

**NOTICE:** This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on November 14, 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 14, 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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THURSDAY  
NOVEMBER 14, 2013

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20 MS. RAND: Thank you, Marty. Good morning,  
21 everyone. As Marty said, we will continue our discussion  
22 on the auditor's reporting model.

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1           Before we do that, though, I want to remind you of  
2 our disclaimer, which is the views expressed by each of the  
3 presenters are our own personal views and not necessarily  
4 those of the PCAOB, Members of the Board or other PCAOB  
5 staff.

6           So, getting into our discussion, yesterday we spent  
7 our time, and our time had been abbreviated, but we did  
8 discuss critical audit matters. Your feedback was very  
9 helpful. I think we may have time today if anybody has any  
10 further comments regarding that toward the end of this  
11 session.

12           But our focus, to start off with, is on the new  
13 elements of the report and the other information standard  
14 that is included in the PCAOB's proposals.

15           Since we are back on schedule and we have time, we  
16 thought that it would be helpful before we just open up the  
17 floor for discussion to provide an overview of the  
18 standards. And then we will get into the discussion. And  
19 then, of course, I expect we will have time at the end if  
20 there is anything else that wasn't covered that is of  
21 interest, certainly we would like to hear your views on that  
22 as well.

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1           So, with that, I will turn it over to Jessica.

2           MS. WATTS: Thank you. As I mentioned yesterday,  
3 the proposed standard, in addition to critical audit  
4 matters, includes new elements. Specifically,  
5 independence and auditor tenure.

6           Related to independence, the proposed standard  
7 would require the auditor to include a statement in the  
8 auditor's report that the auditor is a public accounting  
9 firm registered with the PCAOB and is required to be  
10 independent with respect to the company, in accordance with  
11 the United States federal securities laws and the  
12 applicable rules and regulations of the SEC and the PCAOB.  
13 Under PCAOB and SEC rules, the auditor is required to be  
14 independent of the company.

15           This statement in the auditor's report is intended  
16 to enhance investors' understanding about the auditors'  
17 obligations to be independent and to serve as a reminder  
18 to auditors of these obligations.

19           Related to tenure, the proposed auditor reporting  
20 standard would require the auditor to include in the  
21 auditor's report a statement containing the year that the  
22 auditor began serving as the company's auditor.

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1 Currently, this information is not required to be  
2 communicated by the auditor, management, or the audit  
3 committee to investors or other financial statement users.

4 Auditor tenure has been the subject of discussion  
5 for decades and investors and others have indicated strong  
6 interest in this information. In light of the public  
7 interest, we've proposed auditor tenure as a data point in  
8 the auditor's report. The intent of the proposed  
9 requirement is to disclose the duration of the auditor's  
10 relationship with the company.

11 And then the next thing we will talk about is the  
12 other information standard. So, during the Board's  
13 outreach process, some commenters had indicated that they  
14 would support changes to the auditor's report that describe  
15 the auditor's responsibilities related to other  
16 information and the auditor's conclusions related to the  
17 other information.

18 And in order to provide a basis to better explain  
19 to investors the auditor's responsibilities related to that  
20 other information, and the auditor's conclusions, we  
21 determined that changes to the existing other information  
22 standard were appropriate to provide a specific basis for

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1 this description in the auditor's report.

2 As a result of this link between the proposed  
3 auditor reporting standard and the proposed other  
4 information standard, the financial statement user would  
5 obtain useful information, such as the nature and scope of  
6 the auditor's responsibilities with respect to other  
7 information, clarification of what other information was  
8 evaluated by the auditor, and a description of the results  
9 of the auditor's evaluation of the other information.

10 The other information standard specifically  
11 applies to a company's annual reports filed with the SEC  
12 under the Exchange Act that contain the company's audited  
13 financial statements and the related auditor's report.

