NOTICE: This is an unofficial transcript of the Public Company Accounting Oversight Board's Roundtable on the Auditor's Reporting Model held on September 15, 2011, that related to the Board's concept release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards.

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MR. BAUMANN: Well, good morning, everybody.

I'm Marty Baumann, the PCAOB's chief auditor and director of professional standards.

I want to thank everybody for coming to this roundtable to discuss our concept release on the auditor's reporting model. This is an extremely important project. Efforts are going on not only here at the PCAOB, but in many other places globally discussing the auditor's report.

And our concept release asked for comments by September 30th. So we're looking forward for comment letters. We have received several and very valuable ones and looking for more. And we're very interested in everybody's comments today.

But with that, let me turn it over to our chairman, Jim Doty.

MR. DOTY: Thank you, Marty.

Today's open meeting roundtable of the Public Company Accounting Oversight Board will elicit the views of 32 experts that we have around the table.
this morning. You bring here such various
backgrounds as investors, auditors, corporate board
members, financial statement preparers, and
academics.

In this, the third public meeting on today's
subject, the PCAOB wants to hear how we can improve
the relevance and usefulness of auditors' reporting
on the results of their audits of public company
financial statements.

I want to begin by thanking you, the
distinguished group of participants who have agreed
to spend the day with us to discuss the PCAOB's
auditor's reporting model project. Your active,
robust participation here constitutes the most
meaningful public service our society asks.

Because you each have busy schedules and many
other demands on your time, the PCAOB's chief
auditor, Marty Baumann, who is chairing today's
discussion, and his staff have worked very hard to
ensure that your time is wisely and productively
used here. We have a full day of discussion
topics, and I expect it will be lively. I know it
will be valuable to us and to the public.

I want to also thank the Securities and Exchange Commission, in particular Chairman Schapiro, Chief Accountant Jim Kroeker, Deputy Chief Accountants Mike Starr and Brian Croteau, for their support for the PCAOB and our inquiry into ways that we may be able to make the auditor's report more relevant for investors.

I also want to thank my fellow Board members for their support for and active participation in this project. And before I turn the floor back to Marty, who will invite fellow Board members to offer their thoughts, let me touch briefly on a couple of points about the concept release.

The PCAOB's consideration of the audit reporting model is intended to confront questions that recur in times of economic crisis. In the concept release, we attempt to identify meaningful opportunities to enhance the relevance of auditors' communications to investors.

Our alternatives aim to enhance relevance and to highlight a statement we made in the concept
release -- the alternatives suggested do not aim to change the fundamental role of the auditor to perform an audit and to attest to management's assertions as embodied in management's financial statements.

To be clear, they are not intended to put the auditor in the position of creating and reporting financial information for management. So discussion about that may be very important today.

As the concept release states, the alternatives are not mutually exclusive. A revised auditor's report could include one or a combination of these alternatives, or elements of these alternatives. Discussants may also suggest other alternatives to consider.

We are at a very early stage in this project. The concept release format allows us to frame today's discussion and the broader debate that will play out through the public comment process. It is not intended to lead inexorably to proposed requirements in any of the areas we have suggested.

Proponents of ideas, whether embodied in the
release or introduced today, should come forward with evidence and analysis explaining why the idea is worthwhile. Both supporters and opponents of changes to the auditor reporting model should present persuasive support for positions they advocate.

We are in the middle of a long public comment process. I am confident today will not be the last public discussion of the concept release, but I encourage participants and members of the public who are interested in the project to follow up on today's discussion with any additional analysis or evidence they have to inform and help shape this project.

Thank you again, all of you. Thank you for being here, for your interest in the project.

Thanks to Marty and the staff. Marty?

MR. BAUMANN: Thanks, Jim.

Let me now turn it over to Board member Dan Goelzer for some comments.

Thank you.

MR. GOELZER: Thank you very much.
First, I would like to join Chairman Doty in welcoming all of the roundtable panelists here this morning and thanking you for your willingness to provide the Board with your views on ways in which the auditor's reporting model could be improved.

Exploring whether to expand what auditors communicate to financial statement users raises fundamental issues about the purpose of the audit and about what it means to be an auditor. The Board has heard repeatedly that investors want more from auditors than the assurance that the traditional pass/fail report provides. Frustration over financial institution disclosures in the run-up to the economic crisis crystallized that dissatisfaction with the current reporting model.

As Chairman Doty indicated, to address these concerns, the Board's concept release floats a series of alternatives. At one end of the spectrum, auditors might be required to create an auditor's discussion and analysis commenting on such matters as management's judgments and estimates and its selection of accounting policies
and principles. The auditor might also be asked to characterize particular accounting and auditing decisions as "close calls" and to describe the underlying issues and risks.

The AD&A proposal rests partly on the notion that auditors had insight into undisclosed risks and dubious judgments on which the pre-crisis reporting of major financial institutions rested and should have alerted investors.

In contrast, other concept release alternatives would expand auditors' reporting responsibilities by building on their traditional attestation role without requiring the auditor to compete with management as an information source. For example, emphasis paragraphs keyed to management's disclosures would be a way for the auditor to indicate the existing disclosures that, in his or her view, are the most significant to understanding the company's financial reporting.

Auditors could also be required to opine on the accuracy and completeness of information outside the financial statements that management
already provides, such as in MD&A or in earnings releases.

I have serious doubts about whether financial reporting would benefit from requiring auditors to move from attesting to or emphasizing the importance of information that management presents and into creating their own information about the company's financial reporting. However, as the concept release discusses, even without requiring auditor-created commentary, there is still plenty of room to expand the scope and relevance of auditor communications.

In any event, this threshold issue is one that the Board will have to grapple with as the project moves ahead. I am looking forward to hearing the views of roundtable participants on that question and on the full range of possible ways of making auditor reporting more relevant to users.

Again, thank you very much to everyone for being here, and I'm certainly looking forward to the discussion.

MR. BAUMANN: Thanks, Dan.
Now comments from Board member Steve Harris.

MR. HARRIS: Thank you, Marty, and I will be very brief.

Let me say simply the law states that the purpose of the PCAOB is "to protect the interest of investors and further the public interest in the preparation of informative audit reports." And I stress the words "investors" and "informative."

Investors clearly do not believe the current three-paragraph, largely boilerplate, binary audit report is either sufficiently informative or serves their needs. This is apparent from comments made to regulators both in the United States and abroad in the context of the recent financial crisis.

So the issue before us today is how best to provide the information in a cost-effective and efficient way directly to investors. And by directly to investors, I mean not wholly funneled through management or audit committees.

I asked myself some basic questions. What keeps an auditor awake at night, and what information does an auditor learn from an audit
that he or she would want to know as an investor?

Why shouldn't auditors disclose to investors
that information and the same significant risks
they disclose to audit committees? And since all
that investors are asking for is what auditors
already know, why can't this be done easily and
cost effectively?

There was a time, going back to the days of
Arthur Andersen and Leonard Spacek, that the
profession embraced their obligation to safeguard
investors' interests. I think we need to return to
that mindset and provide investors with more of the
information they are asking for.

I want to thank Kurt Schacht and Joe Carcello
for the surveys they conducted for the Certified
Financial Analysts and the Board's Investor
Advisory Group, which forcefully demonstrate the
desire amongst investors for modernizing today's
antiquated audit report.

I look forward to hearing from our
distinguished participants, and I thank you, Marty
and Mr. Chairman.
MR. BAUMANN: Thank you, Steve.

Everybody should have a package in front of them which includes the concept release, the briefing paper we sent out, an agenda, and various other materials for the day.

I'm going to give a brief overview in a couple of minutes of how we expect this meeting to run and operate today. But before we do that, given the size of the crowd and the distinguished group that we've gathered, I'd like to go around the table and ask everybody to please just take a moment to say hello and introduce themselves.

So I've done that already, and I'll start to my left.

[Introductions.]

MR. BAUMANN: Thank you very much.

If you take a look at your agenda for the day, what we've planned is for each of the topics that are listed there, we at the PCAOB have asked a couple of people to kick off the topic with some opening remarks. After those opening remarks, the floor will be open to all for comments.
I will ask -- I will repeat what we indicated in the briefing paper, that we hope the comments that we get are as specific as possible about the proposals, about your view of the proposed change in the auditor's report, taking into account challenges, implementation issues, as well as what investors' needs are.

But the greater the specificity, the more valuable the input will be to us as we go ahead and think about this meeting and think about future possible changes to the auditor's report.

After the opening commenters speak on each section, anybody who wants to speak please just turn this tent card up on its edge. We'll then make sure we get around and call on each of you to comment and give your views on the specific topic we are discussing.

So, as the agenda indicates, we're starting with the suggested potential auditor's discussion and analysis, then later on moving towards emphasis paragraphs, and auditor assurance in other areas. To the best extent possible, we'd appreciate trying
to stay on topic for each of these areas during the morning.

We also have a section later on to discuss other alternatives, but certainly, variations on the theme of the AD&A or variations on the theme of emphasis paragraphs would be welcome during those discussions.

Opening comments will be made by the following participants, just for your information. In the auditor's discussion and analysis, we've asked Ann Yerger to make opening comments. As you heard, Ann is with CII. Gary Kabureck from Xerox, and Bob Kueppers from Deloitte & Touche will all give opening comments on that subject. Again, after that, the floor will be open to all for comments.

In the required and expanded use of emphasis paragraphs, Joe Carcello from the University of Tennessee will kick that off and then followed by Kevin Reilly from Ernst & Young.

With respect to auditor assurance on other information outside of the financial statements, we've asked Mary Hartman Morris from CalPERS to
lead the discussion initially, followed by Mike
Cook, sometimes audit committee chairman, to follow
thereafter.

And then, the final discussion of the day on
the clarification of the language in the auditor's
report and a further discussion, an open discussion
of other alternatives that participants may have,
Jennifer Rand from the Office of the Chief Auditor
will lead that discussion.

For each topic, we've included questions to be
considered. Your comments, when you make them, can
be related to the questions or to any other aspect
of the specific topic we are addressing. But
again, we do ask that you focus your comments on
specificity, as we requested in the briefing paper.

The outreach we performed, and many people
here were parts of that outreach, greatly informed
the concept release, and we appreciate the great
participation of many people who were part of our
outreach. Outreach gave us a lot of insights into
what ways the audit report could potentially be
changed, but it's this roundtable and comment
letters that we're looking for to really help us get more granular in what those changes will be, as we think of changes going forward.

As a reminder, I just want to repeat one more time that comment letters are due by September 30th, the end of this month. As I said, we've received a number of valuable comment letters to date and hoping to receive many more between now and September 30th.

With that, let's begin starting discussing the auditor's discussion and analysis. The questions we'd like to address in the auditor's discussion and analysis -- and again, we can stay on topic with these questions, or you can think of others -- but include what types of information should an AD&A include about the audit? What is the appropriate content and level of detail regarding these matters presented in an AD&A -- audit risk, audit procedures and results, auditor independence?

What types of information should an AD&A include about the auditor's views of the company's financial statements based on the audit? What is
the appropriate content and level of detail regarding these matters presented in an AD&A? That is, management's judgments and estimates, accounting policies and practices, and difficult or contentious issues, including close calls.

Next, what are your views regarding the potential for an AD&A to present any consistent or competing information between the auditor and management? What effect will this have on the financial statement presentation? And what are the potential benefits and any shortcomings for implementing the AD&A?

So, with that, I will keep these summary questions posted. With that, I would like to turn it over to Ann Yerger for your opening remarks in this area.

Thanks, Ann.

MS. YERGER: Thank you. Good morning, everyone.

Thank you, Chairman Doty, Board members, PCAOB staff, for hosting today's roundtable.

I'll speak on behalf of the Council of
Institutional Investors, that we greatly appreciate your leadership and, indeed, regulatory courage in exploring some issues that have long been debated and that remain very controversial even today.

As noted in the concept release, the quality of the auditor's report has been discussed and debated for decades now. And over the years, a variety of highly respected groups have recommended expanding the breadth and depth of the report.

Calls for reform actually haven't ebbed over the years. In fact, I think we could argue they have intensified in the wake of the financial crisis. Most recently, changes have been recommended by the U.S. Department of Treasury's Advisory Committee on the Auditing Profession; by surveys of members of the CFA Institute, which I am a proud member of; by a recent survey of investors by the PCAOB's own Investor Advisory Group; and by the PCAOB staff's own extensive outreach.

The bottom line is that investors want more information from the outside auditors. Today, an outside audit of a U.S. company may entail
thousands of hours of work, involve reviews of financials produced around the globe, and cost more than $100 million. But all the investing public generally sees of this tremendously valuable labor is a few paragraphs of boilerplate language.

The current pass/fail model does have some benefits. It's brief, and it offers clarity, consistency, and comparability. However, today, it is clear that this report no longer adequately satisfies the information needs of investors, the key customer of this work.

An auditor's discussion and analysis section is an ideal approach for enhancing communications between auditors and investors. This supplemental report would maintain the benefits of the current report while satisfying the needs of investors for more relevant and useful information from the auditor.

This approach was supported by the IAG survey, which found that a majority of the surveyed investors believe there should be a separate AD&A section in the 10-K.
I believe an AD&A should include, at a minimum, the independent auditor's assessment of management's critical accounting judgments and estimates. Such disclosure was supported by 86 percent of the respondents to a 2011 CFA survey and 79 percent of the respondents to the IAG survey.

Respondents to the IAG survey also highly value discussions by the auditor of the following areas: first, high financial statement and audit risk; second, unusual transactions, restatements, and other significant changes to the financial statements; and third, discussions of the quality, not just the acceptability of accounting policies and practices.

And I'm not an auditor. I'm not a technician in this space. But I think the feedback from those surveys sort of suggest that investors want a little more color to what the auditors are seeing and what they view about what's being presented in the financials.

Certainly, there are risks to a supplemental report, and the biggest is that these reports would
become boilerplate and of little value. Clearly, this is not a desired outcome.

To avoid this possibility, the PCAOB must write standards for this report. However, I also believe any standards must not be overly prescriptive and that all AD&As should be subject to robust enforcement by the PCAOB to ensure that auditors present reports tailored for each company's particular risks, facts, and circumstances.

The benefits of AD&As are many. They would provide investors valued information from an independent expert that is relevant for investors analyzing and pricing risks and making an investment and voting decisions. They would also heighten the perceived value of audit firm work and would give audit firms more leverage to effect change and enhance management disclosure in the financial statements.

The end result would be increased transparency to investors and heightened investor confidence in audited financial reports, and that's a good
outcome.

I strongly believe the additional information should come from the audit firms and not management or audit committees. Audit firms are objective, third-party experts that have unique insights into companies, and it is appropriate and beneficial for the investing public to receive more information directly from these unbiased experts.

We would expect that these insights would result in complimentary and not dueling information to that provided by management. This is information that would inform and not confuse investors.

Regarding costs, the information of interest to investors is already being communicated by outside auditors to audit committees. So I do not believe the report should significantly increase audit costs. But regardless, I believe investors would say the benefits of this additional, highly valued information would far outweigh any incremental costs.

Thank you again for letting me participate
today, and I look forward to learning from all of you during the afternoon and morning.

MR. BAUMANN: Thanks, Ann, for those very thoughtful opening comments.

I'll turn it now to Gary Kabureck for his opening comment.

MR. KABURECK: Good morning, everybody.
And let me begin by thanking Marty, you and Jessica and the Board, for inviting me to be here. I'm looking forward to it.

This clearly is a very important project and one certainly worthy of significant efforts by the Board and the staff. And I'd also like to actually compliment the authors of the concept release for a very readable, very professional document. It was very well done.

For today, I'll withhold judgment about how truly critical it is for the current standard order report to change. But that said, I do believe it's desirable and useful to do so.

In broad terms, I believe the preparer community will generally support a number of the
changes in the concept release, provided the report expansion is reasonably concise and is limited to information about the audit, as opposed to the financial statements.

For example, I believe many preparers would support greater use of emphasis paragraphs, where you talk about critical accounting areas, critical audit areas, and likewise, I think you'd support a lot of potential clarifying enhancements in the release.

Regardless of where this project comes out, however, I think sooner rather than later I encourage the Board to decide what level of audit knowledge should be presumed to be known by the users of financial statements. While I personally believe it's a reasonable expectation that a user should be assumed to be a knowledgeable reader and can comprehend what is meant by phrases such as "reasonable assurance" and "free of material misstatements," the Board may conclude otherwise.

An early determination of what level of audit knowledge should be assumed I believe will greatly
aid the Board and the staff in deciding what modifications need to be made to the standard report.

Today, I was asked to talk about a preparer's perspective of the concept of an AD&A. While it's certainly not impossible to do, to the extent any AD&A would provide commentary about a company's financial affairs, I submit that you'll find general opposition from the preparer community for a number of reasons -- some conceptual, some practical.

For instance, in my view, the auditor's report should not be the vehicle to communicate any new information about a company's finances, accounting policies, quality of earnings, significant judgments, conservatism on the account. If the Board or the SEC or the FASB believes additional information is needed, they should make this concern and address it through normal rulemaking processes applicable to preparers.

I think disclosures of a company's financial affairs are the roles of management and the
company's board. To require the auditor to provide
analysis of a company's financial statements I
believe would create some independence and legal
issues for the auditors and, let's be realistic,
has an awful large number of practical limitations.

For example, auditors are experts in
accounting and auditing, not operational and
financial analysis, and I don't think we should
lose sight of this. I think it's also wrong to
assume that an auditor knows more about a client's
financial affairs than management, but any
rulemaking which requires the auditor to comment on
a client's financial disclosures and affairs beyond
management's disclosures could effectively put the
auditor in that position.

And there is nothing an auditor could disclose
that the client couldn't also disclose.
Presumably, management has disclosed everything
relevant or required. And if they haven't, the
auditors have remedies are already available to the
auditor.

Let's play this out and assume an AD&A, as
envisioned by the concept release, becomes required. I think this creates some other problems you're going to need to deal with. For example, to the extent the auditor's disclosures are different or incremental to management's, how to reconcile and explain computing views.

I cannot envision a case where an adverse or more conservative or controversial disclosure by the auditor will go unresponded to by the client. I just don't see how investors and other users are better off in such situations to have competing disclosures.

We need to be mindful that in some types of AD&A, disclosures may be interpreted as close or contentious calls, when, in fact, this might not actually be the case. Then I would ask what controls and training will there be on the auditor to be balanced in his or her thinking? Will the Board or the SEC provide a set of boundaries and other rules that provide management some recourse?

Despite my reservations, should the Board decide to require an AD&A, I would strongly
recommend the auditor be permitted to rely on
similar and presumably new disclosures made by
management, and it would only be the default answer
if management does not provide that information.

I don't believe a goal of this project should
be to increase a company's disclosures through new
audit requirements. However, should this be the
ultimate direction, everyone, in my opinion, is
better off served by having expanded management
disclosures rather than expanded auditor
disclosures.

And my last point just on cost. An AD&A is
not going to be free or even cheap. On the
contrary, when dealing with external report
drafting of this type, this tends to be very
expensive time. I personally believe internal
audit fees would be better spent diverting the
value of this time into increased audit procedures
in the high-risk audit areas rather than report
writing.

So, in closing, I'll go back to the beginning
of my remarks. As a preparer, I can see a number
of beneficial changes in the standard audit report, provided a focus of the audit process. I want to reiterate that I believe it's inappropriate for the audit report to communicate any incremental information about a company's accounting or finances.

If such additional information is ultimately considered appropriate, then I think it should be addressed in FASB or SEC standard-setting processes.

So, again, thank you for the time, Marty. Appreciate it. Thank you.

MR. BAUMANN: And thank you for your willingness to make some opening comments, and we appreciate hearing them.

The third person to introduce this is from the audit profession, and that's Bob Kueppers.

MR. KUEPPERS: Thank you, Marty.

Let me take a few minutes to set out my thoughts on this topic of auditor's discussion and analysis, or AD&A. And I think my views are consistent with the views of my colleagues in the
other firms here today. Of course, if they're not, they'll let me know that.

But the reason I say that is we've spent a lot of time -- actually, the better part of the last year -- collaborating, working together on the issues of what the auditor report might be, and I think there are a couple of important points to sort of set the stage for our part of this dialogue.

First, I think it's important to understand that the profession is in no way opposed to meaningful changes in the auditor's report. To the contrary, I think responsible changes to improve the relevance and information value of what we produce as auditors is a good thing. That should better serve investors and the other users of our reports as the end product of our work.

In fact, we provided the PCAOB with a fairly comprehensive set of examples in a preliminary comment letter just a week after the concept release was published, showing how reports might change under many of the proposals in that concept
release. And now these examples are part of the
public record, and I encourage you to take a look
of so how might it look if certain of these changes
were actually made? Hopefully, that will inform
the standard-setting process.

I will tell you this, informing our views, we
developed a short set of what we're calling
overarching principles, and I think we'll come back
to these throughout the day. And I'll be very
brief, but I want to cover them right here.

First, we think that auditors should not be
the original source of disclosure about the issuer.
Management's responsibility should be preserved in
this regard. One way to think about it is that we
think management should remain the provider of
information, and the auditor should be the provider
of assurance on that information.

Second, changes should enhance or at least in
no way diminish present-day audit quality, and I
think changes should serve to narrow or at least
not widen the expectation gap.

I also think it's important to avoid investor
confusion. Any revisions requiring investors to sort through differences across information from management, the audit committee, and then the auditor I don't think will be an improvement. I think it will create misinterpretation on what it all means, and auditor reporting should focus largely on the objective rather than the subjective.

And finally, I think any changes should be market driven. In other words, they should be called for. What we do that might be different should add value, and I think we have to take note of appropriate cost-benefit considerations.

Now, having said that, while we do not support the changes to require an auditor's discussion and analysis as set forth in the concept release because I think it's contrary to the principles I just covered, I think it's very important to just give you a couple of reasons why we think that's the case.

Now if we become the original source of disclosure about the issuer rather than management,
that is fundamentally changing our role, in my view, and I think it could do a disservice to investors and, in fact, create the confusion I mentioned earlier.

We talk about complicated areas like management estimates and the close calls. So, at the end of a robust discussion with the company, the audit committee, and the auditor, a decision is made, but it's in some nebulous category called a close call. Does that mean that that was not a good decision? Does the decision that was made that was not a close call, is that somehow qualitatively better than the one that received more attention?

The truth is that the -- when you talk about quality of accounting, variability of estimates, that is the subject of a two- or three-way dialogue with the audit committee, and I find that that process works very effectively. It is hard to capture in a report the essence of a dialogue that happens through the course of an entire financial reporting cycle, and I just don't think it lends
itself to a meaningful reporting model that could ever capture the insight or the value of that.

So the audit committee, the knowledge of the management, the knowledge of the financial reporting process, and the oversight that they exhibit throughout an entire cycle is something that doesn't lend itself to a few paragraphs in a written report.

I think it also changes us, changes our role from being objective to subjective. Our work has a lot of subjectivity, a lot of judgment. When you take that and then have another layer of that in the reporting model, I think you will not find comparability across reports from the same firm. You will not find comparability across reports from different firms in the same industry, and I'm not sure that we, at the end of it all, would say that we have actually improved the system.

And I hate to mention it, because it sounds self-serving, but time is a problem. The current reporting deadlines that we face, I can only tell you, and I'll be sort of gentle with this, it is
extremely difficult to get it all done, wrapped up, get our papers ready for inspection, everything that has to be done, all within a very compressed timeframe.

And with some of our new standards, including new standards for engagement quality review, the pressure just keeps building, and I think this kind of a model would add to that.

However, I think we should very carefully keep in mind the problem we're trying to solve. If disclosures are not adequate for the purpose of the users, the investors, the requirements for those disclosures should be changed. Whether it's the management's discussion and analysis, whether it's financial statements themselves, if we're not meeting the needs of investors, that issue must be addressed.

And I think there are some very good ways to do that that will give investors what they say they are lacking, and I think management is in the best position to provide those enhanced disclosures that we remain in the best position to provide assurance
on those disclosures.

And I think some of the disclosures that are on the table today, including emphasis of a matter, some of the potential for assurance on other parts of the document, I think that will come out in the course of our dialogue today.

Let me just close by saying I've been around this process from the day that the doors of the PCAOB opened, and I must tell you, Marty Baumann and his staff have done an incredible job of outreach ahead of the concept release. It's sort of unprecedented. I mean, it went on for weeks, months, I'm not sure.

But having participated in that process, this is one of the healthiest, most informed concept releases you've ever done, and I encourage, as you go forward, to the extent you have the will or the time, to continue that process. I thought it was just excellent.

I look forward to the discussion, and I'm happy to answer questions.

Thank you, Marty.
MR. BAUMANN: Bob, thanks for your opening comments.

I will say during the outreach -- and please, I hope to start seeing tent cards turning up on their edge in the near term. Otherwise, I have to keep talking. Certainly, during the outreach, investors were very strong in their views and amongst a broad group that they needed to hear more from auditors than the standard report that Ann made reference to in her opening comments.

And different terms were used by different investors of what they wanted, but the essential issue was it was simply lacking during the financial crisis and over the years in terms of not understanding that there were certain issues that were borderline on the edge and, at the end of the day, could have caused -- would have informed them better had they known about that.

So those are strong views from investors, and we wound up calling it AD&A in the press release. That term "auditor's discussion and analysis" wound up being used a lot, but the concept was hear more
from the auditor about the types of issues that are
discussed with the audit committee. We did hear
some concerns from the auditors, et cetera, about
some of the problems with that, including
timeframe.

So, with that, I'm glad to see cards.

Jessica, you were up first. I think Mike Cook may
have been up first. So we'll turn to Mike.

MR. COOK: Thank you, Marty.

And my sentiments to you and the staff as
well, as have been expressed by others.

Appreciation for a very thorough and open-minded
approach to a subject that has been studied rather
extensively for a rather long time.

And maybe I'd just offer one historical sort
of perspective on that in that the auditor's report
has changed some over the years. We've modified
references to uncertainties. Where we used to have
"subject to" opinions, the going concern has
changed, the use of emphasis has changed. There
have been some modifications, but the core of the
report and the pass/fail characteristic is not
substantially different than what it has been for a long time.

There is one thing, though, that I think has changed dramatically during that period of time that should be thought about when we analyze whether or not the auditor's report needs to be changed, and that is the emergency and growth of audit committees. Audit committees did not exist in many instances in the early stages of some of these studies that we're talking about.

I can remember being on the Auditing Standards Board 35 years ago when we took up this subject, and it's been lots of folks have had a go at it since then. So it's not an unfamiliar topic.

But the point being that audit committees are there for a reason, and one of the principal parts of the process that the audit committees are engaged in is a very robust dialogue and communication with auditors and with management, with others who participate in the process. And lots of what we're talking about here that we might be thinking about putting into an auditor's
discussion and analysis doesn't end up in the same environment where there is an open discussion among people in person, live, free flowing.

Stating some of that same information is the notion that, "Well, if you say it to the audit committee, why not say it to the investors?" doesn't really comprehend, I don't think, the discussion and the give-and-take and all the effort that goes in to the close calls and things of that kind.

So one thing I would ask, I thought this would be better at a gathering of the American Medical Association. But nonetheless, I would say, as I think I've said once before, let's be sure we don't do any harm. Do no harm here to other communication processes that are emerging and growing and getting better all the time and are working quite well.

And when you get into some of the notions that are being expressed in different ways and what we have before us today, such as all communications from auditors to audit committees need to be in
writing and communications from auditors to audit committees ought to be, in turn, communicated to the public. We start putting those pieces together, and we will drive communications between auditors and audit committees with management back, light-years back from where it is today and take out of the process what I think makes the process really work.

So I would make a plea on behalf of audit committee members and people who are working very hard at this to not be so quick to dismiss the effectiveness of that role in the process and leap from the auditor to the investor as if the audit committees were not actively engaged in the middle.

And I know you have a separate project on communications with audit committees, and perhaps a high degree of coordination between these two projects might produce a better end result for everybody than we might otherwise get.

I'd like to just make an observation about the auditor's discussion and analysis. I think we're all speculating as to what it might turn out to be.
And I, for one, if I was a betting person, I would put all my chips on the boilerplate number, whatever that might be, as opposed to betting that this will turn out to be a free-flowing, open, effective communication because I don't see how you can overcome the potentials from inconsistency from person to person, from company to company, from industry to industry, from firm to firm.

And to the extent we end up with something which is very different from company to company and firm to firm and so on, I think the inconsistency of that and the confusion that that will create, perhaps almost chaos that that will create, would detract so much more than any benefit that would be derived from it.

So if you end up with speculation A, boilerplate, probably not a great deal of harm, just cost with no benefit. If you end up with the alternative, I think you end up with a potential for substantial decline in the overall quality. so I would suggest we need to be very careful at what the standards are and agreeing with Ann saying they
should not be prescriptive. But at the same time,
this can't be a free-for-all.

And I would urge one thing, and that is if the
inclination is to move forward with AD&A that, in
addition to the great outreach you've done up to
now, this needs some serious field testing because
I think the issue of timing, which Bob points out
is critical; the issue of how management will
interact with what the auditor is saying in the
discussion and analysis; the what the content is
going to be, what is it going to look like, how is
it going to be presented should not be done in a
vacuum.

So I'm not a fan of this. I'm not
enthusiastic about it because I still believe the
boilerplate is going to win out in the end. But if
we are going forward, I would say do so with great
care.

MR. BAUMANN: Thanks, Mike.

And I can assure you that the staff and the
Board will certainly encourage us to work with due
care on this most important matter, and we'll
continue to, hopefully, go about this with the thoughtful way in which many of you have complimented us for moving along so far. So thanks for those thoughtful comments.

I'd like to turn to Joe Carcello.

MR. CARCELLO: Thanks, Marty.

First of all, I think Ann did a wonderful job of laying out the case for AD&A. So I won't reiterate what she said, and I thought Gary and Bob and Mike's comments were very good, very thoughtful. I disagree with much of it, and I could try to rebut it, but I won't do that at this point.

I do want to point out -- since in this forum in the past at times I have been critical of the profession when I think their performance has fallen short, I do want to reiterate or second what Bob Kueppers said about the CAQ comment letter, and I've said this to Sam and others in other public forums, I think it's actually a very good comment letter.

