PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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INVESTOR ADVISORY GROUP

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MEETING

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THURSDAY, OCTOBER 27, 2016

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

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P-R-O-C-E-E-D-I-N-G-S

8:59 a.m.

MR. HARRIS: All right. So first of all I'd like to welcome everyone. This is our Seventh Annual Meeting of the Investor Advisory Group. And, you know, it goes without saying that, you know, I appreciate your time, the effort, and the devotion that you've put into this. I know you have busy schedules. And a number of you have traveled very significant distances to be with you -- be with us here today. And it goes without saying that that's appreciated.

You know, Mike came back from Spain last night. I know Linda comes from South Africa. And I know that Sarah Deans is from the U.K. Hopefully not forgetting people. I know that there are others who have come from California. But this means a great deal to us. We do it once a year. And I'd encourage all of you to be aggressive in your comments. It goes without saying we're especially appreciative, to put it mildly, to Chair White who has taken the time out of an unbelievably busy schedule to join us.

I know it means a lot to you. It means a lot to us. And, hopefully, you know, you will hear a fairly lively discussion this morning I think on a topic of considerable interest. I mean we've got three topics. But the non-GAAP has really, you know, raised the attention and the focus of a number of members here and is by no means uniform in terms of where I anticipate people will be coming out. So I look forward very much to what everybody has to say.

At the outset, I'm required to issue the normal disclaimer which I think everybody's heard before. No, the old members, not the new members have heard before. That the comments and the views we express are our own -- I'll say that for the Board and the staff -- and do not necessarily reflect the views of other board members or the staff of PCAOB.

I've already extended a warm welcome to Chair White. But I also similarly want to welcome Wes Bricker. He's the interim chief accountant, you know, at the SEC. Wes, thank you very much. I think it's your first, and we very much welcome you.

And, Brian, thank you for your yeoman's years of service. And I think it's public, so if I can offer you congratulations and I wish you the very best of whatever you decide to do next. We do wish you good fortune and much success in the future.

In order to achieve the best results for investors, the PCAOB must work very closely with the Commission, and particularly with the Commission's Office of Chief Accountant. And for this reason we appreciate the cooperative relationship that exists between our two organizations.

This is the first Advisory Group meeting for some here. And I would like to recognize our new members, and then we'll go around the table and everybody can introduce themselves and their organizations. But they are Mary Bersot, Kevin Chavers, Sarah Deans, Linda de Beer, Dr. Parveen Gupta, Amy McGarrity whom I haven't met yet or spoken to but I know, I recognized you at dinner last night, and, and Michael Smart.

In a moment I'll ask everybody to go around the table to introduce themselves and the organizations you're with. But for now, I'd like to express my appreciation to all of you for participating in today's meeting and for your hard work and your respective -- on your respective working groups. And I especially want to tip my hat to the working group leaders. That's not to say to everybody, but the working group leaders really do put a ton of effort into making these, from my perspective, successful meetings and substantive meetings. And it is a lot of work.

Today we'll be discussing the following topics:

Non-GAAP financial measures and their relevance to assessing company performance; recommendation to the 2008 Bush Administration Treasury Department's Advisory Committee on the Auditing Profession, and the Auditors Reporting Model. But before we start, and for the benefit of our new members and those who may not know a great deal about the PCAOB's Investor Advisory Group, I will briefly discuss the history of the IAG. And it will be brief.

And then I will share some of the topics we have considered over the years. I'll discuss a few of our accomplishments. And then we'll go straight to the agenda, copies of which you have in your packets. So I'm not going to outline them for the, the listening audience.

By way of background, the first Investor Advisory Group meeting was held in May 2010. The group was formed "to provide a public forum specifically for the Board to obtain the views of and advice from the broad investor community on audited oversight matters affecting investors."

And at that meeting I also mentioned that regulators often hear more from the regulated than from the investment community directly.

As the Sarbanes-Oxley Act makes clear, the PCAOB was created to "oversee the audit of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports." And that's a closed quote.

In other words, the Board's most important stakeholders under the Sarbanes-Oxley Act are investors. For seven years now this group has faithfully reported the perspectives of a variety of investor representatives, and in doing so, has served as a vital, tangible connection to what a number of us consider to be our most important constituency.

Over the years we discussed a number of topics, including lessons learned from the financial crisis, foreign inspections, greater transparency in governance of audit firms, greater transparency of the audit process, and auditor expertise and responsibilities. Other topics have included the role of audit committees; the audit firm business model; audit quality indicators; auditor independence, objectivity and professional skepticism; and going concern.

Each of these topics has prompted the subsequent meaningful consideration by the Board and, in a number of instances, Board action. By way of example, the Board has acted on the issue of transparency by providing engagement partner identification. Currently considering amending the audit reporting model. And we have issued a concept release on audit quality indicators.

Further, partly in response to various recommendations from the IAG, the PCAOB has increased its efforts to obtain access to the audits conducted by foreign-registered accounting firms for the purpose of conducting inspections; published on our website, a list of our issuer clients of PCAOB registered firms in jurisdictions where the PCAOB is denied access; issued a report on the observations of our inspectors and related -- related to audit risk areas affected by the financial crisis; and issued audit practice alerts on a variety of topics, including the audit implications of breakdowns in the mortgage foreclosure process; audits of internal control over financial report; auditing revenue and improper alteration of audit documentation.

The Board has also issued timely guidance on hot issues for auditors and boards of directors such as the Audit Committee dialog issued last year; and expanded the inspection reports to provide more information about the audits inspected.

These are a few examples of how your recommendations have made a difference on how the Investor Advisory Group's input has helped the Board establish its priorities and advance its efforts to protect investors. Clearly, more needs to be done, and the Board looks forward to your suggestions throughout the day today.

Just as in the past, the Board intends to carefully consider the views you express and the topics you have chosen. And that's you who have chosen topics. We have not chosen. You have chosen for us for today's discussion.

Today's agenda. I would now like to turn to Chairman Doty with respect to any remarks he may wish to make, then Chair White, and then to other board members who may wish to make statements.

So starting with you, Mr. Chairman.

MR. DOTY: Thank you, Steve. And I join you in thanking everyone for being here. I'm greeting 70 members among our 12, and we welcome all of you.

As Steve indicates, I believe the PCAOB has accomplished a great deal in a short life of less than 14 years. And there are some major achievements there. But they could have been accomp -- they could not have been accomplished without the sustained interest and support of investors, including those here.

In addition, I want to especially acknowledge how much it's meant to me to have the support of Chair Mary Jo White. I could not have begun to do this job without the access to her wisdom and her counsel and the ability to see her on matters of importance to all of you. Thank you for being here today, Chair White, and for your dedicated attention to the role of the Audit Committee and the audits and the Commission's investor protection mandate, and for your advice and encouragement over these years.

It's clear PCAOB accomplishments are attributable directly to Congress' foresight in conferring on the PCAOB the responsibilities and powers set forth in the Sarbanes-Oxley Act to register, inspect, set standards for, and when necessary, discipline the auditors of public companies and, of course most recently, to include brokers and dealers in that regime.

In my view, independent oversight has changed the landscape for the better for investors and capital markets. And here I want to submit for the record my written remarks this morning which contain a bit of a list of that. And really only say that I believe inspections have improved audits. They have changed the firms' attitudes in their execution. There's a lot of work to be done. There's been a positive difference; more work to be done.

Emerging research on our inspections indicates that when we find efficient audits, engagement teams raise their game without a commensurate increase in fees but with a statistically significant production in restatements.

We have also, I think, generated outstanding standard-setting agendas and executing all those, as Steve has mentioned.

I think the awareness of the role of the PCAOB is now firmly established in the public mind. And emerging research is suggesting that this is helping to build public confidence in the audit and the investing.

I've mentioned research, and I believe that credible, insightful research is going to be very important to our ability to continue to affect our message -- mission rather. I firmly believe that by improving audit quality we've played a part in helping to avoid more financial reporting failures that would have occurred and, in turn, to help our economy and our capital markets be resilient and grow.

I believe we have to continue to expand and improve and evolve the audit as a mechanism for capital formation. And we need to shape the audit and audit oversight to meet the needs of investors. And our discussion today and our continuing relationship with all of you will help us do that.

So with that I yield my time. Thank you.

MR. HARRIS: Chair White.

MS. WHITE: Thank you very much.

First, I'm delighted to be here. I don't think I get the medal for traveling the furthest. I think some of the rest of you have that. But it's, it really is important to me to be here.

I want to just start by first thanking Chairman Doty for your continuing strong leadership of the PCAOB; Steve Harris for you chairmanship of this group. And I might just, you know, make also thanks -- finish my thanks and then I want to make a comment up front about how, just how critically important I think the PCAOB is and give you one sort of, you know, anecdote to show you what I say about the PCAOB in other venues as well.

But first, very important thanks to Lew, to Jeanette and Jay, and all of your very hard and very productive work on the Board, as well as the entire PCAOB staff, your dedication and your service to raising audit quality. And then not at all, you know, last but not least I mean really all of you, new members and old members, for your dedication and service to raising audit quality. And it just, it just could not be more important.

You know, having been fortunate enough to attend some of your prior annual meetings, I am always impressed by the very thoughtful dialog that takes place here, and as well as what is obviously the behind-the-scenes work that goes on all year and the preparation, you know, for these meetings, which is certainly, if nowhere else, reflective, reflected in the briefing materials that I have reviewed.

So here's my little anecdote. I mean as one of the things that sort of struck me as being Chair of the SEC that I was a little surprised at in my first year -- that's about four years ago now -- but is how much international work that I have. And part of that is the SEC is, obviously, a member of IOSCO, which are our fellow securities regulators from around the world. Big task forces on and groups working on audit quality, as you should be working on audit quality.

I think maybe the Chairman has heard me say this before, but I say it every time I'm in those meetings talking about that when they're sort of trying to figure out, you know, what to do, what needs to be done, what the priorities are. You know, nobody has what we have here in terms of the PCAOB, in terms of what that's done and continues to do to raise audit quality. I mean it just, you know, there's not, there's just no comparison. There's a lot of good work being done in Europe and elsewhere, but just, but just know what kind of organization you're advising, you know.

So with that, you know, just commentary, let me go on. I mean, again, for this group you don't need me to tell you or anyone else to tell you that the credibility of financial reporting depends on the thorough audits performed by independent, skeptical and skilled auditors. Investors heavily rely on auditors.

And, again, I'm very pleased in particular by the PCAOB's outreach to investors for their input, and that obviously includes you folks and the IAG, which is enormously important.

You know, again, as Steve has alluded to, and your agenda obviously reflects on its face, you have a very full day of discussion on very important topics. And I can only be here for the initial part of the discussion on non-GAAP measures. But I thought what I'd do quickly -- and I will try to do it quickly -- is just offer a couple of thoughts on each of the major agenda items that you have today. I'll be getting a full briefing on the discussion, but I won't be here personally for all of it.

So starting with non-GAAP measures, which is what you're starting with, you know, that's one that, you know, continues to have, it has and continues to have a lot of attention at the Commission, as it should. We have taken a number of steps in response to growing concerns that I have and others have had about the appropriateness of certain reporting practices in this area.

As I know many of you are aware of, earlier this year the SEC staff updated its non-GAAP reporting guidance to further assist issuers in really understanding and complying with the disclosure obligations in this area.

Wes Bricker, our tremendous interim chief accountant, Mark Kornforst, the chief accountant in the Division of Corporation Finance, have also been very active in speaking out on the subject to provide guidance and views about what works and what doesn't, what's permissible and what isn't. So we're going to be, you know, continuing to devote an awful lot of attention in this space to really improve usefulness and the reliability of the information being provided to investors.

Because I think I said to Anne yesterday when we were talking on a different topic, I mean it's, you know, and I try to make this clear when I talk about this, investors want this information. It's useful. But, you know, when you say "this information" you obviously want it provided in the right way and in the most, you know, reliable way that you can.

So I look, you know, forward to hearing your perspectives in this, this area, which really has an awful lot of my attention and others at the Commission.

Your agenda also includes, as Steve said and as it reflects, a status report on the important recommendations from the ACAP Committee from 2008. And I look forward to hearing your perspectives on all of that, but in particular on which matters continue to be of most importance and priority to either undertake or continue, that are already underway, including by the Commission. Obviously there are a number of constituents there represented in terms of the recommendations.

A number of the recommendations have been implemented or partially implemented. And the report and recommendations in addition to the specific recommendations really has been an important resource for the SEC and the PCAOB over the years. They've informed major standard setting initiatives, including the auditors' reporting model work, as well as the PCAOB's Audit Quality Indicator Project. The report and its recommendations have also informed the PCAOB's strategic planning efforts over the years.

I mean, since these recommendations were included in the report to Treasury in 2008, obviously much has, you know, transpired since then, so I think it is important for all of us, you know, as part of the analysis you're doing today and before today and after today, and all of us are doing, is to consider the changes that actually have, you know, taken place since 2008, and in the context of today's regulatory knowledge and experience.

I mean one, one example is, obviously, the PCAOB now has for over a decade, you know, engaged in its inspection program. So it has that decade-plus of experience to draw on in helping to inform its strategic planning and standard setting efforts. And I want to sort of echo what Chairman Doty said about just how much positive impact I think that inspection program is having. I mean and it's more and more every year. Really quite, quite significant.

So I look forward to full download on that discussion from Wes -- and I have my wrong glasses on -- but Brian Croteau who is also down the table. So I was glad someone introduced him so I knew he was here. But and Brian, and what Steve said about Brian I echo in, you know, every way I can. You know, your contributions to the agency and audit quality really across the board, Brian, has just been remarkable.

Auditors' Reporting Model, obviously that's your, I understand your third major topic on the agenda today. Critically important. It's received substantial attention over the past few years.

As you know, the PCAOB exposed its initial concept release in 2011; more recently issued its new proposal in May 2016. Throughout the process -- and this is very good -- there's been active involvement and feedback from a number of stakeholders, including through roundtable discussions, input from this advisory group and many comments.

So I know that the PCAOB staff is working very diligently considering the feedback that it's gotten on this as it develops a final rule. So we at the SEC really look forward to continued progress on the PCAOB's efforts to improve the content of the auditor's report for the benefit of investors.

So before I really do stop talking and let you get to your agenda, let me just take this opportunity to just very briefly say a couple of words on the excellent cooperation between the PCAOB and the Commission in overseeing the public company auditing profession and auditing. I really believe, without question, that that cooperation, the hard work that's done by the staffs at both organizations, has contributed directly to significant improvements in audit quality.

You know, one example, and I'll start with enforcement, I mean the SEC's Division of Enforcement has something that's called the Financial Reporting and Auditing Fraud Group. And it focuses on financial reporting and audit failures. And, of course, the Division also has its Operation Broken Gate. I didn't name that one. I wish I had. But it's an initiative to identify auditors who neglect their duties in the auditing standards. Really a lot of energy and a lot of thought has gone into that initiative.

Recent examples of SEC audit enforcement cases done in close coordination with the PCAOB include charges against three national firms and associated partners for deficient audits, and numerous sanctions of other firms extending from that operation, the Broken Gate Initiative.

In addition, and can't do enough in this space, our enforcement staff has been very active in bringing cases against auditors for violations of the independence rule. Recently two cases brought against a large firm and three former partners for auditor independence failures due to inappropriately close personal relationships. That's, you know, that's an area not for its interest value in that sense of the word but, you know, it's obviously an area that needs attention. And, again, it points out that this is certainly continuing importance of focusing on the independence of auditors and, you know, failures of independence; could not be more important.

Other examples outside of enforcement where you really can see, I think, quite clearly the impact of the PCAOB's work on improving audit quality. Inspections Program we've mentioned. The focus on the importance of the Audit Committee's oversight role, and improvement in the transparency of drivers of audit quality. All of those have contributed to improvements in audit quality and really deserve not only to be praised but to be continued.

It's important for the positive momentum, the tremendous achievements of the PCAOB to continue to keep pace with the investor expectations, as well as the new and emerging reporting risks that always lie ahead and do lie ahead. It's incumbent upon all of us, obviously including the Commission, to continue to monitor our current environment to identify and understand the issues to be addressed, as well as the range of potential approaches to best address those issues.

So we at the Commission will continue to work very hard and collaboratively with the PCAOB and other stakeholders to do just that.

So, as I said, I'll get a full briefing on today's proceedings. Thank you again for your commitment to assisting the PCAOB in its just critical mission to protect investors. And thank you for having me.

MR. HARRIS: Well, thank you, Chair White, first of all for your support and encouragement of the work that we do together, and the work that you especially do at the Securities and Exchange Commission.

And now I'd like to recognize board members who may wish to make brief statements. And I know Jeanette would like to make a statement. And then I recognize Lew, if you would like to make a statement, and Jay, for whatever statements you'd like to make.

Jeanette.

MS. FRANZEL: Thanks, Steve. And congratulations on seven years of heading up this group.

And I must say I'm very impressed by the individuals on this group and the group collectively. And I thank all of you for spending your valuable time to advise us and the PCAOB's very important mission. This is extremely important to us.

I look forward to the agenda today. A lot of these issues are near and dear to my heart. Many of these have been longstanding issues for years, some even decades. And it's really important that we, we deal with these issues and move forward because there are plenty of emerging issues on the horizon that I'm sure we'll be discussing in our future meetings.

In that regard, I'm very pleased that our new standard setting process involves a more formal mechanism for serving the environment and identifying emerging risks and doing research on these issues prior to perhaps setting up a project or determining what actions need to be taken. And so I look forward to having those types of discussions with you in the future.

Chair White mentioned new financial reporting pressures. And, of course, that always puts a little extra risk into the auditing process. And then the auditing process itself is changing drastically in terms of use of technology in the audit, use of data analytics, and even artificial intelligence. So there should be some very important issues for us all to be deliberating about going forward.

I also want to thank the SEC staff and Chair White for their support and attendance here today. And I look forward to today's discussion.

MR. HARRIS: Lew, do you have any comments?

MR. FERGUSON: Yes, I'd just like to thank you all for the work, thank you all for the work that you do here. We are very, very grateful for it. And I am reminded that when I first came on the PCAOB, one of the very first meetings I came to was a meeting of this group of the Investor Advisory Group.

I remember there was a panel led by Joe Carcello in the early days of the Auditors' Reporting Model. And as I listened to the discussion I thought, wow, there are really some smart and thoughtful people who are helping us here. And this is going to be great fun.

So, again, just to say thank you for the work you're done for us.

MR. HARRIS: Jay?

MR. HANSON: Thanks. I'll just echo the other comments my fellow board members have made, and Chair White. And thank you all for coming here. And I'll again acknowledge Brian Croteau and all the work that he has done and the close relationship we've had. We're going to miss him a lot. And the difficult job that Wes Bricker has stepped into as interim chair. And I look forward to the spirited discussion today.

MR. HARRIS: And with that, why don't we get started. First of all, if we can go around the table and everybody briefly introduce themselves and the organizations they're with, that would be helpful. And then we'll get started with the program.

So, Marty, why don't we start with you and just go that way around.

MR. BAUMANN: Hi. I'm Marty Baumann. I'm the Chief Auditor and Director of Professional Standards at PCAOB.

MR. NACHTWEY: Pete Nachtwey, CFO, Legg Mason.

MR. BRICKER: Wes Bricker, Office of the Chief Accountant at the SEC.

MR. BUSER: Curt Buser, CFO, the Carlyle Group.

MR. SMART: Michael Smart, Managing Partner, CSW Private Equity.

MS. SIMPSON: Anne Simpson, Investment Director for Sustainability at CalPERS. And I'm also on the board of the Council of Institutional Investors.

MR. HARRISON: Norman Harrison, Senior Managing Director of FTI Consulting.

MS. DEANS: Sarah Deans. I'm at Exane BNP Paribas.

MR. CARCELLO: Joe Carcello, Professor and Department Head at the University of Tennessee.

MS. BERSOT: Mary Bersot, founder and owner of Bersot Capital Management.

MR. SHOVER: Larry Shover, CIO of SFG Alternatives. Also contributor to Fox Business News.

MR. HEAD: Michael Head, retired chief audit executive at TD Ameritrade, and currently instructor at Texas A&M in the Accounting Department.

MR. GUPTA: I am Parveen Gupta, Professor at

Lehigh University.

MR. CROTEAU: Brian Croteau, Deputy Chief Accountant in the Office of the Chief Accountant at the SEC for I guess about two more weeks, as you've now figured out.

(Laughter.)

MR. WALSH: I'm Gary Walsh, principal and portfolio manager at Luther King Capital Management.

MR. TURNER: Lynn Turner, Trustee of Colorado PERA.

MR. TAROLA: Good morning. I'm Robert Tarola. I'm President of Right Advisory, LLC, which is a turnaround consulting firm, and chair of the audit committee of two public companies.

MS. DE BEER: Good morning. I'm Linda de Beer. I'm the person that won the prize for traveling the furthest. I'm an independent non-executive director on number of listed companies in South Africa. And I was also previously the Chairman of the Consultative Advisory Group of the IAASB. So I've been involved in auditing standards for a long time. I also lecture a little bit on auditing and accounting standards at the University of the Witwatersrand at Johannesburg.

MR. CHAVERS: Good morning. I'm Kevin Chavers, Managing Director at Blackrock in the Public Policy Group.

MS. McGARRITY: Good morning. I'm Amy McGarrity. I'm a global equities product specialist at William Blair Investment Management.

MR. SONDHI: I'm Tony Sondhi. I'm President and founder of A.C. Sondhi & Associates, which is a financial consulting and investment advisor firm.

MR. HARRIS: Well, thank you very much. And if all of you before you speak could give your name for the listening audience that would be helpful. So to the extent that you make comments, if you could indicate who you are, that would be helpful for the record.

Now turning to the schedule, I'd like to ask each of our working group heads to give a five to ten minute overview of their presentations. And then we'll go into the topics in much greater detail. But given the Chair's time schedule, I think it's very important that she really gets the bottom line of what the working group heads would like to deliver in terms of messaging. And then, as I say, we can go into, you know, far greater detail throughout the entire day.

And with that, I'd like to start with Tony Sondhi. And, Tony, you've bitten off a lot. And this, the working group on non-GAAP I was, I was somewhat surprised because when, Curt, you mentioned that that was a topic that you thought we ought to bring up I wasn't clear in my own mind in terms of how interested so many of you would be and, quite frankly, some of the diverse viewpoints that you would bring to this issue.

And, Tony, I've been following a little bit of the email traffic as you coordinated with your group. So I know you've got a tough lift. But with that, if you could outline for the Chair and everybody here, just start us off, you know, what you'd most like the SEC and Chair White to hear, that would be terrific.

MR. SONDHI: Steve, thank you.

I'd like to begin by saying simply that, as Steve has just pointed out, there is just an avalanche of material that had to be used in order to develop the few points that we're going to make. It's very difficult to, you know, overstate the importance. I think it's absolutely critical.

I'm going to begin by telling you a little bit about the non-GAAP measures. And then I'm going to ask Anne Simpson to say a very few words on sustainability, and then Linda De Beer will tell us a little bit about integrated reporting, because those are the three issues that I was asked, our team was asked to address.

The non-GAAP measures, in essence, if you think about the definition, these are measures that exclude items that would have to be included in the most comparable GAAP measure, or they would include items that are not allowed or permitted in the comparable GAAP measures.

Now why do we have such a proliferation and such an enormous increase in non-GAAP measures? And I think it's fair to say that the demand from the investors' side is rather significant. Analysts are asking about it. They want this information. And management equally is intent on providing this information.

What management, in a sense, is doing in presenting the non-GAAP measures is effectively giving us an alternative perspective of performance that in a sense come from two sources: one, there's a demand from analysts and users, from investors, and; second, they're trying to make up for the shortcomings of the GAAP model. And we do have quite a few of those. In a sense, management also provides this information, the non-GAAP measures, because they use them internally. They use them to communicate their perspectives, how they're managing the business to the board of directors, for example.

So in that sense there's rather critical relevance or importance from both sides, management and the investors. And as I pointed out, there certainly has been a proliferation of these. There's a plethora of these non-GAAP measures out there: adjusted income, earnings per share, EBITDA measures, various types of adjustments that got into EBITDA, three cash flow measures.

So the objective has been to develop and provide information that gives a different perspective on performance, it gives you a different perspective on liquidity, it gives you a different sense on the valuation. And certainly, as I said before, investors, analysts use them. Those are forecasts. And as everybody knows here, they have also become a rather significant component of earnings conference calls.

There clearly are limitations to the GAAP model that we have. There's an inconsistent measurement framework. The business structures, the tax structures, those are not necessarily always well reflected.

Many years ago when the FASB issued the standard on segment reporting, the analysts and my colleagues at the CFA Institute were very pleased because we had a big role in working on those. And we were very happy to see that additional information. However, it has not provided the type of information we would like to have. And, clearly, the performance measures in a segment basis are being augmented these days by -- with these non-GAAP measures.

The other aspect that I wanted to be very clear about is that over the last few years, as I said, there's been a tremendous increase, from 2010 to 2015. Last year, for example, it was reported that two-thirds of the DOW 30 were reporting adjustments to GAAP earnings per share. And the difference between the adjusted earnings per share and the GAAP earnings per share had exceeded 30 percent in 2015. And that compares to just under 12 percent the previous year. So that year on year growth is rather significant.

Now, if you think about how all of that works out, you see, as Chair White has pointed out, there has been an increase in attention from the SEC. She herself in speeches has pointed this out. Mr. Bricker, his colleagues, Jim Schnurr, the others have all been talking about this. Mr. Schnurr pointed out that some of the increase was troubling.

Some of the more recent work that you've done, both the May 2016 compliance and disclosure initiatives, the additional Q&A, the information that you provided, the increase in enforcement, that and the work that you've been doing has been very well done from an investor's perspective.

