NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board’s Standing Advisory Group meeting on November 9, 2011 that relates to the Board’s Concept Release on Auditor Independence and Audit Firm Rotation. The other topics discussed during the November 9, 2011 meeting are not included in this transcript excerpt.

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STANDING ADVISORY GROUP MEETING

Public Company Accounting Oversight Board

1666 K Street, N.W.

Suite 800

Washington, D.C. 20006

November 9, 2011

9:00 a.m.
PARTICIPANTS

Moderators:

MARTIN BAUMANN

Participants:

JENNIFER RAND KIKO HARVEY
BRIAN SIPES STEVE RAFFERTY
JOE CARCELLO ANTHONY KENDALL
STEPHEN HOMZA MICHAEL AUERBACH
KURT SCHACHT BOB DUCEY
ARCH ARCHAMBAULT LARRY SMITH
JAY HANSON
MARY HARTMAN MORRIS BRIAN CROUTEAU
DOUG CARMICHAEL JIM KROEKER
KEVIN REILLY ARNOLD SCHILDER
BARBARA ROPER MEGAN ZEITSMAN
WAYNE KOLINS HARRISON GREENE
ARNOLD HANISH GAIL HANSON
SUE HARRIS LYNN TURNER
DAMON SILVERS LIZ GANTNIER
BILL PLATT LEW FERGUSON
Participants (continued):

SCOTT SHOWALTER
JOHN WHITE
JEFF MAHONEY
JIM DOTY
GAYLEN HANSEN
NERI BUCKSPAN
MIKE GALLAGHER
DAN SLACK
DAN GOELZER
DENNY BERESFORD
LISA LINDSLEY
SAM RANZILLA
MICHAEL GURBUTT
KEITH WILSON
BRIAN DEGANO
GREG SCATES
GREG FLETCHER
DMYTRO ANDRIYENKO
DOMINIKA TARASZKIEWICZ
KANNAS RAGHUNANDAN
LISA CALANDRIELLO
[Whereupon, at 11:33 a.m., the meeting resumed.]

MR. BAUMANN: Thanks, everybody, for getting back. And I appreciated the valuable input on our standards-setting agenda and other matters that we should think about in connection with standard-setting. So as always, thanks for that very, very valuable input.

We're going to turn our attention now to the concept release that the board issued in August on auditor independence, objectivity, and professional skepticism, including consideration of mandatory audit firm rotation. The comment period on that concept release ends on December 14th, and certainly comments received here today will be part of an official transcript in our comment period, so we look forward to your input.

Steve Harris will give us some initial comments, and then Michael Gurbutt here will lead the discussion after that.

But I'll turn it over to Steve. Thanks.
MR. HARRIS: Well, thank you very much, Marty, for the opportunity to introduce this extremely important and clearly noncontroversial topic.

[Laughter.]

MR. HARRIS: Independence is clearly key to the credibility of the audit and the viability of the profession. The value of an auditor's opinion depends on the extent to which he or she is an objective third-party with no stake in the company's financial success, and is recognized as such.

The importance of auditor independence has been confirmed by the U.S. Supreme Court, which has said that the auditor owes ultimate allegiance to the corporation's creditors and stockholders as well as to the investing public. Yet at the same time, the accounting firm is a for-profit enterprise that is paid by the company whose financial statements it audits. As a consequence, auditors inevitably must struggle against letting the day-to-day pressures of client service interfere with their overriding obligation to serve investors.

As we all know, the Sarbanes-Oxley Act included a
number of significant provisions designed to bolster the auditor's independence from the company under audit. Yet our inspections show us that there is still significant room for improvement in this area. The inspection reports of many of our international regulatory counterparts show this as well.

In August, the board issued a concept release that fostered broad debate about ways that auditor independence, objectivity, and professional skepticism could be enhanced.

One possible approach, which is explored in depth in the concept release, is mandatory audit firm rotation. As the concept release explains, the theory is that mandatory audit rotation might bolster the auditor's willingness to resist management pressure and to bring a fresh look at the company's accounting.

We on the board have a responsibility to carefully monitor all of the arguments in a transparent, open process, and today we are here to seek the SAG’s views of how best to meaningfully enhance auditor's independence.

So I think it's fair to say that we all look
forward to a lively discussion.

MR. GURBU TT: Thank you, Steve. And good morning, everyone.

Just as a reminder, the concept release itself is included in your package, so you can all make reference to that. And as Steve indicated, before we open this topic up for discussion, the concept release solicits comments on ways that auditor independence, objectivity, and professional skepticism can be enhanced, including through mandatory audit firm rotation.

In addition, the concept release also solicits comments on other approaches as well. You'll see that there are a number of general questions, which are included on pages 18 and 19 of the concept release. And on pages 20 through 24, there are a number of more specific questions on various aspects of any potential rotation requirements.

With that being said, what I would like to do at this point is invite your comments on any aspect of any issue that is raised in the concept release.

Thank you.
MR. BERESFORD: Well, as board members and staff know, I wrote a letter. And first of all, I'd like to make one comment, as Steve pointed out, on the important issue of independence. I just wanted to read a couple of sentences from my letter:

I was somewhat surprised to see that the entire release covered audit firm rotation and not the broader topic of auditor independence. As Chairman Doty noted in the press release that introduced the topic, one cannot talk about audit quality without discussing independence, skepticism, and objectivity. I fully agreed, but would've expected that the board would consider those important topics with a much broader look, rather than what many may feel is a myopic focus on audit firm rotation.

So I'm all in favor of independence, in other words. But this really is, in my opinion, just a focus on audit firm rotation and not a broader request for comments on independence. And that was the intention of my letter.

And to really briefly summarize, I wrote from the
perspective of an audit committee member, which is obviously under attack from the comments in the last session, which I would like to come back to in just a minute.

But I believe, in general, and I'm going to keep this very short, because you can read my letter, I believe overall that the mandatory rotation would lessen the quality of the audit procedures, and I think it would also increase the cost.

And I think that, basically, the approach of mandatory audit rotation takes away a lot of the -- doesn't really take into consideration the important role that audit committee does play now in assessing the annual performance of the auditor and the important decision to reappoint the auditors on an annual basis.

I make two points in my letter, one that I think is consistent with some of the comments that were made earlier, perhaps Arnie's in particular, that I do believe the existing SEC definition of an audit committee financial expert is deficient. It sets way too low of a standard, and it could be enhanced. I know that's not the purview of the PCAOB, but I think
the bully pulpit, if you will, could be used to help
address that.

And a somewhat unrelated topic, but I think that
the PCAOB could require that the inspection results
that come through when you do inspect an individual
firm could be shared on a required basis with the audit
committee.

A couple of comments on the audit committee.
Comments that were made earlier, I have to disagree
with the comments that were made about audit committees
have been backsliding, per Scott. Joe Carcello: half
get it, half don't. Gaylen: management still making
the audit committee selection.

Those comments, I think, are very troubling. If
ture, we have a big problem. And as I said, I think we
can and should readdress the question of audit
committee, the definition of audit committee financial
expert. But I hope that we don't jump to conclusions
based on these kinds of assertions that are being made
without some better evidence of the statements.