The profession has gone further than I thought...
they would. Not as far as I'd like to see them go, but further than I thought they would. And in particular, Marty, I would point out to you in Exhibit A, Item Number 4 on page 4, I think is quite good. I think that's the kind of information that investors are really driving at. So I give the CAQ and their members credit for that.

But what I want to talk about very briefly is we're hearing a lot today, and I think this is really one of the essential issues -- maybe the most essential issue -- is that auditors shouldn't be --

MR. BAUMANN: Just as an aside, that Exhibit A is not something that everybody has in front of them. You're referring to the Exhibit A to the CAQ letter.

MR. CARCELLO: CAQ comment letter.

MR. BAUMANN: That's not in front -- it's on our Web site, but it's not in front of everybody today. I saw some people looking through their folders.

MR. CARCELLO: That's right. It's not in
front of everybody today.

The essential issue is whether the auditor's role in doing more direct reporting is appropriate or inappropriate, and I think that's probably the major source of tension. So I just want to do -- very briefly make a couple of comments not from Joe Carcello, but from the profession itself.

And so, I have a comment here. This is from testimony before ACAP by Dennis Nally -- Mike, your boss, I guess, or one of your bosses -- the chairman of PWC International, who stated, "It's not difficult to imagine a world where the trend to fair value measurement leads one to consider whether it is necessary to change the content of the auditor's report to be more relevant to the capital markets and its various stakeholders."

And in the white paper that the CEOs of the six largest firms produced in 2006, they stated, "The new reporting model should be driven by the wants of investors and other users of company information."

Also in that same white paper, they stated,
"Given our independence and experience, we, the auditor, are in an ideal position to provide value to investors throughout the world." We agree with them. We agree with them.

The last thing, and this is from a book written by Sam DiPiazza, who is a former CEO of PWC and one of his colleagues, and I'm quoting now from this book, "Making the future better requires responding to the market's demand for audit opinions that say more about the information on the health of the business. Today, a great deal of this information is already reported by management and for certain purposes is considered in the course of the audit, including such issues as management estimates, the possibility of fraud, risks, liquidity, and future scenarios.

"The audit opinion" -- I'm still quoting. "The audit opinion could be expanded to address this information, as well as how all the pieces fit together as a whole."

So we're in agreement with everything I've just said there, and I guess my question to my
friends in the profession is what's changed?

Mr. Baumann: Joe, we appreciate those comments and all of the research that you've done on our behalf. And we'll look forward to your ongoing research to support our efforts.

I'll turn to Mark Newsome.

Mr. Newsome: Thank you.

The first thing from my perspective over the years is the audit opinion generally has not provided much value. I typically look to see if it was unqualified or not and if there was something added after that, you know, some type of change in accounting policy.

And so, when I started to think about this invitation -- by the way, thank you for inviting me -- I started to think about what would be nice to see in an audit opinion and what I've seen through other channels in my investing career.

And so, the first thing is I think about what and auditor did review, right? An example might be, as an analogy, a legal opinion that I might see in a private investing transaction. There's a
negotiation that takes place where the company's counsel will provide an opinion and explain what they reviewed and what they did to come to that opinion.

When I think about close calls, I think about not necessarily a contentious situation or, "Boy, that was a close call" type of conclusion. But I think about the range of possibilities that might have been discussed.

For example, if you're talking about a particular figure on a balance sheet, was the probability chosen equal among five possible outcomes, and they settled on one? So then, maybe the auditor should discuss the fact that there was a wide range of possibilities that were relatively equal and potential conclusion.

When I think about coming back to the unqualified opinion, I think about accounting due diligence reports that I've seen where, let's say, an investor would hire an auditing or accounting firm to render some form of opinion on a company's financial profile. And those reports are generally
rich in information, and they provide a lot of value, whereas the audit for public and private companies opinion does not.

And then when I think about the boilerplate comments, my opinion of companies across my career is that each one is different, even within a small peer group where companies do generally the same thing. And I know that the management financials, not necessarily the audited financials, the management financials are generally different from company to company.

And so, if that's the case -- and I encourage management teams to use their own style because I believe the financial statements are a tool to help me understand how they run their company. And so, if management financials are different even within peer groups, then why should the audit opinion be identical for companies within a peer group?

And so, I have lots of other comments, but let me stop there and, again, thank you for the opportunity.

MR. BAUMANN: Thank you.
Steve Buller?

MR. BULLER: Thank you, Marty, and thank you for inviting us to speak this morning.

So I have a number of general observations and then a few specific observations with respect to the questions you've asked.

So, as part of BlackRock, we actually polled the analysts globally to get their input from our firm and also our preparers. So BlackRock preparers roughly -- it is subject to audits on roughly 3,500 sets of financial statements between the corporate entities we have and all the funds.

I was afraid for a while, as I was getting these very passionate views on both sides, that I would be issuing the reciprocal of the SEC disclaimer that the opinions were those of my company and not my own. But we've reached some agreement where they actually are my opinions also.

As part of our challenge in issuing all these statements, many of our statements that we have are SEC registrants, and particularly on the fund side, and those statements are included in the financial
statements of other nonregistrants in the U.S., as well as local registrant and nonregistrant entities overseas.

So one of our general observations is that we really believe it's important that as part of this undertaking, which we believe is important and very useful, that there be a collaborative effort between the PCAOB, the AICPA, the SEC, the FASB, and certainly the IAASB in making sure there is some alignment to the extent possible in the audit opinion effort because we think it might be difficult for many of the users of our statements, who are global users, to see different sets of opinions that might have different levels of content. So, to the extent that those can be developed in a parallel fashion, that would certainly be useful.

So, in addition to that kind of global perspective, we also believe, and I think Bob made the comment from D&T, that it's important to have statements around objective as opposed to subjective information where possible. And we
believe there are a number of objective criteria in
the A&A which do benefit from comment.

And thirdly, again, a comment made by several
people is it's important that management, where
possible, be the original source of disclosure
about the company. And again, we think there is
value to having a review by the SEC and other
entities in the materials that are contained in S-K
to see if some of those should not, in fact, be
moved to S-K because some of the disclosures that
now are being made or should be made perhaps in
MD&A could be subject to auditor oversight and,
therefore, a higher level of assurance by the user.

So, with respect to some more specific
comments, we do believe that the AD&A could be a
useful tool, but there should be some parameters
around the content of the AD&A. And among those
are I think that it would be useful to have
information on -- pointing on significant new
accounting principles and whether they are
preferable in the context of authoritative and
regulatory guidance. So, again, something that is
subject to a specific definitive benchmark, as opposed to a subjective determination.

We also think that our users in particular felt that there were a number of situations where they would have benefitted from additional information on going concern entities. So they thought that whether our issues involving uncertainties, that those — the insight on those uncertainties, declining or concentrated cash flows, upcoming material financial obligations, changes in other characteristics of the operations of the company, that insight, if not communicated by management, would be very helpful to have in the AD&A.

There also are some areas related to auditor independence. And so, we think the AD&A could benefit from a couple of different segments to it. One is general observations on audit procedures, some on the company, and then on auditor independence because not all aspects of auditor independence are, in fact, disclosed in a proxy.

So we, of course, have our audit fees
disclosed in our proxy. We have a number of related party arrangements, including audits of our funds that we sponsor, that do not appear in the -- the fees don't appear in the proxy or other disclosures. And we think it's important for investors to have some perspective on the overall relationship that the auditor has with a registrant, which may be both direct through the fees paid by the registrant as well as indirect through those services provided to affiliates and related parties that can be audit and not audit services that could bear upon independence.

We also think it would be important to have information on the tenure of the audit relationship, again as part of that overall disclosure in the AD&A.

We think that there are some areas that, again, would be helpful to investors, and that would be disclosure of audit procedures and material errors. Now this is a catch-22 because we don't want the AD&A to be a 45-page document talking about every specific procedure performed.
But we do think that there are material errors where at least it would be helpful to allow the investor to have some insight into those significant judgments regarding uncertainty with respect to some of the sensitive areas like fair valuation, review of the impairment of intangible assets, loan loss reserves, tax uncertainties, all those things which have been the flashing red lights in the reports over the past several years.

We would not object to the identification in AD&A of those areas which were -- where there is significant management or auditor judgment or significant uncertainty, given their complexity and, as part of that, the attendant disclosure of some of the key inputs upon which the auditor relied.

And again, part of the thesis that we believe, which is based upon the need for management to make original disclosures, we believe that will in part force management to enhance their disclosure and their financial statements, as opposed to having the auditor talk about their key inputs. Because
we believe that many of the key inputs that the auditor uses in performing their procedures also are the same key inputs that are used by management. Not in all cases, but we believe those would benefit from that.

Responding to the comment on close calls that was made, and I forget who made that, we really do not support disclosure of close calls because it almost has a pejorative nature to the assertion because it sounds like that there is a toggle point, and that toggle point is a close call when, in fact, the very nature of preparation of financial statements involves estimates and a level of uncertainty. And it would be perhaps misleading because it almost implies that there is a failure to adopt proper accounting principles or the failure to have an appropriate determination on the accounting issue.

So we believe there are other ways to communicate that. One of those is in the MD&A section, many firms are encouraged by the SEC literature to include ranges around estimates. We
believe that literature should be clarified to make it clear that information should be prepared by the registrant, included in financial statements to provide more insight on the nature of that uncertainty, as again opposed to a statement by the auditor that there was a close call may imply that something is wrong when, in fact, all there is, is a determination made around a range of possible outcomes.

Again, I think in the MD&A, it's important to the extent that there is also forward-looking information that that forward-looking information be made by management and that the auditor be restricted to objective comments and does not go beyond those points.

And I think those are probably the significant statements that we'd like to make.

Thank you.

MR. BAUMANN: Thanks, Steve.

Can I just follow up a little bit, just want to make sure I was clear on the point you were making on the insight with respect to judgments and
estimates. Were you talking about the insight with respect to what audit procedures were performed by the auditor on those judgments and estimates, or about the auditor's insight as to the quality of those judgments and estimates made by management, or both?

MR. BULLER: So it would be based upon to the extent that there are audit procedures performed, it would be clarification around those procedures performed. So it, in fact, points the reader to understanding that there are areas of significant judgment.

That to the extent that there were inputs that were used in making those determinations by the auditor, potentially disclosure of those inputs so the reader would have some understanding of the basis upon which the auditor reached their conclusion.

MR. BAUMANN: Thank you.

Just so those whose cards are up, brief order I have right now is going to be Bob Guido, Jack Ciesielski, and then Mike Santay. And now I do see
other cards up, but just knowing you're going to be
called on.

MR. GUIDO: Thanks, Marty, and I appreciate
the invite.

Many of the things that I'll mention have been
addressed by a lot of you already. I'm all for
changing the auditor's report in a very
professional way. I've been dealing with the
expectation gap for nearly 45 years, both from a
public accounting standpoint and the last 5 1/2
years as an audit committee chair.

But again, I'll -- not quite as long as Mike
Cook, by the way. But having said that, I do agree
with what Mike said. And Steve, some of your
comments just now, I do agree with.

I might start off by saying that in my mind,
the auditor's report provides assurance that the
financial statements are presented in accordance
with GAAP. I really believe that provides a lot of
value. So I personally take exception to anyone
who doesn't believe that.

The audit is historical. There's no question
the opinion is a point in time. It's not predicting the future. And if we need to focus more on the future, then we need to change a lot more.

I would say that in Mike's summation about audit committees and usefulness of audit committees and what they really have been doing -- and I've been a little bit spoiled in the profession because I had some great audit committees that I worked with. Then I had some not so great ones in the '70s and '80s.

But Sarbanes-Oxley really changed the game plan, and a lot of great things came out of Sarbanes-Oxley, in my mind. And the audit committee arena, which Mike mentioned and I fully agree, really needs to be studied more, where we are and where we're going, because there's a lot of great things happening, in my experience, with audit committee and audit committee institutes across the capital markets.

Today's markets, I would also say, are much more sophisticated, and the investors,
institutional investors, the analysts that I deal with ask great questions. Their predictive models are wonderful.

However, as an audit committee chair, I really am concerned that many suggestions in the AD&A could make the committee's oversight of the audit and communications with the external auditors much more difficult without providing the promised benefits to the ordinary investors. Providing investors with the same information that is provided to audit committees without the context obtained from a two-way dialogue may be incomplete, generate, in my mind, greater confusion, and not enhance the overall understanding of the readers of such a report.

I've also great concern that the notion of an adoptable report that he or she could tailor to a company's specific risks, facts, and circumstances. This, in my mind, would lead likely to an administrative nightmare in trying to wrap up an audit, given that each report would be custom made and would likely have to be cleared with the
national office, accounting and auditing experts, let alone legal.

The resulting report, in my mind, would be extremely long and complex. It would probably lack comparability with other companies and would likely not be in a format that easily can improve communications with users. And again, remember, that's what we're trying to do here.

And last, but not least, I have a real concern that at least in my boards, I want the audit partner to really focus on the risk and the complexity of what they're doing and prove audit quality and not worry about haggling over a lot of words. And I'm very concerned about that.

Thank you.

MR. BAUMANN: Thanks very much, Bob.

You've probably been observing the same thing, but I just want to maybe summarize a little bit because I'd be interested that as you are making your comments, those who think an AD&A is a good idea, those who seem to have expressed concern about it during this session have talked about
timing and how it could impact 60-day reporting deadlines at year end.

The fact of a lack of context maybe that the two-way dialogue had between audit committee members, or three-way -- audit committee members, management, and the auditor. And some concerns that those who were expressing that about inconsistency, since individual partners would be writing the AD&A, inconsistency within a firm, I guess, with respect to various clients and then certainly between firms and industries. And those are some of the concerns being expressed, and we heard those in our outreach.

And I guess to the extent those who have their cards up who think AD&A is a good idea, how do they think that we could work around that as a concept? So please comment on whatever you want, but I just -- those are some consistent themes I hear, and I just am interested in those who have -- believe the AD&A is a good idea maybe to comment on those.

As I said, Jack Ciesielski was going to be the next commenter.
MR. CIESIELSKI: Thanks, Marty.

If I could just tack on to what you just said, obviously, I support the AD&A concept, but I don't think that it has to be a replacement for the audit opinion. It's a supplement. Therefore, I think you could expect to have variability from client to client and within a firm.

If you think about the MD&A as a model, the MD&A wasn't exactly, I think, welcomed by companies when it was first initiated. But it's evolved and developed, and it's not a bad framework for thinking about the AD&A. It's custom tailored to each individual company. There really isn't much comparability from one MD&A from one firm to another, and I don't think investors would expect one AD&A to be the same for two companies in the same industry, even if they're audited by the same firm.

The way I read the concept release and the understanding that I have of what an AD&A should be is a communication between the investor and the auditor. And I think when we start worrying about
having competing disclosures with management's disclosures, I think we're muddying it up a little bit because it's really quite clear in the concept release that this is not intended to contradict or supplement the management disclosures. It really should be about the relationship between the investor and the auditor, which you don't get much of in three paragraphs right now.

I think, actually, if you're going back to the analogy of the MD&A, one place that auditors typically begin their audit is with an assessment of the risks within the company in the operating environment they participate in. So I think it would be very useful for an investor, just to throw away -- getting away from the close calls issue, but what would be good for an investor?

I think it would be good for an investor to understand how the auditor assessed the risks within the firm before they began the audit, how the economy, how their competitors might have effects on the assets and liabilities of that particular company.
There could be competition that's making their product obsolete. It might encourage the auditor to expand their testing of inventory or accounts receivable because maybe their products that they've already shipped are already obsolete, and they have problems with customers.

But understanding the environment that the company operates in is central to the audit, and sharing that assessment with the investor would be useful from a very broad, high-level kind of assessment, and that could be communicated and how that affected the way they performed the audit.

I don't think that the investor wants to have an audit program in an AD&A, but I think they want to know why the accounting principles employed by one company are sufficient. Not just because they're in GAAP, but what makes them preferable?

If I could give an example that's something happening right now? We've had pension accounting for about since 1988 that's a confluence of many deferred losses, deferred gains, all kinds of stuff amortized into pension costs.
Lately, in the past year, we've had companies, within the confines of GAAP, starting to use much more stringent accounting on pension by getting rid of deferred losses that they would otherwise amortize. You have some companies that you have the same audit opinion on both sets of pension accounting principles used.

One is preferable to the other. There is preferability letters for those companies that make the changes, but you don't see that in the audit opinion. It just says it's presented in conformity with GAAP.

I think investors would like to know more about the accounting principles being used, why they're preferable, why they're doing a good job of describing the economics of the firm. And I think that's the kind of thing they'd really like -- that investors would really like to see more of in an AD&A than just near death events, or close calls, whatever you want to call them.

So, that said, I just want to address one theme that was recurring in some of the earlier
remarks about costs. Audits today are still a
bargain. In the last 5 years for the S&P 500, the
total change in the audit fee has been about 5
percent since 2006 through 2010. That's not much.
And in fact, there's in the S&P 500, there is
371 CEOs whose pay was greater than the entire
audit fee. So you can think what you like about
CEO pay, but it's making the audit fee look like a
relative bargain in terms of the work that's done
for the investor. I don't think I've ever heard
investors complain about the size of audit fees.
And I think if you give them something more in
the audit opinion with an AD&A or any of the other
avenues that we're going to explore today, I don't
think they'll complain about an increased fee
either. So I know that that sits well some folks
and not others, but the investors are the ones
ultimately footing the bill, and I don't think
they'd mind.
What else? That's all I've got for right now.
MR. BAUMANN: Thanks, Jack.
And let me turn to Mike Santay and then
Charles Elson and Kevin Reilly and then Flerida Rivera-Alsing.

MR. SANTAY: Thanks, Marty. And thanks, Jack, for your comments on audit fees. We appreciate that.

MR. CIESIELSKI: Thought you would.

MR. SANTAY: We understand investors are seeking more information, and the auditors need to bring more value, and we agree with that. We also agree with the earlier comments that the auditor should not be the original source of some of this information that might be contemplated for the AD&A. We don't think that's operational, as it's currently positioned.

Whether the auditor is the asserter or the attester, the end result should be the same. That is, the information that's presented should be accurate and useful in allowing the investor to make their decisions in evaluating the financial statements and the disclosures.

We believe that the auditor is in the best position to be the asserter in this model, and it's
consistent with what their training has been and what their role has historically been. To provide subjective assumptions about the financial statements in an AD&A we believe has a high risk of calling into question the overall opinion that -- the GAAP opinion that they're providing.

We had analogized that to situations where the auditor is faced with a qualification of their opinion. You know, in those situations, the auditor does become the asserter. They need to -- they have a requirement to disclose what management has not in a qualified opinion. So, from that perspective, the AD&A could be construed as somewhat of a qualification of the auditor's opinion on the financial statements.

Now it strikes me that what the key disclosures are is what management -- what keeps management up all night and why? And that should be the basis for the financial statements and some of the subjective analysis that we've been talking about here.

And as it relates to opportunities for
improvement, I think we'll get into that in some of the other areas as we talk through the day, particularly auditor involvement in other information. We talked about critical accounting estimates. I think we'll talk a little bit about some of the auditor involvement in perhaps interim information and others, and I think that's going to be important.

But I think providing the auditor specific views as it relates to the subjective assessments we think would be problematic.

Thank you.

MR. BAUMANN: Okay. Thank you, Mike.

Charles Elson?

MR. ELSON: I take just a slightly different tact and look a little bit more at sort of the governance implications of -- general governance implications, I think, of the proposal. I mean, no one can be against increased information and transparency. That, in and of itself, is a good goal. But I think sometimes you also have to look at the side impacts of what you're attempting to
What you've seen in the last 10 years since Sarbanes-Oxley has been a tremendous change in the nature of the audit committee. I mean, 20 years ago, the audit committee was really the place you put people who you really didn't know what else to do with, and it was the worst place to end up. Perhaps it still is.

But you've seen a real professionalization of the committee itself, the idea of the financial expert on the committee, the idea of financial literacy on the committee. And it's really changed dramatically. I mean, the notion that you have retired auditors chairing committees is a new concept and I think have been a very helpful concept.

And the role of the committee itself has changed in that the committee today engages the auditor. Where 10, 15 years ago, it was management who, effectively, hired the auditor, today, it's the committee, and that was an important change in SOX. So the idea of the auditor is to effectively
work for the committee, providing assurance to the committee and the shareholders, obviously, of the effectiveness of the financial reporting structure and information that's being reported.

The difficulty, I think, with creating a new auditor discussion and analysis section, which basically reports on what the auditor thinks and what the auditor has said or maybe hasn't said to the committee, is it changes the nature of the committee dramatically, if you think about.

Because what's happening now is the committee engages the auditor, and the auditor is now being asked to comment on all its relations to the committee. It's like hiring a lawyer and having a lawyer, after the lawyer advises you on what to do and not to do, get up publicly and tell everyone what they said to you and what they didn't say to you, which effectively is substituting in a way the auditor for the committee itself.

And that's a bit problematic. There's a difference between advising a committee and giving assurance to a committee and the shareholders and
effectively becoming the committee itself. And from a governance perspective, I think if this goes through as proposed and it begins to weaken the committee -- it removes the committee as the middle person, if you will, between the company and the shareholders -- I think it ultimately may impact negatively the monitoring role obviously that the committee provides and the board itself.

Central to our system is the board within the organization, representing the investors, overseeing management for the benefit of the investors. It's a small group who reviews management for the benefit of the investors in the company itself. And if you diminish their authority and ability to monitor, I think you really create long-term problems with the entire board oversight model.

Substituting a third party, the auditor, for the board itself, elected by the shareholders, in this regard I think ultimately may lead to more problems than not. It's the old "careful with what you wish for, you may get your wish."
This is one of those because I think that while greater disclosure is welcomed, the greater disclosure here I think may lead ultimately to less effective monitoring, which ultimately is more harmful to the organization and the investors.

MR. BAUMANN: Thank you very much for those very thoughtful comments.

Kevin Reilly, Flerida Rivera-Alsing, and then Paul Haaga.

MR. REILLY: Yes, Marty. Just let me make a brief comment, and that is I just want to stress one of the points that I view to be the 800-pound gorilla in this debate. And that is -- and it's the one that speaking for the profession through the CAQ efforts is the one that has given us the greatest amount of indigestion.

And that is the calls for the auditor to provide subjective views and impressions surrounding a company's financial reporting matters is the one that we view to be really troubling in this regard. And that is, look, we have these conversations with audit committees. We provide
these discussions in due diligence reports.

But those communications happen, as Mike Cook mentioned and as Bob Guido reiterated, in the context of an effective, two-way discussion and dialogue. And to blast this stuff out in a widely distributed public report is going to be a real problem and will create, in my view, significant confusion for investors.

So, to Joe Carcello's question to the profession, what's changed? I don't think anything has changed, Joe. We are for change. We think it has to happen, but it has to happen responsibly.

But to try to create a mechanism where we are providing subjective views and conversations and dialogues and impressions about a company's financial reporting matters without the ability of the audience to give and take with those impressions is really not going to be constructive.

MR. BAUMANN: Although, as Joe said, he was reading from a report of the GPPC, the partners of the major firms, who said that in the future, we'll be the ones to give insights and information
because we have it. I'm not quoting you correctly, Joe, but it was something like that.

So I guess that's the question of it sounds like there are some in the profession who think it can be done and others are expressing this concern about because it isn't a two-way dialogue, it's going to be confusing, whereas the investors were speaking up saying, "I don't think I'll be confused. I want the information."

Any further thoughts on that or --

MR. REILLY: Well, Marty, I think, as was articulated in the letter that we sent back in June, I think there are ways that we can address some of the demands from the investors, and we are 100 percent behind that effort. It's just in the context of trying to convey and provide help and assistance or views via our subjective impressions is really not a healthy way to go in a format that involves a wide distribution report.

I can tell you, and I've had the experience of issuing a lot of due diligence reports throughout the years, and I've got to tell you that the report
is issued. You then spend a day with the investor
group or the users of that report going back in
detail on "What do you mean by that?" "Provide
some additional perspective or context on that
finding." "What exactly am I supposed to do with
that?"
And that type of interchange will not exist in
the AD&A concept containing subjective views and
impressions.

MR. BAUMANN: Thanks, Kevin.

Flerida?

MS. RIVERA-ALSING: Thank you.

First of all, thank you for the invite. And
second of all, my opinion that I am going to
express are my personal opinions and not of my
employer.

I support the AD&A. I believe that the
concern about having a boilerplate report moving
forward is something that we should have asked
ourselves like 20 years ago because in the past 40
to 50 years what we have been receiving is a
boilerplate opinion page.
The disclosures I'm looking for from the auditors include what did you do to support the opinion you issued? We have investment in the private markets where the auditors will add an emphasis paragraph saying that 85 percent of the assets, the fair value of it is based on the estimate of management. But there's nothing there that tells me what did you do to be able to issue a clean opinion of that financial statement.

I would also want to see what the auditor -- or to know what the auditors did to assess the risk of fraud. That is not something that is disclosed or discussed in the financial statements. I would also want to see the corrected misstatements. What about the uncorrected misstatements?

These are just some of the things I would like to see. And I promise you and the audit firms that are represented here that the additional information you will provide to us will not confuse me.

Thank you.

MR. BAUMANN: That's what I am hearing the
investors say. They won't be confused.

Paul Haaga, then I'm going to call on Sam Ranzilla, Pete Nachtwey, Mark LaMonte, and Lynn Turner.

MR. HAAGA: Okay. Thank you very much, Marty. And thank you particularly for reaching out to and including investors.

I think that if anybody has seen some of our comments on various accounting issues, we've often pointed out that investors are underrepresented, in our view, on the boards that set these -- the various groups that set these rules. And we're delighted to be included here.

I don't want to be redundant. So I'll just say that I agree with everything that's been said and everything that's going to be said.

[Laughter.]

MR. HAAGA: As I said, we are a buy-side firm that does deep research. We have many, hundreds of analysts who use financial statements, but we also issue hundreds of financial statements for our mutual funds, like the gentleman from BlackRock.
And by the way, Jack, if you're taking a survey, I would gladly trade my compensation for all our audit fees.

But anyway, when I did the survey, I got the information by survey, reaching out to both our accounting staffs and our -- many of whom were previously in private practice, and to our analysts. And there was a lot of passion on both sides, but the statement usually began, "This will be great," or "This will be a disaster." And everybody had a different "this" in mind. It was sort of blind man touching the elephant.

Really, this release just asks a lot of questions, and so I encouraged them not to focus on this, but to turn around and work the other way and say, "Okay, what can we do? What can we do better? What would you recommend?"

There was a very strong consensus from literally everyone, both sides, on the fact that we can do better by investors. So doing something would be our suggestion. I got a number of examples from the analysts, and it always centered
around information that was uniquely known by the auditors. So nobody wants to replace anybody's role, substitute the auditors for management or interfere with the audit committee role, but there is some information known to auditors.

This should be modest, a modest cost for a modest amount of disclosure, which causes me to think that the emphasis paragraph is a better vehicle than an AD&A because an AD&A is a separate document, is likely to grow and be more comprehensive and not be modest. So we would prefer the emphasis paragraph.

I would suggest that the process here not be to sort of work forward from grand concepts of disclosure and matters that are to be commented upon, but just work backwards and take a couple examples. I don't want to fight the last war, but I think we can learn from previous examples of things that went wrong and say, okay, what would the auditors have known? What could the auditors have usefully pointed out without creating liability, cost, or interference with
relationships?

And if we can identify that, then I think we can write rules around that. And some of the suggestions from my analyst colleagues about things they would have liked to have known included Chinese company structures and related party transactions, Citigroup's CDO assessments, Countrywide subprime loan securitizations, Lehman repos, Fannie Mae derivatives, Freddie Mac deferred tax assets, and AIG's credit default swap valuations, just to name a few, and I'm sure there are plenty more.

I also don't want to leave out something that's been mentioned here. It's probably not a mandate or specific role of the PCAOB, but we think it's important, and that's strengthening the hand of the auditors. The mere fact that there's more to say than pass or fail, we think, would give -- and there was broad consensus on this -- we think would give the auditors a stronger hand.

They would win more arguments, and we think that would be a good thing. And that could be a
good thing even if they didn't say anything at all
in the emphasis paragraphs. Simply the ability to
say something there as an additional tool.

So thank you and, again, appreciate being
here.

MR. BAUMANN. Good. And thank you for those
very thoughtful comments.

Sam Ranzilla?

MR. RANZILLA: Thank you, Marty.

I guess where to begin? But I guess a day
that I get a compliment from Joe Carcello, maybe I
should just leave it at that.

[Laughter.]

MR. RANZILLA: But I'm not going to. As a
profession, we have looked at this issue for over a
year and read all the surveys. And I'm telling
you, I think the basic issue that I have had the
most difficulty in dealing with is, is that when
you boil this all down, at least in my view, this
comes as basically a situation where investors are
basically saying we don't trust audit committees.

And as a result, they're looking for the same
information that is provided to audit committees. And I don't know that simply looking at the auditor's report is going to deal with such a fundamental issue as a lack of trust of what audit committees are doing. So I'll leave that as sort of an overriding comment that I'm not certain that this Board can deal with this issue all on its own.

That said, when you get down to a different level of the issue, the common theme is, as an investor, I want to know more about those judgments and estimates that are critical to the financial statements and what is underlying them.

And you can slice that a number of different ways, and I think Ann had a list or somebody had a list of some things. And there might be some things on the periphery of that, but it comes down to most of what people are interested in financial reporting is where are the estimates, and what is the level of measurement uncertainty within those estimates? That's what drives the volatility and the ultimate reliability of a financial reporting.

So Marty tossed out for those that favor AD&A
how you overcome some of the downsides. I don't favor AD&A, for all the reasons that others have expressed that I won't go into today. But I would like to address, and getting a little bit ahead of myself, an alternative that simply does get to a potential root of the issue without an auditor's discussion and analysis.

And I refer you to the SEC financial reporting codification on critical accounting estimates. And I guess, Joe, this side of the room is going to do some reading today, based on a remedial reading class we had last night that you and I had to attend.

But if you look at existing literature today and what's required to be included in MD&A, the concept of a critical accounting estimate is any estimate or assumption is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of those matters to change, and the impact would be material.