At the same time, even with all that increase, what -- and let me also point out some of the most critical things that the SEC has been concerned with: the tailored accounting principles; the adjustments to certain measures and then offering those as liquidity measures; not properly or comprehensively adjusting for the tax consequences of some of those adjustments. But the, in essence I think, the issue with non-GAAP measures from the perspective of the analyst, the user, the investor, is that there are no common definitions. They're inconsistently applied over time within the same firm at times. They certainly do not allow us to compare companies.

The SEC, certainly through Reg G, other initiatives requires a reconciliation. The reconciliations do not always provide the type of information -- very often they do, but they don't always give us the kind of information we would like to have.

But let me very clear about something. From an investor's perspective, and certainly from nine, I would not want to limit the use of non-GAAP measures. It gives me a perspective into management. It tells me something about management, the way they're running it, that I find absolutely critical. I use that with my analysis of GAAP measures to understand companies better.

And so from that perspective, if we think about where we are, despite the regulations, despite the increased enforcement, the fundamental question is whether we ought to have, you know, the information that's provided, whether that ought to be audited.

If we look at the existing auditing guidance we find that it does not cover the gap, the non-GAAP. And bear when I said "gap" I mean G-A-P. So fundamentally, the point there is that if this is as useful as management and analysts feel it is, then we ought to do something about auditing.

So we've considered various approaches to this. Some people have suggested that we ought to limit the number. And I'm against that. I think my team is against that. I don't want to limit it because I prefer that people and managers tell me how they're running the company and what their perspective is.

I'd like more information. I've never thought that there was any such thing as a disclosure overload. But, and I'm an analyst at heart, so I would never say that. So but I use it. I read it, I use it, and I find it very, very helpful.

So I don't want to limit them. I'm not sure that we could come up with robust definitions that would be applicable across the board. Even if we were that good at coming up with those, they would not stand the test of time. Things change. It's a dynamic world out there. I think we need to permit that freedom and that, that ability to express what's going on.

But don't get me wrong, there are also some very serious concerns. The banking regulators, for example, they've been looking at leveraged loans. And that area is not under your end. And from that perspective, when we look at some of the more recent examples that were cited in the Wall Street Journal article a few days ago, the amount by which they've increased -- and this goes to the tailored accounting principles that you've talked about -- the increase at the time of the acquisition by the acquirer, the adjustments that are made to EBITDA, that always brings to mind, you know, that these are flexible definitions. And then they change over time, it would be good to have some sort of a structure which allows us to view what's going on.

I think that if companies want to change what they're using, add or no longer use a particular non-GAAP measures, it would be useful to have them continue to provide it for some period of time so that we can see the trends.

If you take that one step further in terms of what else we could do, another suggestion involves allowing industrial organizations, industry bodies to validate those. I'm not sure that that can actually work. That type of self-regulation has obvious limitations, and we don't see that working.

So that leaves us with two other possibilities, one of which is to mandate their inclusion in the footnotes of the financial statements, thereby making them audited. Now, from that perspective, if I look at the FASB's agenda consultation paper, it is not heartening. Their recommendations with respect to segment reporting, their recommendations with respect to additional disaggregation of information, their recommendations with respect to segment reporting do not add up to a point where they would help us with this.

So the IASB has been working on the same thing. There are other organizations internationally that have talked about different definitions, and so on. You can see, by the way, all of this information in the background material that you have to our presentation. Yet, I don't think I don't, we don't see suggestions or recommendations that are going to help us with this.

So that leaves us with the inclusion in footnotes. Or the alternative would be that they would be covered by supplemental information, so that then AS 17 could be applied to it. The current auditing standards, as you heard at the Standard Advisory Group Meeting in May, those leave a lot to be desired. So we do need a very, very strong sort of assist there. We have to bring them into the fold of reporting.

The last point I want to make is that earnings conference calls have been also very, really worrisome because at times it's hard to see what's GAAP and non-GAAP. The presentations can at times be difficult to use as well. So it would be very help to have that.

So that's what I wanted to say about non-GAAP measures. And, Anne, if you would take a couple minutes and tell us about sustainability amendment, if you would. Thank you.

MS. SIMPSON: Anne Simpson. Thank you very much.

I first of all want to absolutely agree with this idea that you can have too much of a good thing with disclosure. This is too much fresh air. I don't know what the analogy would be. And thank you, Tony, for summing up where the group's got to on the non-GAAP conundrum.

Linda has presented, has prepared some slides on a related topic which is also non-GAAP, defined only by what it isn't, but which is going under the moniker of integrated reporting. And that is a movement in the investment community to try to capture elements which are relevant to value creation, and also to understanding risk.

And we're at the early stages of this work but we have some rude awakenings to report. In companies where the management of financial capital, we would say at CalPERS human capital and natural capital, has not been handled in a way that's suitable for a long-term investor's point of view.

We've seen rapid collapses in value. You know, they're thinking about some players in the coal industry not anticipating the impact of clean air regulations, links to climate change ambition, to new international agreements, as an example. We've seen a major financial institution mismanaging, in our view, human capital where we have an incomplete disclosure about the incentives, the compensation, from what's driving conduct at the worker level, not at the senior executive level, but with dire consequences for the business.

And another example, health and safety. We've seen health and safety and mismanagement of global supply chains. You know, famously in South Asia some terrible collapses of buildings and fires in the retail sector. And the largest company concerned certainly in our portfolio claiming that this didn't affect them, and yet labels from that company were found in the wreckage.

So we think this need for integrated reporting is really a function of the expansion of the complexity, the global reach of businesses, the multi-faceted nature of risk. And certainly for us, in the wake of the financial crisis, understanding that we need companies to manage financial capital, human capital and physical capital for the long term. And the only way that we can get a window into the competence, the independence, the quality of the board is through disclosure, which is of course absolutely the agenda for the SEC and the PCAOB, hopefully not at the Broken Gate, but making sure that the flow of information is reliable, reasonable, timely, relevant and so forth.

So I'll just point to two examples which we find very encouraging. One is that some years ago the SEC, at the request of a group of shareholders -- investors I should say -- did develop guidance on climate risk. I think the SEC is ahead of the game. This is in the world of the Kyoto and the Copenhagen Agreements which really stumbled forward. They didn't have the impact that was intended.

But now we have the Paris Agreement, which has a number attached to it. Here is the number, 2 degrees, that we need to limit global warming, which implies new strategies for the corporate sector in many areas, not just for the energy sector. And that's a terrific foundation. And we hope in due course there will be an opportunity to refresh that guidance. It's extremely important. And it will have new relevance because of the Paris Accord.

Secondly, we'd like to flag our need as investors to understand more on human capital. And the theme for us is diversity and inclusion. We have compelling studies indicating that companies which embrace and understand diversity and inclusion are better positioned to recruit talent, but they're also better positioned to repel the forces of group think, which is nearly what took us over the cliff in the financial crisis.

So, again, the disclosure in this arena is, is poor, feeble even. And the disclosure that we'd need would really enable owners of companies to hold boards accountable, not just for their own composition, but also for our diversity and inclusion are handled right through the corporation.

So thank you for the good work that the SEC is doing. Critical role certainly for the PCAOB. Because if we don't have standards and assurance in these critically new areas of information we're, unfortunately, too often in the grip of a PR exercise. And information coming out in different, different channels at different times, not connected to the financials.

So really our, you know, our vision is of a holistic, forward-looking report. And understand that, you know, investors can walk and chew gum. We can understand different dimensions of corporate reporting. But we do need an improvement in the quality and comparability, which is why we're now looking to standard setters to pick up the material things in this arena.

So, Linda, I don't know if you --

MR. HARRIS: Well, Anne, first of all, thank you very much.

MS. SIMPSON: Thank you.

MR. HARRIS: And then when we go into the discussion later on, maybe you can tie it to the assurance and the related function and what we ought to be doing in that area in terms of the PCAOB, but not now.

And then, Linda, if you could very briefly, because we'll have, you know, time afterwards to develop the discussions, and I want to get to the other two, but if you could give the Chair the oversight and the overview, that would be extremely helpful.

MS. DE BEER: Sure. Thank you. And, Steven, I will be brief because we will obviously go into more detail.

And I think when it comes to the points that Anne made, and when you talk about integrated reporting, and you think how does this all fit into non-GAAP measures, the reality is that the companies are moving forward in the way in which they report. And the non-GAAP measures is one element and a very important aspect to address. Because more and more reporting beyond just financial reporting will happen. And the reality of it is that investors will look at that and make decisions on the basis that they need some level of comfort -- if I, not, if I don't use the word "assurance" -- but some level of comfort that the information is useful and reliable.

And when it comes to something like integrated reporting, it goes way beyond financial information into future looking information, strategy, and all sorts of other aspects. There are also now a whole host of other assurance providers that give assurance on risk and health and safety.

And bringing it back then to the PCAOB, as you mentioned, Steve, it does beg the question as to what is the role of audit standard setters, what's the role of audit regulators being sure that those processes work appropriately. I don't believe that the disclosure will always be the same for every type of company. But at least that is a level of comfort that investors and others can get out of those processes and out of the reliability of the information. So we'll obviously go into that a little bit, in a little bit more detail later on.

MR. HARRIS: Well thank you very much.

And the next topic is the ACAP recommendations. And we've had two co-leads: one, Lynn Turner, and then the other Parveen Gupta.

So, Lynn or Parveen, do you want to take the lead and spend maybe five to ten minutes giving the overview of that?

MR. TURNER: I'll be short and get us back on track.

So first of all, Mary Jo, Madam Chairman, thank you very much. And, Wes, thank you for your help on the, on the letter. We did send out -- well, let me start by saying, as everyone knows, or a lot of people know, ACAP was a U.S. Treasury-formed committee formed by then Treasury Secretary Hank Paulson, really at the request of the auditing profession to look at their sustainability.

But Damon and myself were members of that committee, along with others. And they issued, after a year of deliberation, public hearings around the country, issued a number of recommendations. I'd say generally the recommendations could be summed up as what was necessary to change how the firms thought, approached and conducted audits, staffed those audits, in order to improve the quality of the product that they delivered to the public, consistent in a manner with what the Supreme Court has said that product should be.

And in doing so felt that the best thing to improve the sustainability of the firms was to in fact improve the quality. And if you issued a quality product, then that would be the best way to ensure the sustainability of the firms. And so recommendations were made in three areas. There were three subgroups that committee put together. Damon chaired one of those subgroups on competition and concentration.

I served on the one on firm finances and structure. There was another one on human capital.

As our group went back through those, we asked then for the various organizations assigned to implement that for their written response. And they all provided it. American Accounting Association, AICPA, SEC, PCAOB -- thank you, Gordon and Jim -- as well as NASBA, all provided us written response of their view on the progress. So that was most helpful.

But at the end of the day when we looked at it we did see a number of the key and critical things really haven't yet been accomplished. One was making the quality of audits much more transparent to investors. We each year have to vote on these auditors, putting them in a position to where they can make an informed vote, because today there's no way those folks are informed at all. There's just basically nothing out there.

Second, the creation of a national fraud center at the PCAOB. There was a lot of debate and discussion about this at the time. Correspondence back and forth with the PCAOB itself at the time, and creation of a center that could improve and innovate on ways to improve audits and detection of fraud was certainly one of the top issues at the time.

Improving the quality of the audit report. Jim has noted the progress that has been made. And, hopefully, we'll see, soon see some more progress. Europe, of course, has jumped ahead of us substantially on this. All you have to do is look at some of the European reports. And I give them great kudos over there. There have been some very, very good reports come out, out of there that the investor community has weighed in on.

And also enhancing firm transparency and governance. On the transparency side Europe, again, is well ahead of us with their directive on that. Governance, not much has really happened. It's a sticky, tough subject. But, clearly, more needs to be done in that respect.

And, finally, on human capital I give the AICPA and CPA -- AICPA and AAA tremendous kudos for putting together commissions to try to improve the accounting education. But at the end of the day there's been really slow, grinding progress, if you will, in terms of actually changing curricula. And so we'll talk about that. And it's only if we can get the changes in the curricula that we'll see the accounting education change.

And that really hasn't occurred. Progress on that edge, in accounting education, universities is slow, slow, slow. So.

MR. HARRIS: Well, thank you, Lynn. And, Parveen, we'll get to you. But thank you very much also for your co-leading this. And then we'll look forward to the discussion later in the day. And I want to express my appreciation to you for working on this with Lynn and to your entire working group efforts.

And then, Joe, I know you co-led this with Sarah Deans. And, Sarah, you know this issue back and forwards from the U.K. We very much welcome your comments. But, Joe, you've been an absolute stalwart going back for time immemorial it seems. And you've done the, the outreach and to the, to the investor community.

So why don't I leave it to you to give us the overview. And then later on today we'll get into the substance.

MR. CARCELLO: Steve, I've decided it's time for a fresh face, and time for someone who actually is in a market that has seen this for three years. So although Sarah and I worked very closely on this with the rest of our group, Sarah's going to present our overview.

MR. HARRIS: Well, Sarah, coming from the U.K., we welcome the opportunity to hear from you. And once again, thank you for your leadership and work in the U.K. on this. And so take it away. It's not that Joe's a broken record; we love hearing from him. But, Sarah, you are a new face. So take it from there and then we'll look forward to the larger discussion.

MS. DEANS: Thank you. This is Sarah Deans. I'm new to the group, as you said, so I'd like to firstly say how honored I am to join this group. So thank you very much for that. And I'm very pleased to be here today.

And this is a topic, as you know, that's rather close to my heart. So we're talking about, and the subgroup talked about the re-proposed new standard from the Board in May, the auditor's report on audited financial statements on which the auditor expresses an unqualified opinion. And this is a proposed auditing standard that would enhance the form and content of the auditor's report to make it more relevant and informative to investors and other financial statement users.

One area that we focused on a lot, and talked about in our comment letter -- we submitted comment letter back in August on this as a working group -- was the area of critical audit matters. So the requirement for auditors to include a description of critical audit matters, that is any matter that relates to accounts or disclosures that are material to the financial statements and involved especially challenging subjective or complex auditor judgment.

Now, as has been mentioned, in the U.K. we've had something somewhat similar. It's not an identical rule but a requirement for the last three years that audit reports should discuss the key risks and material misstatements. And I think that has been, from the U.K. perspective, a very positive experience. Certainly I can speak directly on this, I have to confess, in the past I didn't much look at auditor reports. Most times I didn't look at them.

Now when I look at a company and I pick up the annual report, it's one of the first things I look at. It's very helpful. So it's certainly an area where I think from that international perspective, and as you've certainly gone through something somewhat similar, and clearly there are other developments internationally as well. So we have the IWSB's work, we have the EU forthcoming new requirement. So we're going to be having something similar across Europe next year.

So to come back to what the working group discussed. We talked about critical audit matters. We realized this is a relatively late stage in the project's process so that's why we focused on this area. And I'll comment during our presentation today.

If I look at sort of our view as rule, because clearly we believe this represents a meaningful improvement, we're very supportive of the proposed auditing standard. And if I refer back to the mission of PCAOB to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports, to me I cannot say -- and I think the working group agreed -- how this could not be helpful in that mission, particularly in regard to informative auditor reports.

So if we have that information. One thing that we'll talk about is clearly the information provided has to be bespoke to the company. We can't have just standard boilerplate that doesn't inform anything.

And I don't want to overrate the U.K. experience. Clearly we have had instances where reports are not as helpful as they could be, but we think it's going in the right direction.

So the working group strongly supports the proposed auditing standard. However, there is something regarding it we'll discuss this afternoon, if it will be possible to add some additional wording perhaps to encourage the discussion of findings. Because that's where in the U.K. the experience has been particularly helpful, to have auditor reports that not only talk about critical audit matters or key risks and material misstatements, but go further not just in describing work that the auditor did but actually saying what the auditor found, the findings.

We don't have that across the board, but where we have it's been helpful. And I realize that may be difficult, but if that's something the Board could consider, the working group was very keen on that.

Joe, what have I left out there?

MR. CARCELLO: No, you did a great job of hitting what were the important issues.

MR. HARRIS: Well, with that, thank you for those, that overview.

And, Tony, I know that I think you originally came up with well over 100 slides. But if you could now start the discussion. And thank you very much for streamlining the presentation. And we'll get into that and spend an hour on the substance of the new non-GAAP measures. And please proceed as you see fit.

MR. SONDHI: So are we going to put the slides that are there or no?

MR. HARRIS: However you'd like to proceed, that's fine.

(Pause.)

MR. SONDHI: Okay, this is just sort of as an introduction what the existing regulations are. And it's Reg G with some amendments to what's provided in 8-Ks and the item 10(e). And, of course, that's been effective since 2003.

And it also talks about the prominence of the non-GAAP measures. It discusses, you know, how they're to be presented versus comparable GAAP.

And then so this is our team, as you know.

Too, there are some additional requirements that are worth talking about. And this is where the requirements and the regulations ask management to tell us what they believe their presentation and how, why it provides useful information with respect to the financial condition, results of operations.

And then to the extent that it is important or material, it also asks for a statement disclosing the additional purposes, if any, for which the registrant's management uses that non-GAAP financial measure, or the ones that they're disclosing. And lately, as I pointed out earlier with the Compliance and Disclosure Initiatives and then the initial work that the SEC has done, there have been requests for additional information, clarification about these aspects that we've seen over the last several months.

Okay, the use, as I have pointed out in my initial comments, has grown rather significantly since 2010. There is an enormous number of academic studies. Investor reports, brokerage houses, investment bankers, all of them have weighed in with rather significant, very comprehensive analyses at times. There are also several articles in the media. You can find material from the major accounting firms. There are discussions on what types of internal controls should be provided, what the disclosure requirements and how they should be considered, given the changes in the Compliance and Disclosure Initiatives.

And then I just picked one. Although, and there's no reason why this is more informative than others, but you can find studies of the S&P 500. You can find studies of other aggregations. FactSet had pointed out that in 2015, 67 percent of the 30 companies in the DOW were providing non-GAAP information adjustments to GAAP EPS. And that, they also point out, is the difference between non-GAAP and GAAP EPS in fiscal 2015 was 30.7 percent relative to 11.8 percent in fiscal 2014.

So that certainly shows an enormous increase. And if you look back it's, I believe, the highest since 2010, according to most studies.

I also have pointed out that the SEC has noted concerns. And their most important concerns recently are, or among those are the use of individually tailored accounting principles. And certainly there has been in fact an effort to look for the types of adjustments that companies are making to revenues. And although this started with tech companies, I'm starting to see quite a few others. Software as a service or cloud computing companies did a lot of work on these types of revenue adjustments.

And they've long had that problem or that issue with the way GAAP handles subscription revenues. So from that perspective we see a tremendous amount of adjustment going on.

There's also non-GAAP per-share measures that are presented as liquidity measures.

And then finally you have the tax treatment issues.

Public companies, private equity firms, analysts, other investors have all increased their use of the number and the types of non-GAAP measures used over the last several years. And to a great extent this does reflect a growing dissatisfaction with GAAP measures of profitability, operating performance, and liquidity.

Both U.S. and international regulators have expressed their disquiet with this issue as well. There are several proposals out there. The, if you look at -- and then there's this other side where the banking regulators have recently expressed an enormous amount of concerns with respect to this, particularly with the adjustments that companies are making to EBITDA.

Now a very important reason for this, of course, is that these leveraged loans, which are supposed to be limited to six times EBITDA, those have been subsequently sold and they're acquired by other mutual funds, EFTs -- ETFs rather I should say, and so on. These are not currently subject to the SEC oversight, which raises concerns about lending risks and certainly about valuation and liquidity risks as well.

Federal examiners have recently raised concerns about several leveraged loans. And I point out, give you two of them. UFC, which took its -- or the acquirer of UFC adjusted their initially reported EBITDA of 170 million upwards to 300, and as a result was able to go out and borrow $1.8 billion. A significant portion of that increase from 170 to 300 comes from including future licensing revenues.

Solar Winds is another company that went from 178 to 322, with resulting borrowing of 1.6 billion. And there again there's a substantive pulling forward of recent price increases to a full year to be included in that, in the previous year's EBITDA.

So these are some of the concerns. The definition then, in essence, as I pointed out, non-GAAP financial measures normally exclude components of measures that are required in GAAP. And the second bullet point, as you see, basic definition that is they either exclude amounts that are included in the most directly comparable non-GAAP number, or they include amounts that would otherwise be excluded from non-GAAP numbers.

The most commonly used non-GAAP measures are some sort of an adjustment to net income, a recomputation or presentation of the core operating expenses and, therefore, allowing users to adjust or recalibrate the margins that are reported under GAAP, free cash flow numbers. And there are probably at least as many definitions of free cash flow as there are people who employ them. And very often even that changes over time.

And then, of course, there is the EBITDA or variously adjusted EBITDA which has led some people to call EBITDA or to say that the abbreviation stands for something a little bit different because it's not just limited to adjusting depreciation, amortization. It has started over the last several years, it has included adjustments for various other debits, restructuring expenses being probably the most comment. And so there are some rather significant changes.

In keeping with the regulations, companies do provide us with reconciliations. And the reconciliations are very often to comparable GAAP numbers such as gross profit or income or loss from operations.

Free cash flow I do acknowledge, realize is not a GAAP number, and nor is EBITDA.

Net income or loss, diluted earnings per share, so these are some of the reconciliations that we see.

Some of the rationales offered by management for providing this information: additional or alternative view of operating performance. They're used internally and for communications with the board of directors in respect to financial performance. And they often provide much more meaningful metrics than the GAAP measures do, which is one of the most -- is a fairly common rationale provided.

And then they also give you a management perspective which enables comparison to their peers and it facilitates analysis by investors. Investors, of course, also very often will forecast these adjusted GAAP numbers or non-GAAP numbers.

And there are certainly data aggregators that accumulate and report on those types of forecasts.

So what are some of the limitations of GAAP measures? And certainly one of the more important ones is the use of inconsistent measurement frameworks. So there are disagreements with respect to where fair value ought to be used or not used and so on. And there are other disagreements with the estimates that are used with the types of the way amortizations are required. They do not necessarily compare value-relevant information, consolidation, proportion consolidation and the equity method of accounting. For investments many companies will tell you distort their performance measures, liquidity metrics and the capital allocation decisions that are made internally.

The amount and the timing of non-cash charges and benefits are either incorrectly or inadequately depicting performance. And they affect the ability to understand liquidity measures that are used by management and analysts.

And then, finally, another reason is, that the management has offered, is that they're very often not sufficiently robust to capture differences between business models, tax structures and other types of dynamic shifts in business conditions. And clearly, as you can -- as you know, given the amount of time it often takes to develop accounting standards, this does create issues. The new revenue standards and the adjustments that are being made in the last -- have been made in the last few months to that, the new leasing standard, all of these are emblematic of the kinds of problems that we have with respect to GAAP.

The FASB and the IASB have both responded. The FASB recently issued an agenda consultation paper. And that has discussed financial statement presentation, including the income statement and some changes to the statement of cash flows, comprehensive income, other comprehensive income, segment reporting. And all of these suggested improvements that have been -- that are considered in the agenda consultation paper, the addition, proposed addition of new metrics or disaggregations through subtotals, these are all suggestions or recommendations or considerations of the FASB in alleviating this issue with respect to non-GAAP measures.

The IASB has also discussed changes to and additions to subtotals in the income statement, and consideration of measures like earnings before interest and taxes.

As I pointed out earlier, please keep in mind that there is much more detail about each of these in the background material that I have provided.

So let's take a look at some of the characteristics of non-GAAP financial metrics. Clearly they are a critical means of communication for management. They're also very useful signals of management behavior, as I pointed out earlier.

Industry organizations and leadership often discusses and proposes ways of presenting these. And these are often used as non-GAAP measures.

Investors certainly use non-GAAP measures extensively as inputs or adjustments to valuation models. And you will also find a number of academic and investment house or brokerage house analyses of whether non-GAAP measures are useful in predicting value and predicting underpriced or overpriced securities. So there is a lot of that information out there.

Some of the limitations:

There are no common or uniform definitions;

Inconsistent application by companies over time within, for example, the same company, between comparable companies in an industry, and across industries or jurisdictions. So certainly the ones that are favored in this country may not be the ones favored elsewhere;

Limited or no clear comparability results;

And very often the metrics exclude some, at least from some analysts' perspective, probably the most critical and recurring investment expenditures such as amortization of the intangibles by companies that engage in multiple acquisitions over very short periods of time, or certainly recurring expenses such as share-based compensation expense by companies that often use equity and share-based compensation for large and very often significant portion of compensation to their employees.

So some of the inferences and conclusions that we could draw from this in essence, therefore, are that GAAP and non-GAAP financial measures together have the ability to provide a more comprehensive picture or perspective on how management runs the company, and how the board of directors governs the business.

It's also very important to keep in mind that it would be helpful if GAAP and non-GAAP measures consistently were consistently applied and accurately reported and, of course, also presented this way.

And then, finally, it's critical to keep in mind, therefore, that it would be helpful to have non-GAAP measures or audited non-GAAP measures.

And if we take a look at some of the audit requirements that are in place that may be used, if you think about 2710, then other information on other information documents containing audited financial statements, there the auditor is required to read the other information to try to identify any material inconsistencies, and then determine whether revisions are required. And then, if needed, provide an explanatory paragraph in the auditor's report, communicate that to management and the audit committee if there is a material misstatement. You do not see a lot of those examples out there.

In August 2013 PCAOB certainly had issued a proposed auditing standard which was the auditor's report and audit of financial statements, which added certain, some -- or which proposed certain additional requirements.

We can also look at another auditing standard which looks at the responsibilities regarding certain types of filings. Now there, though, that particular standard does not require any specific procedures. It does not address the auditors responsibilities with regards to those performance metrics. And those responsibilities of the auditor do not extend to corporate earnings releases, investor presentations, or other communications with analysts or the public. So there is, in essence, a shortfall, a gap with respect to the auditing of these types of measures.

