

**NOTICE:** This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on November 13, 2013 that relates to the Board's Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments. The other topics discussed during the November 13, 2013 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

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WEDNESDAY  
NOVEMBER 13, 2013

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10           MR. BAUMANN: All good points also, Scott. So I  
11 want to thank SAG members for very good, valuable feedback  
12 from the comments made by the members of the PCAOB, the  
13 SEC and our distinguished academics. And thank you all  
14 on the panel for an excellent job done.

15           Well, this is the beginning of our discussion about  
16 our proposal on the auditor's reporting model. We'll  
17 continue this into tomorrow morning but there was a lot  
18 to cover and we wanted to discuss it starting this evening.

19           As I said, we'll probably go one hour on this and  
20 then our dinner reception begins at 6:30.

21           So joining me up here are Jennifer Rand to my left,  
22 Lillian Ceynowa to my left, Jessica Watts to my right and

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1 Elena Bozhkova to my right. And who's kicking it off,  
2 Jennifer?

3 MS. RAND: I am. Good afternoon, everyone.

4 MR. BAUMANN: I'll let you get settled.

5 MS. RAND: Anything else? All right, we'd like to  
6 get into the auditor's reporting model.

7 The PCAOB issued a proposal a few months ago, August  
8 13th. We've been working extremely hard on the auditor's  
9 reporting model, conducting a lot of outreach. Really  
10 this proposal leads up to three years of work, including  
11 a concept release that we had issued.

12 In front of you, you have the slides for this  
13 session and we had intended to provide background of how  
14 we got here, how we got to the board's proposals, what types  
15 of issues came into our thinking in developing the  
16 proposals as well as the summary.

17 Oh, pressing the wrong buttons. The disclaimer I  
18 think Marty's already covered this morning.

19 MR. BAUMANN: Right.

20 MS. RAND: As far as the slides in front of you,  
21 given that we have limited time in our remaining session  
22 today and given that we're very much interested in hearing

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1 from you rather than us speaking, we don't plan to cover  
2 the slides in any detail. We trust that you've read the  
3 proposals.

4 We had also provided you with a fact sheet,  
5 two/three-page summary of the key elements in the  
6 proposals as well as illustrative examples of the critical  
7 audit matters.

8 So you may want to refer to those in connection with  
9 the discussion, but we plan to just cover a few things in  
10 just very high level and then just open up the floor for  
11 discussion.

12 And our focus today will be on critical audit  
13 matters and tomorrow we'll talk about new elements in the  
14 report as well as other information.

15 So with that, I'm going to turn it over to Jessica  
16 so she'll provide a high-level overview.

17 MS. WATTS: All right, so I'm going to just in the  
18 interest of time talk about two slides.

19 The first slide is an overview of the auditor's  
20 reporting model standard. The proposed standard retains  
21 the pass/fail model of the current auditor's report. We  
22 heard from many commenters that they like this form of

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1 reporting and wanted us to retain it.

2 One of the major changes of the auditor's report  
3 relates to the communication of critical audit matters  
4 specific to each audit.

5 The communication of critical audit matters in the  
6 auditor's report is intended to make the auditor's report  
7 more informative, thus increasing its relevance and  
8 usefulness to investors and other financial statement  
9 users.

10 Additionally the proposal adds new elements to the  
11 auditor's report to provide investors and other financial  
12 statement users with information about the audit and the  
13 auditor. These include auditor independence and auditor  
14 tenure.

15 The proposed audit reporting standard further  
16 describes some of the auditor's existing  
17 responsibilities, such as the auditor responsibilities  
18 for financial statement notes and the risk of material  
19 misstatement due to fraud.

20 The proposed standard retains the existing  
21 requirements related to explanatory paragraphs and also  
22 retains the auditor's ability to emphasize a matter in the

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1 financial statement.

2 So the next slide I want to go over is the definition  
3 of critical audit matters.

4 As defined in the proposed standard, the critical  
5 audit matters are those matters addressed during the audit  
6 that involve the most difficult subjective or complex  
7 auditor judgments, pose the most difficulty to the auditor  
8 in obtaining sufficient appropriate evidence or pose the  
9 most difficulty to the auditor in forming an opinion on  
10 the financial statements.

11 The auditor's communication of critical audit  
12 matters would be based on information known to the auditor  
13 and procedures that the auditor has already performed as  
14 part of the audit.

15 Thus, the communication of critical audit matters  
16 does not modify the objective of the audit or impose new  
17 audit performance requirements, other than the  
18 determination, communication and documentation of the  
19 critical audit matters.

20 So with that, I'd like to turn it back to Jennifer  
21 to start the discussion.

22 MS. RAND: Critical audit matters is a significant

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1 --

2 MS. WATTS: You need --

3 MS. RAND: Sorry. Turn the mic on. That might  
4 help. Critical audit matters is really a very significant  
5 aspect of the board's proposal. It's where the auditor  
6 would be communicating those matters that were the most  
7 significant, the most difficult to the auditor, the issues  
8 that kept the auditor up at night, communicate those in  
9 the report.

10 So for the rest of the day today we'd like to focus  
11 specifically on critical audit matters.

12 And I mentioned tomorrow we'll get into new  
13 elements so that's independence and tenure, other  
14 information and anything else that SAG members may have  
15 an interest in and want to discuss.

16 So with critical audit matters, we have this broken  
17 into four different areas where we're interested in your  
18 feedback.

19 First is on the definition and Jessica just covered  
20 that. And then next, usefulness of reporting, the  
21 determination, communication and the documentation  
22 requirements.

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1           So I see some cards up ready to go. I appreciate  
2 that, so we'll get into it. So Denny Beresford.

3           MR. BERESFORD: Well, I've already written a  
4 comment letter but I'll summarize my views.

5           In fact, I also participated in the development of  
6 a comment letter by the Institute of Management  
7 Accountants and I think it was actually said a little bit  
8 better in that letter. My thinking evolved a little bit  
9 I guess.

10           My concern about the critical audit matters, in  
11 addition to just adding lots and lots of paragraphs  
12 possibly to the report and sort of losing the forest for  
13 the trees in some cases, obscuring the pass/fail key  
14 paragraph, is that the notion of reporting the critical  
15 audit matters, the things that involve the most difficult  
16 audit judgments, et cetera, the proposal itself doesn't  
17 actually call for the reporting of the auditing  
18 procedures.

19           So instead of actually reporting auditing matters,  
20 the proposal calls for a description of the company's  
21 reporting of key accounting objective estimates and things  
22 of that nature.

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1           So for all practical -- I think they've cut me off  
2 on purpose here. For all practical purposes, this is  
3 really an indirect way of identifying important matters  
4 in the company's financial reporting, for example where  
5 significant estimates were made, et cetera, rather than  
6 the company, which they're already doing in their MD&A and  
7 so forth or a few companies have had road maps to their  
8 financial statements and things of that nature.

9           In fact, as I said, as I read the document, it's  
10 silent in the standards section with respect to reporting  
11 the procedures.

