The Advisory Group met in the Hamilton Ballroom of the Hamilton Crowne Plaza Hotel located at 1001 14th Street, N.W., Washington, D.C., at 9:00 a.m., Steven B. Harris, Chairman, presiding.

PRESENT

STEVEN B. HARRIS, Chairman
MARY BERSOT
CURTIS BUSER
DR. JOSEPH V. CARCELLO
KEVIN G. CHAVERS
LINDA de BEER
SARAH DEANS
DR. PARVEEN P. GUPTA
NORMAN J. HARRISON
MICHAEL J. HEAD
AMY McGARRITY
PETER H. NACHTWEY
LAWRENCE M. SHOVER
DAMON A. SILVERS
ANNE SIMPSON
MICHAEL A. SMART
TONY C. SONDHI
JUDGE STANLEY SPORKIN
ROBERT M. TAROLA
LYNN E. TURNER
GARY G. WALSH
SEC REPRESENTATIVES

MARY JO WHITE, Chair
WESLEY R. BRICKER
BRIAN CROTEAU

PCAOB BOARD MEMBERS

JAMES R. DOTY, Chairman
LEWIS H. FERGUSON
JEANETTE M. FRANZEL
JAY D. HANSON

PCAOB STAFF

MARTIN BAUMANN
MARY SJOQUIST
MR. HARRIS: And, Joe, that leads us to your working group presentation.

MS. DEANS: I think at this point Joe is going to hand it over to me to do some of the talking.

Joe is that --

MR. CARCELLO: Yes.

MS. DEANS: That's the plan. Right. Great.

You can click.

MR. CARCELLO: You want me to click? That sounds good.

MS. DEANS: Okay, thank you. So I'm going to try and -- try to keep quite a brief presentation and hopefully that will allow plenty of time for discussion still at this stage in the afternoon.

So we were asked to report as a working group on the proposals about the new -- the auditor's report. So the PCAOB, just to recap, re-proposed in May a standard, the auditor's report, on an audit of financial statements when the auditor expresses a unqualified
opinion. And that was an original proposal back in 2013. It's been re-proposed. And as a working group we submitted a comment letter to that back in August. And I'm going to briefly, briefly go through what we covered in our comment letter then.

So, summarize the proposals, the proposed auditing standard. The intention was to enhance the form and content of the report to make it more relevant and informative to investors and other financial statement users and include a description of critical audit matters. And that's mass communicated to the Audit Committee or required to be communicated that relates to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgments.

There were also some additional improvements to the auditor's report proposed. We haven't touched on those in detail, but obviously we can discuss those afterwards. And also a requirement to dispose auditors' tenure.

Given the relatively late stage in this project, as a working group we felt it best to base our comment
letter and this presentation today on the issue of critical audit matters. So the proposed rule requirements summarized here, the proposed requested audit report, identify critical audit matters, describe why the auditor reviewed this issue, the principal considerations there, and indicate how the auditor addressed these critical audit matters and refer to the relevant line items and disclosures. That's a very brief summary there, just a recap for everyone.

So the working group very much supports this proposal. We believe that the proposed auditing standard does represent a meaningful improvement from the current standard audit report. And if I refer to the mission to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, it seems to me that clearly reports are -- then the proposed standards would be more informative. To me that seems very clear-cut and I think the working group were quite unanimous in agreeing that point, so we think it's very much clear that this would be more informative and therefore very consistent with the mission of the Board.
We take no exceptions. We put here, we don't disagree with any of the four points that were mentioned on the previous slide. We think those requirements for the critical audit matters would be helpful.

One point that we really want to emphasize here is the requirement that the disclosed critical audit matters, the discussion should be -- to be most useful, must be highly bespoke to the company. If it becomes standard boilerplate language, that is not going to be helpful to investors and we certainly believe that there will be a direct correlation between how specific that information is and how valuable it will be to the users.

Just to elaborate here a bit on this UK experience which has been referred to quite a bit already today, on this matter we've had somewhat similar requirements in the UK now for three years. So for most companies listed on the London Stock Exchange we've had three years of these extended audit reports including a discussion, not quite identical wording, but very similar intent, on the risks of material misstatement, that we've had.

I think certainly my experience as a user
accounts and for many of the investors I've spoken to, we've undoubtedly found the additional information useful in the auditor's report. And where it's been very highly bespoke to the company we've found it very useful typically. As I mentioned this morning, now it's one of the first things I look at. I'll pick up annual report and go and look at the auditor's report. And that is very different from the past. So it's straightaway going and look at that.

So we said that we strongly support the proposal, but we do ask or request here perhaps the Board to consider the possibility of doing a little bit more. So one thing the Board has not done is required discussion of what the auditor found when it addressed that critical audit matter and what were the results, the procedures, and simply a disclosure of the findings. That is not required.