So these are some of the questions that we've identified. And should standard setters prescribe definitions of common non-GAAP financial metrics? And should non-GAAP financial metrics be given equal prominence? Should they be audited? And if yes, should all non-GAAP measures that are used, regardless of how they're disclosed or presented by audited, so that you simply put an umbrella requirement around them?

I've also received a -- we did a, the CFA Institute conducted a survey. And that simply shows you that the number of investors who are interested in non-GAAP measures and being audited is rather significant. A very small number that, you know, under 10 percent that didn't. But if you look at the different types of analysts that were surveyed by the Institute, the demand for that is certainly clear.

So some of the recommendations that we've discussed. If you consider whether we ought to prescribe definitions.

ESMA in Europe has discussed this. Certain other regulatory agencies have talked about it elsewhere. The problem I think is, and we feel is that it's difficult to define non-GAAP measures in such a way that they would fit all existing business models, tax structures. And those definitions would certainly need to be dynamic and robust enough to meet the needs over time. And that clearly is not, not an easy exercise.

Limiting the number and use of non-GAAP measures. Those may result in a significant loss of information for investors. And they would also, I think unnecessarily constrain management's ability to explain how, what they are doing with the resources that they are charged with managing.

Non-GAAP measures, third possibility, should be independently validated through self-regulation. And really, to many of us at least, it was unclear how this could actually be managed.

The last two proposals that we've considered I think are fairly useful. One would be to require disclosure in presentation of non-GAAP measures in financial statements, in footnotes for example. And that would ensure that they're consistently calculated and audited.

There are, however, problems. And because if you look at the way the FASB's consultation paper recommends or makes suggestions, look at what the IASB is doing, it's not clear to me that we can get there.

The other possibility is -- by the way, please don't get me wrong, I'm just saying that the proposals as they are don't seem to be. It's a consultation paper, which is an invitation to comment. Clearly comments will be received. There are public roundtables that will be held. And there will be a significant change in those proposals over time. Because I've seen, and everybody here knows, that the FASB does pay attention, they do listen, they do use the comment letters that are provided. So I do expect there will be changes. The question is whether we can get on a timely basis to a point where these would be audited.

And then the next thing is whether they could be mandatorily included, be required to be included, supplementary information and thereby become subject to 17.

So those are the various issues that we raised.

Now what I'd like to do is before we get into the integrated reports, Anne, will you --

MR. HARRIS: Tony, actually let me, let me interrupt you for a second.

MR. SONDHI: Please.

MR. HARRIS: Because I know that Chair White only has five to ten minutes left.

MR. SONDHI: Okay.

MR. HARRIS: So before we get into integrated reporting, Chair White, if you have any questions and comments. And then Wes and Brian will be here throughout the entire day. But I'd like to turn it over to you.

MS. WHITE: Thank you very much, Steven. I know Wes and Brian will have, you know, comments and questions on this.

And I think, first, very, very useful report. I guess I have sort of one foundational question. And that is you're obviously aware of the, through various avenues, of some of the SEC concerns. And I've got a, you know, a slide on it.

Do you think that any of those are overstated in terms of concerns or do they kind of miss the mark of, you know, of things? I mean in what ways do they -- you know, do you have a different view of them or a concern about the concerns we have, if I can phrase it that way? If any, I'll add, so you can --

MR. HARRIS: And then also, Tony, you answered the question. But if there are others here who would like to, you know, respond, please do.

Yes?

MR. SONDHI: Thank you. I, and I am going to respond to you just on my own. I'll let my team speak for themselves.

I don't have a concern with the direction that you've taken. I applaud it. I find the enforcement emphasis very, very helpful as an investor.

I do also believe very strongly -- and this is a personal belief -- that non-GAAP measures, if I look at all the research that I have over the last year-and-a-half that I've been thinking about this, I look at what the brokerage houses have told me, what academic research tells me. Fundamentally I think that non-GAAP measures have been used for even in attempt to obtain higher valuations. They're far more closely related to management compensation than they are to stock prices, to valuation.

These are just the studies that others have done. And there they have their own errors and shortcomings and so on. But that is how, as an investor, I have often looked at them. So I certainly welcome the approaches that you're taking.

I would like to see more enforcement where there are significant -- and particularly with respect to revenue. You might, you may know I do a lot of work on revenue recognition, and I find that extremely helpful. Because the movement to pull forward revenue in these adjustments has been troublesome.

But, as I said, those are personal views.

MR. HARRIS: Lynn Turner?

MR. TURNER: Chairman White, two weeks ago I met with one of the largest active asset managers in the United States; it was their portfolio managers and financial analysts. They have over a trillion in assets under management, probably the firm best known in the United States for fundamental analysis and research.

The meeting wasn't to talk about non-GAAP measures. In fact, it wasn't even on the agenda. But during the course of the meeting the analysts, portfolio managers asked the question What did I think the SEC -- or when did I think the SEC was going to do something about the problems with non-GAAP disclosures? Indicating that they thought that they were misleading.

And so I'd have to say based on that and what I've seen even where I sit on the Board, your concerns are real, and other people share those concerns. What you did earlier this year obviously is a step in the right direction. But the concerns still are real and exist amongst people who are actually doing analysis with these numbers.

MR. HARRIS: If you could just hang in there for --

MS. WHITE: Sure.

MR. HARRIS: We've got three other cards up.

MS. WHITE: Okay.

MR. HARRIS: And then we'll leave it at that. But why don't we go the right way around, Pete and then Curt and then Joe.

MR. NACHTWEY: Thanks, Steve. Thanks, Chair White, for being here and then, Tony, for your leadership of our group.

Pete Nachtwey, Legg Mason. We've got about 725 billion of assets under management in a number of different asset classes.

But I guess the way I look at this, and I know a number of others, actual investors in our firm who are investing the money, any additional information -- and I think this was said by a number of others -- so long as it's credible, thoughtful and useful is always going to be benefitting investors.

I think the two big concerns that I have and I think others in our organization share about it, one, the association of the auditor lending credence to a non-GAAP measure. So I think we have to be really thoughtful about forcing the auditors to do this, if we don't arm them with the right tools and guidance on what are they actually going to do rather than put their name next to it.

And then I share the concern about the fact there's a lack of recognized standard setting bodies for these. I think this is going to be an area where we have to be comfortable with principles-based versus rules-based. We can set some rules but it's going to come down to principles.

But there are some practical things I think auditors can do and would not normally be visible to users of financial statements. So are these measures shown, are they actually shown to the boards? You know, do they actually use them? Do the audit committees actually review and approve them and how they're being described?

Is there documentation that third parties actually use those measures? So there's many things that we report as a public company, so we manage money but we're also a public company. And there's a number of things, contractual documents, et cetera, that have measures in them that, quite frankly, would be useful externally. Some we're able to report, others we're not. But there certainly is documentation that valid third parties use those measures for their own purposes.

And then really comparison across peer groups. So, you know, virtually even public company has a peer group that's codified in the proxy around compensation, et cetera. So is this something that the peers are using? And if it's not, why is it relevant to investors? Why are you using it and we're not?

So thank you.

MS. WHITE: If I can just a real quick comment. One area of emphasis that, you know, I've made, and I think back in December at the IACPA conference, is further engagement by the boards and the audit committee particularly. It's just part of that, so.

MR. HARRIS: Curt. And then, once again, thank you for raising this issue in the first place.

MR. BUSER: Thanks, Steve. I think this is a critical issue and I think the concerns are well founded.

My challenge with this is I'm not really sure it's a standard-setting challenge. I think it is an assurance opportunity. And I think if you, if you do the things that Pete was alluding to I think that there's a whole lot that will force boards, companies and investors to ask the right questions. And I think that that will naturally lead to better reporting.

So what do I mean? Clarification. So I think people would say generally stuff's picked and tied, but is it really linked to the books and records?

The comments that Pete was making in terms of is this really how management is running the business? Is this the way they set budgets? Is this the way that they forecast? I think those -- You know, is this talked about at the board?

How does management think about materiality and these non-GAAP meas -- you know, measures come into the way they think about materiality? How is it tied into the risk setting process? If it's not, I mean so what are we thinking?

I think that if an auditor can do it or in some sort of assurance report, and I think that the new audit report can open up a whole lot of areas for this to occur.

Consistency. So Tony's comments were dead on. So management sets definitions and then they change them? Well, you know, I mean that seems very simple to kind of call that out that, hey, it's changed.

I think comparability to industry. You know, maybe there is no industry standard. Say that. You know, the similar companies either within the industry or what the auditor or management believes are comparable companies, here how it is similar or here how those definitions are different.

And I think that's very useful to an investor. Saves the investor a whole lot of time in terms of being able to figure that out. And it probably also forces industry groups to reach better alignment. The industry groups aren't going to come to clear, consistent definitions without some sort of prodding to get there.

And by doing this and calling out the differences, investors will be able to help push that along.

You know, so anyway, I just think assurance is, you know, now with the new audit report guidance and model, reporting model, I think that there's opportunities to kind of drive this. And I think by doing it that way I think we'll get the types of answers that we really want that are from a concerns standpoint.

Thank you.

MR. HARRIS: And then, Michael, I saw that you were, you know, nodding. Is there anything you want to add? And then we'll go to Joe and wrap it up with this.

MR. SMART: I believe that Curt -- Michael Smart

-- and I believe that Curt pretty much, you know, summed it up. It's non-GAAP items are something that investors are using. But if we're going to put the onus on the auditors to, to audit it, you know, we have to give them the right, I think the right tools to, to do so, and the right support to do so.

I also believe that the audit committees, the onus is on them to ask the right questions about what does this information mean if management is presenting it to them.

MR. HARRIS: And then Joe Carcello.

MR. CARCELLO: So Pete and Curt, I think, came up with some good suggestions to address the concern I had. As we were sitting here listening, Tony, to the presentation, Google is such a wonderful tool, I pulled up AS Number 17 and read it as you were talking.

And essentially what AS Number 17 does, at least my read of it very quickly, is it makes sure that the information is accurate and reconciles with the financial statements and so forth. But the value of auditing, in my mind, one of the main values is that there's an underlying framework that you audit against. Right? And that underlying framework is US GAAP as codified by the FASB. And we don't have that for non-GAAP financial measures.

And it's not clear based on the presentation today that it would be easy to develop that because it's so industry specific. So then the question is how much do we get from an audit without that framework?

And I think the comments that Pete and Curt mentioned about making sure that this information, if it's out in the public domain, have been, has been presented and used by the board and the audit committee; that it's consistently computed over time; that it's used by others in the industry; that it's used by outside parties.

It's not clear to me that that's a PCAOB standard-setting initiative. It's, Chair White, probably more in your neck of the woods. But I think without that, it's not clear to me that you really get the benefit from the audit that you think you're going to get.

So I'm in favor of having it audited. But I think Pete's suggestions and Curt's suggestions are actually quite good.

MR. HARRIS: Chair White, thank you very much.

MS. WHITE: Thank you all very much.

MR. HARRIS: And the senior staff of the SEC remains here. And then we'll go on, Tony, with the presentation from Linda and Anne.

MS. WHITE: Thank you very much.

MR. HARRIS: Thank you.

MS. WHITE: Proceed, please. Don't -- you know.

MR. HARRIS: Thank you.

So, Tony, let's, you know, go ahead with respect to the program on integrated reports. Thank you.

I don't know whether you want to turn it over to Linda or Anne, how we want to proceed.

MR. SONDHI: Yes, I'd turn it over to Anne to talk about sustainability for a bit. And then, Linda, you'll have to relinquish the clicker again to Linda, so.

But, Anne, please.

MS. SIMPSON: Yes, thanks. Thanks very much. Anne Simpson.

I don't think there's anything to add to what was said at the beginning. We laughed at the famous sort of "dot, dot, dot, Dear Reader, wait for the next chapter," which is exactly where Linda steps in. Because the question I think is --

No, I'm not, I'm not the clicker chief. Far too important a job for me to have. It goes to Linda.

The next step in any thinking about this proliferation of new and useful and important information is the role of the auditor. And that's something that Linda's slides address more specifically. So with that, thank you.

MS. DE BEER: Thank you, Anne.

And I thought a couple of the comments that were made are actually really useful. And maybe I'll work it in a little bit because I thought Curt and Pete in our discussion I think it touches on some of these things.

So I've mentioned earlier on that integrated reporting is actually not really within your more narrow definition of, or non-GAAP measures. But you can clearly see the push from investors to go beyond what there is at the moment. And some of the comments that you made were, were really useful.

So maybe just at the very high level integrated reporting -- and I know it's something that's probably not so well grounded here yet, but there is certainly quite a lot of global corporates that are preparing integrated reporting. And where I come from it has become quite common.

And the intention of the integrated reporting framework, which is really just a framework -- Joe, you spoke about criteria and what auditors audit against -- it's not quite that yet, but it gives some indication and gives some level of flexibility that companies can report what they feel they need to. You spoke, Curt, about the need for understanding the business model, the need to understanding strategy, how does that get into risk, how does it -- Is that in line with the way in which companies prepare their budget? Or are non-GAAP measures just a bunch of things that might be relevant and that might make earnings look better this year.

So if, if companies start moving into the direction of doing integrated reports it becomes a lot more consistent from one year to the next, from one industry or one company within an industry to the next, but not necessarily across the globe, across the universe of companies. So it becomes quite industry specific.

And that is really -- I'm not going to go through all of those -- but that's really just a high level key feature slides of the integrated report.

The intention -- I have a few things to flag -- is to, for the reader, the investor to see the strategy of the company through the eyes of management, through the eyes of the board. How do you really do it? How do you plan? How do you strategize? How do you measure performance?

Specifically in the context environment, what's happening out there that will influence your execution of strategy. And very important with the long-term perspective of how do you use and affect the capitals, the six capitals, not just financial capital but also the environment, human capital, intellectual capital, relationship, social, all of those parts of aspect as well.

So that is, that is really what the objective of integrated reports are. If you -- the insight, okay, is this integrated report really different from one entity to the next? What, how do you ensure that there is reliability or integrity of that integrated report? And that is something that stakeholders and investors specifically have an interest in. So, what, if the information is not useful and reliable there is not much that you can, you can do with it.

And certainly the whole AS 17 aspect that you also mentioned earlier, Tony, is relevant. And on an international front there's ISA 720 which is sort of a similar standard where auditors needs to have a look at the information, make sure that it's not -- not auditing it but that there's no inconsistencies between that and the financial information. So there is some value in that.

And the point that you make, Pete, I think is really valid. You know, can auditors really audit all of that? And I've got a slide on that that I'll talk about a little bit more.

Ultimately it is the responsibility of the board. And it's the role of the audit committee that was mentioned before is really important because that's where the buck stops when it comes to the integrity. So there are aspects of that that the auditor might not be able to audit.

The assurance needs of the investors, we have seen now that people want information much more quickly. They, they want the information and insights into the entity as it, as it happens. But your investors want comfort that there is some soundness to the information.

So maybe -- and Pete also made that point -- maybe the convention assurance models would not necessarily work when it comes to integrated reporting. Maybe it's not just a single assurance provider in the form of the auditor, because there are important other assurance providers in the process.

I'm on the board of a mining company. We put a lot of or get a lot of comfort from the work that our in-house geologists will do on the resources and reserves within the company. That's not necessarily a skill that they need to duplicate from an audit perspective. You get the same in financial services with the staff that we actually use. And you have risk functions and compliance functions.

So it moves you into a whole new era of assurance really to a large degree. And then it talks about the level of independence of these assurance providers, the use of experts. And all of those standards become quite, quite common.

In South Africa in our corporate governance code we refer to combined assurance, which is probably not the best of words or best of terms. But that is really that model of assurance with the different assurance providers, internal and external. Because auditors cannot give a single opinion. And you'll see when we look at the challenges, assurance challenges now, it's very unlikely that you will find an audit firm that would be able to give a single opinion on the integrity of the integrated report because of all the challenges there is, but also because of the cost.

So it does move you into, into a whole new ball game when it comes to assurance.

The materiality aspect, I think that you also referred to materiality and how do you determine materiality. That's really important firstly for the company to decide what goes into the integrated report. And can you see how difficult it then becomes for the assurance provider to consider whether there is any material information missing.

Ultimately, as I said, it's the board's responsibility. So you, the board really needs to gather comfort from these different assurance providers so that they, in terms of the integrated reporting framework, can make an explicit statement that the information, that they stand by it, that the information has got the integrity that it needs for people to, to make uses, often communities not just businesses, use to make the decisions that they will on the basis of that information.

And maybe then just wrap up on a, on a couple of challenges. And Tony made the comment earlier on that if you take the GAAP measures and the non-GAAP measures and you put that together, and Anne referred to the sustainability and all these other bits and pieces of information, that is really the picture that you then present, which is much more realistic, much more comprehensive to understand the company. Because those are the things that have a measured impact on where, where a company is going in future. It's not always just the numbers. And there are so many examples of things that go wrong.

So it is very necessary, if you want to consider the reliability of the information, to just understand some of the challenges. And here are a few:

Obviously there is a lot of, there is a lot of predictive information. There is a lot of future information. There is a lot of abstract interpretative information.

How do you audit the company's strategy, the company's disclosure of its strategy?

How do you audit whether the risks that have been disclosed are complete? Whether the material external environmental issues are complete?

I becomes quite complex. And it's actually to a degree impossible to have it externally assured. That's why you need to understand sometimes not so much the information, is the data reliable? But some of it might be the review and consideration of the processes, the underlying processes to get to the information, sort of the internal control type of audit.

So some of it are certainly, would certainly be factual disclosures that you would see in the integrated report, but there are also elements that are not that factual. And, Joe, you referred to the suitable criteria: against what framework can you audit? It's not always so possible to audit against the framework. And it does create the questions around do audit firms have the appropriate skills? What would be the cost implication and adequacy of records, the systems? And very importantly, auditor liability. So what if there's something that they've missed?

I think those are the big challenges and those are the big aspects. And to solve the problem of non-GAAP measures only is sort of a point-in-time issue because reporting is going way beyond that. And I just think as you debate the assurance issues, you probably need to also think where reporting is going into the future and see how some of these aspects should be, should be rolled into, hopefully, some of the solutions.

Thank you.

MR. HARRIS: Well thank you very much, Linda and Tony.

And that brings us to a break time. I know that we have an open discussion period for an hour on this issue. And I also know that there are a lot of questions that have been presented to Tony and a lot of conflicting views on the subject matter. So why don't we take a 15-minute break, come back at 11:00 o'clock. And then we'll have an open discussion.

Thank you.

(Whereupon, the above-entitled matter went off the record at 10:46 a.m., and resumed at 11:05 a.m.)

MR. HARRIS: All right. Tony and Linda, once again thank you for a, you know, a highly enlightening introduction to an extremely topical subject matter. Clearly it's provoked quite a bit of interest because we already have, without having started, a number of tent cards up.

So let me first of all recognize our chief auditor Marty Baumann to kick it off. And then why I leave it to you to recognize the tent cards are you see fit, and go around the table. But I know that Parveen has one, Mike has one, and others will as well.

So, Marty, why don't you kick it off and we'll take it from there.

MR. BAUMANN: Thanks very much, Steve.

And the first thing I want to say is thank you to the working group for the thoughtful work you did and considerations and ideas that you shared with us and that we can take forward in terms of, terms of our thinking. So thanks for your hard work and for the great presentation today.

We have been and are continuing to think about this subject. You mentioned in your slides the proposal that we had in 2013 regarding the other information standard.

And just to remind the group about that, the other information standard does require the audit today to read and consider other information accompanying the annual report to consider whether any of that other information represents a material inconsistency with the audited financial statements. Or, upon reading it, whether the auditor thinks there's a material misstatement of fact in that other information.

In the proposal we upped the game on that in 2013 to a read and evaluate that other information. And we had a lot of comments from the profession and others and attorneys about what does "evaluate" mean? And to be more clear on that, evaluating a lot of information that wasn't necessarily audited raised questions. And we sort of tabled that for the time being as we've moved ahead with the rest of the companion documents in 2013, the critical audit matters. And, hopefully, we'll move that forward pretty soon.

But I want to assure you that we still are thinking of that. And with respect to the read and consider, we could certainly do something even before another standard setting initiative to put out some sort of an alert. Read and consider is a serious obligation in terms of looking at that information and considering whether it does represent a material inconsistency with the audited financial statements or a material misstatement of fact in some way. So there's actions we could take just on that.

But beyond that, we are actively thinking about this whole issue of non-GAAP in a much broader way going forward. And Jeanette mentioned that in her opening comments that we're looking at what are the hot emerging issues and thinking of what should move onto our research agenda, and things we should be tackling more aggressively. Certainly we're thinking of this whole area as one of those. And your comments are very helpful as to how we think about that.

I think this is a subject that's also, though, ripe for us to work together with the SEC and with FASB for a potential solution as to required disclosures by FASB, a consistent framework, someone mentioned before, about certain disclosures. Joe might have mentioned that, about a framework for certain types of disclosures. And our authority would be an important thing to talk to the SEC about. All very helpful.

But having said all that, and so we're going to do that. And we're going to think about this topic and what should auditor procedures possibly be in the future? Should there be required auditor procedures? And what type of auditor reporting? And that's an important subject.

But let me just make a couple of other observations and let me ask how the working group may have thought about this. You largely referred to footnotes to the financials or possibly a supplement to the financial statements which would be covered by AS 17.

We've often heard, though, beyond that -- and I know you're all familiar, or many of you are, with Mike Cook, the former chairman of one of the larger accounting firms and who was on our SAG for many years -- we talked about the annual reporting, in his terms, as being the caboose of financial reporting. And he said there's an engine that's driving the markets 12 months throughout the year of press releases and other information being disclosed by companies in their releases, in their 8-Ks, et cetera. And our audit is very important but it's of the, he described, the caboose, two months or three months after the end of the year, while there are all kinds of things that are moving the market throughout the year.

So I wondered how your committee might have thought about not just annual reporting, but what should the auditor responsibility be with respect to quarterly reporting and press releases of non-GAAP disclosures that are market moving in March and June and September and throughout the year, as opposed to just the association of these numbers back in February or March of the following year. One, one question, what it is the committee working group thought of that?

And the second thing is you talked mostly about non-GAAP measures, and in that you talked about, I think, the measures that are covered by the SEC release that have to be reconciled to GAAP, give equal prominence to GAAP disclosures and things of that nature. Did you also think about what we think of as other company performance measures that we have at least embodied into our project, which includes what are often capped KPIs, key performance indicators, things like that, sales per square foot, backlog, new prescriptions for financial institution portfolio market value sensitivity, sensitivity to interest rate or credit-rate risk, or something like that.

Those are real-time market moving disclosures when backlog is disclosed in March and someone says -- or sales per square foot really goes up for a retailer or same-store sales stores, or whatever it might be, both with respect to auditor association with those type of market moving information, consistency of the calculations of those type of key performance indicators. Of course, there's no consistency either for how same-store sales or backlog is disclosed or new subscriptions, or whatever it might be that could be market moving.

So I'm interested in your thoughts both about with respect to the non-GAAP measures not just annually or quarterly, whatever did you think about that? And did you think about not only non-GAAP in the sense of those that are reconciled, but the other type of company performance measures that can be very important market moving information when those type of statistics are disclosed.

MR. SONDHI: Thank you, Marty. Let me -- before we get started, I just wanted to comment on a couple of things. One is something I, sorry, left out earlier in my remarks. I have wanted to provide a definition of EBITDA just in case that would help understand the way this works at times. We've often thought about EBITDA as standing for Earnings Before Interest Taxes and Debits that we Abhor his year.

(Laughter.)

MR. SONDHI: So in that sense, consistency is a very critical issue from the perspective of users. The second piece or the point that I wanted to make is Marty

-- and response to one of you. I'll come back to the second one about key performance indicators. When I first started doing accounting research, there was a lot of work out there that people had published that demonstrated that annual numbers actually don't move prices very much.

And for some period of time, it seemed to a lot of people puzzling. And then at that point, I was at New York University and my Chairman of the Accounting Department there, George Sorter, who is one of the brightest people I have ever met. He wrote a paper where he said, the reason why it doesn't is not because annual reports don't have information content. The point is exactly what you were saying. There is this enormous amount of information that is provided throughout the year.

As you said, there are quarterly financials that are KPIs that are being provided in different points in time. And the marketplace does pay attention to all of those. It does take the into account. And then when it gets the annual report, it looks for validation of its models. And that's why -- because they've been revising them all the time.

So from that perspective, I would take it to the next step and answer your question. That yes, some sort of assurance on these numbers would be helpful. And you're absolutely right, the key performance indicators such as the backlog, such as the same source sales, et cetera. Those do not get consistently measured. And one of the most important things that we look for in the kind of analysis that I do and the people that I work with do -- we look for those inconsistencies. Because we know they exist, and they inform us about the company.

The other thing I wanted to say is that, you know, the assurance will get into it. And I want to get to the comments. But probably one of the most important things I want to keep in mind is, if we do talk about non-GAAP numbers being provided to audit committees, I'd like to make sure that they are getting reconciliations as well. Right? Because then the question is, how much and what kind of information are they getting?

But let's open it up and -

MR. HARRIS: Actually, since so many cards have gone up, let me recognize the people in the audience.

MR. SONDHI: I was just about to -- oh, okay. Yes, please. Go ahead. So much for your ceding control to me.

(Laughter.)

MR. HARRIS: That's right, yes. Parveen, why don't you start off?

MR. GUPTA: Thank you, Steve. I wanted to make two comments. One, to follow up on what Joe Carcello said. I think with regard to the non-GAAP financial measures, I do agree to the point that you have to have some sort of framework or standard against which the auditors would be auditing on the proprietary of these numbers or measures. But I think the point that I want to bring to the table is, we need to be aware of the concept of false assurance. Because if such a measure or standard doesn't exist involving the auditor and providing an opinion on it -- I think it can lead to worse consequences.