14 The proposed other information standard would  
15 require the auditor to evaluate whether the other  
16 information contains a material inconsistency, a material  
17 misstatement of fact, or both, based on relevant audit  
18 evidence obtained and conclusions reached during the audit.

19 In addition to reading this other information, the  
20 auditor's evaluation of the proposed other information  
21 standard would include performing procedures intended to  
22 help the auditor identify whether the other information

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1 contains a material misstatement of fact or a material  
2 inconsistency. The proposed other information standard  
3 provides specific responses when the auditor identifies a  
4 material inconsistency, or a material misstatement of fact,  
5 or both, such as communication with management and further  
6 procedures as necessary.

7 So, now I will turn it back to Jennifer to start our  
8 discussion.

9 MS. RAND: Okay, thank you. So, to start off, we  
10 would like to talk about the new elements in the report,  
11 specifically the element regarding independence, a  
12 statement from the auditor about independence, and also on  
13 auditor tenure.

14 I see Loretta. Loretta, go ahead.

15 MS. CANGIALOSI: Good morning. On the  
16 independence, I don't have an issue. On the auditor  
17 tenure, I guess my question is, as I read this, it seems  
18 to be far reaching backwards, particularly with predecessor  
19 firms, because, as we know, audit firms have merged over  
20 the years. And one of the things I really would like to hear  
21 from investors is how relevant all of that is.

22 Because if you have been audited by the same firm

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1 for 15 years, 20 years, 30 years, I mean, when does that  
2 really strike them as a hot button? Because going all the  
3 way back, you have a different management, different  
4 partner, different firm. Having previously been with Main  
5 Hurdman and then KMG, I can tell you that when they merged  
6 with KPMG it was a different auditing set of processes.

7 So, I'm not sure how relevant the predecessor firm  
8 is. And also, you know, the fact is that if we are looking  
9 for independence, when you have different management teams  
10 and different auditors and audit firms, again, I don't think  
11 you have that independence issue as striking. But I am  
12 interested to know if there is a cutoff by which investors  
13 believe that it would be satisfactory to say they've been  
14 our auditors for over 25 years, rather than going all the  
15 way back.

16 MS. RAND: Okay, thank you. I think it would be  
17 helpful to get some other views on this topic and we can  
18 go back and respond. But, Gaylen Hansen.

19 MR. HANSEN: Yes, if I could comment on both of  
20 these. Auditor independence. So, certainly the audit  
21 report is titled, "Report of Independent Registered Public  
22 Accounting Firm." So, there is sort of an implied

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1 conclusion that the firm is independent.

2           It's interesting the way the paragraph is written.  
3 It says that the auditors are required to be independent.  
4 It doesn't actually say they are independent. And I  
5 understand the argument that there is violations, a lot of  
6 times very minor, that are resolved with the SEC, or with  
7 actions as taken, so that the firm can be independent during  
8 the course of the audit. But, for me, it's sort of a  
9 disconnect.

10           If the auditor can't say affirmatively that they are  
11 independent, I think there's an expectations gap problem  
12 with that in the report itself. So, I would like to see a  
13 stronger statement here. And I'm not sure exactly -- I  
14 don't know that I have the solution for that, but we have  
15 to make it clear that the auditor is independent in the way  
16 that it's communicated to users.

17           And then on tenure, I don't particularly have any  
18 problem at all with the disclosure of that. It seems to me  
19 that -- and the issue has been raised with me by others.  
20 It may be important as to any implications as to tenure on  
21 independence, and the placement of that in the report could  
22 be important. If it's next to the discussion of

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1 independence, maybe there is an implication that if there  
2 is some period of time that you have been the auditor that  
3 you are raising issues about independence. So I think we  
4 need to be careful about the placement and the manner in  
5 which it is disclosed. Thanks.

6 MS. RAND: Gaylen, did you have any thoughts about  
7 placement? It sounded like you thought an alternative  
8 might be preferable. I just didn't hear if you had made a  
9 suggestion or had any thoughts.