If you fall into that category, this
particular reporting release asks the issuer to respond to a series of questions, such as what factors did you use in arriving at the estimate? How accurate has that estimate been in the past? How much has that estimate changed in the past? And whether the estimate is reasonably likely to change in the future and, if so, to provide some form of sensitivity analysis because of the highly uncertain nature.

Those are existing requirements. And as I've looked at surveys, quite frankly, if that's what you're asking the auditors, and I think that is a major piece of the proposed AD&A, that information is already required to be disclosed by issuers.

And one proposal would be for the auditors to attest to those disclosures, not all of MD&A, just a portion of MD&A to basically achieve two objectives. One, improve those disclosures and the compliance with those disclosures and, secondly, to provide investors with greater confidence around the disclosures around critical accounting estimates.
So my point is, is that I, too, support change. And I think there is a way to get to the root of the issue if you can overcome the basic lack of trust, which I don't think this Board can do on its own.

But as a means to try to improve that situation, there are superior alternatives, ones which will allow management to provide information and auditors to attest to it and allow us to provide objective assessments of otherwise very subjective information. And I think that that particular alternative is superior to an AD&A.

Thanks.

MR. BAUMANN: Thanks, Sam.

And we're going to have a thorough discussion later on, on the possibility of auditor reporting on MD&A or parts thereof, such as critical accounting estimates. Another way, Sam, of looking at the point you just raised of a lack of trust between investors and audit committees might be maybe a lack of compliance with existing MD&A requirements since they call for such information
about estimates, including sensitivity analyses as to how these estimates were made and could change.

And I guess there's at least a question of compliance if investors are saying we don't have that information, and the rules are as specific as I have in front of me and you've read. So we'll explore that issue a little bit later.

Pete Nachtwey?

MR. NACHTWEY: Thanks, Marty.

And I'll just add my compliments to the group, the Board and the others who have done so much of what I think has been -- I know has been incredibly hard work and, I think, very thoughtful work. And it's clearly with the best interests of the investment community in mind.

I'm going to state at the beginning I agree with much of the direction that's being taken here and the fact that the audit report is several decades stale, if we want to refer to it that way. But I also have some concerns just in terms of unintended consequences and making sure that we're thinking this through. And I, again, would add to
someone who said this earlier, compliment the process and just continue to encourage you to keep it open and very broad.

But I'd like to just state for the record, as others have, I don't speak for my organization, which currently is Legg Mason. But what I do speak with is kind of what I think is a bit of a unique perspective with wearing three hats. And while I've had the honor of serving on the Investor Advisory Group because I currently and have been working with several large investment firms for the last going on 5 years, I did spend 25 years in the profession as an audit partner and in other leadership roles.

Then the last 5 as an issuer and preparer of financial statements, including for public companies and, much like Steve mentioned, around the world under various regulatory regimes. And then, those CFO roles have kind of taken me into the investment territory with two large global investment firms that have about $800 billion under management of third-party money.
So, unlike my toughest critic is my wife, and she usually thinks my opinions aren't very well informed, I at least kind of feel I can bring a bit of a 360-degree view of the issues that we're talking about today.

So while I, again, agree with much of what's being talked about, I do have specific concerns, and they primarily relate to the first two topics. So, again, I'll stick to the topic here, Marty, of AD&A but stipulate that I have similar views around the emphasis paragraph.

And first is just the cost benefit of doing this. And as Mike said before, do no harm. We need to understand that the costs that certainly that I know we incur internally -- not just externally, which is disclosed, but internally as well -- to issue financial reports and comply with what, again, are appropriate regulations, but we need to recognize they're incredibly burdensome. And the cost to comply is enormous, and that ultimately is borne by our investors and our shareholders.
Second concern is just the practicality. You know, again, I think all of this is well meaning and well intentioned, but the practicality of it, I think we need to really be thoughtful about. And the questions that I ask myself, particularly on AD&A, are how would an auditor's AD&A differ from management's, first and foremost? And then if it doesn't differ, is the view worth the climb? I mean, why would we do it if it's not significantly different?

But then the catch-22 question, if it is different, then I think most of the folks around this table who are on audit committees or in audit firms or, like me, are CFOs are going to spend an enormous amount of time reconciling the differences, which I think just leads us, at the end of the day, to getting to boilerplate because we simply don't have the time to do a lot of creation of new work in the tight deadlines that we have to operate under.

And then also if they are different, the question is does that really help investors, or
does it cause them more confusion? Because they then need to reconcile the differences, and they won't be able to sit down, as others have said, across from the auditors as the audit committee could or other users of financial statements. I also wonder how this again ends up being something that's new information at the end of the day and not just boilerplate.

So, lastly, just to provide a perspective, because I've been asked to do that, and I'll try to be very balanced. Hopefully, Joe recognizes that, and I've worked with Joe on this. And again, I compliment you and the rest of the committee that's been working on it.

So I've spoken with many of the senior investment people, not just the analysts, because we've got a horde of analysts inside of Legg Mason, a horde of deal people that are inside of Carlyle where I previously served. And yes, they will always say any additional piece of info -- you know, even if it's on a scrap of paper I pick up off the floor, it's like, you know, jeez, maybe
that gives me the one edge that I'm looking for to look really smart to my boss.

But when I go talk to the guys that run our funds and run our affiliates, and these are very, very seasoned guys and gals who've been around for decades, they're not clamoring for a change in the auditor's report. It's, "Yes, it would be nice to have."

What they're clamoring for, they'd love to get more prospective financial information from management, and that's a whole different topic we won't explore today. And of course, the question of should auditors be involved in that? But that's what they like to have, what actually they would say they must have is that prospective information.

They're always looking for what's around the corner, not just what's historical. They do value the audit opinion. They value reputable firms being involved with issuer financial statements to know that's solid base on which to build the rest of the pyramid of how they're doing an analysis of companies they're invested in.
So, at the end of the day, when I press them on this issue, it's much more, "Well, okay, it would be nice to have if we can get it, but it's not a must have." And so, does that get over the cost-benefit hurdle?

So I'd just say in summary, we need to be very careful on how we're approaching this and be very thoughtful. I'm not saying that, again, I'd be against change, wearing any one of my three hats. But just making sure we don't do any harm.

Thanks again for inviting me.

MR. BAUMANN: Thank you for coming and for your comments, Pete.

Mark LaMonte?

MR. LAMONTE: Thank you. And thank you for the opportunity to be here today.

Let me start with some of Peter's comments because I found that very interesting in terms of the value and the "nice to have" versus the "need to have," and how investors and other users of financial statements think about auditor reports today and an audit.
I do think we find audits extremely valuable. When we get a 10-K, there is an expectation that those numbers have been audited, and we can place a level of reliance on the accuracy and completeness of the information that is very critical to the decisions we're making.

The audit opinion itself holds very little value to us in terms of what's written. This concept that the numbers are audited certainly is valuable. The opinion itself is essentially a commodity. It really doesn't matter which firm is auditing the numbers. As long as it's one of the large, reputable firms, we're just happy the numbers are audited.

So from the perspective of is the profession delivering the greatest value, it certainly is delivering a lot of value by providing us with numbers that are audited, but it's not providing us much insight above and beyond that. So I view this as a nice opportunity to provide more.

Going to Pete's comments, is it something that we're clamoring for? Not necessarily. Our
analysts get a set of financial statements today, 
assume they're audited, and start doing their 
work. Could the auditor give us something that 
would be helpful to the work we're trying to do? 
Absolutely.

I think the audit discussion and analysis 
would be an opportunity to do that, would be an 
opportunity for the firms to decommoditize their 
product a bit and make it something that actually 
has differentiated value amongst the firms.

Sam raised a very interesting idea about the 
discussion of critical accounting policies. That 
was a terrific idea when that was introduced, I 
guess, what, 7, 8, 9 years ago now. It's become 
largely boilerplate and another disclosure that's 
largely ignored by investors today. It says the 
same thing every year. It really doesn't say much 
anymore.

Having an auditor provide that with their 
objective view or participate in the delivery of 
those three to five critical areas of judgment or 
uncertainty that the investor needs to understand
to really make the best decisions with the financial statements would be extremely valuable.

Having auditor views on those very difficult decisions that come up or those areas where a decision management has made could have been very different would be valuable. Let me just use a real-time example that would not be a U.S. example, but might emphasize the importance of this should we continue down the path and start incorporating IFRS into our financial reporting.

When you were looking at second quarter numbers for several European banks recently, you saw wildly different outcomes for the numbers that were being reported related to losses on holdings in Greek sovereign paper, just wildly different. Having auditor insight into how those ranges of potential outcome were evaluated and where, to use a golf analogy, a firm was hitting the ball in that fairway of acceptable outcomes and how the conclusion was supported and was okay I think could be just incredibly valuable to investors as they look at the numbers and think about how we want to
adjust or how we want to view the numbers differently in our analysis.

It's always critically important to realize that endless -- and investors are not just taking what's reported. They're taking what's reported and providing their own perspective on it. They're making adjustments. They're making projections. They're thinking about the numbers differently than what's presented.

And having more insight into those from the audit community, I think, with the objective view of the audit committee could be very helpful to us. And AD&A is one of those opportunities to do so.

Thank you.

MR. BAUMANN: So, Mark, as you spoke, you sounded like you were a lot more supportive of the AD&A because you talked about how valuable it would be to understand how the judgments were made around estimates that were so different from company to company and as opposed to I think early on, I thought you said it was a nice to have, but not necessary?
MR. LAMONTE: I'm very supportive of it.
Could we live without it? Sure. If you want to
make an audit valuable beyond just having a
commoditized assurance over the numbers, then I
think it would be a terrific thing to have.

MR. BAUMANN: Okay. Thanks.
I've got Lynn Turner next, and then we'll call
on Steve Kozeracki, Alan Beller, and Wayne Kolins.

MR. TURNER: Thank you, Marty.
It's interesting to listen to this
conversation around the table. I've heard the
phrase "do no harm," "unintended consequences," and
"let's not get overly high on the cost." I can't
think of any other city in the country where I hear
those three phrases said more and yet, at the end
of the day, more damage is done to the investing
American public than any other place.

So I think those are all synonymous with just
saying "do nothing," which is pretty much what has
happened in this profession with this report since
this issue first really got a lot of attention
back, as Mike said, when he was on the Auditing
Standards Board. Unfortunately, at that point in time, they pretty much did nothing and didn't do a whole lot with the report.

It didn't change much. There were some changes around the fringes, and so here we find ourselves three to four decades later with the same problem.

Rather than do no harm, I think, for once, the Board ought to look at doing something that's right, something that actually provides some value, some information to the investing public. I don't think the issue is raised because people don't trust the audit committees. I think the issue is raised because investors see reports like they've seen at Lehman, at AIG, the judgments on the Greek debt. And not only does the Greek debt look impaired, it looks like the judgment of the auditors has been impaired as much.

Adelphia, Xerox, you can go through it. That's why people are asking for this information.

It isn't that they don't trust audit committees. There may be a lack of trust. People don't trust
the auditors because they get that same clean
report from everyone, and yet, all of a sudden,
there is a blow-up and there was no red flags.

And when we get into the court cases, then all
of a sudden, in the court cases, we actually find
the auditors did know a lot. Some of it may have
been conveyed to the audit committee, but in a lot
of times, it isn't conveyed to the audit committee.

So that's what one court case after another
shows. And I think Paul had some very astute
comments in that the Board needs to go look at
those cases and take a look at what it was that the
auditor knew. What was their perspective on the
numbers that they never told the investors about
that would have been useful and helpful
information?

We are not looking for original information
from the companies. I agree with that. The
company has obligation to turn around and disclose
those. Those need to be improved. The CFA
Institute, others told us at the Treasury Committee
that those disclosures are deficit and need to be
improved, especially with respect to significant judgments and estimates. That's the FASB's job.

But what we are looking for is the knowledge that the auditor has and their perspective on the information. That information that they have should come from them. It shouldn't come from the audit committee. It shouldn't come from management. They're the independent body, supposedly the independent body. Yet in so many of these cases, you just wonder if they were ever independent at all.

So that's what we're looking for is that independent, unbiased perspective on some of those significant things. I do think there is some value to the standard report, but when we keep having these blow-ups, you wonder if it's worth paying for.

You know, you look at a Sino-Forest, where someone, an individual outside could go look at just publicly available information and find the problem, but the auditors couldn't? And that with an audit committee with three chartered accountants
on it, you know, it does raise a serious question.

So the auditors did have valuable information, the court documents show, at Adelphia, at Xerox, at Waste Management, at AIG, at Lehman, that I think, unquestionably, any auditor doing basic, fundamental research would have liked to have heard and would have liked to have heard it from the auditor.

I favor an AD&A. But at the end of the day, I really don't care whether you put it in an AD&A or an emphasis paragraph. I just want the information. So whether you print it on page 13 or print it on page 33 in the filing, I really don't care, as much as I care about getting the basic, fundamental information.

The concern with the use of an emphasis paragraph is it does tag on to the current paragraph, and it might be just easier if you just give me the yes or no, pass/fail, and then give me a separate report on what you think. I think that actually will be easier for investors to deal with and read and comprehend.
The other concern with the emphasis paragraph is if you make it optional at all, then I'll guarantee you, you will do harm because you will have not done anything. Because the profession has been able to use emphasis paragraphs for two, three decades now and just never use them. Just never use them. So this is not something that can be made optional.

In regards, as far as boilerplate, I think that's something certainly to be looked at. I think Paul's notion of maybe field testing a little bit here would be helpful in that respect. But we do have MD&As that are very specific to each company, and they are able to do MD&As. And what you're telling me here is the audit partners in these firms are so undertalented that they can't do what the company is doing.

The company seems to be able to write that MD&A. Gary and Larry and others turn around and work on that MD&A. Larry was an audit partner, but you're telling me, as an audit partner, he couldn't write that type of specific company information? I
don't buy it. I think these are very talented partners. I think they're very up to it.

The difference is you've got to pull the attorneys out of it. The audit committee reports have become -- despite encouragement from the SEC not to do it, the audit committee reports have basically been turned over to the attorneys and, viola, of course, we're going to get something boilerplate out of the legal profession. It's what they do.

So I think you'd want to do something to make sure that you don't end up with that, that you do end up with something specific, like MD&A, which you can already do.

As far as timing, I think Mr. Kueppers raised the question about timing. In each of these audits, at the end of the audit before we sign off on the audit report, before the partner signs off, they have to write -- it's mandated by the PCAOB's own standards -- a completion memo. And if there is one thing that investors ever would want to see, it would be that completion memo because that
completion memo is your own standards highlight, tells you you've got to discuss what the big ticket risks were, what the significant items were, and your perspective on those.

That is unequivocally, anyone that's written those, anyone that's seen those would know that's the one thing that investors would really like to -- all you have to do is take those on some of these audits and put it out there publicly and ask investors if they'd like to see it. I guarantee you, they would love to see those memos.

So by the time you get down to writing -- signing off and writing the report, you'd already have some of this drafted because you have to do it as part of the audit. To say that you couldn't write this is incredible because you already have to have written it before you signed off on the audit report. And so, now it's just taking and dropping that down into the right type of language and something that is plain English that the investors could understand, and I see no reason why these talented partners couldn't do that.
I think investors have been very succinct in what they've been asking for. In fact, in their 2006 white papers, the CEOs of these exact large firms turned around and said users of financial information may demand from public companies the ability to receive more finely nuanced opinions from auditors about the degree of a company's compliance with a given set of standards or the relative conservatism of judgments compared to peer groups, or more boldly, investors even may want an auditor's view about the overall health and future prospects of the company they audit.

The CEOs, as Joe aptly noted out before, the very CEOs of these firms, the guys running these firms, have said investors are looking for this type of information. And to the extent we can get information that will enhance the performance in our portfolio because we've done a better job of allocation, we're more than willing to pay that cost because we get tremendous benefit back from it. That's the real benefit.

I can guarantee anyone had had the information
that the auditors did on Adelphia, on a Xerox, on
an AIG, on a Lehman, would undoubtedly have
significantly enhanced their performance, and the
cost would be a drop in the bucket compared to what
it did to the returns on those entities.

As far as the auditors reporting on critical
accounting policies, I've recently had the chance
to go back and look at some critical accounting
policy disclosure by companies. And quite frankly,
there is not a whole lot more in those than what
you already get in the footnotes.

They probably, in a lot of cases, don't comply
with what the SEC was looking for in terms of the
robustness. So I understand the benefit of getting
something that says they've got in there what they
need. But I don't see that as a performance
enhancer to me as an investor.

If you want to have the auditor's report on
the entire MD&A, I can see that. But there is
legitimate arguments that we ought to make sure the
auditors get the entire audit done on the
financials right first before we go on to MD&A, and
I would probably share that view. I'd like to see MD&A, but I'd like to get the financials right first. But just expanding it to critical accounting policies, I see absolutely zero, no benefit to that in terms of enhancing the performance of our portfolios where we need it.

So, with that, I think that's it, Marty.

MR. BAUMANN: Thanks, Lynn.

On your comment regarding emphasis paragraphs, the concept that was in the release dealt with a required and expanded use of emphasis paragraphs. So I do acknowledge that they're used very infrequently today, but if it were an alternative or at least the one presented in the concept release is one in which there would be standards written by us, which would require emphasis paragraphs in certain cases.

So, hopefully, that would at least improve that scenario. And as you said, you don't care if you get it from that way or from an AD&A, you want to get pointed to where the critical information is in the financial statements.
MR. TURNER: What I want, actually, I want the critical information that the auditor knows about what the company has already disclosed. I agree with the statements that the basic information about the company should come from management. The audit report is already required to disclose if information isn't there that should be there, and hopefully, they would uphold that standard.

But I want to know the auditor's perspective about the things like what we saw with the valuations at AIG, the Repo 105 transactions. You know, the Greek debt thing was just an abomination, to say the least. The Xerox, the Adelphia. The auditors in each of those cases, the court cases have shown new, very significant information that was very vital to the investors, and they didn't say anything about it.

And when that occurs, that's when, and very rightfully so, investors lose trust and faith in the auditors. And that's what needs to be fixed. And you talk about the emphasis paragraph. I guess my real concern, Marty, is you'll do incremental
change. You'll tweak with the regular opinion some, and then you'll do a tweak on the emphasis paragraph.

If all we do here is incremental change, people will be -- different people will be in this room three to four decades from now, just as we're here three to four decades after the Cohen Commission report, and we'll be having the same debate/discussion again. I know that's pretty common in this city, but that ain't how to fix problems.

And if you want to just say we'll do no harm, that's where you're going to be. If you want to say let's go do something that's right, then you aren't going to have incremental change.

MR. BAUMANN: Thanks, Lynn.

Stephen?

MR. KOZERACKI: Thanks very much for this forum, and I do echo a lot of Lynn's comments and do think that and Vanguard believes that an AD&A would be very useful. And it's very important to get a better understanding of some of the judgments
and assumptions that are made and how the auditors
basically -- especially for some of the big issues,
how the auditors got themselves comfortable with
that.

And there may be some issues, we're dealing
now with some of the liability for mortgage
putbacks on financial institutions, and maybe those
would be very tough for them to get comfortable
with. But maybe they need to -- it would be
important for them to highlight those that would be
very difficult, and what are the big issues and
what judgments were made. And like I said, how
they got comfortable with it.

So, as I said, we're very comfortable as a
firm and think investors deserve more, and the AD&A
would be very helpful and an emphasis paragraph
would be helpful as well.

The rest are sort of my just personal
comments, and some of this is from listening to
people speak. I've never attended an audit
committee meeting, but I've heard numerous times
from some of the preparers and the auditors about a
two-way dialogue and a three-way dialogue and how
difficult that would be to capture in an AD&A.

And, but just listening to it, it sounds like
it's being approached by the parties involved as
more some sort of negotiation, as opposed to, you
know, are they going in there saying, "The audit
committee want a clean opinion, the auditors want a
clean opinion, and the company wants a clean
opinion. And what's it going to take? And what
are we going to talk about, and who's going to give
what, and how do we all get comfortable with it?"

And that just doesn't feel like that's the way
to be approaching this, if that is what happens.
If the approach is more of how are we going to get
the most accurate financial statements and how are
we going to get the most appropriate information to
investors, it seems like the parties would be
coming and the discussion would be very different.
And it wouldn't be a negotiation. It would be
more about getting it right.

Another comment that came up several times,
this talk of close calls. Close calls sort of goes
back to this idea that the audit committee meetings have turned into negotiations. If the AD&A is there and it's present, maybe close calls go away. Maybe then people say this could get brought up in the AD&A. The auditor may disagree on it. It may be disclosed.

So maybe we're going to take a more conservative approach now, and then now you don't have the close calls. And maybe those stop, and maybe those should be stopped.

We've heard a lot also about that it's the responsibility of management on disclosure. But certainly in the financial institution area, we find disclosure is especially inadequate. Going back to one of the large institutions that failed, you can read in their footnotes about owning $40 billion plus in mortgage-backed securities, the average credit quality of which was AAA. Well, I guess that was an accurate statement, but it clearly, you know, was not adequate and in hindsight clearly not appropriate.

I think we found a lot of times also with
financial institutions, management only provides
the disclosure and the insight and their thought
process and judgment when their stock drops
dramatically or their bond spreads widen. It's
certainly not something that they've shown in
history that it's something they do, that they're
forthcoming about unless it's actually being
reflected in the pricing of their securities in the
capital markets.

Another comment was also made about the MD&A
and the AD&A could be very different. Maybe they
could be different, but maybe that would be just
for a period of time of a year or two where some of
these differences need to be worked through. And
when people start seeing that there are
differences, then it would raise some questions
about what management is doing, how they're
reporting things, what their estimates are, and why
is there a big difference with the auditor
assessment of those?

Like I said, there may be this transition
period. There may be a period of time where it
would be tough to work through. But once you got through that, you might actually get much better behavior and much more accurate reporting from the issuers.

Just finally mentioning again, we're dealing with it right now, people were mentioning the sovereign debt issues, what's going on in the mortgage markets. These are issues that are impacting investors. We have seen market values across markets dropping tens of billions, hundreds of billions, in some cases with major selloffs, trillions of dollars.

Investors, who are ultimately the ones paying for the auditor's opinions, I think would be well served with more disclosure certainly on the big issues. And I think having the AD&A there, I said, we might see better behavior from management and more conservative reporting in general.

MR. BAUMANN: Stephen, thanks for those very thoughtful comments.

I'm going to turn to Alan Beller.

MR. BELLER: Marty, thanks very much and thank
you for allowing me to participate today.

A couple of basic principles. Just my perspective on this. I was at the SEC when some of those rules, which we all would like to work better, were put into place, and some of them should work better.

I'm currently a partner at a Wall Street law firm. I do sit on an audit committee of a Dow Jones company, and so that's where I'm coming from.

I'd like to avoid not only unintended consequences, but intended consequences that are unfortunate. I am in favor of changing the pass/fail model. Don't get me wrong. I think there's value in the pass/fail model. We're all prisoners of our past, and I don't want to sit through Enron again. I don't want to sit through WorldCom again, and I don't want to sit through Tyco again.

But there is no question but that the regulators in the profession and the preparers can do better by investors. And there is no question but that investors are demanding that they do
better.

Having said that, AD&A is as -- AD&A, I think, probably means something different to everybody around this table. But at least the way I'm hearing it, which is a fairly broad-gauged attempt by auditors to describe in their own words what they see about the company as a result of the audit process, I do not favor.

Lynn should not underestimate the ability of my profession to turn that into boilerplate.

[Laughter.]

MR. BELLER: It will become boilerplate. It actually will be less productive than some of the more modest targeted suggestions that have been made around the table.

Paul Haaga said let's be modest. I absolutely agree with him about that. I think there are some meaningful improvements that can be made in terms of asking auditors to tell investors more about the things they really know about that could help the process.

Is that a mini AD&A? Is that required
emphasis paragraphs? I'm not really sure I know, and frankly, like Lynn, I'm not really sure I care. But let's take an example that's been talked about a lot and just focus it on critical accounting estimates. That's actually a two-part exercise.

Sam and Marty both have in front of them the accounting release that was issued January '02?

MR. RANZILLA: Close.

MR. BELLER: December '01? There's been a lot of work done at the SEC since then, and there hasn't been any further codification. You really want better disclosure rules around critical accounting estimates, and you want better auditing standards around critical estimates. And I think if you did those two things, you would really be doing investors a service if you then said let's have the auditors tell us what they did to provide better assurance around those numbers and the identification of those estimates than you're getting today would be a huge win.

And Lynn, we might be here 30 years from now debating what else to do. But if you could promise
me that at the end of today, I would be very happy. And I think investors would at least think they've gotten something out of the bargain.

Same issue around uncertainties and accruals and actuarial information and reserves. Some of those, the standards are actually not too bad. But some of them the standards really aren't very good.

In almost all cases, the auditing standards could be sharpened, and you could accompany that with better disclosure. And if you did those couple of things, I really think you'd be on the right track.

Asking auditors to kind of go through the other information that management discloses, you want auditors to second-guess what the company thinks the competition is going to do? I don't. Do you want the auditors to second-guess what inflation rates are going to be in 2012 and '13? I don't particularly. So I'd leave that on the cutting room floor and take what I could constructively get.

Close calls is, I think, a little tricky because what some think of as close calls -- close
calls. If by close calls, you mean what do people on audit committees spend a lot of time thinking about, those are not necessarily the close calls in the sense that management wants to pull one way and the auditors want to pull the other way. Those are the really super important numbers in somebody's financial statements, and they are going to get more attention at a well-run audit committee. And they are going to get more attention in a well-run company-auditor relationship, but they are not necessarily close calls.

And if we start focusing disclosure on "close calls," the issues where auditors and companies push and pull the most, I think you may be shooting at the wrong targets. And so, I don't really think close calls is where you want to go.

Disagreements. A lot of what we've heard around the table, I think is, and somebody said it earlier on, but it's implicit in a lot of what we heard -- especially I think what we just heard -- some of these kinds of disclosure requirements will provide auditors more leverage over management. At
the end of the day, company disclosure will change.
And indeed, company disclosure might change for the better.

And indeed, that's one of the reasons I kind of like the idea of pushing auditor disclosure around estimates and uncertainties. I think your MD&A disclosure on those subjects will get better over time.

But the flip side of that is what has been going on since Sarbanes-Oxley really is, in the majority of cases, I think, certainly the majority of cases I've seen -- I've seen dysfunctional boards. I've seen functional boards. In the majority of cases I've seen, you've really got audit committees trying to do the right thing already, and giving the auditors the ability to push audit committees in a particular direction, the upside is the auditors may get what they want. And I'm assuming that would be good for investors.

The downside is that auditors might get less information than they're getting now. And I think you have to be -- you have to be careful about
that. You have to be careful about that dynamic.

But there are some really constructive things that can be done within the four corners of this concept release, and I hope that the Board continues on its very thoughtful course and gets us there.

MR. BAUMANN: We're getting lots of thoughtful comments to help get us there. Not along the same track, but a lot of helpful, thoughtful comments to help get us there.

December 2003, the release.

MR. BELLER: Oh, that's my -- I wrote that release.

[Laughter.]

MR. BAUMANN: It is. It's brilliant. I agree with that.

We have Wayne Kolins, Larry Salva. Then we better go to Professor Cox before the rest of his table collapses over there. So I want to get you before something else happens.

MR. KOLINS: Yes, thank you, Marty.

I'll be brief because many of the comments I
It's clear that the reporting model has to change, and in my view, the changes have to be meaningful, and they have to be practical. And I think the better approach to go in that direction is through looking at the alternates of the critical accounting estimates and the mandated emphasis of a matter paragraph. And I think much of what is in there could go a long way to fulfilling the investor needs for information about the sensitive areas of the financial statements.

It was also mentioned earlier on as an example of the kind of information, the information in a due diligent report. But it was mentioned subsequent to that initial mention of it was that the due diligent reports are subject to a significant amount of two-way dialogue in a very granular fashion and not the type of negotiation that was earlier described as possibly a way to describe what happens in a discussion at an audit committee level.
Those kinds of discussions are very granular. They're really to get an understanding of what the issues are and not to negotiate the issue, but to make sure all of the facts are considered and the best decision is arrived at.

Thank you.

MR. BAUMANN: Thanks, Wayne. Larry?

By the way, we're running a little bit over the schedule that was on the agenda. But the AD&A I think is one of the most important subjects and, clearly, one of the most critical topics we want to get input on. So I am going to try to get each of these cards that are still up, and we'll just cut into a little bit of what we cover in the afternoon.

But I think this is clearly a critical aspect of the meeting. So bear with me, and lunch will be about probably just 30 minutes later than was on the schedule.

Larry and then Jim, Professor.

MR. SALVA: Yes, thanks, Marty.

And to try to achieve that or facilitate
achieving that objective, I'll also be brief because I guess the benefit of being late in the lineup is many of the comments that I would have otherwise made have been made by other participants.

But I do want to at least anchor mine in some of those prior comments, and that was the observation that it's been 10 years or less that we've had the SRO mandate of audit committees including financial experts and people with financial literacy.

And the other comment, that the idea of the governance structure that we have of the audit committee actually operating on behalf of the shareholders and investors and users of the financial statements. And so, the financial literacy and financial experts, at least my experience, I think that it was geared more mostly toward accounting knowledge, financial knowledge of accounting matters. It does extend into audit matters when necessary.

But I question whether, as Gary said earlier,
the ordinary investor, who is the ordinary
investor? And I think a lot of the calls for
increased information is coming from investors that
do maintain a fair level of financial literacy and,
in some cases, may actually run to audit literacy
besides just accounting literacy and accounting
expertise.

So my concern, especially with an AD&A, if it
were to get into areas of specific audit procedures
and specific findings, I believe will serve to
confuse rather than inform the "ordinary investor."

It may help sophisticated investors that have
audit knowledge and detailed accounting knowledge.

But I'm concerned that it may, in fact, widen the
expectation gap rather than serve to close it.

So Sam made the point before about the
fundamental concern here may be that there's a
distrust of either management or maybe it's
certainly management, because if you don't trust
the audit committee to do what it's supposed to do,
then there must be a distrust of management doing
what it's supposed to do, which is prepare accurate
and timely financial information for the market.