12           In the basis for conclusions, it said we're not  
13 going to actually require the auditors to report the  
14 procedures when they give the CAMs.

15           And then in the three or four examples that are  
16 given, they actually put in the procedures, which is kind  
17 of an interesting inconsistency I guess you might say about  
18 how those procedures are handled.

19           So it seems rather inconsistent that the approach  
20 that the PCAOB is using is to focus on auditing matters  
21 and yet not discuss any of the auditing, frankly, which  
22 I support.

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1 I think that getting into discussing auditing on  
2 a piecemeal basis raises separate questions about what  
3 would be the opinion on each of those issues.

4 But as I said, it then becomes one of is this the  
5 auditor's responsibility to be listing all of these things  
6 or is it management's responsibility?

7 And in the letter that I wrote, I identified what  
8 I thought would have been the types of items that would  
9 have been reported by two of the boards on which I've  
10 previously, fairly recently served.

11 And those items are very well spelled out right now  
12 in both MD&A and financial statement footnotes so the  
13 reporting of those end CAMs would be a duplication.

14 In addition, of course, there would be the  
15 administrative, I hesitate to use this but I'll use it,  
16 nightmare of the auditors and the company having to  
17 negotiate what goes in the CAMs in the audit report versus  
18 what does the company put in its own disclosures and having  
19 to negotiate those among the auditors' legal counsel,  
20 auditors' national offices, et cetera, et cetera, et  
21 cetera.

22 And all things considered, I just don't see this

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1 as a major step forward. It seems like it's just repeating  
2 information that's in the financial statements already.

3 If there's a need to have these things better  
4 highlighted, I think that's management's responsibility  
5 and, as you can probably guess, I am not in favor.

6 MR. BAUMANN: Denny, I'll just make a very brief  
7 comment. There's a lot of cards up so we'll come back  
8 maybe to the comments later and I know Jennifer and others  
9 will want to react as well.

10 And she didn't go over, Jennifer did not go over  
11 the background but in the concept release we asked, many  
12 people talked about the auditor talking about the  
13 financial statements or the auditor talking about the  
14 audit.

15 And there was a lot more support for the auditor  
16 talking about the audit than about the financial  
17 statements, that the financial statements were the  
18 prerogative of management.

19 And so what we elected here was that option of the  
20 auditor talking about the audit and those matters that were  
21 most difficult and challenging to the auditor.

22 Now, whether they're similar matters that

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1 management's reported on in the financial statements, they  
2 might be.

3           On the other hand, it could be that there was a  
4 particular systems problem that forced the auditor to get  
5 a very difficult time getting audit evidence because of  
6 the breakdown in systems.

7           Whether management intended to talk about that or  
8 not, who knows. Maybe they will after the auditor says  
9 they're going to talk about it.

10           But in any event, we approached this from what were  
11 the most difficult things to the auditor, the most  
12 difficult judgments the auditor had to face?

13           And this is not information necessarily in the  
14 financials. This is what the auditor found to be  
15 difficult and challenging.

16           But we'll take your comments up further about  
17 should procedures be in there or not, but there's so many  
18 cards up, let's turn to Barbara Roper.

19           MS. ROPER: Thanks, Marty. And I appreciate your  
20 scheduling part of this discussion today because, my  
21 apologies in advance, I will not be able to join tomorrow's  
22 discussion.

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1 I think there are a couple of things about this.  
2 You know, I have a son. I'm sure he would have loved over  
3 the years to tell me, you know, each grading semester, mom,  
4 I passed all my courses. I personally found it useful to  
5 get a little more information than that.

6 I think the same, and not to be flippant, but I think  
7 the same is true here. The current report with pass/fail  
8 does not adequately distinguish between the volume of  
9 companies, the vast majority of whom pass.

10 Investors have been saying for years that they want  
11 more information, you know, that the auditor is supposed  
12 to be working for them, reporting to them.

13 And they want more information from the auditor  
14 about issues related to the audit that would help them make  
15 more informed decisions about the companies in which they  
16 invest.

17 In an ideal world that would be enough. Investors  
18 want the information. It's reasonably cost-effective for  
19 auditors to provide the information. We should be talking  
20 just about how we do it and move on. Obviously it's more  
21 complicated than that.

22 I was talking at lunch today a little bit about the

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1 fact that I think in this new world of everything has to  
2 be economic analysis it's very important to think up front  
3 about the problems that you're trying to solve through a  
4 regulation.

5 And clearly one of the problems that you're trying  
6 to solve is that investors don't think they're getting  
7 enough information out of the current audit report.

8 But I would argue that this proposal is relevant  
9 to a number of other important issues that this board is  
10 addressing.

11 In the current system, pass/fail and no other  
12 information, you know, so what are the incentives in that  
13 system?

14 And for the companies that we're worried about, not  
15 the good, aboveboard, strong financial reporting  
16 companies but the companies we're worried about, the  
17 current incentive is to get as aggressive as possible in  
18 their accounting consistent with a clean opinion.

19 If you require the auditor to report about critical  
20 issues, some of that may surface in that context, that they  
21 may find a way to give a clean opinion.

22 But they may raise in the context of this reporting

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1 about critical issues elements that would point to certain  
2 aggressive practices.

3 That could change the incentives for issuers to get  
4 less aggressive. That would be an overall good thing that  
5 this could achieve.

6 You know, there's also a concern we talk about a  
7 lot, is that auditors are not sufficiently focused on the  
8 fact that they're working for investors and not  
9 management.

10 And requiring them to think more clearly in their  
11 auditor's report about what they think they should be  
12 communicating to investors about the key critical issues  
13 in the audit, what made this audit tough, might help to  
14 focus them a little more on their obligations to investors,  
15 you know, in a more concrete way.

16 You know, to the degree that they have to report  
17 out about these things and make a public record about what  
18 they thought were critical issues, they might be a little  
19 tougher in standing up to management in areas where they  
20 need, frankly, to be tougher in standing up to management.

21 And so I think when you look at this issue it's not  
22 just that investors would find this information useful,

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1 and I thought the examples that you provide were good. It  
2 proved to me that this can be done in a way that's not just  
3 boilerplate. This could provide interesting, valuable  
4 information to investors.

5 But beyond that, there are regulatory issues that  
6 you all struggle with, how do you improve professional  
7 skepticism, how do you improve auditor independence, that  
8 this proposal could help to address. It's not a silver  
9 bullet, but it could help to address.

10 One other point, I would just say procedurally when  
11 you think about economic analysis and you look at the court  
12 decision that has driven the SEC further in this direction,  
13 one of the key functions of that, one of the key issues  
14 that they focus on, is the need to assess reasonable  
15 regulatory alternatives that have been suggested.

16 And I know there are a number of suggestions that  
17 investors have made about information that they would like  
18 to see in the audit report that are not reflected in the  
19 board's proposal.