10 MR. HANSEN: The suggestion that has been made to  
11 me was that if it could be -- if the statement about tenure  
12 is not in the independence paragraph, it would be preferred.  
13 And maybe right near the end of the report, somewhere near  
14 the auditor's signature line.

15 MS. RAND: Thank you. Bob Hirth.

16 MR. HIRTH: Thanks, Jennifer. To pile on on the  
17 tenure comment, I had polled a number of CFOs and audit  
18 committee members and I got some consistent comments around  
19 tenure. And let me just kind of read you the sense of one.  
20 "I don't like the proposal to disclose audit tenure. It  
21 would be or is out of context being placed directly in the  
22 auditor's report, and for long-serving auditors, implies

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1 a taint on their independence, which I believe is unfair.  
2 We have independence rules. And either the auditor  
3 complies or not, irrespective of the tenure."

4 To add on to that, one option around placement would  
5 be to put it in the proxy, where there is discussion about  
6 the auditor and approval of the auditor. And you could put  
7 it there.

8 Now, Bob and I were talking about whether that is  
9 voluntary and suggested and companies just decide to do that  
10 or it's a requirement. So, that is a comment on tenure.

11 MS. RAND: Okay, thank you. Elizabeth Mooney.

12 MS. MOONEY: Thanks. I didn't get a chance to make  
13 some comments yesterday. So, I have a couple as well that  
14 might relate to yesterday's discussion, a couple comments.

15 Just on the tenure, from my discussions with  
16 analysts, they are interested in knowing how long the  
17 auditor has been in place on an engagement with the company,  
18 but I can't say there's a consensus around how many years.  
19 But they are very interested in that time frame.

20 And I wouldn't make a blanket statement that it's  
21 a taint. I just think it is helping to educate the  
22 investors. But it is something that they like to know.

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1 And we have gone back and tried to piece it together with  
2 annual reports we can get our hands on. The analysts have  
3 asked me to do that.

4 So, I would just say it is relevant and I don't see  
5 why -- you know, it's a fact. It is a discernable fact, and  
6 where it is, I mean, I don't see why it would be a problem  
7 in the auditor's report.

8 Just another general comment. We talked a little  
9 bit about IAASB's proposal yesterday, and I just would  
10 encourage PCAOB not to wait. Convergence has been a slow  
11 process, and just be a leader and do what the Board thinks  
12 is the best thing. And, hopefully, convergence will happen  
13 naturally.

14 In terms of what information would be especially  
15 useful, you know, I think one important piece is the risk  
16 assessment and how it changed during this year, or this  
17 audit, from the prior period or periods. And, you know, the  
18 biggest risks and how the risk auditors responded to them,  
19 how much time is spent on them, how they got comfortable  
20 with them, any significant adjustments to the work they did.  
21 That is the kind of thing that would be really useful. And,  
22 again, it is about the audit.

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1           And in terms of reporting the critical matters, I  
2 would just encourage you to make sure that the standards  
3 are strong enough. It should be really based on what's  
4 required, what is significant, according to the audit  
5 standards. I think this came up in your IAG meeting, but  
6 I think that's really important so that you can have some  
7 consistency and that it will be actually an enforceable  
8 standard.

9           And on the other information, you know, outside of  
10 the financial statements, I think if auditors know that  
11 investors are getting certain bad information, it's their  
12 responsibility to say something. So I think to fix it or  
13 do something, that makes a ton of sense.

14           Thanks.

15           MR. BAUMANN: So, before we take -- there is a lot  
16 of other cards up -- I thought we would pause just for a  
17 second because a lot of comments were made. Maybe I will  
18 add some color and see if it helps or not.

19           So, the thought on the tenure, because a lot of  
20 points have been made that it's not relevant and firms have  
21 merged and different partners change every so many years,  
22 and therefore to some it's not meaningful or some said it

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1 taints.

