NOTICE: This is an unofficial transcript of the Public Company Accounting Oversight Board's Roundtable on Communications with Audit Committees held on September 21, 2010, that related to the Board's proposed auditing standard, Communications with Audit Committees.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD:

ROUNDTABLE ON AUDITOR COMMUNICATIONS

WITH AUDIT COMMITTEES

September 21, 2010
8:30 a.m.

Washington, D.C.
MR. MARTIN BAUMAN: Good morning. I’d like to welcome everybody here to the PCAOB Roundtable on Auditor Communications with Audit Committees. I’m Marty Bowman, the PCAOB Chief Auditor and Director of Professional Standards. I’d also like to welcome those who are listening in our webcast. Like our SAG meetings, this meeting is webcast. And so I thank all of those folks for joining us as well.

On March 29th, the board proposed a new auditing standard regarding auditor communications with audit committees. And the comment period closed on May 28th. As part of those comments, we received many good comment letters and valuable input, but an important theme that recurred through many of the letters was the fact that the board should consider conducting additional outreach, especially to members of audit committees to gain insights in terms of how they saw the audit committee and auditor communication process working, and getting more views from audit committee members regarding the communications process.
Today's roundtable represents the board's response to those commenters, and also, the ability to get further input on some additional questions in comments that were raised during the comment letter process.

So as part of this roundtable process, we've prepared a briefing paper, which you've all seen. And additionally, the comment period has been reopened and extended through October 21st, 2010.

Today, we'll discuss a number of topics relating to communications with audit committees, auditor communications with audit committees, including which communications are useful to audit committees in their oversight of the audit, communications relating to accounting policies, practices and estimates, two-way communications between the auditor and audit committees. One of the new features of the proposed standard was a requirement for the auditor to evaluate the effectiveness of the two-way communications. And we received quite a few comments in that area as well.

Another important topic would be whether
auditor communications should with written or oral.

There are a lot of differing views on that aspect also. And then several other topics will be discussed along the way.

I want to extend my personal appreciation for the willingness of all of you to be here today. I know you all have very busy schedules. Summer’s just shortly over. And here you are in Washington discussing an important topic with us. It is very valuable to us in this standard setting process. So I want to express how much we appreciate the fact that you all took the time to come today.

Please everybody, please be engaged today. We really are looking for all of your inputs. So and I know I don’t have to say that in most cases for most folks, but I thought I’d say that any way.

This is a very, very important topic communications, auditor communications with the audit committee. It’s our view that or my view at least that it’s one of the very, very important features in terms of ensuring that the audit process is working effectively. And I think Sarbanes Oxley
legislation saw it that way and changed the
relationship between the auditor and management, and
auditor to the audit committee. The level and
quality of those communications are key to an
effective audit process.

Finally, I have some -- a couple of
administrative items. You should have a folder in
front of you today that has all of the materials
you’ll need. It has a copy of the proposed
standard, the briefing paper, seating chart, I think
copies of the slides we’ll be putting up, as well as
the agenda. We’ll be break -- taking a break around
10:15. Lunch will be at noon right outside the
doors here. And we should finish the day around
3:00 p.m. unless the conversations get really
exciting, in which case it could go on very late.

Before I turn the floor over to our acting
chairman Dan Goelzer, I’d like to go around the room
and ask everybody to briefly introduce themselves
and as well as your organizational affiliation
including if you are on audit -- representative of
audit committees, to tell us about that as well. So
again, I’m Marty Bauman and I’ll turn to my left.

MS. JENNIFER RAND: I’m Jennifer Rand. I’m Deputy Director of Professional Standards and also Deputy Chief Auditor, the PCAOB.

MS. JESSICA WATTS: I’m Jessica Watts. And I’m an Associate Chief Auditor with the PCAOB.

MR. JEB BURNS: I’m Jeb Burns. I’m the Chief Investment Officer with the Municipal Employees Retirement System in Michigan.

MS. LISA GAYNOR: I’m Lisa Gaynor. I’m an Assistant Professor at University of South Florida. And I served as member of a research team on audit committee communications.

MR. ROBERT KUEPPERS: Hi, I’m Bob Kueppers with Deloitte. I’m Deputy CEO. My responsibilities are principally regulatory and public policy.

MR. ALEX MANDL: I’m Alex Mandl. I’m on five boards. I’m involved with three audit committees. And I chair one of those. So this topic is very -- great interest to me. Thanks.

MR. STEVE HARRIS: Steve Harris, PCAOB board member.
MR. HAL SCHROEDER: Hal Schroeder, Carlson Capital, a portfolio manager, and until recently, an audit committee member and of a Lloyd syndicate.

MS. KIKO HARVEY: Kiko Harvey, I’m the Vice President of Corporate Audit and Enterprise Risk Management at Delta Airlines. And I report to the audit committee.

MR. MIKE COOK: I’m Mike Cook. I’ve been a member of a variety of audit committees and chaired a few over the years. Currently the chairman of the audit committee of Comcast.

MR. DAN GOELZER: PCAOB board member.

MR. LINDA GRIGGS: I’m Linda Griggs. I’m a lawyer with Morgan, Lewis, and Bockius here in Washington. And my practice consists of advising on securities regulatory matters, including financial reporting matters and corporate governance. I have served on the audit committee of a public company.

MR. ROBERT DOHRER: Bob Dohrer, National Director of Insurance Services for McGladry and Pullen.

MR. GARY KUBURECK: Gary Kubureck, Chief
Accounting Officer of Xerox Corporation. I’ve never been on an audit committee, but I’m a process owner for our audit committee’s meeting process.

MS. JOAN WAGGONER: Joan Waggoner, I’m the Quality Assurance Partner for Blackman Kallick, a Chicago based public accounting firm.

MR. BRIAN CROTEAU: Brian Croteau, Deputy Chief Accountant at the Securities and Exchange Commission. And if I could just briefly say that while anything that I would -- any views I would express today would be my own, I certainly speak on behalf of many at the SEC in commending the PCAOB for holding this roundtable today and for all of the participants in taking the time to attend. We really appreciate it as well.

MR. ARNOLD HANISH: Arnie Hanish, Vice President, Chief Accounting Officer at Eli Lilly and Company. I’ve been involved in interfacing with the audit committee for well over 20 years.

MS. KAREN HASTIE WILLIAMS: Karen Hastie Williams, for my day job, I am a partner at the law firm of Crowell & Moring here in Washington. But I
serve on five corporate boards and chair three audit committees. So I felt this was an important meeting for me to attend. Thank you.

MR. JIM COMR. BAUMAN: Jim Cox, and my day job is a professor at Duke Law School. And I serve and have served on audit committees.

MR. LYNN TURNER: Lynn Turner, I currently serve on the board of trustees at the Colorado Public Retirement System, a $3.8 billion investment fund. I also serve as a Senior Adviser to a forensic and economic consultant firm, LECG. I’ve served on a number of audit committees and chaired three of them. And in a prior life, also as a signing audit partner.

MR. CHARLEY NIEMEIER: Charley Niemeier, PCAOB board member.

MR. DENNY BERESFORD: I’m Denny Beresford. I’m a professor at the University of Georgia. I am now the chairman of the audit committee of three large corporations. And I served 26 years in public accounting with 10 years in between as a standard setter at the FASB.
MR. SAMUEL RANZILLA: Sam Ranzilla, I’m the National Managing Partner for Audit Quality and Professional Practice at KPMG.

MS. MARY HARTMAN MORRIS: I’m Mary Hartman Morris. I’m an investment officer at CALPERS, California Public Employees Retirement System.

MR. BILL GRADISON: I’m Bill Gradison, a member of this -- of the PCAOB board. I formally served on the audit committee of a public company in the health care field.

MR. ROGER COFFIN: Good morning, my name is Roger Coffin. I’m the Associate Director of the Weinberg Center for Corporate Governance and an Associate Professor of the Practice at the University of Delaware.

MR. LARRY SALVA: Larry Salva, Senior Vice President, Chief Accounting Officer of Comcast. Been at Comcast the last 10 years. Prior to that, spent 23 years with Coopers and Lybrand and Price Waterhouse Coopers, including as a signing partner, and also as a national accounting consulting and risk management partner.
MR. GEORGE MUNOZ: Good morning, George Munoz. I’m an attorney and CPA. I’m the audit chair of Altria and the audit chair of the National Geographic.

MR. HASNAT AHMED: Hasnat Ahmed, Assistant Chief Auditor, PCAOB.

MS. BARBARA VANICH: Barbara Vanich, Associate Chief Auditor, PCAOB.

MR. BAUMAN: Well thank you, everybody, for taking the time to do that. And clearly, we’re fortunate to get a group of very qualified people to talk about on the very important subject with us today. So with that, I’d like to ask Dan Goelzer to introduce the program. Dan?

MR. GOELZER: Thank you very much, Marty. And good morning to everyone. I’d also like to welcome everyone to the Public Company Accounting Oversight Board’s Roundtable on Auditor Communications with Audit Committees.

Like Marty, I want to begin by thanking all of the panelists for joining us today and providing us with the benefit of your insights and
experience. The board appreciates your willingness to devote time, effort, and thought to helping us address this important topic.

This roundtable is a key component of the board’s ongoing standards setting process. I’ve spoken in the past about the importance of openness and transparency in board standard setting. Over the last two years, we’ve experimented with the use of concept releases with multiple public comment periods on proposed standards, and with more focused discussion with our standing advisory group of standards setting projects.

I view roundtables like this one as another tool that we can use to make sure that the board receives the most thoughtful and relevant input available when it writes standards, and that investors, preparers, and auditors all have the chance to contribute to our decision making.

The board’s proposal to enhance auditor audit committee communication was published last March. The objective of that proposal was to bring the standards related to auditor communication with
audit committees into line with the role of the Sarbanes Oxley Act assigns to the committee in overseeing the relationship between a public company and its auditor.

The provisions of the act that deal with audit committees are predicated on the idea that independent, informed, and proactive auditor committees are central to protecting the interests of investors in reliable and informative financial disclosure. That vision can only be fully realized if there’s a robust dialogue between the auditor and the committee. The proposed standard aimed to accomplish that by expanding and clarifying the rules of the road that govern auditor audit committee communications.

The board received 34 comments on the proposal, including letters from several of the participants that around the table here with us this morning.

The primary purpose of the roundtable is to explore in more depth some of the issues that were raised in those comments. One theme that ran
through many of the submissions was that before proceeding further with a new standard, the board needed to engage in additional outreach, particularly to directors and others with firsthand experience in the work of audit committees.

Along those lines, some commenters suggested that the March proposal approached the subject too much from the perspective of what auditors thought directors should receive, and without enough sensitivity to what information is actually beneficial to audit committees. Others warned against creating requirements that would turn the communications process into a sterile check the box exercise.

One goal of this roundtable is to address those concerns, and to make sure that the board understands the dynamics of successful auditor audit committee communication.

The comments also reminded us that the auditor and the audit committee have a common interest in the reliability of the company’s financial reporting. That’s why the proposal
emphasized two-way communication between the auditor and the committee. If the auditor views meeting the requirements that govern its relationship with the audit committee as just another regulatory hoop that it must jump through, it may deprive itself of an important source of information and insight. The result could be to undermine the effectiveness of the auditor’s work.

Conversely, if the audit committee treats the audit as just another compliance cost, and one that needs to be minimized as much as possible, the committee may deprive itself of a valuable tool to assist in assuring the integrity of the company’s financial reporting.

Accordingly, it’s vital that any standards the board adopts in this area promote a dialogue between the auditor and the audit committee that benefits both parties.

I’m certainly looking forward to hearing your thoughts on how we can best accomplish that. Thanks again to the panelists for taking the time to be here with us today. And I’ll turn the
proceedings back to you, Marty, to introduce the first topic. Thank you.

MR. BAUMAN: Thank you, Dan. The first topic, and we are going to pretty much -- we will follow the order of the briefing paper that you all have -- our first topic is communications that are useful to the committee's oversight of the audit. And let me ask board member Charley Niemeier to say a few words to introduce this topic.

MR. NIEMEIER: Thank you, Marty. The role of audit committees in corporate governance came into prominence in the 1970s under the directions of Rod Hills as Chairman of the SEC. At that time, as a part of a comprehensive strategy to address revelations of bribery of foreign officials and other corrupt practices by American public companies, the SEC directed the New York Stock Exchange to require all public companies to create -- all listed companies to create independent audit committees to oversee the preparation of accurate corporate financial reports.

In 2002, the Sarbanes Oxley Act added to
the audit committee’s responsibilities to address perceived problems with management’s hold on and control over auditors. Thus, the Act required stock exchanges to require audit committees to be responsible for the appointment, compensation, and oversight of auditors, including a resolution of disagreements between management and the auditor regarding financial reporting.

We are here today to talk about the PCAOB’s proposal to update the existing audit standard, requiring the auditor to communicate certain information to the audit committee. That standard pre-dated the Sarbanes Oxley Act. So it’s not difficult to envision why an update would be appropriate. The purpose of this meeting is to solicit views, based on the practical experience of our participants about what sort of updates we should undertake.

The purpose is also to get a reaction to the draft standard the PCAOB proposed in March, which in addition to updating the existing standard uses new language, new communications from auditors,
both on audit issues and on significant accounting
matters beyond those required in AU Section 380,
which was written long before the Sarbanes Oxley
Act.

Underlying the Sarbanes Oxley Reforms in
this area is the idea that audit committees are
expected to be independent of management and would
need to step in and champion the auditor. That
said, based on PCAOB inspections and other
oversight, I’m concerned that there’s still a lot of
situations where the auditor does not stand up to
the client.

Therefore, from my perspective, the point
of the proposal, whether it takes the form of what
the PCAOB proposed in March, or takes some other
direction, is to give the audit committee adequate
information about what’s going on in the audit, to
allow the audit committee to know when to step in,
and what is needed to do to defend the audit.

Several commenters on the proposal
expressed concern that it would burden audit
committees with too much information, which would
increase review time and possibly obscure important issues in the audit. We’re seeing feedback from the roundtable to understand what communication should be made to audit committees to aid an effective oversight at the audit. Thanks, Marty.

MR. BAUMAN: Thank you, Charley. The discussion questions we’d like to ask you to consider as part of this first topic are up on the screen and in your slides. And the first one is what matters related to the audit are most important to audit committee members in their oversight of the audit? Which of these matters should be required to be communicated by the auditor to the audit committee?

Second question is what matters do investors believe audit committees need to know for effective oversight of the audit? Which of these matters should be required to be communicated by the auditor to the audit committee?

We’ve asked a couple of members of the roundtable to kick off this discussion with a couple of brief comments. Please, during the session,
anybody else who wants to make comments, please just
turn your tent card on its side, on its edge, and
we’ll call on you during the discussion topic.

The first one we’ve asked to provide some
comments on this subject is Denny Beresford.

MR. BERESFORD: I’d like to add my thanks
to the PCAOB for allowing this opportunity for more
input on this project. Among other things, I’d like
to observe that there are more audit committee
members participating in this roundtable than
submitted comments on the proposal. So we’ve
doubled the input simply by showing up here today.

I think that’s terrific.

As Marty said, I was asked to introduce
this topic from an audit committee member’s
perspective. And I’d like to put things in
perspective. Audit committee members consider
independent auditors to be a very important resource
obviously, a critically important resource, but not
necessarily the most important one in terms of sort
of the total package.

We spend most of our time both at
committee meetings and otherwise with financial management of our companies, what I would call kind of the first line of defense. And of course, we have several here today, corporate controllers and CFO’s and so forth.

These are the individuals that we must rely completely on to maintain the accurate accounting records and controls of the corporations. They must also be candid and complete in all of their communications with us. In short, they must be absolutely qualified and trustworthy, or we should act quickly to see that they are replaced. That would be one of our principal responsibilities as audit committee members.

Of course for most companies, we have a second line of defense in the internal audit function like Kiko. This group reports to the audit committee and can help serve as our eyes and ears with respect to many of the specifics of the company’s accounting. The external auditors are all extremely important, but from my perspective, they are what I would call our third line of defense.
As I like to put it when speaking to an auditing group, if there were an Oscar for auditors, it would be for best supporting actor, rather than lead actor.

Now none of that is intended to denigrate the external audit function in any way at all. We need company management audit committees, internal auditors, and external auditors that work together in a very cooperative way to best protect shareholders in the public. But these comments do influence the perspectives in my earlier letter on the proposal that I’ll refer briefly to now.

As noted in the summary document for today’s meeting, I’m concerned that the expanded requirements for auditor communications could easily lead to a checklist approach, whereby routine matters tend to drive out more substantive issues. We actually have a fair amount of that today as present, as auditors already have to present a list of their requirements each quarter or other periods. Part of the duties of an audit committee chair would be to caution the engagement partner to omit reading
them at an audit committee meeting when nothing truly important has happened. Otherwise, there may be a tendency for them to drone on with useless words when audit committee members have many other things that they want to learn. We actually have to tell them to tell us what is actually new or different or unusual from period to period otherwise we just get a bunch of boilerplate.

So what do we really want to know? There are several others with equal or more experience than mine at today’s meeting. We have five or six members of audit committees here today. Currently, there are others that have had them in the past.

So let me start with just a few. And frankly, that’s my emphasis is that we should end up in this document with just a few basic requirements. As noted in my letter, I want to hear an assessment of the tone at the top of the organization, both the financial management and the overall company. And I’m not necessarily suggesting that that should be a requirement in the final standard, but that’s one of most important things that the audit committee wants
to know.

And also, an assessment of the quality of financial management from time to time including internal audit. Again, not necessarily a stated requirement, but something that’s critically important to the audit committee members.

Other things that I’d like to hear about, and these are things that I think are subjects of -- should be the subject of specific requirements. I’d like to hear a summary of the audit plan and particularly any unusual procedures, things that are going to be the particular topics of emphasis during the year of things that have changed from year to year.

Any sensitive matters that the audit engagement partner is aware of that financial management is not bringing to the audit committees attention that should be. And that’s obviously a matter of significant judgment. An important accounting or auditing issues that have been discussed with the accounting firm’s national office because they’re close calls.
I could probably provide a few more topics, but I’d like to let other audit committee members add their ideas during this discussion. Also, as I said, my preference would be to not have a lengthy checklist, but rather leave it to the judgment of the audit partner. And of course, I also leave it to the judgment of the audit committee members to ask the questions that they think are most important, both the judgment of the audit committee chairman, who should have a very good working relationship with the audit engagement partner, but also the other members of the committee who ask questions at the meetings.

I feel that they are more likely to do that if they are not put off what -- by what might become an overly long and boilerplate type report by the external auditors pursuant to the current draft. Again, Marty, thanks very much for the opportunity to lead off this issue. And I look forward to participating throughout the day.

MR. BAUMAN: Thanks, Denny very much for those comments with respect to the first two
questions that we’ve posed. Lynn Turner, we’d like

to hear from you on these questions.

MR. TURNER: Thank you, Marty. And I do
commend the staff for their efforts to date. This
is obviously an important project from an investor
perspective. High quality audits is what really do
-- does give us confidence in the numbers.
Understand that management puts them together, but
it is that independent set of eyes and the process
that goes with it that establishes the credibility
and reliability of those numbers to us as investors.
And that information is extremely important as we
decide where to allocate our capital both here in
the U.S. and abroad in the various markets.

The audit committee plays an extremely
important part in that overall role. They have an
important role as overseers and monitors of the
process. And if the audit committees are going to
get their jobs done in a fashion -- in a diligent
fashion, that means that the audit committees have
got to get the type of information that they need to
make sure that in fact the audit’s getting done in a
high quality fashion.

As I read through your proposal, Marty, I find that for the most part, I think the staff have done an excellent job. I think the topics that they tee up are relevant. They’re certainly, as I went through them, I couldn’t find one of those topics that an audit committee in my opinion wouldn’t want to know if they were actually overseeing and monitoring the project. In fact, I have to ask myself how could it be that someone wouldn’t want to know that information regardless of whether you got it in a list or not.

So I find it a very good starting point. I think the two-way communication, the assessment of that two-way communication is an important factor. Where I’ve sat on the audit committees, I’ve asked auditors to give us that type of feedback. So I do think it’s good. And in fact, as I look through the various topics, again, my experience had been we’ve gone through all those in the various audit committees I’ve sat on. And it’s never really been a problem. It’s never -- if we do our job right,
it’s never turned into a checklist. There is that
dialogue back and forth. And if you got a good
audit partner, you got good audit committee people,
you just don’t see it turn into a boiler plate
checklist, which I agree with Denny on. That’s the
last thing we want to have happen here, but my
experience had been those type of items don’t turn
into that.

I think Denny mentioned a couple things
that are very good as far as things that you as an
audit committee would want to know the assessment of
the tone at the top and the quality of the financial
reporting team. That’s always helpful. But there
were two things that were really in my mind missing
and once not so much missing, but how it’s
prioritized.

But the first thing is I definitely as an
audit committee member want to know what the
staffing is on the audit engagement. You can put
down any firm’s name on that audit report, but the
audit’s only as good as the partner manager in
charge.
And ultimately, as an audit committee member, I want to know who’s on the job, their experience. And then I also want to know who’s doing the heavy lifting on the difficult risky areas? It’s one thing if it’s being done by a partner with many years of experience. It’s another thing if it’s being done by someone that just doesn’t have that experience. So I’m always interested. And I’ve always got a schedule quite frankly from our auditors about who’s doing what on the audit.

The second issue is the issue of risk. And in the proposal, you mentioned back in one of the appendix, I forget which one it might be C or whatever, that when the auditors have a conversation with the audit committee about the scope of the audit, one of the components that discussion should be something about risk. But you really don’t see that in the proposal or in the standard till you get all the way back to the appendix. And it seems to me, especially in light of what we’ve been going through the last few years in this country, and the
focus on risk, that the priority given to a
discussion between the audit committee and the audit
with respect to the risk is very important.

Auditors are already required to identify
the risks. And typically, where I’ve sat on the
audit committee, we’ve asked for the auditor to tee
up to us, as well as the CFO independently, the top
five risks in the business and then how they’re
going to go about auditing those top five risks and
whether it’s consistent with what financial
management is telling us.

And so I think the fact that we don’t find
much until we get to an appendix about the
discussion of risk and the role it plays in the
scoping of the audit, I’d elevate that up to more in
the body of the document.

I would note that, you know, it’s been a
long time since we’ve had the blue ribbon report on
audit committees. It started a lot of this off. As
we did that report, we heard many of the same
concerns at the time about oh, it become
boilerplate, it become a list, it would cool, not
broaden the discussion between the auditors and audit committees. And quite frankly, it just hasn’t, despite all those concerns, it hasn’t occurred.

In fact, we probably, I think most people around the table would say the audit committees today versus where they were in 1998 is the difference between black and white. They’ve come much further and are doing a much better job today.

So again, I commend you for where you go. I think the proposal’s very good. I’d make some refinements to it, but I think it’s about right.

MR. BAUMAN: Next is Mary Hartman Morris.

MS. MORRIS: Thank you, Marty. I mentioned I’m an investment officer for the California Public Employees Retirement System, but in prior life, I was an accountant and an auditor. And I’m here to -- as a representative of CALPERS. I want to spend a little bit of time. CALPERS, of course, as you know, is the nation’s largest public pension fund. What we’re seeing in $210 billion in assets. This capital is allocated over 9,000
companies worldwide. I think it’s important for us -- me to mention that because as an investor, I think we try to bring a perspective that’s important to our beneficiaries.

We appreciate the opportunity to attend this roundtable and offer our perspective as -- on these important issues. Of course, we look forward to hearing a perspective of members of the audit committee -- audit community, and engaging in mutually beneficial dialogue.

Given CALPERS substantial global equity holdings, we have a vested interest in maintaining the integrity and efficiency of the capital markets. As Lynn mentioned, the financial interests of CALPERS beneficiaries are most effectively served in an environment where investors can confidently utilize financial statements to evaluate investments.

We believe robust communication between the auditor and the audit committee helps promote this confidence by ensuring the audit committee has the information it needs to serve as effective
We view the audit committee as a direct link or as a fiduciary to represent all of us as shareowners and capital providers. In our comment letter to the PCAOB, we offered support. And we thought that the communications, a requirement was a good thing and very beneficial to us. And we commend the PCAOB for proposing this regulation. And we believe that a rule of proposal will help set the baseline, although, you know, this communication is ongoing, but we believe -- to support and establish a standard.

To begin, it may be beneficial to outline the view of what we believe as the role of both the auditor and the audit committee as an investor. I spent part of my engaging companies in our portfolios, and talking to some audit committee members. A few of I’ve met -- during those engagement participations.

We believe that the auditors’ role as decreasing the risk, material misstatements and financial reports, you know, along with a lot of
other things, but we do believe that audit committees’ role as protecting investors’ interest and overseeing the integrity of the company’s financial reporting.

From an investor’s perspective, not only is it important that audit committees play the important oversight role to ensure the integrity of financial reporting, but we are very interested in ensuring the auditor provides -- audit committees what information deemed material to the market valuation of the company securities.

So bottom line for us as an investor, what is the value of our investment and the value it provides to our beneficiaries?

With this in mind, we approach the issues of communications beneficial to audit committees by first looking at information investors find important. And I think many of you have already mentioned that. We then derive what we believe the audit committee’s information requirements should be.

We use -- I mean, there’s lots of
different examples, lots of different studies. And
I think many of you here will be speaking to that.

But I think that we used one thing in our
discussion was the Institute of Chartered
Accountants of England, Wales Financial Services,
ICAW, they entitled a report “Audit Banks: Lessons
from the Crisis.”

This report addresses the role of auditors
in providing information to investors. And this
report specifically addresses banks, but we believe,
of course, this is beneficial for all institutions.

Key to this, I think in the crisis, is one
of the things we want to ask is, you know, where
were the auditors? And where was the audit
committee? Was it during the crisis? And I think
there is some issues outlined there that says there
might be some evidence that there needs to be better
communication.