Now, this is a matter where we understand requiring that information could clearly be problematic. We understand that. And instantly is not required. There are other international developments requirements here. It's not required in the IAASB standard, and in
fact the existing UK Financial Council standard does not require the disclosure of findings. We understand that at this late stage in the project that could be very difficult. Mandating that disclosure may not be feasible.

However, we would like to ask the Board to consider the possibility of modifying a proposal with an additional sentence that we've put here, just to state that the inclusion of informative company-specific findings could be considered best practice in auditor reporting and that that could be encouraged, although it's not required in the auditing standard. Certainly we view specific findings would undoubtedly make audit reports more informative, and that would be consistent with the Board's mission.

So to give a little bit of justification for this argument, a few things on the side here. We do regard the disclosure of critical audit matters as undoubtedly useful but incomplete without going that step further to talk about findings. A survey by KPMG found approximately 80 percent of investors argue that they should include findings, that that would be helpful.
And the UK Financial Reporting Councilors in a review of the experience of the new auditor's report requirements that investors clearly valued the additional insight offered by extended auditor reporting, and certainly investors have been particularly -- found it helpful when that included findings. So although in the UK there hasn't been a requirement to include findings, that has occurred in some cases.

And if we move on, talk about that. Thank you. And just to illustrate a little bit of how well received this has been in the UK, and we mentioned here, the IMA, the Investment Management Association, is now sponsoring an annual award for the best auditor reports. We wouldn't have had that in the past. And an example of one that the IMA recommended is the KPMG Rolls-Royce audit report, and for any of you who are not familiar with this report in the room, I thoroughly recommend it. It's a fascinating example of how an audit report can give so much more information and as the IMA said there, provided a real value-add.

And one of the things that that audit report
included was findings as to whether management's judgments were balanced, or in the words of the KPMG auditor, mildly optimistic or mildly pessimistic, so giving us theories as to where in the range those judgments came, and that is something that investors, many, many investors that I've spoken to really appreciated.

There has been discussion in the UK that -- and there's been an evolution over the three years. So in the first year there was quite a lot of boilerplate information that was not so helpful. There was then a discussion about -- amongst investors and the firms as to what was useful and certainly some of the firms now, three of the four big firms have included findings in some of their reports. So that has been a big development over the three years of evolving sort of best practices.

To come back to the point about company-specific information, it's really helpful to get proper information specific to the audit and for example not just have a statement that is something that is obvious anyway from the fact that it was an unmodified audit
report. So for example, it's not helpful if the firm keeps repeating that something was within an acceptable range. That's not what we mean by findings.

It has to be something that's new information. And clearly we need to get sort of set of differentiation reports. Having the same standard sort of report for everything doesn't help us. We want to get new information and find out exactly something that's relevant to understanding the critical audit matters for that audit, for that company. And we've got a couple of -- a quote there from KPMG.

What are the arguments against doing this? I find this quite hard, in a way, because to me it's so clear-cut that including critical audit matters is important, and ideally findings would be very helpful to investors. So the first point I guess is that this is moving in exceeding the auditor's mandate. Yes, perhaps that could be argued, but in my view it's so clearly an improvement that I think the fact that it's such a significant improvement should outweigh that argument.

I'm certainly told that some, particularly in the audit committee community, are questioning what
investors do with this information. Well, I'm quite
disappointed in a way with that comment. And certainly
if you look to the UK experience, many investors in UK
companies support disclosure, support the new
information. They've found it helpful. And there are
plenty of examples, and I'm happy to answer afterwards,
if people want a couple of sort of more specific points
on the kind of thing we've learned and where it's been
helpful, but I don't really feel -- I think that's a
question to ask investors.

Now the third point I do have some sympathy with.
I think as a working group we did, that potentially the
concluding findings exposes auditors to incremental
legal liability. And I'm also well aware the legal
environment in the US is different from that in other
countries where there have been such developments. So
it is something that we understand.

And what we've put here is to say that we think
the fact of encouraging disclosing findings leaves it
then a choice for the audit firm to weigh up the benefit
of a better report against that possible cost argument
in terms of legal liability. And we also in our comment
letter mention potentially supporting a legal safe harbor specific to this findings point, if that was included.

So to conclude, we do clearly -- I want to reiterate the fact that we support the proposal as a working group. I think there is strong investor support. I think the international precedents are very encouraging.

And although we've had this information in the UK for three years, but it's coming now across Europe next year. So we have more to look forward to in Europe. We do think the proposal, however, could be strengthened if it could be encouraged to include findings. And so if it's possible to go a little further, as we've suggested here, that would be greatly appreciated, I believe, by many investors.

MR. HARRIS: Joe?

MR. CARCELLO: Tremendous job by Sarah, as I knew it would be. Just, you know, maybe three things to emphasize very briefly that I think are certainly consonant with what we had up there.