So we have to be very careful of how we craft this in the absence of a standard -- we realize that the non-GAAP financial measures are valued by investors. They are important in the market. And some sort of discipline around them would be important. But equally, we need to recognize that we don't have -- I mean, these definitions are shifting and we do not have the standards. And it's very important to recognize that part.

Second comment I want to make is with regard to non-GAAP, non-financial measures as I would say them, which is the integrated financial reporting. I think all of this information that we are talking about here is certainly valued by the markets. It's relevant. But I think the core question, at least in my view, we keep missing is perhaps cut to the core and ask what exactly is the purpose of the corporation in the society today.

Some people still subscribe to the shareholder model. Other people subscribe to the stakeholder model. And I think it becomes very critical, at least when in the U.S. regulatory setup, corporations are still primarily accountable to the shareholders. And you look at the Delaware law, the duty of care, duty of loyalty of the board of directors, et cetera. All of that should be taken into account as you talk about the integrated reporting. It is important, no doubt about it. But I think we need to keep those things also in mind.

MR. HARRIS: And then Mike Head, you were next.

MR. HEAD: Thank you. This is Mike Head. I didn't think that I would get emotionally charged about a topic, but this one has happened to do that. And I, like others, I bifurcate this between the non-GAAP financial measures and the integrated reporting like you did in your report. So I'm going to make two comments. And two comments that aren't necessarily two sentences because I don't know if I can make one comment in one sentence and another comment in the other.

But on the non-GAAP financial -- historically being on this committee, where I typically try to come from because it's what I was asked to do is come from an investor's perspective. And the non-GAAP financial information, in my humble opinion, investments day-to-day by investors are made more based on what they get out of those than they do the financial statements. And I would be surprised, especially in the retail broker area where they are not the CFAs and they are not the investment advisors, but they are making their self-directed investments on a day-to-day basis.

I would venture to guess the ones that are investing lots of money of their personal money have even read a lot of the footnotes. And I don't say that's right. And I'm not condoning that, but I think the non-GAAP financial information and the news releases, the earnings releases, the A-Ks, the 10-Qs -- all are more digestible from the retail investors' perspective, easier to get their head around. And they think it's sufficient for them to make an investment decision based on no matter what we believe. Okay?

And as a result, I think as professionals, we have an obligation to try to ensure or assure that that information is as consistent, reliable, and accurate, and usable as possible -- useful. Therefore, I just come straight to the bottom line and say it should be included in the footnotes, it should be subject to auditing. It doesn't matter how hard it is to come up with a definition or a standard or a framework to measure it against.

That's our obligation as professionals to the users of our financial information, which is our retail investors. And we get paid to do our job not because it's easy, but because it is hard. Okay? So, you know, that's kind of my thought on the non-GAAP financial information. We have an obligation to the users of the financial statements to give them the information they need, and they need assurance on the non-GAAP financial measures. Bottom line.

The integrated reporting -- my second thought or comment. This one's really hard for me, because it does -- and you did a very good job. Because I was struggling with why. And it's stakeholder versus shareholder now. If there's factual measures, I think we should be providing assurance. If it's qualitative and subjective, it's much, much harder. And I don't like to go and, you know, raise political issues. But there's a lot in the stakeholder arena that is qualitative and subjective that we could probably go outside this room down the street in a pub and debate at great length if we even agree on some of the things.

Especially when you get to the environmental. I don't want to get political, but global warming. I'm not sure if everybody in this room would even agree that it exists, let alone that you should include it in an integrated report and opine on it. So I love the information. Our users of our financial statements need it and want it. I think we need to figure out a way to allow our users to know what is factual-based and what is management's opinions. And try to provide assurance on factual-based and allow the users to make their own personal judgments on if they agree or disagree with the qualitative subjective.

And I don't think that the user of the financial statements quite can get to on their own, which are factual-based and which are subjective. Which ones are management's subjective opinion, and which ones are based on facts that can be verified, tied, recalculated, et cetera. So I will leave it with that, but boy, what a wonderful subject. And if we can have the foresight to make some real progress on this subject, I think the users of our financial information will be very, very well served.

MR. HARRIS: Well, let me skip in terms of the order. And Linda, if you want to respond quickly on that. And then we will get back into --

MS DE BEER: Thank you, Steve. It will be quick.

I absolutely agree with what you are saying about the factual information and what is subjective. Maybe just one clarification. If you read the International Integrative Voting Framework Objective, it does state that it should be done and the information that goes into that must be done. You consider your stakeholders, but the primary stakeholder is the investor.

So it's got a very key focus on the shareholder as the primary stakeholder. But bearing in mind that you might want to include further information -- but, I mean. Maybe just that clarification. But I absolutely agree that that's the difficulty. I don't believe everything can be assured by auditor. I think that's absolutely right.

MR. HARRIS: Robert?

MR. TAROLA: Thank you, Steve. Robert Tarola. I'd like to kind of follow up with what Marty Baumann was saying. First of all Marty, you're right on track, I believe. The information that is made available to investors, shareholders, stakeholders -- we can use whatever word we'd like, is constant. It's continuous. It's formal, at least every three months. But it's continuous even between those time periods. I believe we need to move the assurance function, or the assurance aspects of our capital markets to recognize that. That it is continuous.

That timeliness of assurance is important. Comprehensiveness of assurance is important. Candidly, as a director of a public company, it happened -- you're involved in that every quarter at a minimum. In trying to make sure that the company you oversee is being candid and forthright and accurate and providing useful information. Once a year -- that's not fair. Every quarter, we do involve the auditors in that assessment. But it's limited to the GAAP financial statements. It's up to us as directors to make sure the non-GAAP disclosures are important, useful, relevant, and accurate. And then beyond the numbers that relate to non-GAAP disclosures.

When you really talk about integrative disclosure, you're talking about other value aspects of an enterprise. That also should have some sort of assurance associated with it. So I guess my point to the Board is that I know your mandate might be relatively narrow. But the role of assurance in our capital markets I think needs to go beyond the mandate. And you have the -- I think you have the ability to push it in that direction. And the initiatives that Marty mentioned are going in that direction.

MR. HARRIS: Lynn Turner.

MR. TURNER: On the non-GAAP stuff that first popped up with the dotcom craze, there were a lot of concerns about accuracy at that point in time and thanks to Chairman Harris and Senator Sarbanes, they gave the SEC some authority to step in, which they didn't have before. They issued Reg G and today we're at the same place we were fifteen, twenty years ago in terms of the quality of the information. What has changed is there's much higher usage of non-GAAP numbers today, even than there were in the context of the dotcom craze.

What is interesting is that despite this proliferation -- people talk about analysts, retailer, wholesale, or whoever using this. What's declined in that point in time is the ability of analysts using the financial information they receive including this to create an alpha return, an excess return. In fact, it has declined since then to now despite all this good stuff that people want. Now 85 percent of them can't even beat the market.

So I seriously question whether or not this is, in fact -- and I think the research clearly shows this is not information that people are using to generate alpha type returns. Whether it's misleading or the wrong data. Further study needs to be looked at. I think you raised a very good question and are headed down the right path too, Marty. In that factoring the dotcom craze, the commission for what was then known as the Garten Committee headed up by Dean Jeff Garten from Yale.

And I think one of the things as I recall, it's been a long time, but people discussed in that committee was the use of KPIs. It was, in essence, teed up even before that by the Jenkins Committee. So We've had some carry-on type calls for disclosure of KPIs. Those are pretty much standardized within industry by this point and time. And they're typically available to the public out on the website. And they do impact pricing. So I think the market itself is set. There's great value in the KPI. So I think that is a great way to pursue it.

I was also surprised that not only did the recommendations not talk about KPIs, they failed to talk about the FASB going to the direct method of cash flows. Which CFA Institute has recommended for decades. So I think on top of the KPIs, you have to look at the direct method of cash flow. Because if you have that statement, and there's already a standard for it. All they have to do is eliminate the shortcut method. If you follow the direct method, you get the information that you need to do these types of reconciliations for the most part anyway with one additional item -- and that is in the seventies when the Commission had the Cohen Commission it was discussed about requiring it or not or the footnote for any material non-recurring unusual type item, and have that in an audited footnote.

I think you put those three things together, and all of a sudden you are getting valuable information in market that has indicated it would react to and improve the pricing. As far as an audit, I don't think this stuff should have assurance today. The reason I don't think it should is not that I don't believe that it would be good to have assurance, but the fact that 30 to 40 percent of our audits today don't comply with general accepted accounting standards. Studies show that six to seven percent of all financial statements issued today under GAAP with a benchmark that are being reviewed are restated.

And until we can get those defect rates down, I fear that what we'll get is misleading assurance which is the point that Parveen brought up, and which the courts have said, you know, it's worse than getting no assurance. So I think that's something to seriously consider. We saw that on the environmental disclosures on British Petroleum. We had an audit report from Big Four audit firm saying how everything was hunky-dory at BP just before the oil well sunk. You know?

I've seen another situation where it was very -- where the reconciliation was audited and there was an opinion on that audit. And the numbers in it were absolutely misleading. An outside party eventually looked at them and determined that they were misleading and incorrect and resulted in an incorrect valuation of the company. And that's where you did have an opinion.

So I come back to until we can fix the defect rate on just doing the basic stuff, I certainly wouldn't expand it. And most auditors, as Linda pointed out, most auditors don't have the knowledge or training to be able to issue a report in some of the environmental social type human disclosures that we're asking for today. As far as the actual standard itself, Marty. A-S 17 is better than what there is out at Auditing Standards Board. But I think there's two problems that it would have to be adjusted for, if you will.

First is, we've found that when under current type standards, you audit in relationship to the financial statements taken as a whole. And what Big Four auditors have testified in court to, under oath, is that that only requires them to see that the items in the reconciliation tie back to the accounting books and records. They, in fact, don't have to verify that. So I think there has to be in a standard in the context of you actually have to verify the accuracy, the consistency in the one case that I'm aware of for example.

Six companies in the industry doing this type of stuff, thereabouts. Five of them were all doing it one basis, the one that turned out to be problematic had totally different numbers in the reconciliation. Never challenged. All people did was tie it back. And that just doesn't get it for us.

And the second thing that I think has to be addressed is materiality. You will not get accuracy and verification as long as it's materiality in relationship to the financial statements taken as a whole. These numbers, all too often, are too small for that. And you have to change it to materiality in a relationship to that specific reconciliation or non-GAAP disclosure. That has to go in. If you do it in relationship to the financials as a whole, you can forget about this one being accurate.

I also think that as you're doing that, you also have to deal with the issue of compliance with laws and regulations. We are seeing that pop out as well. We've seen it, for example, in the Wells Fargo thing situation. And I think you've got to -- you know, if you can't even get the auditors to tell you when there's problems with laws and regulations they might become aware of and violations to those. Especially in light of Section(10)a of the securities law that requires them to audit that. You aren't going to get much good out of this.

So I think that needs to be thought of in the context of rolling it all up. I know there's a bunch of shots that are different pieces. But this is one of those pieces, I think, that complies with laws and regulations. Especially in light of what they've just done internationally on that would be important as well.

MR. BAUMANN: Just one quick comment. And I think you'd agree that the expectation of the AS-17 is different than what some people may have said they did. In terms of just tying it back to books and records.

MR. TURNER: Well, yes. I think so. But in reality, it's what do people do. And we see what people do, and I think you have to clarify those types of things if you're going to be able to enforce them at the end of the day. The end result is what is important. And that's what we've got to drive the standard -- the standard has to drive to that result or it's just not effective.

MR. HARRIS: Damon Silvers?

MR. SILVERS: Well, like Lynn, I think Marty, what you were saying sounds good. I just want to make a couple observations about this general topic. Because I think it's important to keep certain things distinct here. And then I also think it's important to note how this topic interweaves with some of what's going on at the Commission. And some of the comments so far today have kind of gotten into that space. It doesn't trouble me at all that companies want to highlight certain numbers that emerge out of the audited financial statements.

To the extent that that's what we mean when we say non-GAAP financial statement and non-GAAP financial disclosures, I think to varying degrees companies have been going that formally and informally forever. Obviously, the Commission's anti-fraud provisions apply to that activity. But there are -- there seems to be developing some practices that I think really are troubling. And some of them are in the PCAOB's jurisdiction, and some of them are in the Commission's jurisdiction. And some of them are in the bank regulator's jurisdiction.

The notion that the financial statements are presented in such a way as to suggest that somehow the audited financials are not the audited financials. And that somehow, investors should be paying attention to other numbers that have not been -- other numbers that have not been audited and that have not been put together in a way that FASB finds to be reflective of the company's true financial condition. That is really -- that is not appropriate, and that is the Commission's responsibility. Because it goes to the integrity of the Form 10-K and the like.

And to the extent that various financial intermediaries who are asserting that they, for example, calculate leverage ratios and make investment decisions based on things like EBITDA -- and then they're not actually using EBITDA. I mean, EBITDA actually does refer to a set of GAAP numbers. All right? And if that's not what's going on, that strikes me as bank fraud. And that is the sort of thing that the bank regulators ought to be looking at.

Now the question is, for this body, for the PCAOB, is where do the auditors fit into this landscape and what should the PCAOB be requiring of auditors in relation to this? And it seems like if what's going on here is that supplementary numbers are being introduced into the audited financials. That the auditors have a requirement to both look at whether or not those supplementary numbers are accurate and well-founded. And whether or not they are presenting a true -- whether are not taken in context, and I think this was Lynn's point. They present a -- together with the required numbers, they represent a fair and accurate picture of the company's financials. That strikes me as the sort of kind of question we ought to be laying in front of auditors.

The thing that troubles me the most is the sort of the notion that companies can invent their own financial statements and try to encourage the users of financial statements to take those more seriously than the ones that are actually subject to independent oversight and are constructed under standards that allow comparability. Now this conversation has gotten intertwined with the SEC's work on Reg S-K. And I think that it's the view of the investor community, which has been expressed by the Investor Advisory Committee to the

SEC that we prefer -- investors prefer more information rather than less. We would like to see Reg S-K strengthened, not weakened.

But then this interfaces with this question that came up in the integrated audit discussion of the use of -- the question of how to handle both disclosure and auditing of issues that are often characterized as social issues as opposed to business issues. And the position of the Investor Advisory Committee to the SEC, which is worth stating here, because it's a subtle position. It's the position that we ought not to be drawing these distinctions that -- workplace safety is often characterized as an ESG issue. It is at the core of the Deepwater Horizon explosion.

That was very expensive. And the -- I don't think anybody would suggest that the issues associated with the Deepwater Horizon explosion were somehow immaterial. Or couldn't be quantified. Just because they have larger social implications doesn't mean they are not serious business issues. What the Investor Advisor Committee to the SEC said in this regard was, let's have a level playing field. All right? Let's have in Reg S-K, the same level of mandated disclosures. Because of course, you have a general obligation to disclose materials, facts, and circumstances on companies in S-K.

Let's have -- but that's buttressed in areas like the debt structure and so forth, with specific requirements. Let's make sure that we have the same level of buttressing with specific requirements in these issues that do have -- that in the judgment of the Commission could have material impact. Like, for example, issues around environmental impact on business. Let's have the same level of that type of buttressing that we do in other areas. Let's not treat these issues as somehow not relevant to business performance when we know they are.

The advocates of ESG disclosure were essentially saying, we are not asking for special treatment. We are simply asking for equal treatment. And I'll just close by saying that, you know, I think it is increasingly turning out that some of these issues are highly quantifiable. All right? People raised climate change. You know, I don't think there's anybody looking at the world today who isn't recognizing that there are highly quantifiable impacts in terms of sea-level rise and what's associated with two degrees Centigrade global warming.

If your business is in something like property and casualty or you have something to do with ports or shipping -- all right? This stuff gets very quantifiable very fast. And we just, again, need to apply the same metrics to that as we might apply to other things that would affect assets, liabilities, revenues, et cetera. Thanks.

MR. HARRIS: Kevin Chavers.

MR. CHAVERS: A number of the things I was going to comment on had actually been addressed. But let me at least take the topic of the integrated reporting. Linda made the point in her response that actually looking at some of the factors there, particularly ESG factors, don't require you to solve the conundrum of a shareholder or stakeholder model. But indeed, are material and relevant to the shareholder model. In fact, we look at ESG issues as an evaluation of management. As a particular indicator of risk for a host of companies.

I respectfully submit you don't have to solve the political conundrum of whether you believe in climate change or don't believe in climate change. That the global regulatory environment is evolving such that it is a material fact for the regime that companies will have to be responsive to going forward. So while I respectfully understand that some of the proponents and some of the advocates in some of this space may indeed have a different agenda.

The fact of the matter is, as an indicator of risk, as an evaluative tool of management, and as a measure of particularly the long-term viability of enterprises -- these are criteria that certainly, we regularly look at and take into account in evaluating the value of a particular enterprise.

MR. HARRIS: Sarah Deans.

MS. DEANS: Thank you, I'm Sarah Deans. I've got three observations, if I may. The first is as many people have said, the market focuses very much on non-GAAP numbers. Auditors work on account numbers. And I think, it's surprising, I talk to a lot of investors and how many professional investors don't realize that non-GAAP numbers are not audited. And that's their fault. They should understand better, but that is a worry for me.

And I think it's a worry, given particularly in our commodity as well as the size of the gap between GAAP and non-GAAP. I think that's really a risk, there, of undermining trust in the whole profession, actually. Because we have this focus on numbers that are so far different than the GAAP numbers.

So the second point on GAAP and the gaps between the non-GAAP and GAAP numbers -- and there were some figures in the presentation, hopefully. I'll just reflect that I think when you look at that gap between the two, it looks big, and also I think there's two elements there. There's a sort of cyclical element, potentially, of one-off items that are getting out of that. But there's also a structural element that I think may grow over time. So some of the adjustments made are items that companies argue are one-off.

And we can all debate whether perhaps that restructuring charge isn't particularly one-off and seems to have occurred previously. But it's that type of adjustment. The other is what I'd call the "we don't like the accounting" adjustments. So adjusting for various items around share-based compensation and so forth. And I think every time a company does an acquisition, that's why there needs to be some more non-GAAP adjustments coming through.

So I just think that makes it even clearer and sort of what an important issue this is. And I know this doesn't help solve it. But I think it really does clearly call for a lot of sort and work. A joined up effort between regulators to address this important issue, which I also feel, by the way, very strongly about. So I'm glad I'm not the only one around this table.

So the third observation is a more practical one. Just working with numbers. And I was working recently looking at -- there were European companies, but some of them were SEC-registered. And I tried to look at the reconciliation between GAAP and non-GAAP. And in many cases a number that clearly relates to a GAAP item, say a pre-tax profit number for example. Reconciling items that you would very much expect for them to be able to find in a financial statement. But you can't. You can't take them, so the amortization is being added back.

It doesn't actually reconcile to the intangibles note without any clear explanation of why. That isn't a number that you'd find either for the total or for the category. Other reconciling items that bundle a number of elements. And when I, hopefully, sort of experience that list is trying to figure out how you could get to that number. It's not at all clear. So it's a very practical point. It would be nice.

I don't know if auditors can do this -- to try to at least encourage that those reconciliations, where they relate to items in the financial statements, can be found by these users. It certainly makes me more confident when I feel it is something that's clearly there in the financial statements. And also as another practical point, I have to say some of the explanations given by companies of why these adjustments are thought appropriate are either lacking or very poor quality, frankly, in my view. So that's three observations, thank you.

MR. HARRIS: Joe Carcello?

MR. CARCELLO: Well, let me start by saying I think the third point that Sarah just made might be the most cogent comment I've heard all morning. So I would hope Wes and Brian would really attend to that. I thought that was a really strong and right-on comment. Three points I'd like to make, and I'll try to be brief.

Linda -- in terms of integrated reporting, and you may not know the answer to this. But I think it would be helpful. Damon talked about the SEC Investor Advisory Committee and I have the pleasure of being on that with him as well. And in July, we had a presentation. And one of the panelists was a senior counsel from GE who talked about their integrated report, which I think they are quite proud of. And so, I would be curious to know, and I'm not saying you should know this. But I would be curious to know if GE has built into that report the ability to track which pages are being opened, because that technology exists.

And so, to me it would be much more compelling if I saw people actually reading some of the things that you talked about. Intellectually, I think it makes sense. But I would feel better knowing that users are actually spending time on that. I wish I had thought of that, Damon -- in July. I would have asked it. But I think that would be useful.

In terms of the comment that Lynn made about how 30 to 40 percent of audits are GAS-deficient. With all due respect to Lynn, I think that's a little harsh. It's 30 percent of audits are GAS-deficient given your selection criteria. And the Chairman and others have heard me say this before. I do think it is problematic that at least some of the audits that are inspected are not random. I know you're moving toward that now. But we really need a baseline.

I think it's important for society that we have a baseline. Because otherwise, and in fairness to the profession and when they should be criticized, I would be right there with Lynn to criticize them. But I don't think the failure rate is 40 percent. And when that number is out there, I think it's hard to refute without other data.

And then the last thing I would say -- and again, I'll leave it to the individuals as to whether they choose to respond to this or not. But on this group, we have Kevin who is at BlackRock. Right? 5.1 trillion dollars of assets under management. Pete who's at Legg Mason. What did you say, Pete? 785 million dollars of assets on their management?

MR. NACHTWEY: Just a rounding error compared to BlackRock, but yes.

(Laughter.)

MR. CARCELLO: Anne at CalPERS. Anne, I'm sorry. I don't know the number, your number, of assets. And then Curt at Carlyle. Granted, they are a little bit different in terms of private equity space. But a very, very major player in that space. And all four folks -- all four of these folks, Tony, were on your Committee that came out with the recommendation that this non-GAAP information should be audited.

So the question I would ask, and you can either respond or not respond, is why don't you tell your portfolio companies that you want the information audited? My guess is that if BlackRock and Legg Mason and CalPERS and Fidelity and Vanguard called up these companies, it would be audited. So if it's such a good idea, right? People like this private ordering idea. Why don't we see any private ordering in this space?

MR. HARRIS: Well let me actually -- I know Curt is going to put his tent card up, but let me recognize a Board Member. You know, Jay, now. And then you'll go into the queue. And I think it's much more fair to let Curt answer your question than Tony. Although Tony is going to do the wrap-up at the end.

MR. HANSON: Well, interesting discussion. And I've done some wondering about this a lot over the years. And I've been in a number of discussions about these general topics over time. I want to follow up on something that Marty was questioning relative to the interim information. But a little bit different focus on that.

So, let's pretend like someone could standardize the non-GAAP measures. I know it wouldn't be us, but let's say somebody could come up with the generally accepted, Not Generally Accepted Accounting Principles. And let's assume that somebody could mandate that these be audited, either voluntarily or mandated. So that the timing question I get to is that most of this information comes out in earnings calls, press releases, things like that. Which for some companies is identically the same day as the filing is made. But most companies it is not.

And in other discussions I've had about this -- and I'm kind of looking at Pete and Curt as both providers of information and consumers of information. If the choice was, delay the press release until the audit was done, is that acceptable to the provider or the consumer of the information? Or if the choice was accelerate the audit to be the same date, so essentially the same difference, would that be workable? Or is it really that it's maybe numbers reported as really, really unaudited early on and then later, a ratification of them in some sort of audited statement? Or is there some other way that operationally this would actually happen?

So I just wonder about that. And in past discussions I've had when the questions were put directly to investors about, well, how long of a delay would be acceptable? Then it's measured in seconds.

Not days or weeks or months. And so, I'm kind of thinking about how this would actually work if we could get over those first two hurdles.

MR. HARRIS: Let me, once again, we'll get to the order that I wrote down. But since Joe and Jay challenged Pete and Curt, maybe the two of you could respond and then we'll go back through the queue.

MR. CARCELLO: In a nice way, Steve. In a nice way.

(Laughter.)

MR. HARRIS: In a totally diplomatic and nice way.

MR. BUSER: Joe, on the comment in terms of why we don't mandate it at portfolio companies -- so, first. I would, you know, let's put it in the backdrop. It's private equity. And so private equity, generally when it's private we have a controlling position. And so we're on the Board. And so we know those numbers. The other thing I would say is that in terms of the ask for assurance, it's a real challenge for the audit firms today because what's the framework that they are to use?

And so now we are asking them to create -- if we are talking about for public reporting, we are asking them to create a framework for reporting that they don't have, and that puts them in a very awkward place. From an internal perspective, an audit committee or a board ought to be asking, how comfortable are we with these numbers before they go out? And then their degree of assurance can come from management, their familiarity with the reporting systems, or also from the auditors. And that's an audit committee board -- you know, committee decision piece by piece.

So I think that that's kind of the way we thought about it. I do think as the criticality of the non-GAAP financial measures is really important. From a -- in terms of the timing or standards, Marty, those were some of your original questions. You know, the framework that people are at -- I think the practical answer is the same thing from whatever is being done today from an assurance on the GAAP numbers, i.e., probably a review standard, is probably the same standard we ought to be at least initially stepping into.

Jay, to your question with respect to kind of timing of getting those numbers out. I think it's the same issue, which is -- as a CFO, I really hate the idea of issuing anything that I pretty much don't have, you know, A) my comfort on, and B) the auditors are in the same place. Because the chance of having a change in those numbers from when I send out an earnings release to when the audit is fully complete, I don't like that risk. And so I think, you know -- and I think that's generally true of most CFOs and most audit committee members that that risk had better be small.

And so, you know. That's where I think the acceleration -- I mean, in a perfect world you would get everything accelerated, but there is a lot more that has to go into it. I think there is a distinction, Marty -- your comment on KPIs. I think it's -- you know, we're struggling in this conversation around non-GAAP financial measures and kind of what's the assurance on it, and kind of what's the standard? And how do we get there? And I think that I can get my head around ways to do it, but obviously to actually get them implemented is hard.

