PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

AUDITOR'S REPORTING MODEL

PUBLIC MEETING

THURSDAY, APRIL 3, 2014

The public meeting convened in the National Ballroom in the Westin Hotel, 1400 M Street, N.W., Washington, D.C. at 9:00 a.m., James R. Doty, PCAOB Chairman, presiding.

PCAOB BOARD

JAMES R. DOTY, Chairman
LEWIS H. FERGUSON, Board Member
JEANETTE M. FRANZEL, Board Member
JAY D. HANSON, Board Member
STEVEN B. HARRIS, Board Member

WITNESSES

JOAN L. AMBLE, President, JCA Consulting;
Member, Council of Audit Committee
Chairs, NACD; Retired EVP and
Principal Accounting Officer, American Express Company; public company board member

JEFFREY L. BURGESS, National Managing Partner of Professional Standards,
Grant Thornton LLP

TONY CATES, UK Head of Audit, KPMG LLP (UK)

PETER CLAPMAN, Former Chief Investment Counsel, TIAA-CREF; public company board member
JOHN CORCORAN, Fund President, Senior Vice President, MFS Investment Management
E. MICHAEL FEHRMAN, Managing Director, Head of Accounting Policy and Advisory Group Americas, Deutsche Bank AG
MICHAEL J. GALLAGHER, Managing Partner, Assurance Quality, PwC
MONTY W. GARRETT, Vice President • Finance, Verizon Communications, Inc.
PHILIP R. JOHNSON, Chairman of the Audit Committee, Yorkshire Building Society
JAMES P. LIDDY, US Vice Chair Audit, KPMG LLP; Regional Head of Audit, Americas
LIZ MURRALL, Director of Corporate Governance and Reporting, UK Investment Management Association
PETER H. NACHTWEY, Senior Executive Vice President, Chief Financial Officer, Legg Mason, Inc.
CHARLES J. PAGANO, Partner, WeiserMazars LLP
JEREMY PERLER, Director of Research, Schilit Forensics
WILLIAM TOUCHE, Partner, Deloitte LLP (UK)
MICHAEL R. YOUNG, Partner, Willkie Farr & Gallagher LLP; Chairman, Financial Reporting Committee, New York City Bar Association

OBSERVERS

BRIAN CROTEAU, Securities and Exchange Commission
JAMES KROEKER, Financial Accounting Standards Board

PCAOB STAFF

MARTIN F. BAUMANN, Chief Auditor and Director of Professional Standards
JENNIFER RAND
JESSICA WATTS
JENNIFER WILLIAMS
CONTENTS

Panel 7: Auditor's Responsibilities for Other Information

Jeremy Perler .................................. 7
Michael Young ................................. 12
Peter Nachtwey ............................... 16
Michael Gallagher ......................... 23

Panel 8: Experience with Changes to the Auditor's Report in the United Kingdom

William Touche ............................... 88
Philip Johnson ............................... 96
Tony Cates .................................. 107
Liz Murrall .................................. 111

Panel 9: Auditor Tenure and Other Basic Elements of the Auditor's Report

Peter Clapman ............................... 156
Monty Garrett .............................. 161
Joan Amble ................................ 166
James Liddy ................................ 171

Panel 10: Considerations Specific to Investment Companies and Brokers and Dealers

Charles Pagano ............................. 215
Michael Fehrman ......................... 220
John Corcoran ............................. 226
Peter Burgess ............................. 235

Adjourn ..................................... 257
MR. DOTY: Well, good morning. Good morning. We have a panel that is focused on the issues raised by the proposal of auditors responsibility for other information. And it's a highly qualified panel.

But before I introduce people, a bit of news from the front. We're advised by Natalie Berger of the EU that the European reform proposals, which were summarized so ably in Sven Gentner's materials yesterday in which he discussed in detail, were passed by the European Parliament this morning.

So they're now law in the EU with the overarching subject to the country and member state is for you to have a more restrictive, or a stronger policy.

The panel, as I said, has extraordinary qualifications. Jeremy Perler is the Director of Research at Schilit Forensics. And he's the co-author of Financial Shenanigans: How to Detect Accounting Gimmicks and Fraud in Financial Reports. It's gone through three editions in 2010.

Previously he served as the in-house forensic

Michael Young. Litigation partner at Willkie Farr & Gallagher. His practice concentrates on securities and financial reporting with a particular emphasis in accounting issues.

He's also chairman of the Financial Reporting Committee of the New York City Bar Association. He is chair of the firm's securities litigation and enforcement practice.

His trial work has included financial reporting matters in federal, state and bankruptcy courts throughout the United States. His experience includes the landmark jury verdict for the Defense in the first securities class action tried before a jury pursuant to the Private Securities Litigation Reform Act of 1996/1995.

He previously served as a member of the Financial Accounting Standards Advisory Counsel. He is the Chair
of the Financial Reporting Committee of the New York City Bar. And he is counsel to the AICPA and the Center for Audit Quality.

Michael has a record -- a distinguished record in this area that is second to none. And he's going to have a lot to say.

Peter Nachtwey is Chief Financial Officer at Legg Mason. A member of the firm's Executive Committee. He's responsible for the areas of finance, investor relations, corporate communications, human resources, operations and technology.

Previously he was Managing Director and Chief Financial Officer of the Carlyle Group. Prior to joining Carlyle, he was a partner at Deloitte & Touche. Served as the Northeast Regional Managing Partner for the Investment Management Industry. He is a current member of our, the PCAOB's Investor Advisory Group.

Mike Gallagher. Manager Partner for Assurance Quality at PWC. He supervises national office efforts in the areas of accounting services, US Securities and Exchange Commission services, risk management, strategic fault leadership, auditing services, auditing
methodology.
He's also responsible for PWC's audit transformation program, learning and development, regulatory relations and inspections groups. He currently serves as the Chair for the Center of Audit Qualities Professional Practice Executive Committee. He is a current member of the PCAOB standing advisory group.

Gentlemen, welcome. Jeremy, the floor is yours.

Thank you.

MR. PERLER: Good morning. And thank you for having me on this distinguished panel. I am delighted to be here today.

It's a great honor to speak with you and share my perspectives on a topic as important as other information and the auditors role in financial reporting. Thank Chairman Doty for that nice introduction.

If I may, I'd like to add a little bit more context on my background as I believe it to be helpful in understanding how my perspectives as a financial statement user have been framed. I spent the last 17 years studying and analyzing companies who employ aggressive accounting and manipulative reporting tactics.
1 to embellish their financial performance.
2 My current role as an advisor to asset managers,
3 is at a forensic accounting consultancy called Schilit
4 Forensics. We advise well regarded investment firms that
5 engage us to unravel complexities and uncover
6 misrepresentations in the accounting and financial
7 reporting of their portfolio companies.
8 Now over the years I've had the pleasure of
9 working with and advising hundreds of asset managers on
10 the accounting and reporting practices of their portfolio
11 companies. So my perspectives today are based not just
12 on being a power financial statement user myself, but on
13 my daily conversations with these investors.
14 From these interactions, I gained a strong
15 understanding of relevancy and how financial information
16 is consumed and used in the investment decision making
17 process. Now the topic of other information is an
18 extremely important one. And I commend the Board of its
19 efforts to increase auditor's scrutiny to areas beyond
20 the financial statements.
21 It speaks to what is to me the biggest problem
22 facing financial reporting today. The growing dissidence
between audited financial results and the key performance metric showcased by management.

This is a weak spot in our financial reporting system that allows issuers to bypass the traditional audited financial statements and engage in an un-scrutinized parallel conversation with investors. By not participating in this conversation, the audit function is weakened and the investors are worse off.

Indeed the traditional audited financial statements are becoming less relevant as an investor communication tool. It has been commonplace for management to present self-made, non-GAAP metrics as more relevant proxies for earnings and cash flow performance. These metrics are delivered to investors in earnings releases, PowerPoint presentations, as well as the MD&A and other places outside the financial statements. And it is usually the case that these metrics are the most important data points and disclosures to the investment community.

Often these metrics make sense and provide very helpful insight into a company's operations. For example same store sales for a retailer, organic growth for an
acquirer or earnings excluding a large litigation settlement.

However in many cases they don't, like something called steady state free cash flow before special items. And the laughable adjusted cash EBITDA less one-time items.

However in all cases, regardless of their legitimacy, these metrics are unaudited and susceptible to the whims of management discretion and definition and disclosure. For example, when EBITDAs no longer flattering, it becomes adjusted EBITDA. And then adjusted cash EBITDA. And then finally adjusted cash EBITDA less one-time items.

And even in cases where the metrics seem commonplace and logical, they are easy to redefine as needed. For example determining which stores are included in same store sales is rife with discretion.

Relying on management to self-police these important metrics is insufficient just as it is insufficient for traditional GAAP measures. To be clear, the issue here is not whether a company is honest or disingenuous about these disclosures, rather it is that
the supremely important disclosures and data points are not being scrutinized by auditors. A point which is generally lost on investors.

This is where I believe the Board's proposals on other information and helpful. The current financial reporting paradigm promotes this environment in which many of the most important metrics to investors are widely unchecked.

Enhancing auditor responsibility over this information by as the Board proposes, requiring evaluation of these disclosures with a focus on material inconsistencies and material in the statements is common sense and will no doubt strengthen and add robustness to our financial reporting system. And ultimately lead to fewer cases of willful or negligent misrepresentation.

I recognize that evaluated scrutiny likely means added procedures. However the benefits to investor protection and public disclosure far outweigh the costs.

The flow of information from companies to investors has changed. And so too should the auditor's responsibilities. Naturally I would like to see more steps taken to reign in the mass promotion and
1 dissemination of un-scrutinized information. But I recognize that many of these efforts would be beyond this Board's jurisdiction.

However I believe this Board's proposal regarding other information shows leadership. And is a very positive step that will have a powerful impact with regard to protecting investors and promoting more reliable and representative financial disclosures.

Thank you for the opportunity to participate in this conversation. And I look forward to our discussion.

MR. DOTY: Thank you. Mr. Young.

MR. YOUNG: Well, I am exceedingly sympathetic to the desire of investors for better information. Like a lot of people in this room, I am reading 10Ks all the time and they have gotten to be as dry as dust.

And what is particularly frustrating as I think about it, is that it does not have to be like that. It is theoretically possible to write about things. To write about business things, even with all of the rules and the regulations and all of that, it is theoretically possible to write about things in a way that is understandable and informative and interesting.
And at the risk of sounding trite and saying the obvious, I would offer that perhaps the best illustration of that is the Annual Shareholder Letter of Warren Buffett. It is interesting, it is understandable. You get the sense of what's going on within his companies. The challenges, the triumphs, the failures. And the question for me is how can we get people to write like Warren Buffett? Boiling it down. My concern with the other information proposed standard is that it doesn't get us there. And in fact my concern is that it may take us in the opposite direction. Now let me explain why. The Board has asked me to focus on how the standard will be interpreted and applied. And that is actually the root of my concern. Under this standard, I would expect auditors to find themselves being held fully accountable for other information. They will be evaluating the information. They will be speaking to its truthfulness and if the information turns out to be false, they will have some explaining to do. And even if they are able to point to the
standard and to say, well we missed the false statement, but look at the standard, we complied with the standard. That to my way of thinking, does not satisfactorily mitigate the concern. Because historically where auditors have missed a false statement, insistence on in compliance with the applicable standard, has not sufficiently mitigated the appearance of professional failure.

So as I think through how this standard will work, my own reaction is that probably two things will happen. One is that the amount of work needed to be undertaken by the auditor will need to increase commensurate with the risk. Or the information will need to get easier to evaluate. Or both. And I would expect both.

So one consequence of the standard, as well intentioned as it is, is that it may create an incentive for management to draft other information in a way that is easier for the auditor to evaluate. That runs less of a risk of auditor recalcitrance.

And the concern is that we will end up building into financial reporting, still another incentive to
favor objectively verifiable information of the sort that auditors are more comfortable with at the expense of the kind of subjective commentary that connects the dots and explains what the data means in very day words of the sort which may be harder for the auditor to evaluate.

And you know, to my way of thinking, that's the opposite of the direction in which we want to go. I mean when I think of it as an investor, I think about wanting management to connect the dots.

Don't just give me the data, but tell me what the data means. Tell me how you are looking at this data and what it's telling you management, as to what it means for your past performance, what it means for your future performance. What the data means for risk.

And I'm concerned that instead, under this standard, we would be headed more in the direction of disconnected, objectively verifiable data. And therefore the 10Ks, if this is possible, would even get less interesting.

And I would like the record to reflect that for the first time in the history of recorded civilization, an attorney has taken less than his allotted time.
MR. DOTY: We'll make up for it Mr. Young. We'll make up for it.

MR. GALLAGHER: Mr. Chairman I'd like to reserve that for my remarks.

MR. DOTY: But did you record the time? Mr. Nachtwey.

MR. NACHTWEY: Thank you Chairman Doty. And hopefully I won't you know, screw up the timing by using all the time he saved us. But first of all good morning to all of you. And thank you and the other members of the PCAOB for the opportunity to be here and speak with you today.

I think the proposed standard regarding auditors reporting on their involvement in other information is of great interest to me and to my organization. But this morning I'll speak from three very different perspectives.

So first as a former audit partner with Deloitte & Touche where I practiced for 25 years. Second as CFO of Legg Mason, an S&P 500 company and an issuer of public company financial statements. And then finally as a fiduciary for almost $700 billion of third-party assets...
under management by Legg Mason.

My remarks represent my own views and do not necessarily reflect those of Legg Mason or my colleagues. So with that bit of housekeeping out of the way, let me address the proposed reporting standard which I generally favor, but with some key caveats that I'll address in a moment.

I think it's important to recognize that with this proposal, we're talking about information auditors are already required to read and consider in auditing public company financials. So I believe it is a positive step to have auditors clarify what they are currently involved with, as users of financial information very often rely on numbers outside of the financial statements.

At a very high level, this proposal provides the audit profession with the opportunity to help investors and others understand what information outside of the financial statements the auditor has been involved with. And that is clearly a worthy objective.

But we should be careful to comprehend the real world implications of such changes and weigh the
potential costs against benefits. In that regard we must be very clear-eyed in understanding the value of these benefits to investors, which easily could be overstated. And we need to be thoughtful about added costs, which are ultimately borne by investors and can easily be understated.

In my view, the public generally believes that auditors already verify information outside the audited financials. As a consequence, many investors have an imperfect understanding of what auditors actually do with that information.

They may believe auditors are involved with any and all numbers in a company's annual report or 10K, including numbers not derived from the books and records. And of course as all the auditors in this room will know, that is not true. But without a bit of a roadmap, how can investors be sure where the auditors have been involved?

So I'll give you an example of this from the asset management industry. For firms like Legg Mason, a key performance indicator is assets under management or AUM. AUM is generally a big number both
quantitatively and qualitatively. And we often use it as shorthand to describe the size and scale of our firms as you may note that I just did in my intro about Legg Mason.

Consequently, AUM gets significant MD&A attention by asset managers. Yet the related numbers are not per se audited. However, our auditors do see our AUM numbers and perform significant work around them given their direct impact on our revenues. And I think investors would likely find value in knowing auditors have done work on these disclosures which would provide an important check on management.

The proposal also may provide the audit community at large with better leverage. Currently there is no recourse for audit firms if they disagree with management assertions outside the financials, other than the nuclear option of pulling their audit opinion and resigning from the client.

So I believe the proposal properly structured, could promote a more useful dialog between auditors and management. There could be other benefits as well.

In stock and debt offerings, underwrites require
the company's auditors to review and report on information outside the financial statements, and provide them with comfort letters. If the other information is already reviewed and reported on, this could expedite and possibly lower the expense of public offerings.

While I like those aspects of the current proposal, it's critically important to determine now, in advance, whether the potential benefits truly justify making a change. Because history has shown that regulations are seldom, if ever, rolled back, owing to silly things like greater than anticipated costs.

I also believe other aspects of the proposal require further review and consideration. First and foremost, we must develop a common understanding of what the word evaluate means. Or eliminate it from the proposal. And this I refer to both in terms of how much work the audit firm should do and how much information they should provide in their reports.

If left in I feel evaluate will cause significant additional work by auditors. The resulting expense to issuers and investors would not add commensurate value in my view.
The PCAOB should make clear whether the proposal calls for auditors to do more work, or simply report on the work they have already done. And I strongly advocate the later.

Further it is unclear what other information is in scope. For example, annual reports often include a company's headcount. A disclosure of the auditor is generally not involved in.

Clarity around how auditors evaluate qualitative statements or assess materiality of non-financial data, is also very important. Examples of these include descriptors firms frequently use to reference their industry standings such as, we are one of the largest, or we are one of the fastest growing.

How can auditors validate those types of statements. Frankly, in my view, they can not and should not. To the extent that information outside the audited financials is deemed part of the auditor's scope, it becomes very important to clearly identify information not within an auditor's expertise, and thus not within their scope.

And then practically speaking, boilerplate
language that would obviate the clarity of the PCAOB and the clarity that the PCAOB investors seek in this area. And I think it's important to recognize that we live in one of the most litigious societies on the plant. And like it or not, boilerplate will be part of the bargain in this proposal. We should acknowledge that up front and be careful to encourage as little of it as possible. Finally, there's the cost of the reporting extension itself. Auditors will be doing more, even if it's just adding language and documentation based on existing requirements. Auditors will want to pass these costs onto their clients.

Clients will also have to deal with a higher level of questions and documentation auditors will needs for their files, which will require them to add headcount. Both of these are costs that our investors would ultimately bear.

The proposal however, need not become onerously expensive or another giant process creator. Thus I do not see any concerns -- any of my concerns here as fatal to its adoption. But I do believe the Board needs to exercise proper due diligence as it has with other
initiatives to avoid the potential pitfalls I and others have noted.

I think this session is a great example of giving the regulatory community, the audit firms and their corporate clients, like Legg Mason, time and opportunity to work through these important issues together.

So I applaud the Board and the staff for making this event happen. And I think you for your kind attention.

MR. DOTY: Thank you. Mr. Gallagher.

MR. GALLAGHER: Thank you Chairman Doty and members of the Board and staff. I appreciate the opportunity to provide feedback today on the Board's proposed auditing standards related to the auditors reporting model and other information.

First let me recognize that these proposals represent the culmination of several years' work by the PCAOB what has taken place in a context of global reexamination of the auditor's reporting model with the objective of making the auditor's report more informative. I commend the PCAOB for this effort and applaud the continued outreach including this public
meeting to seek feedback from all stakeholders.

As the Board has noted, the auditor's pass/fail model is still highly valued. Therefore it's extremely important for the Board to consider the feedback from all stakeholders to look for ways the audit report and the role of the auditor can continue to evolve to better meet the needs of stakeholders today and minimize unintended consequences.

Speaking on behalf of PWC, we support the changes to the auditor's report. Including reporting with respect to other information that will be responsive to the feedback, while maintaining or improving audit quality.

Avoiding the auditor becoming the original source of information about the company, I'll talk more about that in a second, insuring the benefits exceed the cost, and I believe these proposals represent a really strong step in how we can enhance the current auditor's reporting model.

In addition, we're challenging ourselves to continuously explore ways to enhance the role of the auditor, beyond what the profession does today in order
to address the evolving needs and complexity of global capital markets. While we believe there is much in the Board's proposals that has merit, we also have concerns that some of the fundamental changes included in the proposals pose challenges.

Today I'll describe certain of these challenges and then offer suggestions that we believe will still achieve the intended outcomes of the proposals while mitigating unintended consequences. I'll briefly touch on critical audit matters and then focus my comments on other information.

With respect to critical audit matters, we understand that and support, including critical audit matters in the audit report, as a way of making it more valuable to investors. However we believe it should be limited to, or focuses on, matters that were material to the financial statements that resulted in the most significant interaction with the audit committee.

We believe these changes and others that we suggest in our common letter would add meaningful information to the audit report while not placing the auditor in the position of being the original source of
information about the company. It will also minimize the potential that including critical audit matters in the audit report will chill the dialog between auditors and management, something which could have an adverse effect on quality.

Now in listening to the discussion yesterday, which I thought was outstanding, a couple of comments that I at least with respect to PWC's position on CAM, I think is worth some clarification.

There was the notion that if the auditor is not the original source of information about the company, then isn't the auditor just repeating what's in the financial statements. And at least our view of things is no.

That an example of what we would be concerned about is potentially a litigation matter that the auditor discusses with the audit committee. The culmination of that discussion was that no disclosure was required because it was remote.

Well theoretically under the proposal, there may be some pressure to record that or report it as a critical matter, thereby you know, driving disclosure
that management is not required to make, through the audit report. And we would be against that. However, that does not mean that the auditor can't and shouldn't say more about the matters that they are reporting on as CAM. And specifically, the issues that in the auditor's judgment, drove the CAM disclosure. You know, whether it's the materiality of the matter, the judgment involved in coming up with the matter, the susceptibility to change. And talking about the audit response to why something was a CAM. And you won't find that information in the financial statements. But that's information about the audit, and I think that that can be valuable to investors.

The other point I want to raise from the discussion yesterday was this notion of 91 percent. And that 91 percent of investors don't read the auditor's report as it exists today. My own view is that's a very misleading statistic. We do substantial outreach to the investor community at PWC through our investor institute run by Kayla Gillan.
And the feedback we get from investors is, they may not read the reports word for word, it's a standard report, I wouldn't expect most to do that every time. But they look at every report. They look at every single one for who the auditor is, and was there something in the report that went beyond the standard.

So I go back to what Chairman Doty said when he opened up the meeting yesterday. The pass/fail report has value. I would say it has quite a bit of value. What we're talking about today is how do we enhance that value and make a good produce better?

So back to other information. We support the Board's intent to enhance the existing standard by requiring communication about the nature of the auditor's responsibility for other information to report. However, we believe the proposed standard as drafted, could potentially increase rather than decrease the expectation gap and risk increased execution -- or inconsistent execution by the use of language that's ambiguous and susceptible to varying interpretation.

In addition, we believe the proposed other information standard will result in a significant
increase in audit effort. Particularly with respect to information not directly related to the audited financial statements, with a corresponding significant increase in costs that in our view could exceed the value or the benefit.

To be clear, we are not opposed to enhancing the performance standard beyond what it is today if there's a market demand for such an enhancement. However enhancing the performance standard will by definition require additional work, which will increase costs.

It's our understanding that the intent of the Board with this standard was to have the auditor report on the information generally based on the level of work performed under existing practice. If that's the objective, we believe certain changes should be made to the proposed standard which I'll describe.

As an example of language that's ambiguous and susceptible to vary interpretations, is the use of the term evaluate as the performance standard. We believe this term is more commonly associated with the auditor's responsibility in an audit to determine whether the evidence obtained is sufficient and appropriate to
support the opinion to be expressed in the auditor's report.

We recommend replacing the proposed performance standard of read and evaluate with one that is more likely to result in consistent execution and more efficient in terms of the value provided for the effort involved. Specifically, we believe that proposed other information standard should include an overall requirement that the auditor read all other information regardless of whether that other information is directly related to the audited financial statements.

The auditor would then perform a prescriptive set of procedures similar to comfort letter procedures with respect to material other information directly related to the financial statements.

Finally, we recommend the language in the auditor report explicitly describe the limited procedures the auditor performed as opposed to a conclusion. Thereby decreasing the expectation gap and eliminating the practical challenges associated with a conclusion. If the stakeholders would find value and demand exists for the auditor performed procedures on
non-financial information, then perhaps a separate attestation engagement with separate reporting on other information could be considered. Good discussion yesterday about potentially an attestation standard with respect to MD&A or elements of MD&A. We would support that.

So in closing, I'd like to again thank you for the opportunity to provide the feedback on the proposals. The recommendations I've outlined today, and the others provided in our comment letter are intended for the proposals to meet their intended objectives while minimizing unintended consequences.

These proposals represent a strong step in how we can enhance the current auditor's reporting model. And I look forward to continuing the dialog as we evaluate how we can further enhance the role of the auditor in the capital markets beyond what we do today.

Thank you Mr. Chairman.

MR. DOTY: The panel has given us a lot to chew on. Mr. Harris.

MR. HARRIS: Well I think I agree with both Pete and Mike with respect to the term evaluation. And the
need to develop a more common understanding of what the  
word evaluate means.

I'm not quite clear Mike in terms of what you're  
recommending other than described the procedures that  
were follows. So -- and Mike you're a lawyer, so between  
the three of you --

MR. YOUNG: I didn't come here to be insulted.

MR. HARRIS: It wasn't meant as an insult.

Especially given your commentary, which is much  
appreciated.

But how would each of you -- what term would you  
use other than evaluate and other than describing the  
procedures that would presumably go to the word evaluate?  
Is there a term of art that you would prefer?

MR. GALLAGHER: Steve I guess my -- as I  
mentioned in my comments, I think the most plain way to  
communicate is just to share you know, in plain English,  
what we did.

And you know just to give you a flavor of what  
that would be, typically, as you're probably aware, in  
comfort letter situations, when companies are raising  
capital and the underwriters are doing due diligence,
typically what the auditor does with information, an MD&A
for example, where there's comparisons around revenue or
other financial metrics, is the auditor would recalculate
the numbers that are shown in MD&A.
They would compare it to information that's
included in the audited financial statements to the
extent that exists. To the extent that doesn't exist,
you could tie things back to original books and records
which are subject to a company's system of internal
accounting control.
And so our view is the best way not to have an
expectation gap, because I'm not sure there is a perfect
term that would capture in a word or two, what we do is
just -- let's lay it out. Let's explain you know, that
if information is directly related to the financial
statement and it's in there and it's potentially
material, we do these you know, prescriptive -- this is
what we do.
And with respect to the other information, you
know, we do what we do today. We read it for consistency
and look for material inconsistencies in the financial
statements.
MR. HARRIS: And Mr. Young I think that you quoted Chair White in terms of the concern about information overload. And you talked very eloquently about being concise and understandable. So I think that I don't disagree with where Mike is coming from in terms of describing evaluation.

But you know, you could get into some pretty significant information overload just in the description. So how would you concisely deal with the term evaluate?