Joe, I suspect that if you made that comment in a
400-member PricewaterhouseCoopers audit committee
seminar that took place several weeks ago in New York City, for example, that they would not agree, in
general. Or if you said it in a seminar with financial executives sponsored in New York City a couple weeks ago of leading experts from the FEI, they would probably not agree in general. Perhaps when you get down to the very small companies, that might be true. And we would certainly like to see that audit committees of all companies are brought up to snuff.

But it troubles me when we hear those kinds of comments. And I would hope that whether it's through the SEC, whether it's through the PCAOB, whatever, that we start having more hard evidence for these kinds of comments, rather than just assertions that are thrown out like that in public arenas.

My experience in dealing with a number of audit committee members through various associations, through seminars, and so forth, is that these people are dedicated, they're hard-working, and they want very much to do the very right thing.

Thank you.

MR. BAUMANN: Thanks, Denny.
Let me just make one or two comments on your independence point, the points on the concept release. I do hope that many more audit committee members comment on the concept release. We're looking for broad comment, and we appreciate the fact that you sent a letter in early, well before the end of the comment period. And I hope that other audit committee members, members of the board, give us their views. We are seeking broad input on this topic. So thanks for that.

And secondly, on the matter of focusing on mandatory firm rotation, it's a complex subject that needs to be explored with the pros and cons. And yes, there's a lot in there in the concept release about that, not taking a position one way or the another. But certainly we are seeking comments and input from a wide variety of parties, and certainly including the profession on other ideas to improve independence, objectivity, and professional skepticism.

So hopefully we made that clear in the release, and I want to make that clear again today, that we are looking for that.

MR. BERESFORD: If I could just follow up briefly,
and thank you for that comment.

I have, and other people have, tried much harder to get audit committees more involved in the process. I mean, thinking back to the communications between audit committees and auditors, there are a total of three letters that were sent in, which is frankly, embarrassing on behalf of audit committees. And there were only a handful of them that came in on the auditor's report project.

I understand there are already about four or five or so letters on this project, and I can promise you there will be a lot more, because I know many, many are in the process right now. And we're working very hard to see that this happens.

This is one that particularly energizes companies, but I know we're going to have a lot more input. I have talked to Jim already about making sure the audit committees are going to be more represented in the PCAOB's process going forward.

MR. GURBUTT: Thanks, Denny.

Yes, we've received approximately 40 comment letters already. And as you said, we have a number of
comment letters from audit committee chairs, which is great. And people are commenting not only on rotation but also on alternatives as well.

So hopefully that is a sign of things to come, because we are still pretty early in the comment process.

Barbara Roper?

MS. ROPER: First of all, I'm sorry that I stepped out at a key point earlier to take a call, because I missed a discussion on one of my favorite topics, which is audit committees and their role in the oversight of the audit. That's actually something in Sarbanes-Oxley that CFA strongly supported, even while we thought we were -- that the audit committees were a slender reed on which to put our faith in the independence of the audit, particularly in the absence of meaningful board reform.

But that said, on this issue, I actually, I guess from perhaps a slightly different perspective, agree with Denny's point about the broader range of issues that need to be considered in terms of improving independence.
We come to this issue believing that auditor independence is, as I think Damon said, the core value. It is the characteristic without which the audit has no value.

I don't need an auditor who thinks his job is to get comfortable with management numbers. And I don't need an auditor who is afraid of second-guessing management. And I don't need auditor who is going to be willing to find a way to go along with what is in the financial statements, no matter what. I need a skeptical auditor.

And we have a situation where the PCAOB and other regulators are finding that there is a consistent, serious problem in this fundamental, core value of the auditor. So it's a problem that I think we have to take very seriously.

And CFA has supported mandatory rotation in the past as one of the tools that you can use to try to bring greater independence to the audit. I think it's a mistake to look at it as a silver bullet. And particularly, if we go to long enough terms, as some have proposed on the mandatory rotation, you're talking
10-plus years. I think you get the worst of both worlds.

You have a stream of income that people are going to be fearful of losing, so that you don't get the independence of rotation, and you get the disruption of the mandatory rotation. So I'd be very cautious about looking at those kinds of proposals.

But my broader point is not a concern about the way the board presented the options, but that there needs to be a challenge. If you are against mandatory rotation, if for whatever reason you think that rotation is not the answer, then I want to know what you are for to solve this serious problem with the fundamental, core characteristic that the audit needs to have and that the regulators throughout the world say is not, at this point, consistently having. I mean, that is the least that investors ought to be able to ask of their auditors, is that they be independent.

So if you're not for mandatory rotation, and I get there may be good reasons why people are not for mandatory rotation, but tell me what you are for to solve this problem, because we need a solution.
MR. GURBUTT: Damon Silvers?

MR. SILVERS: I'll make a sort of broader comment that I think to some degree is in the vein of what Barb said.

The concept of firm rotation has been debated now since the founding of this board and before the founding of this board as a possible response to the problem of psychological independence of the auditor.

In the context of what some might think, who take a look at this from a more sort of academic kind of point of view, see as really this intractable problem of the folks who are being overseen hiring and supervising the overseers.

Strengthening audit committees was one approach to dealing with that problem. And partner rotation, firm rotation, these are all approaches for managing a fundamental conflict in the nature of the auditing of firms, in particular of public companies.

I think it's fair to say that in the years that this debate has gone on, that, if anything, the relevance of public company financial statements, particularly -- and this reflects the bias of my work
in recent years -- particularly in the financial sector
has diminished. And I think the strongest, the most
obvious evidence of that diminishing relevance is in
the widening gap between market to market
capitalization of these firms and the GAAP value of
these firms.

Now, trying to strengthen these counteracting
mechanisms through, for example, firm rotation strikes
me as a very kind of modest and reasonable way to deal
with a really much sort of deeper, more profound
problem. And it seems to me, one, a solution that
doesn't upend fundamental -- that does not upend the
fundamental relationships that I think all the parties
around this table are familiar with, between
independent auditor, board, preparer, financial staff,
and the like.

I think people need to understand that looming in
the background is the possibility that at some point
policymakers will give up on trying to square the
circle, on trying to make these arrangements work in
their current form, and will look for more structural
remedies.
My view is, let's try this. We've spent years discussing it, and I think the reality is that most thoughtful observers thought that firm rotation at a certain point was good policy 10 years ago, and it's only politics that has blocked it.

So I see this as both a modest step in reality, and one that is long overdue, and one where the need is growing, and where the cost of not taking action in relation to issues of independence is the growing irrelevance of the entire process, the growing irrelevance of GAAP financial statements, of the public audit, of what this board does.

And so there are really significant stakes here, and I think folks who see this as sort of disruptive deeply misunderstand what the other possibilities are here.

MR. GURBUTT: Arnie Hanish?

MR. HANISH: So preface these comments by saying that obviously it's the views of a preparer perspective. I agree with all the comments that are made around the key focus of independence, that that is paramount to audit of our financial statements.
Shouldn't be any disagreement on that point.

I just believe, without any hard data to prove it, but having been in a role for over 25 years, that auditor rotation is not the simple solution to a more complex question.

As to the quality of an audit, it is a very complex question, but I don't believe that auditor rotation is the answer. There is so much to be gained from an investor perspective to have an audit team that has the depth of knowledge of your company, the intricacies of your operations. A multinational company is very complex.