20 And I would encourage you as you analyze this issue  
21 and do the economic analysis that one of the things you  
22 do as part of that is analyze the various proposals that

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1 have been forward and have a good reason, have a good  
2 explanation, a reasonable basis for the decision not to  
3 adopt some of these other proposals because it shouldn't,  
4 frankly, be enough that some issuers don't want the auditor  
5 talking to investors or that some auditors are  
6 uncomfortable in that role. There ought to be a good  
7 regulatory analysis of why that is or isn't valuable  
8 information to have in this report. Thanks.

9 MS. RAND: Thank you, Barbara. Bob Herz.

10 MR. HERZ: Yes, I also thank you, like Barbara, for  
11 spending some time today because I also will not be here  
12 tomorrow and, because of that, I had actually sent Marty  
13 a couple much more technical-type questions I had.

14 I'm generally supportive of the approach you seem  
15 to be taking. I'm also glad that it seems to be, at least  
16 at this stage, pretty similar to the IAASB's approach. Of  
17 course, they call it key audit matters, also KAM, but, you  
18 know, got to be divided by the same language so to speak.

19 But my two questions were, one, it seemed like the  
20 requirement to communicate CAM was only in the context of  
21 an unqualified audit.

22 And I could think of circumstances like we have a

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1 qualification on a specific accounting matter and it would  
2 still be relevant to talk about CAM. That not right?  
3 That's just the way it reads to me.

4 MR. BAUMANN: In a qualified opinion, you'd also  
5 report critical audit matters. It is in the amendments.

6 MR. HERZ: Okay, then I must have read it wrong  
7 because the lead-in says in an unqualified audit the  
8 following requirements --

9 MR. BAUMANN: Not that there are many qualified  
10 opinions filed at the SEC, but it would apply.

11 MR. HERZ: Okay, good. And then secondly, just in  
12 reading some of the examples there, particularly the first  
13 two, the allowance for sales returns and the deferred tax  
14 assets, and maybe I'm too much of a nerd and an auditor  
15 but it kind of left me a little unsatisfied or it wasn't  
16 clear to me -- yes, I knew that clearly, because the auditor  
17 gave a clean opinion overall, that they must have concluded  
18 satisfactorily on this.

19 But it kind of says here's the issue, here's the  
20 problem, blah, blah, blah, and by the way the company's  
21 accounting's in Note 6. There needs some better overall  
22 contextual thing to lead into the whole CAM.

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1 MS. RAND: Did you have anything specific in mind?  
2 We recognize it in the audit opinions and the financial  
3 statements as a whole. We didn't think it was appropriate  
4 to have piecemeal opinions on each thing.

5 MR. HERZ: I understood that problem so --

6 MS. RAND: So was there, kind of in that context  
7 --

8 MR. HERZ: I would just kind of, you know, a  
9 lead-in, something that, you know, the context of our  
10 overall audit which we above concluded, blah, blah, blah,  
11 the following critical matters arose.

12 So at least you alert the, I think an uneducated,  
13 average reader would kind of say, oh my God, this is the  
14 sales returns. They couldn't get happy with that.

15 MR. BAUMANN: We do say in the body of the opinion  
16 that the critical audit matters communicated below do not  
17 alter in any way our opinion of the financial statements  
18 taken as a whole.

19 But your point is well taken and it's somewhat  
20 similar to Denny's point, that should there be the  
21 procedures that were performed or something else, but then  
22 you do run into the problem of piecemeal opinions.

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1           So both good comments that we'll figure out how to  
2 deal with, but thank you and thanks for the support on what  
3 we've done.

4           MS. RAND:   Okay.   Roman Weil.

5           MR. WEIL:   Okay.   Is it working?   Can you hear me?

6           MS. RAND:   Yes.

7           MR. WEIL:   I sent you folks some comments.   That's  
8 not what I'm going to talk about now.   You have that.

9           I'm talking now as a member of an audit committee,  
10 sometimes audit committee, financial expert, sometimes  
11 not.

12           And I'm sitting there in an audit committee meeting  
13 and the auditor says to me, quote, "The PCAOB requires that  
14 I report to you," dot, dot, dot, and everybody's eyes glass  
15 over with boredom.

16           And the piece of paper he's got in front of me goes  
17 on for five or six pages of clear stuff they've taken from  
18 some template that they have at their audit firm and they  
19 reproduce and give it to us.

20           And absolutely nothing useful ever happens after  
21 "The PCAOB requires that we report to you" on X.   Let's  
22 get through that.   Let's get through that and get on to

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1 the discussion of what's important.

2 Now, what I hear here is we're going to have even  
3 more of that. "The PCAOB, in addition to what we've  
4 already told you about, has required that we tell you about  
5 these other things."

6 And I'm not saying these things aren't important,  
7 but you guys have got audit committee overload.

8 The audit committee does not get to schedule the  
9 length of its meetings in the board meetings I go to. The  
10 chairman of the board sets the overall agenda for two or  
11 three days and the audit committee gets some time and the  
12 auditor speaks.

13 And I do not believe that putting this on the plate  
14 is going to increase the amount of time available for real  
15 discussion.

16 So I'm urging you to think about what in other  
17 context people call regulatory overload. If you're going  
18 to put this one in, think about taking something else out.

19 Denny wants to get rid of it altogether and maybe  
20 that's the right way to go, but I'm just telling you that  
21 from being in an audit committee "The PCAOB requires us  
22 to report to you on" X is mind numbing.

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1           MR. BAUMANN: Just a comment on that. When you  
2 said then they went on to talk about a lot of important  
3 stuff, I'm sure the PCAOB requires that the auditor talk  
4 about all those important things that you just referred  
5 to.

6           And maybe in some areas the requirements aren't as  
7 important at a particular company and, therefore, the  
8 auditor certainly has the flexibility, hopefully, to put  
9 the important things up front and then say, in addition,  
10 there are other communications and here they are and say  
11 but at your particular company this year these were not  
12 particularly important matters.

13           But that's another area. That's the audit  
14 committee report. This is about what investors are saying  
15 for years and commissions have been saying for years.

16           The single pass/fail audit report is not serving  
17 the needs and how can we improve the audit report, so that's  
18 our goal here.

19           You know, this certainly would have to be discussed  
20 with the audit committee but we believe these would be the  
21 important matters that were in that audit committee  
22 discussion that would wind up in this critical audit matter

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1 discussion. Who was next?

2 MS. RAND: Scott Showalter.

3 MR. SHOWALTER: Thank you. This semester I gave  
4 my graduate students assignment to compare your proposal  
5 to the IAASB, so I had to do a deep dive on both and read  
6 them.

7 And comments were made and, Bob, you mentioned  
8 about proposal. What concerned me was how similar they  
9 actually were but how different they were and the concern  
10 about a user understanding the difference when they're  
11 reading reports.

12 It's not just difference between key audit matters  
13 versus critical and it seems like you could come to  
14 agreement about that.

15 But the way you start, they start at governance,  
16 you start at lower border definitions, so several comments  
17 have been made about working with IAASB already today.

18 I would just encourage you to try to reconcile that  
19 because I think the user of these reports may lose out in  
20 the end because of the differences and not actually  
21 understand that they actually came from different things.