MR. YOUNG: I wish I had a good answer to that. And appearances notwithstanding, I really would like to be helpful. Let me tell you the challenge as I see it. And that is I agree with the problem with the word evaluate. The challenge is not so much the verb, the challenge is the broader concept of the auditor speaking to the truthfulness of the information because users of the information are going to be inclined to boil it down very quickly.

And if they see the auditor speaking to the subject of the truthfulness of the information, they're not going to think about whether the word is evaluate or examine or inquire into or review. They are going to say...
to themselves, the auditor spoke to the truthfulness of
the information. The information as we now know turned
out to be false. And therefore, it sounds like the
auditor didn't do its job.

And to illustrate, let me just -- let me describe
a newspaper story that we have all seen many, many times.
And that is the newspaper story says there was a fraud
at XYZ Company. The auditor failed to detect the fraud.
Where was the auditor?

How many times have we seen the newspaper story
go on to say, however, under the applicable auditing
standards, this fraud was conducted in such a way that
the auditor would not be expected to detect it. I'm
still waiting for that story after more than 30 years.
The challenge as I see it. Evaluate is a
troublesome concept and a troublesome word. And I agree
with that. And I wish I could say that that problem can
be mitigated by choosing a different word. But I think
the problems more deep rooted than that.

MR. DOTY: Mr. Ferguson.

MR. FERGUSON: Yes, I want to focus for a minute
to see if I understand what was said correctly. And I
1 want to focus particularly on the statements that Jeremy
2 made and Mike Young, which seem to be in many ways polar
3 opposites. And to present us with a binary choice here.
4 As I heard you Jeremy, you said that indications
5 -- or that statements by management, things like key
6 performance indicators, non-GAAP measures, are not
7 subject to audit and are area because they're not looked,
8 are potential areas for fraud or for manipulation or for
9 management to tell a story that is not necessarily
10 reflected in the audited financial statements.
11 You Mike on the other hand, seem to say that if
12 we have the auditor start looking at these things, we
13 will inevitably inhibit their use in such a way that they
14 are effectively the only really clear communication
15 management makes. That the audited financial statements
16 are increasingly not relied on by investors. And that
17 we will actually make disclosures by management less
18 useful.
19 Those seem to me to pose a binary choice. You
20 know, we're dammed if we do and we're dammed if we don't,
21 under your two arguments together. Are they
22 reconcilable? Am I mishearing?
MR. YOUNG: Lew, I actually think that they are. And let me try to reconcile them. Because first of all I'm a big fan of Jeremy and his firm. And I've got Howard Schilit's book on my selves. And he and I are in the same business, which are investigating problems. I think they are reconcilable. And let me explain how. One is one of the things that Jeremy told was that these different ways of looking at things can be helpful. And that's true. They can be helpful. Another thing is we did not hear from Jeremy that the information is not truthful. We just heard that it's not the best way of looking at it. And I give a lot of credit to the sophistication of investors. I mean I think Jeremy's main point was that the information is being sliced and diced in a way that while it's truthful, creates an impression that you shouldn't have if you look at different ways. Also, the information that Jeremy's talking about, I don't think would get included in other information. I mean the 10K isn't going to have that kind of non-GAAP information. So the other information proposal wouldn't really
reach it. You would have to even go further than other
information. If in fact, well let me stop there.
So I don't think, I'm not hearing from Jeremy
that this is misstated stuff. It's just looking at it
in different ways, some of which is helpful, some of
which may be less helpful.
That's not what I'm really speaking to. I'm
really speaking to the concern that management will strip
out sort of the dot connecting subjective information
because of concern about auditor recalcitrance.
Is that helpful? I --
MR. FERGUSON: Yes, I mean that is sort of. I
want to hear from Jeremy too though.
MR. PERLER: And what's most interesting to me,
and I understand right now the scope of the proposal is
very broad, all other information. But my comments are
more focused on all detail and disclosures related to
communicating the financial performance, or financial
status of the company.
So anything like market share, or subjective
comments like that I'm less concerned about. It's more
here is our adjusted earnings. Or here is our non-GAAP
MR. FERGUSON: Statements that are based on the financials.

MR. PERLER: Based on the financials, arrived from or proxy for.

MR. FERGUSON: Just different from the connecting the dots information. Or can be different.

MR. YOUNG: Yes, but how would the auditor police that. I mean if it's true and if it's consistent with the financial statements, is the auditor going to say we don't think that's the best way of looking at it?

MR. PERLER: Well I do also want to say most of the time it is true, it's a way to communicate it. But many of the frauds and many of the you know, fraud with a lower case F if you will, ware rooted in these misstatements that are subjectively altered.

So I don't want to say there are not misstatements in there, but this is the area rife for discretion that I think is -- right now it's beyond the auditor's reach and stepping into that area will not just -- it's not just a matter of policing the metric, it's a matter of changing the overall behaviors.
Maybe auditors -- or maybe companies would not use some less relevant or manipulative metrics.

MR. DOTY: Mr. Hanson.

MR. HANSON: I've got a question and direct towards Pete, but I want everybody to weigh in.

In overall the feedback we've collective heard from you and others that the use of the word evaluate is problematic. The scope of what gets included is problematic, and that's what I want dig a little bit deeper on.

And also the fact that it's a game changer that the auditors actually report on the conclusions from that. And I'm kind of surprised that none of you touched on that one.

So I'll want overall reaction to the actual reporting of we did this stuff, evaluate or whatever the procedures are an didn't find anything. But on the scope.

And Pete you teed up that this is somewhat similar to what's accomplished in a comfort letter. And my experience with comfort letters, that underwriter's counsel starts with, they want every single number,
including the page numbers, some sort of comfort given on it in this 200 page prospectus.

By the time you're all said and done, there's a lot on the cutting room floor that there's no comfort given on so that whatever's disclosed falls on the floor. And the hierarchy of what underwriter's counsel usually wants is, gee if you can trace it directly to the financial statements, that's the best.

The second best is to the general ledger. A third best is to a schedule which reconciles to the general ledger. And then fourth is to a management prepared schedule that doesn't tie to anything, which those sometimes fall on the cutting room floor.

But the exercise of doing the comfort letter is very precise in that the exact number that you're given comfort on is circled with the exact procedure identified as to what was done. And one of my concerns is an investor will never know what comfort was given on any given number within the other information because it's not distinguished.

In some numbers there will be some comfort given, so reconciled the financial statements are tied to the
general ledger. In others, there's not a darn thing you can do about that number because the auditor doesn't have that information. And what we're doing in this proposal would not impose an obligation to go find the support for every number.

So Pete any ideas about how we could better identify to investors to make it more useful for them. And maybe your reaction how your team of analysts and investors would think about this with an unknown, we don't know what the auditor actually did. And whether they did anything to the numbers we find most important. Is that even helpful if it's a well, I don't know what the auditors did, so I can't really take any comfort at all in it.

MR. DOTY: That's compelling testimony. Does Michael Gallagher agree that you're tending toward a comfort letter approach to this?

MR. GALLAGHER: Yes, I believe, yes. I think that we have to be careful not to have the perfect be the enemy of the improvement.

And I think regardless of what standard you put out there, whether it's evaluate or some other standard,
because of the different nature of the information that's included in other information, you're going to have varying degrees of comfort if you will, for lack of a better word, in terms of what the auditor did and what the auditor was able to do.

Now I would hope that whether it's through technology or some way, that the numbers that can be traced back you know, to a system, something that ties to the general ledger or something that is covered by the system of internal control, perhaps that can be identified in some way. Okay, to give that reader better procession in terms of you know, at least some sense of what was done relative to that.

But in the meantime I think some if it will be intuitive. I would say maybe pick your percentage depending on the investor. You know clearly if it's a revenue number or something that's you know, directly related to the financial statements, it will be quite clear based on the articulation of the report, well that was something that was tied to the financial statements or ultimately something that came from the internal control system.
But in the spirit of making improvements and not having it be perfect before we make the improvement, is in the spirit of where we were going with our suggestion.

MR. NACHTWEY: And it's a great question. And I think first of all by referencing the comfort letter process, I think that's a somewhat imperfect process for the reasons you've mentioned. It's all about the investment banks throwing the risk football back and forth between the accounting firms.

And so the more they can get the accounting firms associated with every number including ridiculous things, you know the page number thing isn't too far off. Anything a monkey could do, and they could have their own staff, but they want to have the auditor on the hook.

So I don't think slavishly following the comfort letter approach is probably going to be workable here. I think something that's closer to read and consider, although I'm sure the lawyers in the room and at the table will say, well that's no less specific then evaluate. And I agree it's not.

But it is something that's exactly what the auditors do today. And I think we have to put some of
the burden on this into how the standard is drafted itself. What does it mean when they say if we stuck with evaluate, which I hope we don't, but if we did, you know it's got to be very clear what that means.

If we say read and consider, what does that mean. Right now I think everyone in the accounting profession understands very clearly that means A, read it. B, consider whether it's inconsistent with anything that's in the financial statements you've audited. And C, make sure that if it comes out of the books and records, you've got even more certainty about it.

So I think there's a great understanding in the profession -- I don't think, you know fairly stated, and you know in current standard audit opinion, if we were subjecting that to the same level of scrutiny we're subjecting these words to, we'd have the same issues with fairly stated. But people have gotten used to that over many, many decades of reporting and again, what the standard says.

I also think we're in completely unbroken ground. When we're over many, many decades we're talking about a two paragraph opinion that we've sometimes some of the
firms reverse the paragraphs, or the combine the paragraphs, but they pretty much all say the same thing. And that's given investors and users a lot of comfort. Because they don't have to read a report and guess well, what's the auditor telling me? If it's pass/fail, I know if they've passed it, they've got a good understanding of what was done.

So I think a bunch of what's in scope comes from what are you going to ask the auditors to say. And then again, what should be in scope. I think non-GAAP financial measures, you know by in large virtually every number, I know certainly the ones that Legg Mason reports, of which we've got primarily three.

And frankly, I talk to investors that probably 40 percent of my life is spent either on earnings calls or in investors sessions with both sell side analysts, or buy side investors. And Legg Mason is a buy side, so our mutual funds are out investing in things every day. But they're relying on sell side analysts who mostly work for the Wall Street firms in terms of their diagnosis of our financials.

They're not only relying on that, but they
heavily rely on it. And frankly 80 percent of the questions that I get, and I get all the numbers questions, my CEO gets all the fun ones to talk about strategy, et cetera, 80 percent of those questions are about the non-GAAP measures. Because GAAP unfortunately forces us to do some things in our financials that the analysts look and say that's not relevant.

I'll give you one example and then I'll pass the microphone on. But net revenues in our business. You know there's a lot of tension around wanting to make sure in accounting parlance we're reporting everything that's coming in. And then everything that's flowing out is an expense and what's left for the shareholders.

But in our business we have a huge amount of marketing costs that are referred to as 12b-1 fees that are highly regulated part of the mutual fund business. And 100 percent of those fees are passthroughs to the distribution partners that we have.

So no one looks at that as revenue that comes to Legg Mason, because why in the world would you be in a business where you have 100 percent of your revenues going out as expense?
So the analysts want to understand in terms of are we running the business efficiently. What is the net revenue that's actually coming to you that you're managing. And what's the margin you have off of that. So again, very few of the questions that I get go to the GAAP numbers. They go more to the non-GAAP.

MR. DOTY: Ms. Franzel.

MS. FRANZEL: Thanks for being here today. Assuming we get the verb right here, you know evaluate, consider, read. Or maybe we need more than one, you know sort of verb to apply to different categories of information. I'd be curious to hear your thoughts on that.

But what are the categories of information that you think would be most important to have some kind of explicit auditor involvement and conclusion on. Right now we've got a very broad you know, other information. Are there certain categories where you would envision that we'd get most value from auditor involvement? And what level of auditor involvement would that be? And the question is for all the panelists who would like to respond. Start with Jeremy.
MR. PERLER: Yes, I think in my mind it's a no-brainer for there to be auditor involvement on anything used to communicate financial performance. Be it a number, be it a qualitative disclosure about why revenue grew ten percent this year.

I would say that area is the most important area. Everything else would be below it.

MR. YOUNG: I'm a listener on that one. So I'm going to defer.

MR. NACHTWEY: Ditto.

MR. GALLAGHER: Yes, I like the discussion that was held yesterday where we discussed and we supported the CAQ proposal of reporting the auditor involvement with critical accounting estimates. Because those are the things that if they're done right, are really the most important things that drive financial performance, or where financial performance could be effected most significantly.

And I think there is a real opportunity to up the game in terms of how well they are written. Right now there is not auditor involvement beyond the read and consider. I think if the auditor were to attest to that,
I think the quality of compliance with SEC rules and the clarity with which it was written, I think would only improve.

So supportive there. And as I said, I do agree with Jeremy, I think things that are most significant and directly associated with the financial statements that really drive how a company's evaluated, is where the auditor involvement should be greatest.

MR. NACHTWEY: Again, it's a difficult issue. I think investors probably today assume anything has a dollar sign on it, or even if it's a number, that the auditors have done something with it.

You know frankly I think it's difficult for the audit profession to do much with things that don't come from -- directly from the books and records. And things that are subject to the internal control system, you know a lot of thought and theory that's been put into internal controls by a number of bodies including COSO.

But I think confining it to things that are you know, within the expertise of the auditor, mostly financial information, financial numbers. The things that are so often have been in these tense meetings with
underwriters, that they want auditors to comfort.

And the same kind of things that I think Jeremy is talking about here. I agree they are important numbers. So things like square footage. So a firm that owns office buildings or regional malls, et cetera, is -- has square footage is a key, not so much performance indicator, but certainly a key statistic in their financial reporting.

Yet there's incredible amount of subjectivity as how you measure square footage. So I used to do some real estate work in a prior life. And in New York City, we always talked about the gross leasable area was how far you could throw your boss out the window. And then you've got to measure that distance onto the sidewalk. And this was all a game of the real estate brokers and the owners and the tenants deciding how much they're going to pay in rent. And then what's leasable area? Do we count the restrooms? Do we count the elevator shafts, et cetera? Things that accountants clearly aren't capable of accessing.

The second one, proven reserves. Some of the resource, oil and gas, minerals business, et cetera.
Incredibly complex. Not something -- I can tell you, again I'm a CPA, I spent many, many years both in school studying for the exam. In practice and in no way shape -- I know what a proven reserve should be. But am I engineeringly capable of going out and verifying it? Absolutely not.

And then last but not least, in the valuation space. And there was a time in my prior life at Deloitte where I ran the valuation practice for the firm. Not because I was an NAI and knew really the first thing about the science of valuation, but the firm needed somebody back when FAS 141 and 142 came out, to connect the valuation folks to the auditing folks.

And it's a very different again, amount of rocket science that goes into valuing things. Whether it's hard assets or financial instruments.

So I know I haven't given you a clear answer to that. It's -- this is why I'm suggesting that we have to be very careful at constructing this thing. And making sure that we don't cause more confusion by people assuming once the auditors started reporting on information, if it's not clear exactly what they've done,
1 on what numbers, we create some difficulty.

2 So the last point. In going back to this, we're
3 breaking new ground on the reporting. Everybody's taking
4 comfort in having this one page, two paragraph opinion.
5 And then we may be in a land where you need an appendix
6 to the opinion that describes exactly what's done.

7 You don't want to torture everybody to have to
8 read that to get to the substance, but it might help with
9 the litigation protection. And for the ones who really
10 want to go deep on this, they'll have the information as
11 an appendix to the report.

12 MR. DOTY: Brian Croteau.

13 MR. CROTEAU: I think Pete you started to
14 actually answer the question I was going to ask. But I
15 wanted to come back to the evidence point again.

16 I'm obviously again for the fairest amount.
17 There will be a range of evidence that the auditor
18 gathers and has in his files. And you know, some
19 information will be covered -- would be covered under
20 Jay's model and under the proposed standard.

21 And other -- for other information, there would
22 be a range of relevance relative to the information in
the auditor's file. And to the extent that we're talking about a report that is a paragraph or two versus describing for each specific element of the other information what was done.

My question was really is it more risky or more helpful to have that kind of report? And I'd be interested in other's thoughts on that. I think you just started to answer that question. I'd be interested to know what others think about that.

MR. YOUNG: Forgive me, I don't understand the question.

MR. CROTEAU: So in some cases, the auditor may not have any information from the financial statement audit in the file. And in other cases the information the auditor has may be relevant to some degree, or may be completely relevant to the other information that's being looked at. But yet the report we're talking about wouldn't necessarily identify what was done for each element.

And I guess my question is, is that kind of report that generally describes what the auditor has done, relative to the other information, the procedures
performed, helpful? Or is that likely to be more confusing without what Peter was just sort of describing, sort of a tick mark legend if you will, of what was done for every element?

MR. YOUNG: Right. Here's the challenge. And that is let's say we want to take, I'll call it a comfort letter approach, because that really crystalizes it. You got a number, you circle it, the auditor looks at the number, very little ambiguity there.

The challenge is coming to that level of clarity, that level of crispness, that sort of line of demarcation when you're talking about other information more generally. Now sure if we could have the auditor circle numbers, well yes, okay, that would take care of it.

But in a sense, almost anything you say about the business, at some level ties to something in the financial statements. And let me give you an example which makes it perhaps a little bit more concrete.

And that is risk management, it's a big thing right now. Disclosure about risk management. And let's say that the company says, and speaking, you know speaking operational, we believe that we have effective
Well the auditor knows that the company has FAS 157 Level 3 assets. And let's say sure enough the value of those assets goes down. And then the contention is, auditor, how could you have allowed management to say they have effective risk management when you knew they had FAS 157 Level 3 assets, and look what's happened. The value has gone down. That's not effective risk management. How did you let them say that?

Now that's an example. You don't think of an operational statement about effective risk management as really tying to the financial information. But those dots are not difficult to connect.

How realistic is that hypothetical? Not only is it pretty realistic, it's not even very creative.

MR. DOTY: Mr. Baumann.

MR. HARRIS: What do you do in that situation where there's effective Level 3 assets?

MR. DOTY: Steve, let's hold it. Let's let Marty pursue the question and then we'll get back. You'll get another round.

MR. BAUMANN: Thanks. You've all made a great
contribution to this important topic. And I really appreciate Mike's comment about don't let the perfect be the enemy of the good here.

I -- Jay asked a really good question. He talked about investors really don't know which level of assurance was given on different numbers because the auditor knows more or less about different number in the other information. And that's a good point, but still can't we still improve auditor reporting without getting perfect in this regard?

I'd be interested in Mike and Jeremy's reaction to a comment that was made by Pete in his remarks that, we are the fastest growing company in this industry, is something that he said cannot -- auditors cannot report on that type of information.

Now as part of the risk assessment standards, auditors are required to gain an understanding of the company and it's environment, which encompasses industry factors including a competitive environment. So auditors have to understand a company and it's environment as part of the risk assessment standards.

So if the auditor is doing that and is reading
the company reports about its growth, its strategy, also minutes of the Board of Directors, and is aware of the fact that they believe that they have some problems in growth. And that they have competitors that are growing faster than them, and have better products than they do. And the auditor reads that statement that says we are the fastest growing company in the industry, but the auditor knows that that's not what is reflected in management's own records in the board meetings that he attended, or audit committee meetings, is that not the type of information where the auditor could and should say to management, we think you have a material misstatement of fact here that we think has to be corrected.

So and isn't that the kind of information that otherwise could be very market moving in other information that might be at the heart of what we're trying to get at here?

MR. PERLER: Yes, I think that would be a material, and if the auditor saw that as a material misstatement of fact, that would be a great area for discussion and something that the auditor could speak
about and communicate with management, absolutely.

I recognize the subjectivity of that particular statement, and what are you using to make that judgment? Growth in what measure? And you can pick any measure and say we're the fastest growing company. However I do think that would be a helpful area. Less important to me than actual financial reporting numbers, but helpful.

MR. GALLAGHER: So Marty, the way I think the auditor would approach it today, is ask management, hey you're making this statement, what is it based on. You know recognizing that it's a very ambiguous statement. There are so many ways you could measure you know, fastest growing.

So very ambiguous, and you'd want to get behind it in terms of what is your basis for making that claim. And if there wasn't a basis for making that claim, I think the auditor would likely raise it and say hey, this is problematic.

But it would be very difficult for the auditor to report on that because of the subjectivity of it. And there's probably some metric that they can find given the ambiguity of the measure that they might be able to
1 support the claim. Whether you think that that measure
2 was a reasonable measure would be another matter.
3  So those are -- that's the caution we would have
4 as auditors in terms of reporting on information that's
5 fundamentally not objective, it's subjective and
6 potentially ambiguous.
7  MR. NACHTWEY:  I was thinking Marty, I recognize
8 as well that that's you know, an important area for
9 investors to have a feel for. But it's a question of
10 whether the auditor is the right place to get the
11 information, or a standard that we can craft that
12 everyone would agree objectively. First of all, how do
13 you define industry.
14  And so there's many subsets and levels of SIC
15 codes we could go through as to is it you know, a very
16 finite example, Legg Mason, are we a financial services
17 company? In which case you're going to compare us to
18 insurance companies, banks, broker dealers, et cetera.
19 Or are we an asset management company, and within that
20 are we an active asset manager versus passive like a bank
21 or et cetera.
22  And then getting into the unit of measure, is it,
or what is fastest growing. Is it units of production?
Right now most tech companies that are being sold for billions of dollars have you know, fast growing stuff, and they're not making any money.

So is it you know, growth and profitability, growth in units of sales, growth in revenues. I think is where the challenge is. But like Mike, my prior life, if I had a management that was consistently, you know it when you see it. And if they're consistently misstating things like that, those are the kind of clients you say, should we be associated with.

MR. BAUMANN: Or at a minimum, if they're making that kind of statement and you know it's factually wrong because in their minutes of the board meeting, they've asserted you know, we're the third fastest growing in our industry in every single category. You'd want them to, when you read and whatever the verb is, evaluate or consider, whatever, say maybe that's something I've just read, but I think either management has to correct, or my report would say we did read this and we found something to be materially inconsistent with our knowledge of the company, or a material misstatement of
MR. DOTY: Steve Harris.

MR. HARRIS: Getting back to me.

MR. DOTY: Yes, go ahead Steve.

MR. HARRIS: The question on Level 3, what's the responsibility and role of the auditor to report on, in essence impossible to value assets?

MR. YOUNG: Well I mean I would think it is to come to a judgment as to whether management's judgment in trying to value the assets is fairly presented as of the date of the valuation. You know, it's -- I would not view the auditor as having a -- no, no, now I'm talking about auditing standards. Please correct me where I go astray.

But I would not view the auditor as having a responsibility for you know, thinking what the value's going to be next month. It's what is the value under Level 3 as of the date of the information.

MR. HARRIS: But there is no value. I mean Level 3 is from my understanding --

MR. YOUNG: Oh no, you -- no, there's a value, it's just hard to set the value.
MR. HARRIS: There's such a range. I mean from everything I gather, it's such a range that it's virtually impossible to value. So in essence what you do is to what is extent is the auditor responsible for reporting the difficulty in valuing the Level 3 asset. If at all.

MR. YOUNG: Well -- that actually is a very good point. Because it take us to what Mike Gallagher was talking about earlier about critical audit matters. And that's one, if I may leave other information just for a moment. I mean that's actually something that would be useful for investors to see, that this is challenging number. You know, you've got a FAS 157 Level 3.

But you have to come to a value. I mean the FASB doesn't say, gee it's tough to value, so just leave it blank.

MR. DOTY: Lewis.

MR. FERGUSON: Yes. Alan Beller talked about this yesterday. And as I heard him, what he said was he had two concerns about it. One was the question that there did not appear to be any materiality standard in
terms of what the auditor did. And number two, you didn't really know what the auditor had done beyond evaluate this large body of other information. Would it help for example if assuming we cure the problem with evaluate and come up with a definition of what the auditor, that is clear and understandable and people know what it means. Beyond that, that auditor has to say and in addition, we preformed procedures with respect to the following areas, so the reader knows more specifically in this body of other information, what areas the auditor thought were worthy of attention enough to do work on.

Does that help?

MR. GALLAGHER: So Lew I would break it down between other information and CAM. And I don't recall yesterday whether Alan's comments were focused on articulate -- potentially articulating procedures with respect to critical audit matters.

That I would be less enthusiastic about a litany of procedures that was performed, that may call into question whether you have a problem with that number or not. As opposed other information where again, if the
purpose of the Board was to capture what practice does today with respect to other information. And we do things that go beyond what we're required to do in order to manager our risk.

So we're required to read and consider. Do we do more than that? Sure. We tie numbers out all the time. Whether it's in connection with a comfort letter, or just you know, just to get the 10K done. Every number in MD&A that's the key numbers for sure, are tied out.

So I think articulating procedures and what we do just being transparent about what we do today, recognizing the imperfections that from Jay's comment, which we recognize. And I think Brian's question is exactly the right one in terms of the consumer, would they find it to be more confusing, or would they find it to be helpful?

I think that would be a great thing to test in a field test.

MR. FERGUSON: Are you saying that you do think that would be helpful to do?

MR. GALLAGHER: I think in the context of other information, not CAM.
MR. FERGUSON: Yes, that's what I'm asking. I'm not asking about CAM. I meant other information.

MR. GALLAGHER: I do, but I would keep it limited to you know, a few categories. Not an endless articulation of individual procedures.

MR. DOTY: Jay.

MR. HANSON: A question mostly directly at Jeremy around the non-GAAP financial information. It seems to me that one of the problems is that there are no standards around how you present any particular non-GAAP measure. And I know that we can't solve that problem, the PCAOB.

And I'm looking at Mr. Kroeker, and I'm guessing that he would say gee, we're having enough problems with disclosures on GAAP matters, much less taking on non-GAAP measures. And Brian's colleagues in Corp Fin are the ones that tend to do some policing in the non-GAAP measures.

But it seems like there is a fundamental problem of there are no definitions behind it, nothing uniform. Even if something as on a simpler end of the scale as same store sales, that there are many ways to compute
But without solving that problem, which I don't know is even solvable, I think we're always going to have the problem of people saying whatever they want to say with whatever caveats being on it. And there will always be a schedule that describes how the number was computed.

But you made a -- I'm trying to figure out what my question is here. Because I -- do you have suggestions about getting at the core of that problem of it's a wild, wild west relative to non-GAAP measures. Or is it your message really that auditors paying more attention to that may curb just the use of some non-GAAP measures at all?

