NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board’s Standing Advisory Group meeting on July 15, 2010 that related to the Board’s proposed auditing standard, Communications with Audit Committees. The other topics discussed during the July 15, 2010 meeting are not included in this transcript excerpt.

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8:32 a.m.

Thursday, July 15, 2010

The University Club
1135 16th Street, N.W.
Washington, D.C.
DAN GOELZER: OK, thank you, Marty. As Marty's indicated, the next topic is the board's proposed standard on auditor/audit committee communications. And Jennifer Rand is going to summarize what we heard in the comments on the proposal that was published last March. And I'm just going to kind of briefly set the stage. As I said at the board meeting on this subject last March, it seems to me that 1 of the fundamental objectives of Sarbanes-Oxley is to strengthen the role of the audit committee by putting it at the center of the relationship between the public company and its auditor. The provisions of the act that deal with the committee's oversight of the audit are kind of based on the idea that both the work of the audit committee and the work of the auditor can be strengthened to the extent that there's good communications between the 2. But
building on that objective, we did publish a proposal at the end of March that would try to enhance communication between auditor and audit committee and also put more emphasis on it as a 2-way process, not simply information transmitted from the auditor to the committee, but more of a dialogue between the 2.

We received 35 comments on that proposal reflecting, I would say, a wide range of differing views. To me, at least 2 things came across. One is a number of comments suggested that we needed to do more homework, more outreach on this subject. Some thought we approached the subject too much from the perspective of the auditor and without a full appreciation of what audit committee members wanted and needed. Along the same lines, other comments linked this to the subject we were just talking about and pointed out that there could be similarities between the information that should be communicated to the audit committee and what investors would like to learn or what additional information investors would like to learn coming out
of the auditor's reporting model project.

Based on those comments, there were suggestions from a number of people that we needed more insight from investors, auditors, management, directors, others with an interest in the process before we go further with the -- with the project. The other point that stood out to me was the several comments, many comments emphasized that we needed to be careful not to turn auditor/audit committee communications into an exercise where the primary objective was to check a lot of boxes as to what had to be communicated.

I think there was general agreement that the audit committee benefits from the auditors' insights into the strengths and weaknesses of the companies' financial reporting, but that we needed to guard against overwhelming audit committees with a lot of information that wasn't necessarily useful to them or causing the auditors' communications to become more -- more scripted and more of a compliance exercise.

So with -- with all those comments in mind, I think 1 thing that the board has decided is that it would
be desirable to have a public roundtable on this topic to consider some of the things that we heard in the comment letters and -- and other suggestions about audit/audit committee communications. We would like to hold that roundtable as soon as possible. Schedules being what they are, that probably means in -- well, probably in September rather than next month, which is a difficult time to -- to schedule meetings. We will probably reopen the comment period around the time of any roundtable, since there does seem to be a lot of interest in this subject. And it may not be possible to have everyone with an interest in speaking at the roundtable to actually be part of the program. But we do want to give everyone an opportunity to express any additional views that they may have.

So with that -- with that little bit of introduction, Jennifer is going to be more specific about what we actually heard in the -- in the comments.

JENNIFER RAND: Thank you, Dan. I'd like
to first provide an overview of who we heard from, who commented on the proposal. Dan mentioned 35 commenters sent in letters to us. And we are very grateful for the feedback. I think we felt that we had a wide range of feedback. And this shows you the outline.

Certainly, firms in association of accountants provided -- just if you look at total count, they provided the largest number overall of any particular group. But we also heard from audit committee members and associations, issuers and internal auditors, investor representatives and a couple others. And -- and we were very pleased with the different type of feedback we heard. And we saw some consistent themes among some of them. But we also saw some different views. So with that, I'd like to provide you with an overview of what commenters said. And these are the types of issues that as we put together what the roundtable topics will be, the types of issues that we'll be seeking additional feedback on as well as we hope when we do officially reopen the comment period we'll get
additional comments on these and -- and certainly,
if there's any other issues.
Overall, what came clear to us is there certainly
was support for a revised standard. People
recognize the importance of auditor/audit committee
communications, also recognize the -- the current
standard and the board's interim standards is
directed that -- isn't required that the auditor
establish this understanding, at least with the
engagement letter, with the audit committee and
thought improvements could be made really to align
the board's existing standards -- board standards
with the Sarbanes-Oxley Act requirements. So there
was overwhelming support for the standard. But with
that, like with any of our proposals, there is
areas, you know, for suggestion, improvement. So
I'd like to go through different recommendations
that commenters provided to us.
First, as Dan mentioned, an overwhelming theme that
really came from not just 1 particular group.
Certainly, audit committee members had this view.
But also the Center for Audit Quality encouraged
additional outreach about what issues audit
committee members are interested in. There was some
view that the -- the requirements in this proposed
standard really geared toward maybe what auditors
would like to say to audit committee members as a
result of the audit.
But there may be other issues, additional things.
And so, they really -- commenters really encouraged
us to develop a standard that would be meaningful to
audit committee members in their oversight. And
that could include some additional things and
encouraged us for that additional feedback, which is
why Dan mentioned the roundtable and -- and
additional comment is something we're pursuing.
Another point was it encouraged us to clarify the
process related to the evaluation of 2-way
communication between the auditor and the audit
committee. Certainly, it was recognized that there
is the importance of effective 2-way communication
between the auditor and the audit committee. And at
previous discussions with the SAG when we've talked
about this topic, that's come up as being very
important.

