NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on October 14, 2009 that related to the Board's concept release on requiring the engagement partner to sign the audit report. Other topics discussed during the October 14, 2009 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

(PCAOB)

STANDING ADVISORY GROUP MEETING

9:03 a.m.

Wednesday, October 14, 2009

National Association of Home Builders

1201 15th Street, N.W.

Washington, D.C.

MARTIN BAUMANN: Thanks for your comments on that.

So the third, the third item we have is the concept release on potentially requiring the engagement partner to sign the audit report, in addition to the firm. And that comment period has closed as well, and Bella Rivshin is going to give a summary of the comments received here.

BELLA RIVSHIN: Good afternoon. The July 28th concept release is the most recent concept release the Board issued to solicit public comment on whether the Board should require the auditor with final responsibility for the audit to sign the audit report, in addition to the currently existing requirement for the audit firm to sign its name on the audit report.

As Marty mentioned before lunch, the SAG discussed this topic last year, and this is after the U.S. Department of Treasury Advisory Committee on the Audit Profession issued their final report, which included this recommendation. The Board received 23 comments from auditors, investors, academics, and others.

As you can tell, there was -- most of the comment letters came from accounting firms and

association of accountants. The comment letters can be found on the Board's Web site under their rulemaking docket, Number 29, in addition to the comment letters for confirmations and also risk assessment in case after this discussion you are interested in actually looking at some more specific comments.

I think differently than the comments that were received on confirmations and possibly risk assessment, there were very opposing views relating to this topic. I think, similar to the SAG discussion, there were certain individuals on one side who felt very strongly that this is a requirement that will increase audit quality and investor protection. And there were others who felt that this would not provide any additional information as it relates to investors and would not increase the quality of the audit for several reasons.

The investors who commented do think that this would enhance audit quality by strengthening the auditor accountability and improving the transparency of the audit process. There were academics who commented that such a requirement could have a number

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of positive effects, while an association of academics commented that based on the existing research, it is unclear whether the signature of the engagement partner would improve the audit quality.

Auditors felt strongly that such a requirement would not increase audit quality because partners already held accountable to their own very strong sense of professionalism and accountability supplemented by mechanisms that are in place to allow third parties to hold them accountable. The commenters noted that such mechanisms include the firm's own system of quality control over its auditing and accounting practice, the firm's internal inspection process, the PCAOB inspection process, and the oversight by the audit client's audit committee and other regulators, such as the SEC and State wards of accountancy.

Auditing firms also commented that requiring an engagement partner to sign the audit report would not provide any additional benefit over and above the existing mechanisms of accountability and transparency and, in fact, could result in unintended consequences.

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Finally, the auditors were concerned that the signature may lead to a misconception by investors that in terms of who is actually responsible for the audit and the issuance of the audit opinion. Specifically, audits are accomplished because of all the resources of the firm, which include the engagement team, the engagement quality review partner, specialty partners if certain expertise is needed, and also consultation with the national office, if needed.

There were opposing views again as it relates to the transparency and also the possibility if users would be better -- by having the signature, it would be better to evaluate and predict the quality of a particular audit. Investors stated that the transparency would be useful to investors' audit committees and audit firms because they could evaluate the extent of the engagement partner's experience and the firm's policy on developing and enhancing the engagement partner's expertise, as well as oversight of engagement partners.

They could evaluate the quality expertise and better supervision of the audit team and the entire

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audit process, evaluate whether the auditor biases on information process is reduced and whether there is enhanced auditor's consensus and effort.

Academics who commented pointed out that the engagement partner is already known to the audit committee and that the knowledge and the identity of the engagement partner may be potentially helpful to investors, but they were not aware of any research that directly addresses this issue.

Auditors who commented stated that the engagement partner's name is readily known to the Board of directors, management, and regulators. And they were unclear as to how the knowledge of the name would provide useful information without understanding the specific capabilities of the actual partner.

Auditors stated that it's important to recognize that the corporate governance process operating under the various Federal and regulatory regimes under which investors are represented by the board of directors and, in turn, the audit committee. And the audit committee has the responsibility to hire, evaluate, and compensate the audit firm and, therefore,

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is in the best position to evaluate the firm and the engagement partner.