The move towards lead partner rotation, which has occurred, by itself creates a check and balance, in my view, from a independence perspective. You also see, as I've seen, rotation of senior managers off of the engagement from a periodic perspective. You have the inherent rotation of staff auditors and other managers on an engagement, just because of the natural attrition that occurs within the auditing firms, as I've seen over the last 25 years.

So I believe that at least with respect to the
auditor, that you are gaining, over time, just through
natural attrition and rotation that is occurring, some
independent thinking that occurs, and independent
challenge of our business and our processes, and the
accounting associated with those changes in the
business process that occur over time.

I don't believe that there is lesser quality
because you have consistency of auditors on an
engagement. I think that, as I said, it's a
multifaceted issue.

Part of it is the role that management plays, as
far as challenging issues, setting the right tone and
framework with the auditors, making sure that they are
not just "rubberstamping" issues. That's a role that
management plays in this whole puzzle of creating an
environment.

And I don't know how many controllers, chief
accounting officers, CFOs have the dialogue with their
auditors to reinforce the fact that, you know: What's
your role, what's our role, you know, the challenge
that you have, you are independent. We want to be
challenged. We want this pushback. We want to make
sure that if you surface things, I want to understand if there are inherent systemic issues from a control perspective throughout my organization.

You get there by having that appropriate dialogue with your auditor. I just don't believe that the simple solution, again, is auditor firm rotation. I believe that you would have a situation ultimately where you get less quality, that you have individuals who, depending upon who they're speaking with in an organization, will -- let me back up.

We talk about trust and verify all the time. The verification is critical to the role of an auditor. We have a lot at stake as preparers. We can't have our tentacles everywhere throughout an organization to make sure that we don't have a rogue affiliate CFO or a rogue controller in an affiliate who is trying to do things to hit targets and forecasts because of the pressures that are brought to bear. We rely to a large extent on the auditors to help us there as well, because we can't be everywhere. And so they play a critical role in helping us as management achieve our desired goals and objectives to have financial
statements that are reliable and trustworthy, you know, for the public.

That's what is most critical, is to be able to publish for investors reliable and trustworthy financial statements that are in accordance with GAAP.

And the auditors play a significant role in that process.

But I believe that if we had auditor rotation that the quality would deteriorate because of the lack of knowledge of the industry, the business, our business processes, and how we go about doing things. It takes a long time to get an auditor up to speed on the complexities of our business. And to find that you would have to reeducate over a period of years would be an incredible amount of work and effort, from my perspective, with low value.

So maybe I'll stop there and reserve the right to comment later.

MR. GURBUTT: Thanks, Arnie.

Neri Bukspan?

MR. BUKSPAN: Thank you.

A couple of observations. The first is clearly
the role of independence state of mind of an auditor is clearly important.

But what I would suggest putting in context, and reacting to what Barbara mentioned earlier, is what you are for, if you are against it. I can tell you what could be considered what I am for is -- and actually, reading through the proposal and looking at some of the comments and some of the articulation of what auditor rotation could enhance, could enhance the process, I would suggest that the board should consider it jointly with other proposals that are advocating greater process transparency, including communication with audit committee and others.

Because my concern is that if you create a process, and whether it is 10 years or 7 years or others, there is pressure going on both ways, right, because there's existing pressures on the existing auditors. And if you think those pressures are existing within the system, there could be some pressure on an incoming auditor in order to earn a place for the next 10 years to probably be advocating raising not as many friction as well.
So I think you need to think about how you create a systemic -- how you relieve some of the systemic tension. And in my mind one of the ways to go there is to introduce greater transparency into the system, so integrate transparency with the audit committee, with the auditor communication, allowing market to discriminate, and say even if those rotations occur, what are the circumstances pursuant to which they are occurring rather than simply the technical musical chairs that will be occurring.

So what I would suggest is, one is think about some empirical information in the context of cost vs. benefits. I do think that many good auditors can get up to speed fairly quickly, as we have encountered in the recent past. I'm not overly concerned with the deterioration in quality. What I am concerned with is how we use such a process to improve the quality. And I think transparency in the process, and thinking about the transparency first, would be key, before you go into simply technical rotation.

MR. BAUMANN: Can I just follow up, Neri, in terms of transparency, in what regard? I just want to make
sure that I understand.

You said to think about this in concert with other projects. I guess the first one I thought of was some of the types of things that the auditors communicate to the audit committee, some have suggested in our concept release on the auditor's report that the auditor share more of that with investors on difficult, contentious matters, and so on and so forth, sort of transparency into the audit.

Was that what you were talking about?

MR. BUKSPAN: This is one thing, but in order to try to ascribe a certain level of auditor independence and skepticism, I think from an investor standpoint, a lot of information can be gleaned by a summarization of the communications. What are the key areas of the communication occurring?

And also to Lynn's earlier comment about the nature of 404 topics or the binary nature of an auditor opinion, if you simply encapsulated within a binary opinion, yes/no, there is very little information that investors can glean from the process. Then they revert to comfort in rotation. And it may be a false comfort
in a way, because you still don't know what happens within the box.

So to Barbara's earlier point, what you are for, I am for greater transparency that can be accomplished by virtue of several of your projects taken together. And this is a transparency of the report, this is a transparency into the communication with the audit committee, and transparency into, for example, exception found and how they share it with external constituents. So constituents are in better position to get some assessment of, do I think this is really an indication of independence, a challenge of management.

And this I think could be extremely useful.

MR. BAUMANN: Thanks for the clarification.

MR. GURBUTT: Scott Showalter?

MR. SHOWALTER: Thank you. I felt the need to defend my honor with Denny on the audit committee, but then I want to talk about the standard itself.

Denny, there's actually a paper out there Shyam Sunder was on at Yale that actually talks about the issue where management stepped into the role of audit committees. I'll also tell you of my conversations --
one benefit, as you know, to being an academic is all
the firm's love to talk to you when they come on
campus. So you get all types of information from
partners who are willing to share with you that I never
got when I was with a firm.

So they share with you very clearly the struggles
they have with audit committees. And you have to be
careful that we don't mean all that audit committees.
It's not a personal attack upon you, Denny, which I
know you didn't take.

But as Joe said, there are some other committees
that work very effectively and some that do not. My
observation was the backsliding. It's more of a trend,
as opposed to an absolute number.

But let me talk a minute about that paper, Marty.
I think your papers are well done. I really enjoy
them. I think they have great backing. And I think
it's very helpful.

I guess my reading of it is you haven't built a
case for auditor rotation. What you built a case was
lack of auditor professional skepticism. So I'm
getting to your point. I think there may be a bigger
issue.

In other words, I think if you want to take on auditor rotation, you have to take it on with all the levers that impact of professional skepticism. And there many in there. There's many in there on time pressures.

Every time the time pressure gets moved up, you're squeezing these audit firms to end their audits in a shorter period of time and with less time to get information about fair value, management intent, and forward-looking information.

So we're driving this two different ways. We have a financial reporting model that requires more estimates, less time to get any information about those estimates.

And so I would suggest there many levers out there on professional skepticism other than auditor rotation. I'm not saying it's not a part of that, but I think you need to step back and look at professional skepticism, look at the issues that are in there, and this may be a contributing factor. I'm not sure that this paper builds that. And if you move it forward, I
think you need to build that case more, how this is
going to solve professional skepticism.

The way I read it was, we have all these issues of
professional skepticism; don't disagree at all. I
think that's been an issue with the profession since
day one. And then we kind of leap toward a rotation.