MR. PERLER: It's a great topic. And I think Pete illustrated it really well when he said that 80 percent of his investment community asks him about the non-GAAP metrics then the GAAP metrics.

And I'm not an advocate of banning non-GAAP metrics. Or turning them all to GAAP, or telling companies that you can't report this information, because I agree it would curb information flow.

And I recognize that this is a fundamental
1 problem that the system has, that it could foster a wild
2 west situation. But I think there are absolutely steps
3 that could be taken. Particularly from the auditors
4 perspective.
5 You know some easy ones include -- we all know
6 for every company, what are their most important investor
7 communication metrics? Pete just said at his company
8 there were three non-GAAP metrics that they use. Every
9 -- you go to open-ending earnings release, and you look
10 in bold on page one, and you can see right there what
11 they're communicating to investors.
12 For those metrics, at minimum, to not have any
13 robust quality check or auditor scrutiny on them, I think
14 is a problem that could be fixed with some procedures.
15 I don't want to suggest everything and anything needs to
16 come under the umbrella, but there is a way to pick off
17 the most important investor communication metrics.
18 MR. HANSON: And just a commentary on that, which
19 is -- which we've heard some feedback in different
20 settings that auditor involvement in press releases. And
21 actually Mike Cook, one of our standing advisor group
22 members, talks a lot about the need for auditors to get
on the train earlier than at the tail end when the audit report is issued.

But that in most companies, the auditors do have some involvement with the press release. But definitionally, since most major companies issue press releases long before the audit report is ready to be signed, it's an imperfect exercise. And the auditor is never going to be able to sign off because they're not done with their audit yet. So that is a real change.

MR. PERLER: I recognize that. I think many of these metrics do find their way through the MD&A. And just this overall scrutiny over what the most important metrics are will influence what metrics are used. And just to acknowledge, the audited financial reports are not the primary communication tool with investors. They're not secondary, they're not tertiary, they're what -- above that are the earnings releases, the conference calls, the PowerPoint presentations, the one on ones. This is how companies communicate with their investors. And the audited financial statements are well below that. So I think it -- and I know it speaks to a grander change in the system, but I think some kind of
involvement with the key measures reported in those other communication tools only makes sense from an auditor's perspective. That's where investor protection would be best served.

MR. GALLAGHER: If I could just add to that. I think that I agree with Jeremy. And I would certainly be supportive if the demand exists on the part of the stakeholders, investors and others, to have auditor involvement in press releases and others.

But I would also say that this notion that the audit is all the way at the back end, which from a time perspective it is, but I think when a press release comes out, there's the knowledge that an audit's being done. And God help the company that has numbers that are different in the audited financial statements from their press release.

Now you do have that. Sometimes you have a subsequent event which was beyond their control. And I think the market generally understands that. But if a company consistently, like more than once, has an issue that -- where there's a disconnect between those audited financial statements which come later, and those numbers
are different than that press release, they're going to pay a pretty heavy price.

MR. DOTY: Jeanette.

MS. FRANZEL: I want to talk a little bit about the potential impact of whatever we do. Let's assume we can get it exactly right. The impact on perhaps increasing the expectations gap. Because to me that seems to be another factor that we need to worry about.

So if we define auditor's involvement and we define the scope of auditor's involvement, yet you do have some qualitative connecting of the dots and presentation matters that could potentially be misleading, even though the auditor has managed to get comfortable with the various numbers. What do you all see as potential risk here in terms of increasing expectation gap and what advice would you give for us to consider that?

Let's start with Jeremy. And I think Michael you touched on a lot of that.

MR. PERLER: I think the expectation gap is very large right now. I'm not too worried about increasing it. The question I get very frequently from investors
when I point out some sort of misrepresentation, is why
aren't the auditor's looking at this?
Whether it's in the press release, whether it's
in the MD&A. I would say if you surveyed investors, the
vast majority would think that the MD&A is audited.
Maybe not the press release. But I think the expectation
gap is so wide, I wouldn't fear implementing something
just because it might increase.
MR. YOUNG: I think that in everyday language,
this will be -- start to be referred to as auditing MD&A.
Or auditing the 10K. And the distance between that
articulation and the reality will be the expectation gap.
MR. NACHTWEY: And I actually agree with both
what Jeremy and Mike have said here. And I think there
is a huge expectation gap today. I do think that
investors by and large believe that if auditors have
signed off on an audited financial statement including
in some other public filing, or in a public filing, that
virtually all of the other information, particularly if
it's a number, and if it's got a dollar sign even more.
That the auditors have been involved with that.
And even the ones who have a better or more
sophisticated knowledge, I think assume okay, I realize
the auditor may not have subjected it to the same level
of audit procedures, but it's a higher level than what
auditors are capable of doing.

So I think this is a great opportunity to tighten
that expectation gap. But depending on how we ultimately
you know, articulate the proposal, it could cause -- it
does have the risk of creating more confusion.

MR. GALLAGHER: I agree with Pete's comments.
And I go back to Brian's question. I mean the true test
here is if we can experiment. You know whether it's
finding the perfect word or articulating the procedures,
and get a reaction from those that use the financial
statements. And look at the other information and get
a reaction. Is this helpful, is this widening the
expectation gap, or is it closing it.

MR. DOTY: I am concerned listening to Michael
and to some extent the rest of the panel. With the
notion that we have now auditors as a matter of practice,
looking at other information. The concern that if the
issuer knows they're going to have to say something where
they find inconsistency, this will result in management
leaning toward cooking the books. They will lean toward withholding information. They will lean toward trying to make it -- to neutralize the comment.

It seems to me that they do that at their peril. And the suggestion is what comes out of the suggestion is that the involvement -- some involvement as Jeremy is suggesting of the auditor and the audit process and other information and addressing inconsistencies, should correct, should produce management conduct that is better.

I understand the liability issue. But is the panel comfortable with the notion that we do not -- that we will not empower the auditor. We will not by virtue of directing the auditor to form judgments of some kind. That we've decided that what comes out of this panel discussion is there's a lack of uncertainty about evaluate.

But some -- requiring the auditor to form some judgment and communicate some judgment, is that consistent with best corporate practice and best disclosure? Do you really -- do you believe that that in facts leads us away from boilerplate?
So are you willing to say we're going to abandon
the attempt to have the auditor perform some judgmental
review. And then having done it, communicate that. Is
that where you are? No involvement?

MR. YOUNG: Look, I know you guys have put a lot
of work into this. But I'm afraid that's where I am.
And let me -- and let me respond to.

Warren Buffet in his most recent shareholder
letter says something about a write down. But the number
is economically meaningless. If an auditor were
reporting on that statement, that statement would not be
in there.

And I remember an earlier shareholder letter --
but I do other things in life besides read his
shareholder letters, just but -- an earlier shareholder
letter I think we talked about a reserve. And he said
the one thing we know about that number is it's wrong.

If an auditor had responsibility for reporting
that sentence, it wouldn't be in there. And my concern
-- I mean let me say it this way. The lawyers will take
over. The lawyers will go over the disclosure and they
will look at the risk, and they will say, fastest
growing, maybe it's right, but there's evidence to the contrary, get that statement out of there. Economically meaningless, get that statement out of there.

And the thing -- I mean they have -- 10Ks have so little life now. I mean you know, maybe an argument is they're so unbearable now you can't make it any worse. But, you know, hope spring eternal.

And my concern is bluntly, the lawyers will take over.

MR. NACHTWEY: Chairman Doty, as I said in my comments, I generally favor the standard. And I think because going back to Jeanette's question, I think there's more risk and harm today in terms of the lack of understanding of what auditors are involved with and the other information, that we can close that expectation gap.

And I think to obviate the issue that Mike so wisely raises, you don't want to limit you know, what Warren Buffet could write. But those kind of subjective things, are not really the part, the purview of the audit firms. And we shouldn't be forcing the audit firms to get involved in that stuff.
Again I think it's much more about reporting and what they already do, to make it clear to investors where the auditor's been involved in other information. Or as Mike said, Mike Gallagher said before, and again from my experience of you know, 25 years at Deloitte, we were involved with a lot of the information. And we just have to come up with an appropriate way for them to report on what involvement they have. What the information is they're involved in and the level and scope of what they've done.

MR. DOTY: Well there's a real dichotomy that emerges. Because Jeremy began with a very profound statement that he says that he has an understanding in his career of how information is read and used, consumed. The whole panel I think fits that description.

You all have through your careers, a heightened understanding of how information is read and consumed. And I take it that along with Mike Gallagher's written materials, I thought there was not the same reluctance or the same concern about the critical audit matters, the CAMs.

That in fact in your view of some of the
arguments made that the evidence concerned with involvement in other information, would in fact suggest that you think there is not a risk in having CAMs in the audit report. That's a different breed of cat. I know it's not your panel's subject.

And there are issues of naming the engagement partner and the tenure of the firms that were discussed yesterday and that are coming out of the European model, and that we are considering. I would like to know the panel's views as sua sponte as they are, on whether in fact we should proceed with CAMs, engagement partners, tenure.

Are these matters that are a different issue than the ambiguities and the dangers of other information? Jeremy?

MR. YOUNG: May I speak first to that?

MR. DOTY: Please, please.

MR. YOUNG: Let me speak to the CAM question. I actually think that at a -- I think there's a lot of benefit to the CAM disclosure if it's done right. I mean don't get me wrong. I think there's some issues.

But at a conceptual level, there are tough
numbers. I mean Steve it goes to your point about FAS 157 Level 3 assets. You know the mere fact that FASB says you've got to come up with a number doesn't make it easy. And doesn't mean that there's not a range that takes you from A to Z.

And it's useful for investors to understand that. And that's good for investors. It's good for preparers. It's good for auditors. And by the way, in at a conceptual level, that helps you with regard to litigation risk. I mean you're talking about challenges, you're talking about risks. You're talking about problems.

The disclosure of problems doesn't get you into litigation trouble. It's the non-disclosure of problems that gets you into litigation trouble.

Now permit me to just insert here, I was in the room yesterday when Alan Beller was speaking, and I accept that when you get into the weeds, there are some real issues. But that's really on the implementation. At a conceptual level, I would not suggest that you abandon the CAM project. Quite the contrary. I'm sort of cheering you on as a matter of concept.
MR. PERLER: I agree. There are benefits to the CAM, the auditor's name. I agree with all of that. I think all of those -- or I should say, the most important thing that can be done on the entire proposal is around these most important financial metrics I talk about. All of those are very helpful context as well.

But in my mind, strengthening the robustness of the system for communicating financial performance, is the most important thing that can be done.

MR. NACHTWEY: I appreciate having the opportunity to weigh in on those. Although again, having spent as much time studying them as we did this topic. But I have concerns about all three. Don't have to be fatal.

But in terms of the first, in terms of CAM, so management already does MD&A with massive disclosures and footnotes. If you go to some of the big banks, just critical accounting policy runs on for 20 pages.

So ours is a little less complex, but still runs to probably 10 pages just in the main footnotes. Get into MD&A, there's going to be even more.

So how do we make sure that we're not confusing
investors by auditors saying one thing. Now presumably auditors would agree with our disclosures, or they wouldn't have signed off on the audit opinion. But now you get into words as opposed to numbers.

And so the time that it would take to make sure that we're consistent. And if we're not, the idea that either the company did something wrong, and therefore should have had a qualified opinion. Or the auditor's disclosing information that management should have been disclosing to begin with.

And I do have some tissue rejection about the idea that auditors should be the source of original disclosures from -- about the company. But again I think there could be workable things.

I do agree as Mike says, you know FASB, the Level 3 asset issue, and I've had clients -- audited clients and was the CFO for a firm that literally had 100 percent of their assets that were Level 3. And you know did -- the users of those financial statements really understand the challenges in valuing those.

And the risk, valuing them on any given day is tough enough. Trying to say what's going to happen
between now and next quarter, virtually impossible.

On the engagement partner, that's a, it's a tough one. You know, from my view, I had audit clients, I had one of the largest audit clients in my former firm. I had 200 partners, audit partners around the world that worked on that client.

So, I mean, I can sign it, but, gee, I'm relying in large part on those other 200. Do we want a laundry list, but I accept the fact there were other professions that do, you know put the individual's name on it.

I just question whether -- does that have as much value as people might think? Or is it misleading that there's simply one, you know, one individual that's responsible for the audit.

And then on the tenure front, could be a good disclosure. We do it. We do it in response to a shareholder proposal. But quite frankly, my concern there is it's a data point that without some context to it, can be used by, you know, folks that want to make a point. Well we just should not have long tenured relationships.

Well I guarantee you, that audit whose name will
remain nameless for the moment, but where I had 200 audit partners on it. Imagine trying to get 200 audit partners in the new firm up to speed, overnight, on an incredibly complex business.

So rotation is -- tenure in my mind is simply the camel's nose under the tent of forcing the rotation discussion, another step down the fairway. And I'm not sure it's the appropriate way to do that.

MR. GALLAGHER: So CAM, as the written comments suggest, and my oral comments, very supportive of CAM. As to tenure, very similar to what Pete just articulated. It's a data point. Certainly no issue about having it be somewhere, probably the proxy is the best place to put it to be able to provide that context.

The partner identification as we've communicated in our response letters to that proposal, we're supportive of transparency and letting everyone know who the partner is. Just logistical issues about whether it belongs in the report or if there's a way to do it and have that transparency without creating other issues.

MR. DOTY: Any last questions? Go.

MR. HARRIS: I had just one final question. And
1 Pete I wasn't exactly sure in your statement where you
2 say a key performance indicator is assets under
3 management. What's the auditor's role? What do you view
4 as the auditor's role in that area?
5 MR. NACHTWEY: Again, it's not a number that
6 actually comes out of the general ledger. But it's a
7 number that general ledger numbers are derived from.
8 So assets under management, bottom line is, daily
9 we calculate our revenues off the assets that we manage.
10 So there's I don't know how many thousands of different
11 fund products and separate accounts that all have
12 different fee structures.
13 So every day we obviously have this in the
14 system, but there's also some subjectivity to it, where
15 my finance team has to effectively book revenues on a
16 daily basis. So again the auditors can't ignore AUM,
17 it's the first part of the equation. So asset times fee,
18 equals revenue.
19 On the other hand, AUM isn't subject to the same
20 kind of you know, double entry accounting system tension,
21 or the same -- it's subject certainly to our internal
22 control system, but in a different way.
But again, that's why I used it though as I think a good example, a little bit of what Jeremy's getting at is, you know that's a really important number. And it goes beyond the financials.

Every month the market waits with bated breath for all of -- for my firm and all of our peers, to announce what our AUM is. And it moves the stock immediately once it goes -- once that goes out.

So again, it's something that I think having the market understand clearly, what level of involvement the auditor has and doesn't have with that number is important.

MR. HARRIS: But what do you think the level of involvement of the auditor should be in that instance?

MR. NACHTWEY: Well I think it already is heavy. So I think you know, articulating what that involvement is, I think would be important.

MR. DOTY: We're at break. We're having a break. We have a great panel coming up. Let's take 15 minutes. Let's be back here promptly at 10:45 if we can. Thank you all. And thanks to the panel. Extraordinary panel.
(Whereupon, the foregoing matter went off the record at 10:30 a.m. and resumed at 10:49 a.m.)

MR. DOTY: Good morning. The panel, whom we welcome, includes William Touche, the senior audit partner of Deloitte, in the London audit practice. He also leads Deloitte's UK Center for Corporate Governance. And as a center leader, follows developments in the UK regulatory environment, the listing rules of the SSA, the FSA and the developments of the UK Financial Reporting Counsel.

William Touche is Deloitte's representative on the Audit and Assurance Faculty of the ICAEW and also serves on its corporate governance committee.

Philip Johnson, the Non-Executive Director of Yorkshire Building Society. Prior to joining that society, he was the head of Audit Quality and Risk Management at Deloitte, UK. During his 30 year tenure as a partner at Deloitte, he was a Board member, also served on the Structure and Risk Committee and Compensation Committee, and sat as the first Chairman of the Audit Committee.

Previously he was the President of the Federation
of European Accountants, a member of the International Auditing and Assurance Standards Boards, and the International Ethics Standards Board Consultative Advisory Groups.

He serves on the scientific committee of the World Congress of Accountants of 2014. And he's a current member of the PCAOB Standing Advisory Group.

Tony Cates is head of audit for KPMG UK, and also for Europe, Middle East and Africa. He joined KPMG in 1987, qualified as a chartered accountant in 1990, was promoted to partner in 1998.

He spent a year on secondment to KPMG in Kuwait in the 1990s and has subsequently held a number of senior leadership roles in the firm, as well as serving a wide range of clients from owner managed businesses through to the FTSE listing across a number of sectors -- FTSE 100 clients across a number of sectors.

Liz Murrall. Director of Corporate Governance and Reporting at Investment Management Association, the trade body representing the UK asset management industry. She monitors the developments in corporate governance, companies' reporting requirements, assesses the
implications for the industry, and where necessary, lobbies for change.

She represents the IMA on a number of committees including the Institutional Shareholders Committee, the CBI's Companies and Financial Reporting Committees, the Corporate Reporting Users Forum. She is the secretary to a cross industry group that liaises with the International Accounting Standards Board and the Main Accounting Practices on Reporting and Auditing.

Before IMA, Liz Murrall worked at a number of the main accounting practices providing consulting services to a variety of financial services consultants.

The experience and the expertise represented on this panel regarding changes in the auditor's report in the United Kingdom, have direct relevance for us and what we're trying to learn. And we appreciate your doing it.

Please begin Mr. Touche.

MR. TOUCHE: Well, thank you very much Chairman and members of the Board for inviting us here today. And so I'm going to give you perspectives from the point of view of a practicing audit partner who issued one of the first audit reports under the new
regime. And that was for British Sky Broadcasting and their satellite broadcaster.

I thought I'd touch on three areas. And first why I believe extended auditor reporting is so important for the future of the profession. Second I'll share some observations gained from signing last year in July, one of these first reports.

And third, based on that experience, just a few observations on what works in the UK and some perspectives on what I perceive the challenges will be for the second year of reporting. Because I think we're all very excited about the first. But actually the second is also - you need to have a view on.

So to start, I thought I'd mention that I wouldn't be here today unless I was a big fan of the new regime. However a lot of the success of the regime in the UK is because at the same time as introducing the new auditor reporting, the FRC also introduced new requirements for Boards and for audit committees.

For Boards, to make two statements, first of all that the annual report is fair, balanced and understandable. And second, that it contains sufficient
information to explain the strategy, business model, and performance of the company.

So in addition to these, new requirements for the audit committee and its own reporting to shareholders, that they should examine the scope of the audit, and explain in their report to shareholders, the key issues that they considered and how they were resolved in respect to the financial statements.

So, and I know this is a hot topic here. In my view, this quite properly puts the communication responsibility for financial statement judgments on the company rather than the auditor.

And it also highlights and reinforces the role of the audit committee in supervising on behalf of shareholders, the production of the financial statements, the supervision of the scope of the external audit, and the resolution of key issues raised by the auditors, and doing that on behalf of shareholders.

So second, just a few introductory contextual remarks about B Sky B. It has a reputation as one of the most successful and innovative companies in the UK, well led by a management with a focus on its core mission.
And in common with many consumer-oriented companies, its focus and clarity is reflected already in its annual report.

So I was very pleased when the CFO and the CEO, Andrew Griffith and Martin Gilbert -- and Martin is a significant investor, he's the Chief Executive of Aberdeen Asset Management, a major institution investor -- agreed to take the lead in early adoption.

So first the importance of the new external audit report. So I've been a partner for about 18 years at Deloitte. We employ 15,000 people in the UK. And we recruit about 700 graduates into the audit practice. And all hugely talented people. And most of whom will use their training as a springboard for successful and fulfilling careers in finance and business.

Now for these people, the facts that the key matters we address in our audit work are now directly described in our public reporting, is actually rather inspiring for our new auditors. They're proud to see their work so directly described in an audit report. It underscores the public interest nature of our work at a time when the profession has had a pretty rough ride.
It invigorates their personal sense of responsibility and pride. And it underscores to them why quality is so important in everything that we do.

So from the perspective of Deloitte UK, we see the audit report as an opportunity to inform shareholders about the important work we do on their behalf. We're appointed by shareholders to form our view on the overall financial statements. The commenting now on the major areas of focus of our work actually seems quite natural in the public domain. Even just a few months of the new reporting regime.

So speaking as a member of the profession as a whole, thanks to the leadership of the FRC, and the good work of many others, I think we've been given an opportunity to reestablish the value of audit. And of course without being too sentimental, London's pretty proud that we've taken the lead out there.

And just as also we've taken a bit of the lead on our comply or explain governance model, which has helped the governance regimes' shape around the world, led by the FRC, the ICAEW and the EBRD as well. And that's an important part of the reporting structure.
So what were the experiences of the new extended auditor reporting? As I said Sky embraces it from the very first suggestion. The attitude of the company is very much if we can lead, then we will.

Now the new audit report drives auditors to describe the areas of focus that consume audit effort. And the matters that we chose to report on, record recognition, the recognition of programing costs when they're expensed, and the validity of capitalization of capital projects are those that do consume our audit effort. And are areas that are routinely discussed with the audit committee.

So the topics were already well aired. And there should really be no surprises for management or for the audit committee on any of the topics commented in audit reports. So from a communication perspective, there's a bit of a breakdown would have occurred if there are surprises at the 11th hour.

And the next question I thought would be of interest, if the topics are understood and well aired, were the words difficult to find to describe them. And that, in fact this proved to be uncontroversial as Sky's
1 hugely respectful of the work of the external auditor and
2 of the reporting that we have to make under the standards
3 that we follow.
4 So we had very little discussion about the choice
5 of words. But in some companies that perhaps may be less
6 respectful of the audit, maybe the auditor's latitude
7 that provides a much more potent voice now with the new
8 form audit report, actually should engender greater
9 respect for the role of the auditor and for the
10 profession. And probably greater engagement with the
11 auditor by management and the audit committee. And I
12 expect this will be one of the positive outcomes from our
13 new regime.
14 I thought one of the challenges would be to
15 figure out how many issues to report and the level of
16 detail. But again, this proved to be quite
17 uncontroversial. We actually -- I have a keen focus on
18 trying to keep comments succinct, and again with the
19 focus on year two, I think succinctness will be a
20 benefit.
21 I've had shareholder representatives comment to
22 me that it would be very helpful to flag in year two what
1 has changed. So following the less is more principle
2 when describing the audit risks and responses would be
3 a very good principle to adopt.
4 So to summarize, a few ingredients for success.
5 Early discussion and communication. The company's robust
6 governance that respects the role and work of the
7 auditor. And remember that the audit report is about
8 succinct communication with investors.
9 I think one challenge to be faced in the coming
10 year is the proposed reporting on the internal controls.
11 And you've obviously had internal control reporting here
12 established for longer than we have. Under the proposed
13 changes, it will be very interesting to see how our free
14 form audit reporting develops.
15 So a few final lessons. One boilerplate
16 disclosures are public enemy number one. Innovation and
17 company specific tailoring could be stifled by requiring
18 specific ordering or prescribing standardized language.
19 And you can achieve comparability by achieving a limited
20 number of defined headings, allowing freer form reporting
21 under each.
22 And we're seeing in the UK a wide variety of
practice emerging based between firms and between individual partners. I personally like our opinion, which is focused on the audit effort rather than -- and leaving the audit committee to explain the judgments. And our opinions on the statement as a whole whether they show a true and fair view, it's up to the audit committee to explain their scrutiny of management's judgments.

And I think there needs to be real care and attention in explaining audit procedures. I don't think we should be going into a long laundry list of audit procedures.

And finally, and perhaps the most important point, is we're very lucky to have the governance regime that we have. Where the audit committee itself and the Board has to make these statements, which if you like are auditor reporting regime compliments.

So I hope that's been a helpful commentary. And a scene-setter for the panel discussion.

MR. DOTY: Thank you. Mr. Johnson.

MR. JOHNSON: Thank you Chairman and thank you for -- sorry, technology. Thank you Chairman and thank you for your kind remarks. And also for inviting me to
I am here in my capacity as an audit committee chair, thus representing a part of the non-executive director community. But I've also had great interest in seeing the audit profession move forward.

Having spent 30 years as an audit partner in a Big Four accounting firm, during which time I helped develop communication to audit committees. I had six years in Europe representing the accounting profession discussing changes to our profession and the auditor reporting model.

And now as a chair of one audit committee, and a member of another, at last I can say that we finally started to tackle the long standing information gap concerns, which so long has been described by stakeholders as an expectation gap.

You heard comments yesterday about how long it has been since there was a change in the auditor's report. 80 years was mentioned for the US and Nick Land commented about 150 years in the UK.

This 150 years goes back to the middle of the industrial revolution when trade expanded, companies got
bigger and external capital was sought in ever increasing amounts. The owners were not the managers anymore. So the audit as we know it, was formulated to give assurance to the owners that the financial statements properly reflected the company's financial position.

So having said that, it is quite clear to me that the purpose of the audit is for the auditor to inform the investor. Thus the need to provide more than just a pass or fail. Recognize that the pass or fail model is fundamentally important to the investor.

I appreciate that the UK has a different legal system and a different litigation environment. We also have a set of principles based standards rather than the rules based approach. The new audit reporting standard is only 16 pages long including the application material. And therefore the auditor can use his judgment as to how to report on the requirements in the standard. Quite different to what is normal here in the US.

We heard from Nick Land yesterday that the new auditor reporting model in the UK caused some tensions between auditors and management. When I was working in Brussels, it was stated at one point by the European
commission, that they wanted to create some tension between the audit committee and management in order to create better corporate governance.

The question must be, is it tension or is it challenge? If it's the latter, then it can only be healthy. And for the audit, it can only result in a better quality audit.

So with this backdrop, let me focus a little bit on what happened in the UK. As we already mentioned, the FRC encouraged by Parliament and investor groups, first it looked at the corporate governance code for company reporting, focusing on the role of the audit committee and what it should cover in the audit committee report. And then as an audit standard center, look for changes to the audit report.