The first would be if we end up in a regime
regardless of findings where the CAMs either initially or over time become essentially boilerplate, don't do it. So if you're not willing, PCAOB and SEC, to inspect and enforce, don't do it, because what will happen is even if audit fees don't go up -- people's time is the most valuable thing they have in their life, maybe short of their family. And these reports now will be longer. There is a cost of reading this stuff. And so if it doesn't say anything, it's actually value-destroying.

The second thing that I would say is I think the evidence out of the United Kingdom, three years of data, is that it's clear -- I think it's overwhelmingly clear that investors find specific findings highly valuable. I don't know how -- you might be able to argue against this for other reasons, but I don't think you can argue against that it's valuable. I think we have -- I think the evidence is overwhelming that it's valuable.

So then the question is if it's valuable and you're not requiring it, you're only suggesting it's best practice, there has to I think be a very compelling argument for why you wouldn't suggest this is best practice when clearly the evidence would seem to suggest
that it is.

And then I think the third thing that's important to understand is around the legal liability issue. I remember when this issue was teed up, and Marty and others remember this, and there was a series of round tables, there was a series of focus groups, and I remember at one point corralling some investor people, including some of the people in the room today. And I said is this a disguised attempt to get at the auditor's wallet? Is this just a -- kind of a crafty way to grab for the wallet? And they swore up and down that it wasn't.

And when we went -- when Sarah and I went to them and said would you support a limited legal safe harbor -- which I understand is complicated. You can't do it. Probably the SEC may not even be able to do it. I'm not sure. It may involve Congress. But at least in terms of the investor folks, to a person, at least the ones we talked to, were very much willing to say if we get this information at least as it relates to this information, not everything else, but this information, findings, we would be very supportive of a legal safe harbor.
So this is not some back door way to try to increase legal liability for accounting firms.

MR. HARRIS: Jay?

MR. HANSON: Well, thanks to the working group for the work you've done on this. It was a good discussion to have today.

I want to pick up on something that Sarah said, and Joe as well, about the value. And Sarah and I talked just briefly last night about this, but I'd like to hear more from the other investors in the room that might be invested in UK stocks, or at least evaluating, with some examples of how the information translates into value.

And what I think about in this way, and I want to be educated on this to see if I'm thinking wrong, the value to me could be a new area to explore more deeply in terms of the analysis or it might be information that wasn't known from something else in the publicly available filing information, and how maybe that new information translated into something different in the analysis, maybe a change in the model, a change in the assumptions, change in the discount rate to the
multiple, which ultimately affected the decision itself.
And then ultimately, does that manifest itself in changes in the price or volume and the observable in the marketplace?

And so I'd just kind of like to hear some examples of that, how the good information translates into something actionable, and what's been done. Or maybe if these aren't on the list of things I should be thinking about, maybe things that you do -- how you translate that into value.

MR. HARRIS: I was going to ask pretty much the exact same question, since you led with your chin and volunteered, and that is where has it been helpful? And if you could give us more examples.

MS. DEANS: Yes.

MR. HARRIS: So first you'd answer Jay's and then give us some examples as to exactly --

MS. DEANS: Yes I'm happy to give some examples.

So I think it's an area where just in the specific nuggets -- I'll give you a couple of specific examples.

So one quite small one, but I think it was quite
So a company with a big pension exposure, and it had always been using or had been using a pension discount rate that looked higher than norms. And the auditor's report actually talked about that being a critical audit matter, or key audit or risk material misstatement and actually talked about how the company calculated the discount rate.

And that they were adding on an arbitrary amount on top of the normally calculated discount rate apparently for, I think it was to do with the risk and that. So they were adding on an amount to the discount rate and that was bringing a higher than average discount rate. And this had got through, apparently the amount involved was not so big as to make the overall financial statements misleading, but it was an item that the auditor commented on.

And then that was something that clearly a lot of investors pick up pension deficit numbers in their evaluations of companies that can then be picked up on and discussed as to why that company was taking that approach. And funnily enough the following year, still an important area, still an area the auditor discussed,
but the discount rate had become a little more normal, within the normal range, and that comment had been dropped.

And I'm sure that pension investors had gone to the company and asked about that calculation of the discount rate and why this additional amount had been added on, or at least that's my guess. So I may -- that may be a misconception, but that's how it seemed to me.

Another example, so -- and this is a little unfair, but say for example if you took one of the very big retailers in the UK three years ago the issue of supplier income wasn't really discussed in the financial statements. If you look at the auditor's report, that did flag up as a critical audit matter, supplier income. Not really discussed elsewhere. Well, I mean, in the company, but there was subsequently an issue in that area.