2           When we had hearings around the concept release on  
3 auditor independence, objectivity, and professional  
4 skepticism, including rotation, there were a lot of people  
5 who testified at those hearings and talked about concerns  
6 about long tenure. But at the same time, there were some  
7 people that testified and said they're concerned about  
8 rotation because they think the riskiest audits are in year  
9 one. So there was a lot of points that came out of those  
10 hearings about pro and con rotation with risks in both  
11 directions.

12           So the thought on putting in tenure was, well, for  
13 those investors who think it's very risky in year one of  
14 a new audit, of an audit, for an auditor that really isn't  
15 up to speed, potentially, on all the issues in the company,  
16 that's a valuable data point for that investor that has that  
17 concern.

18           And there are those others that have that concern  
19 that 120-year relationships, even though partners do change  
20 and firms merge, firms tend to value in a certain way their  
21 100-year relationship clients or long-term clients. And  
22 there is probably some pressure on the audit partner,

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1 besides just doing a good audit, to not be the partner that  
2 loses that client that has been a client of the firm and  
3 a crown jewel of the firm for 100 years.

4           So, there is enough pressure doing the audit itself.  
5 But to be the partner who is going to make tough calls that  
6 might cause losing the client puts extra pressure on him.  
7 So maybe investors want to know about those relationships,  
8 because they feel those partners are under a unique kind  
9 of pressure.

10           So, tenure really is thought to be a data point of  
11 value, whether it's the first year of an audit or the  
12 hundredth year of the relationship or somewhere in between.

13           But the comments you're making, I think, are some  
14 of the comments we have heard across the board. Some people  
15 think it is not valuable and other investors have said we  
16 think it's a valuable data point.

17           So, I thought I would just add a little color.  
18 We're not just pointing out the lengthier tenure. It's  
19 whatever it is that could be potentially of value.

20           With respect to the comment on independence and the  
21 fact that we are "required to," as opposed to "we are  
22 independent," I think, Gaylen, you touched on the exact

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1 issue, and that is some firms have violations of  
2 independence rules during the audit. And if they have a  
3 violation, that might affect -- they violated the rules that  
4 year. So, the statement is written in a certain context.

5 I think we will continue to explore that, because  
6 I think your reaction is a fair one and I think others have  
7 that. But I think it's something we have to work through.

8 So, I thought I would just add those points as we  
9 take the rest of the comments.

10 Jennifer, did you have any other additional  
11 reactions?

12 MS. RAND: No.

13 MR. BAUMANN: Okay, thanks.

14 MS. RAND: Okay, next on my list is Steve Buller.

15 MR. BULLER: Thank you. Just thought, a couple  
16 thoughts, again as a user. So, we rely upon the audit firm  
17 to tell us if they are independent. It's hard for a user  
18 to understand if an audit firm is or is not independent.  
19 And additional disclosure is not really meaningful  
20 information which is actionable for us, as an investor,  
21 merely stating that they are independent.

22 I guess while we have the SEC in the room, the thing

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1 I would encourage, actually which is probably of more  
2 benefit to us, is to have a full review of the auditor  
3 independence rules. Because between the investment  
4 company complex rules, the 21010 over-under rules, the  
5 former partner pension rules, they are difficult for the  
6 audit firms. They are difficult for users also. We have  
7 two full-time people who spend all their time, 100 percent,  
8 monitoring auditor independence with contracts and  
9 relationships and former personnel.

10 But, also, it's apparent to us, at least, that there  
11 is going to be a higher degree of auditor rotation. Now,  
12 whether that is one percent or 20 percent, I don't know.  
13 But unless someone goes back and just looks at the issue  
14 of former partner pension plans and unfunded pensions, you  
15 know, as we have more and more former partners who serve  
16 on boards, including our board, if there are rotations we're  
17 going to see more required changes because of partner  
18 pension plans and taints as they bring in new audit firms.  
19 So, I just encourage the SEC to look at that as part of this  
20 longer term project.

