.

Again, my issue -- and it really came to
life when you guys were talking about offshoring,
and somebody mentioned the nature of those hours
were very nonjudgmental, very administerial, and
that's the way things work in our firm. And to
have those hours be viewed as an apples-to-apples
with the U.S., where you really do focus on the
areas that are just so much more judgmental and
more impactful and more important, that was an
issue.

But your point around bifurcating between
what's subject to inspections and not I think could
be a good screen as well.

MR. BAUMANN: Our goal, Joe, is to get
the most meaningful information to investors on
this in transparency. So these are all suggestions
that we'll look forward to seeing in the comment
letters.
I see I think it's Lynn Turner and Scott Showalter.

MS. RAND: Regarding inspections or countries where we haven't been able to inspect, if that's the nature of the comments, I'd be interested in further thoughts on when would that go in? For example, we may get agreement today to inspect, but that inspection may not be conducted by us. So is it when the inspection report is issued, when the country just says we would come in?

When would that lower threshold for disclosure, say, in that example, when do you think that would be appropriate? When would it be lifted? Those are other considerations to take in mind.

And just also even inspections, we may inspect, but that we could have significant findings. So it's like you're qualifying just a firm that we haven't been able to be inspected. It could be the firm -- if we did, we wouldn't have significant findings.
I don't know. Maybe we would. But, so just a thought, you know, if that's kind of the nature of the comments, we'd be interested in further thoughts on that to help our thinking.

MR. TURNER: Marty, a couple thoughts. First, on the signature, I think you have two issues. One, you want to make sure that people understand it's the firm, and you don't want to lessen the role of the firm. But at the same time, we all know that what makes an audit work or not is really the audit partner and whether that audit partner is staying on top of it.

And so, I would encourage you to go back and rather than just disclosure have a signature or something like the name of the firm by the name of the partner then, and I think that would work, by far and away, the best.

With respect to the discussion that just ensued about the percentages and all, as I was listening to it yesterday, I actually think your notion of hours is very good. Because what I want to know is who was doing the significant part of
the audits? And if someone did contribute a
significant number of hours, I would certainly want
to know that.

As the chair of an audit committee, we
were approached by our audit firm to outsource and
outsourced stuff to India. And in this case, it
was a mutual fund, and some of the outsourcing, as
I recall, was going to be pricing. So I don't
think it's all just subjective stuff that's going
overseas, and so I would want to know.

I don't know that I'd do just down to 3
percent. Three percent seems, just my gut
reaction, is awful small. I may raise that up
some. But on the other hand, 20 percent is
probably too high, and I do want to know who's
doing significant things.

And then, to the last point, I do want to
know if that audit firm doing a significant part
isn't subject to your inspections. And to
Jennifer's question, I'd probably put the cutoff at
the date or time that those firms agreed to subject
themselves to inspection, and audits before that
would have to have the disclosure.

Audits that would become subject to inspection -- might not yet have been inspected, but would be subject to inspections thereafter -- I wouldn't subject to that disclosure. But I would very much like to know how much of the audit is done by a firm that has not been subjected to the PCAOB inspection process. That's very important to me.

MR. BAUMANN: Good. Thanks, Lynn.

And Scott?

MR. SHOWALTER: Yes. I want to just briefly mention an issue about reporting on the partner change. I think we mentioned that yesterday briefly at the end of the day.

In my former life, I was actually the partner that approved all partner changes in KPMG. And in here -- so I sort of have a feeling about all the changes that take place. And I know you carved out the one about if you're just at the end of your term, you don't have to report that one.

I would suggest you consider one other,
and it is if you retire in normal course. You'd be surprised how many times that happens. And so, just trying to think about lessening the burden of reporting would be related to. Obviously, if you are at the end of the 5 years, you don't need to report that. But also some partners get on the account, but because of mandatory retirement age, they don't go to full term.

So I would suggest that as a way of reducing that burden. But you'll be surprised how many partner changes take place for very valid reasons.

MS. RAND: The proposal isn't requiring disclosure, though, of reasons of why the partner change occurred. You would just indicate the name. So --

MR. SHOWALTER: Right.

MS. RAND: So I guess I'm -- yes, if you can clarify that?

MR. SHOWALTER: But you particularly carved out if you're at the end of the 5-year rotation, you don't have to report that. I thought
you carved that out, and you said you didn't have
to report that.

So I'm suggesting one other one you may
want to consider is if you're at the end of your
mandatory retirement age, you wouldn't need to
report that change either.

MS. RAND: No, the change -- no, you just
disclose the name.

MR. SHOWALTER: Right.

MS. RAND: So if there is a change
regarding if it's the end of five or four --
whoever is the partner signing the report --

MR. SHOWALTER: Right. Right.

MS. RAND: -- just discloses the name.

So it's not --

MR. SHOWALTER: I may have
misinterpreted. I thought you carved out if they
were at the end of the mandatory rotation, you
didn't disclose that one.

MS. RAND: Disclosure of the name would
be required in all cases.

MR. SHOWALTER: Okay.
MS. RAND: And reasons are not part of the required disclosure.

MR. SHOWALTER: Okay. Thank you.

MR. BAUMANN: Neri?

MR. BUKSPAN: Just an observation. If you do have the partner sign, why do you need to disclose change? It's obvious.

MR. BAUMANN: I think it's just saying we're not requiring disclosure of change. We're requiring the identification of the partner who is responsible for that engagement that year.

MR. BUKSPAN: Correct. Perfect. Thanks.

MR. BAUMANN: That's what we're requiring.