Auditors also commented of how they were unclear how the investor would be able to learn from the public disclosure of the firm partner's name because in most cases, the engagement partner would not otherwise be known to the investing public. And his or her sole identifying characteristic would not -- be nothing more than that she or he is a partner at an accounting firm.

They stated that it's unlikely to assist the users of audit reports to evaluate the qualifications or predict the quality of the audit because only knowing the partner's name, again, would not provide the engagement partner's expertise on a particular type of audit or his or her track record relating to that engagement and other engagements that partner is associated with.

Instead, auditors stated that including the individual engagement partner signature on the audit report could create misconceptions that the single person is responsible for the effort and not the

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collaboration of individuals in the firm.

People did mention that there could be -- this type of requirement could lead to some inaccuracies and conclusions about the quality of the audit under certain circumstances because people might be draw inappropriate or inaccurate conclusions about the audit based solely on the identity of the partner.

People who commented on this were mainly auditors and not investors and others. The auditors stated that such a requirement could result in a creation of databases or other type of clearinghouses that would attempt to create a scorecard of the skills and qualifications of auditors, resulting in what was likely to be an incomplete and misleading information, that these types of databases could provide misleading statistical analysis based on the number of audits performed by an engagement partner.

Or they could level unfair criticism or create adverse publicity for an individual partner because he or she was named as an engagement partner for a controversial company or a company that has gone through some financial difficulties.

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Auditors also stated that a scorecard would not appropriately consider the partner's expertise outside of the public company audit contacts and that a potential impact of these inferences may be that the engagement partner become overly concerned with such a scorecard and, therefore, become reluctant to be associated with certain issuers.

Auditors also stated that the conclusions drawn from such inferences may result in unintended consequences for smaller firms who may not have, may not be perceived to have as robust scorecard as compared to partners from larger firms, which may impact their ability to compete for audits of public companies.

And finally, auditors reiterated that there are many dependent variables that affect any simple statistic of audit quality, only one of which is the identity of the engagement partner. The auditors did also note some other unintended consequences. As I say "unintended consequence," I keep looking over to see if Lynn is over there to comment on the word.

The auditors reiterated that the requirement

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runs counter to how the carefully cultivated culture of collaboration in the firms -- that was a mouthful -- and would send the wrong message to the marketplace that the opinion is the engagement partner's sole responsibility.

There also, as I mentioned, could be what is called "guilt by association" of certain audits. If there is a partner who is repeatedly tasked with handling the most, you know, toughest of the audit engagements, the public may gain an inaccurate impression of that partner due to the perception of guilt by association with companies with financial reporting difficulties.

And as a result, there could be the willingness of audit partners to serve on engagements for certain audit clients may wane.

Auditors also were concerned that investors could second-guess an audit committee selection of an audit firm and the engagement partner, that the shareholders may be believe that it is appropriate to contact the engagement partner directly to ask questions about the audit and the company's financial

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statements and other matters. This would put both the shareholders and the auditors in an uncomfortable position because a lot of the questions probably the auditor could not answer due to confidentiality requirements.

Auditors mentioned that there could be harassment and personal danger to an individual audit partner and that the heightened concerns about personal risk may cause an engagement partner to be less willing, again, to make the professional judgments imperative to the execution and timeliness and cost effectiveness of high-quality audits.

And finally, auditors stated that this could increase the individual liability of partners, which could result in a number of partners willing to sign audit company opinions to be lower and the number of firms willing to undertake this type of work to be negatively impacted. Those firms in the marketplace, they stated, remaining could potentially charge higher fees to the perceived increased liability.

As I stated, these were very interesting comment letters to read and very opposing views on this

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matter, and you are more than welcome to read them in more depth on our rulemaking docket on our Web site.

On that, I'll open it up for comments to SAG members and observers.

And Wayne Kolins?