21 With respect to audit tenure, we don't object to  
22 disclosure of the number of years in which the firm as served

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1 as the auditor. Again, the question is what is actionable  
2 for us.

3 So, for us, we think it probably makes more sense  
4 to have that disclosure in a proxy in the auditor opinion  
5 and here is why. If we think that there is a problem with  
6 the auditor independence or the number of years they've  
7 served, the way we take action is by voting in a proxy to  
8 not reappoint the auditor.

9 It is hard for us to take action when we review  
10 financial statements to understand what it means and the  
11 impact upon financial statements if they have been an  
12 auditor for one year or 50 years. It's just not something  
13 that goes into our analysis of the integrity of those  
14 financial statements. It probably belongs in our  
15 decisionmaking of whether or not to retain the auditor.

16 So, those are a few comments.

17 MR. BAUMANN: Thanks for those comments, Steve.  
18 They're very helpful. I think actually a couple of them  
19 though are really for the SEC more than us.

20 And somebody else also had mentioned earlier that  
21 they had thought, maybe it was Bob Hirth who mentioned that  
22 he thought if tenure is going to be disclosed, it should

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1 be disclosed in the proxy, rather than in the audit report.  
2 So, that is outside the scope of our authority, again, but  
3 we take that point and appreciate that. So, the SEC has  
4 heard your views.

5 MS. RAND: Okay, Professor Cox.

6 MR. COX: So, it was my pleasure, although it  
7 interrupted a vacation, to testify, give some testimony at  
8 the Roundtable on Auditor Rotation in San Francisco a couple  
9 of years ago. And my actually eagerness to do that was  
10 informed by the fact that before I even had the opportunity  
11 to do that, I had started looking at the literature about  
12 what the implications were on the question of independence  
13 and tenure. And I was astounded. It was sort of like a  
14 Goldilocks situation. And that testimony is all a matter  
15 of record. People could look at the studies that have been  
16 done, which I think I tried to correctly summarize.

17 But really it's a Goldilocks moment because it's  
18 like the question about it's either too short or it's too  
19 long and how the empiricists have been able to document the  
20 problems that arose from this. And the studies all  
21 indicate the following, that it's very hard to figure out  
22 what is just right. Okay?

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1           And we moved past the question of mandatory rotation  
2 of audit firms, at least at this moment in time. But it does  
3 make me think that what we would like to do is shine a light  
4 on this problem, because the problems are not only at too  
5 short a tenure, but the problems also exist, again, with  
6 some statistical significance, with too long a tenure.

7           And the whole function of what we are talking about  
8 starting yesterday afternoon and continuing this morning  
9 is where is an appropriate place to shine a light on this.  
10 And some things probably need to be centralized and located  
11 in one place. We all know that when you change an auditor,  
12 that's an 8-K filing that you have to make with the SEC.  
13 But there are some other things we may want to think as well,  
14 and that there is a central location of this very  
15 ever-growing set of financial statements where we would  
16 like to have some things just highlighted. And I think  
17 auditor tenure is one of those.

18           So, I think that just specifying what the length of  
19 the tenure is in the audit statement, in a very crisp  
20 statement, can at least shine a light on it and let investors  
21 do what they want with it. Some have staffs of two people  
22 who do nothing more than that. I'm going to suggest that

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1 a lot of investors don't fall into that category. But by  
2 being able to highlight it, maybe they can dig into the  
3 question more likely and figure out what to make of the  
4 question about too short or too long a tenure.

5 MS. RAND: Thank you. Rick Murray?

6 MR. MURRAY: Thank you, Jennifer. I think there is  
7 a terminological problem that requires some further  
8 attention. The concept of being independent really is two  
9 separate thoughts. One is the condition of being  
10 independent, which is, generally speaking, capable of  
11 objective identification and explanation. The other is  
12 the way of doing things, which is a process, a state of mind,  
13 and a far more subjective and nuanced issue.

