 PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
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INVESTOR ADVISORY GROUP
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MEETING
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MONDAY, OCTOBER 20, 2014
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The Advisory Group met in the Hamilton Ballroom of the Hamilton Crowne Plaza Hotel, 1001 Fourteenth Street, Northwest, Washington, D.C. at 9:00 a.m., Steve Harris, Chairman, presiding.

PRESENT
STEVE HARRIS, PCAOB staff, Chairman
BRANDON BECKER, TIAA-CREF
ROBERT T. BUETTNER, Newbrook Capital Advisors
MERCER E. BULLARD, University of Mississippi, Plancorp, LLC, and Fund Democracy, Inc.
CURTIS L. BUSER, The Carlyle Group
T. GRANT CALLERY, formerly of FINRA
JOSEPH V. CARCELLO, University of Tennessee
NORMAN J. HARRISON, FTI Consulting, Inc.
MICHAEL J. HEAD, Creighton University
PETER H. NACHTWEY, Legg Mason, Inc.
BARBARA L. ROPER, Consumer Federation of America
LAWRENCE M. SHOVER, Solutions Funds Group
DAMON A. SILVERS, AFL-CIO
TONY SONDHI, A.C. Sondhi & Associates, LLC
JUDGE STANLEY SPORKIN, U.S. District Court (Retired)
ROBERT M. TAROLA, Right Advisory, LLC
LYNN E. TURNER, LitiNomics
GARY G. WALSH, Luther King Capital Management
ANN L. YERGER, Council of Institutional Investors
ALSO PRESENT

JIM DOTY, PCAOB Director
BRIAN CROTEAU, Securities and Exchange Commission
MARTIN BAUMANN, PCAOB
LEWIS FERGUSON, PCAOB
JEANETTE FRANZEL, PCAOB
JAY HANSON, PCAOB
JAMES SCHNURR, Securities and Exchange Commission
MARY JO WHITE, Securities and Exchange Commission, Chair
substantial enthusiastic support for this recommendation among all the subcommittees when we were preparing for this PowerPoint. Audit quality would improve by more closely aligning the auditors' incentives with those of users of the audit services. And we expect more informative audit reports produced by higher quality auditors fairly compensated. And in many ways this one recommendation, particularly if mutual funds were required to attend too, addresses a number of the other issues in our presentation. This enables private ordering rather than one-size-fits-all regulations which has the benefit of greater tailoring to individual issuer auditor circumstances. And obviously it's important that it provides investor feedback to the regulators.

MEMBER CARCELLO: Damon's not back, Ann, so maybe--

MEMBER YERGER: Okay. Our first but final recommendation is urging an expanded audit report. I could almost repeat all the comments I made about the signature, this is not a new issue for the Board which is -- it's been considering the issue. It’s actually not
a new issue for this committee, we have discussed it and I think supported it quite robustly. And it's not a new issue globally, as we've discussed, expanded reports are in place in other countries and as we've learned, I think the Rolls Royce example is a terrific one, actually it seems to be working in a really significant way.

So you know, the issue of the quality of the audit report really has been debated for decades and I think there is value from an investor standpoint in the current very blunt pass/fail model that's in the report. It's concise, it's clear, it's comparable. But I think it is clear today that the current auditor's report is just not satisfying the needs and interests of investors who really are the final and the ultimate customer of these products. As we surveyed the members of -- what was it -- of the investors two and a half, maybe, two years ago, three years ago, on this issue there was strong support for an enhanced audit report from the investor community. CFA Institute has similarly surveyed its members and found the same thing. So this is a space where I think investors' viewpoint is pretty consistent and clear, that they would like to know more from the
1 auditors.

2 You know, we do believe there's going to be an enhancement of audit quality if the auditor's report would be expanded, but I think there are also some other real benefits for investors from an expanded report. First of all, I view auditors as independent experts who have knowledge about the company that, you know, most of us investors can't get at. I think there would be real value in gaining from some of their knowledge and expertise and it would help investors analyze and price risks and make investment decisions.

4 I think an expanded report would really heighten the perceived value of the audit firm work, something that Lynn discussed earlier, and I think it might give firms some leverage to effect change and enhance management's disclosures and practices. And I finally think that this expanded reporting would enhance the transparency and promote real confidence in audited financials.