I'm in favor of more modest change. I do absolutely believe that change -- that improvements can be made, but I believe the changes ought to be more modest, as have been suggested by some other commentators, and that they should be focused more on what appear to be the areas that were the concerns in like the critical accounting judgments and estimates.

Some of the companies that have been mentioned clearly were either business failures and/or audit failures. But the majority of what goes on in public reporting are neither of those. And I'm kind of against writing rules to try to prevent that 1 or 2 percent of kind of the bad reporting that occurs or the audit failure that occurs. It's going to burden a system that is, I believe, already burdened significantly in terms of time and cost.

I absolutely believe that audits have value, and I might even believe that -- and this is where I shouldn't get quoted -- that maybe they are cheap
in comparison to some other things that companies pay for, especially legal fees, which I don't see negotiated quite the same way that audit rate per hour fees are negotiated.

But they add tremendous value. But to the average investor, it's very valuable, I believe, to have a pass/fail opinion. It can be supplemented and should be supplemented, as is suggested in the financial reporting or the codification. But I also believe that if you read those specifics, they are rarely complied with by registrants in terms of getting into ranges of estimates or sensitivities or what-ifs in the critical accounting judgments and estimates.

That would be a major improvement, I think, if auditors were involved in looking at that and required to report on it potentially in an emphasis paragraph.

MR. BAUMANN: Thanks, Larry.

Professor Cox?

MR. COX: I'm going to hang on to my microphone because I'm not sure Mark isn't going to
stretch his legs one more time here. So I'll grab it.

I want to just echo the point that was made by a couple others. One, whatever we do, we should probably identify just particular areas. And whether that's going to be in the AD&A or emphasis paragraph may depend on the item, but I don't think it really matters at the end of the day.

But one item I was going to emphasize was something that Jack and Paul had mentioned earlier, and that is I think there is a lot of information, at least on the audit committees I've been on, where -- that's imparted where the auditor comes in and says this is the normal area of reporting on the audit risk. But in this environment we're in, we have a new one.

You can think about relational transactions. You can think about acquisitions that were carried out. You can think about volatility, and I think that, in and of itself, has a good deal of information associated with if it's shared with investors. And I don't think you have to go the
next step and identify to investors the procedures that are going to be used necessarily to go at that. But I defer to others on that, but I think that just identifying those risks are enough.

And then I wanted to relate that to something that Stephen had mentioned earlier, and that is how the impact of disclosure on managerial and oversight decision-making, and that's from some personal experience. And that is I had the great professional pleasure of overseeing the investigation, internal investigation of the largest financial fraud that was carried out in the 1990s.

And one thing that was going on there, much to my surprise, was known by the auditors and known by the audit committee, each of the members of whom I investigated, but never shared with the investing public. And that is the fact that they had carried out a number of acquisitions in which the reporting systems were not compatible, and it enabled this company in a very short period of time, which had a global network of over 30,000 employees, to make
I'm sure that one out of every four paychecks that were sent out -- not just once, but repeatedly -- were the wrong paychecks for the wrong amounts. Okay, that's how bad the accounting system was.

And I always wondered that if there had been disclosure of the risks, which were identified by what was then a "big five" accounting firm going forward, whether that would have changed a lot of the behavior in the organization. I don't know. That's a jump ball.

But I can certainly say that individuals buying this Fortune 100 firm would have thought about it a lot differently if the information that was within the audit committee and in the accounting suites of that firm was made public.

MR. BAUMANN: Thank you.

We have Chris Spahr.

MR. SPAHR: Hi. Thank you.

I've been covering U.S. financial companies for over 10 years with Mike Mayo. We've had many public battles on accounting issues with some of the largest global financial firms. Not once have
we looked at an audit report. We don't find them very helpful. We do appreciate the audit process and the stamp of approval of pass/fail, but we don't find the audit report itself as a useful tool whatsoever.

So we endorse what Lynn recommends with the AD&A, and I have some more specific suggestions I'll have for later panels.

Thank you.

MR. BAUMANN: Thank you.

Mike Gallagher, Doug Bennett, Joan Waggoner, and Mary Hartman Morris gets the final word.

MR. GALLAGHER: Thanks, Marty.

I want to thank Joe Carcello first. Out of all the quotes he might have chosen, he chose two PWC chairmen. So, Joe, thanks for that.

[Laughter.]

MR. GALLAGHER: In all seriousness, I think the comments of Sam and Dennis really demonstrate the mindset of the profession in wanting to be constructive, and I think that we clearly have an interest in doing that, and it gets to the
relevance of what we do in the capital markets.
And so, I think that quote and that comment could
have come from any of the firms because I think
that's the spirit with which we got into this
dialogue.

I also think it's the spirit with which we
responded in the June 28th response to Marty and
team, and I'll echo the compliments of a very
thoughtful process. We, as a profession, have been
thinking about this and working pretty hard over
the last year.

And again, the spirit with which we provided
those comments were we realized that change needed
to happen. We need, in order to be relevant, to
better accommodate the needs of our ultimate users.
And at the same time, it's got to be with the
appropriate balance, looking at the end game, not
just good intentions in terms of what might be good
and what people are asking for necessarily.

Without looking through the lens based on what
we know about what happens on the ground in terms
of practicality. You know, what are the issues,
and how can we do it? How can we move the ball in a positive direction without potentially doing damage? All good intentions aside.

So that was the spirit with which we provided our comments. We are learning. We continue to learn. I think the dialogue we're having today will continue to inform our views as they evolve. I think it's been a good dialogue.

I won't reiterate all the reasons why I believe the alternatives that we put forward are better than auditor discussion and analysis. I think Sam hit a few of them. I think Bob Guido's point about diverting effort towards as opposed to spending the time on meaningful auditing I think are a couple that really resonate with me.

Speaking of audit committees, I guess I would challenge the notion that an audit committee is a negotiation. I've been involved in a lot of audit committee meetings over the years, and I never viewed any of them as a negotiation. It's a great dialogue. It's a great discussion.

The audit committees have the responsibility
for overseeing financial reporting. I think the quality of audit committee performance over the last -- since Sarbanes-Oxley has improved dramatically. Now that we have independent directors, I think they take their roles very seriously.

And I also agree with the point that some are certainly better than others. But the quality has improved dramatically, and I think undermining audit committees is a danger here and is part of the ways that we might do damage if we're not careful.

And if you look at what we've discussed with audit committee, there are very substantive issues around the quality of financial reporting, recognizing that in many cases there are alternatives, not necessarily one being better than the other. Many cases, you have multiple alternatives that two people could have very different views around preferability. And those are good discussions with audit committees.

And the last part about audit committees is
one of the most valuable pieces of the audit committee in my mind, audit committee meetings, is the private session, where an auditor can have that discussion with the audit committee without management and have a real candid dialogue around what we think and hopefully informing the audit committee's mindset in terms of carrying out their responsibilities for oversight.

So, again, I appreciate debate. I think this is a great -- for the profession, this is a great thing. The fact that we're talking about the value that we can bring to the market. I appreciate Ann's comments acknowledging the value that can come out of the audit.

We will continue to look for ways that we can better meet the needs of investors and do it in a way that, hopefully, is balanced and really does achieve the outcome.

So thanks, Marty.

MR. BAUMANN: Thanks. And we appreciated very much the receipt of the letter that you worked on so hard, and others in the profession, from the CAQ
that not everybody in this room would agree with your position on the AD&A, but the thoughtfulness of the letter and the timeliness of putting that out there as a strawman was very helpful, I think, for us. So we appreciate your participation in that.

I think I said Doug and Joan.

MR. BENNETT: Thank you, Marty.

And I'll be brief because many, if not most of the comments that I would make have already been made by my colleagues previously.

But I wanted to emphasize one or two of the points that have been touched on earlier and put this in the context of what troubles me most about AD&A. And that is the notion that -- and I certainly appreciate the fact that investors are looking for additional information. Auditors have information, and is there a way that that can be communicated so that it's meaningful and helpful to investors?

I think that there are ways to do that, and as many have pointed out, I think we'll get to those
this afternoon. But in the context of an AD&A,
I've heard discussion and a desire to just tell us
how you get comfortable with those difficult
estimates or those numbers that are the riskiest
elements of the audit.

And one notion was that, well, we as auditors
have to compose and draft an end of engagement
completion document, which we do. And just give us
that information and put it in a form and context
that the investor could understand.

And I would find that extremely difficult to
try to communicate what my audit team, as skilled
professionals, trained professionals with years of
experience and training, and try to condense that
and communicate that in a document to investors
that don't have -- and the comment has been made
that there is a two-way communication and
opportunities with audit committees to have that
communication.

But without that ability to have some back and
forth discussion and explain what was done, what
the auditor views were, I think, it would, in my
view, be nearly impossible to condense that into a document that could be made a public document.

Thank you.

MR. BAUMANN: Thank you. Joan?

MS. WAGGONER: Well, again, thanks, Marty, for the invitation today.

My firm has a practice in smaller issuers. I have been listening with great interest to the comments today and again will try not to duplicate other comments that have been said that I agree with.

But one of the things that has occurred to me as I've listened today is I've heard how important to investors are the unbiased viewpoints of the auditors. And one of the things that I worry about, should we move to a model of reporting that allows auditors' views to be introduced such as AD&A, that we would be introducing perhaps an element of bias.

And it would seem to me that in the financial statement process, there needs to be someone or a party, such as the auditors, that remain purely
objective and unbiased and are truly the attesters, rather than moving into the preparer role.

I've also heard various examples of places in the statements covering estimates where auditors' insights would be especially helpful in terms of some context around those estimates. And it strikes me that management is really in the best place to put forward the public description of how those estimates were derived and whatever context is included in the required disclosures.

And should they do so, the auditor can then or could, as the model changes or doesn't change, could attest to those and stay, again, pure to the attest role that the auditor is in.

I do agree with Mr. Elson's remarks that I worry about the undermining of the audit committee, but also, even more than that, I worry about undermining the responsibilities that the preparers themselves have for the financial statements.

Thank you.

MR. BAUMANN: Thanks, Joan.

Gary, is your card still up?
MR. KABURECK: It was, but --

MR. BAUMANN: Since you -- why don't you go ahead, and then we'll turn to Mary Hartman Morris?

MR. KABURECK: Okay. Thank you. I'll be quick.

But I've been reflecting all morning on what I thought was a great discussion about I keep going back to the concept of close calls here and began thinking about how would you actually write the guidelines when an audit standard or how would the firms operationalize it?

Just give some really quick perspectives of it is I think the most the Board could perhaps do is write indicators of when a close call would be required. I'm assuming you would be required to disclose close calls in the MD&A. That's the premise of where I'm starting from.

I don't necessarily accept that we should be there, but assuming we are. How would you write boundaries or guidelines for the auditing firms to apply? I still think it would come down to a series of judgments, to judgment with some perhaps

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indicators, indicating when you should or should not consider it.

So I think that's the first thing you need to come up with. What is the boundaries of when a close call would be deemed to be a disclosable event in some capacity?

And then I started going through. I've been involved with a lot of close calls over the years, both as an auditor, as an audit committee member, and in my own company. And a lot of times, I think close calls come down to it's not all that necessarily close in the way that perhaps really seasoned financial regulators might see it. But it comes down to the experience and the skills of either the audit partner or the audit firm or the management of the company.

I mean, I've seen it go both ways, where stuff we thought was a close call and the auditing firms did not, and the reverse is, of course, through stuff we thought was a no-brainer to do it this way, and the auditing firms thought it wasn't quite so clear. So I just wanted to sort of keep that in
mind that some of this stuff will down to the experience and skill sets of the players that are doing it, as opposed to really and truly being a close call.

My third point is that if you're going to write guidelines on close calls, recognize close calls do not always necessarily indicate high risk. And I think high risk is perhaps the more prevalent or perhaps the more important issue to be concerned with. Because a close call doesn't mean it's a wrong call. It just means it's a close call. But I think just don't lose sight of close calls and high risk are not necessarily synonymous.

And then, lastly, I would say close calls, one size does not fit all. So let me sort of explain what I mean by that. I mean, there is estimates and there is judgments where there is recurring estimates, say, your bad debt reserve. And a close call in there may be a range of estimates -- I mean, in theory you've got the critical accounting policies disclosures to handle something like that.

And then there's what I'll call a transactions
close call, where there's a structured transaction. And anybody that works in real estate knows that minimum lease payments are 89.9 percent of the deal. You do not have a capital lease.

Well, you understand the rules, but you move 5 basis points on your assumed interest rate, all of a sudden, you're at 90.1 percent. So is that a close call or not? Maybe it is. Maybe it's not. But it's an established type of structure.

Then there's new structures no one else has ever seen before, the first time an investment banker created it or whatever. And again, maybe it's a different set of close call disclosure guidelines criteria.

So I'm just using those as examples that, basically, the point is one size does not fit all. So as you're trying to write guidelines and your future standards, just to sort of be mindful of that.

MR. BAUMANN: We are very thoughtful of the fact of writing whatever standards we write here will be a challenging task. And certainly, the
chief auditor will need the talents that we have in this division to the greatest extent possible.

Mary Hartman Morris, you have the final word on this subject. So we'll listen very carefully.

MS. HARTMAN MORRIS: Thank you, Marty. I really appreciate being the closer today.

A couple of things. Thank you, Chairman Doty. Thank you, all the Board members. Thank you, Ann, for your thoughtful comments as well, and Steve Harris. I think many of the comments today from all of you were very important to all of us, as an investor.

I know, Kevin, you mentioned that 800-pound gorilla, I thought you were talking about CalPERS, but from that perspective --

MR. REILLY: Not specifically.

MS. HARTMAN MORRIS: But from that perspective, I am here to present CalPERS viewpoints. I think the big point that was brought up earlier was we are capital providers, and I think the audit report is for the customer. So we are the customer.
And so, I think there's a couple of things, just a couple of things I wanted to go through, and there was just five areas. Some of the things about why it is our view from why we want an AD&A. Again, who is the customer?

A little bit, some of the questions that you brought up, Sam, about the confusion. And then -- or maybe that wasn't you, but someone else from investors. And then the fiduciary responsibilities of audit committees and whether or not we trust or mistrust them. And then, of course, the strengthening of the role of the auditor.

So just really quickly, I think it was brought up by Joe earlier, too, the Investors Advisory Group, Anne Simpson, our senior portfolio manager sits on that, and we were talking about the financial institutions, and she quoted we lost something in the order of $70 billion because of the crisis. And those companies at the heart of it had clean accounts and auditor's reports.

Every year, the audit report was the same with an unqualified opinion. The opinion was the same,
but, well, Jack, maybe they didn't increase as much. But the fees increased each year.

For a fund like CalPERS, the loss affects ordinary people's lives and the pensions they receive. So I think that is the reason why we support an AD&A. We think that there is some value.

I think someone mentioned, too, that we were looking for forward future statements, looking for statements. And we're not. I think the four keys areas even mentioned through the ACAP -- key financial statement and audit risk the auditor has considered when conducting the audit and the extent of how the auditor addressed those risks; the auditor's assessment of the key estimates and judgments made by management and how the auditor arrived at that assessment. What keeps him awake at night.

The quality of the accounting policies and practices adopted by management. So you do have the expertise there. And accounting applications and practices that are uncommon to the industry.
You have that viewpoint. You go across industry.

We'd like to understand that.

And then, of course, unusual transactions and
significant changes to accounting policies. Many
more. I think I agree with Lynn. There are some
other areas, but I think those are the top four.

I think that we really believe that it's an
important -- there is some things on a -- it's
about governance. It's about transparency. So I
think, Professor Cox, you mentioned it was a
breakdown of governance. So I think that asking
auditors to step up to the plate is asking for
better governance.

I think that it is a communication tool, and I
don't necessarily agree with Mark. I don't think
we can live without it. I think we've gotten at
this point in our review, in our investments, I
think that it is important that we move to an AD&A.
And I don't think the common investor, the initial
investor, the institutional investor, I don't
think, and I agree with Flerida, I don't think will
be confused.
I don't think that -- there was some issues. I think there was some question about does CalPERS have any -- a question about the inconsistencies, if there were competing viewpoints. And I don't think that there would be having inconsistent or competing information between the auditor and management is necessarily an issue.

Shareowners, which we are, are the owners of the company. And obtaining both management and the board's perspective, along with the independent auditor, a third-party, independent person or group, would provide a better understanding from different perspectives for the stewardship of the company. I think that's the important point. The stewardship of the company.

And I think that, one last point, and no one has really talked about it. But I think it's whether or not the auditors work for their owners, the investors, and how they're paid. I think that's something that's held for a different point. I mean, I know you can't bite the hand that feeds you.
But I think it's really important to know that an AD&A would help, I think, strengthen the role of the auditor, be able to work with management a little bit closer. And I think that the audit committee, we do believe that they do have fiduciary responsibility to the investors.

But again, it's not asking and it's not that it's mistrust. We speak through our engagement process at CalPERS. We talk to many audit committee members, and we respect and understand their viewpoints. But it's also respecting and understanding the viewpoints of the external auditor as the independent party.

So I think it will strengthen the role, and I appreciate the opportunity.

Thank you.

MR. BAUMANN: Thanks, Mary, very much.

And thanks to all of you for a very energetic and informative morning. We've received a wealth of information from you on your views about the auditor's discussion and analysis, its benefits, and the views of some, its potential shortcomings.
We'll study the transcript thoroughly and dig into your comments and continue our research in this area. And again, appreciate tremendously the quality of the comments we received this morning.

We're going to break now. Our lunch for the participants is out in the foyer. And we should try to return promptly by 1:15 p.m.

Thank you very much.

[Break at 12:21 p.m.]

[Reconvened at 1:21 p.m.]

MR. BAUMANN: Okay. Thank you. We will begin the afternoon session. Thanks again, everybody, for the level of energy and involvement this morning. And hopefully, we can keep it up for the next couple of hours.

We're going to turn our attention right now to the -- another alternative for improving the auditor's reporting model, discussed in the concept release. And that is the required and expanded use of emphasis paragraphs.

It was mentioned a number of times this morning, that -- that is, another possible approach
could require auditors to point investors to the most important aspects or greatest areas of judgment and uncertainty in the financial statements, and some have said maybe not as good as the AD&A, from the investor's side. But maybe it has the potential to do that.

Some of the questions, again, we'll -- we'll want to address, but when anybody wants to comment on this, please feel free to look at the questions or -- or not, but what specific information should the required and expanded emphasis paragraphs include regarding the audit of the company's financial statements, regarding the audit or the company's financial statements?

What is the appropriate content and level of detail regarding the matters presented in required emphasis paragraphs?

And again, what are the potential benefits and shortcomings of implementing required and expanded emphasis paragraphs?

As I mentioned earlier, we've asked a couple of participants to kick off this discussion, Joe
Carcello and Kevin Reilly. And I guess, from Joe's perspective -- and Joe you -- I'm sure you'll add whatever color you'd like.

But I was hoping you could touch on, as somebody who's a supporter, as you articulated this morning, a supporter of the AD&A as the tool to improve auditor reporting, could you see the emphasis paragraphs work? And -- and if so, how, or if not, why not?

Then, Kevin, in the letter that the CAQ sent to the PCAOB, in the comment letter, that did include some examples of emphasis paragraphs.

And I guess I'd wonder, from the profession's point of view, what your thoughts were in terms of how we could require those and what kind of boundaries we could put on those to -- so they wouldn't turn into a listing of boilerplate paragraphs, but -- but could actually work in a meaningful way, if you've given any thought to that.

But again, please feel free for your comments to go whichever direction you'd like them to, so
let me kick it off with Joe Carcello.

MR. CARCELLO: Thanks, Marty. So Marty asked me to introduce this topic, so let me -- let me go ahead and do that.

One of the proposed changes to the standard audit report would require the use of emphasis paragraphs in all audit reports.

In addition, according to the Board's concept release, these emphasis paragraphs could be expanded to, one, highlight the most significant matters in the financial statements, including identifying where these matters are disclosed in the financial statements, two, discuss significant management judgments and estimates, areas with significant measurement uncertainty, and other areas that the auditor determines are important for a better understanding of the financial statement presentation, and three, with respect to those significant matters discussed in an emphasis paragraph, including judgment, and estimates, and areas with significant measurement uncertainty, the auditor could be required to comment on key audit
procedures performed, pertaining to identified matters.

Before considering the potential merits of requiring an expanded version of emphasis paragraphs, let's take a brief look at how these emphasis paragraphs are being used today.

I examined the most recent audit report for every company in the S&P500, which represents a meaningful percentage of the total U.S. stock market capitalization. Only 5 of these 500 audit reports contained an emphasis of matter paragraph and 2 other companies had what I would consider an "other" paragraph, basically in -- explaining why they didn't audit equity-method investees.

More troubling than the base rate of inclusion of emphasis paragraphs, 1 to 1.5 percent, was the limited nature of these paragraphs, both in the substance of what was discussed and the lack of detail and transparency with -- with which these matters were discussed.

These five emphasis paragraphs discussed, which to give you something fun to do and that no
good academic would come without, handouts, I've made copies of these five reports. And I've highlighted in yellow the emphasis paragraph, so you can kind of read along with me.

So these five emphasis paragraphs discussed, which are being distributed to you now, number one, the recapitalization of AIG by the Department of the Treasury, the Fed, and the AIG Credit Facility, this was one sentence, three lines.

Two, changes in Morgan Stanley's fiscal year-end, from November 30th to December 31st, this is one sentence, two lines.

Three, allocation of overhead costs from EW Scripps company to Scripps Networks may not be representative of actual costs that would have been incurred by Scripps Networks had it been operating as a standalone company. This was three sentences and seven lines.

Four, similar issue regarding the allocation of overhead costs for a former unit that has been spun off, two sentences, four lines.

It is interesting to note that the last two
emphasis paragraphs were both issued by the same firm, and it is also worth noting that four of the five emphasis paragraphs were by one firm. And the report language, although similar, was not identical.

And the last emphasis paragraph was the announcement of a definitive agreement to acquire all of the outstanding shares of common stock of Marshall & Ilsley by the Bank of Montreal, one sentence, four lines.

If my friends at the PCAOB and at the firms view these as informative audit reports, we are using two radically different dictionaries. So to meet the needs of investors, emphasis paragraphs would have to be used very differently than they are now.

How might this be done? To meaningfully improve the audit report, emphasis paragraphs would have to provide the type of information needed by investors.

First, the emphasis paragraphs would need to discuss significant risks identified by the auditor
and how the auditor's procedures and results of these procedures were responsive to the identified risks. AS number 12 provides the auditor a framework for identifying significant risks.

Second, at a minimum, the emphasis paragraphs would need to identify significant estimates and judgments in how the auditor evaluated the reasonableness of these estimates and judgments. SEC guidance exists to identify significant estimates and judgments.

Third, at a minimum, the emphasis paragraphs would need to discuss significant unusual transactions, how these transactions were audited, and the results of these procedures.

Notwithstanding what Sam said this morning about lack of compliments, here's my second compliment in one day. I was pleased to see that, in the CAQ's June 9th comment letter, on the second line of item two on page four, that unusual transactions would be discussed in a revised audit report with required emphasis of matter paragraphs.

Finally, the emphasis paragraphs would need to
discuss alternative accounting treatments,
discussed with management and the audit committee,
the ramifications of selecting one alternative
other -- over another and the treatment preferred
by the auditor.

    Again, there is SEC and PCAOB guidance on how
the auditor currently discusses these matters
internally.

    From my perspective, although I prefer an
AD&A, the key issue is providing investors with the
additional information they need, whether that
information -- whether that additional disclosure
is in the form of an AD&A -- AD&A, required
emphasis paragraphs, or in some other manner,
because in my view, today's audit reports are
clearly not informative, which is at odds with the
PCAOB's mission statement, to provide informative
audit reports to investors.

    MR. BAUMANN:  Thanks, Joe.  Kevin?

    MR. REILLY:  Yeah.  Thanks, thanks, Marty.
And Joe, I do want to point out that, at lunch, I
learned that today is Sam's 39th birthday, so I
want to commend you for actually giving him two birthday gifts today, so happy birthday, Sam.

[Laughter.]

MR. REILLY: All right. Let me -- I just want to share a couple perspectives with you all on -- on the emphasis of matter approach and I am coming from the -- from the perspective of having been a member of the task force that the CAQ formed to take a look at this issue over the last 12 or 15 months.

But you know, in general, we believe the required -- key word there is required -- an expanded use of emphasis of matter paragraphs is a viable approach that will be helpful to investors and could be implemented by auditors on a practical and cost-effective basis.

As I mentioned, we -- we -- and as has been raised before, we suggested this type of approach back in June with our letter to the standards group, and we continue to support the approach articulated in that letter.

As outlined in the concept release, we think
the approach could be used to highlight matters that, in the auditor's judgment, are the most significant matters in the financial statements, and identify where those matters appear in the financial statements and related disclosures.

In this way, the approach would draw attention to important items that may warrant further investigation by financial statement users and serve as a pointer to assist users in deciphering the often very lengthy and complicated financial statement packages.

We also think that audit report focus on these areas could also help preparers enhance the level of disclosures provided in those areas.

The approach is not perfect and I'm sure we'll hear a lot about that in a few minutes, but we think it could represent a meaningful improvement to the auditor's reporting model as it currently exists.

So let me just spend a couple minutes and go through the questions, Marty, that the concept released asks. And question five is, what should
be covered in the emphasis of matter paragraphs?

A couple thoughts here -- from a common sense perspective, we think the objective of the approach would be to have the auditor answer the following question. What, in your view, are the handful of most important matters impacting the financial statements this year? That was Steve Harris's thoughtful question that he raised first thing this morning.

Understand, developing a workable auditing standard that will answer that question is going to be a bit challenge -- challenging, but we think it can be done, and I know Marty and his team have been diligently kicking the tires on that front for some time.

But we suggest, perhaps, a two-part approach, and the first would be for the auditor to focus on the usual suspects, a significant accounting policy or practice, a subjective accounting estimate, an uncertainty, an unusual or infrequent transaction, or other event, but then give a highlight in the audit report to those types of usual suspects, only
to the extent that the matter was a significant discussion with the audit committee, it involved some substantial audit challenges during the period, or underwent a significant change during the period.

Once again, there are other ways to slice the salami here, and I'm sure Marty and his group, with the help of others, could come up with other alternatives, but we thought that an approach like that would respond to what we heard from investors, as requiring additional focus in audit reports.

Question six relates to, what type of specific content should be reflected in the emphasis of matter paragraphs? And again, I'm going to sound like a broken record here, but I think the focus of our group is to have the auditor provide emphasis in the context of objective descriptions of the matter, as well as a direction to the reader, as to where those items are covered by the company, in the financial statements.

We don't think that having the auditor provide subjective user impressions on the matter in the
audit report is really a constructive way forward. We also don't think that the paragraphs need to give the discussion of the specific audit procedures that the auditor undertook relative to those matters. As you can appreciate, we find it really challenging to try to distill hundreds of hours of audit effort in a particular area into one, or two, or three sentences in a -- in a matter being emphasized in the audit report.

At the same time, if we went -- and I think, Jack, you raised this question -- whole hog and went through page and page of description of the various procedures undertaken by auditors in different areas, we don't really think that's going to be useful to investors.

So again, we don't think that the description of the specific procedures in each emphasis of matter paragraph makes sense.

However, as we suggested in our letter back in June, we do think that the auditor, at the conclusion of the emphasis of matter disclosure areas, could state and identify that including --
that the -- our audit work included performing specific procedures designed to address the risk of material misstatements associated with the individual emphasis matters, and that such procedures were designed in the context of the audit of the financial statements, taken as a whole, again, and try to connect the dots that way as opposed to a paragraph-by-paragraph description of the procedures performed.

So let me summarize. The net benefits of this approach -- we think -- we think it responds to some of the investor requests for more information and identification of the most significant matters by the auditors in the -- in the financial statements.

We think it may enhance, prepare as focus on these disclosure areas and improve them. We think it retains the established role of the auditor to attest to information provided by management. We think it will avoid some of the unintended consequences that we discussed this morning, relative to the AD&A approach. And we also think
it could be likely implemented in a practical and
cost-effective way.

Shortcomings and challenges -- as I mentioned,
coming up with a framework that will be effective,
that will help develop guidelines for an auditor in
terms of what goes into the emphasis of matter
paragraphs will be challenging. We recognize that.

But we want to make sure that the guidelines
are sufficient so that it doesn't give rise to too
many matters being emphasized, that really will not
be helpful to investors.

I'll also tell you that, you know, we -- we
spent some time looking at the French model, in
which the concept released identifies has been out
there since 2003. The French auditing body took a
-- a review of that approach, and went out with
some questionnaires, and -- and got some
interesting feedback.

And the review was mixed. Some were very much
in favor of it. Others raised issues with the
approach. One of the key issues raised in the
approach was, on the downside, was the excessive
standardization of the disclosures, but we think
that can be worked through, relative to the
approach that is ultimately adopted if we move
forward within this direction.

So again, long -- long story short, we think
this is a constructive way forward. It's one of
the -- one of the alternatives that the CAQ views
as being viable.

And with that, Marty, I'll -- I'll turn it
back to you.

MR. BAUMANN: Thanks, Kevin, and thanks, Joe,
for your -- both of you for your very thoughtful
comments to introduce this topic. Chairman Doty?

MR. DOTY: But, well, Kevin, first -- first,
let me say that over -- over lunch, what I heard
was a uniform compliment of the -- of the
discussion that you all have given us here on all
of these matters. The high quality of what you all
have brought to the table is -- is not lost on any
of us.

And this is -- this is really an informational
point, Kevin. Is what -- as I listened to it, is
this, what you have described -- is this really the French model? It -- if it is -- if it differs from the French model, which the firms have been following now for some time, in what respect does it differ? A pure informational point. It sounded to me as if it was largely the French model. Is it completely? What -- what's the difference?

MR. REILLY: Fair -- fair question, Jim, and it -- it does differ from the French model, which is a justification of assessments. And in that model, they will identify things that I have outlined, relative to significant estimates or uncertainties and the like.

The French model will also go into details relative to what the auditor has done to address the risk of material misstatement in those, in those matters, which as I said, is an area that we don't think, on a paragraph-by-paragraph basis, trying to distill the -- the level and effort of audit work on those areas into a crisp sentence or two really makes sense.