I didn't see the connection.

So just passing that on.

MR. GURBUTT: Lisa Lindsley?

MS. LINDSLEY: Thanks.

As I said before, I applaud the board for
considering auditor rotation, and I agree that it's not
sufficient by itself. You need to have other things,
otherwise you do run the risk of luring investors into
thinking they can count on auditing opinions.

I want to respond to Arnie's comments, because I
think that if you keep tossing the hot potato of who is
responsible for independence between auditors and
management, well, eventually the people that get hurt
are neither one. They are the investors, the people
who count on those opinions.

And I think he answered his own question when he

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talked about rogue CFOs and rogue treasurers who are out to manipulate the numbers because their bonuses depend on it.

So I think that independence is important and that rotation is a key component in achieving that.

MR. GURBUTT: Thank you.

Gail Hanson?

MS. HANSON: As I read this report, I thought auditor rotation is potentially very disruptive. And I'm just going to give you one example.

During my last 10 years, I was employed by WellPoint, and we had an audit firm that did the audit. We had a second large firm do the -- we outsourced the internal audit. And we had a third firm do the Sarbanes-Oxley work.

And if you think about rotating auditors, the question is, you take the audit firm out of financial audit work, and what happens to the other two firms? Do they then step-- are they then in line to do the audit? Because of Sarbanes-Oxley, you have one audit firm, and if you want to do any other non-audit-related work, you have other firms.
And so just by the very nature of taking the one firm out of the mix, if you rotate the audit firms, what happens to the other firms? And who then is independent to step into the shoes?

And so, from a preparer's standpoint, thinking about having to rotate all of those firms one to the right, or to pick up a fourth firm or a fifth firm to bring into the mix and then put the others on abeyance for the next several years, it just, logistically, it gives me heartburn.

So I just wanted to bring that up as an example of, just don't think of this as only the rotation of the key firm. Think about what it's going to do for the other non-audit-related services that that issuer employs.

MR. GURBUTT: Thanks for that point. And it's actually something that we acknowledge within the concept release. There are certainly disadvantages to firm rotation that have been proposed by various individuals over time. And so one of the things that the board is interested in is potential mitigating steps that the board might be able take to minimize
some of those issues, for example, around auditor choice.

So again, any comments on that type of thing around potential mitigating actions that the board might take would be appreciated.

Joe Carcello?

MR. CARCELLO: Following up on Scott -- Denny, I'm going to try to defend my honor here a little bit too. In addition to the paper that he said, which is excellent. You should look at it. It's really quite troubling. There's a paper by Jeff Cohen, Ganesh Krishnamoorthy, and Arnie Wright that looks at the engagement of audit committees pre- and post-SOX. And they are more engaged now, significantly so. But in too many instances they still defer to senior management, and it's problematic. And I won't go through the whole paper, but it's worth looking at.

As it relates to auditor rotation, I think before we decide if rotation is the solution, let's decide if there's a problem. And in the concept release, there's a discussion from one firm, as I understand it, and proposals that were delivered to prospective clients
with language like “the auditor should be a partner, support the desired outcome”.

And then in the public meeting when this concept release was released, Jay Hanson, and I think I'm quoting Jay accurately here, said: This is a troubling finding, but our inspectors have not seen such assertions by other firms, so potentially maybe it's just isolated.

Well, I wouldn't want to disappoint you, so what's coming around to each of you, redacted, because I didn't want to embarrass the firm, is two pages from a audit proposal that I have recently received as the chairman of the audit committee of Knox County.

This is not a big multimillion-dollar engagement, guys. This is relatively small potatoes.

And this firm, which is an annually inspected firm, annually inspected, uses language like "helping clients succeed." How do you do that on that audit, exactly?

An exceptional client experience, become a trusted advisor to our clients, earns us a position as a trusted advisor.
This kind of language to me is problematic and very troubling. And so we at least have two annually inspected firms that at least at times use this kind of language. So I think it's fair to say that there may be an issue.

And I agree with Scott. The issue may be skepticism, and whether or not rotation is the answer, I think the jury is still out on that. What I would like to encourage, obviously, the PCAOB has to move forward on their own track, but I think the firms, notwithstanding what Sam has said about me giving compliments to the firms, I think the firms' proposal via the CAQ on the auditors reporting model was very responsible, and had a lot to be said for it.

So I hope the firms, either through the CAQ or on their own take the issue of lack of professional skepticism seriously, because I think it's a valid issue.

And rotation may or may not be the right answer, but the firms have a lot of very smart, talented people working for them. And as Barbara Roper said, if rotation isn't the answer, come up with alternatives.
But ignoring the issue doesn't make it go away.

MR. GURBUTT: Thank you, Joe.

Kiko Harvey?

MS. HARVEY: I will let others debate the merits of the rotation. I think you were asking those as a possible -- for other possible solutions.

And I heard Denny say something that I thought was very important, and that is, you know, the inspection reports that the PCAOB does of the different audit clients that the firms have, I do believe that those should be shared with the audit committee. I am one who still trusts the audit committee and thinks that I have worked with very good ones. So I'm fortunate in that respect.

I think the decision for changing auditors should be with the audit committee, but they need to have some additional information. If there are significant deficiencies, as we say in these inspection reports, and they're significant enough to warrant an upheaval of the current process, in that a mandatory rotation is necessary for all firms, then I think that at least we should start with saying, for those firms that -- where
the recommendation of the PCAOB is that a rotation
should -- is advised or should be considered by the
audit committee, I think the audit committee might want
to hear that.

I would support -- again that's just me
personally, not my company -- but if necessary, that
the PCAOB starts making those recommendations, and the
audit committee is responsible for listening to and
meeting with the firm and talking about what the audit
approach is and how strong it is and what area and what
was deficient. And they come to a decision independent
of management that says whether they retain the firm or
ask for rotation to occur.

MR. GURBUTT: Thanks, Kiko.

Arch?

MR. ARCHAMBAULT: Thank you, Mike.

A lot of concerns have been raised about mandatory
firm rotation. There are certainly very valid concerns
that have to be considered.

And Grant Thornton is currently in the process of
preparing our comment letter on this release. But I'd
like to share at least some of the discussion and
debate that we have had on this issue.

As we've debated this, we feel that audit firm tenure can affect objectivity. No one wants to lose an audit relationship, let alone one that you have had for many, many, many years. A new partner coming in doesn't want to have that burden.

But the extent to which your objectivity might be affected, and when you may reach that point or under what circumstances that point is reached, is really uncertain.

So firm rotation could really be a viable component in the efforts to protect objectivity, but I think we've also talked about -- and it was mentioned earlier -- the extent to which or the timing which rotation might be taking place.

You can't have it too short, because that would be extraordinarily disruptive. So you have to try and come up with a reasonable period of time, if in fact it's implemented.

You'd also probably want to build in something, if you went ahead with this, that would allow for some flexibility, probably as long as it's properly
explained to the investing community, because for example, a company could be in the middle of a major acquisition, and you certainly wouldn't want to have the disruption of the rotation at that point in time. There might also need to be considered the need to have -- I'm not sure if this is the right word -- but some protection about dismissal without cause for the firms. And also, if some measures aren't put in place, mandatory firm rotation, I think there may be some studies -- part of the problem here is that there are not many countries that currently require mandatory firm rotation, so the extent of knowledge about the impact on companies, the impact on firms, and so forth, and the impact on the profession, is certainly debatable. It's not abundantly clear. But the concern is that it could actually lead to an increase in concentration, which we certainly don't believe is good for investors. So really, because so much is unknown about the impact of mandatory firm rotation, we haven't settled, I guess, on a final position. But we are leaning toward a rational consideration of mandatory firm
rotation as one tool to help address the objectivity of concerns.