And of course then it does beg the question of why the auditors were raising it as a critical audit matter and then not talking to the company about getting better disclosure around that topic, but nevertheless it had been flagged up. It was a point that investors were
warned about as a potential risk of material misstatement. So that actually was flagging up a very important issue.

So those are a couple of areas where sort of I've observed there's been particularly useful information, and there are many others. I'm not sure if anyone else in the room who's looked at UK stocks has any other suggestions to contribute.

And also just to come back to the famous KPMG example with Rolls-Royce, I think if you talk about in stock, a lot of those questions that were raised there have been really debated amongst investors. It's important to understand these risks. There's actually, for those of you who haven't seen it, several pages of discussion, and some quite important matters I think have come out through there, a discussion of risks around controls in one division and so forth. And those are really of interest to investors and I've been in many meetings where those points have been discussed.

MR. HARRIS: Linda?

MS. DE BEER: Thank you, Steve. I think just to add to Sarah's point in South Africa we use
international standards in auditing, and obviously the equivalent ISA standard hasn't become effective yet, ISA 701, but very many listed companies have already pushed their auditors or the auditors started insisting on early adopting it. So we've seen quite a couple of those audit reports as well.

And the one other aspect or benefit, Jay, maybe just adding onto your question, that I've certainly seen is it keeps the audit committees honest as well. Because what's happening now -- and we don't have a requirement that you have in the UK that the audit committees must have sort of reflect or mirror some of the disclosure. As you know, that's not an ISA requirement. But what audit committees now do is in their reporting or in their financial statements they sort of take a proactive step to knowing what will be the key audit methods to explain further what the governance process is all around there.

So I think automatically if you look at the key audit methods and at the audit committee reporting, there is just firstly better governance, but also better disclosure for investors to give a more holistic picture.
of those specific areas.

MS. DEANS: One other point, if I could just add,
I think the very fact of having the auditor talking
about these areas makes it very helpful as the user
accounts to engage with the company because it gives you
a hook of information and also if the company doesn't
want to talk about it, it's much easier when you can say
but your auditor has identified this as a risk. So
rather than sort of, well, why are you asking about
that, to be able to say the auditors are talking about
this, makes it harder for a company to close down and
not want to talk about the issue. You're informed.
You're a more informed investor or analyst.

MR. HARRIS: Sarah, in the UK how would you say
it's influenced the behavior of the auditor?

MS. DEANS: This is -- it's a little harder to
say as a user of the accounts rather than an auditor,
but I think it's clearly promoted interest in what
investors think and feel, because we have now more of a
dialogue. I mean, certainly since these have been out
there it's been easier to engage with audit firms and
point them to where it's been helpful, you know, and I
1 think it's incredibly important for the audit firms to
2 see this as an opportunity because they're able to
3 actually show the value to investors of all their
4 knowledge.
5 So in the past up until now, auditors have all
6 these masses of information, but we had -- as users of
7 the accounts have seen no sight of that. They're
8 actually able to prove their value a lot more and I
9 think that's incredibly important when there is quite a
10 lot of skepticism, at least amongst the investors I
11 speak to often, about the value of the audit to them.
12 So in terms of has it changed behavior, I'm sure
13 it has, but we don't get a great deal of insight into
14 that. But certainly if I was an auditor and I knew I
15 was going to be talking about this, I think it puts
16 maybe, I would guess, a little extra pressure to be
17 confident of what you're saying.
18 MS. SIMPSON: Sharpens accountability.
19 MS. DEANS: Sharpens accountability, that's the
20 best --
21 (Off microphone comments.)
22 MS. DEANS: Yes, exactly. So I think I'm sure it
has changed behavior. It's certainly prompted some useful dialogue between investors and the audit firms in the UK. So I really see it as a positive. And there has sort of been a bit of competition amongst the audit firms to be perceived to be being helpful here and to actually improve the standard, which has been very constructive, I think.

MR. HANSON: Sarah, just to clarify, as an investor you're dialoguing directly with the auditors about what's in the audit report?

MS. DEANS: Just to clarify, not typically specifically on companies, but on overall what we found helpful, yes, the audit firms have been quite open to having conversations.

And in those cases, you know, investors are often maybe bringing examples, obviously there's confidentiality that they are not going to give away to us obviously inappropriate information. But certainly company examples have come up in those conversations of what's been -- typically what's been particularly helpful.

MR. CARCELLO: And, Steve, let me add one thing
in following up what Sarah said about the effect on auditors. As you know, I'm sure you're in contact with the folks at the FRC and Marek Grabowski and those folks, and they have done quite a bit on measuring what's changed inside audit firms.

And we alluded to this earlier, one of the unintended consequences, in this case a good unintended consequence, is the staff are more engaged in their work, they're more excited about their work, they feel like what they do every day actually matters more because they see the fruits of their labor in a report that people will read other than a three-paragraph report, as Sarah said I think earlier and others have said, that people typically in the past didn't even read.