7 In terms of cost, Steve, you brought this up earlier, I think a lot of the things that we would like to see in that expanded report, sort of what was in the
Rolls Royce report, is probably already being communicated to the audit committees, so I don't know that I see this as a really expensive undertaking in terms of disclosing to the public.

And I also note, I know that there's a lot of debate about who should this expanded information be coming from? Should it come from the audit committee? Should it come from the outside auditor? And my view is there's real value in getting the insights from the outside auditor, the independent expert that's been retained by the firm. I believe there could be better disclosures from the audit committee but I don't think that the audit committee should solely be responsible for this.
MEMBER SILVERS: First, my thanks to my colleagues for picking up after me. I was at lunch with my wife and didn't realize that I was up next. So now I've gathered my thoughts, I have a couple of things to say about this.

The first is to repeat what I guess has been -- actually what someone said earlier which is, in relation to the question of the expanded audit report, it only -- just to put a further gloss on the recommendations that are here, it only makes -- it's only going to work, I think, if there's a requirement to disclose something. Meaning that if basically the expanded audit report is a mandate to tell us, tell the public, tell investors if something is wrong. The audit firm will, of course, say nothing is wrong.
Now that requirement, that further requirement may give the audit firm some leverage in private negotiations with the issuer but it's not going to result in any new information. What will result in new information is the requirement to disclose, you know, for example, the most -- you know, every audit has matters that come up that are of concern to the auditor that are generally resolved in some fashion that's mutually acceptable. The requirement to disclose the most salient such matter, there's always one, right? And the notion that you can't say nothing seems to me to be something that would actually add value of the kind that the examples in our report outline.
MEMBER FERGER: Steve.

MR. HARRIS: Yes, I don’t want to leave Mercer’s question unanswered. And I think it’s very important that everybody that’s made a recommendation address the issue of exactly what the problem is that we’re trying to solve. To me it’s pretty clear, and that is that audit quality is not what it should be. So how these recommendations will help improve audit quality I think is, one, determinative in terms of why you make the recommendation. But we do need to answer the question rather than throw it out and leave it unanswered. For those of you who have answers and responses, I think it would be very helpful to create a record on that. So for all those who submitted recommendations, what’s the problem that we’re focused on and why the solution?
And then in terms of the audit report based on some of the work that Ann and Norman and Gus Sauder, who used to be a member of this group, did a few years ago,
basically what we heard from users is, although they found the audit useful, they didn't even look at the report because it had no information content. And there are other things we could come up with but at a minimum I think those three are indicative of the fact that there are issues with both audits and the communication of the audit results, that these recommendations are designed to try to be responsive to.

MEMBER YERGER: Does anyone on the subcommittee have anything they'd like to add?

MEMBER TURNER: I would agree that there is an issue and that that issue is audit quality. When we look at the inspections and the findings in the inspections, which have increased, maybe part of that is attributed to the fact that you're doing better inspections today than what you were before, and I think that is, in part, true. So part of it's kudos to you for better inspections. But I also think it's the type of things that are cited when you go through line-by-line in those inspection reports and you see the problems, despite what
and auditor reporting about early warning signals on ongoing concern should be.

MEMBER YERGER: Bob?

MEMBER TAROLA: Thanks, Ann. I'm going to go back to Steve's question. I think it's a question basically what does all this have to do with quality and relevancy. And from my point of view, quality is about technical competency and it's about state of mind. And these recommendations are really going to that state of mind part. You could put in audit quality indicators on the technical side, I think, but what are you going to do to make sure or enhance the chance that these audits are being conducted with the proper state of mind? So whether it's -- you know, whether it's the fee issue, you know, the fee threshold or the governance matter or even the signing, to me that all gets to the state of mind aspect of quality and relevancy.

MEMBER YERGER: Thanks very much, Bob. Lynn, are you -- do you have anything you want to say, Lynn?

CHAIRMAN DOTY: Well, first of all I found this
If you start thinking of what we do in terms of the disclosures that we can now implement to enhance confidence that the public is getting the facts about the audit, and certainly they are, the audit reporting model is the biggest project going in that regard, the practices in the firm that we can lobby for successfully in talking to the firms. And then the final ultima ratio of where we can say we think this responsibility comes to rest outside, those are three fairly important sticks that we have to wield. They are three fairly important devices we have for improving audit quality.
MEMBER CARCELLO:

MEMBER TAROLA: Joe, I think you're up next.