That's where it does, in fact, differ.
MR. BAUMANN: And in looking at the French model -- and I'd looked at a number of financial statements that -- that have -- that had disclosures under those justification of assessments. They typically were pretty much the same.

I could pick up every financial institution and it would say, "See the disclosure on fair values, see the allowance for loan losses," and see one or two other things, similar to off-balance sheet disclosures, which -- and we chatted with some people in our outreach who worked on these, some auditors in France.

And there was some concern that they were becoming rather boilerplate. How could we prevent that from happening, Kevin, or -- or Joe, or anybody?

MR. REILLY: Well, Marty, again -- again, if -- if what we've suggested, which is simply an identification of the -- in the auditor's judgment, the most important matters impacting the financial statements, I, for one, am less concerned about
this boilerplate issue because it -- a judgment is involved in the actual identification on the matters, which we -- we think will be helpful in having investors sort through 200 pages of financial statement data. We're telling the investors -- and, Steve, to your point earlier this morning -- you know, what -- what keeps you up at night?

So I think the importance, Marty, of this approach is -- is in the actual identification of the matters and less so relative to what the auditor says about those matters, because most importantly, if it is a key, critical, important issue, then -- then we have a responsibility to make sure that the financial statements address the material disclosures relative to those matters.

MR. BAUMANN: And I think we could write requirements, as you indicated, or -- or Joe indicated as well, that would link the required emphasis paragraphs to what auditors are required to identify, significant risks in the audit. That's required under -- under our standards.
And to the extent there were significant risks that were identified in the audit, how were they addressed in the financial statements? That would be one way to -- to kind of get at that, and significant and unusual transactions have to be identified. That's another way Joe mentioned as well.

So it does seem to have the potential to -- to put some fences around it, as well as require certain areas. One area where you and Joe differed -- and I just keep this dialogue going just for one second longer. Joe did add that he thought that auditors should indicate, when they identify a significant risk, how they addressed that risk.

I'm just curious, because Joe is as aware as we all are, that the audit includes potentially hundreds of steps and thousands of hours in a particular complex area, like allowance for loan losses or fair value of financial instruments.

How might that be done in a meaningful way, rather than reducing it to some sentence, we tested fair values, which doesn't give investors much of
So I don't know if you have a thought on that. Did Joe or --

MR. CARCELLO: Yeah, I -- I think it would be challenging, Marty. I'm actually working on something now with -- with another -- with a firm to try to do something like that.

And you know, I think it can be done, but it won't be easy. And, you know, at the end of the day, that would be something that, you know, the Board would have to decide. Could they?

If all you're going to end up with -- and I think Kevin's right -- is, in France, the language is so high level, and so general, and so common across different issuers that there's no real differentiation, no value.

And so unless you're going to get some specificity -- but it's going to obviously have to be summarized. It can't be 50 pages. Then it doesn't have value. But I think you probably could draft a standard that would require the auditor to summarize the key procedures they performed in
different areas and, assuming it didn't devolve into boilerplate, you would find differences across firms and across clients.

Now, the firms would probably be uncomfortable with that because they don't really want that. But I think that level of transparency would be very useful to users.

MR. BAUMANN: Thanks. Bob Kueppers?

MR. KUEPPERS: Just before we get deeper into the question, I just -- you know, Joe, thank you for the examples. I'm proud to see that the market is thin, but we've got the major market share of -- of emphasis paragraphs.

I think one of the -- one of the -- one of the points you were making, though, is that this stuff is not all that meaningful. Now, it -- really, you can't tell that unless you see the footnote that's referred to because, if the footnote is fulsome, then you don't have to repeat the language in your -- in your opinion.

I will tell you one I can speak to. And that is, Morgan Stanley changed its year-end from
November to December, and we haven't had a single question about what that means. That one was pretty clear.

But I do think that what's important is, the EOM standard and the lack of, you know, deep practice, is not what we're talking about. We're talking about something where this would be customary. It would be necessary. It would be required, if you will, and you know, I think even using emphasis of matter as a term of -- piece of terminology is a little bit misleading because we all think of, you know, these kinds of examples.

But we're talking about, actually, moving things to the next level. And so we won't know what it really looks like until we begin to work with the Board on it, if -- if you go that way, how -- how it might actually be embodied in a standard.

MR. BAUMANN: Thanks. Sam Ranzilla?

MR. RANZILLA: To -- Marty, to try to address your question of the auditor response -- and over the last 15 months, we have tried to build some models out under an emphasis of matter paragraph or
maybe even other approaches, where the -- where we
would develop a framework where the auditor could
describe its response to whatever the anchor is
that causes you to have an emphasis of matter
paragraph, whether that's significant risk, whether
that's a critical accounting estimate.

Once you've determined what it is that the
auditor is going to emphasize, we've -- we've tried
to -- to develop models. And you know, I'll start
off by first saying, I think when Kevin refers to
the research note that was done out of France in
the -- I think it was excessive boilerplate, I
think that's pointed toward the auditor's response
piece or the justification piece of -- of those
paragraphs, because at least the ones I've looked
at, generally, have -- have evolved to, we came, we
saw, we conquered, and that's the auditor's
response to the particular evaluation issue at
hand.

But when -- when we tried to develop models,
either the -- to try to get something succinct that
didn't -- just didn't overcomment and take over the
auditor's report, it didn't give justice to the level of work that -- that the auditor had done. And in fact, that will become boilerplate, no matter how hard we -- we try, or maybe -- maybe a better word, it will become more standardized over time.

We then took it and said, "Well, okay, if that's not fair to what the auditor did and it doesn't express the -- the absolute depth of what the auditor got into, let's write one that -- that goes into that."

And it was page, after page, after page of description of what the -- what the audit procedures were done, both from a control perspective as well as from a substantive perspective. At the end of the day, we just -- we concluded that neither one of those were -- were helpful.

Surely, though, the succinct model was not giving an appropriate impression. The longer the -- the longer model, people just aren't going to read it. And if you're not familiar and you
haven't been down that journey on that audit, I'm not sure how meaningful it was.

So I understand, Joe, you're working with somebody. I -- you know, we're open to -- to continuing down that, but just to maybe give some background on what -- what we've been doing in trying to -- to develop that model, we've -- we've struggled with finding that, you know, the porridge that's -- that's just right.

MR. BAUMANN: There are some other cards up, but Joe, I assume, was responding back in this dialogue we've been having, so Joe, I'll give you the floor back.

MR. CARCELLO: Thanks. I would -- I would agree with Sam, that this is not easy. Just the little bit I've done so far, I would -- in working with the -- the -- one of the firms, it's -- it's not easy and I'm not sure we're going to be successful. So I'm not -- I'm not surprised that that's their -- the result you've had, Sam.

I think what would be, you know, useful -- and I've tried to encourage the firms to do this, but
they -- they're going to obviously do what they think is in their best interests -- is if -- if when they have these projects on the way -- and they've clearly put a tremendous amount of effort into this in the last 15 months -- if they would pull into their little networks, you know, one or two investors, at a minimum, and then, Sam, when -- if you're reporting out and you're saying, "We did this and it's so high level, nobody can really get anything out of it," or, "We've did this and it's 75 pages, nobody will read it," I'm not saying I don't personally believe you, but it would more credibility, you know, if Mary was part of your group and Mary said that.

MR. RANZILLA: Well, it's always good to know where your credibility lies, but --

[Laughter.]

MR. CARCELLO: Yeah, yeah, well, just because it's a different perspective.

MR. RANZILLA: All right.

MR. CARCELLO: Yeah, it's -- you know, it's an investor perspective rather than an auditor
MR. RANZILLA: I -- I think that that's good counsel. I will say that, before we got too far into the -- into the project, we did meet with a series of investors to try to get a better understanding of what -- what people were -- were concerned about, what were the -- the flashpoints, so that we could focus it.

But -- but you're right. We didn't take the results. We didn't take the 75 pages and three sentences and say, "What do you think? Could -- could you make this work?" And so --

MR. CARCELLO: And you could.

MR. RANZILLA: And -- and -- but Reilly will vouch for me that we actually did it.

MR. CARCELLO: Okay.

MR. REILLY: I -- I can guarantee that we did. And just -- also, just to add some additional color commentary, that the CAQ has also reached out to a number of investors via this future role of audit -- auditor project that they have underway. And I think the feedback that -- that we understand
came out of those sessions was -- was that the investors were really not that fired up about hearing that much about what the auditor did.

They were really keyed into, what -- what's the risk, what's the area, and -- and what is it that, you know, keeps you up at night relative to the issues?

MR. CARCELLO: Kevin, I think, you know, if we go back to this morning -- and I, you know, did the best I could to take notes as people were talking, but obviously I don't have the transcript in front of me -- what I heard this morning was, clearly, some people, and some of the investors, clearly said exactly what you just said.

But I think, if I went back through my notes, there were other investors this morning who seemed to indicate they would find value in more granularity around what the auditor did.

So one of the problems is, you know, auditors are not homogenous and neither are investors, right?

MR. BAUMANN: So Joe and Kevin, I think, are
least reasonably on common ground, as am -- as am
I, that we could probably write some requirements
that could require auditors to point investors to
the most important aspects the -- of the financial
statements, where there's the greatest judgment,
the greatest uncertainty. And that might help
investors as much as the AD&A that a lot of
investors want, but it could go somewhere along the
way.

And by the way, anytime I say anything like
that, don't think that I'm espousing one -- one
version or the other. I'm simply commenting that I
agree that could possibly work, less -- les
agreement on how you get the audit down to a couple
of comments that are meaningful and -- versus a
lengthy discussion.

So with that, a number of cards have been up
and I look forward to your comments. We've got
first three, Larry Salva, Bob Guido, and Lynn
Turner.

MR. SALVA: Thanks, Marty, and just a -- just
a brief comment, just to expand or clarify that the
-- the reference to the emphasis paragraph or whatever paragraph we end up calling it, directing people to where, in the financial statements, these items are discussed or disclosed, I think should be -- we should think broader than that and not limit it to the financial statements, because I think the MDNA is a much more effective communication tool in terms of management getting across certain points that you may not put into footnotes.

So that's the -- the only point is that it -- you know, the auditor does need to read the MDNA under other standards and look for material inconsistencies, etcetera. Management may choose to put a lot more information into the MDNA then into the -- into the footnotes.

And there is a, at least in some sections of the practice, a kind of a hesitancy to refer out of footnotes into MDNA, as opposed to the other way around. So if you just point to the footnotes, they may not get the whole picture.

MR. BAUMANN: Thanks. Bob Guido?

MR. GUIDO: You know, originally, when I read
the information you all produced, I really wasn't
warm to this idea. I lived through, 30 or 40 years
ago, the boilerplate long form reports that we had
in the profession and we blew those up.

But the more I read and the more I hear about
this, I think there's a lot of possibilities here.

One -- one word of caution, if you wait until you
get this all right to get it out, you may never get
it out.

So the only advice I'd have on that is that,
whatever we produce here may not be 100 percent the
right way to go, but it is something that we could
do, and make changes, and modify as we go along.

I think the benefits of this approach -- we're
really going back to what Alan Beller said before
lunch. This could potentially increase the
quality, I believe, of management's disclosures
because of the specific references.

And when -- when I was an audit partner, a
very famous investor, Warren Buffett, on the audit
committee, used to ask me, "Bob, where's the road
map? Where's the road map? Tell me the four, or
five, or six items and this could be our road map."

So with that, there's going to be challenges.

Identifying the most significant matters, I think, will be a challenge to some degree. There's going to be a lot of judgment and subjectivity in that. But I think the way the sample report was crafted probably would -- would take care of that.

I am a little concerned with some liability implications for the profession, but, you know, we could probably work through that, so thank you.

MR. BAUMANN: Thanks, Bob. One thing, you know, if I -- you -- we hopefully don't have to worry about is us not getting it out. I see Steve Harris every day, and can you imagine what would -- my life would be like if we didn't get something out on this?

[Laughter.]

MR. BAUMANN: So there's little risk of -- of that. And yeah, I think -- your other point you made, I'd like to comment on that, too. I think that is a valuable point to make. It's -- some
people say, "Well, you're simply pointing to things in the financial statements."

But emphasizing that in the opinion, one does think that the auditors might do a better job of auditing, though, might do an improved job of auditing those high-risk areas if they're emphasizing that they're high-risk areas.

And one might think that the disclosure that management makes about those high-risk areas might be more robust if they're highlighted as well.

So there can be those other benefits in addition. I would -- I would like to -- sorry to -- to give -- to interrupt the -- the list of people with their cards up. But I wanted to go back with Kevin on one thing.

The -- the mock -- the model report that the CAQ sent in at least looks, to me, like it was more than just pointing somebody towards a particular footnote and not saying anything more about it.

You probably don't have it in front of you, but -- but tell me, Kevin. Am I right in how you approached this? And one example talks about
goodwill of X dollars, and the company performed
ts its impairment analysis, and -- and no impairment
was recognized because they estimated the fair
value exceeded the carrying value at that date.

However, the comparison was close. This --
that's a word like I heard investors say all day
long like that. The comparison was close and a
further decline in fair value of this reporting
unit could give rise to an impairment of the
goodwill balance in the future.

Boy, that sure sounds like stuff that people
were talking about before they wanted. Were you
expecting that, that was in the footnote, that? Or
was that added by you in the mock report as
additional color to the footnote?

MR. REILLY: No. The -- the -- I mean, that's
a fair point, Marty. I think the take-away was
that, that language would -- and that disclosure
would -- would be in the footnotes of the financial
statements.

So again, it is highlighting or giving
emphasis to the goodwill and the related impairment
evaluation as being a critical accounting estimate
and an audit challenge. But the language in there
was -- was essentially taken from what otherwise
would be in the footnotes.

MR. BAUMANN: The company actually would --
said it was close.

MR. REILLY: Yeah, yeah.

MR. CARCELLO: Marty, can I ask Kevin a
question? Because that's the one I -- I -- that
was my first compliment this morning. And -- and
Kevin, I think --

MR. REILLY: And now, you're going to take it
away.

MR. CARCELLO: No, no, I'm not going to take
it away.

[Laughter.]

MR. CARCELLO: I mean, yeah, I -- but I --
that's what I thought was really very, very strong
in your letter, so let me understand, because I
think Marty's question is an excellent question.

If a company didn't put that in the note,
Kevin, and -- but you concluded, as the auditor,
that it was close, you're going to stay silent? Because that's the problem. That's the essential problem.

MR. REILLY: Look, Joe, I don't -- please don't read too much into the -- to the examples that we -- we put into the letter. I think they were put -- put there for illustrative purposes.

But I would tell you that, you know, as -- as we kicked around the issues as auditors, and -- and we were looking at a situation where a company was doing a goodwill impairment analysis, and they were on the rivet, relative to the comparison of book value and fair value, you know, we would scratch our heads saying, "Well, that -- that's something that we would expect that would find its way into the footnote disclosures."

MR. CARCELLO: Okay.

MR. BAUMANN: Thanks. Lynn Turner?

MR. TURNER: Thank you, Marty. I think you raised a good question with respect to the example. And again, I think it's the informational content here that is important, not whether it's in an
emphasis or AD&A. What an investor needs, if we're going to pay for this, is additional information that will be useful and valuable to our bi-cell analysis as we try to actively manage a portfolio.

It's not so much important to the indexers, but for active managers, which I think is going to be a much more important role going forward in this economy, it's important that they get information that can actually add value and informational decision points in the active management.

What I heard Kevin say was, "The CAQ and the firms are proposing that they would give, in essence, investors a table of contents to what's in the financial statements and asterisk the points that they really want to make sure you read."

So we'll tell you, just as in the examples that Joe handed out, as described in note one to the consolidated financial statements, well, that doesn't add any informational content, to me, as I'm analyzing a company and financial statements.

And so the benefit of that would be zero. I don't need another table of content. I don't think
the CAQ -- while they say they really want to make
change, I think that's wordsmithing, because I
really don't think they want to make change. I
think they want more of the same with the current
emphasis paragraphs.

I think we're looking for that additional
informational content that you just highlighted
with your question, Marty, with respect to what was
in the example.

Not only do we want to know what were the --
the big ticket items, as Kevin said, Kevin said
that when they met with investors, they wanted to
know what keeps the auditors up at night. That's
the informational content that can help us with
investment decisions. That's what's in that
completion memo.

That's not what's in a table of contents. A
table of contents, the proposal that Kevin just
described, would be of no value whatsoever. I can
already just read the footnotes and get the
information.

The only thing that he adds is an asterisk to
a table of contents that says make sure you really read this footnote. So I see very little value, whatsoever, with respect to that proposal and see no value being added, in terms of information I need to make a better informed bi-cell decision.

MR. BAUMANN: Thanks, Lynn. We've got Mark LaMonte, Gary Kaburek, and Steve Buller.

MR. LAMONTE: Thanks. I'm going to agree with Lynn and disagree with Lynn in my remarks. I am enthused that the -- the firms seem to be getting behind this a little bit and I think this does have an opportunity to provide valuable value to the financial saving user.

I spoke earlier this week at the AICPA banking conference on loan loss disclosures. And one of the things I highlighted in my -- my slides was the proliferation of disclosures in recent years. If you look at the 10ks of the big four U.S. banks, they've gone from an -- on average, 141 pages in 2003 to 276 pages in 2010. And then you look at a firm like AIG, their 10k this year was 482 pages.

The only people actually reading these entire
documents are some lawyers, some folks in the accounting policy shops at the companies themselves, and the auditors. Investors are getting out commentary on earnings or making decisions shortly after these annual reports come out and they have no ability to sift through all of this information.

We need that road map that Bob referred to. We need to know what the three or five key things that we need to read in those 300 or 400 pages are. And I think Larry's absolutely right. You can't stop at the footnotes. You also need to reference the MDNA.

I think you'd probably be referencing both the footnotes and the MDNA with an individual item. Where I think this could add value beyond just being an additional table of contents that Lynn was referring to is, you not only need to tell the investor what footnote to read, the auditor ought - - should also be saying why they think this is critically important to an investor's potential understanding of this entity, so not just pointing
to where it is, but why you should read it, why
this information is critical to your understanding.

To go to some of Joe's comments earlier, I
don't think a lot of investors or financial saving
users are going to be all that interested in audit
procedures behind these critical areas. A lot of
investors -- I mean, you have a lot of poets with
MBAs and they're not all that interested in
auditing procedures. You don't have a whole lot of
former auditors or accountants out there in
investing, so they're not kind of junkies of audit
procedures or -- or what they mean.

There is one time where I think it would be
very valuable to understand the audit procedures.
And that is when there is a material weakness
reported in the other reports that auditors are
writing, and there's a reference to that material
weakness in the audit opinion. I think it would be
critically important for investors to understand
what incremental audit procedures were performed
for the auditor to get comfortable with that area
where there was a breakdown in controls.
Beyond that, though, I wouldn't be all that excited about knowing about the audit procedures. Thanks.

MR. BAUMANN: Thanks, Mark. Thanks for those comments. Gary, if you don't mind, can I keep your card up for a second? I was going to ask, if you don't mind, if I defer to the SEC and let Brian Croteau -- Croteau put his card up.

MR. CROTEAU: Thanks -- thanks very much, Marty. I guess mine was really a -- a question. Again, without sort of passing judgment around any particular model, it -- it seems to me, from some of what I was hearing, perhaps the power in the emphasis of matter idea comes from the criteria that one would use in determining what to put in an emphasis of a matter.

So if it -- it were truly something that were just, you know, find the 10 largest numbers in the financial statements, anybody can do that and there's no magic to that. But I think what Kevin described in terms of the discussions with audit committees or the extent of procedures the auditor
performed, if there's some amount of judgment in
determining what to put in an emphasis of matter,
which items to select, I -- I wonder if people find
benefit in -- in that to some extent.

Certainly, there may still be limitations to
the extent which -- which one finds that useful.
But to me, sort of the question around what the
right criteria would be to begin with in making the
selection of the items to emphasize might be the
important part of -- of this particular suggestion.

So I guess --

MR. BAUMANN: I agree. The criteria, I think,
is very essential. Thanks, Brian. Gary?

MR. KABUREK: Thanks, Marty. A couple of
comments, just sort of listening to this dialogue,
and I want to go back to one of the opening
comments. I had made my remarks this morning, but
I just listened to, you know, the relative merits
of the French model versus one or two sentence
saying, "We verified fair value," I think, was the
example.

I think that just goes back to -- the point
is, I think the Board needs to decide what level of what knowledge should be assumed by the -- the majority of the financial statement users, because if you assume they know very little, the French model looks pretty good. If you assume they're reasonably knowledgeable in accounting, and auditing, and the similar, well, maybe just saying, "We emphasized fair value testing," is sufficient. So I think -- I do think we need to wrestle that one to the ground.

I think, you know, a couple of corporate professional groups that I'm associated with, I think in general, are supporting the emphasis paragraph approach, you know, provided you keep it to, you know, objective stuff and focusing on accounting policies and the estimation process, you know, the important areas of audit focus. I think we can easily get our mind supportive of that.

I think I want to echo Larry and Mark's comments about -- that you should be -- MDNA should be available, you know, for reference in the auditor's report. If that's the direction you go,
I'd probably take it further and go to the item one, you know, business description, or risk factors, or almost anything that's in the file document.

I will tell you, my experience trying to even have any footnote -- having a sentence say, "See the MDNA, this page, this paragraph for more details," has always been a problem with the audit firms I've been associated with. He said he got me auditing the MDNA. I says, "No, I think all your auditing is -- on that page in that paragraph, there's more information," you know.

So I think you need to wrestle, you know, linkage to the MDNA inside the audited statements. I think that's a narrow one that can be solved.

The -- I think -- and I don't know. Most of the time in these meetings, these usually -- I've usually -- when I've had a problem, I usually suggest an alternative. This one, I actually don't have one.

But when I think about the 10k process, I mean, it's -- you file your statements in, I don't
know, say mid-February. Meanwhile, you're talking about events up to 14 months earlier. And to say, "Here's my audit processes in the critical areas," that's nice, but that's past news.

The question is, how do you keep that evergreen, you know, going forward? And just, when the audit emphasis areas change, I mean, should there be some sort of reporting mechanism to communicate that before 12 months later in the next MDNA or in the next 10k?

And I don't have a solution and I don't even know if it's a great idea. Well, of course, it is. I suggested it. But the -- but I think you should -- is there a way to, when audit emphasis changes significantly during the year for unobvious reasons -- it's one thing to make a big acquisition. I mean, I think the world understands you're doing something.

But how would you update that you're changing your emphasis? And again, maybe staff work, you'll conclude, is just not a good idea. But it's something that occurred to me.
And then so my last thought -- and I'm going to say it now; it's a little out of place, but I might not get a chance later -- is, I'm looking at the four areas of, you know, emphasis of matter, ATA, and so on. If I was project-managing this thing, I might almost break it into two projects, you know, or release, because I think emphasis of a matter and clarification are going to be less contentious of issues. And you might be able to wrap them up quickly, get them out, make some improvements in the world recognizing the ATA and probably assurance outside of the financial statements will be more contentious, going to be more prolonged, and so on.

So you almost might want to consider doing a -- bifurcate the project. It's a thought, you know, and let the staff work however it goes.

MR. BAUMANN: Thanks, Gary. Steve?

MR. BULLER: Thank you. Well, we -- we do support the expanded use of the emphasis of matter paragraph, but think that the AD&A, the emphasis paragraph, and enhanced exposure all have their own
responsibility, and actually, interconnectedness.

So I think that the AD&A is important to us because it does help define audit procedures on significant areas and provides some perspective on accounting principles. And I think, conversely -- conversely to what Lynn said, our analysts believe that the emphasis of matter paragraph should point out the location of the financial statements of certain things that, in the accountant's opinion, are important for the reader to know.

And those are the, you know, the -- the new financial statement disclosures, significant transactions, and related-party transactions that are material, significant judgments and estimates with significant uncertainty, and also, significant information about acquisitions, or related financing, or -- and the reason they're important to our analysts is, they believe that -- that merely by having the auditor identify those in that paragraph points to them that they were important criteria in reaching the opinion.

So to the extent that they need additional
information on the procedures that were performed, that should be in the AD&A. And the two we view as complimentary.

MR. BAUMANN: Good. Thank you. Next, we're going to Paul Haaga, Mike Santay, and Joan Waggoner.

MR. HAAGA: Thank you, Marty. Remarkably, I still agree with everything that's been said. My favorite -- as I was sitting here listening to this, I recall that my favorite movie title of all time is Snakes on a Plane. It tells you everything you need to know, nothing you don't need to know, and is unlikely to become boilerplate because it doesn't describe any other movie.

So following that, I do think shorter is better. I -- that's why I suggested that the emphasis paragraph is better than the AD&A approach. I think there are things that one can say, and we've gone back and forth on whether it's simply a road map to the largest numbers, or at the other extreme, it's the auditors giving their own financial statements and taking over the role of
management.

I think you can strike a fine line between those two. I think it should focus on matters involving the audit and the audit process, but not be limited to that, and can actually comment on some numbers, and still be -- still be very useful to investors.

Just some of the areas -- these have been mentioned, but some of the areas that have been suggested is significant issues that arose in the audit, how they were addressed, areas of greatest risk, how those have changed over time, and where the audit emphasis was, significant estimates and judgments, uncertainties, unusual transactions, restatements, materiality standards.

Now, that sounds like an awful lot and I'm trying to get it down to Snakes on a Plane. But I think that, if you look back at the list of examples, including the examples we've given here, there are very few areas of concern that would have been extremely significant to investors. And I think pointing out those areas of concern and
saying something in just a couple of sentences
would have been very useful.

The challenge, of course, will be writing the
rule that reflects what I think a lot of us
understand or imagine a helpful emphasis paragraph
would have looked like.

MR. BAUMANN: Thanks. And thanks for the
colorful analogy. In particular, as actually, it
works in another way because I think the things we
want disclosed in emphasis paragraphs are the
snakes on the plan. So I think we're right on
target with that one. I wondered if Night of the
Living Dead worked, but maybe that has more
information than you need.

Mike Santay?

MR. SANTAY: Thanks, Marty. You know, as it
relates to the -- to the emphasis paragraphs, we're
supportive, along with others in the profession,
for many of the reasons articulated.

One of the things, if the Board decides to
move forward with this, is -- is going to be
important to think about is transition. You know,
as Joe pointed out, you know, well, there's -- then there's a dearth of information. There's been nothing in -- in audit reports on emphasis, and all of a sudden, you know, there's going to be a new standard, which we wouldn't expect investors to read.

But you know, all of a sudden, there's going to be a lot of disclosures that are going to come popping in. And I think, you know, our view is, there -- there could be some -- you know, we want to make sure that there's a good understanding of what the -- what the framework for that's going to be, and what inspectors -- what investors should expect to see.

You know, that's not going to be operating risk. I mean, if -- if somebody's got a major contract with Wal-Mart that's disclosed, and you know, we're not going to make a judgment on operating risks or other types of risks. Those are, you know, supposed to be disclosed in the front part of the 10k, I think, in the risk factors.
So I think it's going to be important to frame what's being -- you know, we'll -- we, as auditors, will have a good understanding because we're going to, you know, beat the living daylights out of this, and train our people, and that. But I think it's -- it's going to be important for the readers to understand what's being presented.

One -- one comment on audit procedures. I think this one's difficult and I've heard discussions on both sides, as to whether or not it would be -- would be valuable. And you know, it's -- it strikes me that there's times when management does different things, depending on their view of, you know, what they need to do to -- to validate the assertion, you know.

Their -- if you've -- they've got a difficult fair value measure, they may go out and hire a valuation specialist. And that doesn't come through the financial statements, but we, as auditors, get comfort with that and we might think -- decide we need to get less audit evidence because we're vetting that specialist.
And so, you know, I don't know what the answer is here, but I think there's -- there's some aspects to what management's doing and -- and that might not be visible in the financial statements, and you know, the -- you know, all the work they're doing to support their assertion and -- and our response to that varies.

And so I think that's one of the challenges I see in trying to decide what procedures to talk about and what might be valuable, because if we just put our procedures in there, and somebody might look at it and say, "Well, they only did this, somebody else did all this," that could really be misconstrued. So --

MR. BAUMANN: Thanks. I was wondering if I could just ask you a question, since it was discussed by a couple of the other auditors. Getting to the concern that Lynn expressed before, that just pointing to the financial statements, the -- the riskiest areas may not be enough, the table of contents issue.

In the example that I read before, if the --
if the company had not disclosed that the
calculation of impairment was close, and you
concluded you could issue an unqualified opinion
without that sentence, do you think that additional
color is something that you could see auditors
putting into the emphasis paragraphs?

MR. SANTAY: I think the devil's in the
details on that one, Marty, I guess. And this kind
of goes to what some people view -- might view as
close, and versus not. And -- and so I think that,
as it relates to why it's important, I think, you
know, we -- one of my earlier comments today was,
you know, the -- the need for management to discuss
why it's important.

From an auditor perspective, I think I would
have a hard time, you know, making -- you know,
providing guidance to our folks as to what's close,
what's not. But I think that -- you know, I think
there should be sufficient disclosures in the
footnotes for the -- for the reader to be able to
determine that the -- you know, what methods were
used, and what assumptions were used, and
directionally, what -- you know, what -- why
management was able to conclude on the veracity.

So --

MR. BAUMANN: Jay, were you going to comment?

MR. HANSON: Yeah, Marty, I was just going to
respond to you -- your question to Michael about --
about whether an auditor would actually put that
language in -- they wish were in the footnote.

I'm suspecting that, if that threat was there,
it's going to be in the footnote, which in and of
itself, will improve reporting.

MR. BAUMANN: That, I think, is why some, such
as Lynn, might say that additional color would be
helpful. But I agree with your point, Jay. Joan?

MS. WAGGONER: Thank you, Marty. I would
additionally agree with what Jay and Mr. Santay
have said about this. It would be -- if it was
important, sufficiently important, to be considered
for EOM treatment, I think it would be one of those
things that you can't disagree upon. I think
management and the auditors would have to come to
an agreement and you wouldn't be able to issue the
financial statements without it being resolved, if it was of that nature.