But the comment that came through in -- or comments that came through in this regard is, well, how do you go about really objectively evaluating those -- those -- you know, whether or not the 2-way communications were effective, what should that criteria be. And also another comment was the requirement -- proposed requirements we had in the standard were not helping to promote effective 2-way communication. So really just comments on better ways to articulate that, better requirements, better direction on -- on what we're trying to achieve there.

Another area relates to the audit engagement letter. So that's the letter that the auditor provides to the audit committee and the services to be provided in connection with the audit. And in that in the proposed standard it -- it includes different required elements. One is disclosing the auditor's responsibilities and also management's responsibilities. And several commenters suggested to us that the audit committee's responsibility
should also be included in that letter. So we had
several different commenters express that view.
Just moving to the next slide, additional themes --
considering management's communications to the audit
committee to avoid repeating certain requirements.
We have -- have several requirements in the proposed
standard really around the area, most particularly,
about accounting estimates. And -- and we had
language which we intended that the auditors would
not be duplicative of management's communications.
We certainly recognized in developing the proposed
standard that management would be communicating
certain matters to the audit committee. But
nonetheless, we thought the auditors should evaluate
that, perhaps not duplicate things that they didn't
see if it was necessary. But there seemed to be
confusion around how we articulated that and thought
we could better describe what the auditor should do
in considering management's communications so that
it's not completely duplicative.
There was also a suggestion about clarifying which
consultations outside the audit engagement should be
communicated. Several commenters talked about not really clear on where the lines were as far as what constitutes the consultation. You know, if the engagement team consults with someone else, for example, they may want to just call someone to get clarification on an accounting standard or how that's applied. Would that be considered? Would they need to communicate that? Kind of, you know, water cooler conversation, national office, kind of -- excuse me. What is that -- what is in the scope of that. And also some were concerned that if it was just too broad, it could have the unintended consequence of discouraging such consultations, which certainly would not be beneficial.

Moving on to the next slide, we had mixed views in certain areas. One was regarding whether all communication should be in writing. And this is an area that we've sought the SAG's feedback. And we heard mixed views regarding SAG members about permitting flexibility, permitting some -- some communications being made orally, others in writing. Other SAG members thought that all should be in
writing. That same view seemed to persist in the
comment letters that we received. So we -- we did
not -- we were not able to reach a consensus view on
that. And people brought up, you know, very good
reasons for which side, you know, that they were on,
whether or not there should be all in writing or
whether flexibility.

Another area of mixed views is whether all corrected
misstatements, including those detected by
management, should be communicated to the audit
committee by the auditor. Many had concerns that as
management is going through the financial reporting
close process that, you know, certainly their system
of internal controls would identify areas of
misstatement. And part of the controls of the
company's system would identify those and correct
them. So there was some concern about how much --
you know, bringing all these adjustments in. Is
that going to have a negative -- you know, just
duplication, not necessary. It's part of the
company's internal control system. And -- and so,
there were views on -- on whether or not that was an
appropriate communication by the auditor.
And then finally -- and Dan mentioned this, too --
there were many -- many -- there were some concerns
or different views that the proposed requirement in
the standard could just create this "check the box"
mentality, that it appeared to some that what was in
the proposed standard was a lengthy list of required
communications, that perhaps those required
communications were not getting to the heart of
issues. And again, kind of going back to the first
point, what was truly important to the audit
committee in connection with the oversight of the
audit and the financial reporting process. And so,
just encouraged us to kind of revisit what's
required so that it's not too many and that they are
appropriate.
So with that, that's an overview of the -- the
significant comments that came through. And thank
everyone here on the Web cast, you know, for
providing comments on that. We're certainly going
to continue exploring this issue. It's an important
issue. And we recognize the importance of hearing
from audit committee members and others and -- and continuing to debate this and get feedback before we, you know, recommend to the board that they finalize the standard. So with that, I'll open up the floor if there's any comments on going through the comments. Doug Anderson?

DOUG ANDERSON: I just had a question. So is the expectation that after the roundtable you'd come out with another exposure draft? Or do you not know at this point?