MR. BUKSPAN: Yes. All right.

MR. BAUMANN: Steve Harris?

MR. HARRIS: Do the firms accumulate this threshold information as a matter of course, and to what extent is there any administrative burden or cost associated with it?

MR. GALLAGHER: Steve, in terms of hours, you mean? In terms of where the work is done? I
think that would be relatively easy. I think the answer is yes. We have it, and it would be to those who have done it, it's pretty easy to accumulate.

MR. KOLINS: And after that, I think there's a provision in the release talking about estimates, if you don't have the exact number in hand. So, yes, I kind of agree with Mike. It's probably not significant additional burden. It's in the normal course. It's just one additional thing to get together at the time of the filing.

MR. BAUMANN: And that's one of the reasons why we went with that metric is we believe that firms did capture hours in the normal course, and therefore, it wouldn't be a significant burden. Sam? I almost missed you over there, Sam.

MR. RANZILLA: I just think there's been talking around each other here on this change in partner. At least the way I understand it is you're not proposing any Form 3 requirement to have a change when a partner changes off an account. I
thought it was you're asking the question as to whether or not there ought to be a Form 3 requirement?

To Neri's point, you'll be able to see that the partner changed from one report to another. The way I understood your proposal was that's all we're proposing, but do we need to do something like a Form 8-K in between? But that's not actually a part of the rule proposal, is it?

MR. BAUMANN: Correct.

MR. RANZILLA: Okay. I just wanted to make sure I understood.

MR. BAUMANN: Joe Carcello?

MR. CARCELLO: Real quick, Marty. Have you thought -- or maybe Mike, since he raised the issue of hours. Have you thought about having the disclosure threshold not tied to hours, but tied to valuated hours?

So you would take partner billing times hours, manager billing times hours, staff billing times hours, and then use whatever threshold of the valuated number rather than the raw hours. Because
what Mike is saying is not all hours are created equal.

Have you considered that, or what would Mike's reaction be or other firm people? I'm not sure I like it, but it's a way to --

MR. GALLAGHER: I'd be happy to share. My reaction is that I understand why the team went with hours because that is objectively measurable. It's pretty easy to get to, and I'm not sure I've got a better alternative. My only concern was, Joe, just as you articulated, not all hours are created equally. I'm just not sure I have a better one.

That could be another way of thinking about it. What I'm concerned about is do you create potentially a misleading picture around if you use just a pure, objective mathematical calculation? And again, until I have a better solution, hours is as good as anything. But we will be looking hard at how do we best express the qualitative and the quantitative in terms of where the work is done if we're going to go in this
direction?

MS. RAND: Just to -- I just want to point out there is Question 28, since there has been much discussion, on this issue about if hours is the appropriate metric or something else. So Question 28 says should the Board require a discussion of the nature of the work performed by other participants in the audit, in addition to the extent of participation as part of the disclosures?

So that would get to, you know, should there be some discussion about, well, they spent a lot of time, but it wasn't on the significant risk areas. So we are asking questions around that because we recognize that could be a consideration.

MR. BAUMANN: Barbara?

MS. ROPER: Just quickly on that point. I think nature of the work performed strikes me as a much better approach than this hours times pay, or whatever, in part because of one of the reasons you outsource is because you are paying less than hours devoted to doing the same things under different pay scales would look like they weren't
equivalent when they are. So that doesn't strike
me as a particularly good measurement.

But nature of work strikes me as directly
relevant to what you want to know with this
information is, you know, who's doing the work and
how significant is the work that they're doing?

MR. BAUMANN: Sam?

MR. RANZILLA: I agree with Mike that at
least where we are is hours appears to be a fairly
reasonable place, although we recognize that no
measure is going to be perfect. Trying to gauge
the hours on the relevance of the hours I think is
going to be extraordinarily difficult.

And from my perspective, this is an
exercise that will occur in the last 2 weeks of an
audit, and the last thing I want the audit partner
to be doing is trying to figure out whether it's
6.3 percent or 8.1 percent of the hours through
some complicated logarithm that the team had to
develop. I'd say we keep it simple and get people
focused on actually completing the audit, as
opposed to it.
And maybe there are some ways you can bucket hours so that you give -- so, in other words, 10 to 15 percent gets the same value, and then you don't worry about some of the nuances. So my only suggestion is let's try to keep this thing simple. And if it doesn't work, you've always got the chance to amend it, and we'll find a better way.

MR. BAUMANN: That's a good point, Sam. And that was why we came out with hours and the ability to estimate hours reasonably through the end of the period because we didn't want it to interfere with the important aspects of completing the audit. And since this is done in the normal course of events, we thought this would not add significant burden in that regard.

Maybe Arnie Hanish, and maybe we can close down this topic?

MR. HANISH: That would be great.

[Laughter.]

MR. BAUMANN: You get the last word, though.
MR. HANISH: All right. Well, listening to all this, I support Sam 100 percent. We've got to find a way to keep it simple. I hear what you're trying to accomplish. But in the end, we're the ones who are going to pay for all this extra time that they're going to take to try to figure out if it's 3 percent, 4 percent, 5 percent or what are the measures.

The companies are going to pay for this, and let's just, quite frankly, come up with a way to keep it simple and have a threshold at a high enough level that we don't have to deal with small, incremental activities, offshoring, or whatever it might be. But I guess I'd just ask you to, please, keep it simple in the spirit of what you're trying to accomplish.

Thank you.

MR. BAUMANN: Good. Well, thanks for all of those valuable additional comments for us to think about as we go through this, and we'll look forward, obviously, to the comment letters.