To give credit where credit is due, by looking at both audit committee reporting and auditor reporting, the FRC has addressed or moved a long way to addressing the shortcomings of two of the three legs of the corporate reporting stool. The third leg is the financial reporting framework, which also needs some changing. But two out of three is a good start.
This is why I think the SEC and FASB also have a role to play here in the US and not just leave change in this area in the hands of the PCAOB.

Turning to my personal experience of the changing environment in the UK, let me focus on the company where I chair the audit committee and what if any were the differences in reporting I've seen as a consequence of the changes.

By way of scene setting, we are a financial institution. The second largest building society in the UK with 55 billion dollars of assets. We are involved in savings and loans but also have a regulated financial advice business, have some complex financial instruments, undertook two significant mergers during the financial crisis and accounts under IFRS. As a consequence, we have a number of significant judgments to make each year, and also carry some significant risks.

So at December 31, what did our auditors report on? Well let me start by saying that their comments were merely on the risks, which could result in material misstatements in the financial statements relating to critical accounting policies and estimates and the
Firstly, let it be said that the audit opinion, i.e. the pass or fail opinion, came right up front in the first paragraph. So no confusion there. Which was a concern expressed yesterday by some presenters. They made specific comments about going concern and the work that they had undertaken. But also had to comment whether they had identified any material uncertainties that cast significant doubt on the group's ability to continue as a going concern.

They helped to define materiality and the level of audit differences that would be reported to the audit committee. That was covered yesterday, so no need to say more now.

The most significant change however, was the requirement to identify the areas of risk that our auditors consider could give rise to material misstatement in our financial statements. And how the audit scope responded to those risks.

Our audit, the risks identified were loan loss provisions, particularly important due to the change in economic levers; fair value adjustments, an important
judgment as we set those provisions a few years ago when economic conditions were quite different; revenue recognition; provisions to customer remediation as a result of some legacy and current issues identified by the regulator where we had to make provision for future payments to our customers; and potential fines to the regulator.

Capitalization of costs. We're undertaking a very significant upgrade of all our business systems over the next years. With both internal and external experts, and totaling hundreds of millions of pounds.

Hedge accounting, treasury instruments where there is no active market and deferred taxation. Again, reasons articulated yesterday.

You can see from this list, the risks require the company and the auditor to exercise a high level of judgment. And all or a combination of any two or more could have a very significant impact on the report of profit and the financial position of the group. As a financial institution, those matters were seen to be useful to the understanding of our financial position.

In the Rolls Royce audit report mentioned so
often in the submissions yesterday, the risks identified centered on revenue recognition, recoverability intangibles, accounting for subsidiaries and associates due to the many collaboration agreements, liabilities arising from sales financing arrangements, bribery and corruption, and presentation of underlying profit.

Very important to understanding the Rolls Royce position so tailored to that company's circumstances. But quite different from those disclosed in my financials.

So what about the audit committee and the auditor engagement? Was there any difference? Compared to previous years, there was certainly more engagement between the members of my audit committee and the auditor. This was partly due to the enhanced audit committee reporting. But also due to the changes in the audit report.

Both were new requirements in 2013. We had common interests to say what we had done and why we had done it. There was early engagement and improved dialog during the audit process. The audit committee were more engaged during the audit planning phase, focused heavily
1 on key matters within the financial statements, and were
2 far more engaged with management and the auditors to
3 ensure appropriate judgments were being made and that the
4 reporting of these judgments was appropriate.
5 There was more detail provided by the auditor to
6 the audit committee as to how they had satisfied
7 themselves on the key judgments. And there was more
8 challenge to management.
9 As far as the audit team were concerned, the
10 members were far more aware of what was important in the
11 business. And they seemed to share a higher level of
12 skepticism and overall challenge while doing their work.
13 So let me say some concluding remarks. From my
14 experience across two audit committees with two different
15 audit firms, I am certain that the quality of the audit
16 was improved as a consequence of the changes brought in
17 by the FRC. It also helped to move away from boilerplate
18 reporting. Every company is different.
19 So the risks and significant matters identified
20 need different disclosure. I don't subscribe to the
21 notion that the auditor will revert to boilerplate.
22 There will be refinements made in the future. But I
think the auditors recognize the need to inform, not just comply.

Another added value as a result of better auditor reporting will be that across a number of years, stakeholders will be able to identify any changes in the risk profile within a company. Another helpful piece of information to all stakeholders.

Nick Land mentioned that he did not expect a change next year in the Vodafone audit report. But if there was a change and new risks were emerging, then that really is information worth having.

Another positive is in relation to identifying or helping identify sector issues. Analyzing audit reports across particular sectors can inform on emerging issues. We tend to focus on the concern of a company analysis of competitor-disclosed information. It could be that when you do the analysis, one company stands out as an outlier, thus prompting questions to be asked.

So let's focus on the positives coming out of enhanced reporting rather than have a fixation on the negatives. We need consistency however in auditor reporting irrespective of the jurisdiction where a
company resides.  It would be better if we could have just one reporting model across all jurisdictions. But the current PCAOB proposals helped us move closer together. I think looking at the risks rather than looking at the effort should be considered by the PCAOB. But no one party will get everything right the first time. We will improve matters and regulation will evolve just like everything else. Darwin said evolution is a given. We should all take heed of this and evolve.

If the US does not embrace change, I'm sorry to say this, but in my view it would be nonsense if the largest capital market on earth, provided the least amount of information to the investor community on the key matters influencing the financial information on which those investors are making their decisions.

In the UK, in the rest of Europe and internationally through IAASB, the wind has changed. Let us sail in the same direction. And I would encourage the PCAB to move forward just as the rest of the world is moving forward.

MR. DOTY: Thank you. Tony Cates.
MR. CATES: Thank you Chairman. Chairman it's my guess that when Nick Land and now UK regulators chose an accelerated timetable for our review of audit reporting, that was because they wanted the UK experience to be something that others could benefit from.

So I'm very happy to be here today and to talk about what we've been doing in the UK. Let me start by saying, you know, why I think that reform was needed. The catalyst was obviously the financial crisis. But perhaps this just brought to the surface an issue that had been around for some time - a decline in shareholders' trust in companies and in audit.

Audit should have been playing a key role in creating trust between shareholders and their companies. But it became apparent that it wasn't delivering all that it could.

Now to me as an auditor, the value of an audit is very clear. But to the shareholder, the binary audit opinion, just wasn't delivering it.

So I think it was absolutely right that we needed to make a bold move on a long form audit report. To say what we thought the issues were and what we did about
them. After all, auditors are for shareholders. So shouldn't we deliver more of the value that comes from our work directly to those shareholders, not just by the audit committee.

Now in terms of putting that into practice, it may be easier for the UK to do that. In UK law, our audit reports are for and addressed to shareholders as owners only, rather than as traders of shares. Using the audited accounts to hold directors to account. And that's not necessarily the case elsewhere.

Now in practice, my biggest worry was the short timetable and a very short auditing standard. Just five paragraphs. However, there was wide recognition that the regulator had laid down a challenge to use those few words to show the value of audit.

And with the UK's less fiercely litigious environment, it was easier for us than perhaps it may be here, to respond to that challenge on the basis of just five paragraphs. Essentially we did that by learning on the job on our September year-end reports. And converting that experience into firm-wide policy and guidance and rolling it out across the firm, with a
central team to provide support and a measure of consistency in our approach.

So what was the critical deliverable for us? We saw that as the description of our work on the key risk areas. And it's this, not say the materiality figures which were also required, that really demonstrates the value of audit. By showing how we brought our experience and independent mindset and skepticism to bear.

That demands that we flag the key things that we have to test. So not just that we had to test the subjective assumptions in the risk area, but specifically which assumptions. And not just that you tested them, but how you applied your outsider's perspective with a benchmarking against data, or against your own views of say growth potential in the sector or for the specific client.

When we did our KPMG survey of first movers, and at that point only 19 companies had reported in mid-January, this was the area where we found most variety. Not surprising for the most difficult aspect of the new UK reporting.

The UK's new reporting by describing some of our
audit procedures, inevitably begs a question. What more can the report say about for example, what the auditor found in his testing? At KPMG in the UK we thought this question should not be left hanging, but should be tackled face on.

So in order to promote debate about that, about the value and about the challenges, we've tested out the idea in a very small number of reports and we've heard about that just earlier, by also giving the findings of our work in each risk area.

That debate has only just started and I'm not here today to promote any kind of position on that. But I do think that you and your stakeholders debate as you debate the way forward for the US, you might want to have one eye on the question of where it could lead in the future.

So back to the existing reporting model in the UK. Is it a challenge to do this kind of reporting? Yes, it is a challenge. Is it worth doing? Absolutely yes.

But at the same time, we shouldn't fool ourselves that better auditor reporting is the answer to preventing
future financial crisis. It can only ever be part of the solution, and focusing on the adequacy of corporate reporting, of corporate governance and stewardship, are all fundamental prerequisites, without which improved auditor reporting will mean nothing.

Thank you.

MR. DOTY: Thank you. Liz Murrall.

MS. MURRALL: Thank you Chairman. And good morning. And thank you very much for inviting me here. I very much welcome this opportunity to give an investor's perspective of the changes that the FRC introduced to audit reports in the UK, and the improved transparency around the audit process that we now have. I'm here on behalf of the Investment Management Association, the trade body for the UK asset management industry. Our members include the asset management arms of the investment banks, the retail banks, the insurers, the managers of occupational pension schemes and independents.

We have around 220 members in total, and collectively, they have about 4.5 trillion of assets under management globally. 67 percent of those holdings
however are held in companies listed outside the UK. They're held internationally.

This means that our members are major investors in companies. And they have an interest in the requirements governing the preparation and audit of these companies' accounts and the information disclosed to them as users.

So what do investors want from the annual reported accounts, and the assurance and audit of that information? Essentially the accounts are a confirmatory document published some time after the events to which they relate. They're about management's accountability to its investors. The shareholders who put up the risk capital and bear the residual risk.

Management is entrusted with shareholders' funds and corporate reports should show how those funds are put into use and performance derived from them. Accounts show the accountability with stewardship of management.

The fact that these accounts are subject to an audit is vital to investors' confidence in those companies, and the markets value the information and investors believe what they're told about their investee
companies. If that presumption was exposed as faulty then the system could seize up.

Nevertheless, investors have had concerns about the quality of the audit, the auditor's accountability and transparency to investors for some time. Certainly well before the financial crisis. Many of these concerns were a product of the fact that investors felt excluded from the audit process and the real findings. They were largely invisible.

And whilst as we've heard, the binary opinion, pass or fail, is very important, the audit reports otherwise tended to focus very much on details of what the auditor did not do, rather than what they did.

It's been said that 91 percent of investors do not read audit reports. I don't think that's surprising given what's in them. But I would actually refute that. I think investors do look at the audit reports, but it's very quick. Just to see whether or not it's qualified or not and who did the audit.

All this did the profession a disservice and some investors were questioning the value of the audit. This needed to be changed and trust reestablished. Tony has
mentioned trust in his opening statement.

The FRC's framework was a welcome part of that change in introducing a more enlightened audit report. This was a big leap forward. It is the most significant advance in auditor reporting in decades. And a challenge has been thrown down to auditors and a competitive edge, if you like almost, introduced into audit reporting.

And whilst the 30 or 40 examples of the new style reports are quite mixed, this is an evolving process, investors are very positive about the changes.

So what has changed? First the FRC requires auditors to disclose audit materiality. This should mean that investors are better able to assess the quality of those reports. Currently we have few indicators or no indicators of that.

Most importantly, the new audit report tells investors what the auditor assessed, as we've heard, the main risks of material misstatement. Effectively what the critical accounting policies and estimates were.

What is important here is that it's not a kitchen sink approach, but a risk-based approach. Investors don't want a laundry list of procedures. What they need
to know is why something was a risk of material misstatement, what the auditor's response to that risk was, and also what the outcome was.

This information will help investors identify and understand the significant judgments in the accounts. It gives them a hook to further challenge executive management and hold the audit committee and external auditor to account.

This greater understanding should contribute to the relationship between management and investors, enhanced trust, and ultimately, in the long term, reduce the cost of capital and increase the value generated for investors and the end beneficiaries, their clients.

So what have we found? Well the requirements were effective for accounting periods starting on or after October, 2012. And I think it was commendable that certain companies adopted early. As William said, B Sky B did and also Ashmore and Vodafone. And I think Vodafone was producing annual reports in accordance with this while the ink was still drying on the revised standard.

Concerns were raised yesterday whether the
information could be market sensitive. As I've said, the main role of accounts is as a confirmatory document to the market. They're historic and produced some time after the period to which they relate.

The information that is price sensitive has to be disclosed under the market abuse regime. And as for investor's decisions themselves, they're more likely to be made around the preliminary announcement or investor road shows than through the accounts.

But the key thing and the important thing is that all this information that is out there can be tied back to the accounts and that these accounts have been independently assured.

There were also concerns yesterday whether this reporting could result in mixed messaging. We don't believe that is the case and we haven't seen that to date. I think it's important to remember that the preparation of the accounts is the responsibility of the company and its Board and they should made the necessary disclosures about the company's position and performance.

As regards to the transparency we're discussing here, only the auditors can report on what they actually
did and what they found. However one of the concerns
that we did have is whilst the FRC's requirements tells
investors of the key risks and how they were addressed
in the scope, I think it's -- many of us are asking
questions why it didn't go further. And ask what did you
find. How aggressive or cautious did the auditor find
the company's estimates or judgments.

This is something that's already subject to a
dialog between the audit committee and the auditor. And
investors would value this insight too. And I think
we've heard that there are certain reports. And there
are two that I can name, Rolls Royce and UL Resources
that have actually gone that step further and reported
what the auditor found.

Lastly, several standard setters are looking a
proposals to change the audit report. As I said at the
outset, 67 percent of all equities managed by our members
are held internationally. Investors want harmonized
international standards for audit reports.

And whilst we recognize there is some consistency
in a number of the proposals, unintentional and
unnecessary differences should be avoided. And as Philip
has said, we would encourage the PCAOB to follow the steps that have been taken internationally.

To conclude, investors have had concerns about audit quality and the transparency of the audit process for some time. Steps are being taken to address this and the FRC's package of reforms enjoys the support of the investment community - the real end client of the audit process.

Thank you.

MR. DOTY: Before I recognize Jeanette Franzel, let me say that while delivered in a very understated British way, these four statements contain bombshells. They are in fact terrific statements. Jeanette.

MS. FRANZEL: Thanks for coming today and sharing your insights and experience. This is very valuable to us. A couple of you made comments about the need for international -- or for standards to sort of come together internationally. And we've got KAMs, we've got CAMs, and we've got the UK approach.

And so I'd be interested on your views as to maybe the risks that we're currently facing and how can we bring all of these proposals closer together. But
also I'd like to hear about advantages and disadvantages that you've experienced from the UK approach that maybe we should think about as we move forward with our proposals. So start with Mr. Touche.

MR. TOUCHE: Looking forward to year two. I mean if you look back at year two and you've got a huge amount of variation across border, and we've got significant variation in the UK with companies or firms or partners doing different things, I think it could lead to some frustration.

So I would encourage standardization with the user in mind. And so anything you can do to harmonize and lead with all these various definitions and drive an international consensus would be very, very helpful, with the user in mind.

MS. FRANZEL: Any advantages or disadvantages from your experience that we should keep in mind?

MR. TOUCHE: I mean from the perspective of the dialog with companies which is you know, not the source of my invitation today, I think the primary responsibility for commenting on judgments, as I said earlier, should be with management.
Now as I said, we're blessed with a regime where the audit committee is required in the UK to report on judgments. And I think that regime does not exist in many parts of the world. Including perhaps as much as you would like here.

And so I would encourage some evolution of the responsibilities for audit committees to report on key judgments in relation to the financial statements as part of a package of measures.

MR. CATES: Just from my perspective, I think some commonality is a good thing. But actually we are operating in different environments. And having you know, learning from each other as we evolve, could also be seen to be a good thing.

So there would be some positive things about having slightly different approaches. I think in the UK, the short brief kind of overview standard, the five paragraphs I referred to, actually enabled us to be quite innovative in the way we were doing things. And so different partners and different firms have taken slightly different approaches. And I think that's benefitted all of us actually because it will help us
1 evolve a much better product in the long run.
2 MS. MURRALL: I think in terms of trying to align
3 the requirements internationally, I think what we've seen
4 from the European Commission and we've seen from the
5 IAASB and the FRC, is they're actually focusing on things
6 like material misstatements, significant risks.
7 So it's getting away from ensuring that we have
8 a sort of laundry list of issues. And I think that would
9 be very helpful. And just the terminology itself is
10 going to confuse -- could potentially confuse the
11 international markets if that could be aligned.
12 As to the advantages and disadvantages as to what
13 we've seen in the UK, and I think there have been a lot
14 of advantages in terms of opening this Pandora opening
15 this black box so that we can see what happens in the
16 audit process. And I think that is going to help the
17 dialog between auditors, management and investors going
18 forward.
19 But the potential disadvantages is potentially as
20 we heard yesterday, as to whether or not this could
21 become boilerplate over time. And if it's not read, then
22 it's not going to be any use to anybody if that does
1 happen. I think there are various safeguards to prevent, to help that.

3 The fact that the standard itself is very high level and principles-based, and gives the firms a lot of flexibility in terms of what they're reporting. And also was saying a lot of sort of change in the audit process. There's been a lot of pressure and there's been sort of a regulatory proposals for mandatory rotation and tendering. So we're going to have more change of auditors. And I think that will bring a fresh pair of eyes to this reporting and change this.

12 And of course it is different in the UK in that we have a different sort of corporate governance regime. We operate very much with -- under company law with shareholders having certain rights to monitor and respond to what happens in companies. And a very strong role for our audit committees, which is not necessarily shared internationally.

19 MR. DOTY: Jay Hanson.

20 MR. JOHNSON: I was only just going to add a point. That when I, and Martin was also in the IAASB CAG and when they were talking about this project for ISA
700, they were coming up with all manner of things. And I think that there -- they took on board I think that the auditor can't second guess what all the stakeholders will want to see from the audit report.

And I think that is absolutely critical that what is reported is useful information. But doesn't lead people down the road through the financial statements and pinpoint certain things that you ought to look up. You have emphasis -- if something's so important, you have an emphasis matter paragraph.

But I think that you do have to be careful that you don't take away from the user, the ability to read and inquire. And that was a good move. And I think that evolved through the process.

So I would -- all I would say as far as the PCAOB is concerned, it is good not to be too prescriptive and good not to as the chairman was talking about yesterday, leading the witness.

MR. DOTY: Jay.

MR. HANSON: Question for the gentlemen that have actually had to do this one time now. It's a two part question.
One is my observation about the ability to describe the risks, the materiality and then the scope of the audit, how it addressed the risks. That for the well-organized, proactive engagement team, that could pretty much be done at the time you've completed your planning for the engagement. And look back at the end to say well gee, did anything new come up for new risk or anything unintended that we need to do to change how we describe the scope.

And so I just want your thoughts to do it -- did I get that right? That's effectively what, and setting aside maybe the first year of implementation challenges, but that's directionally what your new standard is suggesting.

But then also to connect to something that Ms. Murrall said. That that's one level of helpfulness for investors, but the more helpful thing is going to be so what? What did you find? And maybe your thoughts about the practical implications of how difficult that may be at the end of engagement, to then describe, what did you find?

MR. CATES: I think in terms of the actual risks,
what we're really doing to some extent is describing the risks that we described to the audit committee at the outset of the audit. And we monitor them through the audit and we focus our attention on them. And we comment to the audit committee on them at the end of the audit. And in some sense, it's a frustration, or has been a frustration that actually we have that focus and that debate. And really, you know focus on those risk areas through the audit. And then historically just come up with this binary audit opinion and no one really knows what we focused on.

So actually, it's been a release in a way to be able to say you know, actually these are the things that we did focus on. And ordinarily and for well-run businesses, you will find that you know what those risks you expect to be at the outset and you follow them through. But you're also ready to be flexible at the end and to be skeptical about what new risks might come up towards the end of the audit.

So I think that ties in very well with the audit committee reporting you know, for sure. Now the second part of your question related to the so what question.
And we've released -- KPMG has assigned two reports now, the Rolls Royce report and the New World Resources, which Liz mentioned, where we have put some additional commentary on.

It was with some trepidation that I authorized those approaches and it is one audit partner that has done that. And we spent a lot of time thinking about that. And I'm not really -- we didn't' do that with the intention of doing that in a more widespread way. We did that with the intention to really be bold and to start a debate.

So we haven't really decided where to go with that in the future. But clearly it has kicked off a debate. I think again, what we're doing in that situation is being even more open about the type of discussion that we have with the audit committee. Because we would always have that sort of discussion as to how you know, the level of judgment involved in provisioning and where the company sits on that.

I do feel that you know, it might be -- it will be difficult in the long -- it will be difficult in the short term should I say, to actually you know, do that
with a wider number of companies. But I'm glad we've kicked off that debate at least.

MR. TOUCHE: So yes for sure in the transition year in particular. Most of our clients wanted to see what the audit report would look like before we had done the pass.

So yes, when you present your planning paper, the chances are most of our partners have also presented an outline of what it might look like. And that's just good communication. It allows the annual report to be constructed in a cohesive way.

It allows the audit committee to start thinking about how they're going to describe the key risks and judgments that they're responsible for making. So that they can start thinking about their language and so on.

So that up front communication is essential. And if there's fear in transition, that de-risks and removes quite a lot of that fear in that transition period.

Just coming back to the so what. And the commentary on individual judgments. And as Tony said, I think there is a debate to be had that's only just beginning. My -- and of course the fear is that by
commenting on individual items in the financial statements, you take away from the true and fair view as a whole. It clearly provides color to that. Because there is a range of judgments that all add up.

And we were just talking with Liz earlier and you know, the problem is if you need to go down this path and you say oh, you could have done this, or you could have done that. Or it's a bit cautious, or a bit aggressive here. Investors of course will want to know well, supposing you added all that up, what would the impact be. And then you get an alternative set of numbers.

So this debate will run its course. And I hope that we'll end up with an opinion on the -- a view that reinforces the opinion on the financial statements as a whole rather than a whole list of individual opinions on individual judgment areas.

MR. JOHNSON: Can I just make one point from the audit committee experience. Certainly when we had the report from our auditors to the audit committee, they did, because of all the areas that they were covering, they did put us onto a spectrum.

So each individual item that I commented about
before, whether it was loan loss provisioning, whether it was fair value, et cetera, et cetera. And certainly valuation methods and results. There was, all those were on a spectrum.

We found out as a board -- well as an audit committee and then subsequently that was taken to the board. We found that very useful to assess where we were compared to our peers. Because the auditors did have insight of what was happening in the market, what was happening in that class.

So we were much more comforted by the fact that we had that information available to us as a board. Now the question then is should that be rolled out. I am very much aligned with William, with having some caution about having a whole series of mini-opinions. The audit opinion is the financial statements as a whole.

So if we're actually -- if you, it depends how far it goes to what is described. Because I wouldn't like to be in the position where every major judgment area on my balance sheet had a mini-opinion on it.

But I think it is -- you know I think it is a debate that needs to take place. And I know that it is
already started. And the interesting thing for me is that we're now only, we're six months in. That's all we are. Sixth months in. There's only been 40, 50, whatever number of reports that have taken place.

And already, the auditors are starting to talk about what more they can do. What more information that they can get, rather than go the other way around and saying well, after the first round perhaps we went a bit too far with this or a bit too far with that.

So I think that's an interesting dynamic as far as the audit firms are concerned. Is that they're looking to moving it forward even more. Whereas in the past there had been reticence to do anything.

And so I think that's encouraging. And certainly from an audit committee perspective, we like to know where we sit on that spectrum, and we don't want to be, you know we are a conservative financial institution. So we don't want to be having racy policies and racy judgments. And it does help us to ensure that we're not in that space.

MS. MURRALL: Thank you. I mean I think investors do want to know where management's judgments
lie. And what the audit work was done on that and the assurance gained by it.

And if we look at the requirements as they stand, the audit committee is required to report on the significant issues on what they did. The auditor is required to report on the risks of material misstatement on what they did. But no one is required to report on what they found. Investors want that information.

MR. DOTY: Thank you. Lewis.

MR. FERGUSON: Yes, as I understand it at the present time, these requirements are limited to a subset of public companies, whether it's the FTSE 350 or whatever it is I don't know, but it's a subset.

So I have two questions. One, what do these new requirements do to audit costs and/or fees? And two, will it be and should the requirements be expanded beyond the original subset of companies? Should they be applied to all public companies for example? Or all audits?

MR. CATES: In terms of -- you're right, it's limited to companies actually that comply with the combined code which is largely the FTSE 350 and some others that comply voluntarily.
In terms of costs, I heard Nick Land say yesterday that they didn't think there was any cost. I mean I can ensure you there is some cost. The -- it's not so much getting the issues together. We've already got those issues together for the audit committee. But it's actually you know, drafting the statement and having some form of quality control over the audit opinion.

You know so at KPMG in the UK, we issued around 80 opinions in total. And some in the future. And actually we have a centralized process and we set aside not just our technical people, but some of our best client-facing partners to also review those opinions, so we could get some best practice.

So all of that costs. But it's not a huge cost.

MR. FERGUSON: Were those passed on in higher fees?

MR. CATES: And in most and many cases yes. They were passed on in higher fees. But not -- I wouldn't say that significant fees.

Should it be expanded to other companies? I think it covers the main companies that investors are invested in. It's probably more a question for Liz than
1 me.

2 MS. MURRALL: Yes, I mean it covers all companies
3 that are required to adhere to the UK corporate
4 governance code. That is a premium listed segment in the
5 UK. And that is the main UK listed companies.
6 I suppose one of the concerns that I do have is
7 increasingly we're seeing overseas companies come to the
8 UK to list. And they may have significant operations in
9 countries that may not have the same auditing standards
10 and it's how they're going to actually adhere to this
11 going forward. I think that could be a difficulty for
12 them. Because you need uniformity in the list.
13 As regards the costs themselves, as regards to
14 investors. Auditors are scrutineers on behalf of the
15 investor community. We don't have any issue with what
16 it costs, although obviously we wouldn't want to see the
17 costs should be any cost increases should be reasonable.
18 But I think in terms of that, particularly the
19 increased tendering we're seeing, I think there is a
20 concern to whether or not the audit tenders could compete
21 on cost. And I think it's very important that that
22 process is owned by the audit committee such that cost
doesn't drive the decision and its quality. Thank you.