First, the auditors’ opinion of key
business and audit risk, we think we’d like to see
that.

Second, the auditors’ opinion of key
assumptions used materially important judgments that affect the financial statements. The auditors should state whether these assumptions are aggressive, conservative, or reasonable.

Third, the key audit issues and their resolutions.

Four, significant changes to accounting policies.

Fifth, unusual transactions.

And sixth, accounting applications and practices are unique to the industry. And you know, this is already key things, but I think it’s important to summarize this, because from an investor’s perspective, we want to understand that, and be able to -- the auditor and the audit committee be able to articulate that well to investors.

As representatives of investors, audit committee members must have access to of this information. Furthermore, the information must be detailed enough that committee can effectively evaluate the merits of the company’s financial
While we believe that explicit role, reporting requirement benefit of auditor and audit committee communication, we also acknowledge the individualized nature of each audit. So we do agree that should not be a check the box. And I think even Lynn and Denny mentioned the importance of making sure that that dialogue is consistent with not a check it box process.

That’s why we believe it’s critical that auditors use sound judgment and avoid the check the box communication. Rather, it’s our hope that these regulations serve as a foundation for building even stronger dialogue between these two parties.

We believe an audit standard will ensure a baseline to foster and facilitate robust, meaningful discussion between the auditors and the audit committees. We reiterate the importance of organic discussions between the auditor and the audit committee. And we’re not -- recommend this dialogue be scripted.

And today, of course, we look forward to
hearing from audit committee members, auditors, and institutional investors, other institutional investors and others on those topics. Thank you, Marty.

MR. BAUMAN: Thank you, Mary.

Well, others in the room are putting their tent cards up. And please, do that and we’ll call on you. So please get your cards up. I would just like to let one of our members of the roundtable introduce himself. We went around the table earlier. Don and everybody said who they were and their affiliations and audit committee experience and we’d love to hear from you.

MR. DONALD NICHOLAISEN: Well, good morning. Thank you very much. Don Nicholaisen, former Chief Accountant at the SEC. I’m Chair of the Audit Committee at three companies, Verizon, Morgan Stanley, and Zurich Financial Services.

So delighted to be here. Appreciate the opportunity. And I look forward to a very interesting discussion.

MR. BAUMAN: Thank you. And we look
forward to having your tent card up throughout the meeting. I think the first card up was Mike Cook.

MR. COOK: Thank you, Marty. Brief comments on this topic, agreeing largely with what Denny said, what Lynn said about the audit committee role.

I would like to make an overall observation, though, about this. I -- as I was reading into the materials, I got encouraged at one point because we started talking about financial reporting. And then, my encouragement disappeared because we drifted back into talking only about the audit. And I understand the role and authority of the PCAOB. And maybe that's why that has to be, but as you look at what's useful to the audit, what's relevant to the audit, what relates to the audit and so on and so on, it is only a part of the financial reporting process that the audit committee has a great deal of responsibility for, more so on the audit side perhaps. Another financial communications, but I think there's some evidence, at least in my opinion, that the audit as part of
the total financial reporting package is declining in usefulness or certainly not gaining in usefulness compared to other forms of communication, including earnings releases and quarterly information and business performance information, non GAAP financial information, all of which I think audit committees need to be substantially engaged with and are auditors of our audited financial statements also need to be engaged with, and a dialogue about those topics is often very important.

MR. BAUMAN: I, for the that reason, would be inclined to not favor much in the way of expansion of what we have today about communications related to the audit, because I think they are quite sufficient. In some cases maybe a little more than they need to be. In some cases, they could be enhanced.

But for the most part, they’re adequate.

And I, for one, thinking about audit committees responsibilities and not having unlimited amount of time for these matters would not like to take a lot more time away from other areas of financial
reporting, which are in my opinion, of emerging
importance and perhaps greater importance to spend
on the details of the audit, which already
sufficiently covered, I think, in the existing
requirements.

The only other point I’d make perhaps at
this stage is I think the whole issue of quality of
auditing and quality of financial reporting is
driven by people. And I would be very much inclined
to be sure that the audit committee spends its time
with people meaning the audit team, and I endorse
what Lynn Turner said about who are the people? How
experienced are they? What particular skills do they bring that enables them to fulfill those
responsibilities effectively and endorse what Denny
was suggesting, which I think is critical.

I think some of the most important
communications that I receive as an audit committee
member from the auditing firm are people related,
and are not covered by the types of things that are
easy to put in a pronouncement, such as this, but
tone at the top is number one on the list.
If you said you can only talk to the auditors about one subject in the course of a year, what would it be? For me, it would be tone at the top. And that is not covered here, because it’s very hard to turn it into a requirement.

But if we had a focus here on best practices, and a focus on effective communication, not requirements, I think we’d get a better end product. And tone at the top would be there. The quality of the financial staff, the depth of the financial staff, particularly important as we’ve been through downsizing, cutting back, resources in a lot of areas. The quality of the internal audit function, substantive quality of the internal audit function. How good is it? And how reliable is it for the audit committee and for the financial reporting process?

So I would like to shift the -- some of the discussion to maybe best practices, maybe people oriented, harder to capture in requirements, but it concerns me greatly that we’re going to stack up more and more and more required communications,
which are of less and less value to me as a member
of an audit committee, and less where I want to
spend my time, talking with management and the
auditors. And I won’t give the three legged stool
speech in great depth, but I don’t view anything as
two-way. I view this as a three-way process between
the audit committee, the management and the auditors
internal and external. And each having a equal,
roughly equal place at the table, one being too long
or two short, the stool likely to tumble over.

Anyone left out of the process, and it’s
not an effectively process. The great emphasis here
on two-way communication is not the way I would go.

MR. BAUMAN: Thanks, Mike. If I could
interject with a question, because both you and
Denny brought it up, but I think Denny also said
that he wouldn’t make it as a requirement. I think
I heard both of you say the most important thing you
could hear, it’s one thing, to hear from the
auditors was about the tone at the top and the
quality of management.

But yet, I think you both said that isn’t
something I put into the standard as a requirement for communication.

So if that’s the most important thing you’d want to hear, you’re saying we don’t need to put in there, because you’re going to ask it anyway as audit committee members? Is that the point? Maybe Denny or Mike?

MR. COOK: I’ll take a shot. And Denny can correct me. My concern about it is like anything else, if you make it a required communication, you have to define it in great depth. You have to lawyer-ize it before it takes place. You have to document it. And all of those things will stifle the communication.

And if we could have this in an environment, where not everything had to be defined in great precision, and written down, and so on and so on, I think we would enhance the effectiveness of the communication process. That is my reservation, Marty, is I’d rather list it as a best practice, and have a good dialogue, that make it a requirement and kill it.
And I think we have ample opportunity to kill it, just by trying to argue about what tone at the top really means. But I know what it means. And we, the audit partner, when I ask about it, knows what it means. And we have a very effective dialogue.

If I thought that that same dialogue was taking place after having been cleared by six people and prepared for an advance and so on and so on, it would be far less effective for me. That’s why I’m concerned about the requirement.

But I think it’s absolutely essential. I mean, this notion that audit committees can, notwithstanding their very efforts and time that they put in, you breeze through, you know, six, 12, 15 days a year. You know everybody is on their best behavior. All the desks are clean. All the things are what you expect them to be.

What I want to know is what they’re like when really tough decisions need to be get made? And people need to show what their real standards and principals are. And more often than not, the
auditors like you to be part of those discussions. And that’s what I want to hear about. I’m afraid of institutionalizing that and killing it.

MR. BAUMAN: Thanks for expanding on that.

Denny?

MR. BEREFFORD: My comments would be similar. I just don’t want to take the time to build an infrastructure to determine what tone at the top or quality of financial management means. I’d prefer to work that out on a one to one basis, based on my judgment and my discussions with management.

I’d also, while I’m generally, I shouldn’t say generally, I’m strongly in favor of written communications as a requirement for all the other things in the document, I can’t see this as something that would be subject to written communications at all. And I just think it’s far more effective to let this be a best practice without any particular framework. Just let it be something that you elect people, you appoint people to be audit
committee chairman based in large part on their
experience, their judgment. And I think it’s
something that you should allow them to use that
judgment.

MR. BAUMAN: Thanks. Hal, did you want to
comment on that point?

MR. SCHROEDER: I just want to ask a
question of both of them. Do you think that the
quality of the audit committees is up to what you’re
suggesting? And I ask that because both of you all
are extremely experienced. You’ve been around a
long time. You understand the issues, but not every
audit committee member comes with the same
background that you two gentlemen have.

MR. BERESFORD: Well, there are, I don’t
know what the exact number, 13,000 or 14,000 or
12,828 or something public companies. And I’m sure
that the -- that there is a variance among them, but
and that again is a reason for not specify exact
rule. I’m sure that you’re going to have some
variety and how this -- something like this would be
applied, Hal. That’s the best I can answer it.
MR. BAUMAN: Thanks. Linda Griggs?

MS. GRIGGS: I just want to commend the PCAOB for this document. I think it’s very thought provoking. I think it tees up a lot of the issues that audit committees and auditors need to be thinking about in this two-way communication.

I do think that I come from sort of the bias that a principles based standard might be more effective in requiring the auditors to exercise judgment in developing this communication tool. And I wonder whether rather than a list of required items to discuss, a standard that sets forth recommended areas to consider and perhaps there, you could put tone at the top in this list of recommended areas, because I agree with Denny and Mike, but I also acknowledge that there -- the quality of auditors and the quality of audit committees differs across the nation. And so, providing this list of items for the auditors to think about would be very helpful.

It might not be something that an auditor would think about that he should be talking about,
the tone at the top. And you might have an audit
committee that hadn’t really thought of that.

And so, I think teeing it up as an issue,
but without making it a requirement might address
some of Mike and Denny’s concerns about the need for
an infrastructure to identify.

Because as a lawyer, I understand, you
want some precision. You want to know what the
requirement is, if it in fact is a requirement. But
if it’s simply a list of areas that should be
considered by the auditors in talking to the audit
commitee, perhaps you get away from that.

The other thing is you really want to
empower and make the auditors realize their
responsibility to exercise judgment. They’ve got to
figure out what the audit committee needs to know.
The audit committee doesn’t need to know what’s in
the financial statements. The audit committee
doesn’t need to know things that are very -- have
been already communicated by management.

But the audit committee does need to know
what areas of risk were important enough to the
auditors to develop their plan, their audit plan. They need to know what the auditors found when they completed their audit. And you know, sometimes I don’t find anything bad. So there’s no reason to have a presentation on that.

The other thing I feel strongly about is having been on an audit committee, I did find the written materials enormously helpful. And I don’t think the auditors should be going through all the written materials. I think the auditors should then be required to talk about the important areas.

But having a list, I mean, for a non accountant on an audit committee, it was useful to me to have some of the information that, you know, they had, through their eyes, they had -- they teed up for me.

So I think there’s a balancing as to what is presented orally and what is presented in writing that helps the audit committee in doing their job.

Thanks.

MR. BAUMAN: Thank you. Jim Cox?

MR. COMR. BAUMAN: As I was reading the
proposed statement, I was struck by a sort of a
historical observation that it was drafted roughly
about two months before Don Frank was enacted, which
as we know one of the many provisions in that act,
carves out the non accelerated filers from the
attest function of 404.
And it does raise in my mind whether this
document would have somewhat different content on
drift had it been written, you know, with that
knowledge that that was going to happen.
Now we know that the non accelerant filers
were not already subject to 404. They were only
threatened to be. And they keep getting prolonged
and prolonged. And so, a question that would come
to my mind, and has to come my mind on the audit
committees I served is, and I look rather foolishly
when I asked this because for the following reasons,
because the answer was that we do comply, even
though we’re not required to.
And that is to say what have you done,
auditors, to evaluate the internal controls of this
organization that are different from what you do if
you were performing in a test function? And what are the risks associated with the distance there about what you would have done if you were testing and otherwise?

When I asked this question, two of the three audit committee as a serve on are related to Duke University, which complies fully, even though it’s not required to, with all the requirements. And both listing requirements for the New York Stock Exchange and all the requirements for Sarbanes Oxley. And so, they do have the attest function of our management on internal controls.

So you know, I think something has to be looked at here in terms that evaluating internal controls, because that is the sine quo non for the auditors, a test function for the financial statements themselves.

So I just commend that for the -- to think about going forward.

MR. BAUMAN: Thank you. Roger Coffin?

MR. COFFIN: Thank you, Marty. Good morning. I just wanted to go back a little bit to
the concept that we spoke about regarding check the
box and the nature of the communications between the
audit committee and the auditors becoming too
process oriented.

I think it’s helpful to remember that the
audit committee as part of the board historically
has an oversight role. And in fact, you know, the
board of directors is really designed to act as the
fiduciary on behalf of shareholder interests and to
oversee management, and then through Sarbanes Oxley,
the direct link between the board through the audit
committee and the auditor was established.

And that really, when you think about it,
forms kind of the fundamental basis, I think, of
modern contemporary corporate governance theory,
which is to say an independent board properly
incented subject to open and fair elections is a --
one of the best methods to protect shareholder
interests.

And I think the PCAOB in this standard is
really driving towards the independence and the
informed part of the board aspect. And I commend
you for that. And I largely endorse most of the communications and agree with everything has been said around the table.

I would like, though, to just amplify a little bit about the board’s fiduciary role here, and how that fits into this mix. And I’ve described this in more detail in a comment letter that I submitted to the public file.

Remember, that boards as fiducaries have state law requirements to act in that way. The law that applies to most of the public companies in this country is the law of Delaware. Its enabling statute has a section that -- section 141, that said the business and affairs of the corporation shall be managed by or at the direction of a board of directors.

And what that means, and what the court’s have done with that statute over the past 80 years, is to amplify that, and require boards and audit committees to have broad discretion to exercise fiduciary decisions in a flexible manner.

As a matter of fact, there was a very
significant case in 2008, the case of Computer
Associates versus AFNE (phonetic) in which the
Delaware court actually struck down a shareholder
initiated bylaw that would have purported to have
infringed on the jurisdiction of a board to make its
own determination.

And so, from this takeaway, what we see is
that under state laws, that boards of directors must
be free during their term to be flexible, and not
even the shareholder owners can do things to
influence or change that.

So I guess I would like to caution. That
was not what I would like to caution against,
although that was a wake-up call. And certainly my
comments here are not intended to be that, but to go
forward to this, to place this in the context of
state fiduciary requirements of boards, and to allow
the boards of directors to be able to do what
they’re doing, remember, if you -- sometimes check
the boxes, as I was said, I think by Lynn Turner,
most good boards are going to ask for a lot of these
things. What I think we’ve seen, and I think what
we’ve seen in Enron, was check the boxes actually protect bad boards. In other words, they give back boards of directors something to hide behind and to allow them to look like they’re discharging their fiduciary duties.

So while I broadly endorse what’s the nature of here, I think as you -- and I think all of the communications that we describe are valid. And I think you’d want to know, particularly relating to risk, I think the longer the document gets in terms of listing out the number of required communications, the more danger you run towards going down the scale of making it too much of a process.

And I think the PCAOB really just needs to be cognizant of where along that scale you’d like to fall.

MR. BAUMAN: Roger, thanks for those comments and for the loud burst in between as well that got our attention. In case anybody wasn’t listening carefully, we suddenly did.

Bob Kueppers?
MR. KUEPPERS: Thanks, Marty. I wanted to pick up on -- starting with Mike Cook's comments. I think Linda took it a step further. It suggests then that maybe what we do need to do, or the board should think about is something that is more principle based, perhaps with no more than a handful of absolute musts that should be communicated, things like significant disagreements with management, material written communications with management, uncorrected misstatements. And the one that's actually no in the proposed standard, which I think would be important, is related to party matters, related to party matters have a particular risk to them that I think should require discussion.

Beyond that, I think the circumstances will dictate what else needs to happen. On the one hand, the board is trying to prescribe things auditors must do. Yet in this area, you get quickly into the effectiveness of how the audit committee functions, the relationship with the audit committee in management, the audit committee and the auditor, and the auditors and management.
But the board only has really authority to deal with one corner of that triangle. And I respect that. And I don’t know what the solution is, but it seems to me that, and I have the pleasure of working directly with the audit committees of companies like General Motors, Dow Chemical, and Best Buy. All of them work quite well with all parties.

But you know, trying to look at it through this single lens, I think, puts you in a very difficult place to come up with a comprehensive effective standard and perhaps something principles based with a handful of requirements, plus what the auditors responsibilities are if something, you know, doesn’t get done, or doesn’t work would serve the same purpose as the standard as -- that, you know, that you’ve already proposed.

MR. BAUMAN: Thanks, Bob. Karen Hastie Williams?

MS. WILLIAMS: Thank you. I wanted to just focus for a minute on the relationship between the audit committee of the board and the auditors.
My practice as an audit committee chair has been to meet with the outside auditor, the inside auditor, and the CFO before every board meeting, and go over the agenda, and raise issues that I think would be relevant for the board.

I found that to be very effective in terms of bringing out any kinds of problems or disagreement between the internal auditor and the external auditor. And they have occurred. And it’s from my perspective it’s something that should be taken care of or should be addressed when we have our pre-meeting, so that when we go into the full meeting with the board, we’re prepared to state what the issue is and what the proposed resolution is.

So I think communication is really key, as I think a number of our colleagues have suggested in terms of addressing the relationships between the outside, the inside auditors as well as the CFO.

MR. BAUMAN: Would you see any changes to the proposal that we’re making as a result of that view that you’re expressing?

MS. WILLIAMS: No, I don’t think you need
to make changes to the proposal. I think the proposal is fine the way it is. But I think there should be an understanding as this goes forward that there is an important dialogue. It’s not just simply that the outside auditor is coming in, and here’s what we see, but there is a dialogue between the key folks on the financial side in the company, as well as with the outside auditors.

MR. BAUMAN: Thank you very much. Larry Salva?

MR. SALVA: Thanks, Marty. I agree with a lot of the comments that have been made around the table. Probably most, though, with Bob Kueppers in terms of not tying too much the hands of the auditors in terms of being prescriptive on what needs to be communicated.

Because I start with the premise that Mike and Denny started with earlier. Because I view it the same way is that the -- I’m the asserter of the information. As management, there are financial statements. I take responsibility for the fair presentation that they are free of material
misstatement. And I’m making that assertion in my management report.

I then rely on my internal audit function as part of my system of internal control to give me that assurance that I can make that assertion.

I also rely on the external auditors to give me assurance, as well as to provide that independent and objective so-called stamp of approval. And we’ve talked about this at prior SAG meetings. You know, about could the auditor report be improved in terms of communication, because right now, it’s a pass/fail test.

And it seems like there is a desire on the part of some to get more knowledge about what goes into that decision about the pass/fail test. And right now, a lot of that resides with communications to the audit committee, and not directly to the shareholders or to the readers of the financial statements about the tough decisions that might have been made along the way as to whether they -- the auditors decide to give a pass.

I think that in addition to the -- that
assurance or that stamp of approval that comes from
the auditors, that investors get a source of
information in terms of where to deploy their
capital by observing and determining in their minds
the openness and the transparency with which
management communicates to investors. And that’s
not just through the financial statements. It’s
through their earnings press releases, through their
dealings with analysts on the analyst call, and in
analyst meetings.

So I believe companies get reputations
about how transparent and useful their information
is. So that’s another source.

So it’s, as I tend to agree most with
Denny that the primary line of defense for the audit
committee or the shareholders is the quality of
management and the managing reporting. It’s then
the internal audit function and then the auditors.

So placing it into that context, the, you
know, then what’s most important, it’s tone at the
top. It’s absolutely tone at the top and throughout
the organization as to whether the organization gets
it, that they’re responsibility, you know, is --
they are fiduciaries of shareholder money.
And that it’s not their money to be used
as they see fit. It’s they have a responsibility to
the owners of the business.

That tone at the top just to get back to
that point of it’s so important as a communication,
but it’s a difficult one, and certainly, I think
would hamper the communication if it were required
to be put in writing.

I’m not present in the audit committee
meeting when that is discussed. That is in an
executive session. And I would expect it should be
there. And to require it in writing basically
defeats that purpose. I don’t see minutes of what
is discussed in the executive session. It’s
occasionally -- when appropriate, I am informed of
what has occurred in the executive session.

But one way to address that factor might
be to consider a required communication from the
auditor as to how tone at the top affected their
risk assessment in performing their audit. Whether
it was considered to be a positive factor, a negative factor, or a neutral factor, because at least from my experience in public accounting, auditors will attempt to complete a quality audit, even when the tone at the top is not the greatest. And it enhances risk assessment when it’s there, but you know, and when it’s really bad, typically, the decision is that you release that client from your client portfolio. Or you know, if the board doesn’t deal with it appropriately in terms of changing the tone at the top.

So it’s a factor. It’s probably one of the most important factors, I think, in giving the audit committee their sense of whether they’re dealing with good people, at least in terms of having an oversight role from external auditors and the audit committee itself.

MR. BAUMAN: Thanks, Larry. Just a couple of comments and maybe one question. For the benefit, Larry made a point about the importance of communications by the auditor to investors as well. And some comments that the current audit report,
which is binary pass/fail may not be doing that.

Larry has the benefit of being on our SAG as well, that -- where we’ve discussed this. And we’ve indicated that we are taking on a project in the Office of the Chief Auditor to explore changes to the auditor’s report in that regard. So I wanted to share that with others here because of the importance of the point you made.

But one other thing I’d like to follow up in the context that you’re agreeing with Bob Kueppers, which is an interesting point of itself that I’d to follow up, but --

(laughter)

I thought Hal Schroeder made an interesting point before. And a number of comments have been made about the requirements could just be principles based. And you don’t need to a checklist, but Hal had made the point that gee, we have a very talented group of auditors around this table, and a very experienced group of audit committee members. And do we feel comfortable that we could go with a principles based standard, and
that all of the other auditors who are not sitting
at this table, who may not be part of the larger
organizations and audit committee members who may
sit on just one audit committee and not have as much
experience, wouldn’t they benefit from the more
detailed requirements in here? And I think that was
kind of your point, Hal, wasn’t it earlier?

MR. SCHROEDER: Yes, it was the beginning
of a comment that I can fill in a couple more points
around that. Yeah.

MR. BAUMAN: Okay. Well, I don’t know if
you wanted to comment on that now or we’re let that
thought go, but I know there is that point that was
brought out that I think is an interesting one for
us to continue to explore here.

MR. SCHROEDER: Yeah, I had more of a
question along that front. And I was reminded of a
senior partner at the firm I worked for years ago.
He said, you know, we talked about our internal
audit approach. And he said, well, you know, we
don’t write these audit approaches for the 10
percent of us who really know how to do an audit. We
don’t even need all this written stuff. It’s for the 90 percent of the people that we’re trying to bring along.

And that comment came back to mind as I listened to everyone’s comments around here. We’re trying to write a set of rules for the person who has the least amount of knowledge. And I’m wondering if another solution here is not to go back to the earlier comments about the five key principles, but in the process, leave it to the individual firms to develop training courses and internal programs around that.

If you’re going to be a presenter at a board, or going to be talking to audit committees, you have to go through this program. And we’re going to teach you and train you to what needs to be covered, and what are the key elements.

The flip side is how could you do the same thing for audit committee members to bring them up to a higher level of standard? I mean, there are all sorts of licensing requirements. If you’re in the stock market, why aren’t there licensing
requirements if you’re on an audit committee? And I know some of that’s within your purview and some of it is not.

MR. BAUMAN: Right. Some is within and some isn’t. Thanks, thanks, Hal. George -- sorry, Larry, did you want to respond back to my point?

MR. SALVA: Yeah, just to that point, because I think I agree -- I think Linda said this that, you know, kind of combining Bob’s comment with Linda’s. Five key principles and maybe some short list of required, absolutely required communications. And the balance of it is other items to consider as they’re appropriate in terms of -- or you know, and that will give the -- kind of the best practices or memory joggers for auditors that may not be in that top 10 percent.

MR. BAUMAN: Thanks for that clarification. That was helpful. George?

MR. MUNOZ: Thanks, Marty. Speaking from audit committee perspective, I agree with the comments that Denny and Mike made and then Linda. I liked very much the principles approach to this,
because as an audit committee chair, I am most concerned to make sure is the big question for my fiduciary duty is sort of who audits the auditor?
Well, to me, PCAOB should be auditing the auditor.
So the most important thing that we can hear at the committee is that in fact the auditors are well qualified, well, prepared to handle all of what they are supposed to be handling, so that from that perspective, to me, that’s the biggest area of interest.

Once the PCAOB starts getting onto the agenda of the audit committee, that raises a concern because of our fiduciary duty to make sure that in fact we do protect shareholder interest, and that we talk at the -- on the agenda items represent the most important things for the company at that time.

And the most important things may not be whether the auditors did what they’re supposed to do, but rather if they say they did, and financial management represents that, then we want to go to the more important issue, such as risks and other kinds of things that the audit committee has to
handle.

And so, my biggest concern is that what happens, and we saw this in 404, is that the agenda started getting crowded over -- and everybody has a limited time. There’s only 24 hours in a day no matter what -- however you look at it. And so, what happens is that an audit committee that goes beyond two, three hours, four hours, it gets to the point of not having a good performance in what it does.

So my concern is with the check the box, it’s going to happen because I already saw this in one committee meeting that we have a very effective committee, extremely top notch. And here comes the auditor. And he says, well, I have to communicate. I have to do this.

And we’re all sort of like you -- to the point of getting frustrated and says, look, we all read the material. You don’t have to tell us the accounting policy changes. And we want to move on to more important subject matters. So my concern is that you’re putting the auditor in a very difficult situation because “they have to, they should, they
required to do these things." You’re putting the audit committee in difficult situation because they have more important subject matters to discuss. So I would say I like the principles based.