WAYNE KOLINS: Yes. Mine is more of a process question. I note that of the 23 comment letters, 17 were from accounting firms or associations of accountants. Six were from nonaccounting-related sources. In the Board's deliberation of a standard, obviously, you're looking at the substantive nature of the comments that are made. But to what extent is there -- do you weigh the quantitative nature of the comments espousing a certain position?

BELLA RIVSHIN: I think it's the quality of the comment that is made versus the number of times a comment is made. If there is one person that makes a very significant, well thought-out comment, the Board will take that into consideration, even if they were the only individual who made that comment.

But we always hope that many people will -- many more people will comment on our standards and

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concept releases.

Paul?

PAUL SOBEL: Kind of as a follow-up to what Wayne just mentioned, it seems to me that if only two responses represented investors, I would perceive from that that there is a high level of ambivalence among the investors and that, therefore, I'm not sure if there's a reason to move forward with this. Obviously, the audit firms are probably pretty dead set against it. And if the investors don't seem to think it matters, why are we talking about it?

BARBARA ROPER: This is Barb Roper. Could I comment quickly on that?

BELLA RIVSHIN: Yes, Barbara?

BARBARA ROPER: I just think that's not an assumption that you can make from that low number of responses. I think if you looked across the issues that the Board addresses, the sad fact is that there is consistently a low number of investor responses and that it is a mistake to assume that that reflects ambivalence.

I think it's as likely to reflect a lack of

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awareness on the part of the public about this process rather than anything definitive about what their views would be if they were more aware.

BELLA RIVSHIN: Gaylen Hansen?

GAYLEN HANSEN: During the Treasury Committee proceedings and the testimony, the investors felt very, very strongly about this. So maybe we only had a couple of comment letters, and that would be consistent with what Barbara had just mentioned.

We've been over these arguments. I didn't hear any new arguments in the comment letters that we've heard during the testimony that came before ACAP or in the discussion that we had last year, or maybe it was the last SAG meeting, on this particular issue. But we've been doing what we have for the last hundred years. And if we keep doing things the way we always have, then why would we expect a different outcome? And perhaps it might be time to try something a little bit different?

But I found the comment on the idea that we're going to have a shortage of partners willing to sign audit reports particularly -- I just -- I don't

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even know how to respond to that. I just don't see that happening that people are going to be not willing to step up to the plate and there will be a shortage of partners. I don't see that happening.

BELLA RIVSHIN: Joe Carcello?

JOSEPH CARCELLO: Well, I was involved with one of the comment letters. So how I feel is known. So I'll try to keep what I say brief because there's so much that you said I could respond to.

First, in response to Paul, yes, there were only two investor groups that commented. I would point out that one of those investor groups is essentially an umbrella investor group. Jeff may want to pipe in here at some point. But that investor group controls or the membership of that investor group has $3 trillion of assets under management.

And the other investor group that commented or other investor has $200 billion of assets under management. So these are very, very significant investor groups.

The second point I would make is I would encourage the Board to look at the comment letters from

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the firms were very good. They obviously have very bright people who spend time writing very good comment letters. But in fairness to the firm people, they have a vested interest in this debate, and the two investor groups are the customer of the financial reports and of the auditor report.

And the academics really have no obvious vested interest. And of the five, four of the five were unequivocally in support of this recommendation and only one of the five was somewhat I would say both pro and con in that comment letter.

I think the Board should look at the quality of ACAP, as I talked about this morning, the membership of that group. I would point out that the United Kingdom has already implemented this. The United Kingdom has not only implemented this, they have implemented or are on the way to implementing audit quality indicators. They have firms filing financial statements. I just wrote a comment letter this weekend on independent members of firm governing boards, which they have a concept release out on, which is also part of ACAP.

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So it would appear, to an outside party, that in terms of what investors want, the United Kingdom is leading, and the United States is lagging. As an American citizen, as an investor, that makes me uncomfortable.

I would agree with the firms that I think in most cases, this will not matter. If we were to look at the partners in this room, these are all people of high integrity and high competence, and I don't think it would make any difference on the audits they do. But I do think it could matter in the tails.

