

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Investor Advisory Group meeting on October 16, 2013 that relates to the Board's proposals (1) Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2 and (2) Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments. The other topics discussed during the October 16, 2013 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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INVESTOR ADVISORY GROUP

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MEETING

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WEDNESDAY
OCTOBER 16, 2013

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CHAIRMAN HARRIS: In terms of this final general discussion session, I emailed all the Investor Advisory Group members, tasked them what topics they wanted us to discuss. And they indicated the auditors reporting model, audit transparency, the status of the PCAOB's work on the ACAP recommendations which is, I think everybody knows ACAP refers to the report of the Department of the Treasury's 2008 Advisory Committee on the Auditing Profession, the global agenda, which is something that

1 Anne Simpson raised, oversight of audit committees, and
2 the possibility, although I think there was enough
3 communication that we're probably not going to bring up
4 a fair value accounting.

5 Since the first two topics are under
6 consideration by the Board, we've made it clear that all
7 comments will be transcribed as have the comments of this
8 entire session. But those first two topics deal with the
9 auditors reporting model and audit transparency.

10 And I should say that I anticipate that this last
11 hour's discussion will be relatively free-flowing with
12 members discussing issues as they see fit. And hopefully
13 we'll have time before we break for everybody to bring
14 to our attention what is most on his or her mind.

15 So having said that whether or not we want to
16 start with audit transparency or the audit reporting
17 model, whoever wants to start with that subject matter
18 or either of those raise your tent card and we'll start,
19 Ann, with you first, and then we'll just recognize people
20 as they put up their tent cards. So Ann Yerger?

21 MEMBER YERGER: This is Ann Yerger, one of the
22 two Anns named here. Well, yes, let me make one comment

1 regarding just auditor report, and it sort of links on
2 to our prior conversation.

3 I know we were talking a lot about audit
4 committee disclosures to investors, but I do want to
5 stress that certainly the council and personally I'm in
6 favor of an enhanced auditor report to the public.

7 I appreciate the benefits of sort of that
8 pass/fail model that's in place, but I think there's
9 terrific, important information that the auditors have
10 that I think should be disclosed to the public.

11 Second, let me comment on the issue of auditor
12 transparency. I think that there is no simpler or less
13 expensive reform that should and could be put in place
14 than requiring the disclosure of the name of the partner
15 on the engagement. I think nothing sharpens the mind
16 more than a signature.

17 I know we all have to sign documents, public or
18 not, and I pay a lot of attention to that. I think it's
19 an incredibly important reform and I urge the Board to
20 move forward with that. Thank you.

21 CHAIRMAN HARRIS: Anne Simpson?

22 MEMBER SIMPSON: Thank you. I'd like to fully

1 support what Ann Yerger has just said. I think the
2 question of transparency on the audit, it's hard to
3 understand who would object to this. Who would not be
4 willing to stand and be held accountable for their own
5 work?

6 I recall us having similar discussions around
7 boards of directors 20 years ago about knowing who the
8 board were, what their background was and so forth. It
9 seems to me just exactly as we were talking about, the
10 accountability to shareholders which is in real need of
11 being strengthened. That sense of personal
12 accountability is extremely important. So we fully
13 support this and we actually think it will sharpen the
14 discussion in an extremely useful way.

15 On the auditors reporting model we'll be putting
16 in comments. I think, you know, you will remember, I
17 think it was the first meeting that I came to we looked
18 at the auditor report, was one of the issues in the
19 working group that I participated in.

20 And my party piece of the day was to illustrate
21 the problem we had as shareholders by reading you the
22 audit report from Bank of America before, during and

1 immediately after the crisis. And there was not one dot
2 or comma different.

3 So I think if we can't use the audit report to
4 communicate on critical issues, and many of them are
5 listed out in the consultation, then really this is
6 becoming an exercise in pushing paper around. So
7 accountability will be sharpened with transparency, and
8 quality will most definitely be improved with this new
9 scope to the audit.

10 DIRECTOR DOTY: With transparency there has been
11 an issue raised in the comment process over the original
12 proposal as to whether it was either useful or necessary
13 or appropriate to have the engagement partner disclosed
14 in the audit report, whether the same results could be
15 achieved by having a separate form, a Form 2 filing or
16 a special form that we would devise which would be filed
17 either annually or within a certain period of time
18 following the completion of the audit that would contain
19 this information.

20 That raises also the question of whether you just
21 stick with the auditor's name, the engagement partner's
22 name, or whether you include more extensive information

1 about his or her qualifications and the audit team. Are
2 there any views you have on that?

3 MEMBER YERGER: I would strongly prefer that
4 there not be a second or another filing. You know, the
5 more you make folks hunt and peck for something, I think
6 the less valuable it is. I don't know why you would add,
7 you know, make something more complicated that really
8 doesn't have to be.

9 I don't object, frankly, to having additional
10 information disclosed regarding the background or
11 expertise of the individual. I think that can be helpful
12 as well. But I do think just having the name is a good
13 data point. I think it sharpens the mind and I think it
14 also can give the audit committee good information as
15 well to compare.

16 MEMBER SIMPSON: Yes, I agree with that. I mean
17 an auditor should be proud of the work they're doing.
18 And in the same way that we know more now about the
19 people who serve on the boards, it's entirely appropriate
20 to have that sort of information about the auditor and
21 the audit partner.

22 This is entirely complementary to the

1 improvements we'd like to see to the audit report itself.
2 So if transparency is the watchword, you know, we hope
3 the wind is in your sails. We certainly, as the users,
4 the prime users of this information, fully support what
5 the PCAOB's hoping to achieve.

6 MEMBER BUETTNER: And Steven, I would just say --
7 sorry, just to jump in on the back of that. I would say
8 that if you are going to disclose additional information,
9 the tenure, that particular engagement partner's tenure
10 is actually relevant and important information and should
11 be included.

12 CHAIRMAN HARRIS: Well, as I say, since this is
13 the equivalent of a comment period as well, you're being
14 transcribed, what are your views in terms of the
15 identification of the engagement partner and the
16 identification of other auditors involved in the
17 engagement?

18 MEMBER BUETTNER: I would agree. I think the
19 more information, frankly, the better, and I would think
20 that to put that on a separate form probably complicates
21 the issue as well. It should be relatively easy to find.

22 CHAIRMAN HARRIS: Norman?

1 MEMBER HARRISON: Very quickly on this question.
2 First of all, I violently agree with everything that was
3 just said on the other side of the room. But to take it
4 a step further, as some may recall I was on the working
5 group last year that dealt with the issues around the
6 audit report, and of course we raised this issue at that
7 time.

8 It's an important transparency issue, but it ties
9 in as well to other things we've talked about today
10 including this issue of whether there is or perhaps why
11 there isn't competition for audit services that's based
12 on quality.

13 I think that ownership and putting identities
14 with work product, I think, moves us a step in that
15 direction. And it may have some beneficial aspects for
16 compensation issues as well. So I just wanted to point
17 out, I think that it's an important issue for the reasons
18 that both Anns provided but that it ties into a number
19 of things we've talked about today.

20 CHAIRMAN HARRIS: It's extremely important that
21 we get the temperature of investors on this issue because
22 oftentimes the assertion is made that we only have

1 comment letters from the profession.

2 I mean the profession's comment letters totally
3 outnumber the comment letters that come from investors
4 or representatives of investors or people who are
5 associated with investors. So, you know, to the extent
6 that you can flush out your arguments either pro or con
7 on these issues, it's important to get it on the record.

8 Mike?

9 MEMBER HEAD: Mike Head. And as far as the
10 additional auditors report, obviously I was on the
11 similar subcommittee last time and still feel an
12 auditor's discussion and analysis supplemental report
13 would be very valuable.