And then, there’s the unintended consequences. To me, with these rules, especially when you -- when we get to the other subjects and you’re seeing that somehow, the auditor is going to rate the dual communication, somehow you’re giving a little bit more power, if you will, to the -- in the three legged stool, you’re giving a little bit more say, more power to the outside auditor that maybe is not required because somehow that outside auditor’s not speaking to certain kinds of things without being requested to, that next thing you know, management is playing up to them, because if you did put tone of the talk, which I do think is extremely important, but if you put it as a requirement, for example, now you really are distracting everybody to talk about that point.

So I worry about the balance. And I think the most important thing that the PCAOB can do to
tell the audit committee is to say what I think
Harold just said, is the training of the auditors to
make sure the auditors are looking for the right
things that they are disclosing, are prepared to
disclose.

There’s nothing to keep them from
volunteering, even if not asked, to say oh, by the
way, I think it’s important that we mention that in
executive session or the like.

So in all the committee, and I sit on
three audit committees, in all of them, the subjects
that were discussed in this -- in these requirements
actually do come out without being required because
we get asked at one point or another, but it’s up to
the committee at the right time to bring them up.

Having said that, I think the PCAOB did an
excellent job of probing these things. As an audit
committee member, I really liked reading these
things. I just don’t want them to be requirements
because these have their place.

MR. BAUMAN: Thanks, George. Gary
Kubureck?
MR. KUBURECK: Thank you, Marty. It --

let’s give a few thoughts, having listened for the
last hour or so here to other people. And share
some of the experiences I have with our board. I
think one place perhaps, you know, as you move this
process forward is to actually go to the end of the
process. And by the end of the process, I mean,
what two companies audit committee members need to
walk out of the room with? Sort of knowing or so
on?

And so in preparation for this meeting, I
spoke to some members of our senior management or on
another companies’ boards of directors, and as
particularly in their audit committee roles.

And I would probably paraphrase the
feedback I got, some along these lines, is that the
most important thing they want to walk away from an
audit committee meeting with is confidence that
there’s mutual trust between management and the
auditing firm and the audit committee, that they’re
confident that there’s a very open dialogue in that
there’s a very good effective working relationship
or issues or teed up timely. Everyone has a say at
the table. And you work in a collaborative manner
to resolve the issue, or if the case may be, to
bring it to the audit committee for their decision
as the case may be.

But that’s sort of what I would probably
say is the consensus of what they expect to leave an
audit committee with is that level of confidence
that there’s a very, very good working process in
front of this meeting.

So you ask yourself the question, well,
how do you get there? And I think a lot of the
people who have said that today, it really comes
down to the people that were involved and the
process that tone at the top, if there’s one thing
I’d probably pick tone at the top. But the -- and
again, other people here have mentioned it that the
audit committee has to have a feeling that there’s a
high quality financial staff, both financial
management and internal audit management in their
company, that they’re very comfortable with the
expertise of the audit -- the members of the
auditing firm assigned to the engagement, that you
got the right mixture of skills and experience, and
industry knowledge, and that you understand the
risks associated with the account, whatever they may
be, and that the audit effort is aligned around the
risks.

So going on, I would probably just say
right now that there is a lot of meeting content out
there already in audit committee communications.
And I think you need to be cognizant that it might
not be the best thing in the world to add a lot more
to it, and to allow some flexibility for some
judgments as to what needs to be brought forward or
not.

Just one thing, our meeting protocol, and
this is true for all of our board committees is but
every meeting has pre-read. And from time to time,
all the meeting participants are reminded by the
direct -- the chairs, the committees, is that you
approach a meeting content assuming all pre-read has
been read. And it’s been understood by the members
of the committee and do no spend time just turning
the pages, going through it, but focus on the issues that this case the audit committee truly needs to understand as opposed to just being informed. You can be informed in writing, but spend a limited face to face time on understanding the issues.

And I’ll give an example is -- I mean, our audit committee has to approve from time to time changes in the annual internal audit plan. And things changes or understands that. But what they do expect to understand is well, why is it changing? Was it a delay just to due to scheduling? Or is it a more permanent problem? Or do higher priority projects emerge? You know, so why are they higher priority and so on?

So I think the ED itself is a well written document and a really good effort about trying to pull a lot of stuff together that needs to be updated, but I would just sort of close on sort of advising on being careful about bulking up on required communications at the expense of deflecting and deflating audit committee focus on the critical issues they need to either understand or to make a
decision with.

MR. BAUMAN: Thanks very much, Gary. Joan Waggoner?

MS. WAGGONER: Thank you, Marty. I just wanted to suggest that perhaps there is a place in principle based standards for the smaller companies in firms also. And if there is indeed a list of recommendations that can certainly be used as a sort of a catch all list for them in there.

One of the things that varies widely amongst the smaller companies are all the relationships between these various what do you call it, legs to the stool.

And for instance, in many companies, management and the board are very tight themselves. And so, therefore, the management and the audit committee can have a closer relationship than the audit committee. And as they should in some respects anyway, as do the audit committees and the external auditors.

And so, this creates some odd behaviors,
committee have this open communication. And they talk fairly well. And other times, management will only respond to questions.

You also get that same sort of mindset in the audit committee in the way they talk to the external auditors, where there is not an openness there and so forth and so on.

The other part to this, of course, is the wide range of financial expertise of those participants on the audit committees that you see throughout varies widely. So I don’t want to over generalize here, because there are some audit committees for smaller companies that are truly excellent. And then there’s others that are more margin in terms of their participation in the process.

As a result, the agenda for the meetings and the communications between the auditors and the audit committees needs to be very flexible to reflect those very different skill sets. There are -- there’s oftentimes the discussion of the financial statements and the estimates and the
policies are perhaps the one or three or four times
a year that the audit committee actually does a
deep dive into those particular topics. And they
find it helpful. And so, I would encourage to allow
some flexibility to sort of decide what that agenda
should be in the interest of getting those good
communications moving forward. Thank you very much.

MR. BAUMAN: Alex Mandl?

MR. MANDL: Thank you, Marty. Well, a lot
of really important and good things have been said
here. In a way, it’s almost difficult to add a lot
to that, except maybe to underscore a couple that
are at least particularly important from my
perspective.

The first one in the topic of, you know,
how I guess we call it the first line of defense. I
forget now who said it. You know, the role of
management in this triangular situation to me is a
little bit too much on the side.

I mean, at the end of the day, it is at
least from my point of view, it is management, the
financial management that the audit committee
depends on to really be assured and understand what the issues are, get all the perspectives of new accounting rules, of judgments, of all the things that are being addressed and being concerned.

And to me, the responsibility of the audit committee is to really make sure that management is up to what it should be -- is covering the right issues, has the right qualifications, is doing a more than adequate job in those areas.

And if that is not working right, the audit committee has to address it and do something about it.

So I guess if I sort of have a not a slight, but some additional thoughts on how this three legged stool should work, I think it’s just important to really understand the audit committee’s responsibility, making sure -- ensuring that financial management can really cover all those points, has the experience, the skill set, the capacity to present and address all those things that need to be addressed.

That does not take away in any way from Alderson Reporting Company
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the required communications between the audit committee and the auditor for sure. But the first starting point, the first element of this dialogue, and the flow of information for the audit committee I think comes from management.

And if that doesn’t work, that needs to be addressed. That was one point.

I know it’s been partially said, I think, by Larry and some others, but I think that is, at least from my point of view, really, really important.

The second point has also been made, now this sort of underscored, I mean, if you sort of step back and say what should be brought to the audit committee? I mean, the bottom line is things that are really significant, or potentially significant make a difference. And there’s lots of things proposed that probably are not that significant. And might be of interest, might be important, but somebody said it, I guess it was George, that you know, there is a very limited time that the audit committee has available to address
issues, to address topics, to address new things, to address ongoing concerns, to address risks and on and on and on.

And therefore, the need and the critical need for prioritizing and really only focusing on those things that really will or could have a significant impact on the financial reports or all the things that goes with that, I think would be important. And I think the chairman of a committee has a particular task to make sure that indeed is what happens. Thanks.

MR. BAUMAN: Thanks for those comments. I do want to point out, because it’s come up a couple of times, and we’ll have a further discussion on this in our next topic, the proposed standard clearly does recognize the fact that very important communications are made by management and in the areas of critical accounting estimates and accounting policies and so on and so forth.

And in those areas, the auditor just needs to evaluate whether the management’s made the appropriate communications to the audit committee,
and then only communicate further if the auditor
believes the communications were not sufficient.

But I’ve heard that the point was made a
number of times and we all agree with that, about
the importance of management making those
communications. And maybe we need to spell that out
a little clearer in the standard, because we
recognize that point. Thank you.

MR. BAUMAN: Lynn Turner?

MR. TURNER: Thanks, Marty. To start off
with, I just want to come back to a comment that
Mike made about the usefulness of the audit. And
make it very clear from investors perspective, we
don’t think that the usefulness of the audit has
been denigrated in the last decade any whatsoever,
that in fact, the audit’s probably more important
today than ever, especially given the corporate
scandals and the financial crisis. If we can’t rely
on those financials, and if they aren’t credible,
then we absolutely are making wrong investment
allocations and can’t get the returns we need for
our investors. And that’s critical.
So without a doubt, there is no question that the role of auditors and the usefulness of those audited financial statements are probably more important today than ever before. So I don’t want to leave a misnomer out there that from an investor’s perspective, that those had declined at all, Mike. Just a thought.

On audit committees, though, I think Hal raised a superb question. There are about 12,000 public companies out there. You get beyond the Wilshire 5000, and that leaves you with 7,000. It means the vast majority of those probably aren’t able to attract the type of talent that you see in a Mike Cook or a Denny Beresford or a Don Nicholaisen. And in fact, the surveys have consistently shown that that type of expertise, someone who has actually done an audit and understands and knows an audit are not on those boards.

And in fact, that extends not only to those 7000, but that extends well up into the other 5,000.

So not all audit committees are created
equal. Not all of them have the knowledge base to ask the right questions. That's not that they're bad people or aren't going to get the job done or whatever, it's just a matter of fact. We just don't have that talent pool out there on the audit committees at this point in time.

And in recognition of that, even the blue ribbon committee report suggested -- I know it's heresy to some of you, but they actually suggest a checklist of questions for the audit committees right in the report itself with a list of questions that go beyond what's in the proposal.

And in fact, unfortunately, maybe should have been in use because it gets into a lot of risk assessment questions, and high risk areas, which would have been helpful if some audit committees had been asking those before we ever got into the financial crisis.

So the use of a checklist at times is not a -- necessarily a bad idea. And I think you got to recognize that there is a great diversity amongst the quality and expertise of the people out there
trying to do the job. And if we give them some help, that’s not necessarily a bad thing, because ultimately, what we as investors want to know is it that they’ve done their job. They’ve asked the right questions.

When I go back and look through the proposal, I have to come back and ask everyone around the table, tell me which of those questions that you think the audit committee shouldn’t be asking? Tell me which ones you wouldn’t ask. I don’t think this is a comprehensive blown out list. I think it’s a very reasonable starting point. It is a base list. And we’ve had a principle based approach to audit committees since 1978 when the New York Stock Exchange came out. And that principle based approach quite often has not worked very well.

So creating at least some base floor that will give us as investors some idea that the audit committees are really getting the job done, I think, is good. I would love to in a way, get away from this and just have audit committees tell us in their audit committee report exactly what it is that they
have done, and bring transparency and accountability
that way, which I think would actually even be a
much better approach.

Unfortunately, audit committees who can do
that today have decided not to do it. And instead,
give us a very boilerplate report that quite frankly
doesn’t really tell us anything about all these
areas that I’ve just heard need to be discussed.
You will almost never, in fact, I might say amongst
the 12,000, you won’t find an audit committee report
that tells us about any of those things that are so
critical to us, that people just said, we need to
have them asking.

So the information isn’t there to hold the
audit committee accountable. And I think a lot of
the concern around the table is let’s not create
something that creates that accountability, I
actually think it’s an excellent thing. And I think
what the PCAOB is doing here is good. There was a
question about the federal laws and the role of
directors. I think some of the state laws we’ve seen
the shortcomings. And so, I know it bothers
attorneys tremendously, but we are seeing the federalization of corporate governance here as the state laws, especially in Delaware, have failed miserably. And as a result, we’re now seeing say on pay and proxy access, etcetera.

But the courts have ruled that as far as the fiduciary goes in this role, that having a full heart, wanting to do the right thing, but to use the courts were full heart, but empty mind doesn’t work.

And in the context of the empty mind, if you haven’t asked those questions, the very basic questions that the PCAOB is putting out here, I don’t know how you could respond to the court that you didn’t ask those questions. And if you are asking those questions, how can this stifle the conversation? I don’t understand it.

Back to the issue of the tone at the top. I think there’s been some good points raised about it. Certainly, no one likes to grade another person and put it down in writing. It’s just human behavior. There’s something about that, she just don’t like the feeling of, especially if you’re
rating the person that’s going to be writing your
check. There’s just something that makes you
nervous about that.

But I will also add another point that I
think raised the question about how far you want to
get into that, even though it’s a good question.
And that is if we look at the track record of the
auditors, in actually assessing the tone at the top.
They don’t have a really good track record.

Going back to the mid 1980s, about ’85
when we reset the auditing standards, we actually
required that auditors assess in essence that it’s
tone at the top. Yet you can look at one situation
after another that have popped up where there’s been
problems. And the auditors thought they were okay
with the management team, and rode with them. And
certainly didn’t tell the audit committee that this
is a disaster. And we had a blow out.

So I think it could almost be misleading,
given their historical performance and track record
to be sitting there saying let’s have the auditor
tell us about the tone at the top, and place too
much reliance on that. The track record just doesn’t support that approach at all. Thank you.


MS. MORRIS: Thank you, Marty. I guess there’s a couple points I just wanted to make. I appreciate all the comments this morning. I think they’re very thoughtful. And I think that as an investor, we feel that audit committees have an opportunity to actually embrace some of these ideas, sort of to articulate their perspectives. And what Lynn was explaining, I think they can distinguish themselves in well throughout the standard in providing that information to investors.

There’s a couple of key terms that I think that people have brought out today, that I just wrote down and I thought was really important, you know, good governance, of course, you know, that’s really important. The articulation, the transparency, the fiduciary responsibility. So as investors, you know, we look to the audit committee. That’s their role to us. That is so important to us.
to be able to provide that insight to us.

The articulation, I think the SEC has, you know, proxy plumbing, the enhanced disclosure, I think all of that has helped investors.

I think one point that, you know, it doesn’t relate directly to the standard, but I think audit committees can understand this is and audit committee members and chairs, the effectiveness of audit committees. I think that question’s asked a lot throughout your evaluations, through your perspectives. And I think there is also the point brought up that not all audit committees are equal and not -- the experience is not there. And as an investor, I see that when I go out and I speak to audit committees.

So I think that the standard would help bring these individuals up or at least be able to bring that thought process to them.

I think that -- I was looking at -- not to throw out names, but Tapestry Networks and E and Y, I think they were talking about the evaluation and the effectiveness of audit committees. And I think

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that audit committees said to themselves it’s
important to not have any surprises, to you know, of
course, have their evaluation, to have that full
communication with their auditors, the relationship
building.

And I think that this one point I really
wanted to stress was that the standard provides sort
of teeth. It really does provide the audit
committee the opportunity to sort of distinguish
themselves and to say, you know, for investors, you
know, this is how you are looking and you’re
searching for alpha. And you want to invest in our
company as a capital provider.

So I think it does provide confidence to
investors and from the audit committee’s
perspective. And I think that for our search of
alpha, there are value. We only have -- all of us
have limited capital. It’s our responsibility to
our beneficiaries. But I think this is a way that
audit committees can sort of embrace this new
standard and distinguish themselves. So thank you.

MR. BAUMAN: Thanks. I just wanted to --
so many comments had been made regarding tone at the
top as being -- and the importance of that feature.

Some discussion has been made regarding
that -- how that should be discussed with the audit
committee. And I think it’s important point that
we’ll give some further thought to.

But I wanted to bring out the fact that
the existing PCAOB auditing standards do require the
auditor as part of the audit of an organization and
their evaluation of the internal controls to assess
the tone at the top as part of the control
environment in the organization. So auditors are
doing that, at least they should be doing that as
part of PCAOB standards. And the issue here is now
it maybe come up one -- a couple of times, but some
of the members here at the table feel like that’s
one of the most important things that I’d like to
hear about is that assessment.

Don Nicolaisen?

MR. NICOLAISEN: Thank you. Awful lot of
comments, so I’m not -- I’m going to try not to
repeat anything, but I do commend the board. I
think it’s appropriate to -- with the importance of
the auditor’s relationship with the audit committee,
that there be a clear description of what the
expectations are of the auditor in those
communications.

And having building blocks, those things
that are essential requirements that we all would
concede should be communicated is an appropriate
approach. And I think the listing of items is not
that long or that complicated that it would cause me
a particular concern.

I suspect that a lot of that, because it’s
there ends up being check the box and also from my
perspective, that’s not all that bad if the box is
checked properly, and the work has been done, and
there’s an element of professionalism that the
auditor brought to the work and says to the audit
committee we’ve looked at these areas. These are
the ones you don’t need to work on. Now let’s talk
about those things that are really, we think, you
need to put your focus on those things that are
critical to you.
At the tone of the top, you’ve talked about I tend to get at that another way with auditors. I also ask them do your staff like to be on this job? Is this a job within the office that people are competitively trying to be the auditor of? Or is it one where you’re reluctantly dragging people to the table? And that usually prompts either the issues that are really there and underlying what needs to be dealt with in relationships with management. Or it’s a confirmation that we actually do have the best team.

The element of no surprises is certainly what I look for in an audit relationship. Mary Hartman Morris just mentioned that. I think it’s fully appropriate from both sides. I don’t want to surprise the auditor. I don’t think the auditor ought to be surprising us.

And the auditor ought to expect that if there’s an article in the newspaper about an industry similar to the one that I’m the audit committee chair of, that identifies a problem, somewhere within that industry, or components of
that industry, that I’d want to talk about do we have that concern here? Is it something that we ought to be looking at? Are those issues that should be raised.

And also, where there restatements in the audit firm is involved in those restatements? Are there any indications that there are problems that could also migrate to our account. And in a sense, what I like to do in that way is to test the professionalism and the communication skills of the auditor.

The concept that is in here of two-way communication I agree with. I think it’s sound. I’m not sure it fits all that neatly within a document that’s for the auditors.

And so, there’s probably other ways that you could describe it. For instance, you could describe to the auditor in a standard what to do if the audit committee is not communicating with them.

And I think that the same three or different things that you’ve described here, and I think there our -- they would be signals, red flags that you have a
problem, but I think it may be difficult to try and put in an audit committee responsibility chart or checklist in the form of a standard written for the auditors themselves.

I think you can imply certain things. Out of that, I think you can cause action to occur. I also think not withstanding what some do think is a lack of guidance on best practices for audit committees. I think there’s a ton of material out there almost every account firm, every consulting and operation, endless numbers of conferences that address this issue of what audit committees ought to be paying attention to.

And I think there are some very good practices and that if there’s a perceived need from the audit community that the audit committees are not living up to their expectations, that’s maybe another problem, but it may be that it should be dealt with in a way apart from the communication to the auditor.

So again, I think this is good work. I think you’ve really drawn out a lot of the thing
that do need to be address that are that we all think about. Having guidance is absolutely essential. That’s your role. And I think you’ve done a good job on what you’ve produced at this point.

MR. BAUMAN: Don, thanks for those comments. And some of the other topics that, Don, you touched on two-way communications and others, we will have further sessions today to explore some of those concepts more in-depth.

We have I think about four cards up right now on this particular topic still on what are the right communications that audit committees want and what are the communications that investors want committee members to have? So I think I have Denny Beresford, Bob Dohrer, Kiko Harvey, and Hall Schroeder and--

FEMALE SPEAKER: Arnie Hanish.

MR. BAUMAN: And Arnie Hanish. Five cards. And then we’ll take a break, if that’s all right. So Denny?

MR. BERESFORD: Thanks, Marty. Just a
suggestion. If the PCAOB staff has not already done this, I’d suggest that you actually ask some accounting firms to show you the communications that they actually have with some audit committees, both for some larger corporations and some smaller corporation -- well, some smaller accounting firms. The -- as indicated in my earlier comments, my concern is that we just get overwhelmed as audit committee members. And particularly with written communications, I’m all for written communications, but the problem is if you think about it, we get four letters of representations each year, most of which frankly could take almost the entire amount of time that we devote to audit committees. I’m exaggerating just a little bit, but those things get very long. Very little has changed. The question is, is that a very effective use of our time as audit committee members to read all of those things? We get the annual engagement letter, where audit committee -- where audit firms sometimes try to sneak in CYA type paragraphs from time to time, Bob.
(laughter)

Not looking at you. You just happened to be the auditor for three of my four boards.

MR. KUEPPERS: That’s silly. That’s just -- I can’t imagine that.

MALE SPEAKER: That’s simply baloney. I can’t --

MR. BERESFORD: But again, a whole lot of boilerplate, very little changes from year to year. We get typically a quarterly listing of all of the, I think it’s SAS 61 and 114 I believe it is, if I’m not mistaken type requirements, much of which has not changed from quarter to quarter. We’re -- it’s usually exception type reporting.

Again, we read it all. We’re not sure exactly what it is that we’re supposed to be focusing on. Very little is being called to our attention. So the totality is that we have a lot of information to “read” or at least we think we’re supposed to read it all, but in the final analysis, there probably are maybe two or three little things buried and maybe, I mean, not exaggerating, maybe 50
or 60 pieces of paper that might be of importance to
us.

Now hopefully, if we’ve done a good --
have done a good job with -- as audit committee
members, and the engagement partner, the audit
committee chairs and engagement partners, we’ve had
them focus, at least we’ve had them yellow in them
or something like that. And that they’ve only
talked to us at the meetings about the things that
are important.

But this is part of the problem. And this
is part of the checklist mentality that there are so
many of these required things that just kind of bury
the time for effective communication.

So I really urge you to have the staff, if
you haven’t already done it, just look to see how
this stuff plays out in practice now, and consider
the fact that you’re going to add to it another half
dozent or 8 or 10 -- I don’t know what it is exactly,
but how these things would just be more of the same,
and just add to the fact that we just have this
amount of paperwork that doesn’t really communicate
-- doesn’t really add to communicate -- effective communications. It just is paper that’s not necessarily working.

And as I said -- as several people have said already, all audit committees are not created effectively are the same, I should say. And I’m convinced there a lot of people -- committees out there where the engagement partner just gets up and reads to the audit committee all of those detailed things from SAS 114 each quarter. And the poor audit committee members just sit there and take it. And that’s it.

MR. BAUMAN: Thanks.

MR. BERESFORD: End of sermon.

(laughter)

MR. BAUMAN: Thanks, Denny. A couple things. One, your point is certainly a good one about getting out there and looking at things. And we have looked at audit committee reports. And in some cases, many of us or some of us here have been involved in them in very large companies. And to some extent, some of the additional requirements
that were in here in our view were a reflection of what we saw some of the better audit committee reports, quite frankly, looking like, but just weren’t in today’s requirements. So in any event, but your point of making sure we’re looking to see what’s happening is a very important one.

Bob, you’ll have the first couple of minutes after the break to rebut that, all right?

(laughter)

Arnie Hanish?

MR. HANISH: Thank you, Marty. I’ll try not to be too redundant. But again, thank you. I think that over the blast -- having been in a financial management role for -- and interfacing with an audit committees for over almost 25 years, I think communications are clearly much improved from what they were 20, 25 years ago.

I think that the check the box mentality that I think many of us have talked about, I think Denny I think articulated it pretty well there right there at the end a few minutes ago. I think that what you don’t want is to have all of that litany of
activity in there, and then just going throwing it page by page or line by line.

I think that many of the suggestions that are in here are probably very positive. I think that I agree with Mike Cook in the sense that there needs to be a broader perspective on financial reporting. And specifically, maybe something around press releases and other business communications.

I think that -- I actually value the input that an auditor provides me as a member of financial management with regard to the -- their assessment of our communication in press releases in particular. And I over the years have found a variety of approaches taken by auditors, some better and some worse as to the amount of input they provide.

And I think that in an audit committee, remember, it would be helpful to get the auditors’ assessment as to the -- not necessarily the effectiveness, but you know, whether or not those communications, particularly the press releases, are in their view any way, shape, or form misleading, because I think in the end, some of those press
releases can come back to haunt you as a company.

And I think it’s good to have an independent view.

Now they’re not going to audit those press releases. I want to be careful, because I don’t want to necessarily create situation where there’s more opportunity for fees, but I think that the opportunity here for insight as part of the normal process that they go through, not just to tick and tie numbers, but to give me insights as to their -- and give the audit committee insight into the way things are being communicated and articulated are very important. Woops, are very important.

I also agree that I know we’ll be discussing two-way communications later, but it’s very important. I don’t necessarily agree that they should provide an assessment of effectiveness, but I think the important point is to have that dialogue, and also make sure that the audit committee members are versed -- sufficiently versed to answer an ask the right questions as part of a two way dialogue.

The world of accounting and financial reporting over the last 25 years has become so much
more complex than it was when I started in a financial reporting role, and had been an auditor for a number of years.

But many audit committee members, many, many audit committee members do not have the depth of background to even know what questions to ask in an effective way from a communications standpoint.

And it’s a rare situation in my view, where you get an audit committee chair that has the depth, the background, to even raise those appropriate questions with the auditor to the extent that they need to.

I’ve seen variety of audit committee chairs over the years. And most don’t have the effective background even, many do, but most do not to even ask and engage in effective communication on the topics that are so critical today and from an investor perspective, I would want my audit committee chairs, as well as those individuals designated as financial experts to be truly financial experts and understand the complexities
that we at management are having to deal with today
in order to perform their fiduciary role
responsibly.