JENNIFER RAND: In my view -- and I see Marty is about to jump in. In my view, that might be premature. I think it -- it depends on -- we're certainly open to the feedback. And I'd -- I'd personally be reluctant to prejudge the outcome. So a lot of -- you know, the commenters did encourage us for additional feedback. And -- and we plan to do that in 2 parts, the roundtable and reopening the comment period. And so, I don't want to prejudge what may come out of that.

DAN GOELZER: I think without getting in trouble with Marty and Jennifer, I think it's fair
to say that if we make significant changes in the proposal, then we will re-expose it. And I guess you can -- you can draw your own conclusions from what you've heard about whether that's likely or not.

JENNIFER RAND: Thanks, Dan. Paul Sobel?

PAUL SOBEL: It seems obvious that, you know, a key constituent for this roundtable will be audit committee representation. Have you given some thought to how you're going to make sure you have sufficient representation, whether it's maybe -- there's a few different audit committee organizations? Or would it be directly with audit committee members? And would you pull the plug on it if you don't think you have representation and there's sufficient audit committee representation?

JENNIFER RAND: We have, but that has been a significant consideration for us. Given the composition, we do want to -- we've had -- we do want to have a good number of representatives from audit committees. And -- and also we heard from constituent groups of audit committees. So we're
interested in that as well. Broad feedback, the types of entity, who they may be audited by, different industries -- so we are looking -- because the audit committee members or views that were provided weren't necessarily always unanimous. They had different views, too, about what may be important to them in connection with the oversight of the company. So we are very much interested in that. That's a key driver in -- in the roundtable composition.

MARTIN BAUMANN: Yeah, I'll echo Jennifer's point there. We would expect to have significant representation of audit committee members and a diverse group of audit committee members and -- and seeking such groups such as the NACD to recommend, for instance, certain audit committee members to -- to attend. So -- so we'll be doing some outreach to get the right -- right constituency at the roundtable. Damon, is your card -- yes?

DAMON SILVERS: I commend you on that, what you just said in terms of reaching out to a
diverse and -- and sort of engaged group of audit committee members. But I think it's probably important to keep in mind here that the interaction between auditors and audit committees is that they are -- they are all agents, meaning that you wouldn't want to get into a situation where the mutual desire not to be -- to, A, not inform and, B, not to be informed is viewed as the last word on the -- on the matter.

MARTIN BAUMANN: And I think we've heard mixed views on that. And that's a good point, that there are some audit committee members that express, "I don't need to get all this information, I don't need to hear all of this." And there are other audit committee members who say, "I can't get enough." So that's -- our standard is somewhere between there, I guess.

DAMON SILVERS: Well, perhaps I'm being -- perhaps I expressed myself in too cryptic a way. I mean, I think that -- that the -- the point here, I think, is that the board in looking at a standard here needs to be mindful that -- I mean, there are
some situations where you -- in -- in public policy making where you have essentially 2 constituents and there isn't much else to the story. Right? And then you take their views into account and try to figure out a fair way of balancing them. In this matter, there are -- although you're -- you are prescribing a standard for communications between 2 parties, the -- the -- the -- it's the -- it's the broader investor and public interest that is being served by this communication. And that's what the board ought to keep in mind.

MARTIN BAUMANN: One criticism we got about the proposal was that some communication got back to us that, "This is terrible. Audit committee meetings are going to go from 30 minutes to 3 hours." We -- we wanted to know which companies had the 30-minute audit committee meetings. Barbara pointed out that, yes, the roundtable will include not just audit committee members and auditors, but a broad constituency, including, clearly, investor groups as well. Yeah, absolutely.
Meeting of the Standing Advisory Group

July 15, 2010
8:30 a.m. – 3:45 p.m.

Communications with Audit Committees - Summary of Comments Received

Jennifer Rand

Deputy Chief Auditor, Office of the Chief Auditor
Proposed Standard on Communications with Audit Committees

- **Comment Letters Received**
  - Firms and association of accountants: 19
  - Audit committee members and associations: 6
  - Issuers and internal auditors: 5
  - Investor representatives: 3
  - Others: 2
  - **Total**: 35

Overall support for a revised standard

Respondents recommended -

- Engaging in additional outreach to learn more about what issues are of most importance to audit committee members
- Clarifying the process related to the evaluation of two-way communication
- Including the responsibilities of the audit committee in the audit engagement letter
Proposed Standard on Communications with Audit Committees

- Respondents recommended -
  - Considering management’s communications to the audit committee to avoid repeating certain communications
  - Clarifying which consultations outside the engagement should be communicated

- Respondents had mixed views regarding -
  - Whether all communications should be in writing
  - Whether all corrected misstatements, including those detected by management, should be communicated to the audit committee by the auditor
  - Whether there were too many communication requirements that created a “check the box” mindset