MR. TOUCHE: I echo what Tony has said. And I think it's worth just bearing in mind that the auditor reporting regime was introduced with a package of other measures for boards and audit committees. So that helped if you like in the whole company redesign of annual reports in the last six months, which also has been a modest additional fee. But as Tony said, not enormous.

MR. JOHNSON: Our fee went up really marginally. There was no significant increase in those costs certainly as far as the company was concerned. I don't know whether the auditors will be looking at their margins next year, having gone through the experience and how much time they did have to put into it.

But certainly from the first year that we experienced it, it didn't increase the costs. Whether it should go any broader, in the UK of course we -- there's a large number of companies other than the FTSE 350 that are subject to audit.

From a personal perspective, if you have stock listed on a stock exchange, then why shouldn't you have -- why shouldn't you give this -- why shouldn't the
1 auditor give this information. You can easily lose
2 money. The investor can easily lose money on small
3 companies as they can with large companies.
4 So I think it's not necessarily a size - from my
5 perspective, it's not necessarily a size issue. It's the
6 fact that you have external shareholders investing in
7 your company. And I think that you have to have that
8 mindset. And a lot of the companies, if it goes down to
9 private companies, which in the UK a number of private
10 companies do have a foundation to have audits.
11 Then, when you've got management and owners, it's
12 a small group. I don't think there is a need to do it
13 across the whole spectrum.
14 MR. DOTY: Steve Harris.
15 MR. HARRIS: Well Mr. Touche, first of all, I
16 commend you on your testimony. And when you say without
17 becoming too sentimental, I don't think you were at all
18 sentimental.
19 But I do think your testimony was extraordinarily
20 powerful. Especially in light of the testimony that
21 we've had the previous day. And the way that you grasped
22 at the opportunity and the pride that you took in your
1 profession. And the way that you relished the challenge
2 to reestablish the value of the audit.
3 And the public interest nature of our work and
4 how it invigorates their personal responsibility, the
5 auditor. And how important it is what you're doing on
6 behalf of shareholders, and if we can take the lead, we
7 will. I think that view was shared by all of you.
8 But I just want to say that that is in
9 juxtaposition to some of the comments that we've heard
10 the previous day. And I for one very much appreciate the
11 understated way that each of you communicated that
12 message.
13 I guess I have two questions. One, you all speak
14 about investor groups and the outreach to investor
15 groups. And Liz let me take you out of this conversation
16 for a moment because you are generally viewed among the
17 investor constituency as an investor advocate. And I say
18 that from my perspective in a very positive sense of the
19 word.
20 In the United States, investors are often
21 criticized as not having any idea really what they want.
22 Not speaking with one voice, not having a bottom line.
And the profession being unable to glean what investors want.

Two parts of the question. One, could you describe a little bit of your investor outreach in the UK. Who are these investors and how much money do they have under management?

And second of all, do they speak with anything even remotely approaching a unified voice I terms of what they want and in terms of a bottom line.

MR. TOUCHE: First of all, thank you for your very kind comments. And I think we're all very pleased to be here to make a contribution to your debate.

Yes, we're very lucky. I mean London is you know, a very large capital market. All of us who are practicing there in London, head offices of the big four firms all located within you know probably half an hour's walk of most of the investor groups' offices. And there are probably only you know ten or a dozen people that we need to know. And we are in very regular contact with the representatives of the investor groups, of which you know, Liz is one.

So it's been very strong and open dialog both
between the firms and the investors and the regulators and the investor groups. And that dialog has been not necessarily in plenary forum. It's been one-to-one. We've been exchanging messages and emails, and all the rest of it with people as this thing has evolved.

So it has encouraged an open dialog. And as far as our firm is concerned, two years ago we have -- we instituted an annual general meeting where we invite stakeholders, the public interest to come and hear what we're doing on audit quality and innovation and all those other things. We started that a couple of years ago.

That's gone down very well with the investor groups. And it's their opportunity to quiz us in the form of an annual general meeting, about what we're doing. So that's part of our public interest agenda.

As far as engagement with the companies is concerned, which I think is the other part of this question. I think this is all quite new. Liz mentioned earlier that we've had the remuneration and regulations all changed and investor groups have been very distracted by that's taking up an awful lot of time to form policy with companies.
And we are now waiting and companies are now waiting to see how investors will engage with this huge amount of additional information that they have now received. But we know in advance that for example, the corporate governance teams have been relocated in many instances to sit alongside the fund managers.

So then more integration in some of the investor houses so their joined up dialog, you know, is brought to bear with the companies.

And then the other feature about the UK regime is that we have, the FRC is also responsible for the investor code, which is the stewardship code. To encourage investor groups to reach out to their investee companies.

So we're fortunate that we have the one regulator responsible if you like for all angles in our little dynamic within our -- the city of London where we can walk to each other's offices.

MR. CATES: Just a couple of things to add for me. I mean I think things are changing. I hosted a round table of FTSE 100 audit committee chairs a couple of years ago with some investors. And actually to a
person, they'd had -- no investor had ever talked to them about the audit. Where they said their remuneration committee chairs were always being asked to go and report on remuneration. They haven't had the discussions around audit.

Now that was a couple of years back. And I'm hearing now that that's changing. Part of that due to -- part about interest in audit reporting I think is changing that. And part of that is EU audit reform and rotation and tendering.

And so we're seeing investors, from my perspective at least getting much more interested in audit and what's happening in audit, which I think is a good thing. After all, it's the investors who we report to.

MR. JOHNSON: Can I just, I'd just like to pick up on, not to repeat what's been said, I'd like to pick up something that William said, and that was kind of dialog.

I think in the UK, what we have found is that over the last four or five years, perhaps even longer, that firms, investors, regulators, preparers, academics,
have got together and started to talk -- and talk about the issues. And talk about resolution of issues. And so -- and it may be because we're all in one place, i.e. in London, and we're all within half an hour's walking distance of each other. But there has to be a will for people to actually engage with each other. And I think that in the UK we've been very fortunate that there's been that engagement. From my experience in Europe, that has not been the case in many parts of Europe. There hasn't been that dialog. There hasn't been that engagement.

And the things that have been happening as you mentioned Chairman this morning, the vote has taken place now. And so we've now got law in the European Union. On many matters relating to the audit firms and auditor reporting and even wider, that a lot of the comments that were being made during the early parts of that couldn't be made by the jurisdictions because they couldn't see the future. Because they hadn't had the dialog.

And I think it is so important that the groups do that, have that dialog. And so I would encourage as much dialog as possible in order to get all these groups
And I was also on -- and it goes wider than that, and it's looking to see what more you can deliver. What you can look at. And I was asked to be on a group, on Sir David Tweedie's institute, the ICAS. And there we were looking at assurance on management commentary.

And this was before any standards, it started two, two and a half, three years ago. And the Scottish Institute got the groups that I mentioned, but even further in the group, journalists, financial journalists. And a whole spectrum of -- and there was about 10 or 12. All from a different background. Whether you were an auditor, whether your were an investor, whether you're a journalist. Because they've got an interest and they've got an influence as well through financial journalism.

And it was really looking at where the future was and what things might change. And I think just getting people talking and having that dialog is so important if you want to get the right answer. Because there's all different groups, have different interests. And it's actually making sure that we try to take away some of the
concerns, but also get to what, as much as possible, people do want from all the various different groups.

MR. HARRIS: And then Liz, I didn't want to keep you out. In the United States the fourth hitter in a baseball batting order is the power hitter. That's known as the cleanup. I want to get the three gentlemen on the record.

But if there's anything you'd like to add in terms of the, I guess the bottom line, one of the bottom line issues is do investors from your perspective know what they want in terms of the audit report and some of these issues we're dealing with?

MS. MURRALL: Investors covers quite a wide population. I mean it sometimes can be taken to include this little analyst population. Whereas the investors that I'm representing are the institutional long term investors, the people that put up the risk capital. And I think you will probably get a different perspective from long term investors to analysts preparing sort of research reports. I think it's a different focus as I think I outlined in my talk.

But also what I would highlight in terms of
William mentioned the stewardship code in the UK. This became -- this was introduced into what is now the FSA's rules in December, 2010. And we do, as an industry body, the monitoring on behalf of the FRC as to what adherence to the code actually means in practice.

And what I would highlight, is that in 2010, there were 80 signatures that had committed to stewardship and the code. And in 2013, there are just under about 300.

So investors are engaging on these issues and they are reaching out to companies and auditors to develop that dialog. Thank you.

MR. DOTY: The Chief Auditor has his flag up.

MR. BAUMANN: Thank you. I want to first of all share in the comments that the Board members have made about the quality and depth of your presentations and comments. So thank you very much for all of that.

Mr. Touche, in your commentary, you say a lot of the success of the regime in the UK is because at the same time, it's introducing a new regime for audit reporting. The FRC introduced new requirements for the
board to report about judgments and estimates and other matters like that. No similar initiative is underway in the United States with respect to audit committee or board reporting.

So if I could ask you to speculate a little, all of you, the auditors certainly speculate. Since there's no similar initiative underway here, what, well if you didn't have a similar initiative in the UK, how would that have impacted your reports and your progress in terms of reporting, this extended auditing reporting.

And then maybe Ms. Murrall, from your perspective, what would be the perspective of the quality of the information you received if it was only the auditor report on the risk of material misstatement, but not commentary, at least from the audit committee on significant judgments and estimates in financial reporting.

So given that we don't have the two legs of this stool, how would you think it would be different?

MR. TOUCHE: I think it's quite tough and I'm sure that's why you're asking the question. I think it is quite tough. And I tried to draw that out in my
commentary. I think the auditor can still comment on the areas of focus. And the real question is if the areas of focus are then commented on by the auditor in their report without findings, how are you going to get the findings presented.

And I suspect that you would find that behaviorally, if auditors do that, audit committees may well wish to comment on judgments in the MD&A, or other areas of the front half. So I suspect these things will happen naturally without the structure that we've been blessed with in the UK.

Because I -- and the questions around original information about the company and the company's conclusions. And I suspect most companies would say actually we want to earn the communications of those. And I think from my perspective, that's right and proper.

MR. CATES: Not much to add to what William said. I mean I absolutely agree with what he said.

I mean what we found in our initial survey was that by and large, the issues that the auditor raised in the audit report were the same issues that the audit committee had raised. There were one or two differences,
but generally speaking, you know there was a commonality
between what the audit committee said was really
important and what they focused on and what the auditor
said was important as well.

MR. JOHNSON: Martin, I did say in my submission
that I thought it was very important that the audit
committee report does move along. It's interesting, the
audit committee, the report that we have, one, two,
three, four, five, six pages long, and it covered the
work that we'd done as an audit committee.

Interestingly, I signed it in my personal name as
chairman of the audit committee. Just as William and
Tony signed the audit opinion in their own name as
auditors. And I think that it's all about you know, it's
accountability and all the things that we talked about
as I was saying.

And it would be interesting. I don't know what
we would have done as an audit committee if the FRC
hadn't said to us, you need to enhance the reporting.
You need to do this, you need to do that. I get the
sense actually, because given the amount of engagement
that we have with the auditors, we actually might have
wanted to write the story ourselves and put our perspective on it.

You know I can't say that that would be the case. But I just feel that you know certainly with -- I'm very fortunate, I have some very good audit committee members. But I think that the companies haven't come screaming to this table. They've actually embraced it.

And Tony mentioned that this was a collaborative approach as far as the reports that they issued. And you know, Deloitte was the first with Nick Land as chairman of the audit committee at Vodafone. And that went before it was mandated.

So I think that in the UK, there is a realization that more needs to be done in reporting. And it gave us a framework to work to from the FRC. But I actually think that we would have probably said more than we would have had to, even if it wasn't there. And I think that is useful.

MR. BAUMANN: And then from your perspective Ms. Murrall, what would be the value of the risks of material misstatements without the audit committee reporting on the judgments and estimates?
MS. MURRALL: Well I think if the auditors start to report on things that management has not reported on, I think ultimately it would drive management to report. Otherwise they'd be seen as being you know, dereliction of their own duties to set out their financial position and statement of performance.

So I think there's a strong likelihood it would actually start to drive management to disclose that whether or not the audit committee was disclosed elsewhere in the accounts.

MR. DOTY: I'm aware that I'm standing between this group and lunch. I want to observe that I was pleased to see in the ICGN letter to the IAASB, a ringing endorsement of the point that naming the engagement partner in the audit report improves transparency and provides additional accountability that you believe will foster audit quality.

One of the issues that we face and must wrestle with is how you know that investors will find information useful and why we think it's useful. Mr. Touche has I think written and spoken eloquently to the fact that the more information that is in the new FRC standard, one of
the great benefits of that information being that it has improved a sense of professionalism and a sense of meaningful role for the auditor.

There are other statements shot through your -- that appear in various of your papers on this. We heard in one of the panels earlier, that there is a lot of information that investors may want. Investors always want more information. Information increases volatility. And is it really information that protects investors, or is it merely information that gives them a desired or an imagined benefit? What I find striking about all four of your views of this subject is that first you do not seem to me to insist that investment -- that investors show that their protection requires a certain level of transparency and information.

On the other hand, you seem sure in your confidence that the information that is sought by the FRC proposal and the now European standards, will benefit investors. And it would be very helpful to our thinking if you could instruct the Board on how you know this is beneficial. And whether investors -- how will investors make good use of the information?
MR. TOUCHE: So let mention just the, go back to the one piece that the FRC and package that we haven't focused on. And that is that the company has to explain its business model and the risk inherent in the business model.

So from the very beginning of the annual report, you get a flow focused on what the core business is. What are the risks and challenges. And by the way, we've also had a very clear mandate from the FRC that the annual report is not a marketing document. It is a report about stewardship.

So it's supposed to have balance and be fair and understandable and all those other things. But you start with a business model. And then the accounting risks that we end up describing are those that flow from the company's business quite naturally.

And if you start with that framework in mind, that is the essence of what the investors would like to understand further.

MR. CATES: A couple of comments to add to that. I think the information through the audit report really has given the investor some kind of hook to discuss those
risk areas with management, with the board, which it just
never had before. So there is a wish, for the investor
to have that type of discussion with management.

And secondly, just an observation is that in 20
odd years of auditing, I've never had so much kind of
interest from investors in what I'm doing and sort of
emails out of the blue from people saying this is a
really positive thing.

And much more engagement with investors as a
whole. Not on specific companies, but as a whole. And
I can only see that as a real positive.

MS. MURRALL: I think it's disappointing if
investors keep on asking for more. Because what we do
want is accounts that tell a story of management
stewardship of the business. And we need cohesion
between the front half and the narrative reporting and
the back half and the numbers.

And I think one of the requirements that the FRC
introduced, which I think we very much welcomed, is the
directors have to state that the accounts are fair,
balanced and understandable.

And I think that that is a very good move.
Because I think in the past you could have taken a set of accounts. You could have ripped the front half away from the back half, you may have had trouble matching the two.

So I think you know, we want accounts that tell a story as to what management has done to resources entrusted to it and exercised its stewardship, and that story needs to be cohesive, not full of clutter.

So whereas there may be requirement, people may ask for other information, I think there is other information that could be disposed of in the accounts. Like do we really need to have the director's remuneration regulations in the accounts? Do we need to have all the accounting policies, where they're generally just a restatement of IFRS.

I think these things could be looked at and we could cut some of the clutter. Thank you.

MR. DOTY: Again with the profuse thanks of this Board, this institution for the distance you have traveled, and the thought you have given to helping us with what is perhaps the most challenging and the most important standard setting project that we have.
Thank you. Each of you, thank you again. And it's been wonderful to have you here.

We will adjourn for lunch and we will reconvene promptly at 1:00. Thank you.

(Whereupon, the above-entitled matter went off the record at 12:15 p.m. and resumed at 1:00 p.m.)

A-F-T-E-R-N-O-O-N  S-E-S-S-I-O-N

(1:00 p.m.) Audit Tenure/Elements of Auditor's Report

MR. DOTY: Well, good afternoon.

Peter Clapman is formerly the senior vice president and chief investment officer for TIAA-CREF, chairman of the governance committee and a member of the audit committee of iPass today. He serves on the board of the National Association of Corporate Directors. He is also vice chairman of the Conference of Mutual Fund Leaders, and also a current member of the PCAOB's Standing Advisory Group.

Monty Garrett is vice president of finance at Verizon Communications. Previously, he was chief financial officer and chief accounting officer of Dooson Infracore International, the manufacturer of Bobcat
construction equipment. He is currently a member of the Dooson board of directors and audit committee, and he began his career with Ernst & Young as a member of the audit practice.

Joan Amble is the president of JCA Consulting, a public company board member, NACD Council of Audit Committee Chairs at NACD, and retired executive vice president and principal accounting officer at American Express. Previously, she was with General Electric, as chief operating officer and chief financial officer for GE Capital Markets. She's a director of Booz Allen Hamilton Holding Corporation, Brown Foreman Corporation and Sirius XM Radio, Inc. She is also the co-founder and chairman of Women in America, an organization that focuses on the development of women professionals -- not chairman but chair of Women in America.

Jim Liddy is the US vice chair of audit at KPMG, where he is responsible for creating and executing the strategic vision for the US audit practice. In addition, he serves as the Regional Head of Audit, Americas, and chair of the Americas Audit Steering Committee for the firm. Prior to his current role, he served as national
manager of audit for KPMG, and the national business leader of KPMG's financial services practice. A panel that brings to bear omnicompetent experience and insight on the issues of auditor tenure and other basic elements of the audit report. Thank you all. Peter, if you will begin.

MR. CLAPMAN: Thank you very much, Mr. Chairman. And I hope I'm selected to be the keynoter of this esteemed panel on the premise that I can get things livened up after lunch, and I hope my remarks are taken in that spirit.

I'm very pleased that the PCAOB has convened this roundtable to examine very important issues that address the disclosures given to investors about the audit process. In my opinion, the disclosure system presently is flawed in material respects and improvements are necessary.

The PCAOB has advanced certain proposals that, while modest in tone and scope, would be beneficial and should be implemented. Just to complete the record, in addition to my written remarks, I note that I was -- I participated in a roundtable probably about a year and
a half ago on the issue of a proposal at that time on
whether mandatory auditor firm rotation was in the public
interest.

My position at that time was that auditor
rotation is a sound premise, should be implemented, at
least to the point where companies and audit committees,
after a period of years, should put out the audit
assignment for rebidding, for further discussion, even
allowing for the possibility that the company, the audit
committee, would decide if the present auditor is the
right choice, but at least make that consideration.

And my concern at that time, which is still a
concern today, is that too many audit committees simply
make this a routine matter, and do not, as they should,
seriously consider the selection and tenure of their
outside auditor. And, to me, this goes to the issue of
independence.

I also applaud the PCAOB for inviting to this
roundtable as many participants from other countries, in
particular the UK. In terms of my own experience, as you
noted, I was the chief investment lawyer for TIAA-CREF
and head of its corporate governance program.
I also chaired the International Corporate Governance Network for four years between 2000 and 2004. And at that time, it was clear, and I think would generally be acknowledged by people in this field, that the governance structures and investor protections in the United States was superior to basic protections and governance practices abroad.

And I fear that this is no longer the case. And I think your participants from the UK hopefully made this clear, that they have advanced certain issues, in fact those including the audit process, which provide for greater investment protection in my view than currently exists in the United States. And, in particular, advancing the notion of whether auditor rotation is appropriate, auditor rebidding is appropriate. I'm talking about after a fair number of years, not to just be done sporadically but done consistently and with a view towards enhancing independence.

And I think including in this last panel this morning it was noted that, for example, if you do implement one of your proposals, which I strongly am in favor of, which is to have the audit report include the
tenure, the number of years that the particular audit firm has audited a particular company, that that has generated in the UK, and I think it would in the United States as well, generate more interest on the part of audit committee members, and also create the impetus for investors to care more about this than they currently do. And part of the problem, I think, for investors is that it is extremely hard or almost impractical for an investor to know for how long a particular audit firm has audited a particular company. And I think the record is clear, and it was clear a couple of years ago as well, that some audit firms have been the outside auditor for particular companies as long as decades. I heard in one case that it almost got to be close to 100 years.

So, that sort of disclosure, which I think would help generate greater interest on the part of both investors and audit committee members, I think, would be strongly beneficial and in the public interest and something that investors want.

I also particularly note that your two new proposals, first to include the tenure of the current audit firm, and then secondly to include the named lead
1 engagement partner, involve no costs.

2 One of the issues always at stake on potential
3 reforms or initiatives on the regulatory side is whether
4 particular benefits to some parties will be overwhelmed
5 or in some cases offset too significantly by cost to
6 other investors. And, obviously, regulators have got to
7 take that concern into consideration.

8 Again, my point about these two proposals is that
9 they involve no costs. So, therefore, no investor is
10 unduly burdened with costs affecting disclosures which
11 would be extremely helpful and important to other
12 investors that truly believe independence is a key issue,
13 and that the current system ought to be enhanced in the
14 favor of broader disclosures to protect investors on
15 these audit concerns. Because currently it is very
16 difficult with the disclosure system in place for
17 investors to even find out how audit firms have been
18 selected, how they are regarded in terms of continued
19 tenure and the like, and I think these reforms would be
20 extremely beneficial.

21 One final note, because I see the red light, is
22 that in my former position at TIAA-CREF, we voluntarily
1 did both. We both did rebidding at certain intervals, 2 and at a certain point we did rotate audit firms. Our 3 experience was that the costs were nominal, if any 4 additional cost, and our audit process and the audit 5 quality was enhanced.
6 And we believe that if the PCAOB adopted, first, 7 these particular proposals and considered the broader 8 questions, it would be both cost-worthy and protective 9 of investors, in a way that's very much needed. And I 10 support these proposals.

MR. DOTY: Thank you, Peter. Monty Garrett.

MR. GARRETT: Good afternoon. I appreciate the 11 opportunity to come here today to represent Verizon on 12 this panel. We obviously have a keen interest in matters 13 related to auditor reporting. We also spend a great deal 14 of time and effort communicating with existing and 15 potential investors and finding ways to get them the 16 information they need to make informed investment 17 decisions.
18 To that end, we appreciate the efforts of the 19 PCAOB to address investor needs, and we want to continue 20 to work with the Board and the staff to accomplish this
I was invited here today to provide Verizon's input on the proposal to add auditor tenure to the standard auditor's report. Our view on that specific concept is best understood in conjunction with our views on Docket No. 34 as a whole. As such, I'll discuss our view on tenure, and then expand a bit on the overall proposal.

Like many other public companies, Verizon discloses information about its audit firm, including tenure, in our annual proxy filing, where we ask shareholders to ratify the appointment of the auditors. For the benefit of our shareholders, we also provide background on how the audit committee considers auditor tenure in connection with its evaluation of the auditor's independence, and, more broadly, auditor appointment.

In other words, we see audit firm tenure of one component of a robust governance process discussion in our proxy related to the evaluation of the auditor. Accordingly, we think that reporting of auditor tenure is most meaningful when presented within the governance
It's not completely clear to me what conclusion can be drawn from auditor tenure information, but if an investor finds it useful, there does not seem to be harm in providing the information in an appropriate context.

As mentioned in Appendix 5 of the proposal, the available research findings on correlation between auditor tenure and audit quality vary widely. Some researchers suggest that an auditor with a long tenure may have a higher likelihood of independence being impaired, while other researchers suggest an auditor with a short tenure may not have sufficient depth of understanding of a company to render a reliable opinion.

I believe the Board concluded that there was no analytical information to provide any really meaningful correlation. In all sincerity, I do hope to get insight today on how the tenure information is valuable, as we are always interested in transparency and a better understanding of how to anticipate our investors' needs.

To emphasize this point, we come to work every day knowing there are two groups of people that we cannot live without: our customers and our investors. We're
fully committed to listening to our investors and caring
for their needs, and that includes addressing concerns
that have led to this proposal.

To that end, we have chosen to disclose our
auditor's tenure information in our proxy statement, and
we believe that's the proper home for such disclosure,
rather than the auditor's report. Our view on this is
a subset of our overall view that an auditor's critical
role is to provide assurance that the GAAP financial
statements provided by the issuer are materially
accurate.

Some aspects of the proposal include discussion
of critical audit matters and commentary on other
information, may require the auditor to go beyond its
very critical core responsibility of providing assurance.
As stated in our comment letter, we're concerned with
having auditors provide this commentary, as we feel that
the first line of disclosure about the company should be
provided by the issuer.

If the auditor deems the material misleading or
inadequate, and the issuer does not rectify it, then the
auditor has the means to opine accordingly. 

The current
pass/fail opinion is clear and concise, and leaves no
doubt as to the auditor's view. Free form language may
not be as clear and may leave readers unsure of the audit
result.

Alternatives were discussed yesterday that we
think give investors the additional information on risk
they're seeking while preserving the roles of issuer and
auditor.

Specifically, the alternative of having the
issuer expand the disclosure in Footnote 1 to cover CAM
items in a more thorough fashion, along with an
auditor-specific review of that disclosure, would seem
to address many of our concerns.

Views on that matter were discussed at length in
earlier panels. My only point is to extend our view on
the issuer's and auditor's roles to the tenure
information. Let the issuer provide the information to
investors in the appropriate form and context. Investors
will receive the information they desire, and the risk
of misinterpreting auditor tenure without proper context
will be avoided.

We have no issues with the other basic elements
of the auditor's report included in the proposal. We're not sure if the additional wording on independence adds value, as the existing reporting format already includes reference to the auditor being independent, but we certainly see no harm in including it.

Again, thank you for the opportunity to participate in this very important process.

MR. DOTY: Thank you. Joan Amble.

MS. AMBLE: Okay, thank you. I appreciate the opportunity to participate today and for all of you taking the time to seek constituent views on these very important topics. The comments I offer are my own and do not necessarily represent the views of the organizations of which I am affiliated.

My background includes positions as an accounting instructor, an auditor, a standards-setter, and for most of my career, a senior financial officer of a major corporation. I presently serve on the boards of three public companies, and I believe you have invited me to participate because of that role.