And I just don’t see that consistently
across the board. And I’m not sure that that is
part of what we’re trying to do here. And I don’t
know how we get that into the spirit, but it’s
certainly not part of the standard.

I think that the idea that the auditors
would comment on the quality of financial
management, and I think that’s been discussed by
several individuals, is really critical.

I would welcome as a member of financial
management an in-depth review of--by the auditors
with my audit committee of the quality not only of
myself, but also of the staff and the depth of my
staff.

And I don’t see that happened well and
sufficiently. I don’t see it happen often enough.
And it’s not just a matter of a discussion around
well, how many people do you have certified? Or how
many internal auditors are CIA’s? It’s really a
question of having an appropriate dialogue around their experience level and the depth of knowledge, because as, again, in the fiduciary responsibility as part of this three legged stool, triangle, they clearly do have responsibility to provide an independent assessment. And as an audit committee member, I would hope that I would be getting that for my auditors as to the true depth of knowledge and capabilities and experiences, because you could have an internal audit group that has a whole host of individuals that are CPA’s or CIA’s that very few of whom ever spent a day of their life in public accounting and understand truly what it is to perform an audit.

Many large companies use internal audit as a rotational, educational activity to enhance the skills. But how many of those people have really been educated by CPA firms in the precepts of performing an audit and what to do look for?

And, again, going back to even my own staff, or staffs of people that are working under controllers, how many of those individuals have
really deep knowledge, 8, 10, 12 years of public accounting experience? There's a whole host --
world of difference between somebody who passed the CPA exam, only had a couple years of public accounting experience versus someone who truly does have the depth.

    And I just don't see those questions being asked of the auditors. And I don't see the auditors really becoming -- coming forward with those types of those comments.

    The other aspect is really more around,
and I think it's a responsibility of management, but if management doesn't do it, I think the auditor has to step in. And that's the aspect of education of the audit committee members. If management doesn't do it adequately, then the auditors have a responsibility to step in and educate the audit committee.

    Again, it gets back to the earlier comment that I was making around in order to have an effective two way dialogue, you really do need to truly have audit committee members that understand
what questions that need to be asked. So thanks for
the opportunity, Marty.

MR. BAUMAN: Thanks, Arnie. Bob Dohrer?

MR. DOHRER: Well, thank you, Marty. And
I’ll -- recognizing the time, I’ll keep my comments
brief, but just to pick up perhaps from the
perspective and an auditor a little bit of what
Denny and Lynn and others have referred to, and that
is the over communication, if you will, and just
cautions the board. I’ve heard some discussion
around in lieu of requirements, perhaps a more
principles based approach would be appropriate as to
what information should be communicated in the
proposed standard.

The caution I guess I have there is
knowing the animal that we auditors are, when
there’s a principle that’s indicated, normally,
there’s a hue and a cry for some sort of guidance to
go along with how you implement that principle.
Often, that results in a rather lengthy list of
items that you would consider communicating. And
oftentimes, the way the auditor may react to that is
that becomes the checklist, because particularly
with this subject matter, the auditor would
certainly be very concerned with not communicating
something that perhaps in hindsight, you know, could
have been communicated. And they simply made an
evaluation and a consideration that they didn’t need
to communicate it.

So I think that list of considers
potentially turns into the checklist, which results
in the expansive written type of stuff and bearing
the real important matters that need to be surfaced.

So I guess in summary like -- we’ve heard
tone at the top, quality of financial management if
the consensus is that that’s important information
that should be communicated in substantially all
cases, then let’s call it that, and make it a
requirement but be very careful about how we use
principles, unless the principle is that the auditor
should be prepared to communicate anything else that
the audit committee may ask.

But when we start down the list of what
that might be, in essence, we’ve turned it into a
checklist and a requirement that will lead to boilerplate and over communication.

MR. BAUMAN: Thanks, Bob. Kiko Harvey?

MS. HARVEY: Thank you for the opportunity to join in this roundtable. I think that clearly, this has been a daunting task for the PCAOB to write this, because in a lot of ways, you’re trying to regulate a relationship. And I think that’s a very difficult thing to do to get the right information in the documents. And so, I commend you for your efforts.

I have heard a lot about tone at the top. I want to remind people, I think of course that’s an important discussion for audit committee members to be concerned about. From an internal auditor’s perspective, we probably are in a -- in one of the best roles, along with the external auditors, to provide our views on tone at the top being that we’re in most of the management meetings on a day to day basis. We see the communications that go out at the company level. And so basically, we see it all.

And so, you know, if you’re not reaching
out to your internal audit teams to ask those
questions, and you’re relying solely on the external
audit group, you’re probably just getting part of
the picture. So you know, an important thing to
mention.

Regarding the quality of financial
management, I agree that that’s something that the
audit committees should be very concerned about. I
think that all in all, for most of -- large public
accounting or most large public companies, the
quality management is very good. I also want to,
you know, open the dialogue for the quality of the
internal audit team. I think it’s very important
that that is also considered. And I think that the
external auditors are probably in a unique position
to be able to provide even more insight into whether
the internal audit team is really doing their job
correctly, whether they have sufficiency of
resources, whether they’re actually focused in the
right areas.

And so, I think I would welcome that kind
of feedback from the external audit teams as well.
And I know that we do receive it in the company’s
that I’ve worked for.

So I’ll save my comments for later on. I
know we’re up against a break, but thought I’d share
that with you.

MR. BAUMAN: Appreciate your comments. Hal
Schroeder?

MR. SCHROEDER: Just one quick follow on.

Marty, you had mentioned that in your current
standards, you require an assessment of tone at the
top. And I have to tell you, I’m in the investment
world. And we go both long and short stocks. And
some of our best short ideas have been our own
assessment of tone at the top. So in a perverse
way, I’m glad things aren’t working so well in terms
of assessment.

(laughter)

I say that half jokingly, but truly, some
of our best ideas are looking at the interaction
between the CEO and the CFO. And I have to question
if I can see this, and I only have maybe -- meet
with a CEO or a CFO four or five times a year, see
him at a couple conferences, if I can see it, how do
the auditors and how do the audit committee not see
it? So something really needs to be addressed here.
And we've said it over and over again, but that was
part of a -- the quickest way to get to the point
that I'm making money off of people not doing their
jobs in terms of assessing tone at the top. So
maybe I'll retire after this but --

MR. BAUMAN: Well, I have to break the
rules here. There was -- those were the cards that
were up. And I saw one card came up late, but to
show you the flexibility of the organization, Sam?

MR. RANZILLA: Well, I appreciate that,
Marty. And I will be very brief and not discuss any
topic we're going to discuss later. As I sat
through this, and as I prepared for this, I thought
this first section was a place as an auditor it'd be
really important for me to hear what others want.

And so, as an auditor, I think that -- I
can stress that the relationship between the auditor
and the audit committee is a significant
relationship and plays into our ability as auditors
to appropriately dispense of our professional responsibilities.

And as a result of the importance of that relationship, I think as an auditor, I have my own views about, you know, maybe someday I’ll be an audit committee, and what I think is important. But I think at the end of the day, auditors want to provide information to audit committees that will help them dispense their responsibilities.

And I don’t know where that is, other than my own views, but I do think there is a pretty good rhythm today between audit committees and auditors with respect to communication. Could that be enhanced? Probably. I think your standards got to leave some flexibility with respect to the various requirements.

With respect to comments around writing standards to the lowest common denominator, I mean I don’t think I can emphasize enough how you cannot write standards to the lowest common denominator and expect a high functioning financial reporting regime. It just -- it simply does not work to write
standards—it does quite frankly, it doesn’t in most things in life, make sense to go to the lowest common denominator.

Ask a teacher if you’re teaching to the lowest common denominator, what that does to the overall class? And I’m not a teacher nor an audit committee member, but that hasn’t stopped me yet.

The last thing that I will say is, and something to consider is considering the varied comments around too much, too little. Once you adopt a final standard, whatever way you go, maybe this would be an interesting topic for some field testing post implementation to see whether or not you’ve hit it right.

I mean, obviously, you got to give it a couple of years to see, but maybe this would be a place where a post implementation would make a lot of sense.

MR. BAUMAN: Thanks. Thanks, Sam. And I want to thank everybody for the value of these comments during this very first session. Very, very thoughtful input and very valuable input for us as
we go back and consider the standard.

We’ll take a 15 minute break till about, according to my watch, five minutes to 11:00. And let’s try to back around then. Thank you very much.

[break]

MS. RAND: All right, welcome back. Marty asked that I start this session, which I planned to moderate this session anyway. So that works out perfectly.

The next topic is accounting policies, practices, and estimates. And this is an area where we had also received significant comments from commenters.

And your briefing paper includes an appendix, appendix A, listing paragraphs 12 and 13 from the proposed standard. And those two paragraphs have several requirements regarding accounting policies, practices, and estimates.

So that’s our focus of the discussion right now. Steve Harris, PCAOB board member will provide some introductory remarks. And then, I’ll walk through the questions.
MR. HARRIS: Well, thank you, Jennifer.

And I’ll be very brief. As you point out, for the next 30 minutes, we’d like to hear the group’s views on what you think should be the specific responsibility of the auditors to provide timely observations to the audit committee about accounting policies, practices, and estimates. And we’re particularly pleased that leading the discussion will be Mike Cook and Hal Schroeder. While the proposed standard retains and clarifies many of the existing requirements in the current standard, it also updates the standard by incorporating existing SEC communication requirements.

Several commentators have stated that the proposed required communications, and we’ve heard it this morning, strike the right balance and include important critical issues on which audit committees need to focus. Others, however, and we’ve heard that this morning as well, feel that the proposed standard may be too onerous for audit committees with the volume of required communications, potentially taking time away from more important
issues.

There were also concerns expressed that the requirements overlap with management’s communication responsibilities.

During the discussion today, we are seeking your input and as specifically as possible on whether the board should modify the proposed requirements. And in that regard, we are interested in understanding which additional matters the standards should require, the auditor to communicate if any, or perhaps which proposed or currently required communications should be eliminated.

So Jennifer, thank you very much. And I understand you’ll start the session off with a couple of specific questions.

MS. RAND: Thank you, Steve. We have -- we had three questions in the briefing papers. So I’ll put those up on this slide. The first one was how could the communication requirements be modified so that the auditor and the audit committee focus on the most significant accounting issues and estimates? The next one, how could the proposed
standard: clarify the types of consultations that
should be communicated to the audit committee? And
then finally, are there matters in addition to those
in appendix A, which are paragraphs 12 and 13 of the
standard that the proposed standard should require
auditors to communicate. And if so, what are those
matters? And why should they be required?

If there are any requirements that should
be omitted, why -- what are those and why should be
omitted?

So we’re not flipping back in between
these two slides as we’re going through the
discussion, we have a discussion summary slide,
highlighting those three points on here.

We have asked a couple of people, Mike
Cook and Hal Schroeder to provide some of their
thoughts on these questions to help open up the
discussion. Before I turn it over to Mike, I would
like as Marty had pointed out in the earlier
session, many had commented on that perhaps some of
their requirements in the proposed standard were too
onerous. Most of those comments like that were
directed at these specific requirements. And also, commenters indicated that management often has communicating these -- many of these points regarding accounting policies, practices, and estimates. So why -- it doesn’t make sense for the auditor to duplicate all of that and waste the audit committee’s time.

When we had drafted this standard, we had -- we recognized, as the board’s current standard does, that management often does communicate these type of matters to the audit committee. And we had a -- we think it’s a fix we can make through a drafting point, but many commenters seem to not pick up what we had intended, which was for the auditor to evaluate what management has communicated. And if the auditor believes management is appropriately communicated many of these items, they wouldn’t need to repeat it. It’s only in those instances if the auditor believes management hasn’t done an adequate job of communicating some of these items.

So just wanted to point that out. Many commenters expressed that concern. And we are aware
of that. So with that said, I’d like to open the
discussion and first turn to Mike Cook and then Hal
Schroeder to provide some -- your thoughts on these
questions.

MR. COOK: Jennifer, I’ll try not to
repeat some of the things I said earlier, because
some of the trains of thought are -- consist -- and
I always remember one of my partners said, if you
can’t be right, be consistent. So and probably not
right on some of these topics, but I still have the
same point of view.

A couple of the key questions about, you
know, the issues of what could we add, are present
requirements sufficient, and so on, I have a view
that the present requirements are in fact
sufficient. It troubles me a bit that we are adding
as we describe on page 3, these newer requirements
for the auditor if management hasn’t done its
communication job correctly. That doesn’t sit right
with me. And somebody said, we’ve got the emphasis
on the wrong syllable here.

I mean, we are telling management what
management needs to be communicating, even though we
have no authority to dictate communication practices
to management, but we’re doing that because we’re
saying if you don’t do it, the auditors are going to
be required to do it. And we write rules for
auditors, therefore, we can write the rules that say
if these things haven’t been done, the auditor will
do them.

I don’t think that’s the right thrust.

And I appreciate what Marty said earlier. And I
would just say, please, do give careful attention to
this question about management’s communication
responsibilities and not indirectly by writing rules
for auditors. If management fails, write the
communication rules for management through this type
of communication.

If you think that needs to be done, there
ought to be a forum to do it, but not back door ing
it through the audit communication process in my
judgment is not the right way to go about it.

Likewise, I think there are some things
that could be done with the focus on the audit. And
I continue to believe we need a broader focus on financial reporting. And Lynn and I will debate some parts of that later.

But I do think we need that broader view. And but focusing on the audit, there is one thing I would like to recommend be given consideration because Linda and I and to some extent Denny and others who were on the committee for the improvement and financial reporting labored long and hard and agonized over the issue of a framework for auditors to use and management to use. Management to use in the first instance to make judgments to make estimates. And auditors to evaluate the estimates and judgments that have been made by management in preparing the financial statements I think that would be a superb addition to this document, which would be inquiry or a dialogue between the audit committee and the audit firm about how the audit firm.

It could be the firm as a whole. It could be specific to the engagement or to a particular accounting or auditing matter. How does the firm
make the judgments? What is the framework for the
judgments that are made on the critical issues in
the financial statements?

   Seems to me that fits here, and would be a
nice addition to this dialogue that is not -- it’s
probably suggested in a number of places, but it’s
not addressed directly.

   Present requirements in most areas, I
think, are quite sufficient. I -- this doesn’t
pertain to estimates and judgments, but I would hope
maybe I realize some of the things we have are here
because of the requirements of Sarbanes Oxley.
They’re part of the law. Therefore, the audit
committee gets them whether the audit committee
wants them or not. But it would be refreshing if we
could find a way to in consultation and discussion
with audit committees, to take away some of the
things we don’t want, don’t need, and don’t know
what to do with when we get it. And Denny’s
reference to the representation letters, if we could
get a one paragraph summary of the things that are
new and different in some of these documents, rather
than receiving full text documents. And maybe we
have that flexibility and we’re not using it, but we
sure get a lot of things that I asked, and I think I
have a reasonable basis for knowing what to expect,
I asked why am I getting this? And the answer is
because I’m required to give it to you. And you’re
required to take it if I’m required to give it to
you, even if you don’t want it and don’t know what
to do with it.

To the point that Hal made earlier about
the notion about audit committees, there are audit
committee chairmen who know in addition to what to
emphasize to what to ignore. But there are a lot of
people who don’t have that same training and
background, who when they get a 40 page
representation letter four times a year, presume
that there must be something there that they really
need to know something about and then are encumbered
with the burden of reading it, and trying to
understand it.

And it would be so much better if those
communications could be streamlined, focused on
things that are new and different, which goes to the
point of how do you focus on the things that are
most important? Don’t burden people with things
that are not most important. Or do it in such a way
that it is highly efficient. And best practices can
hopefully convey some of that information.

So I’d like to see us get rid of some of
the existing practices. I would very much like to
see us focus on the judgment framework being a part
of the communication process between the audit
committee and the audit firm, because it is related
to the audit and the process that has followed in
doing the audit.

With respect to this question about
consultation, I think it’s a very good thing. I
think the idea of if there are important issues that
the firm has engaged others, whether they’re
industry specialists, senior partners in the firm,
or the engagement team has brought others to bear on
reaching important judgments and important
conclusions, I think that’s a very valid thing for
an audit committee to have an interest in the
dialogue. Trying to define it, and defining it in some ways with references to things like informal conversations, I really don’t think, particularly if the notion might evolve, that it would have to be a written communication subject to 14 review process, I really don’t think I want to be on the receiving end of a communication when the lead partner decides to call somebody that they happen to know in another office to get an insight on an industry issue or something of that kind.

I would again urge that we write the principle of what we’re trying to achieve. We’re trying to achieve a high level, better level of knowledge, transparency at the audit committee on important issues that the firm has wrestled with. And presumably, management has wrestled with as well. Right the principle and let the firm decide what it is that should be communicated to the audit committee that meets that requirement, and not try to write if it takes more than 15 minutes, or if there are more than three people involved, if it is somebody who’s more than 100 miles away, however
else we might define this consultation, leave that out and let the firm decide what is important to communicate to the audit committee.

And then in the interest of trying to think of something that I would like to suggest we don’t need, there is something, I think it’s in -- back on page 13, which struck my fancy in this new things that we’re going to communicate under accounting estimates. If the auditor determines that potential bias exists in management’s accounting estimates, to begin with, I probably don’t think the auditor needs to be making that determination, but I have never seen an accounting estimate for which there is not potential for bias. I mean, that is the inherent nature of accounting estimates that that potential exists. And it’s that kind of a rule or that kind of an auditor determination requirement that leads to a great deal of consternation effort, cost and little of value.

If management is consistently making judgments with a bias, which produces an overall bias in the financial statements, and you feel that
needs to be communicated to the audit committee, I could understand that and support it.

Every estimate that is made, that has a potential for bias is every estimate that is made. And I wouldn’t suggest that that would be a step forward.

Overall, I mean, I think most of what we have today is good, works well. I’m concerned as an audit committee member of the back dooring management communication requirements and the specificity that this gives to what an audit committee is going to receive that an audit committee may not have decided it needs in a particular situation, and transferring that responsibility to the standard setting process, I think is going a little further than we should.

MR. SCHROEDER: Thanks, Mike. And I had the same observation. I thought all biases are -- there’s a bias in every single estimate. So.

Unlike a lot of you around this table, I don’t spend 100 percent of my time thinking about accounting and auditing issues. I spend maybe two
percent of my time. And so, I apologize in advance, but I’m going to give you kind of my perspective on this.

As I read appendix A, there are three things that really struck me. The first was the volume of information. It was just overwhelming. And it seemed to be extremely technical.

The ability of the average audit committee member, I think it’s going to be beyond the average audit committee member to understand the implications of what’s being said.

I know how much I struggle today with accounting issues in trying to understand the intricacies, and how they affect accounting estimates and other things.

But the thing that really struck me most about this three page excerpt was that the use of the word significant and critical in a three page document, it was used, those two words were used to combine 24 times. If you’re counting, it was 10 significant and 14 critical.

So I started to think about what do those
words really, really mean? And I had trouble answering it, because I couldn't get over the first part of the question.

The first part is significant and critical to who? Is it to the auditor? Is it to the audit committee? Is it the board? Is it the management of the firm? Or is it the investor?

And I stumbled on the word investor because is it a fixed income investor? Is it an equity investor? If it's an equity investor, is there a long only equity investor? Or is there a long short equity investor? And you can go on and on and on.

There are multiple layers. What it reminded me of is a speech I gave to my old firm Ernst and Young. I had spent 13 years there in both practice and national office. And then a few years later, I was a sell side analyst on Wall Street. And they asked me to come back, and basically give a speech somewhere along the lines of what have you learned that you wish you knew when were an auditor? And I thought about it for a second. And I actually
drew a little graphic here on my paper to help me remember what I thought about, but really came down to communication.

What I did not appreciate at the time, I as auditing, was the level of communication that was outside the company. So you’ve got not only the auditors talking to the audit committee and management, but you also have functions within management, particularly investor relations, talking to the investor community, talking to fixed income, talking to equity investors, understanding what their issues are.

And it really came home to me last week when I listened to a presentation last week by a very well known CEO last Tuesday. And he said he came back from vacation. And he sat down with investor relations group and had them put down on a piece of paper what were the critical issues that investors were asking about? This whole wide range of different types of investors. He says I want to address each one of those today.

And in doing that, what he did in
literally about 15 minutes was knock off every single critical issue that the large investor base was thinking about.

And the advantage of it to the company is that investors don’t all think alike, but they come at each company with a wide range of perspectives. They talk to probably more people at a higher level than a lot of audit firms do.

I know when I was auditor, if I got to talk to the CFO or the CEO, that was a really, really big deal. I was usually dealing much lower in the organization.

As an investor, if I’m not talking to the CEO or CFO, I’m talking to a head of a line of business. Very, very different perspectives. And the communication is very, very different.

So the questions that I’m asking then that the investor relations people would do or diligently recording give you a tremendous perspective on what I think is significant and critical, what will move the stock the next day when they say something.

So what I did was I called around or had
some of my team call around to a couple of the large banks that I follow ask them, how do you communicate information questions that we have? And some of them had some very clear routines of not only the CFO and the CEO, but also the board and the audit committee in particular.

Other companies had no real routine. So as I looked at this, I would focus on things like significant and critical, who is it significant and critical to? And how could that massive list of what we think as investors is significant and critical, how can that -- how is that or how could that be effectively communicated, not only through management, the board, and the audit committee, but also to the investor or, excuse me, to the audit firms, again, it comes back to that I wish I had known certain things when I was auditing. It would have given me a lot better sense of what truly was significant and critical.

MR. BAUMAN: Thanks Hal and thanks Mike.

One thing I just did want to point out, probably wouldn’t beyond me, Mike, to try to back door
something into this, but the board wouldn’t let me
do that.

These issues in paragraph 12 were things
that we think should be communicated by the auditor
to the audit committee. It’s just we we’re
reflecting our knowledge of practice. And that is
that in many cases, management does make these
communications. So rather than duplication, we
indicated if management makes them the auditor,
evaluates them, but we really weren’t trying to
require a management communication. There were
things at least from our perspective in writing the
standard, we thought the auditor should communicate.
So that was the purpose there.

With that, is that your card, Charley?

MS. RAND: No, it’s Denny.

MR. BAUMAN: Oh, Denny.

MR. BERESFORD: I’d like to build on I
think both what Mike and Hal said. In my letter, I
strongly recommended that you delete paragraph 12B,
critical accounting estimates. And there were
really a couple of reasons.
Number one, I think that, again, this is part of the overall notion of there's just too much in the requirements, but Hal had an interesting point. And that is that to the extent that some of this information is useful, it's useful on a much broader scale. It might be useful to investors, for example.

In thinking about this, these are new requirements for the most part. Description of the process used by management to develop the critical accounting estimates, have various selections within the range would affect the — basically the PCAOB is setting accounting and/or disclosure requirements here, except they're not disclosing them to anybody except the audit committee.

And it seems to me that the appropriate way to go about this is that the SEC ought to be thinking about these kinds of things for MDNA, for example. Or the FASB ought to be thinking about them for purposes of footnote disclosures. Frankly, I think that it goes well beyond anything the FASB should be interested in right now, but possibly the
SEC might be interested in some of these things.

But it just doesn’t strike me as the kinds of things that the PCAOB should be asking auditors to be focusing on.

Now I recognize Marty has made this point a couple times already that it’s stated in the context of we really think that management should be thinking of these things. And it’s only if management doesn’t bring in to the attention of the audit committee, then the auditors should.

Frankly, that’s stated as the last part of this paragraph. I would make the change and put that as the first part of the paragraph rather than the last. It think that would be an important emphasis change.

But mainly, I think that these are matters that are getting well beyond what the responsibility of the auditor should be, and are expanding frankly requirements even beyond what management needs to do with respect to most of these things.

These are kind of interesting things in some respects. I don’t really think that it’s very
practical. I’d be interested in Arnie and some other people’s comments on this, but to the extent that, for example, what various selections within the range of estimates would be, that’s -- that could be an endless range of possibilities. I will tell you, for example, for Fannie Mae’s loss reserves of $60 billion right now on a $3 trillion book of business, there are lots of possible outcomes of that. And I don’t know how many different possibilities that either Deloitte or internal financial management could come up with there, depending on different assumptions that would be made.

And that’s obviously an extreme example, but even in the simplest situation, I suspect there would be many different possible outcomes. And I think that each of these is fairly subjective. And they’re kind of nice to know types of things, but just go beyond I think what really is necessary and add to the burden.

MS. RAND: Denny, I’d just like to point out, many of the kind of -- and as Steve had

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mentioned, when we were working on the proposed
standard, we looked to the existing standard, the
requirements in there now, plus recognizing Sarbanes
Oxley and SEC Rules. There were additional
communication requirements that aren’t reflected in
the board’s current standard today, but which
nonetheless impose a responsibility on auditors to communicate to the audit committees.

So the requirements, I think, when we had expanded on, but regarding critical accounting policies and critical accounting estimates, those were derived from the SEC’s rules.

So we incorporated those into the standard to make it easier for auditors to have that direction in one place, make sure they weren’t missing any of the communications. But they’re largely derived from requirements that exist today, but from the SEC.

MR. BERESFORD: Suggesting that 12B is all required by existing standards? I tried to check back that, and I was not able to do that. It’s a little confusing, but I tried very hard to go back
and forth between existing standards and existing SEC rules. And 12B kind of eluded me, but I’ve -- I thought that much of it was new.

MS. VANICH: Yeah, Denny, I just -- 12B, a good part on accounting estimates is relatively new. It would be B 2, 3, and 4. Those are relatively new. I think 1, 2, and 3, are fairly closely tied to what the auditor’s required to do now to audit fair value estimates.

It’s 13B and 13E that are current requirements in the SEC rules. So critical accounting policies and practices and alternative treatments permissible under GAAP.

MR. BERESFORD: I was speaking more of the communication requirements, not what the auditors’ requirements were.