14 And I guess based on what you just said I have no
15 problem with a supplemental filing. I would just then
16 require whoever the lead engagement partner is that is
17 on the supplemental filing has to sign and be shown on
18 the opinion in their name. I'd give them both instead
19 of one or the other.

20 CHAIRMAN HARRIS: Lynn?

21 MEMBER TURNER: The getting the auditor's name,
22 I think, would be very good. In fact, I'm shocked that

1 this thing's been debated for 40 years and finally it
2 looks like maybe someone will actually do something about
3 it.

4 I agree, well, I mean put it this way, I don't
5 think it matters whether you have a separate ADNA or you
6 included in the filing the 10-k or whatever filing it is
7 itself, what I'm concerned about is the information and
8 getting the information that you need and I care less
9 about, you know, which page it's printed on.

10 With respect to information that would be useful
11 to and impact on someone voting on whether or not to
12 retain the auditor, I think that stuff clearly ought to
13 go into the proxy because that's when investors are most
14 likely to be looking at it and where they're most likely
15 to look at it when making that vote. So I think it
16 probably ought to go in there. I wouldn't do a separate
17 filing out beyond that.

18 As far as information like tenure and that as
19 long as it's factual, I think that is good. I asked our
20 CIO at Copara to survey all of her analysts and portfolio
21 managers, and one concern that they came back and
22 expressed was asking the auditor to provide information

1 that would be perhaps turned into spin or hype. They
2 were very concerned about that. They wanted it to be
3 factual information and information that the PCAOB or
4 someone at least periodically could test and see that it
5 was actually accurate. So at least in that group they
6 were very concerned about that at Copara.

7 So factual stuff like here's the tenure of the
8 auditor, here's the experience the audit partner has in
9 auditing that industry, that type of stuff is factual and
10 it would be very helpful.

11 CHAIRMAN HARRIS: Damon Silvers?

12 MEMBER SILVERS: Yes, I again want to speak to
13 this question of identifying the partner. Like Lynn, I
14 mean I've been on many bodies that have advised doing
15 this over a period of years and it just continues to
16 surprise me it's not done, particularly against the
17 context of, for example, the fact that individual
18 attorneys sign SEC filings.

19 The fact that in general we demand a great deal
20 of individual disclosure in disclosure systems generally.
21 This is true with respect to boards of directors, to
22 corporate executives. Corporate executives have to

1 individually sign financial statements.

2 This is true in, to take a somewhat far-afield
3 example but one which I'm somewhat familiar with, in the
4 regulation of labor organizations. I mean a great deal
5 of information is publicly available about me. I'm just
6 an employee.

7 And so the idea of sort of some level of personal
8 identification in relationship to important gatekeeper
9 functions strikes me as just totally old hat, and I don't
10 understand why this is controversial, and it's just long
11 overdue.

12 And it ties to what we were discussing earlier.
13 I mean throughout today in terms of the problem of
14 commodification, the problem of audit committees not
15 necessarily doing what they're supposed to do, the
16 minimum that the PCAOB ought to be doing in this area is
17 arming the various actors in this process so that if they
18 choose to want to do their job seriously they have the
19 basic information necessary to do it. And I would say
20 the most basic information is knowing who's in charge of
21 the audit.

22 Now I think there is, in addition, I think there

1 is something that has not gotten a lot of attention here
2 which is the question of who really is, whether we really
3 have a consistent view of quote, who is in charge of the
4 audit.

5 And the Big Four audit firms and now their global
6 networks, is it truly meaningful, what does it mean to
7 say that one of them is in charge of the audit without
8 identifying specific human beings?

9 I think if we were talking about, you know, a
10 Victorian partnership, you know, a handful of people
11 sitting in an office together, you might be able to say,
12 well, it's a meaningful thing to say that those five
13 people or those ten people are in charge of an audit.

14 How many tens of thousands of people represent
15 the institution of PwC or E&Y and is it meaningful to
16 identify them as responsible collectively? I don't think
17 it is.

18 And oddly enough, when we talk about auditor
19 rotation currently we focus on partners. And the idea
20 that we focus on partners there but then don't tell
21 anyone who the partners are, it doesn't make any sense
22 to me.

1 And so, you know, look, there's always going to
2 be a certain amount of pushback here, but this seems sort
3 of like a minimum thing for the PCAOB to move forward and
4 adopt.

5 And then I'll make then a comment about the
6 auditor reporting model for a moment and just a general
7 piece which relates to what a number of people said about
8 the danger of boilerplate in any revisions of the auditor
9 reporting model.

10 Again, having seen a number or requirements for
11 disclosure turn into meaningless mush, it seems to me
12 that if you're going to try to get more information in
13 a meaningful way out of the audit process that then again
14 informs and potentially empowers a variety of actors that
15 surround the, including the audit committee itself, but
16 the actors surrounding the audit committee to try to
17 improve audit quality, that those disclosures really have
18 to either be specific, testable facts of the kind that
19 I think people have discussed here already today, it was
20 the subject, I think, of Ann's presentation, or they have
21 to be kind of processes of requirements that for lack of
22 a better word compel either the auditor or the audit

1 committee to disclose sort of the things that essentially
2 involve grading on a curve.

3 The example of, tell me the five hardest things
4 you had to deal with in the audit process, the five
5 toughest decisions, the five most marginal things, a
6 process that doesn't allow you to say, oh, we don't have
7 any. We're all fine here.

8 I can't help but just saying that, you know, the
9 president of the AFL-CIO just came back from his first-
10 ever trip to China. No president of the AFL-CIO has ever
11 been to China since 1955 when the AFL-CIO was
12 established. If you think about the dates involved
13 you'll understand why.

14 And he had a great trip, but he was constantly in
15 the process of asking people in various settings, so does
16 anything ever go wrong here? Do you all ever have, you
17 know, does the mine ever cave in? And the answer was
18 always, oh no, no, no, no. Never, never, never.

19 Now we all understood that this was part of a
20 ritual back and forth. We don't want to reproduce that
21 kind of ritual back and forth in what we're doing here.
22 And the way in which I think you avoid that is by not

1 allowing, oh, there's no problem to be an answer.

2 MEMBER HANSON: Joe Carcello?

3 And let me ask the people who have commented to
4 also respond to the liability issue associated with the
5 partner identification.

6 MEMBER CARCELLO: Like the other people who've
7 spoken, I also had a couple of comments about both of
8 these. And in terms of the liability issue, I'm not an
9 attorney so there's people in this room who are in a
10 better position than I to talk about that.

11 But in terms of the audit report, let me just
12 give you a very brief quote which I'm sure you've seen.
13 "I believe the audit is at a tipping point. The audit
14 report at present is hopeless."

15 Now that wasn't Damon, that wasn't Lynn, that
16 wasn't either of the Anns. That wasn't me. That was Sir
17 David Tweedie, okay, former Big Four audit partner, a
18 former chairman of the IASB.

19 You know, this is as an establishment profession
20 as you can get, and I could give you a bunch more quotes
21 like that. So I think it's clear that there's a need.

22 I went back and I reviewed the transcript of the

1 September 2011 roundtable, and people who are opposed to
2 your rules always pull out the bogeyman, right, Damon?
3 Unintended consequences. If I've heard that once I've
4 heard that dozens of times.

5 Here's a quote from Paul Haaga at the Capital
6 Group. "The mere fact that there's more to say than pass
7 or fail we think would give," and there was broad
8 consensus on this within the Capital Group, "we think
9 would give auditors a stronger hand. They would win more
10 arguments and we think that would be a good thing."
11 That's an unintended consequence. All unintended
12 consequences aren't necessarily bad. In fact, that would
13 be a good unintended consequence.