As I say, the debate is ongoing, and you will receive our letter.

MR. BAUMANN: You acknowledged many of the challenges that -- and many of those, I think, we do try to touch on in the concept release. I think the concept release tries to be balanced. That was our goal in laying out some of the benefits and some of the challenges in doing that.

So I can see why you're struggling with your position. And we look forward to receiving your letter.

MR. ARCHAMBAULT: Let me add one thing, Marty. It's not only in relation to this issue, but to some of the things we were talking about earlier with some of the other standard-setting efforts you have underway.

This has an impact, obviously, not just in the U.S. but on a global basis. Many of your other projects also are being -- there are similar issues being debated globally. The auditor reporting, for
example, is one.

To whatever extent you possibly can, and I know that you do do this, but I think to avoid inconsistency, which I think would lead to a lot of confusion, coordination of all these efforts and the timing of when these things might become effective, I think is absolutely critical as well.

MR. GURBUTT: Thank you, Arch.

Some interesting points there. Interestingly, the point you made about tenure protection is also something that is included in the concept release. And some people believe that may further bolster an auditor's ability to be independent. So any comment on that point is also appreciated.

Barbara Roper?

MS. ROPER: First of all, if you want to go to some of the people who haven't spoken first, that's fine with me.

MR. GURBUTT: Okay.

Wayne?

MR. KOLINS: Thank you, Barbara.

The concept release recognizes the benefits of a
root cause analysis and also recognizes the difficulty
sometimes of getting to the underlying root cause of an
audit deficiency, in that in the upcoming inspection
cycle, the current inspection cycle, it is looking into
a root cost analysis.

I think from the perspective of getting a better
understanding of what are the impediments to
objectivity, independence, professional skepticism, a
root cause analysis is really a critical element in the
process, and I would strongly recommend that this
approach be followed assiduously, so that things that
we haven't even identified as potential root causes can
be identified, and looking at the solution to the
problem in a holistic manner.

MR. GURBUTT: Thank you, Wayne.

Liz Gantnier?

MS. GANTNIER: Yes, thank you.

I currently work for a smaller CPA firm. There
are some spectacular examples of audit failures, but I
would also describe them as audit committee failures
and client failures, not just audit failures.

And if there is a less than stellar audit
committee in place, you can rotate the firm constantly, and I think you're still going to continue to see failure, because I think as an auditor, I try to find clients -- I know some people don't like that term -- but I try to find clients with the audit committee that's in sync with my thinking about independence and skepticism and who we are serving. We're serving the public trust. We're not serving management. And if the audit committee doesn't share that, then it's going to be a failure, regardless of how many times you rotate the firm.

From a smaller firm perspective, I'd be very interested in seeing statistics about how often this is a big firm issue, as opposed to smaller firm issue. Because quite frankly, I face rotation constantly. There is a lot of fee pressure. There's a lot of competition, and the competitive environment is somewhat different at my level.

And so you might be in a situation where you're going to want to rotate every 7 years. Well, heck, they want to rotate every 4. And so there might be sort of an unintended consequence as a result of this,
that they might keep a firm longer rather than rotate, because of the term limit type of thing.

Lastly, I would also be concerned over time, not immediately, but over time, about losing firms serving this market, because the stress to a smaller firm of rotation every so often and the loss of that income might eventually force some firms like mine out of this business. I'm not exactly sure that that is what we want. I think we want to keep firms in. And I think we want to have healthy competition. I'd be somewhat concerned about, long term, would it affect our presence in this market.

So thank you.

MR. BAUMANN: Liz, thanks for those comments. I just wanted to add a couple thoughts to what you said.

I certainly appreciate that the financial reporting process is improved with management that has great integrity and good controls. And a company that has a very strong audit committee can greatly improve the financial reporting process.

But I am concerned with the comment that without that, with a less than strong audit committee, we're
doomed to audit failure. I think the auditing standards deal with the risk of material misstatement and the fact that one has to assess the risk and the environment, the risk of -- the quality of the controls, the quality of the management, the quality of the audit committee oversight. And that the auditor is responsible for either not accepting a client in certain circumstances or, if you accept that client and you have worrisome controls, extending procedures until one gets satisfied that they have limited the risk of material misstatements.

So I just didn't want the thought to stay out there that just there's weak oversight, that will lead to audit failure. We expect that the audits are still performed in accordance with our standards, and therefore, financial statements present fairly that the auditor has done an audit in accordance with the standards.

MS. GANTNIER: Absolutely. My point was intended to say that, in my experience, the stress to independence does not come from the audit firm. It comes from the client. And it comes from an audit
committee that is not sharing the same ideals with regard to who are we serving.

And from a root cause perspective, I would hope that we concentrate on ways to improve the transparency of the audit committee process, so that that sort of three-legged stool of management, the audit committee, and the auditor, we're not solving one leg but ignoring, perhaps, another one.

Thank you.

MR. BAUMANN: Okay. Thank you very much.

MR. GURBUTT: Lynn Turner?

MR. TURNER: Thank you.

The issue at hand is not new. We have been debating this in the profession for decades. The reasoning around the table has not changed. The arguments haven't changed one iota at all from what I'm hearing.

But the problem doesn't go away. And so I think Ms. Roper asked the right question. If you aren't going to support rotation, then what would you do that would actually solve the problem? I've heard no one from the preparer community and no one from the
auditing community put forward a solution that would really deal with the problem.

The real problem is that management is writing the check to the auditor. It's a very simple fix. If you want to fix it without rotation, and that is change that. Have a fee collected at an exchange or at the PCAOB and dole it out. It's very doable.

I actually don't think that's within the grasp of this board though. But if you really want to fix the problem, and until we fix it in that way, I don't think you're going to solve the problem.

So mandatory rotation seems to be a reasonable step in between as you move towards that path, because I'm convinced eventually not solving the problem, we are going to end up there. It's just how much pain, how many root canals do we go through before we turn around and end up there.

It's inevitable, because the system isn't working. And you can't have someone paying you that you're turning around and giving a report card on. It just doesn't work.

It would help as you go through this process if,
Marty, in your actual standards, you would clarify who
the client is. In all of our auditing literature, we
turn around and tell the auditors that the client is
management. I mean, that's the way the very standards
of the profession are written. And yet, that obviously
doesn't work, but that's who the board says is the
client. That's who auditors think is the client.

So I would suggest that as you go through this
process, you think about redoing that language to make
it very clear that the client is the owners of the
business, the stockholders, not the people that they've
chosen to oversee or the people they've chosen to
manage the business for them, but the actual owners,
the share owners of the business.

As far as some of the arguments we've heard around
the table, we heard that it's important to have depth
of knowledge on the audit. And yet we have phenomenal
depth of knowledge on the audits of the Enrons, the
Tycos, the AIGs, the FANNIEs. They've been there for a
long time. And that depth of knowledge didn't serve to
improve the audit quality. In fact, it served to
create a situation where they were so beholden to
keeping that client, because of who paid them, that it resulted in a degradation of the audit quality.