MR. HARRIS: Mike, and then we'll just go around. I'm sorry. Well, wait a second. Jeanette? Let's recognize the Board first.

MS. FRANZEL: Thanks, Steve. Thanks for this. And I'm wondering, Sarah, can you elaborate a bit more on the very specific issue of company-specific findings?

And I can kind of see this going in two different
directions and so if you have examples of both, that would be helpful. So in one case maybe it's a difficult audit area and the auditor finds that there's just a whole lot of uncertainty and there's nothing really that anybody does about it. And what kind of -- have you seen examples of that, whereas in other cases maybe the auditor found that something needed to be refined or a disclosure needed to be expanded. Management did that. How far do they go in discussing the findings? They say, you know, this was difficult and as a result of our work management expanded its disclosure, or do they say talk about the inadequacies first of the initial disclosure and then the subsequent changes.

So anyway, examples on both types of findings and results, if you have any.

MS. DEANS: Yes, so and I guess to caveat this a little bit, clearly most of the auditor's reports yet do not include findings. The majority do not. It's very much a minority yet. And those findings, again, vary enormously from the very, very detailed examples we have at Rolls-Royce, which I'm sure you've seen, right through to some of the less helpful, you know, blander,
1 not very company-specific that was within a reasonable range type comment that doesn't really help us.

So this is based on not a huge number, but yes, we have seen cases where, for example, it's been commented that errors were found but those were then corrected. And after they'd been -- after an error had been corrected, then the auditor was happy. But that was an insight again that was new. Whereas in other areas there is a lot of just sort of, this is the work we did and this is a risk area without -- either no finding or no very specific finding other than there wasn't anything that required -- well, they didn't say that, but there was clearly nothing that kind of further seemed to be required at that point.

If you look at most of the findings, the PwC ones tend to just be of the it was within a reasonable range and there we left it, sort of thing. If you look at some of the others, one thing actually I should comment that I found quite helpful, at least in terms of presentation, was what I liked about this most recent year's reports from Ernst & Young, from EY, had the column, this is what we reported to the audit committee.
Now having said that, some of those comments then below that are quite bland and you think, well, that must have been a boringly thing.

(Laughter.)

MS. DEANS: You didn't tell them much, but at least I like that way of framing it, that then here is the result, this is what we presented and talked to the audit committee about.

I don't know how much that answers your question, but it is still relatively early days, at least for findings.

MS. FRANZEL: Thanks.

MR. HARRIS: Mike?

MR. HEAD: One, because I was on this committee I have the insights, and this was a topic that again I was very passionate about. But the first comment on findings and results that I wanted to emphasize. We as maybe auditors or accountants our self automatically go to a finding must be an exception, versus a finding can be, they did a great job in this area and we applaud or agree with management's judgments.

Now you're not going to see that kind of wording
in this kind of report, but it should be balanced about
positives and potentially negatives, if there are some,
without assuming it's all going to be negative.
And I correlate what I think the value is here.
I think all of us would agree when you're doing what
I'll call a service center type audit where you're
actually auditing and saying what the state should be,
what your results were, if there was any exceptions, can
it be relied on? And then that type of audit, which kind
of relates to where we've went on the broker-dealers
with the 17(a), you know, this isn't going there, but
this is going that direction. You're trying to get more
color on that -- the audit process and what the results
of the audit process would be. And that starts moving
you down, well, did it work the way you intended during
the period, not just as of a point in time?
I guess the last thing to me is I'm big on
transparency. Everything we're talking about that could
be including findings or results have -- are being
discussed in the audit committee meetings by management,
by the auditors with the audit committee members and at
times at the full board. So this is not something
that's not already being done privately. It's just giving the investors or the shareholders or stakeholders transparency or insight to it. So those are my thoughts, my top of mind.

MR. HARRIS: Parveen?

MR. GUPTA: Sarah and Joe, I guess what I was wondering, maybe you covered this point and I missed it as I stepped out for a few minutes, for the first couple years certainly expanded disclosures in the audit report and the information that we are talking about would be new information and useful. Was there any conversation in your working group that what discipline can be put around the fact that maybe after two, three, four years it could become a boilerplate report? And if so, how do we handle that?

Because, you know, when you go in this direction, you want to make sure that you mandate something that's going to be useful to the capital markets for the longer term rather than just couple years and then the excitement kind of dies down and it's the same report like we've seen the risk disclosures in the 10-K in the US, at least.
MR. CARCELLO: Yes, I'll give some thoughts, Parveen, and then obviously I want to hear what Sarah has to say and what she has seen.

But to me, let's say Company ABC has six critical areas and actually presents findings in years one, two, three, four and so forth. The real important information is going to be change. And if you don't -- if all you end up getting is it's the same six every year and it's the same wording every year, then essentially what you're saying is absolutely nothing changed inside that company on those six areas. That's just not believable.