14 In terms of auditor transparency, there's a
15 growing body of literature that finds that, in fact,
16 identification or signature is helpful. Much of that
17 literature the Board has seen.

18 As others have already said, CEOs, CFOs, chief
19 accounting officers have certified Ks and other documents
20 for years without huge problems. Most of the developed
21 world require the partner to sign or be identified,
22 virtually all of Europe, China, Australia. Has not been

1 a problem.

2 And I'll close with another quote from a very
3 bright person. "Common human experience suggests that
4 when an individual is publicly identified with a
5 particular activity that identification usually leads to
6 a higher degree of care and focus." I agree.

7 CHAIRMAN HARRIS: Mercer Bullard?

8 MEMBER BULLARD: Sure, just a couple of comments
9 on the, you know, on the liability issue. Often you hear
10 liability risk used as if it is always a bad thing. The
11 issue with liability risk is, is it a good liability
12 risk, and then creating the liability is going to create
13 net social benefits, but you always almost hear it as
14 inherently negative.

15 I'm all for reducing liability risk that doesn't
16 create net social benefits, but this is one I think you
17 certainly would. And it also reflects a trend that
18 you're probably aware of in that cohorts have been
19 complaining about holding corporate entities liable and
20 no individual's engaged in the contact for which they're
21 being held liable.

22 Another problem has been true for quite some

1 time. You have corporations in many cases paying
2 damages. The corporation itself pays the damages to
3 shareholders, who of course the shareholders of the
4 corporation paying it, and no individuals are held
5 liable.

6 You have the SEC now saying it's not going to
7 take no-admit, no-deny settlements anymore and pointing
8 out it's going to go after individuals. And this is
9 precisely what we need to do.

10 We need to make individuals responsible, because
11 in this sense corporations are not people. Corporations
12 can't take action without an individual having taken that
13 action. So I think that putting the name and the face
14 on the action will have this behavioral modification
15 effect, it also will be the kind of liability risk that
16 you want.

17 And I think it also, to Anne's point, it really
18 needs to be in the main source of information about the
19 audit. You know, there's a general collective action
20 problem that shareholders have in getting involved in
21 anything. And a big part of the collective action is the
22 information costs, and every time you increase the

1 information costs you make it much less likely
2 shareholders will engage and be active, because as a cost
3 efficiency issue it's just not worth it.

4 And in talking to reporters this is constantly an
5 issue. They will not write good stories if the
6 information is not easily available.

7 And, you know, going further, this is an issue
8 that I've been sort of arguing with the SEC about for
9 more than a decade is, it's not clear to me why
10 information is not provided in a way that when you go on
11 useful websites it's provided where you can click a
12 button and get all the combinations of information that
13 you want that would be relevant.

14 And in the mutual fund world, for example, you
15 should be able to compare ten funds and see their fees.
16 In the context of issuers you should be able to compare
17 the auditors. You should be able to compare who's been
18 with what firm how long, who have been the auditors on
19 different projects, what's the disclosure that is related
20 to PCAOB inspections.

21 And you see the government using virtually none
22 of that technology in order to make information really

1 useful, and that is what would really make it actionable.

2 DIRECTOR DOTY: Mercer, you may have to write
3 that to a legal argument on liability up in a comment
4 letter. December the 4th, 60 days, it gives you until
5 February. You'll have plenty of time to do this at the
6 University of Mississippi. But we're going to need the
7 comment, the legal argument on intended and unintended,
8 good and bad litigation costs in the file.

9 CHAIRMAN HARRIS: That was not a set-up, Mercer.
10 Norman?

11 MEMBER HARRISON: Sorry to come back to it, but
12 actually I had two things, one of which I think Mercer
13 and Ann have eloquently described on the issue of
14 liability.

15 I would second the notion that what the ideal and
16 a probable outcome of engagement partner accountability
17 for the content of an audit report and public visibility
18 with respect to the conduct of the audit, I would think
19 would be a risk mitigation tool not a risk aggravation
20 tool.

21 Secondly, I'm not a litigator, but at the end of
22 the day when an accounting firm is sued over an allegedly

1 blown audit, I mean they're the deep pocket. I don't
2 know that adding, the identity of the partner comes to
3 life early in the litigation.

4 Any event through discovery, I don't get the
5 whole thing, to be quite honest with you, about that adds
6 anything of any material with respect to litigation risk
7 or to risks of judgments or outcomes.

8 The other thing I wanted to mention briefly, and
9 I was putting my board down when the thought popped into
10 my head that when Damon gave so many good analogies I
11 want to offer one more for everyone who's been or is a
12 litigator.

13 I'm sorry the judge isn't here, but many of us in
14 this room have at one point or another in our lives
15 served as an expert witness in civil litigation. And
16 it's not a perfect analogy but it's close, where we've
17 been asked to examine a body of evidence and to apply
18 judgment and experience to it and render an opinion on
19 one or more issues.

20 And certainly under the Federal Rules of Evidence
21 we sign the reports, we don't sign our firms' name to the
22 reports. And then we are often challenged as to whether

1 we possess the requisite expertise or not and a judge has
2 to decide and we're deposed and there is sometimes an
3 exhausting level of review and transparency disclosure
4 on the contents of our report.

5 I'm not suggesting that same level of increase
6 should apply here, but again it goes back to this notion
7 of when someone holds themselves out as a professional
8 it's hard to find many other examples where the
9 individual's name isn't on it.

10 It really goes back to the issue we discussed
11 earlier in our group's discussion of audit quality
12 indicators where I made the point that we're in that
13 context assessing or measuring or evaluating conduct.
14 It's the same thing here.

15 The opinion was ultimately reached and rendered
16 by a human being who had authority or responsibility for
17 conducting an audit process. It was not reached and
18 rendered by a limited liability partnership, a fictional
19 legal entity.

20 Now I'll put my board down. Thank you.

21 CHAIRMAN HARRIS: Barbara Roper?

22 MEMBER ROPER: First of all, I agree with

1 everything Mercer said and plan to cosign his letter when
2 he writes it.

3 We were talking last night, we were kind of
4 joking around about the fact that my sister and I have
5 always said that fear of embarrassment has propelled us
6 towards success. The fear of, you know, of embarrassment
7 keeps us from ever having gone to class not prepared, you
8 know, whatever.

9 I think it's sort of a frivolous example, but
10 people behave differently when their name is on there.
11 People speak differently when they're making an anonymous
12 comment in the blogs or when their name is attached to
13 a comment.

14 We know in a variety of context that this does
15 affect people's conduct, and it affects people's conduct,
16 I think, in this way precisely the way we want to affect
17 it, which is to make them think more seriously about just
18 exactly how comfortable they are with the opinion they're
19 rendering.

20 And so I mean, I think the benefits of this
21 proposal are self-evident. We've been talking about it
22 for years, and I think, you know, I would strongly

1 support the Board moving forward in that area.

2 CHAIRMAN HARRIS: Anne, I'm not going to
3 recognize you now because I know that you want to talk
4 about the global agenda, and we'll -- well, then if you
5 don't we'll recognize you now and then you can talk about
6 the global agenda. But that was one of the items in the
7 email correspondence that you put on there. But talk
8 about whatever and then we'll --

9 MEMBER SIMPSON: True enough, but I'm a
10 nonresident alien so I'm honor bound to talk about other
11 places. No, this was, you said, Steve, that you wanted
12 people who had spoke in favor of transparency to address
13 the question of liability, so I'm briefly going to do
14 that.

15 I agree with what's been said that these
16 corporate forms, be they joint stock companies or
17 partnerships, the corporate forms have a lot of purposes.
18 But these are not moral agents and cannot be held.