MEMBER CARCELLO: Thanks, Bob. And thanks for your presentation. A few points I want to make. I mean, this issue keeps coming up over and over, both at the SAG when I was on that, and now on this group. I think as Pete made the point earlier, my sense, and I think the data supports this, there's huge variation in audit committee quality.
If you look at comment letters on the expansion of the audit report, most, if not all of the institutional investors that have commented support that.
Audit committees seem to be almost unanimous in their opposition. So these are groups that are supposed to represent the interests of investors and on major policy issues are taking policy positions opposite that espoused by investors.

If you look at research on audit committees, which is voluminous, the CEOs, CFOs still drive the process in a large majority of cases. When the governance committee is lax in dependence or have CEO involvement, any benefits of audit committee independence and audit committee expertise seem to vanish. There's a growing literature on social ties between management and the audit committee with the same deleterious consequences. So I would encourage the Board or the SEC to look at that.

So how do you deal with all of this? And I think that Damon is right. I mean, I don't think it's perfect by any stretch of the imagination, but greater transparency by audit committees which will call for expanded reporting. In fact, one of the things that might be worth considering is, should the shareholders have a vote on whether to accept or reject the audit...
MR. BAUMANN:
So we've issued a proposal for the auditor to disclose critical audit matters in the audit report and also to describe what the auditor's responsibility was with respect to other information accompanying the financial statements. Some of the non-audited -- some of the non-GAAP measures and others which could be reported in the other information where the auditor has to read and consider that. But we were heightening some of the requirements there.

We also held public hearings on the expanded auditor report in April of 2014. So our plan now is to issue a reproposal on expanded auditor reporting requirements, taking into account the comments we received during the comment period as well as at the public meeting and to issue that reproposal probably in the first quarter of 2015. We are staying obviously very close to all of those global developments and have had many conversations with the IAASB and European Commission and others.

Just in terms of timing, somebody mentioned falling behind, hopefully we won't fall too far behind here. The IAASB expects to approve a standard on
expanded auditor reporting at their December meeting. And that they expect to be effective for year's ending on or after December 15th, 2016 such that expanded auditor reporting would take place in 2017. So if we can get our reproposal out in the first quarter as I suggested, and hopefully move that along, maybe we can get on track.

By the way, that IAASB report that they expect to approve in December, the IAASB report, does include a requirement to disclose the name of the engagement partner in the audit report so that will be a requirement basically around the world for all those countries over 100 jurisdictions that follow international auditing standards. So again, please weigh in on that reproposal on expanded auditor reporting that we'll issue in the first quarter of 2015.
of Research and Analysis, working with the other divisions, as well, have before us the paper on audit quality indicators. And hopefully this will get out, Greg, around year-end timeframe or so, which I know this is important to all of you. So a lot of things where, again, we'll be seeking comment on that document, as well. So I think a lot going on, we'll be seeking comment on very important matters, all relating to the improvement of audit quality.

MR. HARRIS: Marty, thank you very much for that summary. And then as I indicated, why don't we go around the room and conclude. We welcome your input, welcome your recommendations for priorities in terms of what we ought to be focusing on. And, Pete, we'll start with you.

MEMBER NACHTWEY: Well, great. Well, first of all, thanks to the Board and particularly, Steve, you, for putting this group together because I think it's important to get a lot of different viewpoints and constituencies. And clearly there are lots of things we
And then on this expanded audit report, that we get it right and that it's useful information and not just a lot of boilerplate at the end of the day, if we're going to have companies and the investors in those companies paying for that extra work.
MEMBER HARRISON:

I'll be brief because first of all some of the observations I would have offered have been covered already. I don't want to be repetitive. I'll end on the note or theme I mentioned in one of my comments earlier, and that is that I would strongly urge the Board, in everything you do, but in particular in the rulemaking in which you engage that pertains to the audit report and some of the other disclosure-oriented issues that we've mentioned today, to bear in mind that one of the things that the audit profession and audit firms can do where I think there is tremendous room for improvement is to be an additional source of valuable information that informs the investment process, as we discussed earlier.