I did want to make one other comment about the disclosure of audit procedures, building on what -- what Mike has said, that it might not be in the investor's best interests for audit procedures to -- to become too widely known.

Audit procedures are not supposed to be all that predictable, and if, as a matter of course, audit procedures are disclosed for these more interesting areas that will pop up in emphasis of matter paragraphs, it might be detrimental to the -- the interest of investors in the long term.

There is an element of surprise that is -- is supposed to be part of the whole audit plan that is put together. And I'm not saying that this is filled with mystical secrets or anything, but there -- there certainly is, perhaps, that factor to consider also, as we move forward.

MR. BAUMANN: Thanks, Joan. We have Flerida Rivera-Alsing, Wayne Kolins, and Alan Beller, and I think Kurt Schacht gets the final word.
MS. RIVERA-ALSING: Thank you. I just want to make sure that everybody understands that we value audit. And I am a firm believer that our -- the financial statements of our wholly owned entities and joint ventures are audited.

But how much time do we really spend in looking auditor's report, the opinion page itself? A few seconds. The first thing I tell my people is, "Are there three paragraphs?" "Yes." "Forget about it."

There's only one firm that, to this date, they still issue a one-paragraph audit report. We sampled 25 financial statements of the financial statements that we receive and only 1 firm issues an emphasis paragraph. And -- and that's to the firm represented to my left.

And in those instances, where paragraph -- emphasis paragraph is used, I felt like it is used to limit the auditor's liability. It is just my, you know, perception. I do not want to minimize what Kevin said earlier, advising the users of the financial statements for the significant matters
are -- is a step forward.

But is it enough? I do not believe so. I look at the auditors to tell me why they believe those matters that they have identified are significant and how did they, the auditors, felt comfortable enough to have the name of their firm associated with those financial statements.

Do I have interesting reading for a 173-page report? Absolutely not. And that is the reason why we want you to cover only the significant matters.

My concern, however, if we go to the route of the emphasis paragraphs, how much information can you really give to the investors in a couple of paragraphs to make it meaningful?

Thank you.

MR. BAUMANN: And thank you. Jack, I hadn't seen your card up, so I will do Wayne, Alan Beller, Jack, and we'll still give Kurt his -- the last word, since I promised that before.

MR. KOLINS: Thanks, Marty. I'd like to focus on the audit procedures element and disclosures of
it. And if -- if the objective of disclosure of audit procedures at the emphasis of matter paragraph is to provide a picture of the strength of the audit procedures around the particular area, I'm not sure even a 75-page description of what the audit procedures are is going to fulfill the objective because it won't say what procedure should have been done.

And audit's a very complex mechanism. There's a lot of interconnected parts here because you have to consider the risk of the area. You've got to consider the -- the validity of the evidence. You can describe a procedure that was performed, but if the evidence that the auditor is relying on shouldn't be relied on, that won't come across in terms of describing a procedure.

It also depends on what the controls are, and there could be one particular control that's missing, that would be a house of cards for the entire procedure to stunt.

So without knowing all of that, without entering into a dialogue between the auditor and --
and the investor, you really can't get a full understanding of what the procedures are in any event.

And one other element that seems to be missing, and hasn't been mentioned at all here, is the PCAOB inspections. Now, the financial statements at hand, that are just about to be issued, obviously haven't been inspected by the PCAOB. But it's possible that last year's engagement was inspected by the PCAOB. It's possible that, that particular engagement will be inspected in the subsequent year.

So I think the PCAOB inspection oversight provides an additional degree of comfort. I believe -- I should -- I believe it would be to the investors that the audit procedures are appropriate in the circumstances.

Thank you.

MR. BAUMANN: Good points. Thank you. Alan?

MR. BELLER: Sorry. Thanks, Marty. First of all, I guess I just want to, for purposes of the transcript, import what I said earlier about AD&A
into here, because I think, as I said, I don't much care. I'm not clever enough to know whether it's part one or part two. And I think, if you get what we were talking about, it's all the same.

I also think, though, that in thinking either about AD&A, which I am not a great fan of, or emphasis paragraphs, we all know investors want more information. We have heard, and I think we all know, that investors want more information from the auditors.

But I think there's a line, and it's somewhere -- it's -- sometimes, it's an easy line to draw, and sometimes, it's a harder line to draw, but I think, in continuing with this exercise, it's an important line to draw.

Where is it better to get information from the preparer and where is it better to get information from the auditor? And I want to go back to the goodwill example to kind of talk about that. The example in the -- in the CAQ emphasis paragraph is, they -- a segment was tested. No impairment was found. But it's close. And if value goes down
further, there might be an impairment in the future.

I actually had it, the very same question, for Joe before lunch, that someone asked in this panel, which is, suppose the issuer, suppose the preparer, had said that in the financial statement footnote. And it wasn't an idle question, because I actually know of a preparer that said something like that.

And does it then go in the -- you still have an emphasis paragraph about the impairment because it's an important issue, but do you then go on? You got the information. I think that's the kind of information that's actually better from an issuer.

And the real value of the emphasis paragraph and the value of the process is, well, the auditor's going to put it in if the issuer does it. And I think the auditor has to put it in, in answer to that other question.

But the practical outcome here is, the issuer will put it in. And that's fine. And once the issuer puts it in, does the auditor also put it in?
I'm not sure I care and I'm not sure whether I care whether the standard says the auditor puts in or doesn't.

Let's take this -- let's take this issue one step further and let's stay with goodwill, even though we get a little bit into the weeds. Let's say that, if you do the kind of normal market value of the enterprise, and then you look at the market value of the segment as a portion of the market value of the enterprise, there's clear impairment, but the market just went down 67 percent in the last six months.

And we were there, guys, two years ago. This is not a -- this is not a hypothetical. And so you then do a discounted consent to search flow analysis to see whether, in fact, the market value of the segment supports or the -- or the discounted cash flow of the segment supports the market value, notwithstanding the fact that the market value of the enterprise is below what you get when you add all the segments up.

Do you put all -- does -- it seems to me that
that's important disclosure. It's in the footnote I'm thinking about. And it seems to me that, if it's not in the footnote that I'm thinking about, it goes in the emphasis paragraph.

That's getting pretty close to putting in audit procedures, right? So it's very hard. It's -- and again, if the issuer says it all in the footnote, do you need to do more than flag it in the emphasis paragraph?

Because the issue still is, it's close, and the answer is yes, you do. But do you put all that other stuff in? Don't much care. You want to get the disclosure.

But the second thing that comes out of this example is, sometimes you have to bounce a brush up against the audit procedures to get to the kind of disclosure that I think you're talking about.

The area where I think that actually -- that I'm familiar with, where it would be the most -- the most common is fair value accounting. It's very hard to talk about complicated fair value accounting questions without talking about auditing
procedures in some -- in some cases, and so be it, which leads me to my penultimate point, which is, how do you, in a standard or in a set of disclosure rules, because -- again, I think this is a two-part exercise.

I think Brian's agency and this agency have got to go down this road together to talk about both issuer disclosure and auditing standards. I don't think either agency will be able to effectively write a black-letter rule around what's significant. What are those 10 things that have to be flagged in the emphasis paragraph?

I can almost promise you, you will not do that successfully. What you -- well, you're really in kind of a potter's story. You know it when you see it. You set out the principles. Where are the judgments hardest? Where is the estimation hardest? Where are the numbers biggest? And you put all three of those in a pot, and you stir it up, and out pop the five, or six, or 10 things that the investors care most about. And there really are no black-letter rules you can write that will
produce that outcome.

The final point I would make, which has been talked about a couple of times here, who are the investors we're writing for? And what is their audit knowledge? It is one of the great myths of the U.S. disclosure system, that we are writing -- we are writing mutual fund disclosure for Aunt Martha. At least, we should be.

But we are not writing 10k, 20f, 10q, 8k disclosure for Aunt Martha and we haven't been for 25 years, at least. And you know, I'd love the answer to be different, but it's not. And -- and so what I think we really ought to be thinking about, if we're thinking about what's effective disclosure, think about fairly sophisticated institutional investors, who drive valuation in our market anyway, and Martha's a price taker. She's not a price maker.

Write for those institutions, and write rules for those institutions, and I think you're on the -- you're on the right track. Don't write them for me. I don't understand them.
MR. BAUMANN: Directors of corp fin give consistent advice, because John White, at our last discussion on the SAG on this similar topic, said, "If the auditor is going to put the calculation as close in the emphasis paragraph, it doesn't have to because the client will put it in the footnote."
So we're getting consistent views, as -- as Jay just --

MR. BELLER: Now, you know what John and I do for a living.

MR. BAUMANN: Kurt -- Kurt, you're being delayed one further, I think. Matt Torrey?

MR. TORREY: Yes, thanks, first of all, to the PCAOB for the invitation to participate in this forum, but thank you also for including so many investors in the process. I think that's very, very, very healthy development.

I'd like to second the comments made by -- by Paul Haaga from -- from Capital earlier today, twice earlier today. I think we've got a very high level of consensus that -- that investors would benefit from improved disclosure on many issues, to
ensure financial statements are as accurate as possible and as transparent as possible.

I furthermore believe the use of emphasis paragraphs would be an effective way to ensure that this happens, pointing areas -- investors to areas with the greatest financial statement risk, changes in reporting, and, perhaps, most importantly, most significant estimates and judgment.

So I think a lot of great points have already been made. I'll limit my comments to that.

MR. BAUMANN: Thanks. And there was concern that you were going to concur with Jack's comment that you agree with everything that was said today.

And that was -- I've heard that twice. That was going to be troublesome.

Jack?

MR. CIESIELSKI: Thanks, Marty. Just two things, one thing to not worry about and maybe one thing to think about. I heard a lot of auditors concerned that investors want to see audit procedures and worrying about putting out 75 pages of an emphasis paragraph that includes audit procedures.
And I really -- I have to second Mark's remarks earlier, that investors really don't want to see that. At least, that's my belief. That's what I've encountered in talking with lots of other investors.

They don't want to recalculate an audit. They don't want to re-audit something. They might want to recalculate a number that appears in greater detail in the footnotes, you know, details about assumptions about, I don't know, the black shoals option pricing model used in determining fair value of items, whether it be compensation or consideration.

They -- they might be interested in that, but I don't think they really want to take one audit report, and stack it up against another audit report, and see which audit firm was tougher, or something like that. That's just not within their ken and it's not within the time they have allotted to do their -- their jobs.

That said, I think that they don't care about, you know, the audit procedures as much as they care
about the auditor's assessment of risks. What made
an auditor decide to do more audit procedures in a
particular area?

So I think, you know, the emphasis paragraphs
should speak more to what is driving an auditor's
decision in assessing risk in the audit of a
misstatement.

Something to think about is that we have pages
and pages of risk factors in the 10ks. And you
know, somehow, I -- I don't see a link between that
and the audit opinion. Those risk factors that
have been identified by the client -- they should
have some kind of an effect on the auditor's
assessment of what kind of procedures need to be
used in the audit.

So I think that it -- that might not be a bad
starting place for trying to figure out how an
auditor communicates the effective risks in an
audit to the investor, because the auditor is
supposed to be the eyes, ears, and nose of the
investor within the company. And they should be
doing some kind of risk assessment, and
communicating that to the investor would give them a better idea of what kind of risks they take upon themselves by being an investor in that company.

So I hadn't heard anything about, you know, the risk factors section and trying to integrate that, maybe, with some of these emphasis paragraph issues that we're stumbling around on, so I just wanted to put that out there.

MR. BAUMANN: Thanks.

MR. CIESIELSKY: Sure.

MR. BAUMANN: While I conceptually agree with you on that, on the risk factors, Alan's profession has done a very good job on those risk factors in the 10ks that I read as well, that I don't think anything's omitted these days from those.

Kurt, you have the final word, and then we're going to take a break.

MR. SCHACHT: Thank you very much. Great job, Marty and staff. This is a very through consult and we appreciate the opportunity to -- to talk a little bit about it.

I just spent four days living like a pioneer
up in New York because of Hurricane Irene. I think
a lot of us in the New York area had the same
experience. And I tried to get my kids to sort of
see the romanticism in living like pioneers, and
roughing it, and -- and they would have none of the
-- none of the discussions. I heard words like,
"I'm desperate," and, "Could you go out and get a
small generator so we can at least run the Xbox?"
To show you how desperate I was, as I had a
copy of the PCAOB handbook at home, and I had some
-- some good reading time with -- with the
handbook. And -- and I think we all sort of forget
that a lot of people that are on the IAG and -- and
on the SAG are not audit pros. They're not people
with accounting backgrounds. And it's important
for them to understand, really, how rigorous this
auditing profession is, and all the rules, and the
guidelines, and so forth that are there.
And I think the practice, generally speaking,
has evolved, and it's adapted, and it's -- it's
changed with the times, with the one notable
exception of the communication between the auditor
and the investor/shareholder. And that has not kept pace, in our view.

And you know, the interesting thing that we're hearing about some of these proposals in the comment letters is that this is a monumental change, if we were to do something, or that it changes the fundamental precepts of the auditor/investor relationship.

And the fact of the matter is that everything else in finance, in investment, and in markets has changed. And I'm not sure why this should be off limits, and why we shouldn't make some -- some pretty interesting and bold changes to how this -- this works.

Avoiding repetition, I -- I -- we agree with how Ann and Steve Harris have sort of outlined the investor concerns with respect to these issues. That's where a majority of our CFA institute respondents to surveys are, on three separate occasions.

I think we're sort of -- this -- so we're sort of at the point where this is a game of Clue. Do
you remember that game, where you had to guess whether it was Colonel Mustard with the lead pipe in the -- in the living room?

So we're talking about how should be giving more information, what the information should be, and where that information should reside. And overwhelmingly, we hear from our investor members that they want to hear it from the auditor, that it needs to be from the independent expert, that, that is important, that they want to have information that's informative.

So if we're -- just again, I would agree with the other speakers, that if this is just a boilerplate description of the audit process, and what reasonable assurance means, and that -- and so forth, that that's really not what this discussion should be about.

It's about that informative, customized assessment of -- of the list. And I think we all sort of know what's on the list and what's been articulated in terms of risks, and judgments, and so forth.
Where it resides, again, I agree with the commentators that it's really less important about where it resides and it's more important about who and what is said. And I'm intrigued by this. Our view is that it should be more closely connected with the auditor's opinion, so there's no hunting and pecking around all of the documents associated with financial disclosure, so you see what the auditor thinks, and what the auditor views, and has judgments on in the opinion, either in these emphasis paragraphs, or with another appendix document, or however we might end up structuring it.

So those are -- are -- some of our basic comments. I'm intrigued by this -- this road map concept. I don't think that we have really focused on that as investors. I -- I do agree with Lynn Turner's concern that a simple highlighting by the auditor of where to look for more information and more discussion from management is not the -- is not enough.

But what Mark had -- what Mark LaMonte had
suggested in terms of an iteration where you talk not just about where it is, but why you are specifically trying to emphasize investor's attention to that -- that location would be -- would be a step closer. Thank you.

MR. BAUMANN: Thank you, Kurt, and -- and thanks everyone for a lively, entertaining, and -- but most importantly, very informative discussion of the required and expanded use of emphasis paragraphs, as one of the alternatives to improving the auditor's reporting model. We'll -- we'll take a -- running a little bit behind schedule. Let's try to start again, if we can, at 2:55, and we'll be talking about auditor assurance on other information in the financial -- outside of the financial statements.

[Recessed at 2:43 p.m.]

[Reconvened at 2:55 p.m.]

MR. BAUMANN: The next session on our agenda, and I'm going to turn this over to Jessica in a minute to lead the discussion here, is "Auditor Assurance on Other Information Outside the
And that has come up a number of times today, and I think this is another important area for us to consider as to potential changes in the auditor's reporting model.

And again, I'm not indicating any preferences, because we don't have any at this point in time. But I do want to repeat what Sam Ranzilla said earlier today, that when you read what Alan Beller and team put out in 2003, and what's required by companies, even just the critical accounting estimates, so much of it sounds exactly like what I have been hearing throughout the day as to what investors want to hear: Companies should address material implications of uncertainties associated with the methods, assumptions, and estimates underlying the company's critical accounting measurements. Such disclosures should supplement, not duplicate, the description of accounting policies that are already disclosed in the notes to the financial statements. The disclosures should provide greater insight into the quality and
variability of information regarding financial
collection and operating performance. The companies
should address specifically why its accounting
estimates or assumptions bear the risk of change,
so on and so forth, including a company should
analyze their specific sensitivity to change for
their significant estimates and assumptions.

One of the concerns I've heard is that this is
turned into boilerplate today and the value of
critical accounting estimates is not there. So at
least one of the proposals would be auditor
assurance on this, if we all believe audited
financial statements are of a higher quality,
because auditors audit them with the disclosure
that we get on the MD&A, or critical accounting
estimates, also achieve a higher level and the
spirit of what is in here, which is pretty much
what I've been hearing and what everybody wants is
required already.

So in any event, our next topic, "Auditor
Assurance on Other Information Outside the
Financial Statements," and Jessica.
MS. WATTS: As Marty mentioned, one of the alternatives presented in the concept release is to require auditors to provide assurance on information outside the financial statements, such as the MD&A, portions of the MD&A, or other information; for example, non-GAAP information or earnings releases.

An auditor providing assurance on information outside the financial statements could improve the quality, completeness, and reliability of such information, providing users of financial statements with a higher level of confidence on information provided by management about the company.

This alternative would increase the scope of current auditor responsibilities, require the development of new auditing standards, and require coordination with the SEC.

So the questions for the concept release that we would like to focus on today are on what information should the auditor provide assurance: MD&A, earnings releases, non-GAAP information, or
other matters? And then if the auditor were to provide assurance on a portion or portions of the MD&A, what portion or portions would be most appropriate and why? Would auditor reporting on a portion or portions of the MD&A affect the nature of MD&A disclosures? And then what are the potential benefits and shortcomings of implementing auditor assurance on other information outside the financial statements?

So I will leave up a summary of these questions.

And for this topic, we've asked Mary Hartman Morris and Mike Cook to help kick off this section. Mary?

MS. HARTMAN MORRIS: Thank you, Jessica.

Chairman Doty; board members Ferguson, Goelzer, Hanson, Harris; panelists, and guests, my name is Mary Hartman Morris. I am an investment officer with CalPERS, and I thank you for the opportunity to discuss specifically auditor assurance.

I'm here to represent CalPERS, the largest
pension fund in the United States with
approximately $220 billion in global assets in more
than 9,000 public companies worldwide with 47
markets. CalPERS invests these assets on behalf of
more than 1.6 million public workers, retirees, and
their families, and beneficiaries, in order to fund
retirement and health benefits.

We continue our commitment to the concept of
global best practices that contribute to the
efficiency and effectiveness of capital markets,
including credible, high-quality financial reports,
which serve the needs of investors and other users
of financial information.

CalPERS is fundamentally a long-term fiduciary
investor with a vested interest in the stability of
the markets and integrity of financial reporting.
We believe financial reporting should provide users
the information needed to make informed capital
allocation resource decisions. The integrity and
quality of financial reports is supported and
strengthened by robust external independent audit
carried out objectively and undertaken with a good
dose of professional skepticism on the part of the auditor.

As an independent expert, auditors provide an independent opinion to the quality of financial statements to instill confidence to providers of capital, such as CalPERS. Currently, auditor assurance is critical to investors' confidence in the integrity of financial reporting and its consistency based on U.S. GAAP.

You heard the robust discussion this morning on AD&A, and we support the need for change in the standard audit report, as we had said earlier. We believe the PCAOB has the opportunity to make substantive, robust changes that will improve auditor reporting and provide real value to investors and other users. And we support the resources and efforts being focused on AD&A; however, I know you have asked us to talk about the MD&A.

It has been long recognized that financial statements alone are not sufficient to communicate overall performance of an entity. In particular,
MD&A has become, in our opinion, a core element of the communication package for external reporting purposes.

As underscored by many different individuals and also by the principles for ongoing disclosure material development reporting by listed entities by IAASCO, an issuer should provide all information that would be material to an investor's investment decision, including disclosures in an MD&A.

So you know that the MD&A is meant to cover four principal objectives, enables investors to see the company through the eyes of management; improves financial disclosures overall and provides the context with which financial statements should be analyzed; provides information about different components of earnings and cash flow, and the extent to which they are recurring elements; and provides information about the risks to a company's earnings and cash flow.

MD&A provides a context within which the financial results and financial position can be interpreted. Currently, auditors as part of their
engagement review the MD&A and consider whether such information or the manner of its presentation is materially inconsistent with the financial restatements or represents a material misstatement of fact. We believe the auditor could provide a statement made on their current responsibilities as it relates to MD&A within the AD&A.

Although the auditor would not be providing assurance on future performance, CalPERS believes auditors could through an AD&A provide a statement of whether the MD&A is reasonable, whether assumptions and conclusions are rational based on the current work of the auditor and its review of a company's financial performance.

CalPERS would support a full discussion of the MD&A, specifically as a framework for integrated reporting as further developed. Many of you know the International Integrated Reporting Committee released a request for comment on the integrated reporting framework this week. So I think this should also be considered as we think through the MD&A.
Clearly, from the discussions today, investors like CalPERS would recommend that PCAOB focus on the AD&A and provide clarity within the AD&A on the responsibilities of the auditor on MD&A.

We agree if assurance on other information such as the MD&A is recommended that we defer to the current attestation engagement procedures and have the option to engage the auditor to attest on an MD&A.

This is a great opportunity to determine which issuers, if any, currently request their external auditors to attest to their MD&A. And if an issuer requests an attestation, then the benefits and challenges should have already been outlined to the audit committee and discussion of the benefits will be well-articulated.

I think one of the questions you asked is the greatest benefit, or if audited, what is the effect if the auditor does provide an attestation. So I think the greatest benefit of assurance would be a driver or the impetus for management to do a better job, because I think earlier you heard that MD&A --
management does not necessarily cover everything
MD&As is reflected to present.

So with that, I thank you, and I look forward
to hearing other people's views. Thanks.

MS. WATTS: Thank you, Mary.

Mike Cook?

MR. COOK: Thank you, Jessica. And thank you
to Marty and Jessica for the invitation and the
opportunity to express some views, which will not
be traditional with respect to this subject, but
are heartfelt, I guess.

The notion of auditor's assurance on other
information, I'd like to say that I don't get all
that concerned about the issue of assurance.

If I could involve the auditors in other
information and other financial communications,
whether or not that resulted in the expression of
assurance or a public communication might be
secondary to that. And I would use as an example
of that the current level of auditor involvement
with quarterly releases, which are much more
significant than the annual report that we have
been spending all this time talking about in terms of the importance to the investor community, market-moving information.

We have auditors involved with that, as required, sometimes in greater depth than even as required. There are no reports on that, that I am aware of. It is very rare for those reports to be made public. Probably a handful. They are sometimes given to the audit committees and sometimes not.

But what is important is the auditor's engagement on behalf of the audit committee and the company with respect to the quarterly reporting process and the content of what I would put at the front of the financial reporting train.

And if you can just take this as an illustration, I view this financial reporting train, and what we have been spending all of our time talking about and spend lots and lots of money on, and attention on, is the caboose of the financial reporting train. The annual audited financial statements coming out next March are the
caboose of the financial reporting train. And from now until then, the remainder of the financial reporting train, including the engine, will be very, very important, will be what matters in the marketplace, what matters for investors, not what they will get next March after the year-end process is complete.

I think things like this AD&A and EOM and all these other things, or MOE, or whatever, EOM, all of that is of great interest, but it is polishing the caboose instead of paying attention to what is going on in the most important part of financial reporting.

And unfortunately, today, the auditors, at least in terms of their relationship with the outside world and the investing community, only ride in the caboose. They don't ride in the engine. The engine is driven by the management of the company, and the management of the company, with oversight and guidance from the audit committee and auditors, to some extent, are responsible for their earnings release.
The earnings release has good, real segment information in it, vastly different and far more extensive than the segment information you get in a set of GAAP financial statements, what tells investors what they need to know and what they want to know about the company and about the company's current results, and then use that information to project the future results. The information is timely.

Imagine a financial reporting world where we said, "We'll get back to you next March, and we'll have some AD&As and some MOEs and all that kind of stuff for you. But in the meantime, we're not going to have current financial information for you to use in the marketplace." Not in this world. That is not where it is.

In addition, the earnings releases include lots of valuable information that is just not part of the financial reporting process: the business performance metrics of the company, lots of different things about what goes on in the company that never shows up in the traditional regulation-
based annual audited financial statements done once a year.

And I would suggest that for -- and I realize the limitations of the scope of the PCAOB by legislative mandate, the scope of the auditing profession. But if we don't find a way to get out of the caboose and start moving up toward the engine, and get engaged with what really matters in financial reporting to the investor community, we will be left behind. We will be obsolete. Whether we're obsolete in 5 years or 10 years, maybe beyond my lifetime, I don't know.

But we are increasingly obsolete spending all of our time and all of this money and all of this effort on the caboose of the financial reporting system.

I'd welcome you to disagree with that point of view, and that's okay. But ask the audit committees where they're spending their time, how they allocate their time between quarterly work and confirming the 10-K when they finally get around to the 10-K sometime the following year.
Ask the investors, any of the investors that you in the corporate world have communications with, or the investor community, give up something. Give up the quarterly release or give up the traditional regulatory financial filings. I don't know anybody who would say that the earnings release is not the most significant driving factor in the marketplace that is absolutely essential to investors. If I am missing that, the people I talk to and the people that I hear from are not representative of the investment community.

But I recognize that I really need to talk to colleagues at the SEC about this, because that is where this authority for change would have to come from, if there were to be some higher level of -- I hate the word "regulation" -- but oversight, let's call it, and assurance with respect to quarterly information.

Having made that case, let me then suggest a little bit about then non-GAAP information, the MD&A, and the other items that we are talking about. I would urge that we do whatever is
reasonable to engage the auditing profession in financial information that really is important on a timely basis going to the financial community.

I would suggest that MD&A is the obvious place to start, logically included in the discussion that we have here. And I would urge that the auditors at a minimum get involved in the elements of MD&A that are comprehended by financial statements and financial reporting -- estimates, judgments, so on and so on.

And somebody might say, gee, they already have that. Mary said that they're already engaged with that at a standard of not including a material error, being materially inconsistent. Not good enough. In my opinion, they need to get much more engaged gauged with MD&A.

And to Lynn's point, what you said earlier, it wouldn't make any difference. I will tell you, it will make a difference. I have seen it make a difference, because I've seen companies, and I sat on the audit committees of one -- not currently -- where management was very clear that it was
management's discussion and analysis. It wasn't the auditor's discussion and analysis. Butt out, that's mine.

And to the point where we got to the stage where the MD&A wasn't even complete. And the auditors, without resorting to the audit committee, didn't have any freestanding authority or responsibility for the completeness of MD&A.

So I would suggest it won't matter in 95 percent of the cases, but engaging the auditors with the direct responsibility for MD&A would be a good idea, in my opinion. I'd like to see them involved in all of what's in MD&A, with appropriate protections for forward-looking information and management opinions and things of that kind.

I just think engaging the profession in the entire content of MD&A, and liquidity analysis and things of that kind that are there, would be a good thing, because I think the engagement will be an improvement, will lead to improvement in the quality of the information. Non-GAAP financial information, stuff that can't go in the 10-Q, can't
go to 10-K, but goes into the earnings releases, more often more meaningful information in the headlines of the earnings releases, or at least an equally prominent position, things of that kind that are being reported that auditors have no engagement with -- who would be more logical to be involved with non-GAAP information than the people who understand better than anybody else what GAAP information is.

And it seems to me such a natural extension to have auditors engaged. And again, I don't care about public reporting, but engaged and perhaps reporting to audit committees about the non-GAAP presentations that the company is making, which are very important to the investor communities.

So I would put MD&A as the car closest to the caboose and non-GAAP information a little further up in the train, not too far away from the engine, which is the earnings release, and the information that is going out on a quarterly basis and the quarterly regulatory filings being one notch below that.
So with that, I'd say we'd have to move cautiously, and we will move deliberately in this, if you agree with the premise that the world of financial reporting would be greatly enhanced by having the professionals of the auditing profession engage with all of what really matters in financial reporting, not just the stewardship confirmation 15 months after the beginning of the year, which tells everybody about how the audit went and what was important long after the financial statements for four periods of the year have been in the marketplace and been used for trading purposes.

So I think that each of these things should be taken individually, and the marketplace should be the driving force behind most of what we have here, because if the market doesn't want it, and the market says thanks very much but keep the auditors back where they are, I really don't want either the cost or the other considerations that go with having them involved with the timely information that is, in my judgment, driving the investment process. That's a market decision to make.
But I think I would take the steps, MD&A first; non-GAAP financial information next; quarterlies are already being done, but never being reported on; and then take the earnings release and the content of the earnings release.

I can tell you from the perspective of an audit committee chairman, we engage -- I don't mean in the formal engagement, dollars and cents use of that word -- we engage our auditors every quarter in the earnings release, in other communications are going forward from the company on a timely basis, and we spend substantive time on it. We don't just double-back at the end of the year and ask how the quarters came out.

And I think that's where the profession needs to go, and the PCAOB needs to help them get there.

So I think those are the points that I was hoping to make. I guess one I would address was overall the question about costs and benefit. Costs here can be considerable, depending on which portion of this financial reporting process you engage auditors in that they have not been engaged
previously. The benefits, I think, would be far
greater than the costs, if we could enhance the
quality and credibility of all financial reporting,
not just the annual audited financial statement
process.

   MS. WATTS: Thanks, Mike.

   Mark Newsome?

   Mr. Newsome: Thank you.

   This topic touches on, I think, one of the
more critical areas that we deal with time and time
again with companies. Routinely, we look at
audited information, and we look at management
information, if I could use those two topics.

   I think management financial information would
include the MD&A and other information that the
management teams provide to investors. And so, one
of the things we do routinely is we will look at
the management financials on a quarterly and annual
basis, and then we will go to the audit, since that
is a third-party verification. And we will try to
bridge the gap or reconcile between the two.

   And in most cases -- I'm trying to think of
cases where we have done this on our own. You can do it on your own occasionally, but in most cases, you've got to call the CFO and ask how do we get to the audit from what you provided us. And we do this all the time. And so it's important to us.