19 So whichever Lord Chief Justice, way back when,
20 said, you know, corporations have neither a body to kick
21 nor a soul to condemn to eternal damnation, at that point
22 we're then back to people. And whatever has been said

1 about political donations and political speech about
2 corporations being persons is nonsense.

3 So if we want to change behavior, the corporation
4 is not something that will behave differently. It's
5 people that will behave differently, and behavior does
6 change under observation.

7 If there are concerns about liability it is not
8 to be addressed by drawing a veil over the people who are
9 responsible. If there are issues around litigation and
10 liability they need to be dealt with on their merit, but
11 this would not be the channel I would suggest.

12 CHAIRMAN HARRIS: Okay, Lynn, then Damon.

13 MEMBER TURNER: Two points, one to your question
14 of liability and then one back to the basic audit
15 reporting model and your proposal that the staff have
16 recently put out.

17 First, on the liability issue. In the state of
18 Colorado, engineers and architects, you can add those to
19 the list of people who have to sign in their own personal
20 name, in addition to the CPAs who give expert reports,
21 the boards and all those people.

22 In fact, when you come down it, the auditors

1 signing these audit reports are about the only people
2 that don't have to put their name down. Everyone else
3 does. And they're the only ones, and there's no good
4 reason why they should be given special privilege
5 whatsoever.

6 And on liability, I chaired at the board of
7 trustee committee at Copara that oversees our litigation.
8 I can't fathom us deciding whether or not to sue a firm
9 based upon who an individual partner is.

10 It's going to be based upon whether or not there
11 was an audit report rendered when, in fact, the belief
12 is that it was a failed audit and a clean opinion wasn't
13 warranted.

14 And in every case I've ever seen go into
15 litigation no one sued, first and foremost, the partner
16 and left the firm off the thing. It's ridiculous to even
17 propose that. It's always going to be the firm that gets
18 sued.

19 You go into discovery and immediately upon
20 discovery what's the first thing you find out? The
21 partner's name. So the notion that there's audit risk
22 associated here because of liability is a figment of

1 someone's imagination and dreams. It just isn't
2 supported by actual fact.

3 And in Colorado, and I've checked this with the
4 state Board of Accountancy, you're liable as an
5 individual whether you sign in the firm's name or your
6 own name. So it doesn't affect liability in that respect
7 in any way, fashion, shape or form. So there is no
8 argument on liability on this that is factually based.

9 The second issue on the audit reporting model on
10 the proposal that a comment, I guess, is due in December,
11 and it's good that something's got out there that people
12 can discuss and comment, I'd just say there has been an
13 issue thrown up with respect to that proposal.

14 And depending upon how people look at it, and
15 I've gotten different reads from different people, that
16 proposal may or may not be fatally flawed. And the issue
17 is whether or not that proposal as written would require
18 disclosure of the items set forth, and there's some good
19 items there that are set forth, but whether or not
20 disclosure's required based upon the professional view
21 of the auditor or is based upon what the auditing
22 standards themselves would require to be identified as

1 significant matters.

2 And when the ISB did the old ISB Standard Number
3 1, that standard was written and said you have to
4 disclose to the audit committee, what, in the
5 professional view of the auditor, is deemed to be
6 something that the auditor would believe would impact on
7 their independence wasn't required to be disclosed from
8 an investor perspective or perspective of the standards.

9 And what we saw when the standard was written
10 that way was the auditor's continued to violate black and
11 white independence standards but didn't put it in the
12 standards letter itself, and came back and always said,
13 well, in our professional view.

14 So it became an unenforceable standard when it
15 was written that way because auditors always came back
16 and said, well, it doesn't matter what the standard said
17 because it's what in our professional view was. And so
18 the ISB Standard Number 1 turned out to be basically a
19 fatally flawed and worthless standard.

20 Bill Allen is someone you might recall tried to
21 fix it. He wrote a letter shortly after it was issued,
22 after he and the other three members recognized the fatal

1 flaw, but it never got it fixed and it's never worked.

2 There's been many, many instances of black and
3 white violations that never were told to audit committees
4 in that black and white letter.

5 So depending upon how you've written it, if
6 you've written it to say in the professional view of the
7 auditor this is what they would have to disclose, that
8 document is fatally flawed and will never work. And
9 we've got that experience behind us.

10 If it's written from the perspective of, here are
11 the significant matters you would have to disclose if the
12 auditing standards would deem those to be significant
13 matters, then you're okay. And I've heard different
14 interpretations of that standard.

15 DIRECTOR DOTY: This is a very valid point, and
16 I think the limiting case you lay out, Lynn, is one that
17 the proposal avoids. The proposal requires a discussion
18 of what were the difficult auditor judgments, the
19 difficult issues of supporting opinion, the complex
20 issues.

21 It further goes forward to say if you decide
22 there are none you must explain why. You must document

1 how you got to the decision that there were none. And
2 it goes further to say that it would be not expected that
3 there would be many audits in which the auditor could
4 conclude there were no critical accounting matters.

5 It directs the auditor to decide and to discuss
6 what were the critical audit matters on the basis of, I
7 think, a stated as well as implied assumption that almost
8 any audit involves some critical audit matters.

9 And the documentation is required of the decision
10 either way to exclude, if you exclude something that
11 normally would have been reported to the audit committee
12 you've got to explain why. You've got to document the
13 reason why that would not be a critical audit matter in
14 this case.

15 MEMBER TURNER: But are those critical audit
16 matters determined in accordance with the standards, or
17 critical audit matters determined in the professional
18 view of the auditor? And that's the question.

19 MR. BAUMANN: Well, Lynn, you know, this is a
20 lengthy discussion that we could have and it's probably
21 beyond this room and we'll appreciate your comment letter
22 when it comes in and we'll address it.

1 But clearly, as Jim just mentioned a moment ago,
2 the critical audit matters we indicated would be things
3 that the auditor documented under AS 3 requirements, for
4 documentation requirements.

5 Would likely be things that the engagement
6 quality review are under AS 7 had looked at as the most
7 significant judgments in the audit. Would likely be
8 things that the auditor communicated to the audit
9 committee in connection with AS 16.

10 And went on to say as Jim indicated, if you have
11 such matters that would appear to meet critical audit
12 matters, and have those attributes of having been
13 discussed with the engagement quality review and
14 discussed with the audit committee, documented as a
15 difficult matter, consulted on with the national office,
16 and it's not disclosed as a critical audit matter, then
17 the auditor has to document on the work papers what was
18 the rationale why that was not a critical matter.

19 And that documentation, we believe, would be
20 subject then to inspection to understand is that a
21 reasonable rationale why that wasn't a critical audit
22 matter. So I think it's somewhere in between where

1 you're saying, is it directly driven by the audit
2 standards or judgment?

3 There's definitely judgment involved, but that
4 judgment is linked to existing auditing disclosure
5 requirements in communications with audit committees,
6 documentation requirements under AS 3 and things that are
7 reviewed by the EQR under AS 7.

8 MEMBER TURNER: So are you saying, Marty, that if
9 the auditing standards would deem whatever the matter was
10 that it should have been a significant matter? For
11 whatever reason the auditor decided not to make it a
12 significant matter then that would be a deficiency in the
13 report?

14 MR. BAUMANN: Yes. I am saying that once again
15 if this is a matter that when somebody looks at it and
16 sees the AS 3 required documentation of the most
17 difficult matters, and there's a whole list of AS 3 of
18 what has to be documented, the most difficult subjective
19 matters in the audit, then looks at what was reviewed by
20 the engagement quality reviewer, and the same matters
21 that matter was a high priority for the engagement
22 quality reviewer, what was discussed with the audit

1 committee, the same matter was communicated and was a
2 significant discussion matter with the audit committee,
3 if that matter does not make it into a critical audit
4 matter, I think it would be very difficult for an auditor
5 to justify how they concluded that that was not a
6 critical matter.