22 They may think because one is the key audit matter

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1 versus another one is critical they're the same thing. I  
2 don't think they are. I think they're developed  
3 differently and I'm not sure they would really understand  
4 that.

5           You said you're on the group, Marty. I would  
6 encourage you to do that. From a minor technical thing  
7 --

8           MR. BAUMANN: And Dan Montgomery, who's the chair  
9 of the IAASB's task force on their reporting model, is here  
10 today as well.

11           MR. SHOWALTER: So who should I talk to on this,  
12 you or Dan? Okay, so --

13           MR. BAUMANN: You're talking to both of us, so  
14 that's good.

15           MR. SHOWALTER: Okay. But I think it is important  
16 to the user. You talk about the user. We ought to  
17 probably not encourage that.

18           One technical thing is that if you go to Paragraph  
19 7, and this is the difference between International and  
20 PCAOB version, International I think gives the impression  
21 that you could actually issue an opinion with no key audit  
22 matters.

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1           Your Paragraph 7, you actually say in most you will.  
2 Well, I would suggest in Paragraph 9 the fact that it says  
3 you will always have to talk about the most difficult audit  
4 judgment, the most difficult evidence and the most  
5 difficult thing means you will always have a critical  
6 because it's the most difficult. So if I have ten things  
7 it's the most difficult in each one of those. So you've  
8 got an inconsistency between Paragraph 7 and 9.

9           MS. RAND: Okay, thank you. Steve Buller.

10          MR. BULLER: Thank you. So we also submitted  
11 letters to the IAASB and FASB and both are on the website,  
12 so. And as part of our letter submission, we generally  
13 talk to our analysts.

14          We have, you know, roughly 100 analysts throughout  
15 the organization and we try to talk to roughly 15 or so  
16 and get their thoughts on what their teams think about this  
17 proposal, and this one actually was a fairly spirited  
18 discussion.

19          But the analysts generally were supportive of the  
20 proposal. Their conclusion was that they think it's  
21 useful to have the critical audit matters disclosed. They  
22 did favor brevity.

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1           I think that it was important to them that they  
2 understand what the matter was, why it was a critical audit  
3 matter, where it is in the financial statements so they  
4 at least are informed that there is an issue there where  
5 the auditor spent time and they then can have additional  
6 substantive discussions with management if they need to  
7 to understand why it was and how it was dealt with.

8           There are certain entities which have, I think, an  
9 inherently less business model, less complex business  
10 model, and, as a result, there will be routine matters that  
11 should not require identification, or if they do require  
12 identification, they're infrequent.

13           I think it's important people don't confuse the  
14 fact that someone spends a substantial amount of time with  
15 the fact that an issue is a complex issue or a critical  
16 issue.

17           In our case we have a lot of investment companies  
18 that are 34 registrants that would qualify.

19           I think that one thing we were concerned about, and  
20 this is as a preparer now, is we potentially have a lot  
21 of matters which could be considered critical audit  
22 matters and we're worried a bit about the fear auditors

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1 may have to over-document why a matter is not disclosed  
2 as a critical audit matter just because they spent audit  
3 time in the area.

4           So as a result, we thought there was some use in  
5 the IAASB model where they at least start determining which  
6 matters are critical audit matters or key audit matters  
7 by identifying those which were communicated with those  
8 charged with governance or basically the audit committee  
9 as a starting point for the matters which they would  
10 identify for potential disclosure.

11           We also did not support including the audit  
12 procedures in the opinion. We think that it's possible  
13 to take those out of context.

14           We already provide enough information for somebody  
15 to really understand what was done. It probably would  
16 overwhelm the audit report and we do worry a bit about  
17 people misinterpreting those and having it look a bit like  
18 a piecemeal opinion.

19           I think though, however, there are cases where an  
20 auditor may need to provide disclosure and I can't think  
21 of many examples but perhaps where there is a disclosure  
22 of a significant control weakness, it's not a material

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1 weakness, that somehow had an impact upon the  
2 determination of a financial result outcome.

3           The PCAOB probably should provide additional  
4 guidance on when the auditor should disclose information  
5 that is not in the financial statements if they're going  
6 to include it as part of the audit procedures performed.

7           But so, overall, we were in favor of the  
8 communication of critical audit matters and key audit  
9 matters also.

10           MS. RAND: Steve, just interested in, wanted to  
11 explore one of the -- You had a lot of good points. You  
12 make -- One of them was, kind of the source of the  
13 communications being limited eventually to the audit  
14 committees.

15           And in the PCAOB's proposal we don't limit it to  
16 that. But we say, likely the matters in the report we  
17 would expect would be discussed with the audit committee.  
18 Nonetheless, we also direct auditors to look at what was  
19 documented in their engagement completion memo, which  
20 would include summaries of significant issues and findings  
21 in the audit, as well as the matters that were reviewed  
22 by the engagement quality reviewer.

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1           One question I personally have, so this is my own  
2 view, is if it was limited to just the audit committee,  
3 could that potentially, could there be an unintended  
4 consequence that auditors may be concerned about including  
5 something, or communicating something to the audit  
6 committee, for fear that that's now the target list of  
7 things that could potentially be in the report?

8           So, you know, it places greater emphasis on those  
9 communications. And could that have an effect? So, just  
10 interested in your reactions, since you did mention that  
11 suggestion.

12           MR. BULLER: Well, so our general impression is,  
13 and this is in part our experience and from our analysts,  
14 is that auditors tend to over communicate to audit  
15 committees matters.

16           And as a result, we find it hard to believe there  
17 would be something disclosed in an opinion that would not  
18 be disclosed to the audit committee. I think it's just  
19 hard to understand why they would ever do that.

20           First of all, if it's in the opinion, it's of such  
21 importance. And to not disclose that to the audit  
22 committee, I think would raise issues as to the intent and

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1 competency of the auditor.

2 MS. RAND: Okay. Thank you. Next on the list is  
3 Loretta Cangialosi.

4 MS. CANGIALOSI: Okay. Actually I'm going to talk  
5 about, I think I'm going to talk about three things on your  
6 list there. The first of which is definition.

7 And, you know, before I came into this meeting I  
8 had some concerns about how critical audit matters would  
9 be interpreted by investors and others.

10 And sitting here now, I've heard people talk about,  
11 you know, aggressive practices, and, you know, they're  
12 thinking about, well why was it critical? And they would  
13 discuss it with management, and how they dealt with it.

14 One of my real concerns here is, there's an awful  
15 lot of very subjective things that go on as a result of  
16 the accounting policies that we must follow. I'll take  
17 something that's, I'll say simple but complex, which is  
18 a Level 3 fair value measurement, okay.

19 And if I have to do a 20 year forecast, okay, you  
20 can be sure that that is going to be difficult. It's going  
21 to be difficult to audit. It's a 20 year forecast. So  
22 to the extent that these are like normal things. Are they

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1 hard to do? They're hard for me to do, let alone hard for  
2 the auditors to audit.