So when you think about the information that an auditor could provide in this area, it would be helpful to get some type of assurance about the information that management is providing, other information or valuation reports that management is using, such as an actuarial report or some other type of valuation consultant, not necessarily to opine on that work specifically, but to acknowledge management is using other information to develop these figures.

And that gets back to the AD&A to a degree, I suppose, and maybe it fits somewhere there or somewhere else. I'm not too particular on where it fits, but it would be very helpful.

And then coming back to the role of the auditor, I have heard a couple of comments. From my perspective and I think from most investors'
perspective, it's not about mistrust of management or the audit committee, it's about getting third-party verification. And that's very important in our role as an investor. And again, it's routine. It's something that we do every year and with every case.

Ms. Watts: Thank you.

Bob Kueppers?

Mr. Kueppers: Thanks, Jessica.

In this area, terminology is important. So I'm trying to remember in the last 8 years whether I have ever been part of a conversation with PCAOB and the folks here about something other than an audit, and I don't remember that. So let me just put out a couple of thoughts.

There are three levels of service we can perform as auditors: attestations, reviews, and compilations. And compilations are sort of off the table for public companies.

It's fair to say that, and I can only speak for our firm in this, we are open to doing more. But if we declare that we are open to doing more,
someone will suggest that we're just commercially motivated, and I find that offensive, but is just what it is.

And the point is that if there is a call for it, the chances are that we have the skills and the mechanisms to meet that call.

Let me give you an example. Mary Morris had some really good comments about MD&A, and made the comment that we review that and maybe at some point we should express a conclusion as to whether it's reasonable. Under current standards, the requirement is we don't review it; we read it. We literally read it. And we are, by our standards, required to observe and look for inconsistencies between MD&A disclosures and the financial statements that we do audit, and bring those inconsistencies to the attention of management and possibly the audit committee.

We could not conclude that MD&A is reasonable unless we did a higher level service than what existing -- I keep going to SAS 8. Maybe it's something else. Or it's AU-something. But the
point is that those standards haven't changed in many, many years.
And one thing I'll mention, it's a little sensitive, but maybe it's time we did take another look at those standards, because we literally read the document, look for things that are inconsistent, and raise the flag.

There is another level of service we perform all the time, but it's not in the standards for us to report on, and that's what we call agreed-upon procedures. So it reminds me of what Mike was saying about a press release. Press releases in GAAP, it's called a document, but there are no standards on which you could audit a press release. But you can look at the numbers. You can tie those numbers back to other financial information, the company's records. You can tie it back to a lot of things. You can recalculate percentages. This is the kind of work we do all the time if we're underwriters.

But if we were to do that kind of work and there was a call for public reporting, there's no
standard under which we could issue that report.

Today's standards say you have to be part of the crowd who agreed upon the procedures in order to get a copy of the report.

I'm raising it for two reasons. I think those standards at some point need to be dealt with, because I think there are things we could offer that are a lesser level of service but could give some -- I'll use the word comfort, and I'll use the word assurance, some information to investors or others.

But in order to do that, we really would have to ask our regulator here to take another look at both of those standards, in my view.

So a fascinating topic. We could do it a lot easier if we don't have to publicly report. But if that's wanted, we have to do some work on the mechanism.

MR. BAUMANN: Does that include, for instance, in a press release, for instance, beyond going to tie the numbers into the company's records and things like that, potentially concluding something
like: Based on your knowledge of the company and its environment, that you're not aware of anything misleading in the press release?

MR. KUEPPERS: And that would be what we would call a form of negative assurance. In other words, "nothing came to our attention that."

And I think that there is something very similar in the work we do in the quarter. So certainly, that's a possibility.

MS. WATTs: Gary Walsh?

MR. WALSH: Thank you.

I work with a buy-side firm, and so I guess I'm here representing investors, but I have spent a few good years in my early career as an auditor, so I have a lot of sympathy for some of the issues that are taking place.

It strikes me that there is still an enormous gulf between what auditors think that investors use statements for and what investors think that auditors do. And I think that as I went through the choice of the four options that we have here, I've been struggling for ways that we can bring the
two groups together.

I think if you talk to an investor, unless he had some auditing experience, and asked him about materiality, I think he'd be blown away to think that auditors were passing on audit adjustments that were more than that penny a share that he is selling the stock based on, you know, the earnings miss that quarter. And by the same token, I don't think that auditors have much of an appreciation for what in the world investors are doing. That's too strong, but I do think that there needs to be more of a tight alignment.

When I thought about, if you were to give someone a financial statement, and say you've got 15 minutes to determine whether you're going to invest in this company or not, I don't think that the audit report would even be in consideration for something that someone would look at. I think they would quickly go to other areas. And I think that you want to make sure that the audit report is top of mind and certainly being closely considered, or the audit process becomes somewhat irrelevant.
So when I look through the approaches, the first, the AD&A, I really think that the management is the right person to do most of the AD&A. When I look at emphasis reports, I do worry about boilerplate. I think that that has some interest, and if you could make it so that you provided some type of safe harbor for issues that were brought up in an emphasis paragraph, then maybe you have some carrot to have more open disclosure.

Going down the list again, I guess I would've said that MD&A is really not that interesting. But from Michael's discussion about the train, I really think that that is the right place to focus attention on being relevant. Quarterly earnings, I think that's an area that it's still kind of the Wild West in terms of things that were reported one quarter and then are changed the next quarter. I still think that that is too loose, and investors would really benefit from having more consistency and having the oversight of auditors being involved.

And so the last part, the last option, I think
we can beef up the audit report to provide more clarity into what is going on.

But those are just some random thoughts. I really do like the idea of having them involved in the quarterly report.

MR. BAUMANN: If I could just follow-up, Gary, with a question, just to make sure I understood the point?

If a company reported a $1.50 a share in the quarter -- or for the year, either way, because the auditors do quarterly reviews, too. And the auditors had an adjustment which really would've brought it to a $1.49, but they passed on that penny adjustment there, are you suggesting to investors that's important always, or that's important only if the announced earning target for the quarter was a $1.50?

MR. WALSH: No, I think going back, I think it's very important for auditing to have materiality thresholds. That's very important.

I don't think that investors understand that enough. And I think to have more appreciation
there, it would give investors a better sense of where they should focus their attention, and not purely on that penny. We tend to be pretty long-term-oriented investors, but even saying that, I think the quarterly reports are full of great information.

MR. BAUMANN: Because auditing standards do require -- materiality standards do require auditors to consider not just quantitative misstatements, but qualitative. And that is if the market would think that that penny was important because of what the company had announced, that could be qualitative material, even if it was a relatively small percentage.

But you're right, maybe investors and auditors aren't on the exact same plane with respect to that entire subject.

MR. WALSH: And just for the record, that penny isn't important to anybody. It's the fact that your revenue growth, your operating margins assumption, your competitive advantage period, you realize that all on the same day that they show the
penny disappointment, and that's why you have such a large adjustment to the value that people place on the stock, not because it's a penny.

MR. BAUMANN: Thank you.

MR. WALSH: You bet.

MS. WATTS: Lynn Turner?

MR. TURNER: Interesting to hear the analogy to the caboose. I've heard some say that they ride the caboose and then get out at the end and bayonet the dead.

But I actually think the auditors aren't that far behind. I think they're probably more up in the diner or the dome car. I don't think they're all the way back at the caboose.

And in fact, auditors do have to do a full review of the 10-Q now, underneath the standards. There's not a report required to be issued and filed. I was there when we did those rules. The reason we didn't require it was because at the same time we were doing the audit committee rules and there was enough pushback not only from the business community, but one of the Big 6 at the
time also opposed having a report be filed. And we
went about as far as we thought we could.

I think that, certainly, audit committees, if
they aren't, they should be, the chair should be
requiring a report. They're fools if they aren't,
and they aren't doing their jobs, if they aren't.

But I would certainly think that getting those
reports in the filings would be very beneficial. I
agree with Mike that getting full assurance on the
earnings release would be very beneficial and good,
and I'd do the same thing on the full MD&A. I
think just the critical accounting policies is a
waste of time and money.

However, having said that, we've seen in
recent days in this city where legislation is being
introduced to exclude probably 80 percent, 85
percent all public companies from SOX 404. And the
reality is with the political climate in this
country at this point in time, there is absolutely
zero chance -- none, nada -- that those type of
things could be implemented by this board or the
SEC.
And having lived through that, I think it would be a total waste of this board's time and money, and investors' money, because ultimately we're paying the fees, to go down that path and waste your time on it. Because just politically, it's not going to happen at this point in time in this city.

It's unfortunate. I couldn't agree more with Mike. I think he's absolutely right. But in this city, you can only take on so many fights at a time. The board is already taken on a couple of major fights here, and so I would turn around -- while I think those are all great, and I'd love to see them all, I think at this point in time, it would be a waste of time and resources, because at the end of the day, you try going down there, you're going to have legislation introduced so quick, your head will spin, that will cut you off at the pass, especially with the legislation we're already seeing in recent days pop up.

So I'd love to see it, but you have to deal with practical reality in the city, and it just
can't happen at this point in time. But it's unfortunate. It would greatly benefit investors. I think it would be well worth the money. But it's not a reality.

MS. WATTS: Jack?

MR. CIESIELSKI: Thanks.

I have a few thoughts along those lines of Lynn's, but a little different maybe.

First of all, I'm not sure what kind of form the assurance on an MD&A would take. That's kind of a free-writing prospectus sort of thing that the managements do. And unless you are going to be writing a whole MD&A yourself and comparing it to what the management would come up with, I'm not sure what you would say in an opinion on the MD&A. And that really did not jump out at me in the concept release.

But going back to what Mike said in the beginning about the train, the caboose, et cetera, you're right, absolutely right, that earnings releases are important because they move the market. But they move the market because they're
the first new information after the end of the quarter. So what you're proposing is to put some kind of assurance on the MD&A, which comes out much later in the quarter. And the time you're going to take to put assurance on the MD&A, whatever form that might be, is going to push that Q filing closer to the deadline, farther away from the time that the earnings release is made.

So I find that further cheapening, or maybe not cheapening is the right word, but making the Q somewhat less useful for the investor, because it's going to come out later. Maybe it's got assurance, and maybe that compensates for the fact that it's later, but if you're going to be putting some kind of audit procedures or assurance procedures on it, you're going to have to spend some more time, unless it's just what you're doing now, reading and reviewing and then putting the assurance opinion on it.

I think that if you're going to do anything along these lines, you have to do the whole package at one time. You have to put assurance on the
earnings release, which is maybe in conflict with
GAAP, and have the GAAP numbers out at the same
time. And I think the solution is really to do the
whole thing at once, and not have companies, and
I'm not sure how you legislate this, but not have
companies file an earnings release, issue an
earnings release, without the Q.

The whole package all at once is going to give
everybody all the information they need with all
the assurance. And I think if you piecemeal it by
doing assurance on the Q later, then you're
actually going to give management a reason to go
out and put the earnings release out sooner or
increase the gap between the two, and I think that
that's not a good thing for investors.

So for what it's worth.

And I think that would be an enormous amount
of rules overhauling that goes far beyond changing
the auditor's opinion. I'm not sure how you could
get that synchronization of the earnings release
with the Q in this kind of climate. For what it's
worth.
MR. BAUMANN: I guess that would be something that the SEC would have to take up, in terms of an earnings release would have to accompany -- the Q would have to accompany the earnings release and the SEC would also have take up whether or not to report that Lynn said auditors have to, for procedures right now, in connection with the quarter, but they're not required to issue a report. And I think Lynn suggested he thinks that report should be accompanying the quarterly financial statements, I think -- right, Lynn? -- which would require SEC action.

And I think those are all good points, and worthy of discussion.

In theory, that one doesn't have any extra cost at all involved. If the review is already being done, putting a report attached to it has no cost.

With respect to your comment, I just want to make sure I have it correctly. There are existing attestation standards for reporting on MD&A. There was an example of that in the concept release and
in the mock report that the CAQ put out. It talked about, we have examined the critical accounting estimates, and it talks about what that means. And it gives, "in our opinion, the presentation of the critical accounting estimates," and it goes on and talks about what that opinion means.

MR. CIESIELSKI: I'll have to go back.

MR. BAUMANN: So it's worth looking at that. There are some existing criteria for that.

MR. CIESIELSKI: I was thinking of it in terms of an audit opinion, just, "We have examined the financial statements, and it's in accordance with GAAP." We don't have a body of -- well, we do have the PCAOB standards, so okay.

MR. BAUMANN: But whether we amend that or not would be another factor, but there are existing standards there.

MS. WATTS: Mark LaMonte?

MR. LAMONTE: Thanks. Very interesting discussion. I very much agree with what Mike led off with, the train analogy, where we're talking about the caboose being the driver of what we're
thinking about here.

One of the issues that we're dealing with -- and this may be something we might not be able to really solve in this context; it might be a much bigger issue -- is we're dealing with a very archaic form of financial reporting that doesn't necessarily reflect how investors make decisions or the information they use to make decisions.

It's really about data with investors and the flow of data to investors. You don't have a lot of investors necessarily staring at balance sheets. It's about data that's getting into models. That may be getting into models by someone in India rekeying it at $10 an hour, or it may be a junior person putting it in.

But it's not really about financial statements. It's about the data that drives decisions and whether there is assurance over that data. Some of that data may be extracted from financial statements or earnings releases and be your traditional balance sheet metrics, which are subject to audit, or would be subject to audit
after the fact.

Other pieces of information, which may be absolutely critical, might be more nontraditional information. If you're looking at Wal-Mart, a key driver might be same-store sales, which is never subjected to audit but is absolutely critical to making a decision on whether or not to invest, to buy or sell their securities.

So I think at some point we may need to really refocus on the flow of data rather than the preparation and auditing of the financial statements. And this may be in part why the financial statement presentation that the FASB and IASB has been working on has gotten bogged down. It's just recasting this old, archaic view of financial reporting and not focusing on data flow and then assurance over that key data.

So this might be a much big issue than can be addressed in this project, but I think it's something that the PCAOB and the industry really need to begin to think about.

MR. BAUMANN: In that context, would you be
supporting auditor association with XBRL?

The data that is probably being sent over to India for use in --

MR. LAMONTE: If anybody was actually using XBRL, absolutely.

[Laughter.]

MR. KABURECK: Don't assume anyone is using it.

MR. BAUMANN: Thank you.

MS. WATTS: Peter Nachtwey.

MR. NACHTWEY: Thanks, Jessica.

Well, the first thing I have to share is both Mike and Lynn are taking me back early in my career when I was told what the definition of an auditor was, which was somebody who comes in after the battle was lost and bayonets the wounded. But I was also told that by an attorney -- so, Lou, don't kick me -- who defined lawyers as those who come in after the accountants and strip the bodies.

[Laughter.]

MR. NACHTWEY: So on that ghoulish note, on this proposal, as I said earlier, I definitely
would be supportive, but with some caveats, because I do think it makes clear to investors, more clear what the scope of the auditor's involvement has been outside of the basic financial statements. And it more or less, frankly, acknowledges facts on the ground, as far as my experience shows.

I also think that probably this may be one of the most important things that we're talking about today as a relates to non-GAAP information, because I spent a lot of time on the road with analysts and investors, and, frankly, they spend very little time grilling me about the GAAP information. They spend a lot of time drilling me about the non-GAAP information.

So I think it's especially important that, as I think Mike said, that the auditors, well, you say, gee, they're trained in GAAP, well, they're trained in numbers, they're trained in financial analytics, a lot of things that lend themselves to being involved with that information. And I do think it would be helpful. And frankly, it might cut down on the number of questions that I need to
answer, because people don't think the auditors are involved with that information today.

So I also think the quality and consistency within industries would be enhanced if auditors were involved with that information, and by derivation, this group, the PCAOB.

Conversely, on the earnings release front, I don't think auditor reporting on these really gets you over the cost-benefit hurdle from what happens today, because auditors are heavily involved in the Qs, as several have said, and they ultimately report on these anyway, in terms of the footnote that is in the financials at the end of the year.

So I think that management and auditors stay pretty close already on the numbers. And where they don't, you see embarrassing situations where, after preliminary earnings release, the numbers are revised when the ultimate filings go in, and I think that's already a sign of the involvement that auditors have there.

I just have a little trouble imagining how an auditor report on an earnings release, and
particularly the tight timeframes that the market
gives us to get earnings out, how that would work.

So those are my views.

MS. WATTS: Larry Salva?

MR. SALVA: Thanks, Jessica.

To follow up on something that Mark mentioned, data assurance, or I would put it more association with, and maybe that follows up on the last comment as well, in that I think it would be important for investors to know that auditors are somehow involved with, not necessarily providing assurance on, because somehow that gets more difficult to get into places.

And I note within the concept release that it notes that there is no requirement for an auditor to provide assurance on earnings releases or non-GAAP information. Well, I'd also note that there's actually no requirement for them to even read it for material inconsistencies, because it's not included in the document that includes audited financial statements. But it's absolutely part of
the financial reporting process and integral to it.

To my knowledge, there's no requirement for a public company to actually publish an earnings press release prior to the filing of their 10-Q, although that is practice for most companies. And I could easily see a standard being written that said, in the case where a public registrant publishes a press release as part of its financial reporting process, that the auditor must read it at a minimum. The baby step would be read it for material inconsistency. If you want to go past the baby step, there's not a standard for the preparation of earnings press releases as there is with MD&A, where you can provide an attest report.

But as the concept release also points out on page 24, there are three things that an auditor opines on when they attest to MD&A. The one that I think would be lacking for press release would be that it's complying with certain published rules or specified rules. But they could easily, I think,
get to the second two points, which is historical information has been accurately derived out of historical records of the company, and that maybe negative assurance, possibly, on nothing came to their attention that the underlying information, the termination estimates, assumptions, that the entity provided are not reasonably supported or that there's not a reasonable basis for the disclosures contained.

Auditors do have experience in being involved with statistical data when they issue comfort letters to underwriters. They have the ability to make reasonable determinations and reporting as to whether things are misleading, including statistical data being used that could be misleading. And we could pursue auditors being associated with, or at least involved with, maybe not providing assurance on, but if the standard required involvement with that data, and that the public was then made aware that the auditors do include some procedures on that data, I think it might run to Mark's objective of having, maybe not
assurance, maybe not direct assurance to the investor, but at least knowledge that there was involvement with the data that was published by the company, and that that data is much more timely than what is coming either in the 10-Q with or without a limited review report, because I would also point out that limited review report is boilerplate. It's not tell you anything.

And we all know that the limited review has to be done, so to me it's not important to publish a limited review report. You just know that if you are a registrant, you have had that review done.

So I just think that there is opportunity here to pursue involvement with, but I'm hesitant to go as far as trying to define assurance on press releases.

Obviously, this also gets into cost and time constraints. You're in a very constrained, tight closing cycle. But I think it's possible to have the auditors have involvement with the press releases that should not be inconsistent with the subsequently filed Qs or Ks.
MS. WATTS: Jay Hanson?

MR. HANSON: I want to react to a couple things that the two Garys have said, and Alan Beller mentioned it as well, and maybe just pose a question, and a little bit of a surprise.

Gary Kabureck opened up the day with the question of who are the financial statement preparers writing the financial statements for, and who are the auditors reports directed at. And Alan said succinctly that it's not for Aunt Mabel; it's for the sophisticated investors. And so we have to assume some level of knowledge.

And, Gary, when you mentioned a little bit ago about that one cent differential in the earnings and how much the markets move on that, if they're missed by a penny. And I know that is reality. That happens a lot.

But unless you're looking at Joe's Barbershop's financial statements, which there is probably not a lot of subjectivity in the numbers in those financial statements, almost every sophisticated business today, as well as the larger
financial institutions, there's a lot of squish in almost every number on those financial statements. And it would surprise me if a sophisticated analyst wouldn't appreciate that.

And I realize that Larry Smith is here as a representative of the FASB. And they have been working really hard on trying to get that more transparent in the financial statement for years with the leveling of the fair value measurements, as well as the disclosure proposals about the sensitivity and the measurement uncertainty. But even without specific discussion of this given number could vary by this many dollars, given the substantial improvement in disclosures over the last couple years, I would think that it shouldn't be any surprise to any sophisticated investor that there's just a lot of latitude in a lot of the numbers, the larger the financial institution becomes, and the more fair value measurements are in the financial statements.

MS. WATTS: Brian Croteau?

MR. CROTEAU: Thanks.
Actually, Larry, I'm glad you raised the point about there not being a requirement around earnings releases. Really, the question to pose relative to that point, I guess one is whether we see problems today where companies are re-issuing earnings releases on a regular basis, such that there needs to be some mandate for auditor involvement. And then secondly, I guess there'd be some requirement, presumably, that the auditor finish their work on the earnings release before the press release could be issued.

And I won't sort of get into the points around authority and whether the SEC would take up that kind of project, but I guess I just wanted to understand sort of the impetus and whether we're seeing a problem with the quality of earnings releases today that people are trying to address with this point.

MS. WATTS: Chris Spahr?

MR. SPAHR: As a sell-side analyst, timeliness always matters the most to me. And so I would think anything that would push out the earnings
release is actually detrimental to the investment process.

Secondly, how I view the auditor work is I want accuracy and quality, and I don't know if looking at the sufficiency or the accuracy of an earnings release is actually going to give me greater confidence in the underlying marks or the accuracy of the low-loss provision. So I'm afraid that if you focus on the earnings release, you're going to get away from what we want the auditor to do, which is look at the quality of the financial statements. And that kind of goes back to the first two points, not to this third point.

MR. BAUMANN: I just want to understand your comment on accuracy, because that's not a word that goes particularly well with a set of financial statements, in my view anyway. And I think it was the point Jay was making.

Financial statements are nothing but a mass amount of estimates and judgments, allocations of cost for periods.

And they're anything but accurate. They are
based upon the assumptions and estimates used by a company, hopefully prepared consistently, such that the numbers present reasonably.

Is there any difference of view on that point?

MR. SPAHR: No, actually. I think accuracy would be the granularity of the quality of disclosures and what the exposures are.

I cover financial institutions, so to the extent that I know what the puts are for mortgage-backed CDOs in November 2007, some of that didn't come to light in July of 2007 earnings release, and it wasn't in the Qs following that.

And again, so it wasn't in the Qs, which was in theory reviewed by the auditors. It wasn't in the earnings release. So it was more of a qualitative point on that. Do we have the full amount of information that we need to make a good investment decision?

So again, it comes back to, is there sufficiency in the audit review process, and making sure that investors have all the information they have.
I'd rather judge management on the earnings releases, and then judge auditors on the quality of the Qs and Ks.

MS. WATTS: Sam Ranzilla?

MR. RANZILLA: I think it's fairly clear, based on my comments earlier this morning, that as it relates to the attestation of a portion of MD&A, I think that is a short-term solution to the issues. And I note that others in the room have stated they don't.

I vehemently disagree with that position. And I think if you look at what the CAQ has crafted out for a sliver of MD&A, I think it addresses the kinds of issues that have been raised.

I also agree with the context that today a full attestation of MD&A is not cost-justified. That's what we heard when we talked with investors. I think others have said that as well.

But I do think, from a short-term perspective, critical accounting estimates is a place where this board should look for -- at least pursue further a potential solution.
I would also suggest that the rest of this section dealing with other information outside of the financial statements is better left to a second, separate project, because -- taking earnings releases as an example. I mean, just think about what we just heard is all the challenges are to an auditor association with earnings releases beyond what it is today. So when I say association that means some form of reporting to somebody who’s going to rely upon it beyond either management or the Audit Committee. So the challenges around earnings releases -- one, there’s no framework for which an auditor to assert to.

Bob Kuepper’s point of he maybe agreed upon procedures as a place where we could provide some value but today we’d have to rewrite the rules because agreed-upon procedures reports can only be shared with, in essence, internal people or people that signed our engagement letter that says, do those procedures.

Somewhere that would have to be something like
the SEC would designate the agreed-upon procedures
and then the report could be issued as a standard
form.

The third piece, and the piece that I have
struggled with on whether it’s a quarterly earnings
release or an annual earnings release, is maybe
absent agreed-upon procedures effectively what the
auditor would be doing is reporting on work in
process.

We’re not done the audit -- we’re not done the
quarter -- the interim review at the time the press
release goes out. I think how does an auditor
report on work in process -- something, quite
frankly, that we’ve struggled with a bit on comfort
letters where we’re in the middle of -- you know, a
deal gets done after the press release goes out but
before the 10-Q is issued, and that has always been
a challenge for us and that’s just an agreed-upon
procedures report.

So I think the whole area of non-GAAP and
earnings releases are things where maybe the
profession can place some value.
I just think you ought to carve those out and look at that as a different element of this project because I think the amount of time it would take and maybe to Lynn’s point the willingness of the marketplace to absorb that additional cost is a longer-term project than the more immediate issue of improving the reporting model for the auditor today. Thanks.

MS. WATTS: Steve Buller.

MR. BULLER: Just a few brief comments. I just struggle with whether we’re proposing a solution in search of a problem here, especially with respect to interim reporting. I mean, the auditor for us is involved in reviewing our significant transactions on an interim basis and reading our 10-Q and reads the earnings releases. But they really are focusing on pieces of the entire operation, and certainly they’re in no position to make any assertion on the overall quality of information or on the fairness of presentation. So although people would hate to have it characterized as such, it reacts as a
detect type control for management, and I think
they’d feel comfortable reporting upon anything --
any association with the financial statements other
than perhaps a type of agreed-upon procedure.

With respect to the year-end reporting on the
activities they perform with respect to the MD & A
and other information contained in reports
containing financial statements, I think that
perhaps can be clarified, as we’ll probably discuss
next in the auditor’s report, as opposed to
requiring a further set of procedures over their
function.

MS. WATTS: Flerida Rivera-Alsing.

MS. RIVERA-ALSING: Thank you. One thing --
assurance on certain information is not a matter of
whether we trust the management or we trust the
Audit Committee of the company. I think, as former
President Reagan said, trust and verify, and we
look at the auditors to do the verification on
behalf of the investors.

Saying that the auditors are involved in the
process is enough, I think, is incorrect because
that will give us a false sense of security on those numbers that are being released quarterly under earnings.

And then discussions about who are the users of the financial statements. Some says -- some say only the sophisticated investors. I totally disagree. I think it should be the reasonable investors. Thank you.

MS. WATTS: Okay. We’ll take Bill Clark and then Charles Elson. Bill?

MR. CLARK: Yeah. Just -- I think I basically agree with what Steve from BlackRock said. I mean, just from talking to other pension managers and being in groups that represent funds, I think in the abstract most investors would say everything up on that screen is fantastic and is something we should strive for.

But practically, I can’t say I’ve ever talked to anyone who would put that near the top of a list of things that they would want to see in terms of improved governance in financial reporting.

And maybe it’s because of the cost
justification. Maybe because there are just other
issues that are more important. I just -- I just
don’t see this burning need or desire on the part
of investors to make this a priority item.

And then you kind of link it back to Lynn’s
comments to the extent political capital would have
to be used to get something like this done, I think
I would probably agree we’d rather it be used
elsewhere.

The other point on the earnings releases, I
would say more often than not the things that move
the market the most are the forward-looking
statements which wouldn’t be subject to review
anyway.

So I’m not -- and again, maybe that just gets
to the point in terms of how much value -- is it
relative to the cost and the impact on time in this
because I agree with that as well.

When you get to the fifth business day and
Alcoa is not out there with their earnings results,
I think you’ll see some reactions from investors.

MS. WATTS: Charles Elson.
MR. ELSON: I think there are certainly portions of the MD & A that the auditors could give an assurance on. The problem is once you move beyond the financials and you move way beyond the financials, there’s a real slippery slope, I think, involved that once they are asked to provide assurance outside of the financials into other areas there’s the danger that they’ll be called upon to begin to offer expertise or insurance on all kinds of things, once you go through that -- you break through that line, if you will.

I mean, I’ve always, you know, wanted to be a fighter pilot but I can’t see beyond my nose and, you know, there are certain things that I’m not good at. I can’t repair plumbing and, you know, I can read a law text but that’s where I need to stick to my business.

And I think that if you take them outside of the area which they have traditionally had expertise and knowledge, even if it looks a little bit like outside of that area they have some expertise, it’s a real slippery slope.
Once you do that, then there will be pressure then to go beyond that and they effectively become this sort of uber monitor of the corporation, and that’s not what they were set up to do.

MR. BAUMANN: Thanks, Charles. Sam, I’m going to ask a question -- if you can’t answer it or if Bob or one of the others from the firms want to take a shot or don’t want to answer it -- but Lynn made a point before of what’s politically possible in this -- at this particular point in time and was talking about this area of providing expanding auditor responsibility to cover, for instance, critical accounting estimates.

They may not politically feasible and I guess mainly because he was talking about cost, I think.

From your perspective -- and if you don’t have a view, fine -- would the AD & A be -- what’s the relative costs of auditor reporting in an AD & A format versus auditor reporting on critical accounting estimates?

MR. RANZILLA: Well, let me -- let me reply on behalf of Bob Kueppers and Deloitte & Touche.
Marty, this is just my view and this is something that we have talked about. I believe it is -- it will be more costly to do an attestation of critical accounting estimates than it will be to do some form -- a form of AD & A that is very close to what’s included in the concept release.

So I do think it is. Others might have a different view. But I will tell you I think the risk of affecting filing deadlines is more significant for an AD & A than it is for an attestation of critical accounting estimates because while MD & A is usually prepared later in the reporting cycle, it’s also something that we can continue to do work on over -- first of all, it’s objective in terms of you’ve seen the report, does it comply with SEC standards, where an AD & A is going to go through multiple reviews internally -- it’s going to go through multiple reviews at the company, at the company’s counsel, at the Audit Committee, at the Audit Committee’s counsel.

And I think an AD & A has a higher risk of slowing down financial reporting even though it is
marginally less costly than an attestation of MD & A. That is one man’s view.

MR. BAUMANN: All right. Thanks, Bob. Lynn, is your card up on this topic? Okay.