So the notion that you have to have that is crazy.

In the last decade, we saw about half of the public companies change auditors. You had 3,000-plus, not even including the Andersen, that changed auditors, out of 8,000 public companies.

When management chose to make the change, we never heard management stand up and say, oh, they aren't going to have enough knowledge, or, it's going to cost us too much. And this is thousands of companies where management -- in that case, it was okay. But when all of the sudden, for the sake of investors and confidence in that financials, you say there's got to be a change, all the sudden it's, oh, we can't do it. They won't know what they're doing. It costs us too much. It will lower audit quality.

The reality is we went through that change and after we've gone through that series of changes in public companies, restatements actually dropped in this country. So the evidence supports that rather than lowering audit quality, it actually increased audit
quality, if you actually look at the evidence and the
data.

We change auditors all the time in the
governmental sector. Governmental audits go through
this on a periodic basis. And those thousands of
public companies that were audited and the thousands of
governmental audits where we've rotated auditors, I
have never seen, never heard from a big firm or a small
firm that they go out and say we can't rotate, because
we won't have enough knowledge to do your audit the
first year.

And I've never seen an audit report in the first
year qualified to say: Here is our audit report. It's
a clean opinion, but we're not sure if we have enough
knowledge to do this audit.

This knowledge thing, it's unbelievable that you'd
put that argument out there.

As far as the audit committees, and certainly my
experience has been the same as what Scott and Joe
commented in terms of the quality of the audit
committee. In fact, I spoke to a CFO symposium in the
West last fall, 300 or 400 CFOs, and we talked about
the audit fees and who was retaining the auditor.

And there was general consensus that the CFOs are still driving that process, contrary to Sarbanes-Oxley.

And I would hope that as part of your inspections going forward, you will start to inspect and look at the process by which auditor is actually hired by the audit committee, because I have talked to many an audit committee chair who when I started to ask about specifically what was in the audit engagement letter, their comment is, I'm not sure, the CFO gave it to me and asked me to sign it. I asked him if it was all okay, and he said it was, and we hired him.

And that is not compliance with Sarbanes-Oxley on the behalf of audit committees. And when we see that, we quite frankly ought to be referring it over to the SEC for enforcement action, but because the audit committees aren't complying with the law.

I think rotation will help increase competition. I think one of the problems here amongst the firms is they are actually scared to death to compete with one another. They're afraid to lose a client. And I don't blame them for that. No one likes to lose business.
But I think there needs to be more competition. I think a reasonable rotation period is something like 10 years. I don't think it needs to be every 5 years. Some people like 5, some people like 7. I think if you'd did it within every 10 years, I'd never go out beyond that, because I think it defeats the notion of rotation. But I would do it in 10 years and maybe you want to put it up for bid after 5. But something like 10 years, I think that would be sufficient.

There other options, also, that I think you ought to seriously consider. Paul Volker for a long time has supported and publicly advocated for an audit-only firm. That is certainly another option that you can go to.

But I think if people are going to say this doesn't work, then as Barb says, they need to come up with something that will work, and they can demonstrate that it will work. And the notion of expanded auditor reports, who quite frankly the firms haven't been real supportive of, they're very limited on what they'd expand, other things that are talked about that ultimately don't get to the basic issue of
independence, which is what this is all about.

MR. DOTY: Lynn, you need to take a deep breath.

There are other cards up. I'm concerned about time.

MR. TURNER: I'll leave it at that.

MR. GURBUTT: Thank you, Lynn.

Mike Gallagher?

MR. GALLAGHER: Thanks.

I think Barb's challenge is a good one. I think it's consistent with what Chairman Doty mentioned at the concept release, that coming up with alternatives is the right thing to do.

I think there's a broader issue. I think the notion that we've got competent, capable people, yet there are still issues, therefore it must be skepticism, I do think it's broader. I think skepticism is not an on-off switch. It's not binary. I think it's a continuum. And I think looking at things that can move us up the continuum is a good thing. I think that's something we need to be ever vigilant about.

But I also think there other things that we need to be suggesting as well that will focus and improve on
audit quality. So I think that's what we're going to be doing as a firm and that's what we're going to be doing as a CAQ.

I do think mandatory firm rotation is little bit of a blunt instrument, a one-size-fits-all rather than relying on the audit committee to carry out their responsibility. And so I have concerns that from a quality perspective, taking that discretion away from the audit committee does not support quality.

So we're clearly not for it, neither my firm and certainly my position is I don't think mandatory firm rotation is the answer.

If we did, hopefully as a firm and as an individual, I wouldn't be waiting for standard to tell me to do the right thing. If we didn't believe we could deliver the highest quality to our long-tenured clients, I wouldn't be waiting for a standard to execute on rotation.

And by the way, audit committees have that ability, I think as somebody mentioned earlier today, to drive that rotation either as a matter of process or to do it when they see that the skepticism is not at a
level that they would hope to see to drive the right
kind of quality.

I'll leave it there.

MR. GURBUTT: Thanks, Mike.

Dan Slack?

MR. SLACK: Thank you. I waited too long to put
my card up and Lynn made all of my points but much more
eloquently than I can. But I'll try and just make a
couple of short elaborations on them.

I just think it's important that, as the saying
goes, not to let the perfect be the enemy of the good.

The preparer or issuer pays model has inherent
conflict of interest in it, and so if we wanted to sort
of sit and theoretically talk about this, the best way
is going to be eliminate that or go to audit-only firms
or other ways to remove that inherent tension.

And I think other solutions -- but I think that's
beyond the purview of what we're talking about today,
although other comment is invited in the concept
release.

But other solutions are necessarily going to be a
compromise of some sort, and bearing that in mind, and
that sort of guiding my thinking, I think that mandatory rotation is appropriate to address the issues of independence, objectivity, et cetera.

There's a lot of concerns that were noted in the concept release. I think those are legitimate concerns, and the standard may be needed to be nuanced to deal with that, perhaps with some of the exceptions that Arch mentioned in his remarks, et cetera.

But I think it's an appropriate response to the issue. Thank you.

MR. BAUMANN: This is a very, very lively discussion, and many points on all sides of the equation. I see, I think, six cards up.

We'll start with Gaylen.

Lisa, is your card still up or did it go up again?

Starting with Gaylen, going around the table to Barbara. If we can get those comments in, I'd appreciate it.

MR. HANSEN: I'll be brief because I think a lot of the points have already been made that I would otherwise make.

Everyone has anecdotal experience with this. I
know when I first started out in the profession, I went
-- I was with a very large firm and went to one of
their very largest clients and they had had that client
as a client for decades upon decades. And one of the
first messages that I got as a new staff person was,
Don't screw it up.

And you know, that stuck with me, and I obviously
still remember it. So I think mandatory rotation
should be on the table. And I don't think 2 years is
too long a period to think about.

On the knowledge question that a number have
spoken to it, you know, it's interesting. When I was
with that large firm, I had a lot of knowledge, and it
was really interesting when I went to a small firm
years later, all of a sudden, I guess that knowledge
just went away, which was sort of interesting.

I don't understand it, but it seems to me that
there are some interrelationships and linkages here,
and one of which is competition. And being able to
link this to competition, I think is important and
would be healthy for the profession.