3 So I think my concern here is really that people  
4 come in with a mindset that there's something going on here  
5 when a critical audit matter is flagged. It means it's  
6 hard to do. It doesn't mean it's wrong or aggressive.

7 And so, I think there needs to be some education  
8 around some of these things, that investors should expect  
9 to see these. I mean, they are what they are. You've  
10 written out what you would determine, and the degree of  
11 subjectivity.

12 If you're doing a forecast, let me say it's  
13 subjective, right. We all agree that different people  
14 will come up with different forecasts, you know, the amount  
15 of audit effort to address the matter.

16 So a lot of these things, my concern is that if the  
17 definition is kind of being, people are interpreting it  
18 to mean something funny is going on, or something  
19 aggressive, or something that needs to be fixed. I don't  
20 if that's exactly what's written here. So that was my  
21 first thing on the definition.

22 My second is on the determination and the

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1 communication. And I do have some concerns with that of,  
2 in some cases, I'll say overload of critical matters being  
3 put in, with people rising to a level of looking at these,  
4 and deciding, you know what, I'm not taking any risks.  
5 I'll put everything in. In which case it becomes less and  
6 less valuable, I would think, to an investor.

7           Because they'll have to wade through a whole bunch  
8 of things that maybe aren't so big. But, you know, and  
9 we see this all the time with the SEC, when they come back  
10 and go, why did you disclose that? And people say, because  
11 I didn't want to get a comment.

12           I can see the similar thing happening here. And  
13 it will dilute the effectiveness of the communication if  
14 that occurs.

15           My other thing is, with respect to some of these  
16 factors, and it's not that I don't like the factors. It's  
17 really going to be within the implementation, and how this  
18 gets looked at within an inspection.

19           So, is an inspector going to be looking at every  
20 one of these factors, and expect a paper on what was  
21 considered, why was it considered, every single thing, you  
22 know? So you will actually drive how effective the

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1 communication is by how much they dig in and ask for in  
2 all of this documentation.

3           So, you know, I do have some concerns about  
4 litigation as well. We have a lot of very clever lawyers  
5 in the room. And, you know, I can easily see audit firms  
6 having more litigation as a result of this. And I'm not  
7 saying that's a reason not to do it.

8           But we should just be aware of the potential  
9 consequences with somebody saying, well, you know, didn't  
10 you think an investor would be, would want to know that?  
11 Well, I don't know. I'm not in the head of an investor,  
12 you know. I'm following the rules.

13           And you've set out rules. But I do think that this  
14 could potentially lead to a lot more litigation. I'm not  
15 sure what you do with that. Other than, probably it's in  
16 the implementation that I would caution and kind of take  
17 a measured approach.

18           MR. BAUMANN: Loretta, thanks for all those  
19 comments. I have a question, and maybe one or two  
20 comments. Barbara Roper talked before about, from an  
21 economic analysis perspective, we have to think about,  
22 what's the problem?

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1           And the problem is that investors clearly have  
2 articulated, and a number of commission have articulated  
3 over the years, that the auditor's report just doesn't  
4 communicate enough about what the auditor did and found.  
5 And we're trying to solve that problem.

6           And some said, and wanted us to go really far, and  
7 say have the auditor really talk about the financial  
8 statements, and give some analysis of the financial  
9 statements. And from looking at alternatives, we looked  
10 at this and said, we think, really, the auditors should  
11 stay in the attest role and talk about, stay with their  
12 audit, and what they did in their audit. So that's how  
13 we selected that.

14           And one thing we did stay away from, though, you  
15 said maybe an investor would care about one thing versus  
16 the other. We didn't write this from the perspective of  
17 a report on those things in your audit that investors would  
18 care about, or a report on those things that were the most  
19 difficult things to you to try to avoid that problem.

20           Now, the lawyers may say, there's still an issue  
21 there. And so we're looking for solutions. But we didn't  
22 go to, what do you think a mind of the investor that would

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1 be the most important thing in the audit? But what was  
2 the most difficult issues for you, the most subjective and  
3 tough issues for you?

4 So we did try to think about a lot of those points  
5 that you're raising. I guess my question to you, and if  
6 you don't have an answer that's fine. But I hope preparers  
7 of financials, like you, Loretta, and thoughtful ones,  
8 also point out their concerns about this. But also maybe  
9 have other ideas for solutions.

10 Because this is a problem in need of a solution.  
11 And if you think there's some aspects of this that raise  
12 concerns, like being too many matters reported, et cetera.  
13 Are there ways in which we can improve this? And that's  
14 what we're looking for very much in your comment letters.  
15 So whether you have a comment now, or you want to think  
16 about that.

17 MS. CANGIALOSI: Yes, you know, and I -- One of the  
18 things that I know, there's a pilot that someone is going  
19 to run with the audit firms, I think. And to look at  
20 exactly how you would go about this, and what kinds of  
21 things would go in.

22 And I think it's really through that that we're

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1 going to learn kind of what those solutions might be.  
2 There's nothing like doing it to inform you of, you know,  
3 what the difficulties are.

4 MR. BAUMANN: Yes, we did, that was discussed at  
5 the open meeting when we proposed this with the Board. And  
6 some of the Board Members felt it would be a good idea.  
7 And I agree with that.

8 If auditors were working with their clients and  
9 audit committees today, and said, let's take a look at last  
10 year's financial statements, and last year's audit. What  
11 might we have reported as a critical audit matter? And  
12 try to see what different parties think about that. So,  
13 we do think that's a valuable idea. Wally Cooney. We  
14 have another preparer.

15 MR. COONEY: Yes. I think everyone here  
16 appreciates the balancing act that you all have had to go,  
17 in terms of formulating this proposal, and all the outreach  
18 you've done over the last few years. I guess, I had a few  
19 comments.

20 And, you know, to your point, Marty, I think as we  
21 work on comment letters, I think you hopefully will get  
22 a lot of practical suggestions.

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1           As we were first going through this, I think people  
2 are focusing on some of the concerns that they have. And  
3 then, you know, and hopefully we'll have time, before we  
4 send letters, to step back and think about, you know, what  
5 alternatives we have.

6           Because if you just hear about concerns, without  
7 some resolutions, then, you know, it may not be that  
8 helpful. I think in general, you know, I supported some  
9 type of matter of emphasis proposal.

10           And in reading through the proposal, I think the  
11 overall framing and the objectives appear to be, you know,  
12 read fairly well. They appeared reasonable to me. But  
13 when I got to the examples I became a little bit concerned  
14 that perhaps there's just too much information that might  
15 be considered to be appropriate level of detail.

16           And two things I would mention. In the tax example  
17 there was a fair amount of information in there about lines  
18 of business that I'm not sure would necessarily be in an  
19 MD&A. Wouldn't really be necessarily anywhere in the,  
20 from a management standpoint.

21           And it just appeared that that could be new  
22 information that was being reported in the auditor

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1 opinion, that wasn't anywhere else in the financials.