MR. BAUMAN: One of the -- I appreciate the input, again, Denny. It’s very valuable. We are observing some of the ways in which FASB’s going and communicating to investors is emphasizing the importance of disclosures to investors around ranges. To your point, very difficult to get to
that one number of $60 billion I think you said on
the multi trillion dollar portfolio. And there’s
probably a number of reasonable estimates, other
than that number. And similarly with respect to
fair value and FASB’s most recent proposals, is a
requirement proposed for disclosures to investors of
other reasonable values that could have been
selected in addition to the one that was selected.
And I guess the point in there is in
communicating to you the audit committee or
shareholders that none of these numbers is the
precise number. And there are very wide ranges
today with these areas of measurement, uncertainty
and the better informed that either audit committees
or investors to understand how wide those ranges
might be, and why management selected the number
they did is -- seems to be an important factor in
where FASB’s headed with some of their disclosures
and informing our thinking to some degree here as
well, but thank you for those comments.

MS. RAND: Okay, we have several tent
cards up. So I’d like to get everyone’s thoughts.
Jim Cox?

MR. COMR. BAUMAN: I was going to address Hal's concern. When I read this, and this could be just the wisdom of the parable about the blind man and the elephant, because we want to make sure the language overcomes the parable.

And that is that when I read and have read significant or critical, I thought it was vis a vis a fair presentation of the financial statements. Not the end user, or not to management, nor to the audit committee, but for the matters for which the auditors are rendering an opinion, which is that the financial statements fairly present the financial position and performance.

And then, on Denny's point, I think it is true, Denny, that this does not -- is not a mirror image of the SEC rules about this question, which is implementing not just Sarbanes Oxley requirements, but it goes back to earlier to the exchange listing requirements that were there before SOX mirrored this same requirement.

But I think what it's really seeking, and
again, I -- this may just be the blind man and the elephant and maybe we see if we want to clarify that with language, is to make sure that this discussion, which is mandated between the auditor and the audit committee is as intelligent as it possibly can be under the circumstances. And I think that that’s why you want to have some emphasis here as to the accounts.

Now the devil’s in the details. And about what we mean by significant and critical. And there’s lots of methodologies that could be employed there.

And -- but the important thing is that the auditors engage the audit committee in a discussion about how a handful of estimates or judgments or assumptions could very much change the presentation of the firm’s performance and position. That’s the point, I believe.

MS. RAND: Thanks, Jim. Arnie Hanish?

MR. HANISH: Thanks, Jennifer. A couple of points. So I think that as it was pointed out that these are suggestions and that if management --
these are management’s responsibility to a large extent. And if management doesn’t do it, then I think the auditor clearly has the responsibility to jump in.

But one of the points on -- as far as the requirement to get to I think it’s your second question there around consultations by the auditor outside of the engagement team on significant matters, I’m troubled by what’s written on page four, where it says proposed standard also added a new requirement for the auditor to communicate to the audit committee any consultations by the auditor outside the engagement team related to significant accounting matters. I’m really troubled by the use of those words, any consultations. I mean, again, there ought to be a degree of materiality, significance.

There are many requirements today that auditors have to go to their national office for consultation on matters that at least with regard to the companies believe may not be as significant, but they are required to go to their national office,
because it’s a CYA to some degree.

And so, I would be very cautious with the way these words are written by saying any consultations. So I would suggest that be modified.

I think that I am extremely troubled by the reference with regard to the range of outcomes on accounting estimates. Whether the FASB is headed in one direction or not, I think it’s a -- I don’t think we’ve seen the last of the discussions around that as far as providing ranges of outcomes in our financial disclosures. So I think that is fraught with issues. And I would hope that we wouldn’t necessarily see alternative numbers appear in our financial reporting disclosures around accounting estimates because then that just opens up a whole can of worms as far as the litigation issues around well, why didn’t the company book this number versus this number versus number? These are generally accepted -- these financial statements are fairly presented under GAAP. We all know there’s a bunch – – there’s a whole host of estimates that embedded in these numbers. And we believe they’re reasonably
materially correct. Auditors audit those numbers. Agree that they are materially correct and in accordance with GAAP. And that really should be the end of it, in my view.

Again, I think if the audit committee wants to understand what were or what were the thought processes that went into a determination of judgment, whether it’s Fannie Reserves or in our case, you know, it was reserve set up for a litigation on product liability cases. It’s certainly within the purview of the audit committee to challenge us as management to sit here and review with them the rationale behind how we came to the numbers that we came to, because there are a whole host of assumptions that -- and outcomes that can take place.

But I think for the auditors to have to provide judgment on that, they have provided judgment. They’ve certified our financial statements. And that should be sufficient in my view. Thank you.

MR. BAUMAN: Thanks, Arnie. Just one
clarification, and you did pick up a good catch with
the addition of the word "any" in the briefing
paper, which is not in the standard itself. So that
was a good catch, reading catch on your part.

But it does go on to say that any
consultations related to significant accounting
matters. So I agree with you, it's not -- it's any
consultations didn't belong near the word any, but
the word significant accounting matters does belong
there.

But still, I think the point is we did get
a number of comments regarding what you said. And
that is that there's a lot of consultations that
maybe required by firm policy that the audit
committee doesn't need to hear about. So it's still
an important point for us to rethink as we go
through this. Thanks.

MS. RAND: Thanks, Marty. Hal, I think
you were trying to get my attention earlier. Maybe
to respond to Jim?

MR. SCHROEDER: I just wanted to respond
to Jim's comment about significant. When I think
about significant, it really varies from period to period, quarter to quarter, week to week, month to month. I’ve been somewhat cynical about this. When I talked to our investors, I tell them that, you know, the market generally can only think about one issue per quarter. And that may be even being a little generous.

So significant and I’m thinking about MPAs for banks or net interest margin, they’ll pick one issue and really hone in on it.

So if you’re -- if the management is dealing with is this a nonperforming asset or not, small -- the degree of significance drops a degree or degree of materiality drops tremendously if the entire market has built up an expectation about something.

If the market is not focused on it, you can actually argue that materiality can widen out and in less will bother the market.

So you’re going to map this fair presentation concept against I think market expectations. And then I, again, operate under the
assumption that all things are estimates in the balance sheet anyway.

So you know, we may be looking at MPA’s and looking for a call in the turn of a market. And we saw this earlier this year. MPA’s started to stabilize. And all of a sudden, people got all excited. And they ran banks up for a short while. Was that the right answer? I think that if I were an audit committee, I would be looking at that number and that estimate in that quarter a lot harder than I would have in the middle of when times are very good. So it’s a moving -- basically significant and critical are moving targets.

MS. RAND: Okay, thanks. Just for a time check, as I’m sure you’re all aware, we are over our estimated time or our agenda for this morning, but this is also very important area that we received comments on. So we want to continue this discussion until noon and then we’ll reevaluate our agenda for the afternoon after lunch.

So moving on, Joan Waggoner?

MS. WAGGONER: Thank you, Jennifer. A
couple of things. I first wanted to say that I
really enjoyed Arnie’s comments on the range of
outcomes. And certainly, I’m in agreement with
those.

I would also say that with respect to this
item alone, I believe there would be a significant
cost factor associated with being responsible for
the developing of that data should we need to do so.

Secondly, as I was going through
paragraphs 12 and 13, I was trying to picture myself
in an audit committee meeting on either side.
Didn’t matter which side it was going to go on. And
I was trying to sort of see how is that meeting
flowing along? And so, I’m picturing a conversation
starting to develop with the discussion of
accounting policies and moving on to critical
accounting estimates.

And then it comes back, again, to another
concept of critical accounting estimates in the next
section, and so forth and so on.

And so, I found that I could get really
kind of muddled up in terms of what I’m talking
about at any particular point in time, and whether or not this section of the meeting would actually be effective in terms of actually achieving a good communication.

What it seems to me that could be done to really significantly improve paragraphs 12 and 13 is to integrate them, so that there is a more natural flow between this concept of significant and critical as you organize it to have just one discussion on the topic, rather than having to go back and forth in terms of identification versus what the auditor thinks about them, and so forth and so on. That just might make for a little bit better of a flow.

And lastly, with respect to consultations outside of the engagement team, and for my size, we are a single office firm. Basically, I kind of am the national office. No disrespect to Mr. Ranzilla, of course. But --

(laughter)

And so, what we have on our publicly held engagements is we have an engagement partner. And
we also have the engagement quality reviewer. And I am neither one of those. So I always consult on the financial statement side and review the filings.

So we have three partners that associated with our publicly held filings. And so, just as a matter of course, since we are all in one office, and we can easily find each other, I am consulted fairly frequently in terms of let’s just talk it out. Have you ever seen this? I also have what I would call a consultation network, which is outside of the firm, that I also bounce things off, which is calling someone else and said have you experienced this before? And what would you do, which is more in what I would term educational rather than saying in the set of circumstances, what would you do?

And so, someone earlier had suggested that the -- it be written more in terms of the principle involved. What is it -- what issue is it that you really want to address here? What is it that the audit committee wants to know? And I would say what the audit committee probably really wants to know, whether -- which were the close calls, which were
the tough call, which were the ones? And certain things about consultations are just going to emanate very naturally from such a discussion like that.

And so, one of the things that struck me in various places throughout the standards that sometimes, you know, the standard -- proposed standard is asking about the source of the issue, rather than the issue itself. And I would say if you wrote the principle to just address the issue itself, it might focus things a little bit more in the meeting. Thank you very much.

MS. RAND: Thank you. Linda Griggs?

MS. GRIGGS: Thank you, Jennifer. I just wanted to point out, I think those criteria in 12B are really consistent with the SEC’s MDNA requirements for disclosures about critical accounting estimates. And given that I think critical accounting estimates are the most important thing for the financial statements, it doesn’t offend me in one bit to have these identified in the standard as being very important items that should be addressed if either management has not addressed
it, or there is something that the auditor wants to supplement.

I do agree with the points about the different outcomes. And unfortunately, the SEC has tried over the years to get good disclosures about what would happen if the assumptions used in critical accounting estimates were changed. How does it -- how would it differ? And by and large, those disclosures are pretty weak. And I don’t know whether this is an exercise that management typically goes through or not. I don’t know, I mean, in the first instance, it should be managing making a judgment as to whether it should be going through that exercise.

I agree that it shouldn’t be the auditor going through that exercise, but to the extent management didn’t go through that exercise as an audit committee member, you probably want to know why, and whether or not withstanding not having gone through the exercise. Everybody was comfortable with the judgment made. Thanks.

MS. RAND: Thanks, Linda. Don
Nicholaisen?

MR. NICHOLAISEN: I’d like to support Mike’s comment, which I think other’s have as well about the consultations and what’s the reason for the consultation as opposed to trying to dictate something too finite.

I also say that from a slightly different perspective. And it may just be my own oddity, but I would be -- one of the things I always do want to know is who else did the auditor consult with? Because my expectation is that there would be broad consultation in areas that are difficult or complex. And that would take place. And it’s sort of reaffirming to me to know that they bounced off their national office. They’ve also talked to some of the other firms. And they have a pretty good idea of what the key elements are that ought to be considered, and that they’ve thought about it, then they can give a reasoned professional judgment as to why our company is in a range of acceptability.

The other thing that I would comment on is that I think we’re looking for those things that are
really out of the mainstream. So if there’s an
oddity in the accounts that were not where’d you’d
expect it to be, that that conversation would take
place as well, and that it wouldn’t just be so
mechanical sounding. I don’t think that’s the
intention here, but you could get there.

   It’s not the mechanics. It’s the really
living discussion of what took place, what was
critical, and what wasn’t important, and what was
thought about, and how do we go through those
estimates?

The last point that I would make, and it
may be outside the parameters of this document, but
it troubles me that in financial reporting, in the
public world, audited financial statements, that in
things like we’ve lived through in subprime
mortgages and other areas, there are incredibly
different ranges of estimates for precisely the same
characteristic securities that appear in financial
statements all labeled fair value. And all
receiving a clean audit opinion.

   And same audit firm for I’m sure signs off

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many different values for the same security,

depending upon what their client is.

And I think that denigrates the value of
financial reporting. I think it causes people to be
skeptical about what the process is, how it works,
why the auditors don’t have stronger views, how it
gets articulated.

I certainly would want to know where our
company falls in the range of what is acceptable to
that particular firm

And also, within the industry, but I think
so does the investor. But I think it’s critically
important that at some point, where we have this
range of estimates that are out there, that there be
sufficient guidance to the audit firms. And I think
it has to come from the PCAOB as to what do you
accept and what do you not accept? And how broad
can that range actually be?

And I know in the early days in ’08, that
the ranges were just incredibly broad on what was
accepted. And it’s probably narrow it down now, but
that’s troubling to those who are trying to rely on
financial information.

MS. RAND: Thanks, Don. Gary Kubureck?

MR. KUBURECK: Thanks, Jennifer. It -- in the interest of time, I’m going to limit my comments to only your fourth question about how to clarify what consultations are required to be brought to the attention of the audit committee. And I’ll spend almost all the time on I’ll call it management consultations as opposed to auditor consultations.

And some of this included in my comment letter, but I would repeat some of it as well, is that I would advise the board to be very careful on how you define who is an accountant that management might have a consultation with. I think it’s a no brainer if it’s in the form of someone who is a potential to be a new auditor, the opinion shopping type role. And I don’t think anyone here would disagree with that.

But then as you start going down to -- there’s other accounting firms out there. There’s boutique firms that only do accounting research. They have no ability, no intent to practices and
auditing CPA firm. Is that the type of accountant you have in mind.

So a company might decide it’s cost effective to in effect outsource the really technical research is their view of cost and benefit and skills that are available to them.

I would submit, as long as the managing committee or the board sort of knew that’s generally how finance was operating, or organized, I would that would probably be sufficient.

And your question 12 in the March release talked about non accounting firms such as consulting firms. And again I think in the ordinary sense, maybe not in every instance, but the ordinary sense, I wouldn’t think those consultations would normally be advised, would not normally need to be advised to the audit committee.

Give you an example. Actuarial firms as you very well know, FAS 87 and 106. And the largest actuarial firms, I would submit, know it better than the national offices do. So that’s their job to understand this thing. Likewise, I think the large
law firms understand FAS 5 and range of possible outcomes in remote and regional probable litigation settlements and so on.

So I think that’s all part of the management process of who you engage to help support your business. And I think there’s other examples. There’s valuation firms, who may or may not know FAS 157 very well, but they certainly presumably, if they’re a proficient firm, understand how to value in some capacity the instrument in front of them.

So, again, I don’t think that’s something the audit committee would not normally need to hear about absent some significant problem in that area.

One thing I did wrestle with, it’s not in my comment letter, is what do you do when you’ve got a firm on contract to you, who might have an independence issue, but you consult with? Might be best to explain by example. And we’ve got our independent accounting firm, but we’ve outsourced a large portion of our internal audit work to another big four firm. And we do routinely talk to them. We actually don’t go to them for accounting advice,
but it doesn’t mean those questions don’t come up from time to time, the context of an audit finding. And we have another big four firm who does various go to market activities with us at the moment. So again, I would think in either of those cases, the go to market or the internal audit, they would have a significant independence issue today of which some of it might be able to resolve if I stop into work tomorrow. And some of it might need a block of time before they could potentially, you know, pick up the audit.

So, again, I’m not suggesting what the answer should be, Marty. I’m suggesting it should be addressed if -- otherwise could do an audit, but it’d block from independence reasons that may or not be curable.

And then, with respect to the auditor consultations, I’ll just make it very quickly, I think many of the people in the room have made the point. You really want to hear about the things the audit engagement team wrestled with and lost sleep over. And there’s a lot of routine stuff that goes
on, including education amongst the staff members and so on.

And we as a multinational, we view it that we hired the firm. And all the firm’s resources, in fact, would strongly encourage national office and other specialty consultations, but it doesn’t necessarily immediately follow the audit committee needs to be advised every one of those, because a lot might be routine or ordinary course of business.

And again, you’re back to you want to hear about the ones that the firm engagement partner lost sleep over. Thank you.

MS. RAND: Thanks, Gary. I had a just a -- just to make sure I was clear in your point, I think I am. The -- you were talking about management consultations with other accountants, which in paragraph 15 of the standard, I think. And you know, just so everybody’s clear, we did not specifically ask that -- we weren’t considering that to be included as part of this discussion. And certainly appreciate your views. But we didn’t specifically tee that up in the roundtable specific
question because we got pretty consistent feedback similar to the comments that were -- 

MR. KUBURECK: I’m sorry, that’s the only place I saw consulting with outsiders in the document. And I just didn’t read that closely. I’m sorry.

MS. RAND: Okay, very good. All right.

MR. BAUMAN: Can I just add one more comment. I -- what I’ve been hearing from a number of parties is it’s the language that becomes a little tricky, whether it’s the word significant or something else, many of the people around the table are saying they want to hear about that matter that’s the close call that’s being discussed with national office. And audit committee members want to hear that. They’re trying to wrestle whether that all significant consultations on significant accounting matters equals that or not. And so, it’s -- I think the important aspect for us to take away on that is, yes, a lot of people want to hear about those close calls. How we articulate what that is in this standard is the challenging thing. So thank
you very much for those comments.

MS. RAND: Sam Ranzilla?

MR. RANZILLA: Well, I think that -- I want to make just a couple of points in this area. And I think this was a really opportunity that maybe could be lost of revisiting some of the terms that are used in here. I mean, Hal, I think your count was 24 significant and critical. I'm going to do this at the danger of having two former chief accountants at the SEC in the room, one really close.

(laughter)

But exactly what is the difference between a critical accounting policy and a critical accounting estimate? What is the difference between a critical accounting policy and a significant accounting policy?

And I will tell you having been involved with writing guidance for our people over the years, you know, people will get into debates for days about whether it's a significant accounting policy or a critical accounting estimate, and whether or
not you fit into this bucket or that bucket with respect to a particular matter. And then, you know, most of the time, is it important? Yeah. Well, then just get on with it, right? And let’s go ahead. It doesn’t matter if it’s A or it’s B. It’s important.

And I have struggled with this. I think critical accounting estimates, critical accounting policies have been added to the vernacular as a reaction to a situation. And I just wonder if we could, because I think we all agree, I shouldn’t say that, I think some people agree that what paragraphs 12 and 13 really go to, however you structure them is where is an auditor? Did you devote the most significant amount of your time? And where at the end of the day did you, this is a very eloquent term, but did you go?

I say this is a close call. This -- there’s a range. I’m not big on ranges, but there’s a range with respect to a matter. I might have consulted outside the audit team. I might not have.

But what was the most significant
decisions that you made, and the ones with the most
measurement uncertainty associated with it? I think
that’s what we think audit committees ought to know.
And I just think we’ve cut and paste from a number
of different places. And I just think maybe we’ve
lost an opportunity. I think that includes a
discussion with the SEC about some of their terms.

As it relates to -- I don’t think you’ve
asked this question, so a little value add. I’ll
tell you one of the things that does concern me
about the standard is trying to apply paragraphs 12
and 13 four times a year on each interim period.

I mean, if you just pick out one critical
accounting estimate, any significant change to
assumptions. I don’t know what’s critical
accounting estimate doesn’t have a significant
change in assumption?

At least quarterly, maybe not -- maybe
actually more often than that. And I think on a
quarterly basis, we could have toggled this thing
way too tight in terms of compliance on a quarterly
basis.
Last item, consultations and reporting. I think the standard as its written, I can implement it to make sense. The only thing I would caution you is for those that do have concerns, we shouldn’t do anything in an auditing standard that will reduce people’s comfort with consulting outside of their engagement team. Because I have read some comment letters that said, you know, we think this might cause people, because they don’t want to communicate when they consult outside the team. They have discomfort with that, that it might reduce consultations.

I have never seen an issue that is benefited by reducing consultation within our firm. There’s always limits to what makes sense. But at the end of the day, the more people you talk to, the more knowledgeable people you talk to about an issue, usually, you end up at a better place. And I wouldn’t want to see us do anything whether -- I don’t feel that concerned within my own firm that that would happen, but I read enough comment letters that I would make sure that that didn’t occur in --
whether it’s smaller or different situated type
firms. Thanks.

MR. NICHOLAISEN: Not responding as former
Chief Accountant, but this -- the thing that as an
audit committee member, that I am extremely
interested in is does the auditor understand the
issues? And did they deal with them? And did they
reach a -- did they have the basis? Can they
articulate the basis for their considered
professional judgment as to the conclusion that they
reached.

And so, while in a sense, you’re talking
about that level of communication, the communication
that I’m trying to understand is I want to be able
to evaluate did this audit firm do the job that I’m
expecting them to do? And have they covered the
areas that I’m particularly interested in? And if
the answer to that is no, then we’re back to, you
know, it’s not a communications issue. It’s a
matter of you got to go back and convince me.
You’ve got to build that trust. That relationship
really has to be there.
And a lot of that is hard to write in an auditing standard. And I know that the auditors may take offense at, you know, an attempt at communication as being at least one person’s tool to use to understand did they get it? Did they -- are they doing the things that they really need to do? And I just throw that in because I wanted to respond to Sam’s point.

MS. RAND: Thank you. Roger Coffin?

MR. COFFIN: Thank you. When you look at over the past 25 years, what are the jobs of the board of directors, probably the first one is to select the CEO and the management team, and to make sure that the CEO and the management team have the proper ability to do their jobs.

And really, nothing in Godfrank (phonetic) or Sarbanes Oxley has supplanted that role. And so, when I look at, and it was discussed a little bit, but to come at it from the -- a perspective of a board member, this concept if management has not adequately communicated some of these disclosures, if I’m a board member, and I’m hearing that, reading
this standard, I’m saying to myself, somewhere along
the line, my auditing firm has made a judgment that
my auditor has not done a good job of either
disclosing or has not communicated in some way. And
I think what that really get the point to is that I
would almost be duty bound at that point to ask why
as an audit committee member. Does management not
have the appropriate tools, you know, do they not
have the budget? Do they, you know, what are they
missing? Why am I getting this from you when we all
agree that these are good things to understand. And
I need to know this to be informed. Upon what basis
is your judgment made?

So I’m wondering if there could be some
drafting or there could be, I don’t know, maybe the
way to put it almost like the gateway question into
this is that the gateway question is, you know, does
in the auditor’s judgment, does management have the,
you know, what I’d call the suite or the tools to be
able to make all of these things? And it gets a
little bit I think to what Don was walking about,
the peer group, too, because that’s another thing
that I would like to know. You know, how are our -- how is this being made in relation to peer group estimates and so forth? So I guess that I think from a standpoint of oversight, you would want to know one, why this is happening in this context. And then, the broader question of are there any structural deficiencies in this process from the auditor’s perspective? Thank you.

MR. BAUMAN: Thanks, Roger. I wanted to go back to one thing that Sam raised before, if I may just to clarify a little bit for the rest of the group. And I’m sure Sam knows this. We were -- we tried to be relatively careful not to change the responsibilities of the auditor with respect to interim reporting and the responsibilities on quarterly reporting. But I guess your point is to the extent we changed some of the requirements here in this proposed standard, compared to existing AU 380, that makes the communication at interim some additional communications possibly.

But the context, though, is similar to what is in existing auditing standards today. The
standard with respect to interim financial
information deals with communications to audit
committees. and the existing standard says that,
you know, when conducting a review of interim
financial information, the accountant should
determine whether any of the matters described in
existing AU 380 communications with audit committees
relate to financial information that the audit
commitee needs to be aware of, such as how
management formulated particularly sensitive
accounting estimates, etcetera.

So the concept is still there in the
existing interim review requirements by auditors,
but I guess the point being that to the extent the
requirements are more extensive here, it just makes
the interim burden a little bigger. But there is a
similar requirement today.

MS. RAND: Lynn Turner?

MR. TURNER: First on the consultation
issue, I think Don's comments I definitely
reiterate, and he probably said it better than I
could, but on the comments by Sam, I think it
probably would be beneficial if you included a sentence or two in here that said something to the effect that the PCAOB does encourage consultation when appropriate.

And actually make a positive statement, because you certainly don’t want to reduce consultation at all.

I don’t think you want to limit, though, just to the national office. I can think of situations where I was chairing audit committees. And it was Bob’s firm. And we went to tax specialists. It was Sam’s firm and we went tax tax shares or valuation specialist.

And it was a good thing. I mean, it wasn’t a weakness in the audit partner. We were trying -- these firms turn around and tell you that they bring a firm to the table, not just an individual audit partner.

And so, when you reach out to other pieces in that firm, and you get that expertise, it would seem to me as an audit committee member you want to get informed about those situations. So having them
come with that information to you is extremely helpful. So, again, I really echo what Don was saying in respect to that.

With respect to paragraph 12 and 13, in particular 12B, I’ll reiterate and note that the counsel for institutional investors in their comment letter, they were -- there were three things or so that they actually commented on. This was one of them.

And they were extremely supportive, as am I, of the provisions in 12B. In fact, so much so that if someone told me as an audit committee member they aren’t getting 12B I 2 through 4 there, I would serious questions about whether that audit committee member is actually doing their job.

Investors have said, and they’ve clamored more and more for this, because they haven’t been able to get the information because the thing Linda teed up about the disclosures, that they want to know what the auditor thinks about where their numbers are coming out in the range.

And in fact, the existing auditing
standard on auditing estimates has a provision in it that says the auditor may very well actually have to do their own calculation of that number, and compare it to what management has done, and make an assessment about that. That’s in the existing standard. We aren’t creating new things. We aren’t creating new costs. In fact, if people aren’t doing that, it raised the question as to whether they’re complying with GAAS.

And so, as Don said, again, where you have a wide range, and you’ve got a possibility of picking a number in that wide range, it’s not to say that management’s picked a wrong number, but investors do like to know where it is. And investors told us on the Treasury ACAP Committee we heard testimony from a number of them, that it’s very important to them. We had to -- heard testimony from investors that they want to know what the investor or where the auditor came out o those estimates and what they thought.