So if that's the case, what it's suggesting is that there's not that kind of disclosure around change, and that would be a problem if that was the case.

MS. DEANS: Yes, and this question's been sort of talked about quite a lot in the UK. Is there a danger of this? We've had it three years. Is it just going to come -- in fact, actually so far that hasn't happened because I think the process has been evolving so much anyway that things have changed and moved on.

But certainly one of the examples of sort of best
1 practice which some of the firms are doing, at least
2 some of the time, is to talk about exactly that, where
3 things have changed. So for example, if something was
4 a key risk last year and isn't in there now, to give
5 some explanation of what's changed. Sometimes it's
6 obvious. That division was sold, so we're not worried
7 about it anymore. But other times it's not.
8
9 And also when new risks have evolved. And even
10 again, and I hate having to always give the same sort of
11 example of best practice, but if you look at how again
12 the Rolls-Royce most recent auditor's report, actually
13 gives a little chart of sort of where things have moved.
14 So this risk is actually a bit bigger this or a bit more
15 of a concern this year versus a previous year, and this
16 one has sort of moved down the track a bit.
17
18 So not just which ones have come on and which
19 ones are dropped off, but actually the evolution of
20 we're a bit more worried about this and we're a bit less
21 worried about this now, which is again very useful and
22 I think is an indicator of the quality of what the
23 auditor is doing is quite an interesting one. We know
24 which ones we're actually talking about.
Those kind of processes that they're thinking through, this has become more important. Whereas exactly if an auditor's report is just -- and so far we haven't had it that much the same as last year's and the same as the year before's. Then I think you start worrying. Do you really believe that nothing has changed or is that simply the auditor not doing a great job? So again it's helpful insight into the quality of the auditor potentially. And it's still again early days, but I think that will be interesting as we go further down this track.

So I think, yes, of course I understand there is that risk there. And absolutely, to Joe's point, if this just becomes boilerplate language and doesn't tell us anything specific and so forth, it's hopeless and it is just more pages for no purpose. And that's not what we want.

But actually I think enough does move on and if it's really the auditor's going for best practice and helping the investors understand evolution of risks, that's helpful and that's actually a useful history then of how things have moved on. There was a problem with
internal controls last year in this division. Has that improved this year and has it improved so much that this is no longer a risk or is it just evolving, or is there actually still worry or even worse? So I think there's a lot we can learn from that, so long as the process is done well.

MR. HARRIS: Robert?

MR. TAROLA: Robert Tarola. I find this quite ironic that we're -- that there's resistance to this in the auditing profession, because as I'm listening to all the analysis, this could be the solution to a couple of the problems we talked about today. It appears to me it will raise the value of the work of the auditor to their ultimate customer. It would provide the transparency that folks believe is important in reporting to outside parties for an issuer.

It should make the profession more exciting, that you would want to join. In fact, the way I think about an auditor, it's just the front end of the analysis process. It's the same person on each end. The auditor is a front-end analyst and the investor rep is the back-end analyst. They have to have the same skills, the
same insights, the same knowledge of the company and
business models and how they all work.

So the public accounting profession really needs
a makeover in terms of its marketing. And this may be
the impetus for a makeover.

MR. HARRIS: Well, being an audit committee chair
and an auditor and somebody who's well versed in the
profession, those are very interesting comments.

MR. TAROLA: Well, I was going to start --

MR. HARRIS: But you wear so many different hats
that it's interesting.

MR. TAROLA: Well, when I wear a preparer hat or
an audit chair hat, it's a bit scary --

(Laughter.)

MR. TAROLA: -- to be frank, because you're
really now -- your scorecard is going to be made public
as a preparer and as a, you know, governance committee
of the company. So that's a bit scary.

I think the other -- I think on the auditor side
I'm sure they're nervous about added liability, and I
think Joe's idea is a really good one. Maybe a safe
harbor for audit committees, too.
(Laughter.)

MR. HARRIS: Only for you, Bob.

(Laughter.)

MR. HARRIS: Linda?

MS. DE BEER: Thank you. Just two comments, if I may, and it's more from my experience where we debated this as the advisory group with the IAASB. Jeanette, the comment or the question you asked about the entity-specific information just triggered the thought in my mind, and there were lots of discussions at that point in time really to try and avoid industry disclosure. And I think that is a really important point that must come through.

And, Sarah, you spoke about sometimes the entity-specific information might be a little bit more bland and the range is a little bit more general, but there was, especially at the initial stages of the debate, the real concern that instead of auditors drilling in to the specific critical audit methods or key audit methods within the entity, the role they sort of talk about industry-specific, you know, this is in the platinum industry and the market is distressed.
And, you know, that sort of becomes a critical audit method because that information would certainly not be useful at all. And I think it's very important that the wording must be tight enough to avoid that sort of general disclosure, critical areas for the industry as a whole versus that company specifically.