7 MEMBER TURNER: Yes, but I don't think that
8 things will get to that point, Marty. We saw that with
9 the ISB-1 thing. The bottom line was it didn't get to
10 that point of being discussed with the audit committee
11 and that was the problem.

12 MR. BAUMANN: Well, that would be a violation of
13 AS 16 then, if things are missed and not discussed with
14 the audit committee that should be, and I think that
15 would be something we would inspect against as well.

16 So if people are omitting required disclosures to
17 the audit committee, that itself is a problem and then
18 we could have an inspection finding with respect to that
19 also.

20 CHAIRMAN HARRIS: Lynn, let me jump in for a
21 second. Two things. First, we do look forward to your
22 comment letter. Second, I do think you raise a very

1 valid question with respect to the objectivity of the
2 standard and to the extent that there's judgment and
3 whether or not there could be tightened. You have five
4 Board members with five different viewpoints on it, so
5 I think you ought to reduce your comments to writing
6 which I think we'll review very carefully.

7 Damon, you know, go ahead, and then Mercer. And
8 then I would like to, because, you know, we're going to
9 be approaching the end of the session, I did raise other
10 issues that were brought to the attention of the Board
11 in terms of what other people might want to bring up.

12 But to the extent that anybody has an issue that
13 they want to bring to our attention, I want to go right
14 the way around the room and spend the last 15 minutes,
15 you know, for you to tell us what you want us to hear,
16 and to the SEC as well.

17 I'm sorry. Brian, your card is up so we'll
18 recognize you and then we'll go to Mercer.

19 MR. CROTEAU: Well, thanks, and it does relate to
20 the point we were just talking about, so I'll take the
21 opportunity. I think it's a great discussion we're
22 having relative to what would be a critical matter, and

1 certainly there's an open comment period.

2 I think one of the important questions to think
3 about, really, is the criteria for what is a critical
4 audit matter sufficiently objective or should it be any
5 more objective than it is? And I think the PCAOB's asked
6 some thoughtful questions in the release around that.

7 Certainly Marty's described the documentation and
8 others have described the documentation requirements, you
9 know, the question can be asked to whether documentation
10 requirements are enough to overcome what some might view
11 as a more subjective definition to begin with.

12 So very interested in comments as to whether
13 there's improvement that can or should be made to the
14 definition of a critical audit matter in the first
15 instance, but I think the PCAOB's at least been very
16 thoughtful in trying to put forth an initial proposal in
17 that regard. But I think it's an area that could benefit
18 from some focus and public comment.

19 MEMBER HANSON: Mercer?

20 MEMBER BULLARD: I'm just trying to figure out
21 the dynamics here. So it sounds like there are scenarios
22 in which the auditor will be exercising discretion, and

1 whichever way they go is going to determine whether they
2 have to disclose something as a significant issue.

3 And if that's true, why wouldn't the disclosure
4 requirement give them a very strong incentive not to take
5 those steps? In other words, decide differently, not
6 bring something to the committee precisely because that
7 will trigger a different requirement where they don't
8 want disclosure.

9 Or is it objections, there's no discretion for
10 them to make those because it sounds like they're taking
11 it up the chain was one thing you mentioned. If I'm the
12 auditor I'm not going to take it up the chain if it means
13 I'm going to get public disclosure out of that. So how
14 does that dynamic work?

15 MR. BAUMANN: Well, again I think it's rather
16 than getting into a lengthy discussion about this item,
17 I think it's important to read the proposal, read the
18 standards and raise questions if you think that the way
19 that it's crafted leaves the ability for an auditor to
20 not disclose things and to not meet the spirit of what
21 we're trying to get at here.

22 So I'll support what Brian said, and that is we

1 worked really hard to get a standard that we think would
2 improve disclosures to investors about what's critical
3 in the audit. It's hard to mandate those things that
4 were most difficult to the auditor because it's whatever
5 was most difficult to the auditor in those particular
6 circumstances. So you can't say what they'd be, it was
7 what was difficult in that particular audit.

8 So as Damon said before, name the five things
9 that were most difficult. Well, we could put a number
10 five on it. We actually thought about that and we asked
11 questions, should we have a minimum number? So that
12 actually was a question in the release that would help.

13 Should there be any situations where you would
14 not have critical audit matters? That's another
15 situation, another question we asked. So there's lots
16 of ways in which people can comment to us that listen,
17 you can make this tighter in your final document by doing
18 X, Y, or Z. And I think that's very valuable comment to
19 get that.

20 But that's sort of the way it's structured. And
21 we had a conversation way back when, Damon, you and I
22 together and at the SAG also about, Marty, just have them

1 disclose the five toughest matters. And that's sort of
2 what this is.

3 But we are looking for valuable comment about how
4 to make this crisp and tight so that this really does
5 achieve the objectives and that matters aren't avoided
6 by, well, I'm not going to communicate this to the audit
7 committee because then it will look like it's too
8 critical.

9 So you're right. We want to avoid those
10 consequences, but we want to think about all those
11 things. And if in the proposal, if there are ways in
12 which people think that it can be fixed and made even
13 better, we're looking forward to those comments and we'll
14 move forward on that. We certainly want to have a strong
15 standard here that greatly improves the audit report.

16 MEMBER HANSON: Damon, did your card go back up
17 or --

18 MEMBER SILVERS: It was up before.

19 MEMBER HANSON: Oh, I'm sorry. Oh, I thought I
20 heard you before. By all means, go ahead.

21 MEMBER SILVERS: Well, I had two things. Now
22 after Marty spoke I've got three. Look, at first it was

1 in response to your question about liability. I want to
2 just even intensify what Lynn said.

3 I don't understand the argument about liability
4 from the auditing firms. As Lynn pointed out it is a
5 trivial matter in litigation to get the name of the
6 partner. And the notion that somehow the lack of
7 disclosure of the name in non-litigation situations is
8 going to promote, that that's somehow protection against
9 litigation, I think is not a serious argument.

10 And I would urge the PCAOB to the extent that
11 auditors are making a litigation argument, and this
12 doesn't even get into Mercer's point, I'm just saying I
13 don't get what the argument is. And I think the PCAOB
14 needs to sort of insist people who make this argument be
15 specific as to what they think exactly is going to
16 happen. But I think if you follow the thread of that
17 logic through a little bit you get to a deeper issue.

18 So if litigation's not the point, what is the
19 point? Why do investors want to see this name? And the
20 reason is precisely because you want to be able to engage
21 in types of accountability that don't rise to litigation,
22 and you want to facilitate that on the part of investors

1 who may not have the muscle to get it on their own.

2 Because I think, in addition to the fact that
3 litigation can get that name, okay, if you hold three
4 percent of a company's stock you can probably get that
5 name. It's probably not that hard, in fact, to get that
6 name.

7 What's absent though is in this regime, the
8 existing regime we have, is the sense of a level playing
9 field in the securities markets that is what, in fact,
10 the audit report is all about in the first place.

11 I mean why, you know, we've had this conversation
12 today and people have talked about what is an audit
13 report for? Well, increasingly, I think, and I think Joe
14 said this earlier that there's a real danger here of the
15 diminishment of the value of the audit report in general.

16 And what's going on right now, and it's visible
17 to me in terms of at least what is now, you know, ten
18 years of this body's existence and going back to the
19 period before this body was created, this body being the
20 PCAOB, that what has increasingly happened, I think, is
21 that the securities markets have become for a variety of
22 different reasons, and a lot of people have talked about

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1 high-speed trading as part of this but that's not the
2 only driver of this, the securities markets have become
3 increasingly hostile to the involvement of investors who
4 lack enormous scale and enormous resources.