Getting the KPIs I think is probably a second step. But I do think it's something we ought to be thinking about, because you were talking about comfort level process. Now, how do you get that into a tool that could be reported on? That's the challenge that's embedded in there in terms of a path forward. Because to change that, I think, is going to be tough. So anyway, those are some thoughts. Hopefully it's helpful.

MR. HARRIS: Anne? No, I'm sorry. Pete.

MR. NACHTWAY: No, that's a great summary, Curt. I just wanted to add a couple of things. One to Joe, your point. So I used to be at Carlyle working with Curt, and I remember the private equity world very, very well. But I operate in a different world now where, though, where we own a tremendous swath of publically traded securities of companies both here in the U.S. and around the world.

But any individual company, typically our concentration limits are saying we're going to own, you know, a couple of percent. And very often less than that. So it's very difficult for a company to respond to one shareholder, kind of that level. I think we have to -- that's what this whole group largely is about is, how do we speak una voce so there's one voice and then there's an opportunity for the profession and registrants -- but I appreciate the nature of the question.

And then in terms of acceleration -- I echo what Curt said. By the time we do our earnings release, and a number of different folks around the table at BlackRock, I think did yours, almost two weeks ago. You know, Carlyle did theirs yesterday and I'm doing ours tomorrow. But our 10-Q won't get filed now for a week or so. But you can absolutely be certain that the folks that are going to have to sign off on all those filings are confident of the numbers that are being reported in the earnings release.

But by the same token the 10-Q, which I'm carrying around in my briefcase and is wearing my shoulder down, takes quite a bit of time to get all the disclosures and everything else right. So I think -- but again. Can you count on every company and every set of management teams and the auditors that are involved with their financials doing their homework? You're always going to find a few bad apples that are out there that are not doing that. I think the majority are.

MR. CHAVERS: Steve, if I might just very quickly just to echo on Curt and Pete's comment. Joe, I think the answer to your question, you answered it yourself. And that was when you articulated in your earlier comments the need for a framework. And I would also respectfully submit that Damon's comments earlier also was the other part of the question. Is that, while we sit here in this Advisory Group -- this is really a more comprehensive question of a holistic issue that both requires the PCAOB's response as well as the SEC. And so for a large investor, no matter how large, to say -- you know, we're going to take it upon ourselves to effectuate self-help and our governance responsibilities to reform the industry's practice is, you know, it would be a bit naive of us to think that that would happen.

MR. HARRIS: Anne Simpson?

MS. SIMPSON: Yes, and thank you, Kevin. Very well said. And Damon's point is well taken. The need for joined-up thinking. Just because we're in one room with one title, we need to be able to understand the whole process. So it seems to me there's some comment about why do this, and that then gets tangled up with how would you do it. So the commentary about it being difficult and needing to build new skills and data and all that jazz -- I think it should be separated. Because that would be on your to-do list if you decided this was worthwhile.

And the second thought is the comment about Alfa -- Lynn, that you're making. And is there any discernible benefit? You're speaking to a minority community in the wider ownership structure of the U.S. capital markets. You know, our interest in this information is not because we want to trade madly. We're too big -- 303 billion -- Joe? We're not big enough, though, where -- you know. We went into the financial crisis underfunded. And we are now hovering close to 70 percent funded. So the question of long-term sustainable returns is absolutely fundamental for CalPERS getting its own job done.

So this information is very important to us. But the way that we use it, because we are long term, we are permanent liabilities stretching for the best part of a century. It's in our engagement with companies. And then the voting that follows good stewardship of those assets. And if you look at the shareowner proposals that are filed in the U.S., they are overwhelmingly focused on asking for improved disclosure.

I mean, most recently we saw huge levels of support for improved climate risk reporting because of the regulatory framework firming up around the Paris Accord. You know, so this is where events have overtaken the current reporting framework. So I think this is not just a trading game. It's not just a quarterly reports and analysts game. The owners, the ownership section of the market is looking for this information for these long-term purposes of holding boards accountable.

And I think that's recognized in the way materiality is thought about and understood through the Supreme Court commentary on this point. But that really is the most important piece of the discussion. You know, traders, raiders and owners. We're not a group of homogenous shareholders anymore.

MR. SMART: Just to add to Anne's point. The owners are actually using the information. I think the question is, we just like it to be verified and confirmed by the auditors. And I think that's what we're all looking for. It's not as if the question hasn't been asked. You know, I asked Curt and I asked Anne. And I'm in private equity also. We ask our auditors to look at that information. And they dance around the issue, frankly. And they don't have a framework to do so. And they won't do it until it's mandated for them to do it.

MR. HARRIS: Gary?

MR. WALSH: It's Gary Walsh. I'm with Luther King Capital Management, and we manage 14 billion dollars in Fort Worth, Texas. I guess it's a good thing I'm a Texan because this discussion has really made me feel smaller than I've ever felt with 14 billion dollars.

(Laughter.)

MR. WALSH: So the confidence that I have from being a Texan is helpful here. Our firm is, we have about 17 dedicated fundamental analysts. And we visit with hundreds of companies every year. And what I think is interesting is non-GAAP dominates the discussion because that's what Wall Street analysts really use to set their earnings estimates. I sit in in a lot of those meetings, and I talk with our analysts. And in preparation for coming over and spending the day with this group, I've been asking, how many other investors are worried about the difference between GAAP and non-GAAP? And the companies traditionally say, very few people bring it up.

And so I think there's work that needs to be done on the private equity side. But it's not getting done on the public side, either. I don't worry about that as much as I could, because I think the market does a really good job of discounting the quality of accounting. And they traditionally pay lower multiples for companies that are more aggressive in their accounting. And our analysts do try to decipher who is being aggressive and who isn't. You know, there are even vendors that have come out with quality of earnings scoring and purity of accounting assessments. And so there is a cottage industry trying to shortcut this whole process by deriving the quality of earnings.

The other thing that's clear -- I wish I had quantitative numbers for all of this. But it is clear that more complexity drives lower multiples. And so, I think that drives a lot of people trying to spinoff companies. And so the more complexity we see, the lower multiples that those companies are getting. And I think the gap between GAAP and non-GAAP is also playing a role there.

It's still uncomfortable as an investor to know that there is this widening gulf. And at some point, there is going to be a day of reckoning. That is clear. And any assurance that we can get from the auditors on non-GAAP financial measures -- and I know it's difficult, but KPIs would be welcome. And I think that's an opportunity for the auditors to actually become more relevant in the whole process as well. Thanks.

MR. HARRIS: Mary Bersot?

MS. BERSOT: Hi, I am Mary Bersot. Actually, Gary, you just said everything I was going to say except I feel smaller than you.

(Laughter.)

MS. BERSOT: I managed 24 billion at one time, but not now. I feel that we are taking these numbers as fact in the earnings reports. I got a list yesterday from FactSet, you know, just a summary. And there were only two of about 15 items that even listed a GAAP number. They were all non-GAAP numbers. And you know, I am not with CalPERS or a big firm and I don't sit down face to face with management like the majority of investors. We are relying on the words that we read and the analysts' opinions.

Analysts are then revising their models based on these non-GAAP numbers, and these are being fed into our databases. So, I think it's a growing problem that it's taken on a life of its own. In the last ten years since I started my own firm, we have seen more and more of these non-GAAP numbers being reported on earnings day. And they do drive stock prices. And you know, once the work is done, which could be two or three hours later or sometimes a day later, the price has changed again. But I'm concerned that for the moderate, the lower investor or the non-institutional investor, that we might be misleading the community.

I also do believe that there is a multiple compression based on complexity. If we are concerned about the numbers being valid or real, or if they are confusing, then we will lower the multiple. But in some risk on markets, that doesn't happen. It takes a life of its own. So I'm concerned as an investor that we are not giving enough emphasis or credence to the GAAP numbers, that we are ignoring those and not putting enough emphasis on them. Thank you.

MR. HARRIS: Thank you, Mary. And I think, Tony -- even though your tent card went up earlier, I'd like to leave it to you and then the Chairman to wrap up. So let me recognize Lynn and then Linda de Beer. And then you can make your final closing comments, and then I want to turn it to the Chairman.

MR. TURNER: Jay, I'd like to thank you for asking that question you did because having been on the preparer's side, I think that's a critically important question. Without any data, I would guess that half of the public company filers could not provide that data within the same time frame they do today if it was required to be at least reviewed on an interim basis, and there is no standard whatsoever for a review, AS 17 deals with an audit -- or in the context of the audit.

And when you think of how quickly companies like ALCOA comes out, or the large financial institutions, these people are coming out with these numbers within seven to fourteen days. So I think that is, you know, investors tend to say, well, we'll ask for it and we should get it, but the practical reality is sometimes that just can't be done. And I think you also risk censure even more so compressing the time frame in which the audit work or review work has to be done. You are raising the risk that that auditor review can't be done in accordance with professional standards.

So I think you raise an excellent question. And I would urge, before you did something in that regard -- you've got an Office of Economic Analysis -- that's the type of thing they certainly could reach out and study. The CFA Institute has done studies on the investor side. And every single time when they've asked do you want the data unaudited on an early basis or audited on a later basis? They always -- every time, it's been give it to us earlier unaudited.

And I'd certainly hate to put increased pressure on auditors which already have a tough time complying with standards and make it even tougher for them to do that, and I think that's a real issue. And I thank you for raising that question. I'm sure preparers around this country thank you as well.

MR. HARRIS: Linda?

MS. DE BEER: Thank you. Just a quick response, Joe. You asked a question about GE and whether they track, and I obviously can't respond on behalf of them, but certainly on some of the boards and audit committees where I chair or where I serve and in South African companies, there are companies doing a lot of tracking on the integrated report on their website to see who is interested in what pages.

They also, the bigger ones also go to the institutional investors and ask them to write and to give an opinion on what information is useful and especially what information is missing. It took a while. It's obviously a process, but as we are on year seven or eight now of integrated reporting, so other companies are doing quite a good job of making sure that they put information in there that's in the first instance important to investors, but also to other stakeholders.

MR. HARRIS: Tony, you know. Thank you again for organizing a terrific conversation. And clearly there is quite a divergent number of views. But if you would like to take the time now to summarize as you see fit or make any comments as you see fit, and then I will turn it over to the Chairman.

MR. SONDHI: Thank you, Steve. As I've said before, I appreciate the opportunity. So I'm glad to be able to do this. In terms of some comments to sort of close it in that sense, I'll say that restructuring charges that Sarah raised, the amortization of intangibles that don't necessarily add up, the reconciliations that don't necessarily add up: these are some of the issues that we're concerned about. And I was really happy to see that the SEC has actually started pushing on these. For example, asking -- you provided as a rationale that you use it, please tell us how you use it. Just don't say that you use it.

So in that sense, we are starting to see that.

But the real fundamental problem is that these adjustments don't necessarily make sense in the way they are made, very often. The restructuring charges -- I can tell you because I did research myself on restructuring charges a few years ago. I was involved with the impairment standard that we have and I found that there are very few companies that report only on restructuring charge only once. In fact, I found that the best predictor of a restructuring charge is the fact that you took one last year.

So in that sense, restructuring charges -- they are just all over the place. They happen all the time. It's a very small number of companies that only take one in their lifetime. That's one thing. Amortization of intangibles, as you correctly point out, it's very very difficult to justify some of the numbers. Stock compensation: it's very difficult to justify some of the numbers being used.

So if you think about those problems and then you come back to the one assertion or comment that many people have made, that there is no framework in which they can audit the stuff, well, the very name of this metric we're talking about: non-GAAP. The only reason it should work is that it leaves something. It doesn't do something that GAAP does. So there is a framework.

The fundamental point is we need to find a way to develop applicable, useful audit standards. My last comment on this whole issue, then, is something Linda has pointed out and some other people have pointed out -- our biggest problem is that our GAAP standards and some of the ways that we look at things in auditing, they are not robust enough. Very often we write standards that are responses to what happened yesterday. And sometimes much, much more than yesterday.

So the way we need to think about standard-setting is to try to look forward at the same time. So that presents an extraordinary challenge with respect to non-GAAP numbers. There's no question about that. But from an investor's perspective, the growing reliance on numbers that cannot be, at times, justified is a problem. And we do look for them.

MR. HARRIS: So just getting to the question that you just raised. What challenges do you see the auditor reporting on these measures and how would you go about doing that?

MR. SONDHI: Well at the very least, for example, we could ask them to talk to us about the consistency of the way these are calculated. Are the reconciliations correctly provided? So what is the base? What is it that you're doing? Are the tax effects, as the SEC is focusing on, are you correctly adjusting for the tax effects?

I have a feeling, though, that my ability to do this is going to be hampered by some of the changes the FASB has proposed on the disclosures of the details of different taxes. And it's something that I find very, very difficult to accept, because the FASB tells me that it's too costly to provide this information. I have no idea how you come up with a netted number without calculating the two numbers you're netting.

(Laughter.)

MR. SONDHI: I just don't know how you do it. I don't care how -- where is the cost-saving? So in that sense, when I look at that, my ability to develop a reliable estimate of the effective tax rate is being hampered. And if I can't come up with a good understanding of an effective tax rate, I am not going to be able to figure out whether the reconciliation in the tax effect is being correctly done. So I think that there is a framework. There are ways in which we can do it if we keep in mind how critical having this information is. Thank you.

MR. HARRIS: Mr. Chairman?

MR. DOTY: Well thank you, Steve. I think this could be fairly characterized as the most productive single session that we have ever held with the Investor Advisory Group -- possibly at the SEC and the SAG and all of our other advisory groups. The extent of convergence of comment and the reference back to what the role of the PCAOB is and should be is what is most important and instructive here.

I'm not going to summarize. I'll be standing between you and lunch. But Joe, the need to randomize a baseline of audits that are not risk-based: got it, check, on the list, working on it. Damon raises a very important point. And that is, how can we find and know that those areas in this subject matter where auditors are just not giving appropriate attention to what they're looking at, and taking that back and reflecting on how that affects the validity of the audit and the kind of mistakes that Parveen and others have referred to. That is our charge, I think.

Gary Walsh makes a very telling statement. A day of reckoning is coming for sure, he said. I've been taking copious notes and that went in the notes. The fact is that Bob Tarola, Linda de Beer and others have urged us to start thinking about how we move more in the standards and in what we're doing at the Board to recognize that the information flow is continuous and it needs to get to the board.

This is what we need to think about. I am very impressed that the SEC has stepped out with the CD&I. And I think that is perhaps a ship in whose wake we should follow, and Marty has spoken to it. That is to say, I am very interested in the extent to which we should start thinking about interpretations even beyond the Audit Practice Alerts we have issued that indicate where we think the interpretation of standards that may be practiced in the field is simply too narrow for what the standards should require.

We should begin to expand and work on the ways in which we affect the daily conduct of auditors -- referring them back to the standards and to what we are now seeing here and where it leads us. The distinction that Mike Head made of aiming us to direct people to what is factual information versus opinion information is something that may be benefitted by the Critical Audit Matters and Key Performance Indicators. We should work on that.

The one thing I think we should not do -- the one thing we cannot do, is to look at the technical obstacles and challenges that exist to achieving Tony Sondhi's goal and taking those as a reason for not starting or for throwing this aside. That is the way to the day of reckoning that Gary Walsh referred to, and it's what we cannot afford to do as regulators. And I think what you have given us today is tremendous stimulation to keep thinking and not giving into the temptation of thinking that it's someone else's business. So, many thanks.

MR. HARRIS: I said at the outset how much we very much appreciated Chair White's being here, but also how much we appreciated Brian being here throughout all of our sessions. But Wes, I know that you want to make a final comment and I want to recognize you for the closing comments on this session and then we will break.

MR. BRICKER: Well, thank you very much. And consistent with Mary Jo's comments at the beginning and consistent with Chairman Doty's comments and yours as well, Steve. This is an incredibly important and informative discussion that informs our work as has been referenced throughout the dialogue. I know it informs, certainly, the work of the PCAOB as well as it should. But it also informs the work of the FASB because it really runs to, I think, the credibility of information.

It also runs to the point that information is, as a concept, is not static; it has changed over time. It has changed from the concept of our rule-making in this area post-Sarbanes-Oxley. It has been revisited on periodic intervals, just as it is now. So the dialogue is important. I would also urge and reinforce the role of audit committees to draw out a valuable discussion through their relationship and their responsibilities with external auditors, with internal auditors and management as they together have a point of view about the nature of the measures that are being provided in the marketplace.

Even in the absence of additional standard-setting. But I do believe the dialogue has been good. I do believe that the approach to reinforcing not only our rules but also the role of credible information is making progress. But I look forward to more work being done.

MR. HARRIS: Well with that, we will take a break and revisit it at 1:30 p.m. We will come back to the schedule. And so we will get those of you who have made plans to get out, out on time. But the next session promises to be an extremely interesting session as well. So we will break and see you back here at 1:30. Thank you.

(Whereupon, the above-entitled matter went off the record at 12:26 p.m. and resumed at 1:32 p.m.)

MR. HARRIS: However you want to organize it, the two of you, please feel free to go ahead.

MR. GUPTA: Lynn, you want to start the first couple slides?

MR. TURNER: Sure, Parveen. Damon Silvers was going to start us off and, unfortunately, he had a luncheon at the White House that was going to start at 11:30 and as our morning session kept going on, he delayed it and delayed it and he conveniently delayed it to 1:30.

MR. HARRIS: Well, we got to give him a little grief in the future, because I think we've heard that once before. So, we'll have to --

(Laughter.)

MR. TURNER: I know I've heard it more than once.

MR. HARRIS: We'll have to keep him honest.

MR. TURNER: Really, what I want to know is, what are they serving up at the White House? So, at any rate, but Damon gave me instructions on what to say, so, Parveen, if you can flip the slide?

Our charge was really to go back through the recommendations of the ACAP Committee that came out in October of 2008, eight years ago, and discuss those in the context of investors and prioritize recommendations that haven't been implemented in terms of what is thought to be most important to, would be most important to investors. Want to flip it?

Just to give you some background, as Damon pointed out to me, this was considered to be a very significant undertaking and study by the Bush administration. After discussions with the auditing profession, when it was put together by Secretary Paulson, he went through a very thoughtful process in terms of picking the members.

He had Paul Volcker on it, Arthur Levitt, Rodgin Cohen, the lead and very distinguished attorney at Sullivan and Cromwell, a number of people from the business community, Bank of America, Goldman Sachs, well known members of audit committees, the heads of a couple of the audit firms, KPMG, Tim Flynn from, I believe that one was one of the second-tier firms, and then there was one, Gaylen Hansen, from one of the smaller firms. So, very broad selection.

On top of the 21 members, there were a number of observers, Dan Goelzer from the PCAOB at the time, Bob Herz from the FASB, David Tweedie from the International Accounting Standards Board participated, a number of people from foreign regulators, as I recall, Michel

Prada came in and participated.

And there were -- the deliberations really got started in the fall of 2007, there was a request, an extensive request for information from the auditing firms themselves, financial and otherwise. Some of those were fulfilled, a number of them went unanswered, if you will. There was a number of presentations in private. There was public hearings, both here in Washington, D.C., as well as out in out in L.A., so on both coasts. Comments were solicited, there was an exposure draft with recommendations put out.

The group overall decided to break into three groups. One on human capital, because the talent pool was considered to be significant and a big issue to audit sustainability, if you don't get the people you need, it's tough to do the job and put out the right product.

Firm finances and structure was an important part. In that group, there was a very extensive discussion, debate about auditor liability and auditor liability reforms. This is actually the only major report on the auditing profession where there was not a recommendation for further reforms of auditor liability.

And it was interesting, the business community representatives actually strongly supported that conclusion and finding on the panel. The investors definitely were there, but it was fascinating to see the people from the business community come and oppose further liability reform for the auditing profession in that section.

And then, finally, there was the section led by Damon on competition and concentration. There was views that companies, the business community wanted more selection, more choices to select from. By that point in time, we were down to the four, they wanted more than that and wanted more options. So, that section got into that.

And so, finally then, in October 2008, out came the final recommendations. There are 21 recommendations and it's because those are the three areas that were considered important to maintaining the firms. And they came out and the report got published, if you will.

And probably a shortcoming of the whole thing was there was never any mechanism that was put in place to monitor the implementation by the various groups, and this has been typically true.

There's been other major reports on the profession in the past, the Cohen Commission, the Treadway Commission, there's one other, it escapes my mind, in between that and this one, but there was never a monitoring mechanism, although the GAO at one point in time, this might have been under Jeanette, did a very good evaluation at the request, I think, of Dingell probably, that went back in and issued a good report that said, here's what's happened with those. And, in fact, that report became part of the deliberations that led up to this report. There was tons of binders of information that the group went through. So, I'll leave it at that and out came the recommendations and away we go.

MR. GUPTA: Okay. Thank you, Lynn. I think, Mary, would you talk about this slide now?

MS. BERSOT: Yes, thank you. I'm not going to go through each one of these, to spare you all and we are behind schedule. So, what we did as a group, we looked at these recommendations and tried to pull them together and come up with what we thought were really the basic or the most important principles for investors.

So, these are really the things that we feel the recommendations accomplish. In a perfect world, if all of them were to be implemented, we really feel that they would add enormously to the quality of the audit, disclosure information, more --- clearer communications, which we think are important.

The two things I want to mention that we did spend some time talking about was the establishment of a national research center for fraud. We all agree that fraud is a very serious problem that we can't really get our arms around in advance, except the PCAOB is in a wonderful position to be able to look at fraud, to study past fraud, and perhaps set up a database for others to use so that certain trends or patterns could be recognized. So, this is the one thing that we pulled out of this that I wanted to mention today that we did as a group think was important to investors.

And then the last thing is, increasing the competency of the people working in the profession. When I first looked at this, I thought, you know, I'm not so sure it's real important that these auditing firms are really financially strong.

I don't know where that came from, but in going through this process, I realized it's critically important, because they need to attract talent and they need to train people and people need to be skilled in the work they're doing and they need to have the funds to invest in the database and the technology that they need.

So, this human capital portion of these recommendations, as far as our group is concerned, is definitely of value to investors. So, I'm going to move on. I'm not going to go through each one of these points, I think they're pretty self-explanatory.

MR. GUPTA: Okay. So, at this point, what I will do, I will talk about the next few slides, provide an update. And those of you -- as Lynn mentioned, the ACAP report, which we printed and read, the whole big copy is still available on the website of the Treasury. And we wrote letters to AAA, AICPA, NASBA, SEC, and PCAOB and we got responses from everyone. And we also did our own research in terms of figuring out what progress has been made.

So, what I'll do in the next few slides is summarize that progress. And also, one important point to mention, the working group did discuss what is going to be our lens in evaluating the progress made towards these recommendations and we agreed that we are going to be looking at it from the viewpoint of how these recommendations have helped the investor, or they have the potential to help the investing sort of community.

And then also, the progress was evaluated from the same angle and then we came up with the five priorities we thought that the Board may like to focus on in the near term. And then, I think, Norman is going to take over and talk about some of those.

So, as you can see, we have a fairly big report that we wrote, along with everything else, and it's available for you to review. But we decided to use a color-coded scheme, and we acknowledge that people may have a disagreement, we can certainly have a big debate on it, but that's not what the intention is, that what progress is made.

So, very clear, this is a scheme that most of us have seen in the boardrooms. And red means little or no meaningful progress has occurred in the opinion of the working group. And orange or yellow is some implementation has occurred, but more remains to be done. And green is that the ACAP recommendation has been acted upon with some successful results.

So, I will go through these relatively quickly to give you an idea and bring everyone on the same page. So recommendation -- the first category was human capital. And within the human capital, the first recommendation, 1(a), is talking about updating the exams and things like that, updating of the certification.

CPA exam has been revised and the new version is to be launched on April 1, 2017, and many of us in the audience know that what changes are occurring, so I will not go into those details, except the number of hours have gone up from 14 to 16 also. The reason we have there the yellow or the orange is because significant diversity continues to exist in the 54 jurisdictions regarding requirements to sit for the exam.

1(b) and 1(c) are talking about updating the business and the accounting curriculum and the reason for that particular color there is that there is no systematic process currently in place at the national level, either via AAA or any other organizing group, to track what changes are occurring, are they timely, are they -- the curriculum is current or not. So, that's what is the status with regard to 1(b) and (c).

With regard to the 2(a) and 2(b), which is recruiting and retaining minorities in the auditing profession, some positive movement has occurred in this direction and we quote some data from the latest 2015 AICPA Trends Survey. Just to give an idea that in 2008, at the time of ACAP's recommendations, according to that particular survey, there were 32 percent of the accounting students graduating were non-whites and in 2015, the number went up to 38.

And the number of new hires in the accounting field, that 28 percent was non-white and it has gone up to 31 percent. We could not find the data on the retention, so obviously some efforts need to be made on that side to see what kind of information is available.

2(c) talks about the role of the community colleges in recruiting minority. Was very difficult to get some relevant information on that. And 2(d) and 2(e) are talking about cross-sabbaticals at Historically Black Colleges and Universities and increase in the PhD programs of minority population. So, there is a progress as a result of the PhD project, from 294 PhDs in 1994 to about 1,300 in 2015. So that's the progress on that.

On the 3(a), supply of PhD qualified accounting faculty and professors of practice. Accounting doctoral scholars program is there, AICPA and the Big Four firms have committed over $17 million in that particular initiative. AAA and AICPA have come up with the Pathways Commission. More emphasis is taking place on the professionally focused faculty. Cross-sabbaticals, we are all aware of, the Securities and Exchange Commission has some, I have served in that role myself, and PCAOB has also started in 2009.

In terms of the 3(c), which is private funding for the accounting research, certainly is not happening at the large scale like the sciences. And one of the discussions in the working group was primarily, perhaps some of the research that academics are conducting, the regulators, policy centers, and the practitioners may not be finding it as useful. The divide between the academic research and what practitioners want is certainly growing.

In terms of moving on to the human capital recommendations, Number 4 and 5 here, Number 4 deals with the demographic data, program profile data. We really don't have access to any coordinated data set there, except what the AICPA Trends Survey is giving us the information on.