2           The other example was what appeared to be a  
3 description of a significant deficiency, which as you  
4 know, is not required currently to be included in 10-K  
5 filings. And so the example appeared to be reporting a  
6 significant deficiency in the auditor opinion, which is  
7 at odds with what the current requirements are.

8           I guess, somebody made a point about perhaps  
9 limiting the audit matters to the audit committee,  
10 reported items. And I think, in general, I'd probably be  
11 in favor of that approach. Partly because, to simplify  
12 the job of figuring out what needs to potentially be  
13 considered.

14           And to limit it to becoming potentially a really  
15 onerous exercise, with the idea that anything that could  
16 potentially go in an audit opinion would almost surely have  
17 to have been communicated to an audit committee before.

18           I guess just another general comment. And it was  
19 that, you could be highlighting items that aren't  
20 particularly important. And Loretta got to this when she  
21 talked about things that are hard.

22           And there are some really important things that are

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1 in the financial statements that perhaps, you know,  
2 wouldn't be mentioned. And I guess a general concern that  
3 we've had is that people look at the audit opinion. And  
4 they look at it as a shortcut to identify the items that  
5 might be particularly important that an investor should  
6 look at.

7 And investors really need to look at the financial  
8 statements, the footnotes, the MD&A, the critical  
9 accounting policies, the entire Annual Report, not just  
10 a few bullet points that the auditor mentions.

11 And I think there's some danger that that could be  
12 a shortcut to people, to investors looking at the Annual  
13 Report and the financials.

14 MS. RAND: Thanks, Wally. Lisa Roth.

15 MR. BAUMANN: I just wanted to make a comment if  
16 I could, just with respect to one or two of those things.  
17 And, Wally, those are really good comments. You're a very  
18 good reader. We did point out in some of these examples  
19 that there could be things --

20 We structured them in a way that there could be  
21 something that wasn't otherwise in the financial  
22 statements. There could be a significant deficiency that

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1 was the most difficult matter, that required the auditor  
2 to really extend their audit procedures. And it was very  
3 difficult to get evidence because of that.

4 But only a material weakness has to be disclosed  
5 by management, and not a significant deficiency. So  
6 therefore, we wanted to point out that there could be  
7 things disclosed through these CAMs that may not otherwise  
8 be required to be disclosed.

9 So we intentionally did that to bring out that  
10 issue, and make sure people addressed it. And commented  
11 pro or con with respect to that. So thanks for pointing  
12 that out. But that was done intentionally to get feedback  
13 in that area. Lisa Roth.

14 MS. ROTH: Thanks. So I'm a regulatory compliance  
15 auditor, not a financial auditor. So when I look at the  
16 critical audit matters and those questions, I find them  
17 to be really thoughtful and meaningful. And I'm sure you  
18 work out the technical semantics, and so on, to make it  
19 a really great addition to the audit program.

20 But I also recognize that the incorporation of the  
21 reporting in that manner greatly expands the scope of the  
22 audit, if not the liability to the auditor. And I fear

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1 the next impact will be a heightened fee, higher fees.

2 I would imagine those of you who are financial  
3 auditors are going to charge more for that kind of audit.  
4 So I think it's important to recognize that about 3,000  
5 broker-dealers that are subject to PCAOB audits are  
6 nonpublic, privately held, nonpublic, non-custodial  
7 firms. And they'll be subject to those audits.

8 And as Barbara mentioned, the auditor's working for  
9 the investors, meaning the shareholders, not the firm.  
10 But in those instances firms don't have investors. And  
11 1,000 of those broker dealers are not only nonpublic, non  
12 custodial, but they have less than a million dollars in  
13 annual revenues, and two or fewer business lines in what  
14 are deemed to be generally low risk areas.

15 So for those firms in particular, the imposition  
16 of audit standards of this scope, I anticipate will be  
17 financially burdensome, with none of the impact that  
18 you've set out to accomplish. Because these firms don't  
19 have public investors. Their customers won't ever see the  
20 audits or the reports because they're privately held. And  
21 the impact is lost.

22 So I would encourage the Board to consider limiting

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1 the scope, or limiting the audience for this type of  
2 reporting, to those firms that will benefit, or those  
3 investors that will benefit from it the most.

4 MS. WATTS: Lisa, I'd like to address two points  
5 in your question. First, we don't plan on actually  
6 increasing the scope of the audit. This would be based  
7 on what the auditor has already done throughout the audit.

8 So we do recognize that liability or fees could  
9 increase. But it's based on what the auditor has already  
10 done. So the costs should be related to communication,  
11 determination and documentation. So that was one point.

12 And then the other one was, on brokers and dealers,  
13 we did recognize that in the release that brokers and  
14 dealers have a different ownership structure than issuers.  
15 And we put in some examples of how we understand that. And  
16 asked questions on whether or not this should apply to  
17 brokers and dealers.

18 MS. ROTH: Yes, thanks. And I will respond to that  
19 in a written comment letter. And I thought that the  
20 example that you used applies very well to a custodial  
21 broker dealer. And I'll comment in writing with respect  
22 to the rest of the community. Thanks.

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1 MR. BAUMANN: Thanks, Lisa. And Gaylen Hansen.

2 MR. HANSEN: Yes, Marty, I think what this is all  
3 about is balance. And I think you've framed it very well,  
4 the responsibility management and the auditor.

5 But I can tell you, you know, over the years I've  
6 been to a lot of these audit committee meetings. And the  
7 auditor comes in and says, we didn't have any difficulties.  
8 And that's just nonsense. I've lost a lot of sleep over  
9 the years, laying awake at night worrying about things,  
10 as I'm sure many people here have. And those are the  
11 things, those few things is what has to be communicated.

12 But if I go to Paragraph 8, and we've had, I've heard  
13 a number of people talk about it. Critical audit matters  
14 ordinarily are those ordinarily required to be in the  
15 engagement completion document, the engagement quality  
16 review discussion, or in the discussions with the audit  
17 committee.

18 I don't like limiting it to even those. I think  
19 it's anything that has that auditor laying awake at night  
20 worrying about it. So while I'm in favor of this, and I  
21 think you've struck a good balance, and you're going to,  
22 with all the comments that are going to come back, I'm sure

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1 that you, I believe that you're on the right direction  
2 here.

3 I think, you know, to Jennifer's comment though,  
4 that you could get some unintended consequences if you  
5 start limiting things when it comes to critical audit  
6 matters. So that's basically how I feel about it.

7 MS. RAND: Thank you, Gaylen. Wayne Kolins.

8 MR. KOLINS: Thank you, Jennifer. A couple of  
9 comments, one narrow, one a little broader. A couple of  
10 times it was mentioned about the significant deficiencies,  
11 and one of the possible items that might lead you to a  
12 critical audit matter.

13 Aside from the question of whether that's other  
14 information, or additional information over and above  
15 what's in the financial statements, there's another  
16 potential consequence is that absence of any  
17 characterization of a critical audit matter attributable  
18 to a significant deficiency, and could imply that it's a  
19 positive opinion on the effectiveness of internal control.  
20 So it's one thing to consider.