It was addressed by the treasury committee. As a
member of that committee, we really grappled with this. And I think that rotation is an opportunity for us to consider. I think Liz raised it in her remarks as well. Smaller firms are not as impacted by this, because we're constantly competing.

Thank you.

MR. GURBUTT: Thanks, Gaylen.

Jeff?

MR. MAHONEY: Thank you. I'll be brief.

The Council of Institutional Investors has some membership-approved policies relating to auditor independence. Those policies indicate that independence may be enhanced if there is regular consideration given both by the audit committee as well as by shareholders with respect to changing auditors.

For example, our policies include a provision that says that there should be an annual shareholder vote on the retention of the auditor. Since we put that policy in place, most public companies now have that provision.

In addition, our policies provide that the audit committee should seek competitive bids for the external
engagement every 5 years. In light of the PCAOB's
concept release, and the other work that is being done
in Europe and elsewhere, in light of the fact that our
policies with respect to auditor independence are more
than 10 years old, our policy committee is currently
reviewing this area. And we expect to either change
our policies or not change our policies, but make some
decisions sometime next year.

Thank you.

MR. GURBUTT: Thanks so much, Jeff.

And actually, one of the questions in the concept
release is to solicit comments on audit committees'
experiences as to whether or not they would consider
implementing a policy of mandatory rotation. So we're
definitely interested in the views of audit committees
on that matter.

John?

MR. WHITE: First, Marty, I'm very pleased that
the board has taken up this topic. It's obviously a
very challenging one.

And I don't often agree with Damon but I do agree
with Damon's statement that independence is -- I think
to use your words, Damon -- the core theme that gives auditing its legitimacy.

And I think on balance, I accept that auditor rotation could, at least at the margins, enhance professional skepticism. But I guess as I keep balancing and I hear the costs and I listen to Gail and Arnie about various issues related to audit quality and so on, it got me thinking about whether there are any analogies in the legal world to this.

And I'm not sure this analogy is perfect, but it seemed to work for me in part. It's not common to rotate your law firm, if you think about it. But there are situations where corporations bring in a new law firm, basically independent counsel. And they're actually in the most challenging situations that corporations face, usually M&A transactions and so on.

And I said independent, and that means generally independent from management. And the key when you bring in an independent law firm is they're reporting -- it's who they're reporting to, and it's usually the audit committee or a special board committee. And they're hiring and supervising them. They're still
being paid by the company, but they're being hired and
supervised by that special committee.

And I guess it just seems to me that in those most
important situations for corporations, where the legal
world at least, you rely on a board committee to do the
job of supervising at least one set of professionals, I
guess on balance I think we should keep trying to have
the audit committee do that job with respect to the
auditors.

It's not a perfect analogy, but at least from the
legal perspective, it seemed to me to get part of the
way there.

MR. GURBUTT: Thank you, John.

Damon?

MR. SILVERS: It's been a long conversation, but I
wanted to return to the basic mechanisms here, that got
a little clouded. The notion -- why has auditor
rotation been a staple of debate about how to enhance
auditor independence for a long time? The reason is
because it's an effort at self-policing. The
alternatives -- I think we've heard from a number of
different people from different perspectives as to why
there is a continuing problem here, in terms of both independence and the resulting quality of audits and the financial statements.

The alternatives are not self-policing. They are external policing. This is self-policing, meaning it creates a mechanism by which one audit firm looks at the work of another, and takes a fresh look at the financial statements of the preparer and the internal controls of the preparer and so forth.

Several people have talked about the question of quality of audit firms, the quality of audit committees and the like. It's certainly true that if you have really high quality audit committees that the need for all kinds of formal things are lessened. If you have really high quality preparers, the need for an independent audit is lessened.

It's not entirely clear to me that we actually need financial statements. If you had really exemplary human beings giving a narrative description of the business, they could probably cover most of what investors would want to know. But we don't make the rules for exemplary human beings. We make them in
recognition that all the links in the chain I just went through -- not everyone's above average. In fact, the average is not above average.

And so this initiative is an initiative to create, A, competition and, B, self-policing. Those seem to me to be things that are not -- that shouldn't be controversial. And, B, obviously there are costs involved in everything. There are costs involved in competition. If you didn't put stuff out for bid, there would be no bidding costs.

The alternatives here, and there are alternatives, are far more unpleasant, I think, from the perspective of those are unhappy with this idea. And I people ought to be mindful of that.

MR. GURBUTT: Thank you, Damon.

Steve?

MR. HARRIS: John, I just wanted to follow-up on your idea of bringing in an independent accountant. Both former SEC Chairman Harvey Pitt and Judge Stanley Sporkin have talked about the role of a forensic accountant and bringing in -- mandating bringing in forensic accountants. At what point would you bring in
a forensic accountant, or for that matter, an independent accountant?

MR. WHITE: I'm not sure that is what I was suggesting. I think I was more going to the analogy that we look to the response -- we look to a board committee to their supervisory powers over special counsel or auditors as the right standard, I mean as the right people to do that.

I mean, I wasn't going to the idea that you would bring in a forensic auditor.

MR. GURBUTT: Arnie?

MR. HARRIS: I wish you would take that under advisement given the fact that you have had a former chairman and a former head of the division of enforcement of the SEC recommending it as one of many alternatives.

I associate myself as well with Barbara and Lynn's comments.

And, Neri, you said what are we for in increasing transparency, and I think we ought to flesh out a little bit more what increasing transparency means, because -- and we'll get to that with respect to the
audit report.

But if we're not for audit rotation, I agree with the comments made so far. I haven't heard any alternatives, really, to it, in terms of increasing professional skepticism, independence, and objectivity, which are discrete topics.

But since these issues, as I raised in my introductory remarks, are common globally with respect to what all regulators are finding across the board, I think it's absolutely incumbent upon us to figure out what are other alternatives to skinning the cat.

MR. GURBUTT: Thank you, Steve.

Arnie?

MR. HANISH: I don't know where to start.

So first of all, John, maybe to build upon your point. You raised an interesting point. And I'm thinking about the situation that occurred actually at our company a few years ago, where as a result of some issues, the auditing firm brought in truly somebody who was an independent. When I say independent, they were part of their firm, but had nothing to do with our audit engagement. It was an industry expert. He did
1 come in and do a very thorough review of our financial
2 accounting policies that we have in place and
3 practices. And concluded after discussions with us,
4 that they really didn't see anything that was
5 inappropriate as far as application and interpretation
6 of GAAP and principles.
7 But I actually thought it was a healthy review
8 that took place of our published internal policies and
9 practices that we have. And you know, would I be
10 offended or concerned if an independent person, an
11 industry expert, came in from another firm periodically
12 and took a look at our practices and stated policies?
13 I don't think I would. It certainly would not offend
14 me.
15 So it's an interesting comment or perspective, as
16 offering up again, and in the spirit of offering up
17 alternative solutions, that might be a reasonable
18 alternative solution.
19 I think also, if there's concerns -- and some of
20 the documents I've read, you know, concerns around the
21 firms having targets and goals of trying to enhance the
22 revenue from a particular audit client, one simple
solution there is to clearly limit nonaudit services
totally, which is not in the cards right now. I mean,
the firms are able to provide limited nonaudit services
as long as they don't feel like it impugns their
independence.