Number 5, certainly, is satisfied in the sense that the AAA and the AICPA formed the joint commission, Pathways Commission. A lot of work has been done in that area, a lot of reports have come out, and they're all publicly available as a matter of fact.

On the concentration and competition, which is the second category, Recommendation 1(a) is talking about public disclosure by corporations of any agreements with third parties that restrict the auditor choice. No such rule exists as of today and we did some search to figure out, in the material definitive agreements section of the reports, to find if there's any incidents of disclosure in this area and at least I could not find anything when I did the word searches through a program to see what might be there.

1(b) is talking about the inclusion of representatives of smaller audit firms in the various forums, fellowships, and engagements with the AICPA, PCAOB, SEC. It's occurring, we can tell from our experience, but once again, we do not have any empirical data to really conclude whether tangible progress and sustainable progress is being made in that direction or not.

On the Recommendation 2(a) and 2(b) here, this one is particularly critical in the sense it talks about PCAOB's monitoring of potential sources of catastrophic risk that would threaten the audit quality.

According to the response we got from the PCAOB, as well as what we saw on the website, the strategic plan does list something to this effect as a priority and what's said in there is they study the business models of the firms, but we could not find any other information that would allow us to conclude what exactly has been done and what progress has been made in this area.

2(b) deals with the establishing a mechanism to assist in the rehabilitation of a troubled large CPA firm in case, god forbid, that were to happen. And we couldn't find a whole lot of information in that area also that what progress is made. Now, remember, all of this is research based in the publicly available information sources that we have.

Number 3 in this category talks about the AQIs, as we talked about a little bit in the morning also. In general, yes, efforts are underway and lots of stuff has occurred in that area, implementation has yet to occur in the sense of a final rule or something of that sort.

In terms of 4(a), single source of access for auditor independence requirements in one place, there are various places where that information is available, but, again, as the ACAP intended perhaps in one particular place freely available information, that is still not available. But, yes, that information is out there and many commercial outfits are selling that for a fee also.

4(b) is talking about training to develop professional skepticism regarding independence and other conflicts. We know that progress has occurred in that area in the sense PCAOB Staff Audit Practice Alert Number 10, NASBA and AICPA have several projects underway in that area.

With regard to the Recommendation 5, which is the verification of auditor appointment by the shareholders, informally, it is occurring quite a bit in the public space, but there is no formal rule in that area yet.

Number 6 is talking about enhancing the regulatory collaboration between the Board and its foreign counterparts. And, yes, progress is definitely occurring in that area, as we read in the news.

With regard to firm structure and finance and governance, the first one is, and this actually comes out in our priorities, national center on fraud. And we know that the Board started in this direction under Mr. Goelzer in 2010, but it's still pending and did not follow through.

There are initiatives, as the Board reported to us, that they have, for internal training, fraud cases, fraud databases there, and they have a goal to make it available to the public and it will be good to get some clarity on that.

On the Recommendation 2(a), which talks about the mobility provisions, progress is being made, 49 out of 54 jurisdictions have adopted, but we are not quite at the finish line yet. 2(b) is talking about the regulatory roundtables. Yes, they exist, they are occurring between NASBA, PCAOB, SEC, and other regulatory bodies.

2(c) is talking about the greater financial and operational independence of the state boards of accountancy. And NASBA seems to be advocating quite a bit in this direction, so progress has been made.

Recommendation 3 is auditing firm governance, that comes out, that we'll talk shortly, in our priorities also. That deals with the independent board members with full voting power and transfer and disclosure of their governance controls. The feeling of the working group was that compared to the EU, we in the United States still have a long way to go in that direction.

Number 4 is talking about amendments to Form 8-K to appropriately characterize any premature auditor changes. There are all kinds of disclosures being made in the Form 8-K, but they are still not capturing this premature partner rotation, so we believe that the progress needs to be made in that area.

Number 5 is the auditors standard reporting model. We have a separate working group on that, we'll be talking about it. And so, there is a movement here, everybody knows, so I'm not going to talk too much on that, but there is work being done in that area.

Then, Number 6 is dealing with the engagement partner signature. Yes, working group acknowledges that true for maybe these disclosures are being made, but the conversations occurred in the working group that it's not as easy to obtain information and there would be additional time and cost imposed on the investors in terms of securing this information. Perhaps more progress can be made in that area.

Number 7 is talking about the annual report by large audit firms, something along the lines of the EU's Eighth Directive. And progress certainly needs to be made in that area, when we are talking about what we are doing here, what's being done in Europe.

So, with that, I'm going to turn it over to Mr. Harrison to talk about the five priorities of the working group that we want to bring to the attention of the Board for near term actions.

MR. HARRISON: Thank you, Parveen. So, as you've seen, we, in essence, divided our work and our presentation into two elements. The first being a review, recap, research into work that's done to date, information gathering. The portion I'll touch off now in my remarks has to do with the advisory piece of our work and our proposal.

We decided that it would be most productive to focus on a limited number of the initiatives that received either an amber or red score on our review, those that we felt, if completed or if fully implemented, would result in the greatest benefit to the investor community. And the interesting thing was that there was a good healthy discussion among the working group members, but at the end, there was some strong consensus around the five.

Here they are, and I'll move to the next slide in a minute, but what I'll point out here is that, if I'm not mistaken, all five of them, or at least four of the five, should be familiar to some of the longer serving members of this group because these are all topics that we have discussed --

(Laughter.)

MR. HARRISON: -- more than once over the history of our time together, which may say something in itself. So, let's move on to the first one.

First area where we would urge the Board to continue and complete its work is in the area of AQIs. And this goes to what we view as a fundamental issue of educating the investor community, providing them with information that they need to have a well-informed say, and provide well informed feedback to audit committees, in the cases where their shareholders are permitted to vote, to cast an educated vote as to whether or not to approve the reappointment of an auditor.

That information simply doesn't exist today and we think there's some fairly strong concern and consensus in the investor community that it would be very useful information to have.

We talked during the earlier presentation about the results of the Board's inspections of firms and I take to heart the point that Joe raised about selection criteria and how to read the results, but nonetheless, there are, the deficiency rates, as you all well know, are in the view of some, disturbingly high.

Over the past, 2012-2014 period, among the Big Four firms, the deficiency rates were between 35 and almost 40 percent. One of the firms had a 50 percent deficiency rate in 2013. Those numbers are higher for the second-tier firms, and we think that alone provides a basis for concern about audit quality and a strong basis for having a set of criteria or indicators that would help investors better understand the quality of the audit and the quality of the auditor performing the audit.

This was, as I mentioned, this particular topic was covered here in 2013, and I think all the members of the working group are still here, I think it was Tony and Lynn, Gary, Mike, and Damon and I, I think were the members of the working group that recommended to the

Board a set of AQIs that had as their objective a focus more on the outcomes of the audit than on the process by which the audit was conducted.

That, of course, was followed by the concept release and the receipt of comments. Our understanding based on the correspondence we received from the Board is that the current plan is for there to be continuing study of this topic and, in the meantime, prior to any eventual action, encouragement of audit firms in the U.S. to develop their own and employ them on a voluntary basis.

Some would say that's a polite way of saying that this initiative has run to ground, and I think the view of this group is that it deserves to be a priority and that we'd strongly urge to keep going. Next.

The fraud center, Parveen mentioned as well. And just briefly to recover, there was some early action here at the Board to create a center. There was a listing for a position of a director and that did not come to fruition. We are mindful of some of the work that both CEA and ORA are doing that touches on the gathering of data and dissemination of data relating to frauds and we understand and appreciate the importance of that.

But it, nonetheless, is the strong view of this group that the fraud center, the concept originally envisioned by the Commission, the Paulson Commission, is a worthwhile and important effort in itself that should be undertaken independently and have a life and a body and funding and staffing of its own.

And that, while there may be some questions or concerns about cost, we think this is a good example of a category of initiatives where the cost/benefit analysis can be difficult, because the costs are probably somewhat easy to measure in quantitative terms, the potential benefits we all think are enormous and difficult to capture in financial terms.

The level of information, the encouragement of research, and identification of trends relating to fraud and categories of fraud among the professional firms and the investor community, we think is an initiative that deserves the Board's full attention and priority. So, we would strongly urge you to revisit and keep going in the area of establishing an actual fraud center as originally envisioned by ACAP.

Again, the audit report is a topic of the next panel, and we certainly don't want to step on their toes. I will simply point out here some areas in which we believe investors would obtain the greatest benefit from fuller disclosure or discussion in the audit report. One of those, as the Committee recommended, was statement and clarification of existing rules, including the Board's standards related to the auditor's responsibility for fraud detection.

Critical audit matters is a topic for Joe's panel, which we will discuss in a few minutes. We believe that disclosure of the auditor's tenure and the disclosure of the process and result by which the auditor confirmed its independence are important for investors to see and have an opportunity to read.

And in addition, other information concerning the manner in which the audit was conducted, the results, and the risks that the audit firm identified in its application of the risk assessment process that the Board's new rules now require.

The fourth topic where we believe strongly that we've fallen behind here in the U.S. is on the issue or the category of transparency and governance of the large audit firms. And, again, this is a topic that this group has visited in the past and the theme here, the underlying principle here, is that the audit firms obviously occupy a central position in the capital markets in our economy.

There is a legislative mandate to employ them and engage their services for audit. I know a lot of us who are in the consulting or advisory business would love for there to be a legislative mandate for people to hire us, but it --

(Laughter.)

MR. HARRISON: And then their status as economic entities in our economy is also a somewhat protected status, and we all believe and believe that the investor community strongly believes that, in exchange for that, it is only reasonable to expect some level of disclosure about the manner in which the firms are governed and about their financial strength and sustainability that is much greater than the information that's provided today.

And, as I mentioned, the European, EU standards concerning transparency reporting are much stronger than here in the U.S. They require detailed discussion of legal structure, governance structures of the firms, a discussion of their internal quality control systems, and a statement regarding efforts that have been made to ensure the effectiveness of those systems, including specifically an explanation of when their last quality control assessment took place and what the results of it were, and disclosures around independence practices and confirmation that internal independence reviews have been conducted and the results of those reviews.

All of which we think are critically important issues that go to the integrity of the firms, their independence, and the audit process they undertake. And I think the best that I can do here by way of example, and it's only one, is to show you.

In doing a little homework for this presentation, I pulled up the copies of a 2015 transparency report for one of the Big Four firms. This is the U.S. firm's report, this is the European firm's report.

MR. SMART: On the firms, that's the --

MR. HARRISON: This is their --

MR. SMART: -- firm's audit?

MR. HARRISON: -- the transparency report. Nine pages, 83 pages, 22 of which in the European -- and I should -- strike that, I misspoke.

MR. DOTY: Norm, the firms are now color coded, so you want to be careful.

MR. HARRISON: Yes, I got that. Yes. But what I think -- right. There would be, these are in the public domain, I think the trend would be uniform. This is actually the U.K. member firm's report, so I want to be sure I'm -- one country.

Eighty-eight pages versus eight, nine, including detailed discussion of internal control, quality control systems, the manner in which they're implemented, and statements of quality assessment reviews conducted both internally, through their professional practice protocols and groups, as well as by external reviews.

And so, we think that the picture is worth a thousand words there, that we're behind and that given the relative size of the capital markets and the difference in revenues between the two, the two member firms that are at issue here and in other examples we could provide, that investors in the U.S. or investors in companies listed and audited in the U.S. are not receiving a fraction of the information that investors in other economies are receiving with respect to the governance and risk assessment processes and financial stability of the Big Four firms.

So, those are four of the five. The fifth topic that we will cover, the fifth recommendation relates to the human capital recommendations, so I'm going to turn it back over to Parveen and to Joe, I believe, on this one. This is an area that both of them have devoted a great deal of time and scholarship to, so I'm happy to turn it back over to Parveen.

MR. GUPTA: Thank you, Norman. And I think this is last, but not least, important. It's a critical topic that's very near and dear to Joe and myself as educators. And although the recommendation in the ACAP report talks about upgrading the curriculum, but if you really look beneath it, what it is talking about is making sure that the human capital supply chain is fit for purpose.

And it directly impacts the audit quality and, hence, the investor protection and capital formation. So, there is a direct causality in the linkage and it's very important.

Now, what we did in this case, although the ACAP recommendation was asking for that there should be some monitoring of the processes in place, how frequently and how critically the curriculum in accounting and business is upgraded, and as I said in my update, there is no formal mechanism in place where we can go and really do a study over a ten, 15, 20 year period to see what is happening.

And there are reasons for it and, obviously, there is no one particular agency that keeps track of this thing. And American Accounting Association is just a group of professors who contribute information on a voluntary basis, but there is no coordinated effort there.

So, once we went a little bit further, and, Joe, feel free to chime in, we kind of identified what are the hurdles here that we see from our experience in my role as a chair of the department for nine years, I stepped down on June 30, and Joe is still the chair of the department.

We interact with the firms, we place our students in the auditing supply chain, so it's a little bit of our own experience also interacting with the supply chain, so to say. Lower financial return in auditing, basically, this is public information.

What I learned by collecting this data, and Lehigh is just one example, auditing student is getting anywhere, 55 to 58, or maybe 60 at the most, starting salary. And, as a matter of fact, when you look on the advisory side, the salaries are 75, 78.

So, when you are talking to a 23 year old student who is really carrying a lot of debt and their parents are saying that, honey, it's done, after that you go and do the job, student will come and sit in the office and rightfully argue with you that, what is it that is going to motivate me to make a career in auditing as opposed to where I'm going to get money?

Twenty thousand dollars at that young age is a substantial sum of money, it's almost 40 percent of your auditing salary. So, that is one particular hurdle we see in the way of the supply chain.

The other aspect which I used to think maybe I'm the only one who thinks and then Joe validated that after he became the chair, and this is critical, as a matter of fact, when we were putting this together, Joe said that, Parveen, if we can hit on this point, I think rest of the problems will be solved, and the point basically is, lack of understanding and recognition by many in the higher administration of our universities, particularly the business deans, quite frankly, that accounting programs are very unique.

And they need to be treated differently than, with all due respect to finance and marketing and supply chain and human resources, et cetera, because there is a public and trust mandate, so to say, we have.

And what is happening is, when the accounting programs are being treated just the same way as everything else, there are problems in terms of upgrading curriculum, because you have to go through the bureaucratic process and then you get into territorial battles, why accounting should have the higher number of credits and why not marketing?

And we all know the human nature, so you start fighting those battles. And as a chair, time comes when you say, enough is enough and I'm not going to pursue this line any further. And the other is the engagement of the accounting faculty, that the profession is very critical.

And I think our experience is that, because there is a publish-or-perish mentality, that is forcing many of the pre-tenure faculty and even the tenured colleagues who are at the associate level to hide in their offices and just do research that is getting published in the elite journals.

And whether the practice community, the regulators, policy makers are getting informed or not, it doesn't really matter, but I don't want to waste my time interacting with the practice folks, I just want to hide and do my work and publish in some of the journals that you may not even touch.

The MS in accounting programs, I think we share a concern that it is important that the right way accounting education, the 150 credit hour implementation, perhaps should accredit to a post-graduate degree in accounting. And that was very clearly highlighted in the ACAP report, in one of the dissenting opinions also.

And our experience is that, actually twofold in this sense, many students are doing a checklist kind of mentality, as in the academic circles we would say that a number of students end up taking proverbial basket-weaving courses, you get the credit and you are done, you are complete 150. So, it does impact the quality of the auditing, it does impact whether we are imparting in them the skill set which is essential to audit the complex businesses of today.

Another thing that's happening is, a lot of one year programs are popping up for the revenue generation. And we were talking about this at the lunch table too. Universities are significantly focused on raising revenue, everybody's feeling the crunch. And what is happening in the process is that non-undergraduate accounting students are joining these programs and you are cramming everything into one year or 18 months or maybe a little bit longer.

And people acknowledge in our academic circles that the pass rate for such students on the CPA exam is much lower, but they say, so what? At the end of the day, they are going to go do auditing for two years and move on. I think that's a cause of concern. It is really not producing fit for purpose supply chain.

Lack of uniformity in the state board requirements, we came across some research, the number of credit hours varies significantly within the 54 jurisdictions. Fine, at the end of the day, everybody takes the CPA exam and you could argue that, hey, the playing field is level there, when they take the exam, they get the certificate.

And we all know that the CPA exam is short-term memory exam, it trains you for entry level, but what we are talking about here is developing mature judgment, developing professional skepticism, and the ability to ask the right questions through developing that particular skill set.

Couple other points here on this slide are, you may not be familiar with the idea of how the accreditation works in the accounting programs, particularly the way the dominating agency, which is the

AACSB, does the accreditation is, my accounting program can design its own mission.

They will come and evaluate us in light of that mission, that mission may have nothing to do with the public and trust. If lot of my students are going to into public accounting, but my mission has nothing to do with the public accounting, I still get the accreditation. Obviously, there are some hooks there, but at the end of the day, it is a self-mission driven approach as opposed to the public and trust mission approach that we would advocate in that sense.

And then, I think another concern is, we don't have the analysis to support it, it is sort of our personal views here in the sense that we are seeing lot of faculty coming into the classroom without the CPA degrees or the certification or without even real life practical experience.

And you wonder what level of engagement they will have, what level of instruction they might have. It is not to say that the people who don't have this kind of a background are not good teachers, but I think it's a joint mission between the academia and the practice and we own it together to make sure that we are preparing students who are really fit for the purpose, and the purpose is becoming complex and complex as we are going forward. So, those are some of the hurdles we see. Joe, do you want to say something on this slide?

MR. CARCELLO: I mean, you did a wonderful job, Parveen. I think one of the challenges here is it's really not clear who owns this. This is one of the big problems, it's not obviously by any stretch a PCAOB issue, it's not obviously an SEC issue, so it's very hard to assign accountability for this.

And the recommendations were originally made largely to AAA and NASBA. I think with the benefit of hindsight, that might have been a mistake. AAA has no power, so for the people in the room who are not familiar with AAA, do not deceive yourself, there's no power there.

NASBA, to some extent, but only through the CPA exam. And candidly, NASBA can change whatever they want and some schools are just going to say, well, that's more responsibility for Becker. So, that's not even going to move the needle that much. The only thing that probably would move the needle would be one of two things.

For major employers to say, this is what we expect, if you don't have this, we're not going to hire from your institution. The problem with that is, with starting salaries at $55,000, their biggest concern is not having enough people, so they don't want to start biting the hand that feeds them.

The other issue that might be able to move the needle, and Parveen certainly alluded to this, is AACSB. AACSB does have the ability to change behavior because of accreditation standards that most schools care about. But it's not obvious to me that the SEC or the PCAOB, it would have to be more moral suasion, you don't really have any authority, at least not that I'm aware of, over AACSB.

MR. GUPTA: I guess the only thing I would say, and what we did on the next slide is couple of thoughts we have put down together here for some of these voluntary organizations, like AAA and NASBA, to consider.

The only place where I would submit that the

Board could pursue it is the firms, since you do have the direct jurisdiction over the firms, and continuously questioning them that, what are you doing in order to attract the right talent? And that may perhaps lead to some of these organizations making sure that they are getting the right set of students.

Yes, it is absolutely true that this is very much a market driven problem and what we are recommending here basically is that perhaps the American Accounting Association, of which both of us are members, may wish to commission a study in a systematic way to figure out that what are the potential solutions?

Because the view that we have is we are all in it together and educators have a role to play, AAA has a role to play, NASBA has a role to play, AICPA has a role to play, and then, obviously, Board has a role to play in terms of, because all of this feeds into providing the right labor pools so that the audit quality is enhanced and which will take us to our eventual goal of reliable financial reporting.

So, that's sort of the thinking of the Committee. And I invite any other members of the working group to chime in and give some thoughts if you wish to share.

MR. TURNER: Michael, you seem to have an interest in reading those financial reports. We'd be more than happy, we gathered them all for the U.S. and international top seven firm and we've got them, we'd be happy to ask Nina to photocopy them for you and send you a copy.

(Laughter.)

MR. SMART: I appreciate that volunteerism, Lynn. My --

(Laughter.)

MR. SMART: But my thought and question is, just along those lines, was there clearly should be some form of transparency. I actually asked Curt, who audits the auditors? And he said, well, they're all private, so they pretty much audit themselves.

But I would think that we could recommend or suggest some form of body, because it's not a lot of firms, especially when you look at the larger ones, the top seven or eight, to give some better transparency on how strong they are, especially since the public investors depending on what they're publishing. That's one.

The other point I wanted to raise, just on human capital, which I found very interesting and I think you were spot on, I think a lot of it has to really depend on the firms, who are really seeking to have the right individuals come into the auditing profession.

You had a couple of comments there about dealing with Historically Black Institutions, Historically Black Colleges, if I can be of any help or assistance, and I know it's not one of your top five priorities or maybe it is sort of thrown in there somewhere, if I can be of any help or assistance through my association with Howard University, please feel free to volunteer me for that, Lynn.

MR. HARRIS: Lynn, let me ask a couple of questions too. And that is, first of all, thank you for the offering of that assistance, because I know that that's been an area of considerable concern to Jeanette and myself, and that is the outreach to the minority community. And it's a difficult and direct uphill climb.

Let me make some very brief statements and I'll get to the question that I want to ask. First of all, Marty Baumann is directly involved with commenting on the CPA exam, and I don't know whether you want to say any words at all about that.

But then, also, with recruiting, with respect to recruiting minorities, we have a scholarship program, which is in Sarbanes-Oxley, and we put quite a bit of effort into the scholarship program. And Bill Gradison, a former member of the Board, was very intricately and directly involved in trying to ensure that we get a little bit more diversity than we otherwise would have in that context.

And, Mary, I don't know whether you'd want to say anything at all about that, and Norm, I'm not asking either one of you, unless you want to volunteer afterwards.

AQIs, you're perfectly right, we developed 38 indicators and we need to do more. But we have followed up on that recommendation and we're actively pursuing it. There are 28 indicators, they are voluntary. So, those are just generic remarks, a lot of which you have indicated are within the jurisdiction of the AAA, the

AICPA, the NASBA.

But getting to a couple of issues. First of all, for the entire time that I've been here, I've kind of hid behind the ACAP recommendations, with respect to transparency, with respect to the audit reporting model, and others. They've been -- they served somewhat as my bible, and eight years later, we're making some progress on some of them.

But I'd like to pursue with you recommendations on catastrophic risk, audited financial statements, and the annual report transparency. First of all, there's some feeling among some that these firms are either too big to fail or too few to fail. So, could you talk a little bit about why some of your membership felt that there ought to be audited financial statements, what's the rationale behind that?

And then also, with respect to the annual report transparency, what specific types of transparency are you looking for from the PCAOB and how would you like to pursue that?

And then, just another comment, I won't comment on a number that you've raised, behind closed doors, we have been talking about the importance in terms of the governing bodies of the firms and the need, at least some of us have, in terms of independent board members.

That's not a standard setting activity, but there are a number of us on the Board who've directly talked about governance of the firms and the fact that there ought to be independent board members on there, because if you are in effect, at least with respect to the largest firms, a top 200 firm in the United States, maybe you ought to be, maybe you ought to apply by some of the same governance standards as a Fortune 500 or a Fortune 200 company.

But why don't you talk a little bit about the recommendation on catastrophic risk, audited financial statements, and what you'd like to see with respect to the greater transparency.

And then, Marty, if you want to talk at all about what you've been working on, on the CPA exams, and, Mary, if you want to talk at all, which I'm not asking you, but if you want to, on the scholarship program, just to enlighten what we've been doing. But, Lynn, why don't you take it away.

MR. TURNER: Well, let me echo your thoughts to Michael, thank you. The diversity issue, I'd be remiss if I didn't say that Bess Joffe from TIAA-CREF, who couldn't be here with us today, she's out of London and she's due in the foreseeable future, so her doctor wouldn't let her get on the airplane, but she felt very strongly about diversity, so I think I owe it to her to -- she felt that was very important and a very important part that the governance of the firms should be looking at.

I actually went out and looked at the data. The data is much improved from when I was in school. I mentioned that to my wife, who is a dentist, and she reminded me that there were three women in her class of about 78 and she said, progress isn't enough, we need to make more today. And I think that's true.

In fact, it was somewhat discouraging, I thought, in the last year or two, we as a profession had moved in the wrong direction, backwards, on diversity. And I would hope we would continue, so I think your point is well taken, hope the Board will take you up on that offer.

As far as transparency and governance, let me take it in two pieces. First piece is the transparency piece. On the ACAP Committee, during the public -- well, to start off with, we sent a letter to the profession, people on the Committee met with the profession.

In that, we asked for specific financial information, data, that would allow us to take a look at the firms. That was precipitated by the fact that the firms were arguing that any one particular case could cause them to fail. And so, we wanted to say, okay, what's the liquidity, what's the funding, what's the capital, and is that true or not? And the firms refused to present us that data.

They gave us limited data though that did raise a concern because it appeared that if you recorded liability for all their post-retirement benefits, that there could be one, maybe possibly two of the firms that would actually have negative equity, at least at the time.

But they were unwilling to provide that data, parts of that is the way they operate as a partnership and they tend to distribute 90 percent of the earnings each year out to the partners, because the partners want the money to be able to pay taxes on the income.

So, then we started to, since we couldn't get really the data to do that, then we started to look at other things. We had a presentation made by someone who helps defend the firms and that showed that on the litigation payouts, the payouts on average were around half a penny, a penny on every dollar of claim. So, they really -- the settlements that they were actually paying out in cash weren't that significant.

In fact, the largest payouts had nothing to do with audits, it had to do with consulting and tax services. There were some big ones on audits, don't get me wrong, but we found that.

And so, then we started to ask in the public hearings, we went through and asked for the record each of the CEOs of the firms, or their representative testifying, what financial information they had that they were providing the partners at the time.