Therefore, while my comments are informed by all of my experiences, they apply most specifically to those
as audit committee chair and member. However, my perspective, similar to most, I assume, is to seek sound financial reporting with an unequivocal commitment to integrity, strong governance and transparency, as it relates to all parties involved. Company management, directors and auditors each have a role to play.

Although asked to comment on auditor tenure and other basic elements of the auditor's report, given the significance of the important topic of disclosure of critical audit matters, I feel compelled to note that I disagree with the direction the Board has taken on this proposal and do not support it as currently written.

Along with the vast majority of audit committee members with whom I've had the opportunity to discuss this matter, I believe including critical audit matters in auditor's reports would lead only to much longer but not necessarily more useful reports by including information already adequately provided by management in footnotes or MD&A.

I was pleased to see that many audit committee members, as well as the NACD, provided input to the Board to elaborate on the reasoning for this opposition.
The other subject not subject to this panel's discussion relates to the auditor's responsibility regarding other information, on which, time permitting, I will provide comment, as that too is an element of the proposed changes I do not support as currently written. The specific areas to be addressed in my comments today are audit tenure, independence, and auditor's responsibility for financial statements and related notes and schedules and for fraud. While auditor tenure may be an interesting data point for some users of financial statements, I do not support its disclosure in the auditor's report.

Auditor tenure, when taken out of context, has the potential to unnecessarily obscure the question of audit quality and perhaps cause some to erroneously conclude a direct correlation between tenure and audit quality, which, to my knowledge, no verifiable correlation exists.

Further, I do not think auditor tenure negatively impacts audit quality or independence. People and actions do. My experience has been that the engagement team on the ground, and its ability to access specialized
expertise within the firm, provides the basis for sound audit quality, not the number of years a firm has audited a company.

In addition, mandatory rotation limits the years senior members of the engagement team can audit, which provides a regular introduction of differing and fresh perspective to the audit engagement. If tenure were to be introduced as an element of governance, the placement seems better situated in the proxy statement as part of the audit committee report, or with the ratification of auditors.

I have no objection with the recommendation to expand the auditor's report regarding independence. However, having said this, I think it is important to underscore the significance of the ongoing review of audit quality by the audit committee, and the use of audit committee executive sessions and other interactions with auditors to understand the nature and the quality of the engagement, and to engage in dialogue about the independence, the integrity, the objectivity and competence of the engagement team and the firm in fulfilling its professional responsibility as the
This ongoing review of audit quality is a core responsibility of the audit committee, and provides a thoughtful basis of judgment regarding the audit quality we seek, and provides a firm foundation for continuous improvement in audit quality from the auditor.

I support the Board's proposal to enhance the auditor's report by identifying financial statements, including related notes and schedules as part of the financial statements that were audited. I also support the proposal to revise the auditor's report to recognize the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements, whether caused by error or fraud.

As noted at the onset, I would like to close with my brief perspective on auditor's responsibility regarding other information. As many have noted, clarification of work done by the auditors should be provided in the auditor's report.

If the Board determines it will move forward with this proposal in some form, I encourage the Board to
1 accept Deloitte's offer of assistance in the development of a workable model for expanded auditor involvement with other information.

4 I further recommend that consideration be given, first, in a phased approach, to the auditor's responsibility regarding quantitative non-GAAP measures.

7 There are many instances when a company feels quantitative non-GAAP measures are more meaningful to users of their financial statements than GAAP measures.

10 However, I would venture to say that auditor involvement, in terms of evaluating the rigor around the process, the controls and testing of those non-GAAP quantitative disclosures is varied and therein lays an opportunity to clarify what the auditor's responsibility for that information should be, and how this responsibility should manifest in terms of auditor reporting. Thank you for the opportunity to speak.

18 MR. DOTY: Thank you. Jim Liddy.

19 MR. LIDDY: Thank you. Chairman Doty, Members of the Board, Chief Auditor Baumann, and other representatives of the PCAOB, SEC and FASB, I appreciate the opportunity to meet with you and share some
perspectives on the PCAOB's auditor reporting model project, and more specifically to address the topic of auditor tenure and other potential changes to the auditor's report.

Speaking on behalf of KPMG, we certainly support the Board's objective to improve the auditor's reporting model and increase its relevance to financial statement users, and we are in favor of constructive and practical changes to the auditor's reporting model.

However, as we have heard in certain of the panels, including the one just before us at lunch, stakeholders are not necessarily aligned regarding the nature and extent of such changes. Investors, audit committees, auditors and preparers have differing views on what information auditors should provide.

This is an important project of great interest to many different stakeholders, and one that requires careful deliberation to develop a solution that can be practically applied. We need to take our time to figure out what the markets need relative to what auditors are able to provide. We also need to be mindful of what's happening globally, and certainly over the last day and
1 a half we've gotten some great commentary in that particular regard.

Moreover, we need to recognize and accept that no solution in this area will meet the desires of all stakeholders. In developing possible enhancements to the auditor's report, we have been guided by a set of principles including: one, auditors should not be the original source of information about the entity. Management's responsibilities should be preserved in this regard. A fundamental shift from the auditor attesting to information prepared by management to the auditor providing original information about the company could result in unintended consequences that are not in the best interest of investors.

Secondly, any changes to the auditor's reporting model should enhance or at least maintain audit quality. On behalf of the 7,000 folks in our audit practice in the United States, I can tell you that we're focused on audit quality each and every day, and our efforts of continuous improvement, together with that of the Board, have very positively contributed to an increase in audit quality over the last dozen years or so.
Third, any changes to the auditor's reporting model should narrow, or at least not expand, the expectation gap.

Fourth, any changes to the auditor's reporting model should add value, and not create investor misunderstanding. Specifically, any revision should not require investors to sort through what we refer to as "dueling information" provided by management, the audit committee and/or the independent auditors.

And lastly, auditor reporting should focus on the objective rather than the subjective. Financial reporting matters assessed by the auditor can be highly subjective. However, it's important that auditor communications provide objective information about these matters.

As it relates specifically the topics of independence and tenure, we agree with the addition of language on auditor independence explicitly stating that the auditor is required to be independent. This is consistent with the requirement that the auditor's report be titled "Report of Independent Registered Public Accounting Firm," and provides clarification of this
within the auditor's report.

We do not believe, however, that the inclusion of a sentence about the auditor's tenure within the auditor's report is appropriate. As noted in the PCAOB release, no nexus has been established between an auditor's tenure and audit quality, and requiring such information in the auditor's report might give the false impression that a correlation between the two does in fact exist.

We do, however, acknowledge that the communication of an auditor's tenure may be an item of interest to some stakeholders, and we support the communication and transparency that disclosing this information may provide. Therefore, we recommend that this information be required to be disclosed through different means, such as in Form 2, or as our other panelists today have indicated, in the audit committee's report.

Finally, with respect to the topic of addressees of an auditor's report, we do not support addressing the auditor's report to parties other than shareholders and the board of directors, or an equivalent body.
We believe this would create additional litigation risk and would not improve the communicative value of the auditor's report. Adding addressees to the auditor's report will not affect those with access to it. The auditor's report is a general use report available to all capital market participants: shareholders, bondholders, rating agencies, analysts and others, that the issuer can distribute without restriction, and to which third parties have ready access via the issuer's SEC filings.

This concludes my prepared remarks. Thank you again for the opportunity to participate in today's discussion, and I look forward to addressing any questions the Board might have on this important topic.

MR. DOTY: Thank you. Mr. Harris?

MR. HARRIS: Well, I would just agree with Jim. I think it's important to focus on the objective, narrow the expectation gap, and be mindful of what is happening globally on the audit quality. I don't have any questions. I think that I heard from the previous panel what's happening in terms of globally on the audit quality. I think it's different from what's happening
I think the trend outside the United States is considerably different from what's been going on in the United States. So I think we do have to keep that in mind.

I think the expectation gap is huge, and I think everything ought to be done to attempt to narrow it, because I think the focus of investors versus the profession is not narrowing, it's broadening.

So I was happy to hear from the last panel that there is increased dialogue, and I agree that there ought to be a focus on the objective. So I don't have any questions, Mr. Chairman.

MR. DOTY: Lewis.

MR. FERGUSON: Yeah. I have a question, essentially, for all of you, but may be directed mostly to Ms. Amble. Because it appears as I listened to you is that your view is that the auditor, at most, should be commenting on disclosures by management, and what the management talks about risks and audit policies in its footnotes or whatever should be the source of the disclosure rather than the auditor.

We just listened to a panel from the United
Kingdom, where their model has gone in a very different
direction, and as far as I could tell, the investor
response to that appears to have been overwhelmingly
positive. That's point one.

Point two, it looks like the IAASB is about to
adopt a standard that's very similar to ours and -- so
there are two questions here, really. One, what should
we make of the UK experience? Is it is anomalous because
it's the UK?

Number two, do we run a risk as a nation if the
international standard diverges significantly in terms
of what auditors should do, that we have a standard that
does not really comport with that at all?

So it's two questions, but if each of you could
address it, I'd appreciate it.

MS. AMBLE: In terms of -- because you're
speaking to the critical audit matters at this point, and
as I think about that, there's a question about what is
disclosed as having been done by the auditors. But, to
me, the bigger question is is the concern that there is
a view that the auditors are not doing enough? And I
don't know how disclosure addresses that.
It would seem to me if the issue is, number one, we think that auditors are not performing the appropriate procedures, if we think that they are somehow the source of the issues that companies have had, whether it's financial failure or accounting misstatements, then I would address that issue. And I would address that in terms of the training, the audit requirements that out there, the protocols and how they are monitored.

But disclosing it only -- as I read, you know, I read through the -- one of the reports, I think it was the Rolls Royce report on critical audit matters, and I found it to be very interesting in terms of what they did. But, honestly, I didn't see anything that was astounding in terms of audit procedures that were done. It made sense for the areas that they were auditing.

So while I found it interesting, it wasn't necessarily that enlightening to me. I did see something that was interesting, because on one of their comments, they mentioned that -- they talked about a design of control having a weakness, which, to me, is now getting at their assertions and their comments with regards to internal controls over financial reporting.
But other than that, that was the only real substantive comment on that. And, honestly, I think that's an area, if they were going to be any discussion, is worthy of more discussion, in terms of what is done to ensure that the SOX processes are designed appropriately, the internal controls over financial reporting are designed appropriately, and that there's the right corporate culture to ensure that issues are appropriately raised, and when raised are appropriately addressed.

I don't know that critical audit matters get to that in itself. I would just get to the direct part of the issue.

The second point that I would say is if there's a concern with the core responsibility of the audit committee, which is to look at the audit quality on a continual basis, not just an annual basis, then I would look to the performance of the audit committees, and whether or not there needs to be more enlightening there. So I hear your point. Whether there's a divergence of practice, that in and of itself does not create any substantial issues for me. There's divergence
in how we account for matters. So, in terms of how auditors discuss their audits, that is not disturbing to me in any way.

I just don't know whether disclosure in and of itself will improve audit quality. And if that's the desired objective, I don't know how disclosing and discussing it achieves that objective.

MR. CLAPMAN: I would try to answer your question in rather broad terms, and drawing back to my earlier point that at one point -- at one stage back in the early part of the prior decade, the US was considered the leading country in the world in terms of investor protections, which I no longer think is the case.

And I think the UK, for example, experience, shows how investor interest on particular questions gets enhanced as regulation or, in some ways, soft regulation through the manner in which Great Britain encourages these developments, really does generate a better relationship between investors and companies, audit committees and audit firms.

I don't think, in response to the last comment, that it's an issue of concern in the UK about the audit
1 committee. I think the point, and it was raised in
2 basically the presentation of this roundtable, that
3 there's currently an asymmetry in terms of regulation,
4 in terms of what the company knows its audit committee
5 deals with and what investors know. And, in the interest
6 of investor protection, I think this asymmetry ought to
7 be narrowed, and I think the proposals of the PCAOB go
8 in that direction, and that's why I support them.
9
10 MR. LIDDY: I'm going to refer back to our
11 comment letter, because if you think about the core
12 objective of the project at hand, you know, we do have
13 a responsibility at present, you know, relative to the
14 information that's in MD&A, specifically as it relates
15 to critical accounting estimates and such.
16
17 But the practical reporting in that regard is on
18 an exception basis, meaning if there's information
19 therein that's materially inconsistent with the
20 information that we've gained in the performance of the
21 audit. We believe, actually, one of the best ways to
22 help achieve the objective that the Board has laid out
23 is to require auditor association with that particular
24 information in MD&A.
Now, that would require some changes, and what I mean by that is we have to -- the SEC would have to require that the critical accounting estimates section be clearly within MD&A; they'd have to review existing interpretive guidance to determine how it fits in within the context of Regulation S-K.

But then we'd also have to, from a PCAOB perspective, look at the existing attestation standard, and see what we could do therein to more formally associate the external auditor with the critical accounting estimates section within MD&A.

MR. GARRETT: Thank you. I guess the way I look at this as an issuer is -- and maybe I shouldn't, but if the auditor is being relied on to tell the investor so much, I almost feel like I've failed in my disclosure attempts as a preparer.

It seems, in a perfect world, I should be giving all the information that's needed to the investor on the estimates and the other more difficult things to account for an audit, which would leave the auditor almost rehashing what generally-accepted auditing standards are, which is, I know, not the point of all this.
So I feel like we've got to look, as issuers, internally at where are we failing, where we need an auditor to pick up for us. Maybe that's not the way we should look at it, but that's kind of the way I hear it. As far as the UK comment, the only thing I can say is there are differences in the environment. The accounting is fundamentally different, as we all know, between with IFRS and US GAAP. As Peter pointed out, there's differences in the role of the audit committee and the audit committee chairman.

So I think it's almost unavoidable to have some differences, not to mention, as has been pointed out, we are in a litigious society in the United States. It seems inevitable there will be some differences. But I don't think we can just accept that there will be differences and go on. We should narrow the gap.

I think the last thing I'd say to Mr. Harris is I really take what you had to say to heart. I feel like you seem almost disappointed in us. So we, as issuers of financial statements, don't want to have the PCAOB kind of throwing their hands up and not being happy with what we're doing. So I really listen to what you have
to say.

MR. HARRIS: Well, I appreciate that, and we obviously want to work very closely with you.

MR. DOTY: Jay?

MR. HANSON: One primary question that is based on something that, Joan, you had in your statement, but I'm going to direct it first to Jim, and then let the rest of you comment. And then separately I've got a different question for Peter.

So, on the point you made, Joan, about the independence assertion in the audit report, and the importance of the audit committee's role in the dialogue with the auditor about their independence, their objectivity, their skepticism, their competence, it just sparked kind of a tangential question that I'll start with Jim, about what -- at KPMG, what do you do to help educate audit committees and management about their role in making sure that the auditor is independent within the specific independence rules around scope of services and things like that? Which, as some of us know, is an incredibly complex book of rules that sometimes, at least in my view, are not always easy to figure out what the
1 right answer is.

2 And I'm just curious about what you do to help
3 educate effectively the possible buyer of the services,
4 like you educate all of your professionals as the sellers
5 of the services. And then, Joan and Monty, your
6 experience with -- as preparers and audit committee
7 members.

8 So I'll pause for a second to let you answer.
9 But, Peter, my question for you is just slightly
10 different from that in that on the auditor tenure
11 question, your three co-panelists have each suggested
12 that, while they don't object to tenure, but it's better
13 placed in the audit committee report. And I'm just kind
14 of curious as to your reaction to their positions on
15 this.

16 So, I'll start with Jim.

17 MR. LIDDY: Well, that particular question, I
18 think we've got to recognize that when you look across
19 the spate of public companies that we are associated
20 with, there's different levels of maturities within those
21 companies themselves. And you tend to find, in the
22 larger companies in particular, that there's a level of
maturity there, not only with respect to the auditor
independence rules, but there is a better and more
comprehensive understanding of the roles and
responsibilities of management, as well as the roles and
responsibilities of the auditors per se.

Now, certainly, whether it be a mature company or
one that is, I want to say, less mature, there's a fair
amount of dialogue obviously at different points of year,
presentation of the audit plan, a very specific
discussion of our responsibilities, a compare and
contrast to management's responsibilities.

So, I mean, the most fundamental way it gets
achieved, quite frankly, is through regular and ongoing
dialogue about the auditor's responsibilities, and making
sure that there's absolute transparency from an audit
committee perspective.

MS. AMBLE: In terms of -- I'll speak to what
approach we've taken on audit committees. It's really
no different than when you're working in a company as
well, but there's a number of different things, and there
are a lot of good opportunities.

One thing which I think is very helpful is
continuing education, whatever form that is; being part of different professional organizations and currently having highlighted what the responsibilities are and best practices and what people are doing.

That is very, very helpful to keep that in front of you in terms of important things to think about, particularly looking how companies are growing and are so much more complex today, which means the audit of those companies is obviously going to be more complex.

So in terms, certainly what I do on my audit committees, is I really look very seriously at whether or not the auditors being assigned have grown with the company, and their skills match the skills that are requisite for the risks inherent within the company, just as you would look at the finance organization within the organization as well.

The other thing is to look very seriously, and not to allow it be reduced to five minutes, is how you engage in the executive sessions with the auditors. That's the time when people can just really talk very clearly and you can get into issues potentially in a more in-depth way, and taking advantage of that, and how the
auditors respond gives you a very good indication of independence.

I know there are a lot of independence rules in terms of the investments and so on, and I assume the firm does that very, very well. What we will look to is the character of the individual, and do they understand the culture of the company well enough so that issues are being appropriately raised, and when they are being raised, they know how to deal with the difficult conversations, if you ever have any.

I mean, that is so important to be able to do that, just as it's important for management as well.

The other thing is really the offline discussions you have as well. Anybody knows, if they're not a committee chair, that your job goes well beyond the audit meetings. There's a lot that happens in the preparatory meetings, where you meet with management in advance of the meeting to go through the agenda and the particular topics that will be addressed. But then you also meet with the auditors as well.

And, again, those discussions give you what I call the ability to have the Ouija board test, to
1 understand the talent of the team and how seriously
2 they're looking at things, and if they're looking at the
3 right things.
4 So those are some -- certainly not all, but some
5 of the things that I think are pretty common with audit
6 committees and audit committee chairs.
7 MR. GARRETT: I am fortunate to work at a company
8 that does have a very strong focus on governance. We
9 have a very strong audit committee, a very strong
10 chairman of our audit committee, and a lot of the culture
11 flows from that.
12 I think, similar to Joan, we have a very robust,
13 more offline process of discussing issues with the audit
14 committee and getting their reaction. I think there's
15 a healthy amount of respect between the audit firm and
16 the company and the audit committee that also helps.
17 There's, I would say -- I wouldn't use the word
18 "tension," but there is healthy challenge that goes back
19 and forth, and it never causes a problem. Part of that
20 is the strong governance culture.
21 I think, in terms of the auditor getting involved
22 in helping the company with governance, I kind of have
a different perspective on that with the company for which I'm on the audit committee, which in some ways the opposite of Verizon. It's a small private company, and there it's almost indispensable, the work that the auditor performs in helping the company understand how to govern better.

MR. CLAPMAN: If I could go immediately the questions that you posed to me. First, I thought I was actually in agreement with Monty Garrett, that disclosure is appropriate. He puts it in the proxy statement, as opposed to the auditor report, which is the focus of this discussion.

I would note that that's voluntary, that there is no requirement that Verizon or any other company do that. And the reality for the investment world is very few companies do what Verizon does do. There are some that do.

So I'll then try to address the other comments from the two panelists that oppose, for example, the inclusion of the tenure of the particular auditor in the audit report.

Here I'll start, at the risk of what you can
generalize from an anecdotal experience, when I was at TIAA-CREF, we shifted from one audit firm to another, and one of the benefits to us as an organization was that the second audit firm -- which the first audit firm was high quality; they did a terrific job.

The second audit firm took a second look at some of the questions that had been seemingly resolved with the first audit firm. And in retrospect now, as I view that experience, there were a couple of instances of that. It was a healthy development to go through as an organization, somebody that has a second look at issues that were resolved one way, and see how they might be resolved in another way.

Apart from that, I do take issue with the notion that inclusion of auditor tenure could be misleading. And basically I think that is -- to make that right, you'd have to believe that investors just don't know how to use the information that's disclosed to them, and I would challenge that notion.

I think if you surveyed some of the key institutional investors, they believe that auditor tenure going to the issue ultimately of auditor independence --
1 and it's not just technical independence. I think there
2 are a few instances where auditor tenure might affect a
3 situation where auditor independence was lacking in the
4 past.
5 But there's auditor independence and there's
6 auditor independence, and getting back to the second look
7 aspect of it, I think that's extremely valuable. So I
8 would say that there should be more trust that investors
9 that think it's valuable will use it appropriately;
10 investors that think it has no value could ignore it.
11 It's a disclosure that you could require that
12 imposes no costs on the investors that don't care about
13 auditor tenure. But I believe, just like in the British
14 experience, that once these issues get onto the table,
15 you will find more dialogue, more interest on the part
16 of institutional investors and other investors, and
17 you'll have examples of where a particular audit firm has
18 been the auditor for a particular company for decades,
19 and that will give investors the opportunity to at least
20 ask questions about it. And right now they don't have
21 the information. And that's why I would strongly support
22 the PCAOB making that disclosure a requirement.
MR. HANSON: A couple of reactions. And when I posed my question, it was really in a context I didn't describe, which is in the imaginary world that the SEC would take up the issue of making it required in a proxy statement. So it wasn't just voluntary, which as Brian has observed, we have observed lots of things on the SEC's agenda, and we have no ability to impose that on the SEC, and there might be several things that might be worthy for them to take up.

Another just reflection and a little bit of a surprise at what you've said, is that for the analyst that wants to know how long a company's been -- an audit firm has been a company's auditor, at least I'm not an expert in using the SEC's online filing search system, but in any company I've tried to figure it out, I could figure it out in about two or three minutes, the auditor changes within the last 20 years on the EDGAR system.

So it's not hard to find. So it just kind of surprised me that those that want it can't find it.

MR. DOTY: Do you want to respond to that, Peter?

MR. CLAPMAN: Yeah. There's lots of things that could be required conveniently in the way of disclosure
1 to make the information convenient without going into an
2 elaborate process, even if it's doable.
3 Again, I come back to the question that this is
4 a costless requirement to put in information of this
5 sort, that some investors, and I would suggest that most
6 of the institutional investors will find this information
7 potentially important and interesting, to make that
8 disclosure better for them is a positive thing the PCAOB
9 could do.

10 MR. DOTY: Jeanette Franzel.

11 MS. FRANZEL: This has been a very interesting
12 discussion. Many of the panelists here have touched on
13 issues which we've been hearing throughout these two
14 days, and it's really an issue of, gee, does some of this
15 really belong in the auditor's report? Should the
16 auditor be reporting on original disclosures or should
17 management be doing it? Should the audit committee be
18 putting some of this into the audit committee report or
19 in the proxy statement, you know?
20 And, unfortunately, the reality is our system of
21 regulation over financial reporting and governance and
22 disclosure is fragmented. So here we are at the PCAOB
identifying potential disclosures that might be helpful to investors, and the only thing we can do is require that it be thrown into the auditor's report.

So I think that, in some cases, we're hearing discussion or we're hearing disagreement on certain issues that would be of great value to some investors, but the real disagreement is putting it into the auditor's report.

You know, so I guess we can always just keep requiring more and more in the audit report. But at some point, you know, some of these issues of critical accounting policies and MD&A and tweaks that maybe need to be made on management's side, so that then the auditor can take a different role, would strengthen the system, you know, in its entirety.

So I have that concern, and I would like just to hear your comments in terms of how concerned are you about that. Maybe it's not a big concern. Maybe we can compensate, you know, for all of the problems in the disclosure system by putting it all into the auditor's report.

But I think at some point the fragmentation here
will cause risk, and it will cause proposals that might not be the best solutions. I guess what really caused me to go down this line of thinking was Peter's comments that, in his opinion, the disclosure system presently is flawed in material respects.

Well, if that's the case, I'm not sure we can solve it all through the auditor's report. But I'd appreciate any comments or thoughts that you all have on that, how it relates to some of the things we've been talking about, and I see I just caused Brian to raise his name card as well.

MR. GARRETT: I think it is interesting the way you described that, that it's a bit fragmented. And, you know, you have your purview over the auditor's report, and is that really the best way to address some of these things? I think our opinion is maybe not, especially with the items like the CAMs.

Again, it just feels strange to have the auditor giving information other than just their basic audit steps, which, as I think about it, aren't those really available? I mean, you have steps -- everyone uses the same steps to audit certain things. It's prescribed.
So if there's a shortfall, it seems it's up to the company to beef up the disclosures on what things. Again, if it was hard to audit, it was also hard to account for. So if that's the problem we're trying to solve, then we do need to solve it if investors are concerned about it.

To me, it doesn't seem like the audit report is the way to do that.

MR. DOTY: Jim Kroeker had his flag up first.

MS. FRANZEL: Do any of the other panelists want to comment on that?

MR. LIDDY: I guess, if I may, I'll just make one anecdotal comment, and I think back to my many years in practice, when I'd go and I'd talk to the financial management people at a particular audit client, and we would -- I would discuss as it relates to a particular transaction or estimate or policy statement or whatever, and talk about disclosure in the underlying financial statements.

And someone would invariably say, well, that's in the 10-K. Well, it's in MD&A per se, but it's not in the financial statements and we think it's particularly
important that it be included in there. And I think that's an important point, because at the end of the day, when we put an audit opinion on a set of financial statements, we've got to be satisfied that there is reasonable and appropriate disclosure of all those matters that are important from an investor perspective, in terms of understanding those financial statements taken as a whole.

I'm not commenting about the disclosure framework, you know, overall. But I am talking to that I think it's a pretty important part of our job to evaluate those financial statements, and to make sure that the discussions are appropriate in the context of the financials as a whole.

MS. AMBLE: Since you brought it up, which goes outside of the topics of the discussion today, I think it would be fabulous if the SEC and the FASB and the PCAOB could be in concert on a number of things.