I wouldn't necessarily be in favor of limiting tax
services, because I think there is a clear integration
between audit and tax services, as far as the knowledge
of the company. But if there were other services,
certainly a number of companies have stated policies
around not utilizing their auditors for non-audit
related services, other than tax.

I think it's important also to conduct a root
cause analysis. The things that Lynn talks about, the
examples, the Enrons, the Tycos, the AIGs, to a large
extent those are, I believe, if my dating is correct,
all pre-Sarbanes-Oxley, to a large extent. It would be
interesting to see what the data shows on a post-
Sarbanes-Oxley environment. I'm not sure. I don't
know. I don't have the data, but it's hard for me to
believe that the 3,000 audit changes is a direct cause
of reduction of restatements.
I believe that the reduction of restatements in the post-Sarbanes-Oxley world is because the law enabled companies like ours to go out and hire more capable and competent people on our staff. To me that was one of the significant benefits of Sarbanes-Oxley, that no longer did I have to debate with my financial colleagues and my CFO and others about the ability to go out and hire competent specialists and additional staff because of the complexities and to deal with the complexities that we have to deal with today because of the FASB's rules and practices that we all have to deal with.

And the accounting rules have become greatly enhanced and more complex in the last 8 to 10 years than they were in the previous 20.

So I don't know if in fact the reduction in restatements is because of auditor rotation. I attribute it, quite frankly, to having had the ability to hire more competent staff, which I think was an offshoot of SOX and the law.

MR. BAUMANN: In the interest of time, this is probably a great debate on what is causing the
decreasing of restatements.

MR. HANISH: If I could just give a couple more points?

MR. BAUMANN: Thank you.

MR. HANISH: So, yes, I think that one solution could be to have the firms audit at a lower materiality level. They establish a materiality level based upon whatever firm guidance that they put out. It tends to be a big black box for many of us. But one solution is that maybe you lower the thresholds as far as definition of materiality and whether there's material statement potential.

That has an added cost to us, but quite frankly I'm willing to pay that added cost if I can get a greater degree of comfort that they're auditing at a lower level of materiality.

Another solution would be to require training for board members. We talked a lot about board members. While I recognize that the NACD and other organizations put on training for board members, it's not consistent. And maybe there ought to be some sort of, I'll call it CPE requirement to requirements for board members, if
they're going to be members of audit committees, to go through required training.

And I think that's -- I'll stop there. Thank you.

MR. GURBUTT: Okay, thanks, Arnie.

I think we'll take the three cards on the right-hand side here and then we will break for lunch.

So, Barbara Roper, please?

MS. ROPER: So quickly, and I did not coordinate with Damon first. I also always feel like I come to Lake Woebegone when I come to these SAG meetings.

If I could have Arnie as my chief accounting officer, and Lynn and Denny on my audit committee, and there are too many auditors in the room for me to pick one, but one of the many fine auditors in this room to pick one, I'm sure we would have perfect financial statements. And it perhaps speaks very well for the modesty of the people in this room that they seem to think of themselves as representative. And I don't think that's the case.

And I think as we make policy in this area, we need to recognize that that is not the case.

But one of the points that I just wanted to make
quickly is that we've gotten a lot -- we've heard a lot in different contexts in recent years about the need to go more toward professional judgment. We have more fair value, respect for professional judgment, both by issuers and by auditors. And all I can say is, anybody can audit 2+2 equals 4. Well, maybe not my son, but most people could audit 2+2 equals 4.

But if we want to go into the world of auditing the financial equivalent of theoretical physics, one, you better be awfully competent but, two, you sure better be independent, because the value of independence goes up as the complexity and lack of clarity of the financial statements goes up.

MR. GURBUTT: Thanks, Barbara.

Doug?

MR. CARMICHAEL: The Cohen Commission concluded that auditing at the time and the problems were that auditing was suffering from too little -- well, it was really suffering from too much competition. And I can recall making a presentation at the University of Chicago, where on behalf of the Cohen Commission, where it was drilled into us that there was no such thing as
too much competition. And I think auditor rotation
would increase competition as a positive effect.

The Cohen Commission was the first that I know of
that came up with idea that one of the risks of auditor
rotation was that the auditor would be unfamiliar with
the client and there was increase audit failure risk.
And I think, in hindsight, the sample they used was
much too small. I know there have been some other
research studies, but they're too many confounding
events, and maybe too few observations to give any
credence to that.

Finally, I know John White didn't intend it that
way, I think he identified a viable alternative to
auditor rotation, and that is to have specialist firms
that would come in periodically and evaluate the
quality of the company's accounting and the quality of
the auditing and how they public report on it. And
that could be done every several years, 3 years, 5
years.

If what is said about the increased cost of
auditor rotation is true, it would not really add to
the costs significantly. And it would open up the
opportunity for increased competition for firms that
are perhaps too small to take on the audit of a large
global company. They wouldn't be too small to make
this kind of evaluation.

MR. GURBUTT: Thank you.

Mary?

MS. HARTMAN MORRIS: Thank you. I think timing is
everything. I think I'm the last card, right?

I just wanted to point out, thank you so much, and
I agree with all the different speakers on many
different points, but from an investor's perspective
from CalPERS, independence is key to investors
confidence. And as the largest institutional investors
in our allocations, we have to look at some of those
factors, and the independence of auditors is really key
to us.

The second point I wanted to make was what Jeff
had said, was CalPERS has had principles around this.
We're part of the Council of Institutional Investors,
the CFA Institute, the International Corporate
Governance Network, that have principles around this
policy about mandatory auditor rotation, or at least
looking at the enhancement of the auditors in themselves.

I think it's really key though that we also look at that time frame. And I don't know necessarily that we have the right key on what the timeframe should be, but I think it should be vetted. It should be provided that the audit committee does have a perspective on that. But even if the auditor -- annual auditor ratification is really important to CalPERS.

And the last point I really wanted to make was what was what Gaylen mentioned and also what Doug just sort of mentioned as well, and I think also, Arnie, you did as well.

Gaylen didn't lose his knowledge when we went from a big firm to a smaller firm. And part of our testimony in ACAP was that with auditor rotation and mandatory auditor rotation, it might provide some great benefits. It might increase audit choice, ability to have different auditors, to have that choice of auditors, improve audit quality.

So I think from that perspective, and I think others mentioned it as well, I think Liz you said from
a smaller firm's perspective, regional firms should be considered. And I think, Doug, that you mentioned that there might be another opportunity about bringing them in on special cases.

But I think this is a good point that mandatory auditor rotation would increase that benefit of audit choice.

So thank you.

MR. BAUMANN: Thanks, Mary.

Thanks to everybody for a very valuable input to us as we consider this very, very important question about enhancing, improving auditor independence, objectivity, and professional skepticism for the benefit of investors and improved financial statements.

I'll just echo a thought that was expressed by many that was to the extent -- we want to hear comments across the board, of course, and as much information as we can get. But to the extent that one doesn't support audit firm rotation, we look forward to comments on other ways that the board can go about improving auditor professional skepticism. We look forward to those comments very much and letters we may receive.
So thank you very much for this discussion. We're a little bit behind schedule. We're due to get back here at 1:30, which won't happen, but let's see if we can make it to one close to 1:45. Thank you.

[Whereupon, at 1:01 p.m., the meeting recessed.]