None of the Big Four were providing a GAAP-basis set of financial statements to their partners, none of those -- well, if you aren't providing GAAP-basis financial statements, they aren't going to be audited GAAP-basis financial statements, so that was off the -- and that was triggered by the fact that in the U.K. at the time, they were requiring those top seven or so firms to have audited financial statements.

And they did have them over there and they were made available to the public on their website, but we didn't have that here. And so, if you didn't have the GAAP-basis set of financials, they hadn't even prepared them, then it gave rise to this concern, well, how can you monitor that from a public policy perspective?

So, we don't get into a too big to fail possibility, because the firms were saying, we have this catastrophic risk, we got beyond that somewhat because, and that's why this report didn't have any recommendation for tort reform, because it appeared that the catastrophic risk wasn't being due to the actual settlements on the large audit cases. Perhaps other reasons.

But given that, then we had a great discussion, okay, if that's the case, we don't want to get into a too big to fail, then what do we want to have? Because we didn't have anything in the U.S., so we looked to what the European Union was doing at the time with their Eighth Directive or Fortieth Directive, whatever it is, their Directive, okay.

And started looking at that and thought that was a good starting point and, in fact, some of the accountants on the group actually said the same thing, that's a good starting point, get something in place. Chairman Doty has been very good at at least moving the ball, if you will, not always where I'd move the ball, but he gets things done.

And so, along those same similar lines, the notion was, let's try to at least start in middle with the Eighth European Union Directive and get that information and then, once we get that, then people can decide where we go from there. There were people on the Committee who would have gone to where the U.K. had gone.

The U.K. was much ahead of European at that point in time, because the U.K. was saying, we want full GAAP-basis audited financial statements, which were great.

The U.K. was at the top, kudos to them, then Europe, and then the U.S.

What we see as we go through these is they don't provide you, the U.S. ones, because that's what we're talking about, the U.S. firms, they don't provide you with sufficient financial information to make an assessment about stability, sustainability, they don't give you the information on the balance sheet, and we certainly don't have the information on these huge post -- no, you just don't have that in these reports.

And I think if you look on averages, Norm pointed out the European do have more data on the firm in all aspects in term of governance and, in fact, in some -- well, I'll come back to that. But just more on governance, what the firm is doing, the finances, so overall, it's just a much more thorough report.

So, I would turn around and say, these firms are the only people they have to hire for an IPO or for an offering of securities, you don't have to hire an attorney, you don't have to hire an underwriters, these are the one person mandated by law. So they've got a very important federally mandated utility, and with that should come some obligations, especially since we're just down to four.

So, I think going back, while I'd prefer the U.K. approach, because I thought that was great, I think even getting us to where the European was, which is what the ACAP recommended, I think that's where, to Steve's question, we need to get.

I would have hoped that by this point in time it would have been done voluntarily, there was some discussion with representatives of the profession on the ACAP that they would move in that direction to do it voluntarily, it just hasn't happened. We're eight years out, people have short memories.

I remember when Arthur Andersen, after the scandals in the 1970s, early 1980s, Arthur Andersen put on an advisory board and memories got short, time passed, and the board, that advisory board went the way of the dinosaurs. So, I think unless the PCAOB does something here, we're going to be at the same place we are the next time we have an Andersen, whenever that does occur and it's likely to occur, I think. So, that's the issue on transparency.

On governance, when you look through the reports again, the governance of the firms, for the most part, is much the same it was when I was a partner, and I assume when Pete was a partner as -- so, the governance structure hasn't changed and it does impact the culture of the firms.

The people at the very top, the CEO, is selected by the partners, and then there's a board of partners, a select group of partners, that form the governing board for the partnership and they direct it, but they're all internal, they're all internally focused, none of them have that independent perspective that we look for in public companies.

Because the unique structure of these things, all being LLPs or LLCs, on ACAP, we didn't say, here's how you got to set up that structure. But what we said is, go study that structure and then come up with something.

That's, in essence, where we were going with it, because we hadn't, in the year we had to do this all, we only had one year, we couldn't go beyond that because of the federal laws, we said, go ahead and study it, figure out the best way to do it, and then put that in place.

Now, again, to their credit, in Europe and in the U.K., especially the U.K., where I noticed they have put together what they call, I think, a public interest member and they have so many independent. The firm is actually picking that person, so you've got to take it with a grain of salt, okay?

The firm leadership, which is picking that thing, we don't have an independent nominating committee like we have with boards here now, but at least it's a step in the right direction to get that public interest member on there. They've gone to that, we don't have that.

We're still back the same governance structure we had in this industry when I came into it 40 years ago, and when you think of the magnitude of the changes of public company corporate structure over that 40 years, to think in the accounting profession we're still in the same place we were four decades ago is almost mind-boggling, yes, almost scary.

And I think what concerns people is when you don't have that outside perspective, then people don't always think about that public interest obligation.

We're certainly seeing that and we don't see the type of culture -- and when you look at the compensation structure, which plays into this, ultimately, at the end of the day, the ultimate compensation structure is really set by those people on that governing board and the person or lady at the top.

And the good news is, we got some women at the top of these things, so maybe things will get better. But that compensation runs downhill, if you will, and so the guy at the top or lady at the top are really setting the compensation for those key partners and they're probably not going to challenge that person, because if they do, that's going to have a negative impact.

And so, you get into this very much silo mentality and mindset rather than being able to think out of the box. And that was discussed in this group and agreed by just about everyone in the Committee that we needed to get modern corporate-style governance, independent thinking into that and if we could get that, get better governance, get better transparency, so people can measure.

We're very concerned that if -- if you aren't even getting the data, the risk of too big to fail is humongous. And so, if you look at these recommendations, a bunch of them, or not a bunch, but some, they don't say, go get audited financial statements, they say, let's start with the European Directive and go get that type of stuff and then we'll see what comes next.

And so, my perspective is, I'd just go back -- I would just like to see what we got, can get, in terms of ACAP. We aren't there, we're eight years down the road. If we haven't even got there in eight years, I'd like to see us, while I'd go further, I'd like to see us just be able to get there. If we can't get there, there is no question, without a doubt, we do face catastrophic risk.

And there's been arguments on the Board about whether or not they have the ability to look at financial stability, but if you look at the Supreme Court case that this organization went through a number of years ago where their constitutionality was challenged and you look at the Supreme Court decision, the Supreme Court decision in and of itself says that SOX gave this Board the ability to legislate, I think the actual language is something like, legislate everything about the public accounting profession.

I don't think there's anything in the legislation that would preclude the Board from getting enough financial data that they can monitor financial risk and the possibility of another Andersen.

MR. HARRIS: Marty, do you want to talk briefly about what we did on the CPA exam? And then, very briefly, Mary, if you want to talk about the scholarship and our outreach? And then, Lew, you've dealt with our international counterparts, maybe you can say two words on our cooperation and coordination with our international counterparts.

MR. BAUMANN: Yes, thanks, Steve. Glad to do that. We had not all -- we had looked at the CPA exam in the past when the AICPA was making changes to it, but we took this recommendation of yours in ACAP here very seriously in the past year, or the last couple of years when the AICPA was going through a study to make changes, and said that the role of the PCAOB is to ensure high quality audits.

And to do that, we need high quality CPAs. And so, we took a much greater involvement in this particular change that took place in the new CPA exam that's being rolled out, as was mentioned, in 2017. And it wasn't just me, I was an active participant with some of my staff on the task force from start to finish, but our comments that we had we shared with the Board and got Board input from that in terms of getting new input into the CPA exam.

So, some of the improvements that were made in the new CPA exam reflected things that we were seeing as problems in our inspection process. So, we emphasized more technical matters, such as a new CPA's ability to audit complex accounting estimates, to audit fair value measures, to audit internal control of financial reporting. And greater emphasis was put on that in the new CPA exam.

We also talked to the task force about, and the task force was very responsive to make the changes we wanted, the exam now has less memorization and enhanced testing of higher-order cognitive skills. Some of these include things like critical thinking, problem solving, analytical ability, professional skepticism, writing skills, the ability to take a problem, analyze it, and write a good conclusion about that.

So, I think the test is much more focused on not just memorizing what you learned, but applying all of that in a work environment. So, I think the exam made progress, we took an active part in it, and we think it's an improvement, and I think they're going to make improvements going forward. As was mentioned, the exam also increased from 14 to 16 hours. So, we took involvement, I think it was good steps, and I think they made good progress on it.

MR. HARRIS: Mary, very briefly?

MS. SJOQUIST: Very briefly. Just a couple of points. One that was on Slide 26 talked about the scholarship fund awarding the fines only to students who were in advanced degree programs. And just to point out that the scholarship program, as it stands right now, and the Board can make changes to it if they wish, divides the numbers of recipients into a group of 75 percent and a group of 25 percent.

The 75 percent represents the schools with the highest granting, the highest number of master's degrees. So, 75 percent of the schools that we select are in that group. And the selection is random and done by an outside provider. The other 25 percent is the balance of the schools, which is where the vast majority of the schools exist.

One other thing that I wanted to mention is that we do, in the program, encourage diversity. It's not required, the Sarbanes-Oxley Act basically says that the awards should be merit awards, and we have not defined what merit is, we've left that up to the various deans of the accounting schools to determine what merit should be from school to school.

We did do one very informal survey of recipients from last year's recipients and we discovered that the recipients reflected the general population of the U.S.A. as a whole. But I would greatly appreciate any help that we could get, particularly from you, Mike, thanks very much for volunteering.

MR. DOTY: Mary, you want to mention the amount and the number of scholarships?

MS. SJOQUIST: Oh my gosh, total? Over the years? I'm not sure I've got the total amount. I can tell you that the largest number of awards that we granted in a year was 102 and at $10,000 per award, that's $1,020,000.

Starting with our first year, and I think our first year, correct me if I am wrong, was 2008, 2009, and we started with a much lower amount because our fines had only accumulated to a certain amount. And I think we had 45 recipients that year. And it's been down a little bit this past year.

MR. GUPTA: The data on those, I was wondering, Mary, do you track how many go into public accounting of these recipients and how many go otherwise?

MS. SJOQUIST: The program encourages them all to go into public accounting, we have not tracked that. And we have talked about this and talked about how we could best track this, and I know that we're still considering how to do this. So, any advice that we could receive, we'd be happy to listen.

MR. SMART: With no restrictions on the funds? So, do you have --

MS. SJOQUIST: No. I mean --

MR. SMART: Do you have to commit two years to public accounting or you --

MS. SJOQUIST: No, there's no --

MR. SMART: -- have to refund the money?

MS. SJOQUIST: There's no restriction like that. The only restriction really on the use of funds is that it's used to serve the purpose of the degree. In other words, they can't use it to take a trip to Europe.

MR. CARCELLO: Mary, that wouldn't really be very difficult to track if you wanted it. I mean, you could just make it as a requirement to the school that receives the reward --

MS. SJOQUIST: Yes.

MR. CARCELLO: -- that at the end of the year they have to report back to you where that stood and is going to work? Because if it's certainly in a master's program most credible master's programs have close to 100 percent placement?

MS. SJOQUIST: Yes.

MR. CARCELLO: So like out of our master's program; I'm sure this is true for you as well, Parveen, we know exactly where every one of those people is going to work.

MS. SJOQUIST: We could certainly talk about that with the Board, and it would be nice to think that we can follow up on that and also track retention.

MR. GUPTA: Yes, I think we can always go to the chairs that collect this data because it isn't their own interest to collect this information to boast about the statistics outside, yes.

MR. HARRIS: And one of the facts, one of the issues you brought up in terms of the ACAP recommendations was collaboration with our international counterparts. And so Lew was the chairman of IFIAR and now how he's the chair of the GPPC Working Group. And then the chairman I think is on the Monitoring Group, but he also has entered into innumerable bilateral arrangements.

So maybe, Lew, you go first.

And, Mr. Chairman, if you want to talk a little bit about the bilateral relations that we've had with respect to our international counterparts, that'll give you some flavor in terms of what we're doing with respect to that recommendation.

MR. FERGUSON: Yes, this is an area where I think we've had as much -- or sort of a quite dramatic increase in our area of activity, the international outreach, and I'll talk briefly about IFIAR.

IFIAR is an organization that started in 2006 and now has 55 members from countries around the world on every continent basically, every major industrial -- most of the major industrialized countries are members of it. China and India are not yet, India primarily because it doesn't have an independent audit regulator that we're satisfied exists, China because of just complicated relations.

One of the things that it has allowed -- that IFIAR has allowed us to do though is to both assess the quality of auditing around the world -- and I think one of the things we've learned both through a survey that IFIAR has prepared now for five years running, which basically is a global survey of audit quality, is that whatever problems we have with audit quality in the United States, particularly in the developing world and the emerging countries world, our problems are dwarfed by the problems of audit quality in those countries. So we spend a lot of time.

And if you are with the leadership of the global Big 6 networks -- and one of the things that's interesting about this organization is that because you'll have 10 major countries, representatives from major countries sitting around a table, I think we get a level of attention from the very senior leadership of the global audit networks that you really don't -- that no single regulator, including the PCAOB, gets.

And so we have been working very closely with them to try to understand better what they're doing to improve audit quality, what kinds of impediments there are, what kind of controls that the global leadership has, what are their abilities to impose audit quality worldwide, what are the impediments structural, cultural, other kinds of things to do this.

We've set a goal, for example, with respect to the survey that we do every year, that we want to see a 25 percent increase -- or decrease, I should say, a 25 percent decrease in the number of audit findings that regulators around the world find from these Big 6 firms over the next four years. This is the first time that we've ever given a quantitative goal for this.

So the international cooperation has I think given us an opportunity to see the profession from a different light than I think any individual regulator gets. And as a result of that we also learn -- by interacting with people we also learn about a lot of the new governance things that are happening around the world, new kinds of auditing reports, new oversight techniques, new cooperative techniques. So it's been I think very much a learning experience for us, and I think for frankly our counterparts around the world.

MR. DOTY: We inspect in over 40 foreign jurisdictions. We have bilateral arrangements, statements of protocol with 27. We inspect now and have these bilateral arrangements in every European country except for Belgium, and that represents -- or I am including in that agreements in Ireland, in Greece and in Italy, which have been achieved this year.

The significance of Europe is that we now have an extension of the adequacy determination which means that we will be able to continue to inspect in Europe merely with renewal with the statements of protocol bilaterally. We do not have to achieve a separate determination at the EU level, at the Commission level of the adequacy of our inspection regime until I guess 2022.

Yes, so this is a significant extension of our ability to operate bilaterally in Europe and we continue to seek arrangements in other countries such as the Republic of China. But these statements of protocol are modeled on the SEC's MOUs, which are also extensive and which provide for information sharing and confidentiality.

The joint inspections have yielded tremendous ability to look at the global network firm audit in a new light. It informs for example our proposed rule on supervision of other audit firms and the global audit.

MR. TURNER: Steve, if you will for a moment, back to the scholarship thing, I think it's phenomenal, especially in a day and age when these universities cost 20 to 50 grand a year and you're talking about 5, 6 years of school, so a student facing a phenomenal amount of cost and facing a high amount of debt when they come out. I think the fact that you guys are providing a million dollars, perhaps a million dollars plus to help fund those educations, hopefully to people from all walks of life, is just phenomenal, and I give you a hand for that.

(Applause.)

MR. DOTY: Congress wants it, yes.

MR. HARRIS: Parveen, let me ask you just a final question on this overall topic. And we discussed this a little bit last night, but it's one thing that is certainly of concern to me and I think to the other Board members as well, and that is with the rise in advisory and consulting services and the attractiveness and the resulting salary differential between what your graduating students are getting to go into advisory and consulting how do we make the audit more attractive to your students and what do we do to ensure that more capable -- well, the most capable competent people go into auditing? So could you talk just a little bit about how you envision the future of the audit and where we're going from here?

MR. GUPTA: In terms of the future of the audit, as we spoke last night, certainly lot is going to change. And when I talk to the firms and interact with the professionals, they are -- there is no doubt the technology is being incorporated in the audit to a larger extent and a number of tasks which are currently or were previously being done by the humans, so to say, are being converted in some sort of technology. And last night at the dinner table we were talking about the example of blockchain and things like that.

So all of that change is certainly going to impact the audit considerably. Maybe some of the change is good because many times the errors and omissions do occur on the part of the humans and sometimes we are the weak links in the entire value chain. So it's good in that sense.

The question regarding how do you make the audit more attractive is an excellent question and it is sad that as an educator I confront that question many times from the students, and you're trying to help them understand the role of the audit in the larger capital markets, but a 23-year-old sometimes doesn't get it when you're seeing a salary differential. So the simple answer is if there is a financial reward, that would certainly make it more attractive to the students.

To give you just a simple example of my own son who is finishing up his fellowship in robotic surgery, he is 33 years old, not yet settled. He's looking for a job right now and he's going to start being an attending on July 1. So one day I just asked him, I said, you know, if you had to do this all over again, would you still do it? He said, dad, of course. I love it. I know that I'm still making $55,000 only as a fellow, but every morning I get up and I'm excited about it.

I think that is the key part, that how can we make our students think like that? I know that it may not be as glamorous as advising or advisory services maybe. And the students do gravitate towards that. I think maybe I've always thought how come somebody at the AICBA and other state societies haven't come up some sort of a marketing campaign that would glamorize the accounting profession and we will break out of this image. But financial rewards is certainly a goal to a large extent.

Now as Joe talked about, some of these things are not within the control of the folks at this table, but

I think the way Board could influence is continuously asking the questions of the firms that what mechanisms they are putting in place to make sure that you are attracting the best and the brightest, at least from the pool that is coming into the colleges, into the accounting side.

MR. TURNER: Steve, if I could use my co-chair here, let me just chime in. Back in 2000 we had that same question put to us as we did the auditor independence rules, and we did a study of it. And what we found was engineers and other professions paid substantially more and students gyrated to that. Two, three years ago McKinsey & Co. did a fabulous study into teachers and what it takes to attract teachers. And it was important to us on our pension fund that we understand that. And I looked at it then.

McKinsey talked about in their study how ultimately the driver of where students go to work and what fields they go into, one, has to do with their ability to get into that field, but then, two, that's driven by compensation. So the brightest minds go where they can earn and have the best compensation. Starts with the medical and the law professions. Goes on down to engineering. In accounting, we're well below that.

Our accounting model, which is more of a triangle-type situation, not like a law firm where they have a lot of para-professionals. We will probably have to adjust that business model because we do not -- despite what people say, we do not attract the brightest people into the profession these days. They go into the other fields. They're going to go into engineering, medical, science, law. And until we change that pyramid model and get it to where we can pay higher compensation, substantially higher than the 55,000 that Joe or Parveen mentioned, we will not -- it's just a matter of economics. We will not attract the best and the brightest.

MS. FRANZEL; Thanks, Lynn and Parveen, for a great presentation. And there was obviously a lot of work behind this. I saw the package where you wrote letters to the various organizations and then everything they wrote back. I'm wondering if you are going to transmit this to those organizations and make yourselves available if they have questions about your assessment and some of the analysis behind that.

MR. TURNER: Parveen said he would.

(Laughter.)

MR. GUPTA: I think Lynn just volunteered me. That's okay, but I have no problem.

MS. FRANZEL: I think that would be excellent because for some of these issues it's, well, who owns the problem? And if we're going to get any accountability or action in some of these really important issues, I think it's important to push a little bit.

MR. TURNER: I think having that on your web site is a good starting point to have.

MS. FRANZEL: That would be terrific. And we can always use our bully pulpit here as well.

MR. HARRIS: Damon, we're going to resist the temptation to ask you how your lunch went, but Lynn did indicate that you had a meeting across the street and he indicated it might be in a white house, but --

(Laughter.)

MR. HARRIS: -- we'll recognize you for other purposes than disclose the content of what you were doing in your great escape.

MR. SILVERS: Well, they forced this dessert on me in the Navy mess that slowed me down a little bit.

I wanted to -- and I apologize for being absent for part of this report which I was supposed to contribute to. I wanted to comment on how these things interact, that -- and thinking back on our work on the ACAP that Lynn talked about, which was -- I don't know if he said this or not in my absence, but it was really a very unusual exercise of this type. And I've been involved in a lot of these types of exercises and this one had all the right players at the table with a real desire to get to substantive answers that a consensus could support.

And in that work, right, there was human capital which we have just been discussing and there was competitiveness, which I was responsible for. And we just had this conversation this morning about essentially the dwindling relevance of the substance that auditors look at, the GAAP financials.

And I think it's important that the Board understand how these things are connected, that it is very difficult to get competitive compensation levels or competitive professional challenges in an environment which is not -- and where there isn't a clear sense of -- a strong sense either of public-spirited mission or competitiveness that drives the kind of economics that draw people, as Lynn was saying.

The ACAP recommendations were looking at -- designed to look at a profession where there was real concern about this -- about these issues, now some years ago and put forward a set of integrated recommendations that would lead to a more competitive, more public-spirited auditing profession that then could attract the kinds of people we've just been discussing.

I think what this morning's conversation shows us is that there is -- that in an environment where in court depositions and the like we see leaders in the audit profession saying that really they view their mission as entirely focused on management of client, where issues like fraud prevention are not their job. And whether this is an accurate description of their responsibilities is not relevant. It's what they perceive them to be and against an environment in which the competition issues have not been resolved, right, where if anything they are more severe than they were when we did the ACAP report.

You can see a circumstance in which the relevance and attractiveness of auditing as a profession is inevitably going to be diminished either because it's -- it doesn't -- there aren't the competitive dynamics and the demands for excellence that would derive from the audit function being seen as absolutely critical to the people who are paying for it, nor is it sufficiently -- nor has its standing as a kind of quasi-public service exercise that draws people for the same reason that people say are drawn to serve at the PCAOB or the SEC.

That hasn't been rebuilt sufficiently, I think. I think it's pretty clear now that that has not been rebuilt sufficiently in the aftermath of not just the scandals that gave rise to this body, to the PCAOB, but I think more tellingly, in the aftermath of the 2008 financial crisis, which is something I've spoken to many times in front of this body.

We are seeing this week a repetition of this in relation to Wells Fargo. All right? We've got multiple

United States senators signing letters asking where were the auditors?

That dynamic and the failure -- which I do not ascribe to the leadership of the PCAOB, I ascribe it elsewhere, the failure to hold the auditing profession accountable and the firms accountable for what happened in these circumstances doesn't produce an environment in which anybody thinks this is a public-spirited thing to do, nor does it produce an environment in which firms -- in which issuers and preparers see that they really need to pay top dollar to make sure they don't have a problem, right? That is the integrated story here. It's completely tied to what we were talking about this morning.

And I give great credit to the PCAOB and to its Chair to try to -- in trying to do something about this. I don't mean to be -- I really want to be clear, I am not -- this is not an indictment of this Board. It's an indictment of the larger political forces that this Board is functioning within.

And the fact that we're having this conversation is the most positive sign out there. The fact that this body exists, that you've encouraged us to pursue this conversation, you know, that is, I feel, an incredibly positive thing. But I think we need to understand the nature of the challenge we're facing and the nature of the problem and the way in which it's integrated. It's not a human capital problem in isolation. It's not a problem of companies doing -- making up their own numbers, which was this morning's discussion, in isolation. Right? And it's not a problem of lack of competition in public company auditing in isolation.

These things are one problem. And I hope the Board is able to take out of this meeting sort of that understanding and that that will help guide what you try to -- guide you as you try to address these things, which you have been trying to do.

MR. HARRIS: Wes?

MR. BRICKER: I appreciate the dialogue, the work of the working group on this issue, as I said in the letter to Lynn and Parveen, certainly enjoyed the dialogue that we had throughout the course of the preparation work as Chair White also mentioned this morning.

I do think it's important to take stock of the ACAP recommendations and then also reflect on the number of changes that have occurred since then.

And so, to that end, and certainly reflecting on the importance of these topics, I look forward to continuing dialogue just as the PCAOB I'm sure does as well.

MR. HARRIS: Okay. Now, rather than take a break, I think --

(Off microphone comments.)

MR. HARRIS: Sure. And then we will not take a break, Joe, we're going to go directly to you so we do end up on time. And then people who want to take a break can have their refreshments after they leave or take them during the course of a brilliant presentation. But we'll just go right the way through.

MR. BAUMANN: So many pointed out that compensation was a driving factor. So compensation of course derives from value. And so value is going to derive from the role and relevance of the audit to the capital markets. Many today have said that auditing still has to improve in terms of the quality of auditing, so consistent high-quality audits will be more relevant to the capital markets, drug rate or pay. But beyond that, the new audit report for instance, in terms of the auditor now talking about critical audit matters and the most sensitive things and the most subjective complex things in the audit, will make the audit more relevant and a greater role of the audit in the capital markets.

That's already evident from the United Kingdom. We're hearing already from the firms and from the FRC that the auditors are way more engaged, and staff are way more engaged in the audit, because they're not just ticking and tying. What they're going to doing is going to be communicated to the stakeholders, to the shareholders, in the audit report. That should make their role more relevant, the audit more relevant.

And beyond that, and Damon mentioned this in this morning's discussion, what drives the capital markets? Yes, the financial statements are critical, but these other types of things, non-GAAP measures, KPIs, periodic reporting, what should the role of the auditor be in the future with respect to these things that drive the capital markets that will be critical to the role and relevance of the audit, therefore critical to getting the high quality people into the profession?

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 telling. 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 think it's incredibly important for the audit firms to see this as an opportunity because they're able to actually show the value to investors of all their knowledge.

So in the past up until now, auditors have all these masses of information, but we had -- as users of the accounts have seen no sight of that. They're actually able to prove their value a lot more and I think that's incredibly important when there is quite a lot of skepticism, at least amongst the investors I speak to often, about the value of the audit to them.

So in terms of has it changed behavior, I'm sure it has, but we don't get a great deal of insight into that. But certainly if I was an auditor and I knew I was going to be talking about this, I think it puts maybe, I would guess, a little extra pressure to be confident of what you're saying.