MR. TURNER: Yeah. Also speaking for Bob Kueppers, I’d probably beg to differ with Sam on the -- the critical accounting policies, when I’ve gone through and I’ve done this here recently, looked at them and compared them to what their auditor is already reporting on in terms of the accounting policies back in the financial statements, there just isn’t that much difference these days, quite frankly, and in fact in some cases you actually see more and more robust disclosures back in the actual footnotes.

So I would be shocked or surprised if it cost me more to get an audit report and assurance on the critical accounting policies than it would be to do a separate AD & A.

Having gone through and done MD & As and knowing the process that we’ve gone through to do that, I think there would be levels of review.
It’d take you more time -- not a lot more time because keep in mind you have to have that completion memo done by the time you sign off on the financials and get to the report date, and most of what you’re going to write about would be at least in that completion memo anyway, which the partner -- concurring partner -- and if it has to go up the ladder that already has to be signed off on -- and so I think the AD & A would have additional cost.

Do I think it would slow things down that much? No, since I don’t believe we’re asking the auditors to do any more audit work.

What we’re telling -- asking them is to tell us what they know from the audit work they’ve already done and they already have to capture that in that completion memo.

I don’t think it should be significant additional cost, and if you do it on a fairly limited basis along the lines of what Alan Beller was suggesting I think there should be some additional cost and reimbursement but I don’t think
they’ll be that significant. But that’s just
talking for myself.

MR. BAUMANN: Thanks, Lynn. All right. I
think we have Bill Clark, Sam Ranzilla -- still up,
Sam? Bob Kueppers to probably speak for himself,
and Mike Gallagher.

MR. KUEPPERS: I don’t -- I don’t agree with
Bob Kueppers.

[Laughter.]

MR. KUEPPERS: Either one of them.

MR. BAUMANN: Does that often happen to you?

[Laughter.]

MR. KUEPPERS: Here’s the truth. Sam’s right.

We talked about it. But what he said that I -- I
just want to point out I think the critical
accounting estimates -- you know, attestation --
that’s going to be about the work, less about the
report.

It just -- AD & A is all about the report and
I think -- I think there are additional costs but
it’s because of the iterative process you're going
to end up going through -- certain amounts of
reviews.

But we don’t have any data that would suggest one versus the other. You know, Sam said marginal.

There’s a cost but we have done no studies to determine with any reliability the distinction between the two.

MR. BAUMANN: Mike.

MR. GALLAGHER: Yeah, Marty. That’s kind of where I’m at. I mean, I honestly don’t know. It was interesting. Sam went one way, Lynn went the other way. I’ll say I don’t know.

But don’t underestimate the cost associated with the level of review, and it’s not as simple as taking that completion memo and just publishing it. At the levels of review that would be extensive. And I’ll just add to it, the other option -- the emphasis of matter paragraph -- I would say out of the three that’s the least costly or and I would say most cost effective, perhaps.

You could argue between whether MD & A or whether that, but in terms of being able to do something quickly and relatively inexpensively that
strikes me as something that would be the lower
cost alternative and maybe greatest value.

MR. BAUMANN: Mike, you began. You were one of the two that began this discussion and Dan, is your card up too? Oh, Flerida. So Flerida, why don’t I give you the floor and then Mike, I’ll give you the last word on this one before we turn to our next topic.

MS. RIVERA-ALSING: Thank you. I just want to agree with Lynn. I will be very shocked that the assurance and critical accounting policies would cost more than the AD & A. Currently, the audit firms are already disclosing that and giving that assurance to the Audit Committee.

MR. BAUMANN: Mike.

MR. COOK: Marty, I share that same view. I guess if I were talking to a group -- a room full of Audit Committee chairmen I would say to them have a conversation with your auditing firm, your lead partner, and ask them what it would cost to report to you, perhaps -- might be the external reporting -- we could think of that separately --
on MD & A, and if it’s going to cost a lot then I
would be asking myself why is it that that isn’t
being done today because this is critical
accounting policies, estimates, and judgments that
go into the preparation of the financial statement.
This is not new territory for the auditors.

Why would it take a great deal of effort to
give us a report on something that is so integral
to the financial statements? And if the answer is
it’s going to cost a lot, maybe we ought to start
spending it because auditors aren’t spending the
time with critical accounting policies, estimates
and judgments that they should be. I don’t -- I
just don’t know.

I just personally don’t think this is a big
add-on, and the form of reporting that has been
suggested seems pretty reasonable to me.

Just a final thought on the overall
discussion. I think there -- you know, again,
there are things here that are a bit controversial
-- provocative, maybe, but also just thought
stimulating. But I do think we ought to -- and not
perhaps as a part of this specific project -- I thought the notion of keeping these separate is a pretty sensible thing because they’re quite complex and quite different.

But looking at the total financial reporting process and who uses the results of financial reporting and when is it used and how is it used and where is the audit effort going, I’d like to hear from the investor community.

What do they use to make investment decisions? If their particular firm made a hundred investment decisions or recommendations in a year, how many of those are based on the annual financial statements that we’re going to do a lot potentially to change in terms of the auditor’s reporting on them?

How many of the decisions are made based on those statements? How many decisions are made based on quarterly earnings releases or Qs?

Take your pick. And ask yourself if we have the cost of assurance attestation reasonably aligned with the decision making that is resulting from that. I’d kind of like to know because if
they make a hundred decisions a year and 94 of them are made for reasons other than what’s in the annual financial statements, and Mike’s point I agree with -- the data which is driving that -- then are we spending all of what we’re spending on 6 percent of the decisions that are being made and is that a wise allocation of limited resources, and maybe those resources should be reallocated.

The thing I think that comes up here is this question about quarterlies and does it really make sense not to have some form of auditor engagement that reaches third parties.

If you stood back and asked the question would the emphasis of matters make a whole lot more sense if it was done on a timely basis instead of emphasizing things next March that are relevant in the second quarter of this year, and maybe that ought to be integrated into the quarterly reporting process, not into the annual financial statements.

Again, I realize the jurisdictional problems of PCAOB and others and I realize the real-world
limitations that Lynn refers to, and I’m just saying let’s think about what matters, when people get it and if we’re going to fix things would it be better to invest some of our resources in fixing the things that matter the most instead of continuing to shine the caboose. So I’ll leave it at that. Thank you, Marty.

MR. BAUMANN: Thanks, Mike. Sam, is your card up again?

MR. RANZILLA: It is, if I might indulge you one last time. First of all, I’d like to -- there’s a difference between critical accounting estimates and critical accounting policies. We, at the CAQ’s recommendation, is very specific to critical accounting estimates.

The second point that I’d like to make for your consideration is when you go back and read what is required under the critical accounting estimates for disclosure, I ask you to then try and find those disclosures in today’s MD & A.

And while I agree the auditor is all over critical accounting estimates in determining
whether or not the financial statements taken as a whole are fairly stated, I don’t think there is a significant amount of original work.

But the disclosures that are required under that financial reporting release are fairly extensive and will require additional work on -- if not being done today on both behalf of issuers and with auditors.

So I just ask you to look at that very closely when you assess what all that would take and what is the cost benefit around that approach.

MR. BAUMANN: Thanks, Sam. Lynn, is your card up again or -- thanks.

MR. TURNER: Just one quick comment on the issue of who are you doing these for, Marty, and the reasonable or whoever the investor is -- Aunt Martha or Uncle Lyle.

But another thing to think about there’s a -- there’s a study been completed by IBM by a person who’s now at State Street, and in that study it demonstrates and finds that 85 percent of the portfolio investment managers in this country
underperform just industry benchmark averages, which leads you to believe that if you're indexing with Fidelity or Vanguard you’re probably well ahead.

But 85 percent of the portfolio managers are underperforming, and I’d have to think that there’s some group of those people who are underperforming just because they don’t know what they should know and aren’t doing their homework.

But I also think that a piece of that underperformance is they aren’t getting the pieces of information that they need, which is to Mark and Michael’s point about the reporting model. And as you go and look through this, this is another example of a situation where investors are saying, we do need this additional piece of information.

And so if we’re going to try to get it to where these portfolios, which are so important to Americans retiring now and to this country in that respect, then we ought to really look at trying to get those investors the information that they need because the studies show that they aren’t getting
it and they are seriously underperforming.

And if you got 85 percent underperforming, that’s a really serious problem. Eighty-five percent of these people aren’t dumb and aren’t incompetent. So I’d suggest you may want to go get that study out of IBM and see if -- and/or talk to the lady who did the study who’s now at State Street and see if there’s some additional information that came out of there that might give you some tidbits on information that you could require that would help improve that for American investors.

MR. BAUMANN: I think I’d like to turn to the very last subject. But Stephen, do you have one more word on this?

MR. KOZERACKI: Yes. I just -- I was listening to what Mike Cook was saying about, you know, the timeliness and the importance of the quarterlies and, I mean, I think he is correct and that probably a lot more decisions get made based on the quarterly information.

But I think one of the differences is that,
you know, most large public companies, after they release quarterly information, you know, the analyst community and investors have, you know, access to management for anywhere from, you know, 45 minutes to a -- maybe up to an hour and a half and, you know, you have sort of an entire group of educated investors and analysts who are sort of able to pepper them with questions and ask them, you know, a lot of detailed questions about, you know, perhaps how some things -- businesses perform during it and maybe even get some outlook on, you know, what’s happening in the current quarter.

And so I think, you know, investors get some -- more comfort from that, and then also there’s transcripts from those calls that allow the investors to review that as well. And I’m not sure they would want to give that up or the timeliness they get from the earnings release with the follow-up call with the -- with management just to get, you know, something that says, you know, we reviewed the earnings release and it, you know, appears to be accurate.
So I think there are more decisions from the quarterly information but I think it’s as much based on the follow-up conversations with management and the investor calls rather than, you know, what’s being attested to that the quarterly release is accurate.

MR. BAUMANN: Thank you very much. Well, turning to the last subject, Jennifer Rand does a lot of extraordinary work in the Office of the Chief Auditor and she will miraculously cover the last hourly topic in the next 30 minutes. Jennifer?

MS. RAND: Thanks, Marty. Okay. We’re in the last section of talking about alternatives in the to the audit -- changing the auditor’s report. This section will cover both clarifying language in the standard auditor’s report as well as other alternatives that weren’t described in the concept release or could also be a combination of the alternatives.

Going to the clarification, when we did -- when we did our outreach -- and a lot has been
talked about the outreach we performed, which really helped inform our views on the concept release -- we did hear that while the current report is boilerplate, there would be some benefit to enhancing that quote, unquote, "boilerplate language" to better describe what an audit is and what an audit represents.

Many in our outreach said that would be a cost effective way to making some changes and there could be some benefits to doing so because there is some confusion about the auditor’s responsibility over certain information like other information and other matters.

So certain other topics, and this list is not all inclusive, but it would be describing what’s meant by reasonable assurance, and an auditor’s report provides reasonable assurance that the financial statements are fairly presented.

So some have said it’d be helpful if the report described what reasonable assurance means. Another area is the auditor’s responsibility for fraud. The auditor’s report today does not
describe what that responsibility is and some said it would be helpful if it did.

Another is the auditor’s responsibility for financial statement disclosures. The financial statements include balance sheet, income statement, cash flow as well as the notes to the financial statements, and some have suggested perhaps it would be helpful if that was mentioned in the report.

Another is management’s responsibility for the preparation of the financial statements. There’s a sentence in the report today that says the financial statements are the responsibility of management but some have said it would help if it – if there was better clarification that management is determining estimates and judgments and then the auditor’s responsibility is to issue an opinion on those financial statements. So what goes into the preparation of the financial statements.

Another is the auditor’s responsibility for information outside the financial statements, so MD & A. For example, we just talked about should
there be greater assurance and we’ve talked about that auditors read MD & A for material inconsistency.

But the auditor opinion doesn’t tell you that, and from what I heard from comments in the last section some think that auditors do a lot and they’re all over it, as one person said, and others indicated well, they do a lot but it is limited to reading and so forth.

It doesn’t go into all the things that’s in the attestation report that exists but currently many auditors are not engaged to do those type of assurance reports.

And another possible area is auditor independence. The title says it’s the independent auditor’s report but some have said it’d be helpful to know more about auditors’ independence -- if there’s any potential issues discussed with the Audit Committee and have that brought forward in the auditor’s report.

So the questions we’re asking in that area include would these potential clarifications serve
to enhance the auditor’s report and help readers understand the report, the auditor’s responsibilities, why or why not; what other clarifications or improvements could be made to better communicate the nature of an audit.

I said that the list I just went over was not all inclusive. There’s others. And then what are the potential benefits and shortcomings to providing clarifications in the report.

And then also in this section I want to cover other alternatives. So what alternatives or are there any other alternatives that the Board should consider as far as changing the auditor’s report. Would a combination of the alternatives that we’ve discussed today or presented in the concept release be more effective, so are you supportive of emphasis plus reporting on MD & A or something like that, and which alternative is the most appropriate and why.

So with that, I’m going to open up the discussion to both talking about clarification and other alternatives and we will effectively do that
in now 25 minutes. So I open the floor up for your
comments.

MR. BAUMANN: Things we are particularly
interested in, as well as the commentary on
clarification, are the things that we haven’t
thought about that we’re not yet -- that weren’t
put in the concept release that somebody here
thinks this is another good way to deal with
clarifying or improving the auditor’s reporting
model, as Jennifer said.

MS. YERGER: Well, it’s hard to say you oppose
a clarification because by its very nature, I mean,
everyone wants things clarified. I think -- when I
see the long laundry list I get concerned that one
of the primary benefits of that -- the current
pass/fail report is its brevity and you add a lot
of legalese, which I think a lot of this would be.

I don't know if that’s a good thing. So let
me just comment on two clarification/enhancements
that were part of the Treasury Department’s
Advisory Committee on the Auditing Profession --
the ACAP, as we lovingly called it -- I was on that committee -- and I think they should be considered.

One has to do with the auditor’s responsibilities regarding fraud, and we talked a lot in that committee about that expectation gap and our feeling was that the biggest expectation gap was about what’s the auditor’s responsibility when it comes to detecting fraud.

I think it’s shocking, in a way, that the auditor’s report doesn’t even mention fraud, and the auditing standards do currently require the auditor to plan and perform the engagement to detect material misstatements whether caused by error or fraud, and I think that does need to be explicitly placed into the auditor’s report.

The second item, which might be dubbed in the more provocative area and it’s certainly an enhancement and not a clarification -- is -- and it was something that was discussed quite a bit at the ACAP was the addition of the name/signature of the audit engagement partner on these reports.

I don't think anything sharpens the mind more
than placing a name on something and we think that
would be a very important and valuable addition to
the current report.

   MS. RAND: Thank you. We do -- just on the
second point regarding the name, we do have a
separate project looking in that -- at that. So
that’s very active. I’m involved in that one as
well.

   This audit report is looking at the content --
what should be in the report. That other separate
project, which is actively moving forward, goes
into who providing transparency and to who. Is
that Charles Elson or -- no, totally wrong.
Sorry.

   MR. SANTAY: Mike Santay.


   MR. SANTAY: Yeah. That’s okay. Just a
couple of brief comments. Generally, we support
the changes that are outlined and some of these,
you know, I think there could be some alignment
with some of the proposed standards. For example,
the International Standards on Auditing have
addressed some of these matters and I think would be helpful to look at that as part of these considerations.

And then just, you know, operationally -- for example, if we were to add something around other information -- you know, reports get reissued, consents get used -- the other information might change. Just so from an operational perspective just be careful with how much detail we get into or specificity in some of these additions if the Board decides to move forward with some of these recommendations.

MS. RAND: Thank you. Mark Newsome.

MR. NEWSOME: Thank you. You know, the first thing is, you know, if you’re going to expand the form in a boilerplate fashion I’m not sure that would be all that helpful.

I would encourage auditors to differentiate themselves with the letter -- make it more like an opinion that you might see in other situations. But with regard to the audit opinion itself, I would encourage you to include a negative assurance
We often ask that of auditors in private investment transactions where the auditor will actually send us a letter, we’re not aware of any defaults or other things that might cause you to be concerned or might cause a default in your own investment structure. I think that would be very, very helpful and something that people often want to see.

MS. RAND: The auditor’s opinion is reasonable assurance (inaudible) higher than negative assurance unless you’re looking for a particular negative assurance on particular items because the opinion goes as a whole -- the financial statements as a whole.

So are you looking for certain specific --

MR. NEWSOME: Right. I’m not looking for a lower level of assurance and so what I’m talking about specifically is a statement, we are not aware or have not become aware of any defaults or fraud or other matters, you know, in the opinion itself. That’s something that we ask for from auditors
separately from their opinion.

MS. RAND: It looks like I have the order down in a row. So Gary Kabureck and then Mark LaMonte.

MR. KABURECK: Thank you, Jennifer. Just a couple of quick comments in here. In terms of other alternatives, one thing you might consider is in the auditor’s end report the role -- their involvement with unaudited statements, and you got a unaudited quarterly data footnote. I mean, it -- you’ve got some other unaudited, you know, subsequent events footnotes.

Maybe there’s some other special industry disclosures that are unaudited. So what -- so these are annual financial statements. I mean, they’re -- when they’re filed they’re covering stuff at least 14 months earlier.

So what’s their involvement or responsibility for the unaudited data in their -- I’m thinking quarterly or subsequent events but maybe there are some other things -- again, just clarifying responsibilities that your work extends to the annual statements and not to the interim.
Now, maybe you got to clarify and say we’ve done reasonable procedures or something that goes back to the rest of the stuff about what else would you opine on. So there’s that on the unaudited and the interim.

I think if you’re going to pick one thing off this list I would say it’s the responsibility for fraud whether -- either what the current responsibility is or what the (inaudible) may choose that should be in the future.

And then lastly, you know, Ann’s point -- I absolutely personally agree with putting the auditor’s -- signing engagement partner’s name in the report, and I know we’ve discussed it several times at SAG and the PCAOB has done many times and you’ve heard me say more than once in this forum.

We’ve spent a lot of time on it. It’s time to just give it a thumbs up or thumbs down vote, in my view. But since my own name is the releasing officer’s in there I see no reason, you know, why the firm couldn’t be there too.

I do appreciate you've hired the firm, not an
individual. But nonetheless, these are Xerox’s financial statements, in my case, but they are going out under my signature so --

MR. BAUMANN: You’re endorsing the signature concept. Thank you.

MS. RAND: Okay. Mark LaMonte.

MR. LAMONTE: Thanks. Looking at your laundry list, I do see value in an investor knowing more about many of those things and the auditor’s various responsibilities and the limitations thereof.

The concern I have about this or the thought I have about this is that you’re just going to probably get very standardized language that will be the same from report to report depending on who the signing firm is.

So an easy way to address this or a way to address this more efficiently where you’re not, you know, just increasing the forest for the trees problem we already have with very long annual reports is just include a Web link in audit opinions. It takes you to the firm’s website where
all of these things are described.

Beyond that, the one that could be unique for -- from company to company is the discussion of auditor independence and issues affecting auditor independence.

Quite honestly, I would be surprised if investors are ever making investment decisions based on a view of whether or not they think an auditor is more or slightly less independent. So I’m not sure adding much on that in an opinion really would add value for investors.

MR. BAUMANN: On the point that Mark just made, Mike, or someone else, maybe you could help me. The U.K., I think, has that requirement today, don’t they, where there’s the opinion but there’s a link to some of this other information about the audit. Do you know if that’s accurate or not?

MR. GALLAGHER: Yeah, I think that is. I think that’s -- you know, we’d certainly be, you know, very interested in looking -- certainly would have no objection to looking at that, Marty.

MS. RAND: Mark, just to follow up on your
point about independence, in our outreach one of the -- I guess another reason that was cited that it might be helpful just to at least have a statement in the opinion for the auditors to reaffirm their independence. The title says independent auditor’s report but if they sign off every year, yes, and we are independent there might be -- some perceive there might be some benefit to that.

MR. LAMONTE: I don’t think a brief statement would hurt. I think that’d be fine. An extensive discussion, however, would not add value.

MR. BAUMANN: Well, the auditors are also required to report to the Audit Committee of matters that might be thought to bear on independence, such as if they had an independence violation during the year what that was and why they believe that doesn’t affect their independence.

Do you think investors would benefit hearing about the things that might be thought to bear on independence -- that is, we found out that our
manager owns some shares of stock and we replaced
him or her and reaudited the area they were
responsible for, and therefore we believe we can
continue to express an opinion. Would that type of
information be of value?

MR. LAMONTE: Of all the things we talked
about today, I think that would be one of the least
influential on an investor’s actual decision
making.

MR. BAUMANN: Thanks for that clear answer.
We got clarity around something today.

[Laughter.]

MS. RAND: Okay. Flerida.

MS. RIVERA-ALSING: Thank you. Of all the
list that you have, there are three things that I
do support. The auditor’s responsibility for fraud
-- I would like to know what auditors do to assess
the risk of fraud in the entities that they are
auditing, and then the auditor’s responsibility for
financial statement disclosures.

On opinion page of the auditor’s, they
referred to the financial statements as only the
balance sheet, the income statements and the
statement cash flows. Nothing is being said about
the notes to the financial statements, but really
the devil is in the details. If you read the notes
to the financial statements you will learn more
about the financials.

The third one is the -- is the auditor
independence. We hired a lot of auditors in our
organization and they do an extensive check on
whether indeed the entire audit firm is
independent, but I noticed that it is more
exhaustive when the entity that they are auditing
is a public entity.

But if it is a private entity they don’t
really do a lot of -- I don’t know, it’s just my
impression. They do affirm to the Audit Committee
their independence and I do know that there are
discussions about it.

Whether that is valuable to the individual
investors or not, I think it is important for us to
know if there is a conflict of interest as far as
the auditors are concerned because we are relying
on their words but if there is a conflict of interest should we rely on their words.

The fourth item that I do support is the name of the engagement partner. I would like to know who did sign the financial statements. Why should it be a secret? It is known in the entire audit firm. It is known in the company. Why should it not be made public? That’s all.


MR. CIESIELSKI: Thank you. First of all, I’d just like to point out, and maybe it’s stating the obvious, but this is a little different than the other three areas that we discussed in the proposal in that it’s not really so much amplifying information about the audit -- it’s more or less redefining the audit report.

Maybe I’m envisioning it wrong from the concept release but I’m thinking that this would be a revised standard opinion and the language probably wouldn’t change much from one company to another or from one auditor to another.

But I think what we have heard today is that
there are different levels of knowledge of what
goes on in an audit by investors and there’s
different levels of what investors -- knowledge of
what investors do by auditors.

But, you know, by having something out there
that more clearly delineates responsibility for
fraud, for disclosures, management’s
responsibility, a statement of independence other
than just, you know, the one reference to
independence that we already have I think it would
be good.

You know, maybe it would be a standard rubber
stamp opinion but I think it would be a way of
educating some investors about what an audit does
or doesn’t do, and I think if you have the
possibility of having to state something
embarrassing like what happened with our
independence during the year I think investors
indirectly benefit because I think firms would be
very much more on their toes about whether their
independence is impaired or the appearance of
independence is impaired.
So, you know, I don’t view the clarification of language section of the concept release as anything that’s, you know, earth shaking but more or less, you know, clarifying what we’ve already implied in the existing audit report. So that’s it.

MS. RAND: Okay. Thank you, Jack. Steven Buller.

MR. BULLER: Thank you. We sat down with our analysts and walked through these criteria, and it was interesting because as you go through them one by one you say, is it a good idea to put in clarification on reasonable assurance and the answer is oh yeah, it’s a good idea.

And you go down to responsibility for fraud and they said oh, that’s a good idea too. And you go through all of them and one by one they say, you know, those are good ideas.

Well, then you say okay, so here’s what the opinion looks like, and they say oh, that’s a lot of opinion. And so you almost -- we sat down and said let’s talk about a Mazlovian hierarchy of
needs and what you think would be most important to
a user of financial statements -- what’s least
clear right now -- and they said that probably the
auditor responsibility for information outside the
financial statements for them would be the one
thing which will be useful for clarification and
also the responsibility for fraud would be good
clarifications.

They thought that, consistent with our earlier
comments, auditor independence should be in an AD &
A section where it talks about auditor -- or an
auditor inputs being used, the procedures they’re
performing -- belongs in that section.

They thought it was a good idea but not
necessary to include auditor responsibility for
financial statement disclosures and for preparation
of financial statements. They thought those were
pretty self-apparent.

But they would not -- we wouldn’t object,
certainly, with support and inclusion of all these
in clarification somewhere. We just think that if
it’s -- if these are all part of the ultimate
solution they probably belong in a separate and subsequent paragraph or a long footnote somewhere in the opinion so it doesn’t overwhelm and obfuscate the ultimate communication you’re trying to make about the auditor’s conclusion on the fairness and presentation.

MS. RAND: Thank you. Regarding clarification, just a couple of thoughts. I see clarification as having a couple potential benefits. One, it really would add -- it would -- while it would add language to the standard auditor’s report, it could serve to help educate investors -- better inform investors and other users of the financial statements about what an audit is and what it represents.

And another benefit I potentially see is, when the auditors are signing that opinion, having the auditor’s responsibility stated in there for fraud helps reaffirms that responsibility when they’re issuing the report that the auditor has done those things, potentially. So I see those two potential benefits.
I am very -- I don’t see any other tent cards up but I am very -- we haven’t gone over my 30 minutes for this session. So I am interested if others have any suggestions, thoughts for other alternatives that we have not explored today.

I guess we -- oh. Is that -- oh, Joe Carcello. Sorry.

MR. CARCELLO: This isn’t really another alternative, Jennifer, but it looks like we’re winding down and I wanted to get this in before. I didn’t know when you were going to kind of call time here.

So it struck me that, really, this afternoon was very different than this morning. I think the last hour, although not unimportant, is -- clearly is lesser importance than the three things we talked about earlier today, and I think our discussion about the MD & A -- I agree with Sam on this -- it’s a worthwhile discussion but it’s probably down the road.

I think the real issue for the Board is going to be an AD & A and/or in emphasis paragraphs and
how those are implemented. And so I went back and I looked at who we had here today and I -- if I counted right there’s approximately 32 folks here today, not counting the Board and not counting observers.

Sixteen of those people could be classified as either direct investors or indirect investors or investor advocates, and the other 16 would be auditors, Audit Committee members and preparers.

And although those 16 auditors, Audit Committee members and preparers are very bright and very articulate and very well informed, the mandate of the Board is very clear in the language that Congress create -- used to create the Board and that is to protect the interests of investors.

There’s really no ambiguity about that.

And so with apologies to George Orwell, all stakeholders are created equal but some stakeholders are more equal than others, and I would say investors are more equal than others than the people here today.

So I tabulated where people stood on the AD &
A and versus an emphasis paragraph -- and I encourage you and I’m sure you will go back through the transcript and audit my representation here. And so I’m going to go through this very quickly and if I’m miscategorizing anybody I would ask that they speak up, and this is in no particular order.

Steven Buller from BlackRock -- and this is a direct quote -- "AD & A could be useful" and then he kind of fleshed it out in a number of ways where he thought it could be useful. Flerida from the Florida Board in favor of an AD & A; Steven from Vanguard, AD & A would be helpful; Chris from Credit Agricole endorse AD & A.

Lynn Turner favors AD & A; I favor the AD & A. Ann Yerger favors the AD & A. Mary from CALPERS wants an AD & A. Jack favors the AD & A. Kurt wants the information from the auditor whereas less important so I’m not sure how you classify him. Paul from Capital Research, Matt from Fidelity and Gary Walsh prefer the emphasis paragraphs.

Mark Newsome from ING, I couldn’t tell -- he
never really explicitly stated it or if he did I
missed it. But he talked about due diligence
reports and how useful they were and it sounded a
whole lot more to me like an AD & A than an
emphasis paragraph.

MR. NEWSOME: AD & A.

MR. CARCELLO: I’m sorry -- AD & A. Mark
LaMonte from Moody’s -- give firms an opportunity
to decommoditize their product. Again, I don’t
know if he said it explicitly but I think they
probably have a better shot of doing that with an
AD & A than an emphasis, but that’s my judgment.
And William Clark from the Federal Reserve, I
couldn’t -- I couldn’t find where he really
expressed an opinion on this.

So if I’m even close to right, there’s 10
votes for the AD & A, three for the emphasis, two
no opinions and one no statement at all. If you
got that kind of vote on almost anything else in
today’s society you’d have an overwhelming mandate.

MR. BAUMANN: Thank you and -- well, I was
just about to acknowledge you, Chairman Doty, but I
I wanted to first thank the group for a tremendous energy and participation today and throughout the entire day.

I know it was a long day and throughout the entire day everybody stayed committed to the discussions and gave us a lot of important information, and for that I thank you all very much. And I would like to turn it over to our chairman, Jim Doty, for final comments.

MR. DOTY: It struck me today how much this resembled a real deliberation and not a polarized debate. It is what regulatory administrative -- quasi-administrative bodies have to have.

When we started off this morning saying it wasn’t the last such discussion we’re going to have it certainly -- we may not have another roundtable before the end of the year on this concept release and on this issue but there are going to be other discussions of this kind.

And I think you should be very proud of the way in which you conducted the deliberation by linking all of the important things you had to say
about the auditor reporting model concept release
to the bigger issues that relate to the future of
the audit profession, the welfare of shareholders,
the vitality of corporate governance in our
economy.

Listening to it, I think anyone who was
thinking about whether a process is moving in the
right direction would have been heartened and we
are deeply grateful for that and cannot conceive of
a better panel of expert opinion and enlightened
thought.

Lawyers always talk about leaving your
client’s interest at the door. It never really is
possible.

But in this case, we’re speaking with the
people who have the direct immediate interest in
the financial reporting model and its issues from
one vantage point or another, and you have managed
to articulate your own interest in it in an
enlightened self-interest way and in a way that
helps all of us get to a better understanding of
what each of us has to worry about.
We are deeply grateful to Martin Baumann and the standards group of the PCAOB. They have worked tirelessly and over the spring. This has been a most arduous period for them.

Like the long gray line of Douglas MacArthur’s remarks, they have not failed us. They have never failed us and they never will, and we thank you all again for the support you’ve given them. You will hear from all of us again. Thank you.

MR. BAUMANN: Thank you, and safe travels.

[Whereupon, at 4:59 p.m., the meeting was adjourned.]