Well, if they aren’t even sharing that with the audit committee, who’s supposed to be
overseeing the process, I think very consistent with the council letter, there’s something missing here. And there’s a big disconnect, a huge disconnect between what investors think the audit committees are doing in their oversight and monitoring role and what is actually occurring.

And so, I think what you’ve got there is very consistent with the SEC rules. It’s very consistent with what investors are asking for. I kind of share Sam’s view about critical -- what do you call it, critical or significant, or you know, important. But that’s water over the dam. The SEC’s got a lot on their plate this year. And so, the possibility of going through that, it’s probably, and it shouldn’t be a priority to them.

So I think staying consistent with what they’ve got is probably the best thing you can do, short of just saying talk to us about dam important items.

So -- which I suppose if you did that way, then people would probably understand it.

MS. RAND: Thanks, Lynn. Bob Dohrer?
MR. DOHRER: Thanks, Jennifer, I can be fairly brief here, because actually, very much in line with Roger's earlier comments. And thank the staff for acknowledging perhaps some shortcomings in the drafting around management's responsibilities for some of these communications.

But perhaps to take it a step further, I think it would be very helpful -- nobody disagrees that the audit committee should be provided with any and all information that they need to discharge their oversight responsibilities. But to gloss over management responsibilities, I think is a problem. And I would ask the staff to consider embellishing around the importance of that management communication from a couple of different aspects.

One, not the least of which being is certainly is a deficiency in internal control over financial reporting that shouldn't be glossed over. But equally as important, I think the real value to the audit committee would be having management's perspective, and then the auditors' evaluation or the auditors perspective on these issues, such as
what does critical mean and what is significant?
And where are we going with those types of things?
And just to simply say that, you know,
it’s the auditors’ responsibility to step in, if
those communications aren’t made, don’t disagree
with that, but really impacts in my mind anyway the
effectiveness of how the audit committee can
discharge their oversight responsibilities in the
absence of management communication.

MS. RAND: Thanks, Bob. Arnie? I’ll let
you have the last word.

MS. HANISH: Thanks, Jennifer. Just --
hopefully these won’t be redundant, but you know, I
think that responsibility with regard to this 12B
and I’ll go the little 4, again to reiterate that
management has this responsibility. I think it’s
important, however, for the audit committee to
understand what decisions and what assumptions where
there might have been close calls. And I think
either Mike Cook or somebody alluded to that. I
don’t recall who it was who made the statement, but
I agree that the audit committees need to understand
where there were close calls.

One of the things that concerns me as a member of management, however, is that are wide outcomes and wide ranges of outcomes with multiple assumptions. I would hope that if management do an adequate job of communicating changes in basic assumptions, whether it’s been changes to the consistency of those assumptions, that the auditors would step in and disclose that appropriately. And that wouldn’t trouble me if I as a member of management at least failed to communicate to my audit committee where there were significant changes.

One of the concerns I have is that where those changes, however, where you get into a disagreement, or a judgment factor with your auditors as to where those changes could result in different numbers, then it’s a matter of a debate inside of an audit committee as to which number is better. These are management’s financial statements. And in a estimate for a liability that could be an outcome which ranges anywhere from $50
to $100 million, you’ve chosen a number that you think is reasonable and accurate within a framework. What I think would be difficult would be to get into the dialogue within an audit committee discussion as to the distinction between why the auditors felt one number was better than the other, if the assumptions clearly were not wrong on either party.

But it was management’s judgment to go one direction versus another. But that’s one of the concerns that I have when I read 12B that you can find yourself potentially getting into that debate within an audit committee structure that may put the firm in an awkward position with not only the audit committee, but also with the auditors.

MS. RAND: Thanks, Arnie. Mike, it looks like you had -- you wanted to add something?

MR. COOK: And a suggestion having to do with this area of management responsibility and management communication versus the auditor’s communication, just a -- something for you to think about is whether the term adequately is going to be sufficient. It’s going to be understood. And
whether it is clear here that if the auditor has a
different view than management, even if management’s
communication is complete, that that disclosure
requirement would come into play. Just take a look
at that.

And I was taken by Rogers comment that if
the auditor is doing the communicating, because
management hasn’t or whatever the reason might be,
seems to me that ought to be brought to the
attention of the audit committee specifically.

I’m talking to you about this because I’m
required to do so, because somebody else didn’t.
And leading to the question of well, why didn’t
somebody else? And whether it’s a lack of
competence, an unwillingness, whatever it might be,
that’s a really important piece of information for
an audit committee to have.

So as you focus on this redrafting as
Marty referred to it, and I agree with it, about
different responsibilities, if the auditor
responsibility comes into play, because management
has not carried out their responsibilities, there
are implications to that that need to be communicated. I thought it was a very good point.

MR. BAUMAN: Thanks, Mike for that comment. One other point I’d just like to mention.
The question was raised earlier during this discussion as to what critical and significant meant -- critical and significant to whom, to the investor, to the auditor, whatever. And I think the answer was in my view was given by Professor Cox that I agreed with. And that was these matters are significant or critical to an understanding of the fair presentation of the financial statements. And so they are critical to an understanding of the fair presentation of financial statements by the auditor, by whomever.

So I think that’s the context of which I understand those words. And I just thought I’d share that I think that was the comment made by Professor Cox that I wanted to join in with that interpretation of significant and critical.

MALE SPEAKER: Might be worthwhile to add those words then.
MR. BAUMAN: With that, I think we're ready to take a break. And let's -- we were scheduled to break at 12:00 and get back at 1:00, but let's -- we're a little late on that, but let's still try to get back at 1:00. Thank you.

[break]
MR. BAUMAN: Since we are about four topics behind, I was asked if we have a plan and the answer is yes. We're not going to divulge that plan yet but we have a plan which includes speaking very fast.

The first topic for this afternoon is a discussion of Two-Way Communications and a requirement that was added in the proposed standard that's not in the existing auditing standard for the auditor to evaluate the effectiveness of the two-way communications between the auditor and the audit committee.

Board Member Bill Gradison is going to make some introductory comments on this issue.

MR. GRADISON: Thank you very much. Just one personal comment and then I'll get right down to business.

I suppose as a regulator my job is to regulate but I have to say I'm troubled by the philosophy behind the staff proposal because there's
nothing in this standard that an audit committee
can't get now if they ask for it, nothing. It would
suggest to me that maybe the challenge here is
education. I mean, perhaps we could accomplish the
goal by the issuance of an audit alert or something
and then encourage the auditors to share the audit
with members of the committees and get past some of
these difficulties of definition but that's a
personal thing. That's not why I was asked to start
this thing off.

But I do get to vote on it, if I'm not
replaced before we -- those comments in no way
lessen the value of effective two-way communication
and it's important in assisting the auditor and the
audit committee in understanding significant
matters, however you define them, related to the
audit.

On matters of material misstatements or
concerns about accounting and auditing matters, the
discussion might contribute to audit quality. I
have been struck by the discussion so far. I think
I'm the first one to use the term "audit quality."
I may have missed something earlier, but since that's what we're in the business of encouraging, I think that might even be a significant observation. The Board included a requirement in the proposed standard for the auditor to evaluate the adequacy of the two-way communication between the auditor and the audit committee to emphasize that effective two-way communications are beneficial to achieving the objectives of the audit.

I think it's kind of striking that our goal is effective two-way communications but we're going to do this without two-way evaluation. The evaluation of the audit committee is going to be made by the auditor but nothing is coming back the other way.

Now there's a reason for that because that's up to the SEC. That's not within our purview, but it has led me to think that since our role is limited to the auditor side and the SEC's very comprehensive role includes not only oversight and approval of whatever we do but also the role with regard to the issuer, the Board, the audit
committee, I have wondered whether we would be better off in the long run, if this project moves forward, if it were done jointly with the SEC.

In other words, if they were moving something parallel that had to do with the responsibilities of the audit committee, for example, evaluating the communication from the audit committee's point of view which we can't do, at the same time we were doing it from the other direction.

In any event, the purpose of the upcoming discussion is to seek feedback from all of you regarding the importance of effective two-way communication and how or whether these requirements before us should be modified to support the objectives of the audit.

MR. BAUMAN: Thanks, Bill, and there was some questions in that regard in the briefing paper which pretty much went to what Bill has just said that is, how important is effective two-way communications to the audit committee's responsibility and the oversight of the audit.

If it is important, how can the
requirements in the proposed standard be modified to promote effective two-way communication?

Additionally, considering that the PCAOB does not have oversight of audit committees, what other ways can the Board promote effective two-way communication without being able to impose requirements on the audit committee?

I should add that when we were thinking about proposing this as a standard, we had a discussion with our SAG and the SAG felt that promoting effective two-way communications was a very important part of any standard we might put out and so that was certainly in our thought processes as we issued this proposed standard.

Some of the other questions are how could the requirement for the auditor's evaluation of whether the communications with the audit committee have been adequate be modified to support the objectives of the audit and, finally, which came up in some of the comments, should the auditor's evaluation of effective two-way communications be expanded to include an evaluation of the
communications between management and the audit
committee?

Bob Kueppers, I think you want to begin
the discussion here.

MR. KUEPPERS: Yes. Thanks, Marty, and I
don't want to alarm the group, but I've actually
been thinking about this.

You know, let me just remind you quickly
what Paragraphs 26 through 28 require and it's under
the rubric of adequacy of two-way communications, as
we just teed up, but as you go through it, to Board
Member Gradison's point, this is really a one-way
evaluation. It does not require any, you know,
evaluation of the audit committee of how well the
auditor is communicating.

So it leads me to believe that the
entirety of it will rest on the auditor's perception
of whether they're getting information they need to
complete the objectives of their audit, of their
examination, and if you take it the full distance,
through Paragraph 28, it goes to, okay, what happens
if the communications have not been adequate and it
tees up a couple possibilities: communicating with the full board, perhaps a scope limitation in your opinion, or, you know, the ultimate vote with your feet, withdrawing from the engagement.

As I look at this and just take the construction of those paragraphs and forget the title for a minute, this actually works pretty well if you change it to say consequences on the engagement of inadequate audit committee communication. In other words, what is an auditor to do if they're not getting the engagement they need from the audit committee? Either they're unwilling to talk about fraud risk, they're withholding information that you somehow through your corroboration find out was an issue that they were aware of. All of these things would be very concerning to an auditor.

If that were -- I know that's not your objective in the standard, Marty, but if that were the title of the section and you did a little tweaking, it would all make sense to me. You know, these are the kinds of things you'd look at. If you
become aware that you're not receiving adequate communication from your client, from the audit committee, there are consequences of that, and these are the steps you might take.

And the first one, while it's viewed as an option or should consider, to me would be mandatory as it would if I were having difficulty with management, is to communicate with the full board, that that shouldn't be -- I mean that's -- to me, that's step number 1. If the audit committee's not working with you, the next place I go is the full board. If management wasn't working with us, the first place I'd go is the audit committee and I don't think that should -- I think that's absolutely necessary.

Now, where it goes from there could ultimately determine whether you ever get to an opinion, whether you have to modify your opinion or hopefully you would resolve the issue.

My point is, as I look through all the comments from some analyses I saw, you know, investor comment letters, auditors, corporate
governance folks, folks on boards, I really didn't see any group that embraced this as a meaningful additional element, but it might be helpful from an auditor's standpoint again if there was some specificity about consequences once you concluded -- you might have some indicia of inadequate communications and say if you conclude they're not adequate, then these are the things you either must do or should consider.

So as I looked at this, it struck me that this really had little to do about two-way communications and the most important thing is what's the end of the story on my engagement if there's this problem?


MS. WILLIAMS: Thank you. It's important for the Board to make an evaluation about a particular issue. You're hearing one perspective from the person making the presentation but do you see other issues and do you want some feedback from other parts of the corporation, the company that
you're dealing with, and I think that's something that audit committees should feel open to raise issues and to get as much information as they can and whether it comes from the external auditor or internal auditor, I think that the issue is you want your board to have as much information as they can absorb with respect to an issue.

And I agree with you, that if you're not getting cooperation from particular individuals or officers in the company, then you go to the CEO and say, look, this is important to us, we need to get this information. So I think that's the way that I would interpret that.

MR. BAUMAN: I'm sorry. Linda Griggs.

MS. GRIGGS: Thank you. I find this part of the standard very confusing. The release talks about the promotion of effective two-way communications as a goal but then Paragraph 3 tees up this evaluation of the audit committee and I'm confused about how this effectiveness of the audit committee two-way communication relates to internal control of financial reporting.
There's a very effective mechanism, it seems to me, for the evaluation of the audit committee's oversight, or the board when there's no audit committee, through the audit of ICFR.

Now, I recognize with Dodd-Frank, we've got a slightly different issue there and I don't know, I haven't thought through how it would affect small businesses, but it does seem to me that the mechanism now in place to evaluate oversight is an appropriate one.

If in fact there's a concern about the effectiveness of two-way communications, does that mean that there is a material weakness in internal control of financial reporting? If so, I'd like to see AS-5 revised. I think AS-5 should provide the guidance.

If in fact we now think that rather than the audit committee's role being incidental, which is the way Auditing Standard 380 talks about the audit communications as being incidental to the audit, we now think these two-way communications are critical, then I think we need to be a little bit
clearer about that in the standard.

I think the standard should be to promote effective two-way communications. I agree completely with Bob. If there is a problem with those communications, the auditor needs to go immediately, as soon as he discovers the problem, to the board of directors.

If the board of directors doesn't do something, then I think, you know, the consequences are you've got ineffective internal control because clearly there is not an oversight mechanism to the financial reporting process and then maybe the auditor needs to resign because they can't be comfortable that they can even conduct an audit.

But I think the consequences -- I think that the consequences laid out in Paragraph 28 are really not the focus that the standard should have. I think the standard should be focused on promoting this communication and if there's a problem have a discussion and maybe actually I was wrong.

Maybe the first discussion is the auditor sits down with the audit committee and says, look,
we don't think we're really getting this free flow of discussion. We think that's the best way to assure that the financial reporting process works first. So that's really the first step.

If that doesn't work, then you go to the board. If that doesn't work, all right, then there isn't effective oversight, it seems to me, but I do think we need to somehow integrate AS-5 with this standard, if you're going to leave the effectiveness in here, because I just think it's very confusing.

If this yet another standard or is this the same as AS-5? Thanks.

MR. BAUMAN: Thanks, Linda, for those comments.

Let me just make a brief comment and then I'll pass it on to Barbara.

I think your points are good ones and raise interesting challenges for us as we look at the standard. I think, as I said in my opening comments, it clearly was a strong point from our Standing Advisory Group that this standard promote effective two-way communications.
So an interesting comment. I'll be glad to be trying to -- I hope to hear from others, would be are there other ways in which this standard might be able to promote effective two-way communications, other than the manner in which we've done it in the standard so far. So I'll be interested in further comments in that regard.

Barbara, maybe you could just comment very briefly on the intersection between this and AS-5.

MS. VANICH: Sure. Thank you, Marty.

Yes. Just to follow up, I guess in the staff's view, this requirement is more narrow than the assessment of the control environment that the auditor would do as part of an integrated audit in AS-5.

The standard does refer the auditor back to AS-5 if the auditor were to determine that the communications haven't been adequate. For this standard, it's really just a part of your overall assessment in AS-5.

Just a couple other points to note. This standard would apply to all audits, whether they
would be integrated audits or audits of smaller
issuers that would not be subject to AS-5. So this
really, I think, is not anywhere near the full
scope, the scope of AS-5.

MR. BAUMAN: Thanks, Barbara. George
Munoz.

MR. MUNOZ: Thanks, Marty. In terms of
another alternative, I would say that, first of all,
promoting two-way communication is crucially
important. So another way is to simply, if you want
to put a standard on the auditors, simply require
the auditors to request an executive session at the
audit committee, period, and in that executive
session, then the auditors should do all of the best
practices, all of the kinds of things that are
important because in that way that's the only time
that -- that's one way that the auditor can force
issues, bring up issues and see the reaction and the
like, instead of this other way, which I think is
more complicated.

So let me address a few things that are on
this communication, but before I do, I don't get
many opportunities to speak to the PCAOB. So let me expand on this opportunity.

I actually look at PCAOB as a very good check mechanism for the audit committees; that is, if the audit committees know that somebody's auditing the auditors, that is, that the auditors are meeting high levels of certification, qualification, training, education, that there's competition in the profession, that there's more people in the pipeline, that the schools are teaching the right things, that's great for the audit committee. Somebody's doing -- somebody's taking care of that.

We know it's not the SEC. We know it's not the Congress. We know it's not everything else, but the PCAOB to me is a wonderful opportunity. So I have -- the reason why this is relevant is because I have to gauge the priorities and importance of what's before us against what I and from the audit committee would look to.

For example, IFRS, the position that PCAOB -- it has to speak up on IFRS. It has to, because
that is going to affect how audits are done and what is looked for and the like and therefore to me that's a higher priority. I'm not saying you're not, but I'm just saying I would hope that this kind of conference is held on that.

On competition, there's only four major companies. I would love to have the PCAOB speak to is there enough competition in there so that we have more auditors to work with. Are they prepared? Are they well-trained? Are the colleges teaching what they're doing?

So in that context, as I look at this rule, I say, all right, so now we're putting a standard out there. Is this the kind of thing that I expect the PCAOB to give some precedence to?

I look at Item Number 10 in Communications, which is -- let me get to it. 10 says, "The auditor should communicate the following matters to the audit committee." That means I'm going to have to put it on the agenda or it's going to take up time and here's Item Number A, "The auditor's determination of whether persons with
specialized skill or knowledge are needed for the audit."

Well, of course, I would hope that the auditor is always going to use a special skills, special person, but he doesn't have to take up the audit committee's agenda time to tell us that he's going to call on some special skill. He's got -- we look to the auditor to do that.

The second item is, and this is on the agenda again, "The auditor's consideration of and planned use of the company's internal audit function." That's a judgment call. You know, these are things that now the PCAOB's requiring that there be communication on. So is that the two-way communication? I'm sorry, but it doesn't rise to the level of importance for what that audit committee's fiduciary responsibility is.

I go to Item Number 15 and it says, "Management consultations with other accountants. When the auditor is aware that management consulted with other accountants about auditing or accounting matters, accounting matters is a lot, the auditor
should communicate to the audit committee his or her views about significant matters that were the subject of such consultation."

Why? I don't see the relevance, unless the auditor thinks that a particular discussion may be of relevance, but this requires that they do it pretty much regardless of whatever they consider to be significant. So if these were not requirements but, rather, considerations, I would be supportive of it.

So then I go to your question, which is 26. So in Paragraph 26, it requires that somehow the auditor evaluate this two-way communication and that evaluation is going to be in writing, it's going to be the like, and it's almost like the audit committee's the one who's hiring, if you will, engaging the auditor and yet the auditor's going to "report on" the audit committee.

I wonder what -- how that plays in people's minds because that auditor's going to do -- be writing some report card, if you will, and I don't know if that's the way it should be. I'd like
the audit committee to be writing the report card on
the auditor and I'm not sure that it should work the
other way around. Not to say that that's not
relevant.

So I would say that I would substitute all
this with one standard that says auditors in any
case where any of these things exist should request
an executive session with the audit committee and
speak to that issue.

MR. BAUMAN: Thanks, George. Don
Nicolaisen.

MR. NICOLAISEN: I think when you get to
the area of effective communication, it's a tough
area. I think of the businessman who wants a one-
page memorandum that cuts to the chase of what's
important, what are the decision points, what do we
need to deal with. I think of the general that gave
a 28-page memo to his superior that had a covering
comment that said I'm sorry this memo is 28 pages, I
didn't have time to reduce it to one.

What we've been talking about today is
very complicated communications from the auditor to
the audit committee that goes on for pages and pages and pages. Typically of the ones that I see, they're 50 to 100 pages. Not all of that is of equal importance. Not all of it, I would think of as conveyance of communications or effective communications, and so I think part of the problem starts there of how do you have effective communication and if one of the requirements is a bookload of information that gets dumped on the audit committee with a view that that's the communication from the auditor, now it's the communication back from the audit committee something that can be effectively evaluated.

I watch my son and his buddies will come over. One of them will look up, three of them will grunt and they'll all go because they know exactly what they're going to do. I see my son talk to his girlfriend for hours and then I see his girlfriend come to mom and say I'm not sure we're communicating.

And so what is effective communication? How do you get there and how do you measure it and
if you're asking this party that writes 50-page
documents is the communication from the other side
effective, I'm not sure they're the right people to
be asking that question and then you get into, well,
should we have somebody who's actually a moderator
who can help the audit committee talk to the
auditor, and I don't think we want to go there.

So my view is pretty much I think what
I've heard others express. Effective communication
is necessary, it's desirable, should be encouraged,
but I don't think you can write rules that say if
you do this, this, and this, you've had effective
communication because I think you can still fail
miserably.

MR. BAUMAN: Thanks, Don. Mike Cook.

MR. COOK: Marty, thank you. Maybe a
little bit along the lines of what Don was
suggesting but then I have a question, also, at the
end.

I'm kind of the same place. I could see
putting a requirement in place for the auditors to
obtain an evaluation of their effectiveness as
communicators from the audit committee. I don't quite understand why we would empower and through a standard require auditors to evaluate the effectiveness of somebody else communicating with them in the ordinary sense.

I can understand if there's a breakdown, you need to talk to people and you need to have open dialogue and I'm all in favor of promoting communication. It'd be un-American not to be in favor of promoting communication, but if the burden is on anybody here, we ought to put the burden on the firm to obtain an evaluation of its effectiveness, not the other way around, and I think this is just ass backward, excuse the French, and, I mean, and I don't think it's going to be effective and it's another requirement added on top of others that I don't think is going to stimulate better things but it will certainly take more time, more cost, and I don't know what you get at the end of the day.

I did have one question, however. What we have here all seems to be talking about
communication in a non-litigious/non-threatened environment and that is the way the world should be 98 percent of the time, but when you get into special investigations and matters of that type, you get into some very tricky issues, of privilege issues, of timing, of public disclosure, and there are times when it's appropriate for there to be two-way communication and there are other times when people are not free to have two-way communications in advance of other things taking place.

I don't know if you can make that distinction if you choose to retain this notion, but somewhere it ought to say that these broad and general rules about evaluating communication and if you don't get back what you want, you do what Bob Kueppers said you're going to do, you think about whether you have to quit and all those kind of things.

Some of those rules don't work well in a special investigation-type situation where the audit committee is working with outside counsel and there's counsel engaged for the audit committee.
itself, not for the company, not for other people, and not for the purpose of informing the auditors, and the audit committee understands you've got to keep them informed. You can't shut them out, but you don't just invite them in to these highly-private sessions prematurely and so I don't know if you can make that distinction.

But somewhere this can't be just a general rule that says Bob Kueppers should come visit me in the midst of a special investigation and tell me he wants to know everything that's going on because that doesn't work and Bob would be -- having been involved in a number of them, he'd be the first one to recognize it.

MR. BAUMAN: Thanks for those clear and unambiguous comments, Mike.

Next, we have Alex Mandl.

MR. MANDL: Well, ditto to Mike, frankly. Took the words right out of my mouth. I think it is backwards, candidly. I mean, we talked about the three-legged stool earlier and the balance of that and the necessary balance of
the three-legged stool, and I think this would
actually, you know, throw it off balance, would
offset that balance in a way that could actually
impair or impede the communications that are so
important and I fully agree.

I mean, communications between those two
groups are critical and if they don't go well, you
know, something has to happen. There's no doubt
about that. You know, the governance committee can
get involved if something doesn't go right. I mean,
there are some other means but to have the authority
for the auditor to give a report on the audit
committee which has implications, you know, of
various kinds, I think, throws the whole system out
of balance and is -- I would urge us not to do that.

MR. BAUMAN: There is a number of other
cards up, but I would want to ask a question. Maybe
Bob Kueppers or Sam possibly could add some insight
into this. If you can't, then I'll continue with
the rest of the cards.

But this is a requirement in the
International Standards on Auditing under the IAASB,
Communications with audit committees has this same requirement.

I'm wondering. Can you shed any light as to whether this is working in any effective way on audits outside U.S. jurisdictions where this requirement exists already or not?

MR. KUEPPERS: This clearly is a Sam Ranzilla question.

MR. RANZILLA: I don't have an answer to either of those.

I have not -- Marty, I will couch this with it's a question I did not ask in either preparing -- helping our guys prepare a response or preparing for today.

I have not heard any noise out of the system that would lead me to believe that this has been a significant issue. You know, I think it's important to recognize -- well, I don't dispute any -- quite frankly, I don't feel real strongly on this particular, whether it's in or it's out, because auditors already today are required under AS-5 to consider the effectiveness of an audit committee and
its assessment as to whether or not internal
controls are effective.

This is just one slice of the
effectiveness of an audit committee but already that
system exists where an auditor is making an
assessment and, quite frankly, when AS-2 came out,
you know, we had some chuckles thinking that's going
to work really well. Those are going to be some
interesting conversations if you determine the only
material weakness your client has are the people
you're delivering that message to.

So I -- and again, I don't think that has
been an impediment to effective communication and
again we believe audit committees are really
important in the conduct of our audits and I don't
think that's gotten in the way of it.

So I'd be happy to get back with you with
an answer. Unfortunately, I won't be able to share
it with everybody, but I'd be happy to follow up on
that, if you'd like.

MR. BAUMAN: Thank you very much for that.
Because again, like in other aspects of this,
trying to get further information about how it's working elsewhere or what are the things that are working is always useful to know.

But as you point out, very appropriately, AS-5 does require the auditor to evaluate the audit committee internationally with internal controls of financial reporting and this is, if you will, an element, an element of that.

Bob Dohrer.

MR. DOHRER: It just strikes me, as we're having this discussion, that perhaps evaluating effectiveness of two-way communication really is somewhat of a fancy way of asking for two separate evaluations.