And I think one area -- I mean, some of the discussions and push-back that you've heard is the volume of the financial statements just becomes very substantial, and they're already very substantial.
Part of the culprit for the volume of the financial statements is there is duplication, because you do have two different bodies, the SEC and the FASB, requiring information, and you cannot cross-reference in all cases for them to be complete.

So I think anything to take away the duplication and things that add no value, in the way in which they're presented today, would be a wonderful thing.

I also think having clear line of sight of responsibilities for each of the organizations being adhered to, so that you don't bring in things that are interesting and nice to know, but really not directly under that organization's purview. I think that would be, you know, something very positive.

I also think if you were to get the MD&A and the financials more consolidated, you may also have the opportunity to have SOX oversee more than just financial controls. One of the biggest concerns I have with non-GAAP measurements is they're not under SOX. And arguably if that is more important to investors, and that moves the needle on your stock price, it would seem to me that the standards required for GAAP measurement...
should be at a minimum what should be required for those.

Today, they're not under SOX. And I know that because it was something that was not determined to be part of the basic financial statements. And I would disagree with that. I would think that you should have it expand to that as well.

So that's kind of going beyond your question, but getting to would it be nice for all of us standard setters to kind of coalesce? I think that would be great if they were sitting here potentially, and not us.

MR. DOTY: Peter, I'm going to get back to you, but I want to give FASB and the SEC a chance.

MR. KROEKER: Actually, your remarks are a good segue to the question I had. One, I think we do have a fabric that works well together. You know, obviously our responsibility is much narrower than the SEC's comprehensive authority with respect to accounting standards that we have. I think we do work complimentary together, but just a personal view.

But, Jim, you mentioned earlier the issue of auditing assurance, or some type of attestation around critical accounting policies, critical accounting
estimates. And it occurs to me, in the vein of duplication at least potentially, and there's a lot of complaint about Footnote 1 often and how does that correspond to critical accounting policies.

One way to address that, again, speaking for one person from the FASB, would be for us to consider bringing more directly the obligations that are existing in MD&A, and we'd have to deal with staff interpretations and other things, but to bring that into the financial statements.

That could accomplish two things. One, reduction, at least, of confusion about whether there's duplication, but also then bring in directly an auditor attestation requirement specifically to things that are already often covered in the context of an audit. But I wonder if you or others had reaction on that.

MR. LIDDY: My only reaction, quite frankly, is I think, you know, we're raising it in the context that a dialogue in this vein, you know, we think is both reasonable and appropriate when you think about the core objective of the reporting model standard here.

We'd welcome a dialogue about it to figure out
the best way to provide the information that's of most value to investors, and potentially the least cost to the companies themselves.

MR. CLAPMAN: If I could just have one final crack at your question, it would be that we've going to deal with the situation that we've got to deal with. That's my perspective on it. I've urged the SEC to include disclosure about auditor tenure, as Verizon voluntarily does. We might be having a different conversation if the SEC had done it or will do it.

But from an investor perspective, I think it comes back -- and you made the point earlier -- that I think there's a material flaw in the disclosure system now, and there's something that PCAOB can do about it. There's something the SEC can do about it, and I'd encourage each to move on it. That's, I guess, where I come down on your broad question.

MR. DOTY: I'm not through with you yet, Peter. Brian.

MR. CROTEAU: Thank you. I just wanted to follow on from Jeanette's remarks, and actually, Peter, your remarks, and actually some of what Jim has now just said.
Now is probably a good time just to remind you that these are my own views.

But with respect to what the SEC can or can't do, I just want to comment that, you know, in the seven or eight years that I've been now involved in this, I've been involved in making recommendations to the Commission on nearly all of the PCAOB standards that they've developed thus far. And not once have we made a recommendation, so far, that says we recommend that the Commission adopt this because you're too busy to do something that would be better or more appropriate. I certainly don't think we should start that now, is my own view. So to the extent that -- that was the basis for my comment yesterday.

To the extent that commenters still believe that there's something the SEC should be doing, or that a disclosure would be better placed in the audit committee report, I'm glad that we're still hearing those kinds of comments and I encourage those kinds of comments, because I don't think we should start with the presumption that the Commission wouldn't do something or couldn't do something.
So I really appreciate the feedback that we're getting in that regard, and we'll continue to listen to that.

MR. DOTY: I'm mystified a bit. There's been a lot of discussion in the panels to a matter that Lewis alluded to, and that's the fact that Europe is moving ahead, and the UK is moving ahead, and the concern that we might not be right there in the vanguard of disclosure.

Whether that will translate into different costs of capital for us in the long run, we don't know. But one of the things the Board, I think, must worry about is the potential that, after some years, it will translate into some differential in the premium which our equity markets enjoy, and the charges for which capital exacts -- sources of capital exact their funds.

And the confidence that they have in the completeness of the regimen or the regime of disclosure, and the enforcement of the regime of disclosure, seems to be, if we're reading the sources correctly, if we're reading the academic research correctly, that seems to be something that does translate into cost of capital.
Verizon discloses this tenure matter for some reason. If you put aside just the fact that other advanced capital centers are making the disclosures that we have asked you comment on, and if you look at just what we are doing or not doing, it would seem to me that preparers, directors, audit committee people, auditors, are all to be concerned that if there's something we can do here that gives investors information which they have been asking for for over a decade, in some cases decades, and if we can do that without increasing a great deal of the cost of obtaining and delivering that information, we ought to seriously consider doing it.

And I would be surprised if in Jim Liddy's long and distinguished career as an auditor, Jim, if you had never seen a case in which the desire of a young auditor not to lose or vex a promising or a valued client had never prejudiced that accountant's views.

The point being, I don't think it's possible to prove the negative here and to say that there is no relationship between tenure and independence, there's no relationship between tenure and skepticism.

Therefore, I am puzzled with how you deal with
Peter Clapman's position as an investor, and as a former CREF official, that this is something that investors want. How do you face your investors and say, we think you can't handle the information, we don't believe you can use it, we don't know that it's useful, we think it may confuse you, we think you may make precipitous judgments based on tenure?

You have the entire proxy statement. You've got a lot of things available, many megaphones available to management, megaphones available to audit firms that KPMG uses regularly in the reports that they issue, on why it is that, in fact, the retention and the choice of an auditor is a complicated matter.

Many things have to be valued. Many things have to be weighed. But why would it be that we would want to deny this information to investors now, when it is in many ways the easiest, the best-known and the cheapest kind of information to include in an audit report?

And it has the risk that if we don't do this, we're actually withholding something that looks to the investor, that is perceived by the capital markets as being something that diminishes the completeness of our
1 disclosure regime and the enforceability of our 2 disclosure regime.
3 We're putting ourselves at risk, possibly, on 4 cost of capital. Why do you want to do that? Anybody. 5 MR. LIDDY: If I may, I'll start. I mean, just 6 to make it clear, I mean, this information may very well 7 be important to investors, and we're actually supportive 8 of the idea of communication and transparency regarding 9 the concept of auditor tenure.
10 I guess our objection relates to specifically 11 including it in the auditor's report, and it relates to 12 a specific correlation being made between the tenure 13 number and whether that is reflective on audit quality 14 or not.
15 MR. DOTY: But, Jim, that's your most immediate 16 communication with your stakeholders, with your investing 17 public, is your report.
18 MR. LIDDY: I don't disagree with that, but, 19 again, I think, you know, from our vantage point, we're 20 supportive of, you know, greater transparency about it. 21 We see a growing, growing number of companies that are, 22 as a normal practice, disclosing it in their audit
1 committee reports. We also think that as a matter of 2 convenience that could be done in the Form 2 as well.

3 MS. AMBLE: I've actually been on both sides of 4 the fence on this one. My initial reaction when I read 5 the proposal was what's the problem? Putting it in 6 doesn't cost anything.

7 It was really after thinking about it further 8 that I thought, you know, it really isn't, though, an 9 audit matter per se. It's a governance issue. I mean, 10 if I had my druthers, I'd rather have the auditor sign 11 the report personally.

12 I mean, I know that's not a very popular position 13 to take, but to me that's more important. The individual 14 who was responsible for that audit engagement and 15 ensuring that everything, all of the professional 16 responsibilities have been discharged appropriately. 17 That is much more important to me.

18 I think, from an audit committee perspective, 19 it's important to look at the duration of the audit firm. 20 But quite frankly, whether it's one year or 30 years, it 21 still boils down to the people with the feet on the 22 ground, the people that are there in the engagement and
how they're responding to the needs and risks of the company.

So, like I said, I think if it's deemed important for everyone to disclose it from a governance perspective, put it in the proxy. Two of my three firms where I'm on the audit committee, we do disclose it. But it's not for the gallant reasons that you just described. I mean, one disclosed it, but they're challenging whether they want to anymore, because they thought it was a good thing to say that we've had the same auditor for a number of years, and we've developed a very positive and thoughtful relationship in ensuring quality audits. Now that they're seeing that people are seeing that tenure might connote something negative, they're wondering, gee, I wonder if that wasn't a good disclosure.

The other one had it in because we had changed auditors, because we had merged firms, and one firm had one auditor and the other had another. So you had to pick one, and so it was required to be put in, and it was just kept over for the last couple of years. So my guess is there are probably other people in that same camp as
So, while, you know, I think it's an interesting disclosure, I think when you speak of it in the context of how the audit committee may evaluate that, I think that's very relevant. So putting it in the proxy, I'm not objecting to at all. But there are a lot of other interesting things that you could put in the audit report that we're not talking about, that I don't think are as high a priority, personally.

MR. CLAPMAN: If I could make, Jim, one further comment. The nature of prediction, that if there is disclosure of the tenure of audit firms, I think what you will do in this country is have a healthy debate, some of which has been aired at this panel, as to whether it's important, whether it serves the interest of investors and the public interest.

But I think it's a debate that is needed, and I think if you did have that disclosure, it would encourage more dialogue and I think this would be a healthy thing for the system.

MR. DOTY: I'm afraid that, at times, Ferguson and I both evidence frustration that we're not law
professors. So I hope you will forgive me for trying to
push the Socratic method a little on you on the law
professorial note. I think Jay did a good job of arguing
with the witness, Peter, and arguing with you on this
issue.

So this is a panel in which there's been a lot of
give and take. Steve, do you want one more give and
take?

MR. HARRIS: Yeah. Mr. Garrett, just so you
understand where I'm coming from, I didn't want to leave
any misimpression. The mission of the PCAOB very
specifically is defined in Section 101. It's unequivocal
and it's in quotes, and that's the preparation of
informative, accurate and independent reports, audit
reports.

So my perspective is how can we make the audit
report more informative? So I want to elicit from as
many people as I can, you know, a marketplace of ideas
for how we improve the audit report. That's my
perspective. Thank you.

MR. DOTY: We have a panel waiting, but this one
has been terrific. Thank you all, and we'll see you
I'll introduce the next panel as they're coming in.

Charles Pagano is a partner at WeiserMazars, and his industry experience includes broker-dealers and financial services. He's currently a member of the AICPA and the Securities Industry and Financial Markets Association, in their compliance and legal division, as well as the financial management division. He's a current member of the NYSSCPA and the Stock Brokerage Committee. He chairs the Foundation of Accounting Education's annual technical conferences on audit issues for broker-dealers, and their annual conference on the securities industry.

Michael Fehrman is a managing director and head of the Accounting Policy and Advisory Group of the Americas at Deutsche Bank. In addition to providing transaction advisory services and financial statement review, he undertakes special projects throughout the bank and participates in various valuation and control oversight committees. Previously, Michael Fehrman was a member of the accounting policy team at Goldman Sachs,
1 and held various positions at UBS.

2 John Corcoran is a former vice president of MFS Investment Management. He also serves as the fund president of the MFS Funds, and fund treasurer for the MFS Meridian Funds. In his role, he manages the financial reporting, tax fund administration, custody and accounting oversight and valuation functions of MFS.

3 Previously, he was a senior vice president of State Street, where his roles included managing the integration of Investors Bank & Trust, holding senior positions in fund administration and serving as the managing director of State Street's office in Edinburgh.

4 Jeff Burgess is Grant Thornton's national managing partner of professional standards. Earlier, he was the partner in charge of the firm's National Professional Practice Director Group, and the National Professional Practice Director for the Southeast Region.

5 At Grant Thornton, he's also served as the partner in charge of the Greensboro, North Carolina office, and as the professional standards partner for the Carolinas practice.

6 This panel is here to discuss considerations
specific to investment companies and broker-dealers, and
we appreciate it. Thank you. Charles?

MR. PAGANO: Thank you, Chairman Doty, and thank
you for inviting me to participate in this PCAOB public
meeting. As the leader of my firm's broker-dealer
practice and former two-time chair of the New York State
Society of CPA Stock Brokerage Committee, and current
member of that committee, I welcome the opportunity to
express views on the proposal.

The Mazars Group includes 14,000 professionals in
70 countries, and WeiserMazars LLP here in the US
includes 100 partners and 650 professionals in six US
offices. We are the auditor for small issuers with less
than .5 billion in market cap, and broker-dealers which
range from small to medium-sized firms, non-clearing
firms, including retail, trading, investment banking and
firms with net capital ranging from $20,000 to $3
billion; employees from three to several hundred.

For purposes of this discussion, I will define
small broker-dealers as those which are noted in the
proposal by the PCAOB's Office of Research and Analysis,
specifically those BDs which comprise approximately 2,200
1 of the approximately 4,200 BDs in the US, and which have
2 a minimum net capital of only $5,000.
3 Also noted by ORA, 1,700 have revenues of less
4 than a million, and only nine percent of the BDs are
5 subsidiaries of issuers, who presumably are audited under
6 PCAOB standards as part of the parent-subsidiary
7 consolidations.
8 Only 311 of the 4,200 broker-dealers are subject
9 to the customer protection rule, SEC Rule 15c3-3. The
10 vast majority hold no customer funds or securities. The
11 purpose of the proposed rule is to allow investors to
12 enhance their ability to make investment decisions and
13 for other financial users, which, in the case of
14 broker-dealers, would be the regulators.
15 As noted in the proposal, approximately 90
16 percent of the BDs are directly owned by an individual
17 or an entity that owns more than 50 percent of the
18 broker-dealer, and approximately 75 percent have five or
19 fewer direct owners, who, the ORA suggests, and is my
20 experience, are often active in the business.
21 Investors do not invest in the broker-dealer
22 proper. When a broker-dealer attempts to attract
capital, it will look to bring in other active shareholders or subordinated lenders who are generally existing shareholders. Therefore, we believe that investor would not benefit from the proposed change, as they are not investing in the broker-dealer.

The other financial users are the regulators. The BD industry is heavily regulated, with a robust surveillance system in place that includes FINRA, the SEC, the CFTC and state regulators. There will also be additional auditing oversight under PCAOB standards for years ending after June 1st, 2014, which will allow potential referral by the PCAOB to regulators.

If enacted, many BDs will have common critical audit matters that are already addressed in other reporting areas. Disclosure and information available to users, namely the regulators, is more than adequate in areas that are common to many BDs.

For example, valuation of securities and revenue recognition, which are both addressed in comprehensive footnote disclosures; the net capital computation, which is addressed in a required supplementary schedule and is extensively audited and disclosed; and compliance with
the exemptive provisions of Rule 15c3-3, the customer protection rule.

The additional costs of applying PCAOB Auditing Standard No. 7, effective June 2014, along with the implementation of other PCAOB auditing standards, have already added incremental audit costs to the small broker-dealer. A small broker-dealer will be asked to absorb additional costs if the proposed auditing standards are enacted.

A mid-size auditing firm's additional manpower costs to comply with the proposed reporting requirements for critical audit matters would include incremental time incurred by a senior manager, a partner, an EQR, an engagement quality control reviewer, in-house and possibly outside counsel and other firm experts or specialists to issue a report.

The BD is asked to issue a report within 60 days of year-end. This existing time constraint, with the possibility of additional reporting requirements, if enacted and applied to broker-dealers, is a more stringent time frame for a more significant public company, which may have a 75 or a 90-day filing
There's a concern that additional reporting with these time constraints may affect audit quality in the race to get reports issued to meet existing deadlines. Documentation of critical audit areas and compliance with the Auditing Standard No. 3 may be more burdensome and costly. Depending on the capabilities of the auditor, given a similar fact pattern, different auditors may produce different results.

Thus, the playing field may not be level for different sized accounting firms and their clients. The August 2013 SEC report on the progress of the interim inspection program noted that of 783 accounting firms that audited BDs for the 2012 audit year, 756 or 83 percent of those firms audited only one to five broker-dealers each, while 14 firms or two percent audited 51 or more BDs.

I suspect that this might be somewhat price-driven. Some BDs may, in the interest of saving dollars, look for those auditors who can perform less costly audits, and in some cases, quality may suffer.

Given the statistics already acknowledged by the
PCAOB, including the size of the majority of the BDs, the size of the accounting firms that audit them and the likelihood that no useful additional information may be gained by additional requirements, we believe broker-dealers should be excluded from the proposed standards.

Our lack of support for certain aspects of the proposed audit standards, including their effect on issuers, as noted in our December 9th, 2013 letter to the PCAOB, primarily relate to the conviction that we should not supplant the responsibilities of management or audit committees.

We remain committed to participating in future discussions with the Board and staff to further enhance audit quality. We thank you for today's opportunity to participate.

MR. DOTY: Thank you. Mr. Fehrman.

MR. FEHRMAN: Thank you very much for the opportunity to appear today and to present Deutsche Bank's views on this topic. Deutsche Bank is a global universal bank, and one of the largest financial institutions in the world. To facilitate the products
and services we offer, we have a wholly-owned broker-dealer subsidiary in the United States, Deutsche Bank Securities, Incorporated, or DBSI.

Because Deutsche Bank is an SEC registrant, our auditors are subject to inspection by the PCAOB. As DBSI is a broker-dealer, the audits of its separate financial statements are also subject to inspection.

We support the goal of enhancing the information provided to users of financial statements, but believe the information should be presented by management.

In our view, any critical audit matter would most likely be a critical accounting matter as well, and therefore already discussed by the issuer. At best, therefore, a discussion of critical audit matters would seem to be redundant. Accordingly, we do not support this proposal in its current form.

I've been asked to comment on issues that this proposal would present to broker-dealers for their financial statements. While there are certain issues related specifically to broker-dealers, I believe many of the concerns we have with the proposal would be shared by other preparers of financial statements. But I will
begin with the matters that are specific to broker-dealers.

As you know, many broker-dealers do not provide a complete set of financial statements to their customers, and instead provide only a balance sheet with limited disclosures. It is highly likely that an auditor would find that there are critical audit matters resulting from income statement or disclosure information that is not included in the information provided to customers by a preparer.

Similarly, auditor comments on responsibilities regarding other information would have little meaning to the user if the information itself is not included in the report. If those comments are to be included in the customer report, it will raise confusion for the user of the report.

Clearly, the intent of this proposal is to add clarity and not confusion for the reader, and we believe this matter should be addressed during this exposure stage. We see this matter as an indication that perhaps application of a proposal to broker-dealers may not have received the same attention as for other entities.
While I very much appreciate the opportunity to comment on matters relevant to a broker-dealer, I do not believe my appearance today can adequately address the concerns of the whole industry. Accordingly, I would respectfully suggest that an additional outreach effort be made, particularly to smaller broker-dealers who may not have had the regular practice of responding to matters such as this.

Since PCAOB standards have only recently been applied to audits of broker-dealers, and given the small size and closely-held nature of many broker-dealers, I'm concerned that there could be significant matters that may be brought to light only with a more targeted effort to solicit input from the industry across all its segments.

One other aspect directly affecting broker-dealers is that the industry is already subject to significant regulation and oversight in both business practices, maintenance of capital levels and financial statement presentation.

Coupling that with the fact that broker-dealer financial statements are more often used by customers of
broker-dealers rather than investors, we question whether applying this proposal to broker-dealers will yield significant benefits that are not already addressed by existing regulations and oversight.

At a minimum, we would like to suggest that the PCAOB give further consideration to excluding broker-dealers from this proposal.

There are other concerns that apply to companies in general, but may be more acute for broker-dealers. For example, complex business activities, and the related management judgments applied, are more likely to result in critical audit matters than are simple business activities.

We are concerned that certain complex matters would almost always be cited by auditors as a critical audit matter. For example, hard to value securities, such as Level 3 securities, would likely be named as a critical audit matter for many broker-dealers.

As a result, rather than adding clarity for the user, there's a risk that such matters would come to be viewed as boilerplate disclosure and be ignored by the user.
On the other hand, a user of financial statements could react very negatively to all critical audit matters, and reach an incorrect conclusion that critical audit matters are indicators of problems in the broker-dealer's business.

Given the extent of discussion of Level 3 assets in both notes to financial statements and MD&A, there seems to be little information content to be gained from having them as a critical audit matter as well.

Further, a decision that something is a critical audit matter could be the result of the individual auditor's knowledge and comfort level, rather than an assessment of the matter itself. Of course, this concern is also applicable to financial institutions in general, and is not limited to broker-dealers. There may be other examples of critical audit matters that would become either false red flags or boilerplate language that would be ignored for both financial institutions and other industries as well.

We all know that the number of pages included in both quarterly and annual reports has steadily increased in recent years. Nowhere is this more true than for
financial firms of all types. Adding to the sheer volume of the material is the fact that much of the information is very complex as well.

Both the complexity of the business itself and the increasing requirements of accounting standards contribute to this increase in length and complexity of financial reports. Companies spend very substantial resources in preparing and explaining information and trying to do so in the most understandable way possible.

The result, however, is a perennial call for simplification and elimination of disclosure overload. Adding an additional view or set of commentary will certainly not help this situation.

As noted at the beginning of these remarks, we support efforts for increased transparency in providing additional useful information to users of financial statements. We do not think it should be the role of auditors to do so, and we cannot support the proposal as it currently exists. Thank you for your time.

MR. DOTY: John Corcoran.

MR. CORCORAN: Well, I'd like to thank the PCAOB for having us here today and to hear our comments. I'd
also like to thank you for saving what we think is the best panel for last.

Today I'm going to focus my comments on how the proposal impacts investment companies. And to put my role into perspective, at MFS, we have over 140 US mutual funds that we're issuing financial statements on, representing $170 billion in assets under management.

US investment companies as a whole are responsible for the investment of nearly $14 trillion in assets, and most of that being in mutual funds that have 92 million shareholders. And there's approximately 10,000 investment companies that are subject to annual audit requirement, and oversight by the PCAOB and the SEC.

As we stated in our letter, in our comment letter to the PCAOB, we do understand the PCAOB's overall objective to improve the value and relevance of the audit report, and support many of the proposed changes. But there are certain aspects of the changes proposed that we do have concerns with, especially as they relate to investment companies.

So, first, let's talk about where we support the
changes. Under the proposal, the auditor's report will be modified to include a statement that the auditor is registered with the PCAOB and is required to be independent. It also recommends the auditor's report more specifically articulate the auditor's responsibility with regard to fraud in notes to the financial statements.

We think these enhancements provide better clarity to investors of what the auditor's role is. It can be done without expanding the scope of an audit, and we support that.

The area that we probably have the most concerns about and do not support is the proposed introduction of critical audit matters, or CAMs. Let me take a few minutes to explain why.

We feel that in the context of an investment company, the CAMs are going to be associated to be a red flag or a sign there could be something is wrong with a fund, when in fact judgments and estimates and assumptions are an inherent part of the financial statement process.

As an investment company, we make extensive
financial disclosures and make certain judgments regarding disclosures on investment valuation. We'd expect the auditor to have to cull that out as a critical audit matter. But I think it's important to note that, even though those judgments are made, the auditor is certainly able to obtain enough information to give an unqualified opinion.

In these circumstances, calling this out as a red flag, we think, could raise a red flag to investors when no problem exists. Significant disclosure is already made and the financial statement opinion is unqualified. Given the view that we would not expect to see an audit that doesn't have CAM, we think that's going to incent an auditor to identify more CAM to show the comprehensiveness of the work that they've done and their compliance with the PCAOB's directive.

Given our concern that these CAMs could be perceived as a red flag, it could have the unintended negative consequences that investors are going to use that as an objective yardstick in determining one fund's value versus another.

Let me explain how that could play out for us.
In a large complex like MFS, we employ more than one auditor. We have a two auditor model. So when this two auditor model, and it happens, we've got substantially similar funds audited by different audit firms, each of whom is going to have their own unique thoughts on what constitutes a CAM and how to document that within the auditor's report.

So we could have a fund with the same strategy, holdings, investment performance and disclosures, and still end up with having a different description of critical audit matters. And that would have the unintended consequence of putting one fund at a disadvantage over the other one because of subjective language in an auditor's report.

When you then take that and take it outside of just one complex and put it across the universe of investment companies, you can see that that expands our concern.

We also share the concerns raised over the last couple of days about CAM creating a piecemeal opinion and putting an auditor in a position to disclose information that management may not be required to disclose. I'm not
I'm going to add anything to that today. I did in my written comments. I won't in the verbal comments today, other than to suggest that, in our context, if our financial statements and presentation over something like investments and investment valuation is not sufficient, I don't understand how an auditor is going to be able to reach an unqualified opinion on our financial statements.

The last concern I'll raise about CAM, and it's probably the one that's going to have the most impact on myself and my staff, is additional cost and time it's going to take with auditor's reports.

One could argue the level of audit evidence and audit work required to reach a qualified or unqualified opinion wouldn't change. But there will be additional effort to document conclusions of why something is or isn't a CAM, and to put documentation and non-standard language into the audit report. When non-standard language is put into the audit report, it's going to require additional review within the audit firm and within the management company, and depending on what it is, it could involve others.

The people who are doing that review are not the
low level, least expensive folks. So it's definitely
going to add cost to review that language. That is also
going to occur when a substantial amount of the audit
work is complete. So it's going to be towards the end
of a very compressed schedule for us. So we do have
corns with that.

Another aspect of the proposed standard that
concerned us a bit is the inclusion of audit tenure in
the auditor's report. I won't repeat what was said in
the last panel, but our concern is just that the
auditor's report is not impacted by audit tenure.