I won't go into too much depth, but there have been enforcement actions by the PCAOB against some individual partners -- in my opinion, somewhat egregious cases of knowing behavior. And if that person had to sign his or her name, would it have been different? It's hard to prove in advance, but it certainly might.

It's obvious that the firms are against this. The one argument that they made that I do agree with is I do think it's important to craft whatever you do here so as to not increase legal liability on the part of

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individual partners. I think there is enough legal liability. So I don't think they need more legal liability.

So I think that's a fair argument. Some of their other arguments I thought were pretty weak. But I think that's a fair argument.

And given the opposition by the firms, I think I have a very simple solution for you, and that is the United Kingdom has implemented this requirement in 2008. As of December 31, 2009, you're going to have 2 years of data. Study the data. See what happens.

Does mean behavior change? Does the variance change? What are the outcomes, both good and bad, of this requirement? Talk about a petri dish. Short of Canada, the United Kingdom is going to be about as close as you're going to get. And so, I think that could be very informative to the Board.

BELLA RIVSHIN: Thank you, Joe.

Jeff Mahoney?

JEFF MAHONEY: I think Joe just covered every point I was going to make, but maybe I have a couple more. So thank you, Joe.

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Just a couple to add on. One of the individuals who brought this to the attention of the committee, a very prominent accountant that we all know. His name is in the report, so I'm not going to name him, but worked for a "big four" accounting firm. I asked him if he was on the Treasury Committee, what is the number-one thing that he would recommend, and this was his idea. Former big four partner, internationally known, very well respected.

I've also had conversations offline with big four auditors on this point and the arguments, and I get a little bit different story than what you recited in the letters. I've heard all the arguments as part of the Treasury Committee, and I find most all of them very weak.

I would also point out on the legal issue, I agree with Joe on that. The committee discussed that. We had some very prominent attorneys involved in that process. You'll see in the Treasury report that they indicated that this could be done without imposing additional liability on auditors with language similar to language that was used for Section 407 on audit committee financial experts. That's Footnote 87 in the Treasury report.

Thank you.

BELLA RIVSHIN: If there aren't any other comments, we will move on to our next topic on fair value measurements and the use of specialists.

MARTIN BAUMANN: I hope you found this helpful that we will from time to time, as we have standards that we're proposing or concept releases that are outstanding, as we get comments, we'll try to share it with the SAG to try to keep you updated as we're moving ahead with our standard-setting and to bring that before the SAG and see if there's any further input that we can get from you in our thinking.

So I found it useful, and I hope you all did as well.

Meeting of the Standing Advisory Group

October 14, 2009

9:00 a.m. – 2:30 p.m.

Update on Proposed Standards and Concept Release Issued

Keith Wilson, Dee Mirando-Gould, and Bella Rivshin

Associate Chief Auditors, Office of the Chief Auditor

Update on Proposed Standards and Concept Releases

- Proposed standards on risk assessment
- Audit confirmations concept release
- Signing the auditor’s report concept release

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Signing the Auditor’s Report

- Comment Letters Received

Firms and association of accountants	17
Academics and associations of academics	3
Investor representatives	2
Other individuals	1
Total	**23**

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Signing the Auditor's Report

- Key Themes of Comment Letters
  - Opposing views on whether the engagement partner should sign the audit report
  - Opposing views on whether requiring the engagement partner to sign the audit report will enhance audit quality and investor protection
  - Opposing views on whether such a requirement would improve the engagement partner's focus on his or her existing responsibilities
  - Opposing views on whether the transparency of requiring the engagement partner to sign the audit report would be useful to investors, audit committees, and others
  - Opposing views on whether requiring the engagement partner to sign the audit report would allow users of audit reports to better evaluate or predict the quality of a particular audit

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Signing the Auditor's Report

- Key Themes of Comment Letters (cont'd)
  - Some commenters stated that requiring the engagement partner to sign the audit report could lead to inaccurate conclusions about audit quality under some circumstances
  - Some commenters stated that there are potential unintended consequences of requiring the engagement partner to sign the audit report
  - Some commenters stated that there could be an effect on the engagement partner's potential liability in private litigation

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