21 And the other one is, the FRC in the UK has a  
22 standard that it's already been issued, it's already in

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1 implementation now. There's been a handful of reports  
2 issued under it. I think it was for years, beginning after  
3 October 1st, 2012. There'll be a lot more issued after  
4 the year end.

5 To what extent are you going to be reviewing the  
6 feedback from those, or any -- It would be great if a pilot  
7 test could be done on those. Because those would be  
8 reflective of live situations, versus a retrospective  
9 pilot done on engagements that were conducted in 2012.

10 MS. RAND: I think I heard one question regarding  
11 the FRC. And I wasn't sure if I missed a second question.  
12 Did you have a second question there?

13 MR. KOLINS: Well, the first question was about the  
14 significant deficiency. That wasn't a question. That  
15 was just a comment. And it was a question on the FRC, to  
16 what extent could you think about, you know, some kind of  
17 a pilot being developed to look at that, even though it  
18 is in a different environment?

19 It's in the UK environment. But the standard is  
20 relatively similar to that of the PCAOB. It's probably  
21 closer to the IAASB proposal. And they do have a  
22 requirement to indicate what the, how the audit approach

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1 has been reflective of the critical audit matter. So  
2 there are auditing procedures on a high level that could  
3 be in there.

4 MS. RAND: We have been actively monitoring the  
5 FRC's project, as well as certainly the IAASB developments  
6 in France, which happened several years ago. You're  
7 correct, the FRC --

8 And I'm not sure if everyone's aware of it. But  
9 in the UK the FRC issued a new audit report. Those are  
10 standards that are currently effective. And I think at  
11 the beginning of this year we'll be seeing a lot of those  
12 reports come out. I think, as you've rightly pointed out,  
13 there's just a handful right now.

14 But they are, they're a different approach. They  
15 talk about there are some differences. So I think it's  
16 useful to have different approaches, at least as we're in  
17 a development period.

18 Because to the extent commoners can review  
19 different approaches by the PCAOB and others, I think we  
20 can benefit in trying to develop an approach that would  
21 be suitable. So I think it's helpful to have other  
22 examples.

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1           We'll certainly be looking at that, as well as  
2 monitoring comments that come in on the IAASB, and comments  
3 that come in to us, as far as our next steps. But we're  
4 certainly aware of that, and considering it.

5           MR. BAUMANN: Thanks. In the interest of making  
6 sure we don't keep you here all night, and we appreciate  
7 the amount of attention you've given to all of these  
8 matters today. I see, I think only four cards up. If I'm  
9 missing any, let me know

10           But I see Mike Gallagher's, Bob Guido, Barbara  
11 Roper, and Jeff Mahoney. If there's any others, please  
12 raise your hand. So maybe we can take those four, and then  
13 call it a day and get back to business tomorrow morning.  
14 So, Mike.

15           MR. GALLAGHER: So, Marty, your point about maybe  
16 being provocative in the examples, about showing a case  
17 where it's information not otherwise disclosed, I think  
18 is helpful.

19           And I think it will be mission accomplished in terms  
20 of your objective, in eliciting feedback. So that's  
21 definitely one of the areas that I hear a lot. And it's  
22 kind of connected also, you know, being the original source

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1 of information.

2           And Jennifer's point about potentially chilling  
3 the dialogue, you know, with audit committees. I know,  
4 Jennifer, that comment was in the context, if the audit  
5 committee information was the sole source, would that  
6 potentially make an auditor cautious about putting  
7 something on the agenda with an audit committee? That  
8 fear is there.

9           By the way, I am for narrowing it. Because I can't  
10 imagine a case where an auditor, based upon information  
11 not communicated to the audit committee, came up with  
12 something that he or she put in CAM. I think that auditor  
13 would have a major problem with the audit committee in that  
14 case. That, you know, you --

15           MR. BAUMANN: Just to comment on that one. It's  
16 really the opposite that we're concerned about. And that  
17 is, therefore, CAM doesn't get reported, because it was  
18 kept out of the audit committee report.

19           MR. GALLAGHER: Okay.

20           MR. BAUMANN: So that's the risk that we're  
21 concerned about. We also can't see a case where you  
22 wouldn't report a CAM that didn't get reported to the

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1 committee. But if you're limited to only things that were  
2 reported to the committee, then potentially there's  
3 something that would not be reported as a CAM. That was  
4 the thinking there, anyway.

5 MR. GALLAGHER: Fair enough. But, Marty, I guess  
6 what I would --

7 MR. BAUMANN: Again, just to be controversial, to  
8 provoke --

9 MR. GALLAGHER: What I would say is, that's  
10 operator error in my mind. You know, just because the  
11 auditor chose not to communicate something to an audit  
12 committee, doesn't mean he or she shouldn't have, okay.

13 And so, you know, the point being that, you know,  
14 there's an expectation that the most critical matters  
15 that, you know, come up during an audit must be reported  
16 to an audit committee. And I can't imagine a case where  
17 an auditor would say, okay, I've got to communicate  
18 something in CAM.

19 And that's outside the universe of things that I've  
20 communicated with an audit committee. And so, you know,  
21 having a more narrow focus in the spirit of not having CAMs  
22 go on forever, number one. And in the spirit of an auditor

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1 being comfortable of limiting, you know, the numbers to  
2 a manageable number.

3           You know, it seems to me narrowing that universe  
4 is helpful. But the two issues that I think you're going  
5 to need a lot of feedback on, the original source of  
6 information, you know.

7           And is this a back door way of requiring registrants  
8 to disclose things otherwise not required through the  
9 auditor's report? And then the chilling of the dialogue.

10           MS. RAND: Mike, I have a follow up question  
11 regarding the issue, which is an important issue, and one  
12 we did flag in our proposal, is something like significant  
13 deficiencies that might, would not be communicated.

14           But let's say it is a critical audit matter in  
15 auditing a particular area. And the auditor, you know,  
16 should the auditor then leave that out of the list of a  
17 critical audit matter, because it's not otherwise  
18 communicated?

19           You know, what would be the resolution for those  
20 type of things that otherwise are the types of things that  
21 kept the auditor up at night?

22           MR. GALLAGHER: Yes. And I think it's a fair

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1 point. And the two issues that I hear, that are of  
2 concern. One is, have we lowered the bar in terms of  
3 requirements for communicating things below material  
4 weakness to significant deficiency?

5 And I do take your point. How do you communicate  
6 that issue with respect to the audit, and how the auditor  
7 got comfortable, and what kept the auditor up at night?

8 The other thing is potential litigation, you know,  
9 where there's discussion at an audit committee around a  
10 matter of litigation. And whether or not it should be  
11 disclosed or not.

12 And if the answer was no, not required under the  
13 standards, could this be a back door way of requiring  
14 disclosure in the CAMs?

15 And obviously, to Marty's point earlier, if an  
16 auditor is going to disclose something in the CAMs, you  
17 better believe management's going to disclose it in the  
18 financial statements.