The other point that came through very clearly as well, and Mike, when you spoke it reminded me, was that a lot of the people around the table at that advisory group felt very strongly that they're not really interested in audit procedures. They sort of want to know what the issue was and what the finding is. They couldn't really care all that much what the auditor did to get the comfort that he needed, but more sort of what the ultimate outcome or finding is.

And I think there is a risk that if auditors start disclosing a lot of procedures, it will again become really boring reports that people won't read.

MR. HARRIS: Curt, I think you had your card up next.

MR. BUSER: Thanks, Steve. So like Bob, I think this has a lot of opportunity for the whole audit
profession, and from an assurance standpoint I think it's potentially a very good product.

I have a couple questions though that I'm just curious in terms of how the working group thought about it. So first, if there are no findings or they're boilerplate-type answers, does that create a false sense of assurance?

Related to that, do the critical audit matters create kind of a piecemeal opinion approach with respect to the report on the financial statements otherwise taken as a whole? How do you think about materiality and disclosure requirements around that?

And then last, as it relates to internal controls, right now we have a criteria, as least as I understand it, that obviously the material control weaknesses, they need to be disclosed and talked about, significant deficiencies, obviously talked about with the audit committee and kind of resolved.

So does this change that standard? So does this kind of enforce significant deficiencies to be publicly disclosed as a critical audit matter, or how do you then kind of say no, no, no, you don't have to talk about
that, but it's a significant matter? Thanks.

MR. CARCELLO: Yes, I'll start off, but again I certainly want to hear what Sarah has to say.

Curt, these are, as I would expect, excellent issues to raise. On the first if there's no findings or if the findings are boilerplate, does that give you a false sense of assurance -- and I think if the Board decided to do what we're suggesting that they might, which is to encourage findings but not require them, I think the reality is inside the United States, and we recognize this, that at least initially there's probably not going to be a whole lot of findings.

I mean, we're not finding a whole lot of findings right now in the United Kingdom. So I don't think there's going to be a global conclusion about an issuer if there aren't findings. Now maybe down the road 10 years, 15 years, 20 years, but let's worry about that 10 years from now.

On the second issue, the piecemeal opinion, and certainly this is a concern that's been expressed, it doesn't appear to me, but I want to hear what Sarah has to say, to have been a problem in the United Kingdom.
I think the marginal investor in most stocks today is pretty sophisticated and I think they're going to understand that it's not a piecemeal opinion, but I want to hear Sarah's explanation or experience in the United Kingdom.

The significant deficiencies is maybe not a fair thing to throw to her because I don't believe there's reporting on internal control over financial reporting in the United Kingdom. This is not something we talked about, Curt. I know it's a major concern of issuers and of audit committees and of auditors, so it's a fair point and I think it would have to be looked at further.

I think to -- not to move forward in encouraging findings because of that, I think that can be solved even if that's scoped out. That's not a strong enough reason not to do it.

MS. DEANS: Okay. So to add to that, is there a risk with a sort of piecemeal opinion? I just don't think that's been perceived as a problem in practice over the three years. We understand, or at least the professional investors I speak to understand the overall audit opinion. And then this is additional helpful
information. And I just don't perceive it's a problem.

I think -- was there -- sorry, was there also a question about materiality that we didn't cover there?

MR. BUSER: Yes, and if you're going to talk kind of on a piecemeal basis or call that out, I mean, how does materiality kind of play into that especially as -- if a critical audit matter how would it affect your materiality assessments?

MR. CARCELLO: Again, that didn't come up, Curt. We didn't even talk about that. Id' have to think about it more, but it's a fair point.

MS. DEANS: I guess that does -- we'll say just maybe one tab one point, which is one area where the U.K. has also gone further is actually requiring disclosure about materiality and the calculation of materiality. And I know that that has sort of fallen by the wayside a bit here, but I -- personally actually I found it very interesting. And actually if I was to put my finger on where I think practice has most been affected or things appear to have changed most as a result of extending required information in the auditor's report, I'd actually look to that because


first year we had a lot of outliers taking a pretty high percentage of pre-tax profit. So that's been changing.

MR. HARRIS: Judge, you're not allowed to put your card down.

MR. SPORKIN: The only thing that -- I've listened now for this whole day and I was thinking what are we talking about?

MR. HARRIS: Judge? Judge, hit your mic.