14 I don't think it's clear in the materials whether  
15 one or both of those uses of the word are clearly intended.  
16 It seems to me there are places where you would imply one  
17 thought attaching to the way independence is used and other  
18 places where it seems more to be the other.

19 So, I would encourage a review of the drafting  
20 process, so that whichever of those the Board intends to  
21 be the purpose of independence for this purpose is clearly  
22 specified.

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1           Second, and a briefer comment, there is a catch-22  
2 here in that, for 40 years, there has been a debate about  
3 whether it is possible, at least theoretically, to be  
4 independent when being compensated by the client. And  
5 there are, clearly, many voices who continue to believe that  
6 it's not and that it is a misrepresentation, if you will,  
7 for an audit firm to declare itself to be independent in  
8 the current context of the way compensation is arranged.

9           For those voices, some in academia, some in a  
10 variety of other communities, the use of litigation as a  
11 tool to challenge that alleged misrepresentation, and to  
12 use this new element of the audit report to accuse the firm  
13 of overtly misrepresenting their status as independent, if  
14 that is the way that the Board elects to use the word, is  
15 an unintended consequence that I think needs some  
16 attention. It can be clarified by defining a little more  
17 closely what the standards are that are being used for that  
18 purpose.

19           But when you ask the auditor to make a  
20 self-declaration of that, it ought to be clear whether the  
21 declaration is one status or of process and how that can  
22 be recognized by the regulator as an accurate statement,

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1 in light of the compensation of auditors.

2 MR. BAUMANN: I would like to explore that a little  
3 bit, Rick, if we can. That's a very interesting comment.

4 I think the first thought is, by including a  
5 statement in the audit report that we are required to be  
6 independent, according to the rules of the SEC and the  
7 PCAOB, our intent in drafting that and putting it in the  
8 report was we thought that that had a chance of increasing  
9 the auditors' thinking about their decisions that they had  
10 to be independent of mind and had that objectivity in the  
11 decisions they were making as they were coming to their  
12 conclusion on the financial statements. It might have that  
13 intangible benefit of increasing that independent state of  
14 mind that you talked about that's one of the couple of  
15 aspects of independence. I think that is the main reason  
16 for putting that there.

17 We would also like to put in the statement "we are  
18 independent," to Gaylen's point, but there are some other  
19 technical issues with that.

20 But I would like to explore what you meant by this  
21 has a liability and litigation issue and overtly  
22 misrepresenting the auditor's position. So maybe you

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1 could share with me a little bit more your thoughts in that  
2 regard.

3 MR. MURRAY: First and most simply, Marty, if it is  
4 clearly the intent of the Board that the reference in the  
5 audit report is to the state of mind, the process, rather  
6 than the independence, that goes a long way. If that is  
7 clarified, that goes a long way to take both of my comments  
8 out of play.

9 MR. BAUMANN: Well, it didn't mean to say it ignores  
10 the fact that we had to comply with rules as well and that  
11 we are required to comply with rules. But, certainly,  
12 there are the two aspects. There is the rules and the state  
13 of mind.

14 MR. MURRAY: I may be wrong factually on this. But  
15 it is my impression that neither the SEC nor the PCAOB have  
16 ever overtly said we have examined the nature of the  
17 compensation of auditors in this system of financial  
18 reporting and we have concluded that that does not impair  
19 the auditor's ability to function independently.

20 If that were to be clarified and the declaration in  
21 the audit report were to fit into that model saying we have  
22 functioned independently, I think that reconciles the

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1 problem. It's the overhang of a historical and not  
2 formally resolved question about the effect of  
3 compensation, coupled with asking the auditor to make a  
4 self-declaration that, if claimed to be materially  
5 misleading, which is certainly within the reach of trial  
6 lawyers these days, that creates the concern.