5 If you have enormous scale and enormous
6 resources, there's a sense in which maybe you don't need
7 an audit report. You can send your own team of financial
8 experts in to talk to a public company.

9 You've got a variety of ways, if you've got that
10 kind of scale. You know, if you're at Black Rock you can
11 have that conversation, closed doors, demand whatever
12 metrics you want to get whatever you get and make your
13 own conclusions.

14 Maybe for any given public company there are 20
15 investors who can do that. Everybody else is kind of
16 left in the dark. As financial statements have become
17 more complex, as the ability of firms to essentially play
18 games with financial statements has grown, and in
19 parallel, as trading processes have become less friendly
20 to smaller investors, you have an overall drift away from
21 a level playing field in the markets. Identifying
22 auditors by name is by no means a solution to this

1 problem broadly writ, but it pushes back on it a little
2 bit.

3 DIRECTOR DOTY: I've got to ask you, is this
4 about making small investors feel good about large,
5 complex and impersonal markets or is it about having them
6 think they have information that other people have and
7 feel better about it that way, or is there something of
8 use to them?

9 Of what utility is it for them to have the
10 information given the situation they're in, which you and
11 Ann have so articulated?

12 MEMBER SILVERS: I think it's a very fair
13 question, and I think that there are two answers that go
14 beyond feel-goodism here. I think the first is, is that
15 it will be possible for a wide variety of actors,
16 academic actors, providers of public, the press and other
17 sort of providers of public analysis to look at the pay-
18 driven individual partners across companies that is, and
19 tell investors things that are meaningful.

20 The second thing I think is possible is, is that
21 I think there is a landscape between, really, the small
22 investor, the individual investor, there's a landscape

1 between that party and the very largest players who have
2 the resources and the market leverage to extract
3 information sort of willy-nilly from companies.

4 And those, if you look at the history of
5 corporate governance reform in the United States, it's
6 often been those investors who have pushed the envelope
7 on things and, you know, using publicly available data
8 as opposed to what they can extract as a private party.

9 I think that was certainly true in the initial
10 push for auditor independence, in the push around Board
11 independence. A number of those funds are ones, this is
12 certainly true of a lot of funds that are collectively
13 bargained in one or another. I don't think this is a
14 transformative move in relation to any of these dynamics,
15 but I think it pushes it the right way. And I think it's
16 not feel-goodism.

17 CHAIRMAN HARRIS: Well, I want to begin the wrap-
18 up period here and just start, Brandon, with you and just
19 go right the way around in terms of any final parting
20 shots that you would like to leave the Board with in
21 terms of what we should be doing to improve audit quality
22 and protect investors.

1 MEMBER BECKER: Well, I do think that the
2 signature makes a lot of sense, the same way we do it
3 with mutual fund portfolio managers and the like where
4 the SEC has been much more aggressive. I discount the
5 liability issues for the various and other sundry
6 reasons.

7 The context of the discussion today though, I
8 think, really goes to the audit quality indicators in the
9 morning, getting those built into the governance process.
10 Because as Curt highlighted and as various have referred,
11 basically the relevancy of the audit, getting more of
12 that quality and ultimately going to the quality of
13 earnings so that there is more value extracted rather
14 than check the box from the audit would be valuable.

15 I should say, however, that while greater
16 transparency to the audit is important, we would be
17 worried if we lost the pass/fail. We think that we would
18 not want to see the greater transparency degrade the
19 pass/fail. I don't think it needs to, but I did want to
20 at least highlight our concern along those lines.

21 CHAIRMAN HARRIS: Curt?

22 MEMBER BUSER: So I think the audit quality

1 initiatives are key. I think that, you know, what I'd
2 like to see happen is the PCAOB start to get in a
3 position where it can comment on, you know, what we see
4 in improvements in audit quality and what's the state of
5 the profession and be able to answer a lot of the
6 questions that are unknown about the quality of the
7 people that are carrying this out. So I think we need
8 to know, kind of, is the profession having the right
9 people in place or not?

10 CHAIRMAN HARRIS: Grant?

11 MEMBER CALLERY: I think I'd like to see the
12 Board take a further look into some of the issues, the
13 governance issues that we talked about where you do have
14 access to information. Because I think a lot of the sort
15 of presumptive reactions that people have were based on
16 very surface level knowledge and that you really ought
17 to delve into it and see whether there's "there" there,
18 and then move accordingly from there.

19 CHAIRMAN HARRIS: Grant, we certainly welcome you
20 to the Investor Advisory Group.

21 MEMBER WALSH: Yes, I've been trying to think
22 about how investors will react to a lot of what we've

1 talked about today, and I think it's hard to imagine a
2 situation where investors go in and short stocks of
3 companies whose audit partners have shown mistakes in the
4 past and buy really strong audit companies.

5 I don't know that that's going to happen, and
6 before we get to that point we'll see trading cards with
7 auditors on the face, and I think at that point you
8 really do end the worry about commoditization.

9 But I really do have a sense that we need to get
10 to more information, and I don't know how the market will
11 use what we've talked about with audit quality indicators
12 or how they're going to use identification of the
13 partners responsible for the audit, perhaps the
14 identification of the audit committee chairman.

15 I don't know how it will be used, but I think
16 that there's an invisible hand that will ferret that
17 information out and it's a process and we'll get better
18 at this, and maybe we have 70 indicators that we disclose
19 Round 1, it turns out that there 35 that are helpful.
20 The market will figure that out and migrate towards those
21 indicators.

22 And so I'm all in favor of more information

1 rather than less, even if we don't know how it'll be used
2 or which ones are going to be the most helpful. But I'm
3 very encouraged by what we're talking about today.

4 CHAIRMAN HARRIS: Thank you.

5 Damon?

6 MEMBER SILVERS: Since the chairman caught me in
7 my train of thought I left out my comment from Marty.
8 I'm just going to make that. I think it's quite
9 dangerous to have even with the caveat that you don't
10 expect to see very many of them, I think, in the
11 reporting model, it's very dangerous to have an option
12 of saying no, we don't have any serious issues.

13 I think it raises this issue of then all of
14 sudden auditors are, it becomes tricky to push issues in
15 the internal process, I think, if you do that. I stand
16 by what I said to you when however long ago that you were
17 citing, which is put a number on it, one, two, three,
18 five, whatever that number is and everyone has to
19 disclose what that is. Every audit has an issue. It's
20 not possible to have an audit without an issue.

21 CHAIRMAN HARRIS: Norman?

22 MEMBER HARRISON: Nothing new to add other than

1 to thank you all for having us and for inviting us to be
2 participants. And I'll say only we've covered a lot of
3 ground today, not only in the panel-specific discussions
4 but certainly here at the end.

5 And, you know, I think when you take a step back
6 you realize that the issue of quality is the silver
7 thread that connects it all and then the need to define
8 it, to measure it, to report it and to use it as a tool
9 for improving or providing safeguards around audit
10 quality, I think there's further work to be done.

11 So by way of parting comment I'll say that rather
12 than show up again next year, you know, see where we are,
13 I'm happy to continue being supportive in any way I can
14 as the staff moves forward.

15 CHAIRMAN HARRIS: Thank you very much.

16 Tony? Tony Sondhi?

17 MEMBER SONDHI: Thank you. I'd like to simply
18 emphasize what I thought was the two main things I said
19 this morning. One is that as Norman just said, audit
20 quality is the critical issue.

21 But if you develop indicators that are based on
22 audit firm quality and audit process and not focus on

1 audit quality, I think we're going to miss very
2 significant opportunity. I think it's absolutely
3 critical that we focus on audit quality.