MR. SPORKIN: What we're talking about is what you need to do in this profession as it's been done in the legal profession, medical profession is branding. If an organization has a brand that it's known that you don't get their name on it unless you've done the greatest job in the world. I mean, you don't get a Sullivan & Cromwell's name on a report unless they believe it's the right thing to do. Not the client. Sullivan & Cromwell won't put their name on something, or Korvath, Wachtell & Lipton. It's a branding. You got to get a brand that says this accounting firm you're not going to get that name on that accounting firm unless it's the report that we want to go out. You won't get a Wells Fargo -- your name on Wells Fargo
1 unless it's right.
2 And they know. I mean, how do these people know?
3 They can read the report and they can know something's
4 right or something's wrong. They could ask the right
5 questions. Why is it? Or you never see them getting
6 into the kinds of problems with some of the accounting
7 firms you're getting into. Is it trying to get minimum
8 standards or is it trying to get the best standards? I
9 mean, you see the commercial, people go to BDO if they
10 got a problem. I don't know whether it means they're
11 the best, but what I'm saying is that you want to brand
12 your organization, that nobody gets my name unless it's
13 the way we want it, not the way the client wants it.
14 You can't buy our name. I don't know if that means
15 anything, but I'll tell you that's what I see here.
16 MR. HARRIS: Thank you. And, Lynn?
17 MR. TURNER: A couple things. As one of the
18 people in the room that's actually written critical
19 audit matter memos at the completion of an audit having
20 to identify those, I think it's going to take some time
21 just based on this conversation for the investor
22 community to really understand. Probably have to be
some education because some of these CAMs do stay the same year to year. They do not change in companies, especially industry-specific. So to expect things to see change time to time, that's probably -- maybe some cases that will occur, but it's certainly not going to occur.

And also as I listened to that discussion earlier, it tells me there's going to have to be some education of the investor community and they're still going to have to do their homework. In fact, your earlier conversation led me to believe that probably going to need to be a lot of education of the investor community if that's what the expectation was.

The second thing is on findings I actually think better than the Rolls-Royce report in this case is the Dutch report on Aegon. I think it's an excellent report because it does get into the findings and does I think a very good job of coming back. I forget which Board member asked about the value associated with the stuff, but the Aegon report to me laid out more of the information I'd want to know with respect to the risk in the company and where some of the things were going and
what the auditors did to address those. So I thought that was a pretty thing -- pretty good disclosure.

But then with respect to your notion of a legal safe harbor, I find that to be most disturbing, because you've turned around and told me this is such critical information, I need to become informed and it needs to be very good and really tell me what the auditor thinks. But on the other hand, if they mislead me, I can't hold them accountable. So I would vehemently oppose any safe harbor.

I would rather not have the CAMs than to have the CAMs with the safe harbor. I think as we saw, as we've seen in the past with some of the things, when you provide those legal protections the accountability goes away and the quality goes down, so I think the safe harbor is a disaster in waiting.

MR. HARRIS: Tony?

MR. SONDHI: Thank you. I actually did -- wanted to address that last point that Lynn was making, and I really do think that the safe harbor would be a disaster. But I also at the same time believe that -- very strongly again, that saying such and such
disclosure or something is encouraged is also a very big problem for a very simple reason: I served on a committee that helped write the International Accounting Standard on the cash flow statements and very narrowly lost the fight to get the direct method. And the IASC chair at that point, David Cairns, told me that he wanted -- he agreed with me that it should be direct method. He says but he was hoping to accomplish it by encouraging.

And if you look at both the U.S. GAAP on cash flow statements and the international, they both start with the same thing in the first paragraph: you -- the direct method is better. You are encouraged. But the problem is when you go to the glossary of terms, "encouraged" is defined as you don't have to do this. And that's the definition people are using. They're not looking at it in terms of what the language tells you. So using "encouraged" I think is a problem.

I think Lynn is also right that it may take us awhile as investors to learn that some of these CAMs are going to stick around, and there is a reason for them to stick around. But I have two responses to that: One is
that I am willing to learn. I would like to find out.
But I'm also tired of the kind of boilerplate information that I see.

I'll give you an example. A few years ago I had found a company that in its footnotes said -- what its footnotes were saying was that the basket of currencies they operated in were weakening against the dollar, but when I turned to the stockholder's equity where they had the cumulative adjustment, that change suggested the opposite. And I couldn't reconcile those two, so I finally called the CFO and he -- when he got -- he said I'll figure it out and get back to you. And he called me back to say that he was disappointed that I didn't understand something that simple. He says we've just simply had that disclosure for the last 10 years. We like it and that's why it's sitting in there --

(Laughter.)

MR. SONDHI: which I think was his way of saying, sorry, we missed something.

But the point is that these boilerplate terms, these kinds of things that get into the disclosures and they don't go out -- so there is a danger when something
sticks around for too long. So but I would sort of very, very strongly suggest not to have anything that's encouraged.

MR. HARRIS: Well, Joe and Sarah, thank you very much. I think your comment letter is self-explanatory, speaks for itself, and we very much appreciate your having gotten it to us in the timely fashion that you did.