There's also a logistical problem with investment
companies. For a company like ours, we have new funds
starting and merging and changing every year. And there
are some times that there's going to be reports with
multiple funds being reported in one book and one set of
audit opinions. Each has a different start date and
therefore a different logistical audit tenure. So we
think that would need to be addressed. We don't have a
problem with disclosing audit tenure, but we think
there's probably a more appropriate place to do it than
the auditor's report.
The last area of the proposed standard I would like to comment on is the clarification of the auditor's responsibility for other information. We absolutely agree it could be helpful to clarify what components of other information we want the auditor to look at and what the expected level of auditor effort is here.

We do think some more work needs to be done to actually specify exactly which areas you would like the auditors to look at and what is the expected level of effort there.

This is particularly important with an investment company. If you put it in our context, whereas a financial company may have one set of financial statements that the annual auditor's doing every year, I have a set of funds being audited every month. We have over 35 different filings annually by trusts that have multiple financial statements within them, okay? So there's definitely going to be some costs associated with that, and there's definitely going to be some logistical issues associated with that.

So we want to make sure enough study is done on that what we have the auditors look at is something that
they have the expertise to look at. And that it has the appropriate cost-benefit.

So, given that, we would encourage additional outreach to be done to determine what are the areas of additional information that are of most value to investors? Of those, which of those does the auditor have the expertise to take a look at? And then have the auditor do some field testing so we can just test that the level of benefit does exceed the level of cost to do that.

So, in concluding, we do support a number of the initiatives. We certainly support the intent of what the PCAOB is doing. We thank you for having us here today, but as it relates to investment companies, there's a few things we would ask you to consider.

First, we'd ask you to reconsider the inclusions of critical audit matters in our reports, given that we think it would increase the cost of the audit and also could introduce some other notable negative unintended consequences to our funds.

We'd also ask you to consider using other public documents in the auditor's report, if you want to
disclose auditor tenure, and would ask for that additional outreach to be done on other information to clarify what other information might the auditor take a look at. Thank you.

MR. DOTY: Thank you. Jeff Burgess.

MR. BURGESS: Good afternoon, and thank you for the opportunity to provide my comments related to this important topic of auditor reporting. I commend the PCAOB for organizing this roundtable, and for its continued outreach. Grant Thornton supports the Board's effort to enhance the relevance and usefulness of the auditor's report.

My comments today are focused on the applicability of the proposed new rules to investment companies. And in doing so, I'll also provide some general comments about certain of the key aspects of the proposals, primarily CAMs and other information.

The application of the PCAOB's standards should, in most circumstances, be applied uniformly to all issuers. Although we understand the view that investment companies and broker-dealers could be scoped out of the proposal, we struggle with trying to define which issuers...
1 should be included, versus those that would be exempt.

2 Where do you draw the line?

3 It's difficult to distinguish the circumstances in which an issuer or group of issuers might merit a discussion of CAMs from those that would not merit such disclosure.

4 Second, certain aspects of the proposals would likely need further evaluation, outreach and deliberation to be applicable to many investment companies, including consideration of the various fund structures and regulatory reporting constructs such as multi-fund filings.

5 With respect to CAMs, we believe that providing more insight into critical audit matters can give investors and other users of the financial statements information that could be useful in evaluating the underlying financial statements.

6 Grant Thornton's comment letter identifies suggestions for improvement with respect to the proposal scope, filtering mechanisms and form of communication.

7 Our suggestions are intended to address concerns we have as to how the proposal aligns with current audit
Concentrating on issuer investment companies, we share what seems to be the general view of many other commenters that the primary focus of CAMs will be in the valuation of investment securities. Valuation has been a significant focus of the SEC and investors in recent years, so a CAM related to this complex audit area could be relevant.

It's been our experience that audit teams are spending considerable time evaluating the sufficiency of audit evidence relating to valuing the more complex Level 2 investments, as well as the Level 3 investments.

While we acknowledge that required financial disclosures in set forth in ASC 820, combined with additional management disclosures of portfolio risks and other details around investment portfolios, provide investors with a significant amount of information, it's possible that audit commentary for certain matters around a specific investment valuation that might be included in the CAM could be useful.

Most of the challenges relating to reporting CAMs for investment companies are ones that we believe also
apply to the broader population of commercial entities. We've highlighted three concerns that we've noted, and on which we've seen others comment.

The first two have been discussed at length for the last couple of days: the comparability and the issuer boilerplate language, the disclosure of original information by the auditors. The third comment relates to the ability of the information to be operational to the investor, and not just in a negative way.

And along the lines of what John said, it's essential for investors to better understand the context for how the auditor determines CAMs, and how those matters relate to the underlying financial information. We share concerns expressed by others that investors may inappropriately look at the auditor's reporting of a CAM or multiple CAMs as a negative indicator as it relates to a fund, resulting in misinformed investment decisions.

These aren't easy issues to solve, and we suggest that further discussion and outreach, including perhaps consideration of a phase-in approach, might be a prudent way forward.
One final point on CAMs related to investment companies is the expectation included in the proposal that the auditor will rarely not identify a matter as critical. We believe that this expectation may create pressure to identify a matter, or multiple matters, when they really aren't any.

For example, a mutual fund that has a very straightforward and non-complex investment portfolio may not have matters that really meet the definition of a CAM, but the auditor might feel compelled to call certain matters CAMs just in order to report something under the proposed standard. So, in that regard, we suggest the PCAOB reconsider its view that the auditor will rarely not identify a CAM.

In response to the proposal related to auditor's responsibility regarding other information, we agree with the Board's view that investors and other users of the financial statements would benefit from understanding the auditor's responsibility for information that accompanies the auditor's report and financial statements.

Consistent with our views on CAMs, we also believe that this proposal should apply to investment
companies and broker-dealers that are issuers. However, we do not agree with the change in scope of the auditor's responsibility, or in the breadth of information subject to the proposed standard.

Current standards and practice provides for a read-and-consider model. The current PCAOB proposal increases the requirement to an evaluate-and-conclude model, which we believe would lengthen the time the auditor would need to spend on such efforts, thereby increasing the costs.

We do not perceive that these increased efforts will provide sufficient benefits to investors to justify the changes proposed in the release. Additionally, the annual filing requirements for investment companies differ from those of commercial entities.

Further analysis and outreach is important and could result in meaningful application guidance for investment companies to strike the right balance between enhancing the transparency of the auditor's involvement in information outside the financials and the additional cost in providing such information.

As the Board moves forward with its proposals, we
support a post-implementation review separate from the Board's inspection process that includes an evaluation of the direct and indirect efforts, effects on financial markets, regulatory scrutiny and litigation matters.

We believe it's inevitable that auditor judgments across and within firms will differ with respect to determining and describing CAMs, and as a result, there will be diversity in practice. We also believe that users of financial statements would utilize and apply the additional information to be included in the auditor's report in diverse ways to suit their specific needs.

Accordingly, monitoring the effects of the new auditor's reporting model, and whether it is not only being applied appropriately by auditors, but also has met user expectations, will be essential to achieving the objective of the proposed standards.

We're committed to providing meaningful and transparent information that's useful to investors, and doing so in a manner that will provide the most benefit while not creating a significant burden to issuers and investors in the market in general. Thanks again for the opportunity to share our views.
MR. DOTY: Thank you. Jeanette Franzel?

MS. FRANZEL: My question deals specifically with brokers and dealers, and who's using those financial statements, those audited financial statements, customers versus investors in the broker-dealer itself, and how might this be different from the discussions we've been having about investors and issuers, and how should we consider that?

MR. PAGANO: Okay. Well, as I noted, approximately 300 firms, 300 broker-dealers, are clearing or carrying-type firms, which hold customer securities and funds. In those instances, you know, there is a reporting requirement to the customer.

But on all other BDs, the majority, there is no customer statement nor ordered report that's sent to those individuals. It's not required. The securities and the funds are held by the clearing broker.

Now, there is a SEC website where even the small, introducing-type firm has to put an audited financial statement on that through the SEC website, and somebody could see the -- usually, the confidential report is not on that. Well, in some cases it is. But usually it's
1 just a balance sheet with footnotes.
2 MR. FEHRMAN: I think that's correct and
3 consistent with my understanding as well, although I
4 would just note that for a firm such as ours, our
5 broker-dealer is wholly owned by the parent. So we have
6 no outside investors at all, and it would really only be
7 customers and regulators that would use the broker-dealer
8 financial statements.
9 MR. HANSON: A question related to the funds.
10 And we have suggested in our proposal that the
11 application, especially around CAMs, is intended to be
12 scalable. So not over-killing it, not under-killing it,
13 but making it be the right size for the entity.
14 And I've heard the comments that you're making
15 about, gee, are there really any CAMs for most
16 straightforward funds that invest in traded securities
17 where there aren't the Level 3 valuation issues? And I
18 know we've put words in the proposal that suggest that
19 most companies will have CAMs.
20 And I wonder if we have an opportunity here,
21 because I don't like the idea of carve-outs. So if we
22 could write something that would be applicable for all
1 types of audits, but scalable so that it's hitting the
2 right things for the right companies.
3     Do you think it's possible for us to craft
4 language that would accomplish the objectives without
5 making a specific carve-out for a fund that would get at
6 the scalability aspects, that it might very well that in
7 a given fund there might not be a CAM and that's okay?
8 Thoughts?
9     MR. CORCORAN: I'll defer to the auditor on how
10 they'll interpret it. My fear would be that the auditor
11 is going to want to demonstrate, hey, we've done a good
12 job and there are critical audit matters. It's hard to
13 suggest that the valuation of investments in an
14 investment company is not a critical audit step, if
15 nothing else.
16     I'd also point out that on our funds, for which
17 we have minimal Level 3 disclosures -- I think our
18 highest concentration of Level 3 securities in our funds
19 are less than half of one percent. I still have,
20 generally, three pages of disclosure on how I valued the
21 investments. And the auditor is, as part of their audit
22 guide, they are looking at 100 percent of the valuation
1 of my investments, okay?

2 So I'd be still fearful that they're going to
3 want to cull that out as a critical audit matter. But
4 it's not an issue. If it were an issue, they wouldn't
5 be able to give me an unqualified opinion. That's my
6 concern.

7 MR. BURGESS: I think John's concern is fair, but
8 at the same time I do think that you could write the
9 standard in such a way that this could be addressed. I
10 think it's important that the standard be clear, that it
11 is contemplated that it wouldn't be rare that a company
12 might have no CAMs.

13 You know, in the terms of an investment company,
14 like John described, where there are no Level 3
15 investments -- we even have some that have mostly Level
16 1 investments -- I have a hard time seeing that there
17 would be a critical audit matter relative to investments
18 in a fund that has primarily Level 1 investments.

19 But I do think there is some risk that auditors
20 will feel the need to have at least one CAM. Or if I
21 don't, you know, I run the risk of having not met the
22 standard in the eyes of an inspector or somebody else.
So I think you just have to be mindful of each side of that coin.

MR. CORCORAN: I'm also not sure what a CAM could draw out about an example like investment valuation that I'm not already required to disclose.

MR. HANSON: In other words, how many times do you have to say "it's hard."

MR. FERGUSON: Yeah. I have a question. And I'm struck listening to you by, obviously, the enormous diversity among broker-dealers in this country. You talk about, Mr. Pagano, clients with capital ranging from $20,000 to $3 billion, and I assume Deutsche Bank is much, much larger than that.

So these are almost too different kinds of businesses. And the question I have is if we were to consider exemptions here, where we simply exempted certain businesses from these rules, what would be the line we should draw? I mean, they're clearing and introducing brokers. I mean, should it be introducing brokers that are excluded? Should there be a capital level below which you don't need to comply with these things? What would your advice be on that?
MR. PAGANO: Well, I would say, you know, if you're involved with customer funds, I think that's something that I could see having an interest in getting some confidence that those customer funds are in a good place.

So I would say that would be my biggest driver. You know, there are some broker-dealers that are part of a public filing as the holding company is a public entity, and presumably those are audited under PCAOB standards also.

So that would be important to us. I think those two things would be crucial. And I just -- I wanted to add -- Jeanette, you had a question before. Primarily with the smaller broker-dealers, it's the SEC and FINRA that are waiting for these audited statements to be filed within 60 days, and now SIPC this year. There was a recent change this past year where SIPC gets the full report clipping, the internal control report.

MR. FEHRMAN: I'm just sort of guessing here, but I would think that in a world where this proposal has come to fruition, a reader of Deutsche Bank's consolidated financials and related audit report would...
probably not get much different information than a reader of the broker-dealer financial statement separately.

So I see the appeal of Mr. Pagano's comment, that perhaps broker-dealers that are a subsidiary of a company that's otherwise audited and otherwise reporting under PCAOB standards might possibly be exempted.

I think you might think about an exemption also for audits of smaller broker-dealers that are very closely held. I don't think that people look to the financial statements for safety and soundness. I think they look to the regulators for that. So I'm not sure there's much to be gained by that. They're not investing in the broker-dealer per se.

MR. FERGUSON: Do you have any experience, for example, from your customers who are customers of your broker-dealer, whether when they look at Deutsche Bank's financial statements, do they only focus on the consolidated financial statements of the Bank itself? Or are they interested about the entity actually with which they're dealing? Or do you know?

MR. FEHRMAN: I don't know the answer to that.

I do know that we are required to send customers of the
1 broker-dealer broker-dealer financial statements, and
2 we're not required to send them consolidated financial
3 statements. But they are certainly available. But we
4 have not made a study of that nature.
5
MR. HARRIS: Mr. Fehrman, you heard Mr. Corcoran
6 tick off a number of items in the proposed standard that
7 he supported. Is there anything in the proposed standard
8 that you support?
9
MR. FEHRMAN: I think a great deal of what's in
10 the standard, frankly, is already being done. It's just
11 reported to the audit committee, rather than to the
12 public at large. In as much as the audit committee is
13 meant to be an independent body, and is in fact an
14 independent body, I think that they are there also to
15 protect the users of the financial statements.
16
So you have the company making an honest effort
17 to provide good disclosure, in accordance with the
18 requirements, in a way that's understandable. You have
19 the auditors checking that. You have the audit committee
20 checking the auditors.
21
So to answer your question, no. The thing I fear
22 is this. The financial statements in and of themselves
are already a summary. You know, we have millions and
millions of transactions, and we could give anybody more
information -- and I jokingly said to people in the green
room, we could print a copy of our trial balance and mail
that out, and I would say that would detract rather than
add to the information content of our annual report.
So, you know, just because the information is
available and low cost, as was discussed on the previous
panel, that does not make it useful information. So I
have to say quite honestly, sir, that, no, I do not
support this proposal.
MR. PAGANO: I'd like to add just to the
auditor's responsibilities on other information. The
oath or affirmation that's attached to the report, was
noted in the proposal, would be subject to this. And
actually I do see benefit in that the order gives some
comfort on that.
MR. DOTY: Well, here's the problem. We had a
financial crisis. And I take it some of the entities
that fell flat were substantial banks and broker-dealers.
And we had an investment company that broke the buck as
a result of a concentration in the securities of the
broker-dealer. Holding itself out as a money market fund, it broke the buck.

And this attracted a lot of attention, and it resulted in us being charged with creating standards, audit standards for broker-dealers. The SEC reminded broker-dealers that they had to have audited financial statements, and that included some schedules and some fairly specific information. And I share here with Jay Hanson's concern over the carve-outs.

I think there's a well-trod, well-understood path for regulators creating guidance. And perhaps if you have funds for which the auditor has satisfied themselves there really is nothing in that fund portfolio but cash, money, high-quality government securities, maybe there are times in which the guidance could indicate that critical audit matters may in fact not be so rare in a particular area or segment, if we looked at it.

But right now, we're sitting here having looked at some broker-dealers, and having reluctantly determined that many of them, some of whom are carrying, don't have audits that are independent. We have a lot of errors that we see in the preparation of books and records by
the auditors. The material is in our public report. So how do we simply say, well, notwithstanding the financial collapse, notwithstanding the instructions of Dodd-Frank, notwithstanding the statute under which we operate, which says we have to foster the interests of the public in good financial reporting. And notwithstanding the fact that we know that the SEC also wants to know, for the audits that it has a primary interest in, or that FINRA has a primary interest in, they want to know that the audit has been well-performed. How do we do our duty by a wholesale exemption of an entire industry, which, as John points out, now has trillions of American savings in it? I guess Mr. Fehrman's position has the beauty of saying you don't think we should do any of it for anybody. But don't we have a problem with the general carve-out? And isn't it clear that we've got to get to some kind of a mechanism for scaling the wind to the shorn lamb and treating how these different companies' business model suggest themselves to an auditor? Don't we have to do something here to fine-tune?

MR. FEHRMAN: I fully agree that things need to
1 be done. And things have been done, I think. We have
2 Sarbanes-Oxley, of course, which I think actually
3 predated the crisis. But we have the Volcker rule, we
4 have Dodd-Frank, we have increasing levels of capital
5 requirements.
6 We have substantial increase in regulatory
7 oversight, all good and necessary things that I think are
8 past due, and we're working hard every day to comply with
9 all those things as well. I just question whether it's
10 specific to broker-dealers, or much more broadly, whether
11 this helps that situation.
12 If the auditor's doing a good job, he's doing a
13 good job. I question whether the reader of the critical
14 audit matters, the reader of the report on other
15 information, will find that useful.
16 I think that they would rather know that there's
17 a team of regulators, a team of auditors from the
18 regulator that live in our building, that are there every
19 single day, and are working very hard to make sure, as
20 we are, that the institution is safe and sound and will
21 be here, I hope, for another hundred years or more. I
22 don't think this is the right way.
MR. DOTY: The comment from the United Kingdom yesterday and today was that they have managed it there. They've managed an expanded audit report, and they've done that without having undue delay in the delivery of the report and the reporting schedule, and without some kind of a hockey stick increase in costs.

So does your British -- you all have resources there. Does your UK experience suggest that perhaps this can be done?

MR. FEHRMAN: I'm not familiar with what's going on in the UK, quite honestly. I have read the IAASB proposal, which I think is very similar to this. I think we would have a similar reaction there.

You know, again, I just have to say that I think that the regulators are doing a very diligent job, and I think that that's the appropriate place to address many of the concerns you're listing.

MR. CORCORAN: I'm by no means an expert on what changes have happened in the UK. But my understanding is they are not -- the subset that they're applying to now does not include an OEIC, an open-end investment company, which would equate to our investment company.
I do think you need to consider, for lack of a better term, the simple nature of the operations of an investment company. Every investment company really has -- they may have different objectives in terms of what type of investments they're going to go into and what not, but all the more just in turn investing money in a portfolio that is 100 percent disclosed, 100 percent validated by the auditor, and pages of the disclosure on how those valuations take place.

MR. DOTY: John, it's a fair point, up to a point. To the extent you're talking about two-auditor funds, I think this is something that is of great interest. But when you're saying that you're concerned with critical audit matters, that there's going to be an assumption of something being wrong and a tendency to -- many of your objections to the proposal would go to the kind of issuers who have been subject to it in the UK. So I think you have in some ways narrowed the concern, when you say investment companies are a unique animal. It's a narrower subset of concerns you have when you're focusing on the peculiarities of the investment fund, of the investment company industry, it would seem
MR. CORCORAN: What I'm trying to suggest is the subjective nature of an auditor being able to cull out -- two different auditors may decide something different is a critical audit matter.

In a simplified structure like an investment company, that's going to have a much different impact than if I'm talking about a multinational corporation, where you would expect that sorts of things to be different.

MR. DOTY: And I do see that as a concern, lodged just as to how the proposal might affect investment companies. But I'm saying that on the broader attack which you make on the proposal, or the broader expression of disagreement with it, you are going to many of the issues which the UK seems to have successfully confronted and dealt with.

MR. CORCORAN: I think we can probably agree to disagree as it relates to an investment company context, which is all I'm speaking about.

MR. DOTY: Well, this has been helpful and informative and we thank you.
This concludes the first roundtable on the audit reporting model, and in some ways we did save the best to last. You all did a great job. Thank you.

(Whereupon, at 2:59 p.m., the meeting in the above-entitled matter was concluded.)
enabled 120:18
enacted 217:13
218:9,20
encompasses 57:18
encourage 22:7
106:19 118:1
119:11 120:6
139:13 141:21
170:22 203:16
204:19 211:18
234:3
encouraged 99:10
138:6
encourages 181:17
encouraging 130:14
endless 66:4
endorsement 149:14
enemy 42:20 57:3
95:16
enforceability 208:1
enforcement 5:12
205:19
engage 8:5 9:5
139:2 141:6
169:19 188:19
engaged 103:22
104:2
engagement 31:2
78:6,11 82:2
94:10 103:12,13
103:20 124:4,6,20
138:16 141:8,11
144:1 147:21
149:14 152:9
160:1 168:21
169:5,7,19,21
209:14,22 218:14
engaging 144:11
engender 94:8
engineeringly 52:5
English 32:17
enhance 24:18,21
28:10,13 31:14,16
147:19 170:7
173:16 216:12
220:14 235:11
enhanced 103:15
105:20 115:11
160:13 161:5
181:16
enhancement 29:8
enhancements 173:5 225:8
enhancing 11:9
29:6,9 158:18
221:8 240:19
enjoy 205:15
enjoys 118:6
enlightened 114:3
enlightening 179:17 180:19
enormous 134:8
246:9
ensure 104:3
130:19 132:3
180:5,8
ensuring 121:7
209:15 210:12
enthusiastic 64:19
entire 80:4 207:8
252:12
entirety 196:15
entities 222:22
238:1 240:15
250:19
entity 173:8 216:17
243:13 247:9
248:19
entrusted 112:15
153:7
entry 84:20
environment 11:6
57:18,19,20 86:8
98:12 100:5
108:17 184:6
environments 120:12
envision 48:19
EQR 218:13
equals 84:18
equate 254:22
equation 84:17
equipment 155:1
equities 117:17
equity 5:2 205:15
equivalent 175:22
Ernst 155:3
erroneously 168:15
error 170:15
erors 251:21
especially 32:9
135:20 197:16
227:20 243:11
essence 62:7 63:3
151:18
essential 127:16
238:11 241:15
essentially 108:19
112:10 177:15
established 95:12
175:5
estate 51:11,15
esteemed 156:9
estimate 198:17
estimates 49:14
100:22 114:19
117:7 145:1,16
148:22 182:14
183:3,11 192:1
228:19
et 47:4 51:5,19,22
60:18,21 129:2,2
ternal 76:7
Ethics 87:3
EU 4:8,13 140:9
Europe 87:9 97:9
106:17 141:9,10
205:6
European 4:9,11
78:8 87:1 98:22
121:4 141:14
150:18
evaluate 14:14,19
15:5 20:15,19
21:9 29:19 30:4
31:15 32:2,12,13
34:9,14,21 35:15
40:7,16 42:22
44:20 45:3 48:9
61:17 64:3,5
74:17 199:12
211:4
evaluate-and-contr...
240:7
evaluated 11:16
50:7
evaluating 13:18
171:11 236:16
237:10
evaluation 11:11
31:22 34:6 162:15
162:20 236:8
241:2
event 23:8 70:18
events 112:11
everybody 40:5
53:7
Everybody's 53:3
everyday 72:9
evidence 29:22
53:15,17 76:1
78:1 211:22
231:12 237:11
evolution 106:9
120:6
evolve 24:6 106:8
106:10 120:13
121:1
evolved 123:14
138:5
evolving 25:1 114:9
EVP 1:17
exact 41:15,16
205:16
exactly 44:21 52:22
53:6 65:14 71:6
84:1 233:8
exacts 205:16
exam 52:3
examine 34:22 90:5
156:13
example 9:21 10:10
10:16 18:19 21:6
23:3 26:15 29:17
33:2 47:8 55:17
Neal R. Gross and Co., Inc.
202-234-4433
<table>
<thead>
<tr>
<th>Page 288</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neal R. Gross and Co., Inc.</td>
</tr>
</tbody>
</table>
thoughtful 18:4
thoughts 48:12
54:7 124:10,18
197:8 230:5 244:8
thousands 84:10

three 4:21 16:16
32:6 46:13 68:8
80:13 89:3 99:19
99:22 142:8 143:6
147:9 166:18
186:11 194:16
210:5 215:18
238:2 244:20

throw 51:13

thoughtful 14:3 15:6
60:7 62:16 126:7
127:12,15 150:19
197:3 209:7

third 41:10 61:15
89:8 99:20 174:1
176:9 238:7

third-party 16:22
Thornton 1:20
214:18 235:10

Thornton's 214:13
236:18

thorough 165:11

thought 26:7 50:17
64:11 77:19 89:3
89:14 93:19 94:14
107:22 110:3
147:6 153:20
191:8 209:8 210:9

transformation 7:3

transition 127:3,17
127:18

translate 205:10,14
205:22

transparency 83:17,20 111:13
113:5 116:21
118:4 149:15
150:15 163:18
167:4 175:13
187:15 208:8,20
226:15 240:19

treacherousness 65:11
241:18

traveled 153:20
treasurer 214:4
treasury 102:12

treatment 252:19

touche 2:12 3:7
6:14 16:19 86:4
86:11 88:17,18
119:4,5,18 127:3
134:2 135:15
137:10 144:19
145:20 149:20
151:1
touched 40:13

19:19 95:12
tough 63:16 78:22
81:22 82:2 145:20
145:22

trace 41:7

traced 43:8

trade 87:20 97:22

111:15

traded 243:16

traders 108:8

trading 215:16

traditional 9:4,9
10:20

train 69:1

training 91:14

179:7

transaction 198:17

213:18

transactions 250:2

transformation 7:3

transition 127:3,17

127:18

translate 205:10,14

205:22

transparency 83:17,20

111:13

113:5 116:21

118:4 149:15

150:15 163:18

167:4 175:13

187:15 208:8,20

226:15 240:19

241:18

treacherousness 65:11

Neal R. Gross and Co., Inc.
202-234-4433
CERTIFICATE

This is to certify that the foregoing transcript

In the matter of: Auditor's Reporting Model

Before: Public Company Accounting Oversight Board

Date: 04-03-14

Place: Washington, DC

was duly recorded and accurately transcribed under my direction; further, that said transcript is a true and accurate record of the proceedings.

-----------------------

Court Reporter

NEAL R. GROSS
COURT REPORTERS AND TRANSCRIBERS
1323 RHODE ISLAND AVE., N.W.
WASHINGTON, D.C. 20005-3701
www.nealrgross.com