MS. SIMPSON: Sharpens accountability.

MS. DEANS: Sharpens accountability, that's the best --

(Off microphone comments.)

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, 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 practice which some of the firms are doing, at least some of the time, is to talk about exactly that, where things have changed. So for example, if something was a key risk last year and isn't in there now, to give some explanation of what's changed. Sometimes it's obvious. That division was sold, so we're not worried about it anymore. But other times it's not.

And also when new risks have evolved. And even again, and I hate having to always give the same sort of example of best practice, but if you look at how again the Rolls-Royce most recent auditor's report, actually gives a little chart of sort of where things have moved. So this risk is actually a bit bigger this or a bit more of a concern this year versus a previous year, and this one has sort of moved down the track a bit.

So not just which ones have come on and which ones are dropped off, but actually the evolution of we're a bit more worried about this and we're a bit less worried about this now, which is again very useful and I think is an indicator of the quality of what the auditor is doing is quite an interesting one. We know 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 unless it's right.

And they know. I mean, how do these people know? They can read the report and they can know something's right or something's wrong. They could ask the right questions. Why is it? Or you never see them getting into the kinds of problems with some of the accounting firms you're getting into. Is it trying to get minimum standards or is it trying to get the best standards? I mean, you see the commercial, people go to BDO if they got a problem. I don't know whether it means they're the best, but what I'm saying is that you want to brand your organization, that nobody gets my name unless it's the way we want it, not the way the client wants it. You can't buy our name. I don't know if that means anything, but I'll tell you that's what I see here.

MR. HARRIS: Thank you. And, Lynn?

MR. TURNER: A couple things. As one of the people in the room that's actually written critical audit matter memos at the completion of an audit having to identify those, I think it's going to take some time just based on this conversation for the investor 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 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 that 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.

Now with respect to the conclusion, I've asked everybody to give a little bit of thought to any recommendations or suggestions for future topics or issues or recommendations to the Board. I don't know whether or not people have them, but, Mary, starting with you, I'd like to go right the way around the room and we'll conclude with topics that you think ought to be on the agenda for our next meeting.

MS. BERSOT: Well, I looked at some of the topics that we had a choice for this meeting and I think revenue recognition is one that I think is coming up. And I also think valuations. How are we valuing companies? I don't know if these are PCAOB issues, but I do believe that these would become issues for investors and I would recommend that we take a look at either one of those.

MR. HARRIS: Joe?

MR. CARCELLO: Maybe a more global one, Steve. We were talking about the inspection deficiency rate this morning. And even if we say, okay, well, let's just look at those audits where there's a heightened risk of problems, which is what you try to inspect, those are the audits you try to look at. And the inspection deficiency rates, whether they're 20 or 25 or 30 or 35, or whatever they are, they still I think strike most people as high. And the Board's been around for 15 years.

So then the question I think -- I think it's -- a fair question to ask is are you just getting a lot better at identifying where problems are or are you raising the bar, or is meaningfully improving quality, even where it's most difficult to get right in the hardest areas -- why are we not moving that more? And what is the real challenges inside the financial reporting process: auditors, audit committees, issuers that are preventing that?

I have my own bias. I actually think in many cases auditing is better than we deserve given the institutional arrangements. I think the one weakness in Sarbanes-Oxley is that audit committees have tremendous responsibility and for every good person like Bob Tarola there's someone on the other side who isn't.

And the accountability. The SEC does what they can, but I think there's an issue with accountability there. And it's very hard for auditors I think to hit on every cylinder if they're fighting management and fighting the audit committee at the same time. I think at a certain point you have to be realistic what you expect, too.

MR. HARRIS: Thank you. Sarah?

MS. DEANS: I suspect as I'm new to the group this has been discussed in the past, but something that I feel sort of over the last few years the lid has been lifted a little bit for me on this issue of materiality in the U.K., and it's certainly prompted some questions over there. And I'd be very interested sort of -- and it's such a hot topic in other areas, so for me that's something that's really on my mind.

MR. HARRIS: Norman?

MR. HARRISON: Well, Steve, first of all thank you once again for everything you've done to support us and the groups and organizing such a great meeting. I have been a -- I'm a charter member of this group, and I've been thinking just over the past 30 minutes or so as we were winding down the discussion of what a really interesting day this has been.

And I think part of the reason it's been fascinating to me is that this may be the first time I think that all of the working group topics -- I mean, there's a silver thread here that kind of ties everything together and touches on some big issues that I think would warrant our continuing attention going forward.

So I think my short answer is in addition to new topics we may take up for next year I think we need to revisit some of these perhaps as a group. Because think of what we've talked about today. We've talked about potentially significant changes to the scope and the business model of an audit, building a framework around non-GAAP financial measures, reporting on CAMs an expanded reporting model, which we're about to see your final handiwork on. And we'll have a year of experience under our belt by next year in terms of how that has developed, what the reaction has been. Some of these changes would be market-driven, others are regulatory.

But we've then also talked today about doing a better job of measuring the quality of what may be expanded or differently structured audits going forward. The AQIs and increased reporting in transparency reports around the results of internal audit quality reviews as well as external ones that the firms engage in.

Now once we do a better job of measuring it, it will be easier for investors to attach greater significance and value to it, and therefore for them and for the ultimate customer to be willing to pay more for it, as Bob noted a few minutes ago, which is really what got me thinking about all this.

And once there is greater market value to this product or this service, there may be opportunities to reward those who provide the best service, both at a firm level through increased fees to the point the judge and others have made about the value of the brand, if you will, as well as possibly through -- this would be nothing for this group to consider, but perhaps through some changes to compensation models in firms where high performing individuals and groups could be incentivized or rewarded on the basis of good outcomes. Not good outcomes in the sense of a clean audit, but good outcomes in terms of external objective measures of audit quality.

And that in turn will attract better talent and address the issue we talked about in the last group about what to do about young people who may have some reluctance now to consider the audit profession because it doesn't have the same appeal or glamour or even your medium-term compensation potential. This may be -- these factors aligning may get us to a solution or the beginnings of a solution to that.

So I really think there's been a fascinating convergence of topics. I think they're all part of an integrated set of issues around the business model of the profession. And I would urge that we in some form take it up again next year.

MR. HARRIS: Thank you. Anne?

MS. SIMPSON: Yes, I'd like to make a thanks to our founder, Steve. It's been a fascinating day.

Three thoughts have caught me during the discussions: The first is this issue of audit firm governance. So much that we understand about corporate performance flows from understanding governance ideas like independent oversight, transparency. And if audit quality is our goal, then I do feel the governance path needs to be trodden. And looking at some international examples or picking that up in a deeper discussion would to me be very helpful.

Because in the U.S. you only -- in most or many companies have the right for shareholders to ratify, but we could strengthen that line of accountability to the corporate owners and strengthen that sharper sense of who are you working for. So that's one thought.

The other is -- and perhaps Norman expressed it well about the scope of the audit. And I'm thinking about these new reporting, into which bucket I put the two parts of our working group, which is the non-GAAP stuff, but also the IFRS world and the whole bundle of new issues coming through around sustainability, or externalities is the unifying theme for us.

And then in terms of the human capital side of the ACAP report, it seems to me that this question about diversity and talent management is critical. Because diversity on corporate boards, we have terrific evidence that it's really good for decision making, both on risk and also on value. And as we look at more dimensions of diversity from gender to race, ethnicity, disability, sexual orientation; in other words anything, you're not only capturing better talent because you've broadened and deepened your pool to go and look for people, but you also then get a much higher quality of input because people come from different perspectives.

So it seems to me that that would be maybe a complement to looking at the audit firm governance. But I also like very much Sarah's point about materiality, which I do think is a unifying theme through all of this. But materiality we would want to hold onto it through the eyes of the beholder, which is of course the investor. We don't want that to me thought of in a more diminished way as just an issuer consideration. But thank you very much.

MR. HARRIS: Thank you, Anne.

Mike?

MR. SMART: First I'd like to thank you, Steve, and the rest of the Board for allowing me an opportunity to serve. I found today just fascinating and frankly invigorating, just finding out some of the things that you're trying to do and have been doing in the past.

As it relates to new ideas and topics of discussion, from my perspective I'd actually like to continue a focus on the non-GAAP accounting. I think that's pretty critical from my perspective. And I think from all investors' perspective. I think if accountants can put a value and definition on derivatives, they can very clearly define something as simple as EBITDA in particular industries. I think that non-GAAP component and issue sort of leads to valuation. So I think they're sort of connected to the hip because many investors use a lot of non-GAAP items for valuation purposes.

The second item is that of human capital. As I mentioned, I have a sincere interest in helping out in any way I can. I think it's very important to try and demonstrate and illustrate to those in college and graduate school, the importance of the audit process, the value that you're bringing. And I think that this body can -- working with the profession can come up with something that makes sense and accomplishes that goal.

I'd also like to help as much as I can on the issue of diversity. Thank you again.

MR. HARRIS: Thank you. Curt?

MR. BUSER: Thanks, Steve. And I'd like to compliment the Board on really everything you guys have been doing. I think if you look back, really just as Chairman Doty said at the beginning, over the course of the PCAOB's existence the improvement in audit quality of that time period has been very good. And so we should not ever lose sight of really kind of that collective work.

In terms of thoughts on what we should be looking at, I'm going to put this out with -- it is a very standard item, but it may not be in your direct purview of scope. I have clearly no expectation that we'll solve it, but a lot of these things have a long tail and we got to get started on it.

So cyber security, business continuity and disaster recovery. Those are areas that are ripe for assurance. There's no easy answers. There are other organizations that are working on products and the like, but those are real threats, real issues that we need to provide help to the profession, the community, the preparer community. And it's clearly in the mind set of investors. So thank you.

MR. HARRIS: I'm smiling because I brought up the issue of cyber security maybe three or four years ago in terms of what's the role of the auditor vis-á-vis assurance on cyber security, so I would welcome any thoughts because I think that the general sense that I get from the profession is that things are fine as is. And if they're not --

MR. BUSER: I think it's a really hard issue. I think that the talent that you have can bring some fresh ideas and as long as we kind of view it as one of these things that we'll probably talk about for several years, that's helpful.

MR. HARRIS: Peter?

MR. NACHTWEY: Thanks, Steve. I agree with everything that's been said here so far. I'm not sure how you're going to handle all the work by the time you get around the table though.

(Laughter.)

MR. NACHTWEY: We're going to have 19 different ideas of things for you guys to focus on. But I'll actually just reiterate one that has been talked about before; and I've spoken with Jay and Jeanette last night on this in terms of the audit committee outreach, the fact that -- I kind of view there's a -- there should be a partnership there. I realize it's not directly in your purview, but with the PCAOB kind of governing the macro and setting the rules for where the rubber meets the road is with the audit committees.

And Jeanette was kind enough to come and meet with ours at Legg Mason several years ago. I think there's a lot that can be learned. And a lot of audit committee members, while they're financial experts, aren't necessary audit experts in figuring out a way to share learnings and best practices and strengthen the role of audit committees I think will go a long way to helping in terms of quality audits.

MR. HANSON: Just one quick reaction to Pete. Thank you and I appreciate the invitations we get. I recently met with another group, a specific company audit committee, and very valuable for us. We learn a lot from those interactions, so appreciate that.

Just one comment to follow up on something that I think, Norm, you might have been holding these reports out earlier relative to some of the firm transparency reports. I can't remember who's -- I didn't see what you had, but the one thing that was sticking with me is the U.S. report you're referring to from that firm, there's a much lengthier report than that I know I've seen. I just looked it up. It's more equivalent to the U.K. report. And so not a perfect analogy, but there's much more out there for that particular firm you were holding up than what you had in your hand.

MR. HARRIS: Tony?

MR. SONDHI: In terms of things that we might want to consider for next year or so, I have seen a lot of material lately on blockchain technology, the issues that relate to it. Brainard has been talking about it and how that affects data that the Federal Reserve, the banking system is affected by.

But if you combine that information with say data analytics, the artificial intelligence and how that's affecting audits today -- because I know that some of the audit firms are already starting to look into the real-time auditing, as they like to call it. Deloitte is one of them. And so these are the kinds of things.

And we -- obviously it's a very, very large issue, very big issue, but we can -- I think we ought to start thinking about it because it certainly affects the way financial analysis is being done and will be done tomorrow.

My second thought is to go back and take another look -- this is along the lines of what Norman said. The way I was looking at it was sort of like the post-implementation reviews that the two -- the FASB and the IASB have been conducting, except there are times when I wish they would actually read what those post-implementation reviews are telling them. But at the same time I think we might want to do a little bit of that as well and see if we can then look at it from that perspective.

And the last point is audit committees. Pete just pointed out that they may be financial experts, but they're not necessarily audit experts. Sometime back I think Lynn had pointed out something about that requirement for accounting literacy that was -- accounting literate people that we needed and how much that had been watered down.

I was wondering if one could just go back and take a look at a good sample of audit committees and find out -- and rank them according to their accounting or financial literacy. Might be a service we might be able to provide. So if I do start that business, I probably won't be here.

(Laughter.)

MR. SONDHI: But in any case, jokes aside, I really do think that we need to take a look at blockchain, artificial intelligence and how that's going to affect it.

And last I wanted to say that I appreciate the opportunity to talk about non-GAAP measures and I don't know how I would be able to sufficiently thank you for the help I got from both you -- from Nina and from you.

So I do appreciate that a great deal. Thanks.

MR. HARRIS: I must say that I've heard exactly the same thing as you have with respect to the role and relevance of blockchain and how it might impact the audit of the future. I don't pretend to understand it. I haven't spoken to too many people who do understand it, but it's clearly coming and it's clearly a chain to the audit. And so I would welcome your thinking on that. And whether we take it up next year or at some point in the future, it's coming.

Amy?

MS. McGARRITY: Thank you. I guess first off I just wanted to really express my gratitude to you, Steve, and also just to be part of the group and the conversation. It's been an incredible learning opportunity for me today and throughout the time I've been on the group.

I think Sarah mentioned it earlier that as investors I think we maybe take a lot of this information for granted, and so just being here today has been an incredible opportunity, experience and learning process for me. So I'm grateful for that.

I think a lot of the information that people have suggested we continue to study is relevant and I look forward to those discussions. Some areas that I'd like to call out and echo include materiality -- and I think that because I'm new to the group it's definitely been spoken of before, so it may be a repeat for a lot of you, but to some of the newer members it might be very relevant.

And then Tony just talked about something quite interesting that I hadn't even considered with blockchain and AI. And I think BlackRock is doing a lot with AI, so I'd be interested in Kevin's input into that and to the investment process. But I think that could be an area of increasing investor interest which could benefit from audit oversight potentially. So those could be some areas of interest for me.

And then I think the discussion of non-GAAP and also integrated reporting could be continued as well. I think we had a lot of interest there and a lot of good information discussed. Thank you.

MR. HARRIS: Kevin?

MR. CHAVERS: First of all, I'd also like to thank the Board for the opportunity to actually work with Steve again, or work for Steve, as the case may be from time to time.

A couple of observations and then a recommendation. I was fascinated by the discussion frankly about the industry and the business model of the audit practice in firms and it strikes me as a very similar conversation sort of in the wake of the financial crisis that the rating agency models have gone through in trying to understand their value limit, their liability.

Both industries have the unique situation of having frankly been written into our securities laws, and so they are integral to the capital markets but seem to struggle with how to make their value proposition reflect the product that they delivered given the significance that they enjoy. And they seem to be struggling with a very similar conundrum.

So in terms of future-looking subjects I would hearken back to a continuation of the non-GAAP accounting standards, particularly though as it related to the integrated reporting issue. I think as you look forward to new topics it's important to be just that, forward-looking.

And as sort of the ESG standards of disclosure continue to be an evolving issue amongst the -- with the SEC, I think it's important to look at what it means to provide assurances for those standards going forward. And whether it's in the traditional accounting model or there are other validators or other sources of assurances I think is a topic worthy of additional conversation.

And then as a host of others have now touched upon, the issues that technology brings to the fore of cyber security, blockchain and the implications of even the primitive of FinTech going forward I think is an interesting topic for exploration going forward.

MR. HARRIS: Thank you, Kevin.

Linda?

MS. DE BEER: Thank you. I must say it was certainly fascinating for me as well, so I really enjoyed it and thank you for inviting me.

I think my comments are very similar to what a lot of people have said. I don't think any of the issues we discussed today have been put to bed. I think there is still a lot of work on most of them.

For me a couple of them: Obviously the non-GAAP I think are really important, but the one that just really hit home for me is just drilling a little bit deeper into the governance of the firms. It is such an overarching issue, the governance of the firm, the transparency of the firms, the whole business model of the firms. I think to do justice to that there is probably quite a bit of homework to be done to get the right information to really understand how it works and what underlies all of that.

But I think that is also the long-term key to the survival and the thriving of the profession, because as the world is changing, if the auditing profession is not going to change in accordance, I think we're going to be in trouble. So I think that on the one hand governance, transparency and on the other hand audit quality. And audit quality is actually such a big topic. It should also stay on the agenda. If I think about audit quality -- I think it was Norman that referred to the inspection findings and understanding that and -- or maybe it was

Joe.

And part of audit quality is also the skills, the skills of the -- if we talk about human capital, the skills that auditors need going forward, the skills that auditors need in dealing with simple things as accounting estimates, but also with all of these new complex topics that are coming up. So I do think audit quality is important. And you can't really de-link these topics from one another.

And then obviously the upcoming aspects. That was -- I had similar thoughts to Tony. I think the things for example like big data, data analytics, all of these upcoming topics that will again change the business model and the way in which auditors will be auditing in future away from sampling, probably do more real-time audit, more complete populations and so on.

I think those things we must keep an eye on. So you probably will have more than enough, Steve, to fill your agenda.

MR. HARRIS: Bob?

MR. TAROLA: Yes, thank you, Steve, and thank you for your leadership here. And I also want to say to the

Board I've been watching your work for -- since 2002, I guess, and it's -- you need to be commended because we're not really talking about bad audits much anymore. And I was just one of your recent subjects. You inspected a company where I serve as the chair of the audit committee, and I got to talk to your inspectors about what we do. So it was a good experience and they're doing a good job.

I want to reemphasize a couple things: One is what we're talking about; and I'd ask any investor in the room, investors invest in managements. And a lot of what we talked about today was how to help management display their own credibility and capability by having it in essence independently assessed.

The pass/fail audit report doesn't help them much in that independent assessment, but certainly one that talks about their judgments would help with that independent assessment. So I think if one looks at it with an open mind, it helps the auditing professions and it also helps their clients to be perceived more -- with more credibility in the marketplace.

And then I'll just endorse the -- I think a good topic for this group would be the changing technology environment. Not just how it might impact how auditors do their work, but also how investors digest financial information and the connectivity between the auditor and the investor in that technology exchange.

The idea of only exchanging information as a whole is probably an obsolete model because investors don't digest financial information as a whole. They digest it in bits. And we could find a way to get connectivity between the user and the auditor in that environment.

MR. HARRIS: Thanks, Bob.

Gary?

MR. WALSH: Yes, this has been the best meeting that we've had so far in my opinion, that I've seen, and so I was trying to figure out why that was the case. And I think the topics have been really good, but we also have a different mix and we're getting a lot more of what's going on internationally. And I think we can learn a ton from the different viewpoints, and so I encourage us all to continue to reach out to wherever good ideas are coming from.

I think I'd like to kind of lean against what we've talked about a lot of the time here today and I'd like to see a simplification of the financial reporting process. I dream of the one-page annual report. I think that would make -- give us a lot more free time.

(Laughter.)

MR. WALSH: But I do think that there is some progress that can be made in terms of simplifying what investors have to read. I want all the disclosures that we've got and everything else, but I think that somehow we should go through and figure out how to make it as simple as possible. But thanks for having me.

MR. HARRIS: Well, thank you and thank you for that comment about the international participation. I think we can learn a lot from our international counterparts and so we appreciate their input.

Parveen?

MR. GUPTA: Steve, I'd like to thank you and the other Board members also. This was my first meeting, so I really enjoyed a lot and thank you for the opportunity to be a co-lead on one of the topics. It was a tremendous learning experience for me.

One of the topics that come to my mind that maybe will be of consideration is in the area of internal control. And I know internal control over financial reporting continues to remain a challenge, but I guess what I'm thinking in that area is as follows: Currently management uses the causal framework to opine against the efficacy of their control systems. And then auditors also use the same framework to render an opinion, but at the same time you also have Auditing Standard No. 5 where absence of material weakness leads one to conclude the control systems over financial reporting are effective.

But when you look at the causal framework, there are five elements, and whatever little research I have done in that area I understand that folks are evaluating individually each one of those five components: controlled environment, controlled activities, risk assessment, monitoring, and information and communication.

I wonder do the investors understand that, how the existence of that framework -- how it is being employed by the management and the use of the framework by the auditors, and concurrently the existence of AS 5 criteria with regard to presence of absence of a material weakness? How does that interplay and impact the ultimately conclusion that comes on internal control over financial reporting, whether the company has an effective system or not an effective system?

It ties into the audit quality, because when we talk about the audit quality under the current regime, we are looking at -- not only at the process that leads to the final product. We also look at the final product. So I think it's important to maybe think that how internal control is being evaluated, implemented and what's the role of these standards in this area?

MR. HARRIS: Thank you.

Mike?

MR. HEAD: The good thing about being this far down the path is that you can say me too, me too, me too.

(Laughter.)

MR. HEAD: The bad thing is that you always feel this pressure: do you need to come up with a new idea? I'm not going to come up with a new idea.

But I think prospectively, from again an investor and especially a retail investor point of view and how heavily they're utilizing or relying on the non-GAAP financial measures, I'd like to see us not let that drop to the side too far. I'd like to see -- there was a lot of comments about potential enhancement on format and content of combination of the financial statements and the footnotes that would allow you to readily see the non-GAAP financial measures within the financial statements and the supporting footnotes and this netting and where do the numbers come from?

And in conjunction with that an audit framework and standards to audit against. I think there's a lot of value to the retail investor in that area. And I think we scratched the surface today, but I think it's a really, really important topic.

And then the way retail investors do their investing today and this whole big data, blockchain, cyber risk, data analytic, continuous auditing, all of that technology, I think that's a significant area of support, risk, help we could give the retail investors also in that area.

MR. HARRIS: Larry?

MR. SHOVER: I have the booby prize, but I've had this written since this morning, so I'm not copying anybody.

(Laughter.)

MR. SHOVER: I'm thankful for everybody. I've learned so much. Special thanks to Tony Sondhi down at the end who led our group. And I am strongly proposing Non-GAAP Part 2 next year. I am -- as useful as it is, I am both suspicious and concerned with its rapid spike in growth, although I do believe that it might be because we live in a zero-knowledge world. Like knowledge is cheap, information is cheap, and perhaps that's part of it. I don't know.

The cynical part of me could say like why are earnings adjustments always asymmetrical? Why? Why are exceptions so often not exceptional? Or how is it that management can define what -- their roles and get paid on those roles without any oversight, or very limited oversight?

That said, those aren't even the big issue. I mean, I think the big issue is that we have to realize that non-GAAP is probably here to stay and might even grow, and how can we better educate people and how can we come up with some type of comparability, if there is any, or any kind of uniformity? If we start tomorrow, maybe we'll have some answers by next year, but I really do believe that that is the big issue. Thank you.

MR. HARRIS: Thank you. And then, Brian, you and Wes have been -- you certainly have been covering us in participating, Brian from the initiation. And if either of you have comments that you'd like to make, we'd certainly welcome them. And if you'd also pass along our thanks to Chair White for her participation, that would be most appreciated.

MR. CROTEAU: Yes, just for my part, having participated in these meetings now for six years, I do recognize the value and would just like to echo the remarks that Chair White made this morning. Certainly you've covered a range of important topics and I think a lot to think about coming out of the meeting today. I know that the PCAOB staff and SEC staff as well will utilize this information and really value the work that this group does and the contributions that you're making.

MR. BRICKER: I'll be very brief. Much appreciation for all of the work of the committee, the group in the dialogue, the discussion that certainly informs the work that we do and that we do with the PCAOB. So we do appreciate that, as does Chair White and the other commissioners. So thank you very much. It's been a very productive day and discussion from my perspective.

MR. HARRIS: Now a very special thanks first of all to everybody here, but to our presenters.

I agree with the chairman. I think. Tony, that your presentation on non-GAAP was extraordinarily well done and insightful and certainly left a number of issues for both us and the SEC to consider. And I know because I've been, as I said, part of the traffic that putting that together really was a yeoman's effort. So for you and your entire team compliments.

Thank you, Parveen, for keeping our feet to the fire with respect to the ACAP recommendations. I'm a terrific supporter of the ACAP recommendations. And if you could thank Lynn in absence and your entire working group, I would appreciate that. But I thought your presentation was excellent as well.

Joe has left, but I want to thank the empty chair for his eight years' worth of his participation on this issue, which is hopefully coming to a final point.

And, Sarah, for all your work in the U.K., for your participation here today, for your presentation thank you very much. It's well worth it to us.

And the same goes for you, Linda, from traveling from South Africa. It's been a significant contribution.

And in conclusion these meetings could not take place without Nina Mojiri-Azad and Tope Folarin. So Nina and Tope, who are over here, both substantively, administratively, every single aspect of this -- it's a three-person effort and I want to really give you all the credit in the world, which you deserve. So thank you very much.

(Applause.)

MR. HARRIS: And with that, I hope to see you next year.

(Whereupon, the above-entitled matter went off the record at 4:45 p.m.)

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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Investor Advisory Group

Before: Public Company Accounting Oversight Board

Date: 10-27-16

Place: Washington, DC

was duly recorded and accurately transcribed under my direction; further, that said transcript is a true and accurate record of the proceedings.

Neal R Gross

Court Reporter