19 MR. BAUMANN: Thanks, Mike. Bob Guido.

20 MR. GUIDO: Mike just summarized a lot of my  
21 comments and observations. So thank you. I would like  
22 to just drop back for a second though. The last 12 years,

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1 I want to go on record as saying, that the audit firms  
2 report to the audit committees. So I want everyone to  
3 fully appreciate that that's happened in the capital  
4 markets.

5 Audit firms understand they report to audit  
6 committees. So with that in mind, I also say that good  
7 audit committees, and most audit committees that I'm  
8 familiar with, do talk about the qualitative aspects of  
9 management judgments, estimates and accounting policies.

10 And I'll tell you, if they get close to the line  
11 there's a lot of problems by the audit committees. So I  
12 just want everyone, you know, to know that there is  
13 pushback there. We're not just letting the audit firms  
14 or management do their thing.

15 There is a lot of checks and balances that are  
16 happening every day. And I can't overemphasize that. I  
17 like conservative accounting. I like conservative  
18 reporting. And the firms that work with me know that.  
19 And so does management, that I sit on Boards of Directors.

20 So there are a lot of checks and balances that have  
21 happened since Sarbanes. And there were probably a lot  
22 before Sarbanes. Having said that, I was -- if the

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1 critical audit matters live, I really like the idea of  
2 narrowing.

3 I'm one for a lot of communications. And I  
4 believe, very strongly, there ought to be a lot of  
5 communications at the audit committee level. And there  
6 ought to be a lot of things, probably in that closing  
7 document, or whatever we call it now, that don't go into  
8 a CAM. And I think that's fine.

9 If we say that there's indicators that they have  
10 to be, then I think that the CAMs, or excuse me, the closing  
11 documents and the communications with audit committees,  
12 you know, will be shortened. And that's an unintended  
13 consequence. I would encourage, if we do pilot testing,  
14 that, Marty, you mentioned, you know, the preparers, and  
15 the firms, and the audit committees.

16 I would get users involved. I think somehow users  
17 got to get involved in pilot testing too, to get feedback  
18 from users. And then last, but not least, I don't know  
19 what the issue is on this significant deficiency.

20 I would agree with you, if I were a registrant, and  
21 someone brought a significant deficiency in the CAM, I'd  
22 have a disclosure somehow. But again, that's backdooring

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1 what Sarbanes-Oxley requires on material weaknesses.

2           So, anyway, but I'm for more limiting if we go with  
3 -- If CAMs stand, I would rather see less, and really focus  
4 on those, and have users focus on those, are the more  
5 significant matters. Thank you.

6           MR. BAUMANN: Thanks, Bob. And again, thanks for  
7 the comments on the fact that we were transparent in this  
8 document about including certain things, so we could get  
9 input back on those kind of things. Barbara.

10           MS. ROPER: Right. One thing I want to clarify,  
11 and then I want to add one thing. First of all, when I  
12 was, in my initial comments it strikes me that there are  
13 two different things you need to do in your analysis.

14           One is, that there is this central point of what  
15 information investors want in the audit report, that's  
16 relevant to their investment decisions. The other is how  
17 this proposal relates to other priorities of the Board.

18           So when I talk about things like changing the  
19 incentives with regard to regressive accounting, that's  
20 not as the primary goal of this proposal. It's a way to  
21 think about the other positive impacts that it could have.

22           But in response to that, we get the issue about

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1 there are certain things that are hard, and there are  
2 certain things that are very subjective. And it is very  
3 different, as an investor, if you're looking at an audit  
4 report where you're talking about, well the financial  
5 statements were pretty straightforward.

6 There was very little subjectivity. The issues  
7 were pretty, you know, I mean, that's a different report  
8 than one that there's a lot of stuff here that's really  
9 hard. And there's a lot of stuff here that's really  
10 subjective.

11 And as an investor I would think you would look at  
12 those financial reports differently. And you should.  
13 And the audit report, by reporting critical matters, could  
14 help you do that.

15 You know, on this issue of the population of things  
16 that might be CAMs. I too find it virtually impossible  
17 to imagine that an auditor would communicate to investors  
18 something they wouldn't communicate to audit committees.  
19 And I would find that very troubling if they did.

20 But beyond that, I also think that there is, that  
21 we don't want -- If you look at different areas, you look  
22 at disclosures about risks in mutual funds. You get 20

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1 boilerplate disclosures that tell you absolutely nothing  
2 about risks in mutual funds. And I think, you know, or  
3 anything that you would care about as an investor in  
4 choosing that fund over a different fund.

5           And I think in your examples you've done a good job  
6 of writing these in a way that are, you know, provide useful  
7 information. They're robust enough to be there. And  
8 they don't go on for 20 pages. We don't want, I don't  
9 think, I don't think most of us want 20 pages of boilerplate  
10 discussion.

11           So I don't necessarily disagree with the comments  
12 from people who say, you want to keep this focused on the  
13 really critical issues, and not just sort of go -- You don't  
14 want to create an incentive to report everything that might  
15 come up. I don't think you've done that.

16           But just the point being, I don't necessarily  
17 disagree with the comments of those who say, keep this  
18 focused on the really critical issues.

19           MR. BAUMANN: Yes, that's been good counsel for us.  
20 So thanks for pointing that out again. And, Jeff Mahoney,  
21 you get to have the final word. Or, you're the last person  
22 to keep us away from the reception.

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1           MR. MAHONEY: Okay. In that case, I'll be very  
2 brief, extra brief.

3           MR. BAUMANN: No, that was not the point.

4           MR. MAHONEY: I just want to commend the Board and  
5 staff. And I personally believe that this was a very  
6 important recommendation of the Treasury Advisory  
7 Committee. So I just want to commend you for sticking with  
8 this, and getting to the point of issuing a proposal, and  
9 having a full due process around this important  
10 recommendation.

11           Just two brief points. One, I share the concern  
12 about having an overload of disclosure regarding critical  
13 audit matters. There's too many. We end up having a  
14 phone book that's not going to be helpful to investors,  
15 or anyone else.

16           But I'm also concerned on the other end that there  
17 would be a significant number of companies where the  
18 auditor, in their judgment, would decide that there should  
19 be no disclosure at all. If that ends up being the case,  
20 I think that's also going to be a real problem, in that  
21 it's going to undercut the basic objective of the project.

22           Second, my reading of the input from investors, and

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1 a lot of the surveys and studies, one of the common themes  
2 was that they wanted more insights from the auditor,  
3 focused on some of the key estimates and judgments. And  
4 so to the extent that through the auditor's judgment, they  
5 disclose critical audit matters, that are something other  
6 than some of the key estimates and judgments, and that ends  
7 up being a common practice.

8 I think many of the investors who were supportive  
9 of this project are going to be disappointed, since that's  
10 what many thought they were going to get out of this  
11 project. Thank you.

12 MR. BAUMANN: Okay. Thanks, Jeff. And thank  
13 you, all of the members of the SAG, and all observers here,  
14 for very valuable input on all of our discussions today,  
15 and particularly right now on the audit reporting model,  
16 one of our most important priorities.

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