It seems to me that the audit committee needs to evaluate whether or not they are receiving the information they need from the auditors and I don't think there's much argument about that.

At the same time as an auditor, I don't think it's inappropriate for an evaluation to be made of whether the audit committee is responsive and provides the auditor information that may be
relevant to the conduct of the audit going forward. I'm not sure that's all wrapped up in something we can call effective two-way communication, but perhaps if there was more of a spin to it of both parties need to evaluate whether or not the information required to discharge their individual responsibilities are being obtained, that information is being obtained throughout the engagement, would be a better way to go about it.

For example, in Mike's situation with the ongoing special investigation, you know, one could argue that if Mike responded that he couldn't discuss something that we had not had effective two-way communication, but I think what's more relevant is that the auditor understand the ramifications to the conduct of the audit and the outcome from Mike being in the position that he is at that current time as an audit committee member.

So I wonder if there's a way that we could accomplish, I think, what we're all aiming to get at here, without trying to wrap it around something that's as nebulous as sons talking to girlfriends.
and trying to evaluate whether communication has been effective or not.

MR. BAUMAN: Thank you. There is two more cards up and as part of our grand plan to get back on schedule, if we can limit the discussion on this particular question to the two cards that are up. Joan Waggoner and then finally Lynn Turner. Thanks.

MS. WAGGONER: Thanks very much, Marty. I think in terms of our practice and the smaller company practice, the issue really kind of drills down what would be on our big wish list here. Our big wish list basically is does -- to understand or to have the audit committee understand is do they feel that it is their responsibility, if they become aware of something that affects financial reporting or the internal controls of financial report, that they have an obligation to share that with the external auditors, and in my view, I think they do. I think most people would agree that they do. I don't know that all audit committees feel that way, especially in the smaller companies. So that is my big focus in terms of evaluating two-way
communication, the one big thing that I would like
to see a bit more solidly placed in terms of a
communication between the audit committee and the
external auditor.

    Thank you.

    MR. BAUMAN: Good. Thanks. And Lynn.

    MR. TURNER: Marty, I think the correct
term for this is an upward evaluation and companies,
like General Electric, have used upward evaluations
for years very successfully.

    I have twice on audit companies of public
entities used an evaluation where we not only
evaluated the auditor but we actually had the
auditor do a formal evaluation of the audit
committee and at the start of the audit each year,
everyone knew that we'd be evaluating them and we
also told them they'd be evaluating us. So we asked
them to take a look at what we're doing and if we
weren't doing things right or could do it better,
we'd want to know about that and the evaluation
provided them an opportunity to do that.

    In both those instances, it actually had a
very significant positive impact on the communication between the two sides and actually probably impacted the timing of that communication and brought some of it forward, if you will. So I've found from my experience where we've actually done these type of evaluations, it has been very positive.

I also think that an auditor -- the audit committee just plays a phenomenally important role in the financial reporting process. There's just no question about that, no denying that, and with that, the audit committee oversees not just the auditor but that audit committee oversees the internal auditors, oversees the financial management that we've all talked about, and is a critical, very important control here, and if you're an auditor, I look at these four questions and the actual standard says the auditor's just going to evaluate, but it doesn't say you're going to issue any type of special reports.

So all it does is say the auditor's going to go evaluate that extremely important piece of the
overall control and it's not just to deal with the audit but it's to deal with some other very significant parts of the financial reporting process and I looked through the four questions: appropriateness and timeliness of actions taken by this very important audit committee, the openness of it to communicate with auditor.

I mean, the audit committee will not communicate with them. I as an auditor probably have some grave concerns. The willingness and capacity of the audit committee to meet with them in executive session. If they won't do that, there's got to be a problem.

These are very plain Jane, very simple, basic things that are not that difficult, and the fourth question, the extent to which the audit committee probes issues raised by the auditor. You know, as an investor, I certainly hope the audit committees are doing that. If not, we're probably wasting some of our money on those board of director fees.

So there are very simple things and it
just says the auditor's going to go through and 
evaluate those things and come to a conclusion about 
where that very significant control is working 
adequately or not and so to say there's an issue 
with that, I think, tells you just from a common 
sense perspective we're missing something in the 
system and if we're so worried as audit committee 
members about the auditor looking at those things, 
then there's probably a bigger issue here that we 
don't have on the table.

So I think what's here is fine. I've done 
it before and it's worked well and, if anything, it 
enhanced and brought the communications to an 
earlier stage and was very beneficial for us on the 
audit committee and I think benefited the auditor, 
as well.

So I think it's very, very solid, very 
simple, very easy thing to do, and something as an 
auditor I can't comprehend how you wouldn't do it 
anyway.

MR. SCHROEDER: Did you do it more than 
one year or is it just the one year deal?
MR. TURNER: Yeah. The way we actually started this out, the first time I did it was when I was a CFO and to Don's question, I wanted to find out if the auditor thought this was really a good audit to work on. So I required that the auditor, including the staff that actually had to work on the audit, the junior staff even, to fill out an evaluation and you never know. You know, when you do that, you're sitting here going to myself, I'll just get the bejesus beat out of me or not, but if it was, I wanted to know, and I figured it was better to manage the issue and know about it, if there was one, rather than not know it.

So we did it for several years as the CFO and then on the audit committee, yes, we did it each year then. It just became part of the evaluation process and after the first year, what I found was that butterfly feeling in your stomach about how it's going to turn out, after the first year and I did have those concerns, it always went away. It just -- the communication just became very natural. You know, it just -- no one gave it a second
thought after that. It just became part of what you did.

MR. BAUMAN: Thanks, Lynn. One more comment.

MR. NICOLAISEN: I just wanted to ask one question. At least the audit committees that I'm on, there's a client satisfaction process that goes both ways which is maybe not as direct as this, but it is more comprehensive, deals with all the issues and hence the surface things, and there's no mention of that any place. Is that -- I just wouldn't -- if you have a process that works and it's effective, I'm not sure that you need to introduce another one and at least if that's done comprehensively, you might want to at least in here, if you decide to go ahead with the requirement, that you acknowledge there may be other ways to accomplish the same objective.

MR. BAUMAN: Thank you very much.

MR. MANDL: The only point was there ought to be some mutuality on how this process works and I guess what you're describing is a mutual process.
What this says, at least the way I read it, this is a one-way process and that was my main concern with the whole issue and I'll stop there.

MR. BAUMAN: Thank you very much. I appreciate it. A lot of very constructive input on an interesting topic that was introduced into this standard that was not an existing standard. So thank you for all of the good feedback.

Another topic where we had a lot of comments again was whether communications should be written or oral and again this was led by a lot of discussions at our SAG meeting, again with some very strong views from our SAG members about this topic.

So, Jennifer, why don't I turn this to you?

MS. RAND: Yes. Thank you, Marty. Actually, I'm going to turn it over to Dan Goelzer, who's agreed to provide some opening remarks.

MR. GOELZER: Okay. Thanks, Jennifer. Like the existing standards, the Board's proposal would allow the auditor, with a few exceptions, to choose between written or oral communication of the
information that he or she is required to communicate to the audit committee and, as Jennifer suggested, we did ask for comment on whether that was the appropriate approach.

Views were quite sharply split. While there were exceptions, I would say that, in general, auditors favored the idea of continuing our flexibility to choose between written or oral communication.

On the other hand, audit committees and investors tended to support the idea that the required communications should be in writing.

The proponents of written communication argue that writing provides a record that permits committee members to refer back to what was communicated and avoids the risk of future disputes or misunderstanding. Writing, we were told, is also a more effective way to communicate complex information about topics like critical accounting estimates. Moreover, people pointed out that written communication is more efficient since committee members can consider the information at
any time and then use their time at committee
members with the auditor to ask questions.

In contrast, those who urged flexibility
pointed out that a choice between written and oral
communication allows the auditor to determine what's
going to work best, based on the facts and
circumstances and will best lead to open
communication.

In some cases, oral communication may also
be more consistent with candor and oral
communication minimizes the risk that points will
simply be communicated as boilerplate in writing.

So we're hoping that the roundtable will
give us some insight into how we ought to resolve
this split in views. I would point out that all
communications that are required would have to be
memorialized in the workpapers, so there would be a
record of what was communicated from a workpaper
perspective, but beyond that, whether the
communications themselves should be written or oral,
appreciate your views on what would be most
effective.
Thank you.

MS. RAND: Thanks, Dan. We have three discussion questions here and these questions are intended to probe further in trying to get behind the reasons. You know, if you think it should be in writing, what are those reasons? Or orally, if it's made orally, then, you know, what are the reasons to continue with that?

So let me go through the questions and we'll get into the discussion.

First one is should all matters be communicated by the auditor to the audit committee be in writing or only certain matters? If only certain matters should be communicated to the audit committee in writing, what are those matters? And the last one, what are the risks of allowing some of the communications to be made orally?

So if you're in the camp that you believe all communications should be in writing, why do you have that? What risks do you perceive would be out there if some of them are made orally?

Next question. So if the standard
required all communications to be in writing, should
the auditor document oral discussions that relate to
such written communications?

So we've heard today about robust dialogue
and open discussions. If you're someone that
believes everything should be in writing, then
what's your view on those open robust dialogues?
Does that mean that the auditor should go back and
document exactly what was said in those oral
discussions? Is that what you're intending, as
well, if you believe everything should be in
writing?

Next question. If all required
communications to the audit committee were required
to be in writing, would there be any effect on the
dialogue between the auditor and the audit
committee? Would the dialogue on key matters
continue to be robust? In other words, would those
discussions still be open and frank or would there
be some concern if I've got to document everything,
then, you know, you might not want to have -- you
know, pass along something that you think is a harsh
evaluation but -- for fear because it's in writing or how that might be interpreted.

So would there be any effect? Would it chill, if you will, some of the conversations if everything you said needed to be in writing?

I've asked Don Nicolaisen to provide some opening views to open up the discussion and then we'll open it up to everyone.

So Don.

MR. NICOLAISEN: Great. I think the issues have been well described, Mr. Chairman. Thank you for your comments. I'm somewhat indifferent whether the communication is in oral form or writing for the most part, but when you come to a standard that requires all significant communication to be documented and part of it is shared, documented to me means you've written it and so if you've written it down and you share only a portion of that written piece with the audit committee, and then another portion is maintained somewhere else and the audit committee is not aware that those things were considered significant by the
auditor because they were communicated in a
different format and perhaps the writing was
different than the actual discussion took place, I
could imagine situations where certain people are
tepid about raising difficult issues but they're not
hesitant to put in a memo that I raised it and I
discussed it, even though it might have been very
cryptic in its explanation.

And so that's my primary concern with this
and I'll leave it with that.

MS. RAND: Thank you, Don. I don't see
any other tent cards, but we did get significant
views.

Here's Linda. Linda Griggs.

MS. GRIGGS: I just had a question. I
mean, what are you contemplating, PCAOB, would need
to then be documented in the workpapers?

I guess I need to understand what the
purpose for that documentation is and would that
have to be very extensive or is it just we had a
discussion about, you know, the CFO's transgressions
and that would be it? I mean, how detailed would
What the standard says is it's to enable an experienced auditor to understand that communications were made to comply with the provisions of the standard.

Well, it might be enough to just say we had this very difficult discussion, but if it has to get into the details, then I guess I'm with Don. I'd want to know what those details were. If it's going to be written down, it seems to me that's something the audit committee should be aware of.

MR. BAUMAN: Well, I'll take a shot at responding to that.

Again, we had lengthy discussions at the SAG meeting and many of the SAG representatives thought that requiring all communications to be in writing would stifle some of the natural dialogue that takes place among the auditor and the audit committee and so in drafting this, we decided to permit the matters to be communicated either in writing or orally.

However, we felt that certainly from an
inspection perspective, if nothing else, if the
communications were made orally, we would have no
idea whether or not the communications were made or
what they might be and so we established a
requirement that if they are made orally, they would
at least have to be documented to the extent that
somebody, an experienced auditor, having no previous
connection with the engagement, could understand the
communications in sufficient detail to know
essentially what would be communicated if the
required communications were made in writing.

So, in essence, it would be they could be
made in writing or, for one reason or another, if
the committee and the auditor decided that some of
the communications would be made orally, that we at
least felt that the substance and the importance of
that still needed to be documented in the auditor's
workpapers such that we could understand that the
objectives of this standard were met by being able
to read that documentation.

I understand the point that Don's raising
is, well, then I as an audit committee member, if
you didn't send me the written report, well, then
maybe send me the memorandum that went to your files
because I might not agree with how you characterized
them that I think is the issue here.

MS. GRIGGS: If I could also add, I think
when we were drafting that language, we were also
considering the fact that the engagement quality
reviewer needs to be able to determine that the
engagement team has complied with the standard and
these are matters that are very important for that
reviewer maybe to be aware of, also.

MS. RAND: Well, and I also just want to
point out that the way our standard is drafted now
about if it's made orally, then you document in your
workpapers, that exists in the standard today. So
that isn't a new concept that we would be adding.
The auditors have that today.

MR. BAUMAN: Lisa Gaynor.

MS. GAYNOR: A few years ago, I took part
in this research synthesis team and we were asked to
address this very issue as to these questions and
looked to the academic literature to see what had
been done and what we had discovered is nothing had been done in this area, specifically in accounting and auditing.

However, we did make the statement that in communication and there's called communication richness theory and here we keep talking about oral versus written and we've heard throughout this morning that there's so much information that's put in writing, the reports are 50 to 100 pages, that clearly we don't want to add more written information just so it's documented.

But if you go to theory, theory would say that we should be talking not necessarily about oral versus written but about the richness of a communication versus the leanness of the communication.

So you've got the distinction here maybe between effectiveness and the efficiency of a communication. More complex -- I mean, it's pretty simple. More complex thoughts and messages should be in a richer format and a richer format isn't necessarily -- it's usually face to face where you
can see expressions.

As you were saying, as Don was saying, you have -- we discussed during a meeting and then they go to -- and they kind of just like skirted the issue in the meeting, but then they get into the documentation stage and so a rich format would include both a face to face or an oral, if that's how you choose to call it, as well as a written format, as well, or just even including the face to face. It's not even just oral because you get into looking at people and seeing expressions and making your own intuitions from there.

So more complex, more rich, less complex, leaner. Thank you.


MR. TURNER: Marty, on the committees I've sat on, we have asked auditors to give it to us in writing and they've used graphs or it's taken various forms, whatever worked best for everyone involved. So I think you've got to give flexibility to that. Some of this can be graphed better than it can in just a written word.
So I'm a big fan of putting it in writing. I get very nervous about the point that Don raised about something sitting in the audit workpapers about me as the audit committee that I've never seen before that talks about what they were telling me in a conversation.

There's just something about that I don't like and so I'm a strong supporter of having it in writing. The Blue Ribbon Panel Committee on Audit Committees recommended this type of stuff be in writing.

There was actually some language in it that I think is very good that I'd suggest you consider. It says, "This requirement should be written in a way to encourage open frank discussion and to avoid boilerplate."

I think having a sentence in there like that, even if you leave it optional, is very good to put that in there because I think that's what you're trying to get at.

MR. BAUMAN: Thanks, Lynn. If I can follow up, so if all the communications are in
writing and as you know, of course, then there's a robust dialogue and oftentimes there's further inquiry by the audit committee about what the auditor meant by something that he or she put into writing and if there's additional obviously explanations by the auditor about the matters during the committee meeting, would you expect then that those matters would also be then documented in writing and further shared with the audit committee or not?

MR. TURNER: Oh, I can think most recently of a conversation about what the auditor documented on the quality of the accounting practices, the very key critical accounting policies and where they set the line and in that particular case, there was one audit committee member disagreed with the auditor's assessment and at the following meeting there was follow-up by the auditor on that particular point.

So, you know, I think it depends upon what the particular situation is as to what goes with it. I think some of Denny's comments are very relevant in this area. I don't think you want to get a 100-
page document necessarily here. I think you want to get a document that really focuses on the key things and again I think a lot of your questions, a lot of your points are very key things. So I think they'll flow.

But you don't want to have it turning into a CYA document. You want to have it turned into a real dialogue between the audit committee and the auditor and then if there's things that are set up for follow-up, then so be it.

In that particular board, we had a standard process for if something was -- like that got teed up, we would note it in the section of the audit committee minutes or the board minutes, note for follow-up, and the first thing we did at the next board meeting or audit committee meeting was always take on the follow-up items because they're the things that people tend to forget about and drop through a hole. So we had a process for doing that.

So we got back to them.

MR. BAUMAN: Thanks very much. Gary Kubureck.
MR. KUBURECK: Thanks, Marty. I'm going
to sort of share some thoughts that were in my
comment letter but also reading many of the comment
letters here, I think, generally consistent with the
preparers of the audit committee members here.

I think as a starting point, I would
recommend anything of critical importance, you know,
should be documented as a very strong general rule
and going back from experience, more than once in my
time as a preparer and going back far enough when I
was an auditor, I can assure you more than once
auditors documented something in a private
memorandum in the file that no one else in the room
remembered or, if they did remember, they didn't
agree with the conclusion. We thought the answer
was left and they thought it was right or whatever.

So I think, if nothing else, to avoid
misunderstandings, to have a shared sense of the
facts of the matter, it's important to have things
documented.

Now, I think there's some flexibility in
level of documentation. So as an example, you know,
four times a year we do our quarterly earnings review with the audit committee and they get the thing the night before and it's a bulleted list of the things we're going to talk about, you know, reserves, taxes, cash flow or whatever, but there's no details, but at least it's memorialized that you are going to talk about these subjects, you know, earnings release, 10-Q type releases, real-time stuff, and we have five standing meetings a year, couple hours long each, and the pre-read goes out two weeks earlier and there's plenty of time for robust documentation.

Again, I think it can take a lot of forms, a lot of levels of detail. So I would suggest if you're going to write rulemaking on this, the beginning assumption is it is documented and maybe there's exclusions.

I think of executive committees or you're talking individual staff qualifications and stuff. Maybe it's sufficient that you memorialize that the subject was discussed but not necessarily in detail and process that in due course.
But the other thing is I can truly see problems for the PCAOB, for the auditors and management down the line if you allow some things to be done orally and then there's a blow-up a year or two later and there was no requirement to share this critical dialogue in writing with the audit committee or the board of directors, as the case may be, again along the lines of there's a shared understanding of the various views of the issue and the assessment of the facts, the issues of substance.

So I err on the side of more writing is better. Again, I think some flexibility about the level of detail.

MR. BAUMAN: Thanks, Gary. Denny.

MR. BERESFORD: I obviously prefer less than 100 pages of written documents, but having said that, if there is something that's important for the auditor to communicate, I think it's well to have it be in writing and I think specifically of something like an important accounting that was communicated or consulted with the national office.
Generally speaking, when that is the case, I ask the accounting firm or the company, usually the company, to write it up for the accounting firm, so that we can have it in advance, so that we can read about it before the meeting.

These things are complicated, as I think Arnie indicated before, and, generally speaking, if these things are just foisted upon the audit committee verbally at the meeting, the chances of the audit committee members fully understanding and being able to ask intelligent questions are fairly low.

If we've had a chance to look at the material in advance and particularly then ask questions, maybe call or e-mail in advance and ask for a little bit more elaboration, if we wish to, there can be much more robust discussion and more effective discussion at the meeting.

I think, Marty, the idea of having an after-the-fact follow-up with the material, in other words, having the audit committee receive the documents of the accounting firm confirming the
Discussions kind of defeats the purpose.

It seems to me that if we're going to have something in writing, those materials should go to the members of the committee in advance so that they can be part of the effective communication to lead to better discussions at the committee meetings and enhance the entire process for everyone.


MS. HARVEY: Yes. Thank you, Marty. I'm having difficulty, having sat in the room with audit committees and auditors and trying to figure out how we're going to operationalize this documentation of oral communications. It just seems problematic, generally speaking, that, you know, there's a free flow of communications. There's a lot of back and forth and questions and answers, and I don't see anybody, other than the secretary, taking the minutes of the meeting, you know, who's a scribe in that process. So I find it difficult to do.

That being said, so I'm a big proponent of having material matters in writing. I don't like this thought of the auditors going back to their
desks and documenting a whole bunch of discussions they had with the audit committee and then not -- or with management and then not sharing that information. So I would caution against that.

I do think the matters that should be in writing, if they were oral, if you were going to go down that path, anything that's obviously audit-related, audit conclusions, discussions about issues that they've settled in on, one way or the other, and I do think that it should only be the important communications, certainly not the back and forth and casual communications that we have or we'll have hundreds and tens of hundreds of documents to go through.

MR. BAUMAN: Thank you. Sam Ranzilla.

MR. RANZILLA: I think you run the risk of, if everything's in writing, maybe reducing -- one is I think you run the risk of some boilerplate with some of the more sensitive issues, and I don't think it's boilerplate around things that would already be in the workpapers. The thing that sort of comes to mind for me that would be boilerplate
might be around a discussion around your overall
view of the quality of the company's financial
reporting. You know, is it aggressive, ugly,
whatever terms you might use. It's that sort of
thing.

I'm not -- I don't -- oral or written, I
mean, if you're reaching a conclusion that the loan
loss allowance is appropriately stated within the
context of the financial statements taken as a
whole, you're going to -- that's going to be in your
papers just dead on. You're not going to be
uncomfortable with reaching that conclusion.

So I think it's around the more subjective
areas. I think you run some risk associated with
some boilerplate language around it. I don't know
if that's the end of the world. We live in a legal
environment where boilerplate is sort of a fact of
life.

If all the communications were required to
be in writing, you know what, at some point we got
to stop documenting everything that occurs. I mean,
I think that's excessive, to say here are the
requirements, put them in writing, and that anything
-- discussion that you have around them also has to
be documented. I could see -- I mean that's just
anarchy.

And again, you know, I think I'm making
almost no progress on this, but again am troubled by
the writing of auditing standards meant to enhance
the inspection of auditors. I don't think that's
why -- you write auditing standards to make it
easier for your inspectors to do their work and I'll
leave it at that.

MR. BAUMAN: Were there any other
comments? I'm sorry.

MR. COOK: I just wanted to make one
suggestion and I agree with most of what was said
about the value of written communications, but would
you please, as you put this together, be practical
and think about the realities of spontaneous
communications and the advantages of something other
than a written letter reviewed and all of those
things?

Maybe a PowerPoint slide or two might get
the job done in a particular case. Just try to keep
this as general as you can, still meeting whatever
objective you're trying to accomplish and
particularly, while I agree 100 percent with what
Denny said, it's so much more effective if you have
it in writing in advance, a chance to read it, but
spontaneous communication in executive sessions and
elsewhere is invaluable, and the last thing you want
is somebody who says, well, I'm sorry, I can't talk
to you about that because I have to go put it in
writing and I'll send it to you next week.

So allow for subsequent documentation of
conversations or as much flexibility as you can if
you're headed down that road.

MR. BAUMAN: Thanks, Mike. Arnie Hanish.

MR. HANISH: Yes. Marty, just one
comment, and I went back and in preparation for
this, I went back and looked at our auditor
communications that take place already and I guess
it wasn't clear to me, and I haven't commented
previously, as to what problem are we trying to fix
here with this issue because I look at the
communications that take place between our auditor and the audit committee.

It's, for the most part, everything fairly detailed and in writing in advance, goes out in advance. It covers most of what everything everybody's talked about here and I guess I question what's really broken in my mind with the way the communications are today in writing.

You know, there may be ad hoc communications that take place that are not part of this document that take place -- that get sent out in advance, but, generally speaking, the corporate secretary will minute a lot of that at a reasonably high level as to what takes place in the course of the conversations inside the audit committee meeting and that seems to be, at least in my mind, an adequate level of documentation.

If there was something additional that was critical that maybe wasn't captured, maybe that could be incorporated inside the minutes of the audit committee by the corporate secretary. I'm just not sure why you need to have the auditors
writing voluminous additional memos for the files
documenting maybe what was said in an ad hoc manner.

MS. VANICH: Arnie, just to respond to
that briefly, we appreciate your comments. One of
the things we considered in drafting this language
was some findings that were reported in the Board's
4010 Report on Triennially-Reviewed Firms and there
were some instances where firms were not making all
the required communications or it wasn't evidenced
in any way in the workpapers. So I think we tried
to strike a balance between some firms that we see
do a pretty robust good presentation and a good job
versus those who are not doing even what's required
now.

MR. BAUMAN: I think I see two more -- one
card and one hand up here. So in keeping with the
spirit of trying to get all these topics covered,
George Munoz and then Bob.

MR. MUNOZ: Just very quickly, Arnie,
Arnie asked about, you know, what's broken, and I
think we always have to ask ourselves that, but just
did the PCAOB do a study on whether the accounting
firms that audit the public firms that got in 
trouble, whether the accounting firms had any issues 
with their requirements that the PCAOB oversees was 
part of the problem?

MR. BAUMAN: I'm probably not going to 
answer the question anyway, but I wasn't sure I 
understood it.

MR. MUNOZ: Okay. I guess we got a 
proposal before us because somehow somebody thinks 
something's broken or could be greatly improved and 
that's why it's worth a cost and worth all these 
extra procedures and putting things on the agenda. 
So I assume did that stem from a study 
that the PCAOB did in terms of the fiasco that, you 
know, our companies went through a year and a half 
ago or so?

MR. BAUMAN: I'd say that the standard, 
the proposed standard on auditor communications with 
audit committees reflected a number of things and 
that was observations from our inspections process, 
observations of some of the best practices we were 
seeing where there were communications with audit
committees, but they weren't in our standard that some firms were doing but on certain engagements but not on all, and observations from what other standard-setters were doing.

So there were a variety of things that input into our thinking as to this proposed standard. So I wouldn't say there was a particular study done but just a lot of variety of factors that influenced our thinking.