4 The second point I want to make is that what the
5 discussion today showed is that there are concerns. I
6 understand that the sort of the nexus where the output
7 based indicators meet, financial reporting quality and
8 some of the other issues that Lynn and some other people
9 have raised, and Joe, I think, I think that although that
10 nexus is a difficult one, I think that should not get in
11 the way of developing really good audit quality
12 indicators. And being very firm, the complexity
13 shouldn't get in the way.

14 CHAIRMAN HARRIS: Bob?

15 MEMBER BUETTNER: I hope this is not off-topic,
16 but as you said you were hoping to get what was on our
17 minds at this time. My question are something that I
18 think at some point I'd like more explanation on was the
19 issue around the Chinese reverse merger issues.

20 And most specifically, in fact, this might just
21 go to harmonization of global accounting standards, but
22 the differentials that existed between the Chinese

1 accounts and the accounts that were ultimately reported
2 here, I think the collapse that we saw and the investor
3 losses that we saw across a wide range of those companies
4 was really a black mark on the U.S. capital markets.

5 And so, really, my questions are more around,
6 one, how was this allowed to happen? In other words,
7 that these companies were able to, sort of, from an
8 accounting and audit perspective slip under the radar?
9 And then secondarily, are there processes that we can put
10 in place to ensure that situations like that do not recur
11 again?

12 DIRECTOR DOTY: Audits were ostensibly performed
13 where we have reason to believe now there was no work
14 done. In some cases by registered firms within China,
15 in some cases by registered firms in the United States
16 which were relying on firms in China.

17 That situation has received a lot of attention
18 both in the area of enforcement, which will continue as
19 an interest that we have, but also in our relations with
20 the People's Republic we are continuing to press for a
21 joint inspection regime.

22 I think that unless we could get to a position in

1 which our division of inspections can go to China and can
2 satisfy themselves about the quality of the audits that
3 are being used to issue securities or trade securities
4 in the secondary market here, we will have to move toward
5 deregistration of firms and that will have, of course,
6 implications for markets. It'll be something that we
7 will have to work out with our colleagues at the SEC.

8 CHAIRMAN HARRIS: Anne Simpson?

9 MEMBER SIMPSON: Yes, I had two points, one of
10 which I think Robert has referred to. So CalPERS invests
11 in 47 markets worldwide and regulation is a global game.
12 It's not just of account audits, it's accounting,
13 securities law, capital adequacy for banks, you name it.

14 And what struck, although there are the
15 multiplicity of regulators, the core of the regulatee is
16 the Big Four, maybe plus two. So the work that you're
17 doing to cooperate and coordinate is really important,
18 but I hope it's also a weather eye to the fact that these
19 public agencies are stumbling over themselves and each
20 other dealing with four business networks.

21 And I don't know what the solution to that is,
22 but that is something I would have talked about. So I

1 really encourage that work that you're doing and thank
2 you very much for it. If there's anything more we on the
3 investor side can do to support you please let me know.

4 And the other thing, my closing comment is that
5 with regard to audit, shareholders are weak and ill-
6 informed. And you can do something about the ill-
7 informed part and our friends at the SEC can do something
8 about the weak part.

9 So I hope that we can make progress on this,
10 because all this good work on quality and disclosure and
11 all the rest of it, if we can't, you know, both speak
12 softly but carry the big stick, if there's no stick, if
13 we can't move in as the shareholders, it would be Teddy
14 Roosevelt in style, it won't work.

15 But thank you for what you're doing. We greatly
16 appreciate it. I think the PCAOB is doing tremendous
17 work. We very much value what you do. Thank you.

18 CHAIRMAN HARRIS: Ann Yerger?

19 MEMBER YERGER: Well, let me echo the thank you.
20 This is an energized Board and we really appreciate it.
21 You've been bold, I think, recommending and proposing
22 reforms, and I think on behalf of investors and the

1 Council we really appreciate it.

2 I would urge you to maybe get one easy or
3 seemingly easy win and that's the auditor or the
4 engagement partner transparency. I think it just seems
5 like that's not a complicated reform and it would be
6 great to push that across the finish line.

7 I think the second point is as everyone else has
8 said, this is all about audit quality. I think the work
9 that you're doing on audit quality indicators is
10 profoundly important so I commend you to move forward
11 with that, but also to not let the perfect be the enemy
12 of the good.

13 I don't know that there's one perfect
14 prescription for how to do this and this could get
15 analyzed forever without a resolution. I think it's
16 important to move along. I do believe public disclosure
17 of audit quality indicators is very important.

18 I do think it's an interim step issuing some
19 guidance, additional guidance to audit committees so they
20 have a better arsenal of questions to be asking on audit
21 quality, I think could be very helpful as well.

22 CHAIRMAN HARRIS: Mercer?

1 MEMBER BULLARD: I just would probably emphasize
2 that the way I see the quality issue is really something
3 bigger. It's more of a value-added issue. It's not so
4 much quality to prevent fraud, it's to make the case for
5 public companies. Because from the securities law
6 perspective, you know, what I see is, 15 years ago there
7 was twice as many companies on the New York Stock
8 Exchange as there are now.

9 Over the last couple of years more money was
10 raised in private markets in IPOs -- than in IPOs. You
11 see Facebook trading on private markets millions of
12 shares a day, so liquidity is not going out the window
13 is a reason to an IPO.

14 You have the JOBS Act that's now eliminated, and
15 this is the first meeting since the SEC adopted rules,
16 eliminated the general solicitation in advertising which,
17 I think, will have a geometric effect on the
18 advantageousness of private offerings.

19 JOBS Act has also expanded the number of
20 investors that require you to go public and also excluded
21 certain investors from being counted, and the SEC takes
22 a very liberal view as to how you count pass-through

1 entities toward that and that will also another reason
2 you'll have fewer public companies.

3 It's hard to know where this is all going to go.
4 The trend is pretty clear, but I think the brand that is
5 the public company, especially with steps that have
6 essentially made what it means to be a public company be
7 different things for different companies, 404 here, 404
8 not there, has really put the public company brand at
9 risk.

10 And if you want to look at a specific threat to
11 the importance of honest accounting, look at the filing
12 of confidential registration statements, where I looked
13 at about the last ten that have been done and you see
14 three to eight confidential filings. And these were
15 prompted, this rule was prompted by a company that you
16 all recall went public and had repeatedly to go back to
17 its registration and correct what were pretty blatant
18 accounting abuses.

19 If you were to go into those confidential filings
20 and you did a lot of work you'd probably find the same
21 thing. And that is, you know, this is a market that is
22 becoming more and more for retail investors only.

1 If you are going to go public now, it seems to me
2 the biggest reason to do so is to sell to the least
3 sophisticated group, because you will have gotten all the
4 money you needed out of institutional investors and
5 accredited investors before you go public. Because, you
6 know, one of the key classes I teach is the pros and cons
7 of an IPO, and most of the pros are disappearing.

8 CHAIRMAN HARRIS: Pete?

9 MEMBER NACHTWEY: Thanks Steve, and thanks to the
10 Board for putting this group together and reaching out
11 to us for input, and more importantly, maybe the staff
12 for doing all the hard work to pull it off, so much
13 appreciated.

14 Maybe three quick comments I'll canter through.
15 One, I do agree audit quality indicators is a key thing
16 coming out of the discussion today, but I think it has
17 to be married up with heightened expectations for audit
18 committees because there's got to be two levels of this.

19 One that I think the PCAOB is ideally suited for
20 of looking at firm level quality, but where the rubber
21 meets the road is individual audits and audit committees
22 are going to be in the best position to really judge, are

1 they getting quality, both people, the scope and the work
2 plan that's put in place?