7 MR. BAUMANN: Thanks. I would be interested in  
8 others' reactions to that, but I understand the point you  
9 are saying, that potentially the client pays model creates  
10 a conflict that inherently affects independence and  
11 therefore making that declaration raises the point that you  
12 are concerned about. I don't know if anybody has a reaction  
13 to that, but if they do, I hope to hear from them as part  
14 of the discussion.

15 MS. RAND: Okay, thank you. Jeff Mahoney.

16 MR. MAHONEY: Thank you. I just wanted to agree  
17 with the staff statement that there is strong investor  
18 interest in the tenure information. That's reflected in  
19 our corporate governance policies in at least two ways.  
20 First, with respect to shareowners' oversight of the audit  
21 committee, our policies related to audit committees  
22 indicate that tenure should be a factor that the audit

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1 committee looks at with respect to the retention issue.

2 MS. RAND: Jeff, I'm sorry. We were getting --  
3 obviously, you are hearing that noise, but I was missing  
4 some of what you were saying. It was quite distracting.  
5 It seems like it has subsided. If you could just repeat  
6 that again. I apologize. I don't want to miss your point.

7 MR. MAHONEY: Sure. I wanted to express my  
8 agreement with the staff statement that there is a strong  
9 interest by investors in the tenure information. That's  
10 reflected in our corporate governance policies in two  
11 different areas. First, with respect to shareholders'  
12 oversight of the audit committee, in our policies related  
13 to the audit committee, we do say that the audit committee  
14 should look at auditor's tenure as one of many factors when  
15 considering auditor retention issues.

16 In addition, we ask for disclosure by the audit  
17 committee. When the auditor has been retained for ten  
18 consecutive years or more, that there be some additional  
19 disclosure by the committee about that decision to retain  
20 the same auditor beyond the tenure period.

21 It also has relevance with respect to our policies  
22 which many public companies have adopted with respect to

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1 the annual shareowner vote on the ratification of the  
2 external auditor, where we believe that the tenure of the  
3 auditor should be one factor. Again, not necessarily the  
4 most important factor, but one factor that shareowners  
5 should look at when making that retention vote, which, as  
6 I indicated, is a very common at a large number of public  
7 companies.

8           With respect to where the information is disclosed,  
9 we do not have a policy saying that the tenure information  
10 should be disclosed in the auditor's report or in the proxy  
11 statement. I can see the argument that it be disclosed in  
12 the proxy but I'm not aware of anyone in our membership who  
13 would be upset if that information was disclosed in the  
14 auditor's report, which is the main vehicle of  
15 communication between the external auditor and  
16 shareowners, rather than in the proxy statement.

17           In addition, I think if you asked them if it's  
18 disclosed in the auditor's report, you may get this  
19 information in a shorter period of time -- you may get this  
20 information in a few years. If it's disclosed in the proxy,  
21 it may be a long time before you ever get that information.  
22 If you add that to the conversation, I think a number of

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1 our members would agree or support the idea of having tenure  
2 disclosed in the auditor's report if they think they are  
3 more likely to get that information sooner rather than  
4 later.

5 Thank you.

6 MS. RAND: Thank you, Jeff. Bob Guido.

7 MR. GUIDO: Thank you. I just wanted to pick up on  
8 a couple of points, especially -- there goes the hammer.

9 But what Steve Buller said about independence, and  
10 not to dwell on this issue too much, but go back to the  
11 premise that we on the committee spend a lot of time in this  
12 area, and we do challenge. And I would like to just remind  
13 everyone that tenure, from an audit committee's  
14 perspective, is one year at a time, which means the firms  
15 have to prove themselves, not only in performance on an  
16 annual basis but in the independence, objectivity, et  
17 cetera. Fact and state of mind.

18 Therefore, if something -- and I really believe that  
19 disclosing this in the auditor's report is out of context.  
20 Put it in the proxy where, if we want to, make it voluntary.  
21 I will bet you if you do best practices, there will be a  
22 lot of registrants that will follow suit. But it could be

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1 couched within the audit committee's report, where we, in  
2 effect, challenge performance and reappointment.