Alex, you okay? Well, thanks for the lively discussion on this topic. I think it gave us a lot of things to think about regarding a subject that doesn't sound that complex about whether it should be written or oral but there's a lot of strong views on it and a lot of different views and balancing, I think, that comes into play, as well.

So thanks for your thoughts.

The next topic is audit committee responsibilities and the engagement letter.

The existing PCAOB standards require that the auditor establish an understanding with the client regarding the audit and given changes in
Sarbanes-Oxley where the audit committee was put in the middle between the auditor and the audit client with the responsibility of the auditor dealing with the audit committee, we made a change, proposed change in the standard that the auditor should establish a mutual understanding of the terms of the engagement with the audit committee in connection with the audit as opposed to typically that letter was so the engagement understanding was with management, and the mutual understanding includes communicating to the audit committee the objectives of the audit, the responsibilities of the auditor, responsibilities of management, etcetera.

Several commenters actually stated that the mutual understanding should include the audit committee's responsibilities related to the audit, as well, and that those responsibilities should be included in the engagement letter and one commenter, included a briefing paper here on Page 8, gave a number of suggestions as to what should be included in that letter.

So that's the next topic of discussion and
that is, the question is should the engagement
to include the responsibilities of the audit
committee, in addition to those of the auditor and
management, and, if so, what should those
responsibilities be?

And I've asked two people to address this
topic, Bob Dohrer and Jim Cox and maybe, Bob, you
could start us off.

MR. DOHRER: Sure. Thanks, Marty, and
actually I think this dovetails nicely with some of
the prior discussion we've had around the
effectiveness of two-way communication and other
issues surrounding who does what in an audit and
who's responsible.

As we know, the proposed standard
includes, among other objectives, objectives for the
auditor to communicate to the audit committee the
responsibilities of the auditor and to, as Marty
alluded to, establish a mutual understanding of the
terms of the engagement, as well as to evaluate the
adequacy of the two-way communication.

Today, the engagement letter essentially
lays out the responsibilities of the auditor and of management, but, of course, is currently void of any description of the responsibilities of the audit committee and I harken back to earlier today, the description of the three-legged stool and one of those legs are completely missing in the engagement letter.

So in the spirit of promoting effective two-way communication, I think the question needs to be asked whether or not a well-articulated and mutually-agreed-upon description of the responsibilities of the audit committee contained in the engagement letter would actually facilitate or enhance in any way the effectiveness of the two-way communication, and if the answer to that is yes, I don't think -- you know, I'm quite sure the Sarbanes-Oxley Act doesn't go into any detail about what the responsibilities are, other than for oversight of the audit process, but actually taking -- drawing from the proposed standard some of the items that were discussed there, I think the list potentially for the audit committee responsibilities
is not long and not prescriptive, other than, you
know, naturally to provide oversight to the
financial reporting process, to inform the auditor
about anything the audit committee knows that would
be relevant to the audit would certainly be expected
and then getting into kind of some of the elements
or criteria that were laid out that would be useful
and effective in evaluating the effectiveness of the
two-way communication could also be included perhaps
in the engagement letter.

    Things like taking timely and appropriate
actions and willingness to meet in the absence of
management with the auditor, so on and so forth. So
the question then in our mind is whether or not
clearly-articulated and mutually-agreed-upon
responsibilities of all three parties in this
scenario would actually enhance more effective
communication.

    Thank you, Marty.

    MR. BAUMAN: Thank you. Jim Cox.

    MR. COX: Yes. Thank you. I think I can
be brief.
All the letters did point out what Bob was saying and that is, that all the letters commenting on the proposal, the importance of the engagement letter generally and the audit committee's missing from that, for perhaps historical reasons.

In a way, the audit committee's really not missing from that at all because audit committees customarily have -- I think the percentages are very high -- a charter that sets forth what their obligations are.

So when I looked at this proposal and thought about it, I was trying to figure out what would really be added by adding something to the engagement letter that was already in a charter at some location. You know, the only thing I could come up with is that the ritual is important, but I think that that's of momentary importance.

It did make me think that what would happen in the instance in which there was an audit of a firm that for some reason a very small group that didn't have a charter at which point that then I think a reasonable auditor would then ask the
questions about, well, what do you envision your role as since it's not memorialized, etcetera, and if you just visit our website we can provide you with a charter and we can take care of this in a nanosecond.

So at the end, being an academic, I'll end on this ponderous note and that is, I'm not sure what this would really address that wouldn't be already addressed in any fashion anyway through reasonable standards. It's not clear to me that it's a problem that's broken nor is it a problem that's really missing something, this third prong of the stool, because it's in likely the charter.

MR. BAUMAN: Thanks for those comments and let's take some cards around the table. I think, George, yours was up first.

MR. MUNOZ: Yes. Thank you, Marty. I think I'd question if the engagement letter which is a contract now includes some obligations on the part of the audit committee on a contractual basis, whether there's a potential conflict with the fiduciary duty that the audit committee has to the -
- and this contractual arrangement that it now has with the auditor and what the real purpose of that is and throughout this whole thing what we have to keep in mind is that there are maybe 90 percent other ways that the audit committee is engaging with management, engaging with the board, engaging with the other parties that the auditor's not in the loop for and does not need to be in the loop for.

    So somehow, you know, these requirements of reporting and communication and assessing seems to indicate as if the auditor needs to be present throughout all those situations and I just would be cautious.

    I don't know what the answer is, but if there's a potential conflict of fiduciary duty with the contractual agreement, I think we have to be cognizant of that.

    It also sets a precedent; that is, once you include something in that engagement letter of "obligation" on the part -- a contractual obligation on the part of the audit committee, you've opened up the door to that kind of add-ons and it doesn't take
long before the audit team -- the auditor starts
saying you know what, I want them on the hook, I
want this, I want that, and the next thing you know
-- so there's a potential conflict.

Isn't the bottom line that the auditor
here is supposed to be independent; that is, they
call it as they see it. It's like an umpire. They
come in, they do the work, they assess everything
else, and they call it as they see it. There's a
weakness or there's a problem or the audit committee
is weak, there's an issue, and they report on that,
and I think that's the way it should be stated as
opposed to a contract, the way it's proposed.

MR. BAUMAN: Thanks. Well, just to be
clear, in the proposed standard, there was not a
requirement for the engagement letter to include
responsibilities of the audit committee. That was a
suggestion that was made by several commenters to
us, just to make sure that that point was clear.

Roger Coffin.

MR. COFFIN: Thank you. I think that the
innovation in Sarbanes-Oxley to put the audit
committee in control of the audit process in my judgment was probably one of the most significant in corporate governance in a long time and therefore when I approached this standard and what we're talking about now is the concept that you mentioned, Marty, of defining the roles of the audit committee in an engagement letter, I think in a perfect world, it has some attraction and it sounds like a good idea, but the more that I thought about it, the more that I thought that the concept of the charter, for example, and which, by the way, I mean anyone who takes a look at audit company charters will know how long and how defined they are.

When I teach this in my class, I'll take a bunch of audit company charters and go through them with students and they'll say you mean this is not a full-time job. I mean, they're very lengthy.

And when I think about how this might play out and given that there are over 12,000 public companies and thinking about what all these contracts might say, I guess I come down on that this might be a box that you might not want to go
I think it's a fair question to ask whether or not, you know, because you do want to have this concept that's clear and delineated, what the roles and responsibilities of all sides, but I think you have to leave the audit committee's roles and responsibilities to the governance process; that is to say, to the shareholders as it's set forth in their charter, subject to various, you know, other rules of perhaps the SEC or the listing standards and leave that piece out of it for want of just getting into something that is going to cause I think ultimately the PCAOB more trouble than it's worth.

Thank you.

MR. BAUMAN: Linda Griggs.

MS. GRIGGS: My only observation is that often these engagement letters are not actually something that's negotiated, unlike most contracts which are negotiated and the words are worked out.

You normally are handed an engagement letter by the accounting firm and you take it or
leave it and when you try to raise comments, they're frequently rejected because this is our form.

So while I think it would be a great idea if you really did have a back and forth and you sat down and the auditors said to the audit committee I'm really expecting you to do this, that, and the other and you actually had a meeting of the mind and a mutual agreement on responsibilities, that would be great. In the real world that won't happen. We'll be handed the engagement letter and we'll take it.

So I think I'm with Jim. We've got a charter. The charters are very robust. If audit committees aren't fulfilling the terms of their charter, like I said before, it seems to me the auditors should sit down and talk with them and say, look, we think there's some inadequacies in our communication, but I don't think this is the way to do it.

MR. BAUMAN: Okay. Thanks. I think we've gotten some pretty clear views on that question and in keeping with our grand plan to get us on schedule
and out of here by 3 o'clock, Topic 6 on Management Communications which we're going to ask Gary Kubureck to lead the discussion. Gary agreed with us that we probably covered management communications extensively this morning, as our entire discussion about communications and what should be communicated by management versus the auditor.

So we're zooming right past Topic 6, unless there's any objections. If somebody was really, you know, waiting to get a comment out on that, and we're going to Topic 7 on -- I'm sorry.

Larry Salva.

MR. SALVA: Can I just ask a question because I noticed that in between Paragraph 12 and 13, you had the note after 12 basically acknowledging things communicated by the management need not be repeated, but to the extent that management has covered anything in Paragraph 13, shouldn't that same guidance apply?

MS. VANICH: Larry, I think that the way it's bifurcated now leads to we do believe what's in
13 should be communicated by the auditor because in most instances it represents the auditor's views and so the auditor's views should be coming from the auditor.

A few of the other matters in Paragraph 13 are similar to the SEC requirements. The SEC requires the auditor to report critical accounting policies and alternative treatments under GAAP and therefore we picked up the same type of language.

MR. BAUMAN: So Paragraph 12 was more about the financial statements, critical estimates that were in the financial statements. 13 is more about the auditor's qualitative assessment of the adequacy of disclosures and the propriety of the accounting policies given the situation in the industry, etcetera.

MR. MUNOZ: I guess maybe I just -- I'll take issue with that and think that, just as a general matter, especially if it's a collaborative kind of, you know, working relationship between auditor, audit committee and management, that to the extent that the management has made a presentation
and often the audit committee will turn to the
auditors and ask them if they have additional
comments, that's when we hear them and if we don't
hear them, then I assume that they're going in
executive session and supplementing the comments if
they don't want to make them in front of me.

But, you know, I just think that, to the
extent they're made by management, they need not be
repeated.

MR. BAUMAN: Thanks. And I agree. We've
had a lot of input today about Paragraph 12
requirements and who should make those
communications and Paragraph 13. So we've gotten a
lot of valuable input on that during the day.

Moving to Topic 7, Jennifer.

MS. RAND: Thanks, Marty. So the next and
last discussion topic is on Uncorrected
Misstatements.

Just to remind everybody, the proposed
standard requires the auditor to provide the audit
committee with the schedule of uncorrected
misstatements related to accounts and disclosures
that was presented to management.

We included this requirement in the standard because we believe it's consistent with the requirement of the SEC which requires the auditor to report to the audit committee material written communications to management and they include unadjusted differences as one of those items.

In addition, although management and the auditor may have concluded that these misstatements are immaterial to the financial statements, misstatements could be material in future periods, especially to the extent they result from a control deficiency which is not mitigated.

So that's another reason we thought it was appropriate to share those types of issues for the audit committee's considerations.

A number of commenters didn't object to this requirement. However, some did object to it and felt that the requirement resulted in providing the audit committee with too much detail on adjustments that do not have a material effect on the financial statements.
So we're seeking views on whether or not the schedule -- you know, this requirement should be included in the final standard and we'd asked Arnie Hanish to open up the discussion with his views.

MR. HANISH: Thank you, Jennifer. I'll try to be brief, and the issues that at least I see around this center more on clarification of materiality. While I don't disagree at all, it's important that auditors provide a list of unadjusted misstatements, uncorrected misstatements to management as well as the audit committees.

I just want to make sure that it's perfectly clear and concise within the proposal that this will be done based upon materiality levels. We all have thresholds that are provided to us. Auditors go through an analytical analysis as to what those thresholds will be as to what would get communicated. It varies from company to company, based upon the size of the company, income of the company, relative size of the balance sheet.

I just believe that we need to be consistent in keeping with those levels of materiality.
materiality and not necessarily encumber the audit
committee with a degree of detail that would be,
quite frankly, inappropriate as far as a level of
some items which might be uncovered as part of the
audit as uncorrected misstatements.

I do believe that items that result and
would have resulted in, if left uncorrected,
significant deficiencies, material weaknesses, or
could have suggested that there were trends from
year to year clearly need to be communicated and
that's something that I believe needs to be made
clear in the statement, as well, with regard to the
impact that these left uncorrected would have on the
degree of controls relative to significant
deficiencies or material weaknesses.

So that is pretty much the degree of
comments that I wanted to make as far as
introductory remarks to try to set the stage. It's
not that I would necessarily personally object. I
believe that it's important to have communications
of that sort to the audit committee. It's really
the degree and the amount and the number of
uncorrected misstatements and I guess one other point is I would -- I don't believe it's necessary, again unless it would result in a controlled deficiency and a significant controlled deficiency to report to the audit committee those items that management has corrected that were discovered by management during the normal course of their audit.

I think, quite frankly, if management finds things during the normal course -- I'm sorry -- not of its audit, of its closing process. To me, that's a positive in the sense that management has the appropriate controls in place to detect items and has found them and corrected them appropriately and again, unless it was pervasive and suggested that there was a control breakdown or a significant deficiency or material weakness in internal controls, other than that, I really don't believe it's necessary for an auditor to communicate those items that management has detected during its closing process.

MS. RAND: Thanks, Arnie. Denny Beresford, you had your card up.
MR. BERESFORD: I think this is a useful disclosure for audit committee members. The one thing I would ask you to consider adding in this case is some guidance on disclosures; that that is, I've seen remarkable amount of inconsistency in my limited board experience on what information auditors feel they have to provide to audit committee members with respect to omitted disclosures and I just don't think that people understand right now what the ground rules are and in theory, I guess, if you went down the typical GAAP checklist, there could be scores, if not hundreds, of omitted disclosures on the basis of materiality and that's clearly not going to be very helpful to audit committee members.

But I think it is something that's not covered at all in the existing auditing standard and I suggest that it's something you should give some consideration to.

MS. RAND: Arnie, can I ask a follow-up question regarding your last point on disclosures? I'm just curious if you've seen any or had any
communications or best practices of how omitted disclosures would have been presented to you as an audit committee member, chair, any suggestions in that area?

MR. BURNS: What I can say is that in one of my boards, one of the firms has simply listed omitted disclosures, said that these were ones that they thought were technically required under GAAP that were omitted on the basis of immateriality. On the other boards, there was no such listing. They just never said anything about any disclosures that were omitted. I don't know if any of the other audit committee members have seen any listings of omitted disclosures.

MS. RAND: Thanks, Denny. Kiko Harvey.

MS. HARVEY: Yes. I generally support the submission of the uncorrected misstatements to the audit committee. I think that's probably pretty common practice anyway.

But on this matter of corrected misstatements, I agree that if management is identifying them as part of the normal closing
process, I don't believe that those require any disclosures of the audit committee.

The ones I would be a little bit more concerned about, though, are those that are caught that relate to a prior accounting period that's already been filed. Obviously that would beg the question of whether or not that's an issue under ICFR, but I really -- you know, I -- because of the materiality, I just don't know how that's captured in practice, as well, and I would like to see some emphasis in that area.

MS. RAND: Thank you. Just as far as your point on corrected misstatements that are picked up through the normal close process, we didn't include that as a requirement. It's just ones picked up by the auditor. So I think that's come up a couple of times.

George Munoz.

MR. MUNOZ: This is, I think, a good requirement and that's because the audit committee is not only looking at the financial statement, the current financial statement but it's evaluating --
it's evaluating management and it's evaluating the outside auditor and so as it gets information about uncorrected misstatements or the like, over time, so I would favor that it doesn't have to be material because over time the audit committee can be better positioned to evaluate or judge the work and the interactions between management and the outside auditor and even qualifications.

So from that perspective, I would not restrict it only to materiality but this is a good requirement.


MR. KUBURECK: Thanks, Jennifer. I'll be quick. First of all, I'd echo Arnie's comments on stuff found by management in the ordinary course of the close which will be hard to define what is ordinary closing adjustment versus sound controls versus something that's significant deficiency material weakness which probably should be brought to the auditor's attention, to the audit committee's attention.

I do support a SUD, you know, being
presented to the audit committee. I'm actually

hanging on the one word, "the same schedule of

uncorrected differences." I would -- I don't think

that they really mean the same schedule, looking at

us as a multinational company.

There's many schedules, subsidiary and

business unit levels, and some of which you've got

postings significance of very small dollars, small

subsidiary because, you know, a statutory audit

report's coming versus what affects the consolidated

financial statements taken as a whole.

So I would be careful in the use of the

word "same" and then likewise even if it's the same

items, the one presented to management might be the

more granular level of detail as what specific

account number does it belong to and again that's

sort of irrelevant at the consolidated level. So

just be careful on the use of the word "same."

My last comment is regarding disclosure

omissions. The FASB, as you may know, has a project

on disclosure framework and what should a disclosure

framework look like and one of the things that
working group is wrestling with is what is the
answer to the question.

As you know, every FASB standard, the last
box said, you know, this can be omitted, you know,
doesn't have to be applied to individual items.
Well, does that mean if you omit it, it's perfect,
its GAAP, or does it mean no, it's still not GAAP,
even if it's small, but we're just not going to make
a big deal out of it, and they're wrestling with
what is the answer to that question.

If you say if it's immaterial and the
conclusion is it's GAAP to omit it, if it's
immaterial, then there is no issue. So they're
wrestling with that and my only advice, Jennifer and
Marty, would be to sort of stick close with the
FASB's project team on this. I don't know where
they're going to come out but they are working it.

MS. RAND: Thanks, Gary. I wanted to
comment on one of the things you said which was the
word "same." I think you were suggesting that maybe
not the same schedule needed to be presented to the
audit committee as management and the way we drafted
the requirement in the proposed standard is it is
the same.

We are aware of some instances, have
concerns or could be others, that a different type
of schedule might be -- you know, would be presented
to the audit committee that is misleading to the --
you know, that may net some of the adjustments that
appear better than it really may have been or just
isn't giving a true or fair presentation of what
happens. So that's a reason why we use the word
"the same" so that that might not happen.

Lynn Turner.

MR. TURNER: I'd just like to say I agree
with what Denny was saying about a list of omitted
disclosures. I think we've seen times where people
have left information on pension plans out of
footnotes and that type of stuff and so requiring
that, I think, would be helpful, in addition to the
unadjusted entry score sheet, which I would have
just the auditor things on it. I wouldn't -- I
agree with Arnie. I wouldn't throw everything on it
that management finds. I think that's part of the
overall internal control analysis.


    MS. MORRIS: Thank you, Jennifer. I just wanted to point out a couple things that people have said and that was, I do agree that it should be included, uncorrected misstatements, and it should be provided to the audit committee because I think that all of us have gone through, you know, different divisions have to go through and correct or look at some of these issues and deal with it through management and I don't know necessarily the audit committee sees the big picture and, you know, cumulative effect and so I think that that would be helpful because I think it was brought up about whether or not there's some trends or pervasiveness.

    So I think that, you know, just seeing that, you know, is not something that the audit committee has to deal with a lot or work with it, but just seeing that year over year they might get that feeling of, okay, are there some issues that are underlying that need to be addressed. So I
think that is important.

MS. RAND: Thank you, Arnie.

MR. HANISH: Jennifer, just one point of clarification and just to make sure that I didn't misrepresent anything in my opening remarks, that we're talking about here, at least what I'm talking about are those items that are above what I'll call the threshold, that I mean I would hope that we're not looking to have the auditors -- again just to restate what I said earlier, that I'm hoping we're not looking to have the auditors provide whatever detailed lists there might be of things that are below a certain threshold.

I think it's important to, in the aggregate, maybe indicate to the audit committee what those items were. I think it's important to indicate if they're all going one way, but if it nets out if they were below the threshold and the aggregate was not above a threshold that had been established for levels of materiality, I guess it troubles me that we would provide that kind of list of what I would consider to be very immaterial,
especially if it was in the aggregate below the
level of materiality that had been established,
either at the balance sheet level or the income
statement level.

MS. RAND: Our standards on evaluating on
differences of materiality would indicate that the
auditor would record those things that are above
being considered clearly trivial. So if it's
clearly trivial, it does not need to go on the list,
but otherwise individually in the aggregate if it's
above clearly trivial, then those type of things
would be recorded. So that might help some of your
concerns.

Harold Schroeder.

MR. SCHROEDER: I was just going to add,
having gone through that enough times in my 13 years
of auditing, there tended to be some games that get
played with this type of issue, oh, well, we'll put
this on the schedule, we won't put this on the
schedule, what are we going to say, is it judgment,
is it just application, is it a factual error, is it
a misapplication of accounting.
There are all sorts of different types of these misstatements and I'm clearly in the camp of this is a good -- some type of summary level, telling an audit committee we had generally these types of issues, half of them fell in the judgment, half of them fell in the systems or cutoff issues, whatever, just to give them a sense and feel because I think it's a strong educational purpose, you know, certainly not providing all of the individual layers and detail, some high level, I think just a good education.

MS. RAND: Don Nicolaisen.

MR. NICOLAISEN: I would just echo that. I think one of the things that is helpful -- one of the things that's not helpful is a whole lot of data that gets provided, photocopies of schedules that are uncorrected errors and misstatements and omissions and whatever else that are just sort of dumped on the audit committee. It's sort of the same thing where there's random walks through we've got a lot of estimates and the estimates are difficult and it could be this or it could be that.
What you're really looking for, at least what I'm really looking for, from the auditor is some interpretative guidance that says this is meaningful. We've never seen this many errors that have gone uncorrected in our history of our firm. You really ought to deal with this. That's helpful. To just dump them on us and say here's a bunch of stuff that we found during our audit and we photocopied it and here you are and we're required to give this to you, I'm not sure is a particularly meaningful exercise.

MR. BAUMAN: Don, was that a real-life experience you were --

MR. NICOLAISEN: No, but it could happen.

You never know.

MS. RAND: Charley.

MR. NIEMEIER: Yes. Just one follow-up comment related to disclosure and I appreciate, Gary, your comments about FASB's project.

I just want to highlight this because I think disclosure is going to become a big challenge when it comes to determining materiality. I'm not
sure there's any real set rules on that the way that we deal with misstatements and correcting numbers and one thing about FASB -- I'm not sure that FASB has the ability to actually determine what is material in that regard, even though it may present some interesting information about that.

In the end, I think what a reasonable investor believes is material under the securities laws is what's going to be governing and it's just -- I only point that out because I think this is an area that's going to be a moving target.

What may have been deemed to be not material as a disclosure item may actually become material in the near future.

MS. RAND: Larry, you had a comment.

MR. SALVA: Yes. I would just make the point in terms of summary of past disclosures, if you will, is that I think what drives that, at least in my experience, in seeing what the auditors put on our lists, are the things that are clearly not the ones that are getting there because they're immaterial disclosures and they agree with that.
conclusion and that it's not a tough conclusion to
get there.

It's the ones where there is a bit of
judgment involved in reaching that conclusion that
that omitted disclosure is not significant to a
potential user of the financial statements.

I think there's a judgment being made by
the auditors as to what they post on to that
schedule. There are clearly -- like we've taken
approaches that I've discussed with the SEC staff of
not making every required disclosure in our pension
footnote because we have frozen pension plans and
it's just not all that significant, but we make
certain disclosures there and the auditors, you
know, will reference that point because that's kind
of, you know, somewhat aggressive position, not
quite -- I don't think it's aggressive at all. I
think that's using the box at the back of the
standard that says if it's immaterial, don't include
it, but that makes it on to the list.

There are a couple -- a few minor other
things that make it on to the list, but they're
clearly not putting every item that shows up on the
disclosure checklist where they've made a note that
said it was immaterial.

MS. RAND: Thanks, Larry. Mike.

MR. COOK: Very quick observation on this.
I could have made this observation on at least a
half a dozen items before this, would be I think it
would be just fine to say that the auditors should
reach an understanding with the chairman of the
audit committee or with the audit committee on the
degree of information and detail prepared here or
provided here to meet the needs of the audit
committee within the boundaries of the standard and
then if you wanted to go on and say in the absence
of such an agreement, you can or can't give the same
schedule.

It's true of so many things, I think we've
been talking about, is really kind of wonder why the
auditors or the standard-setters for the auditors
are deciding what the audit committee ought to get,
as long as the standards are complied with, and I'm
not suggesting anything different than that, but
right in this one, just talk about it, see what it is that the committee needs and provide it. It doesn't seem too difficult.

MS. RAND: Thank you. I think, Mike, you ended the session on that for us, and I don't see any other tent cards.

We are getting close to 3, which is our closing time. So we'll move into the wrap-up section, and I'll turn it over to Dan Goelzer to provide a wrap-up and summary.

MR. GOELZER: Well, thank you, Jennifer. Marty did have to leave early because of a family matter and asked me to do the wrap-up, but I am going to be mercifully brief. I think we've had a very busy and active day and so the only wrap-up I would like to give is to thank everyone for their participation, for their advice and for the ideas that you've given us.

I think we certainly have a lot to think about in terms of the standard. I don't know if I would go so far as to say that there was a consensus on anything, except possibly whether the audit
committee's responsibilities ought to be described
in the engagement letter or not, but we certainly
will carefully consider everything that we've heard
here today, and I think you'll see the results of
this meeting as we go forward with this project.

As I said in my opening remarks this
morning, I think the success of our standard-setting
is very much dependent upon the willingness of those
who have firsthand experience in the matters that we
deal with and give us the benefit of their views and
advice and from that perspective, I think this has
been a very effective roundtable.

So again, thank you very much to all of
you and I will adjourn the roundtable. Thank you.

[Whereupon, at 2:56 p.m., the roundtable
was adjourned.]

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