3 And then hat in hand with that has to come kind
4 of heightened focus on what's a financial expert
5 particularly for saying the auditors, the external
6 auditors and the internal auditors are reporting to the
7 audit committee, making sure we have somebody who is able
8 to, on those audit committees, really manage that work.

9 Second topic, and I'm mindful of something. Curt
10 will know the author of this statement, but everything's
11 been said just not everybody's said it, but I'll jump in
12 on the audit opinion, audit reporting model.

13 One, I do agree around the transparency on having
14 audit partners. I don't why that would be any different
15 than the professions that Lynn listed or responsibilities
16 that people like I have to certify financial statements
17 that we submit to the SEC.

18 On the other hand I think we've got to also be
19 mindful of the dichotomy that we can't be aghast when we
20 see marketing material with firms saying well, the
21 individual signing partner has responsibility. So we've
22 got to be careful a little bit of what we wish for, and

1 I think at the end of the day be mindful of the fact that
2 we are, when we're buying an audit from a firm we're
3 buying the firm and that's what we want. But I do agree
4 it crystallizes the focus of that partner who ultimately
5 has the signing pen.

6 But there were a couple other aspects of the
7 reporting model. The critical accounting matters I do
8 think can be an interesting expansion, but I think we've
9 got to be practical about it. So how does that marry up
10 with management's disclosure on critical accounting
11 policies and estimates?

12 I would envision there would be a pretty parallel
13 set of disclosures there, so if it's just duplicative do
14 we get anything or do we just put more cost and time into
15 the process of getting audits and financial statements
16 prepared?

17 So, you know, whether we kind of road test that
18 or find some way to say what's the practical aspects of
19 it, then how do we make sure it doesn't end up being
20 heavily lawyered, and no disservice to the legal
21 profession but they're going to represent their clients,
22 in this case the Big Four.

1 If we end up with 50 pages of boilerplate in
2 their audit opinions and we can't find the pass/fail,
3 which I think when I think I talk to our portfolio
4 managers and analysts who are managing \$650 billion of
5 investor money, the thing they want to know at the end
6 of the day, did they pass or did they fail? Because I
7 don't have enough time to go through all the rest of the
8 aspects.

9 And then last but not least, being the author of
10 the fair value accounting, and I won't spend a lot of
11 time on it, Steve, because I know it's an issue we could
12 we spend eons on, but just to be clear on what I think
13 the issue is there, which is the procyclicality of fair
14 value accounting combined with the false precision that
15 when you take numbers out to two decimal places and it's
16 fair value and it's judgments and estimates on top of
17 judgments and estimates it's important that, I think,
18 somehow we have investors understand a), that level of
19 imprecision, and b) the procyclicality that's just as bad
20 in an environment that's being fueled by quantitative
21 easing as it was in '09 and '10 when there was a dramatic
22 cycle down. So enough said. Thank you.

1 CHAIRMAN HARRIS: Barbara Roper?

2 MEMBER ROPER: I think at some point in all of
3 these meetings I say that the audit only has value to
4 investors if it's conducted with an appropriate degree
5 of professional skepticism. And we have seen a
6 persistent problem with insufficient professional
7 skepticism which, I think, is arguably the main driver
8 of low audit quality.

9 So I would sort of review each of these issues
10 we've talked about today through that lens of to what
11 degree is there potential through whether it's audit
12 quality indicators or whatever, to drive a higher degree
13 of professional skepticism in the conduct of audits?

14 And toward that end, I actually think it's the
15 issues that Grant's subcommittee was working on in terms
16 of incentives and governance where there's rather a
17 largely unexplored potential for further progress in
18 terms of driving toward a more independent and skeptical
19 audit.

20 CHAIRMAN HARRIS: Bob Tarola?

21 MEMBER TAROLA: Yes, thanks Steve. I guess I
22 want to say I hope that you don't marginalize the audit

1 committee. They're the primary body responsible to the
2 shareholders. And I'm going to also be in favor of a
3 pass/fail model, an auditor report for that very reason,
4 is that if there are difficulties in auditing and
5 enterprise let the audit committee explain those
6 difficulties. The management of the enterprise has an
7 obligation to do good accounting and disclose how they
8 did it.

9 So if an auditor just comes behind them and says
10 they did good accounting, we audited it and we're happy
11 with it, I'm not sure what the benefit of that is. But
12 if you have the audit committee explain how they
13 monitored that audit with respect to those difficult
14 issues, I think the investors, I think the system works
15 better. Let me just say that.

16 I am in favor of transparency of the signer of
17 the audit opinion. I think that there should be no
18 difference between that signature and that of a CFO on
19 the financial statements. And also I think if you're
20 going to support the audit committee's role then you also
21 have to look at the qualification question.

22 CHAIRMAN HARRIS: Thank you Bob.

1 Joe Carcello?

2 MEMBER CARCELLO: Yes. In the interest of time
3 I think we're talking about the right things. I think
4 the Board's looking at the right issues. I just would
5 second what Ann Yerger said, let's get some things across
6 the goal line.

7 CHAIRMAN HARRIS: Judge Sporkin, we've just gone
8 around the table concluding and we've asked everybody for
9 their final comment in terms of what they would most like
10 the Board to address in terms of improving audit quality
11 and investor protection.

12 I know you've mentioned 10A in the past but
13 whatever you want to wrap this up with would be most
14 appreciated, as long as you keep it under five minutes.

15 JUDGE SPORKIN: No, I've just got a few seconds.
16 I agree with Chairman Doty's view on the signature on the
17 audit. I think that the person who has done it has got
18 to sign it. I think that should be a no-brainer.

19 The only other thing I think you, I didn't hear
20 what whether there was much discussion, but 10A of the
21 Securities Exchange Act is an extremely important
22 provision, and I would like to see some emphasis on that

1 provision. Because I do believe that it is not being
2 followed the way the drafters of the provision want it
3 to be followed. So I would hope that you would put that
4 on your agenda. Thank you.

5 CHAIRMAN HARRIS: Judge, in terms of the
6 transparency, since there are transcript, this is, you
7 know, an open release, why do you support it?

8 JUDGE SPORKIN: Well, when I say it's a no-
9 brainer is why shouldn't the person who has been involved
10 sign it? I don't understand why there should be any
11 question. It seems to me that if he knows he's got to
12 sign it he knows it's got to be credible.

13 I'll tell you this as a lawyer that when I sign
14 a pleading in court I want to make sure that it has what
15 I wanted. There have been pleadings that I have, even
16 though I've been co-counsel in cases, there have been
17 pleadings that I have refused to sign because it didn't
18 have what I thought it should have.

19 And it seems to me the accountant will have to
20 make sure that he believes in it before he puts his
21 signature. He's not going to put his signature on
22 something that he has any question with. He's just not

1 going to sign it.

2 CHAIRMAN HARRIS: Are there any final closing
3 comments that Board members would like to make, then I'll
4 just make a very brief one? No? Well, in that case I
5 want to thank everybody for what I considered to be an
6 excellent meeting.

7 We very much appreciate the leadership of the
8 working group members, all the members on the working
9 group, the entire membership of the Investor Advisory
10 Group, and I personally especially want to thank Nina
11 Mojiri-Azad and Tope Folarin.

12 Pete, you hit a home run. You mentioned that
13 this is not possible without really extraordinary staff
14 support. And I'm very lucky because I've had that
15 support. And so Nina, wherever you are I want to thank
16 you. And Tope, I want to thank you.

17 And Joann, you set the marker and I can think
18 we're carrying the ball forward with respect to our
19 Investor Advisory Group. So thank everybody for
20 participating.

21 (Whereupon, the foregoing matter was concluded at
22 5:06 p.m.)