3           However, if that doesn't fly, I have another  
4 suggestion. Ten years ago, we used to file with the PCAOB  
5 all of our registrant information. I don't know if that is  
6 still being done but I assume that it is. Why don't we just  
7 have the firms put in there how long they, in effect, have  
8 been a client? And that has access -- it used to be public  
9 information maybe it isn't anymore. But any investor that  
10 is interested could access that public information in a few  
11 seconds.

12           So anyway, just a thought.

13           MR. BAUMANN: Do you have a reaction to the comment  
14 that Jeff made that to the extent investors think that this  
15 is important, this is a proposal that we get this out to  
16 investors potentially in the near term. Whereas, if your  
17 argument is, maybe it belongs more in the proxy, there is  
18 no action taking place right now or no proposals on the plate  
19 to put that information in the proxy, other than voluntary.  
20 And there are some companies that are voluntarily  
21 disclosing that but there is no action underway, as far as  
22 I know, to put it required in the proxy.

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1           MR. GUIDO: Well yes, I don't know of any action  
2 either. I do know that some registrants already put it in  
3 the proxy. And working with NACD and others, we could get  
4 this going, if that is so important to investors.

5           But again, I will go back to what I said before. For  
6 audit committees to opine on independence and performance,  
7 we do represent shareholders. And therefore, we have  
8 already concluded on that issue.

9           However, if we want to have it in the sunshine, put  
10 it in these reports and the firms file them annually, I  
11 believe. They still do, I hope.

12           MR. BAUMANN: They do. That is a form 2E you are  
13 referring to and that is available. Of course, an investor  
14 would have to do some searching to find not only the firm  
15 but then the issuer and so on and so forth. But it is an  
16 option, I am glad you pointed that possibility out.

17           MS. RAND: Okay, Jerry de St. Paer.

18           MR. DE ST. PAER: Thank you. I guess this is going  
19 to feel like piling on but I think my perception of it, while  
20 consistent with the views, for example, that Bob just  
21 expressed and others, it has a twist to it.

22           I chair one audit committee. I am on another audit

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1 committee. In every one of the audit committee meetings,  
2 we take pains to confirm with the auditors that they  
3 understand that they report to us, the audit committee.  
4 They don't report to management. We make that very clear.  
5 We make it very clear that they have access.

6 But the other thing that is very clear is that the  
7 responsibility for taking -- I thought the comment by  
8 Professor Cox was very interesting -- too short, too long.  
9 The audit committee is where the buck stops in deciding  
10 whether it is too short or too long or what the other factors  
11 are. It is not the auditor.

12 I mean with all due respect, the auditor can have  
13 their views of it but who actually decides whether you are  
14 going to recommend the appointment of that auditor for  
15 another year, as Bob says, one year at a time? It falls to  
16 the audit committee.

17 So, I hear the point about the issue about timing,  
18 that if you put it into the auditor's report you are going  
19 to get something sooner. But it absolutely is out of  
20 context because it doesn't include the judgment of the  
21 people who are actually making the decision whether the  
22 independence is adequate for reappointment or not. That is

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1 the audit committee.

2 So, I guess I would urge -- we have got Brian sitting  
3 here. We could all go beat up on Brian to try to get  
4 something moving at the SEC or to get the NACD or others.

5 I think that what I am focused on here is what is  
6 right and not what is expedient. I can understand why  
7 investors find this information meaningful. I completely  
8 get that. I completely also understand and sympathize with  
9 the view of the PCAOB to try to do something about that.  
10 I just think that we have got the ball in the wrong place.

11 I think to have an auditor to say they think they  
12 are independent is fine but I think it misses the fact.

13 The second thing that I wanted to express, and it  
14 has to do with this auditor independence when I read the  
15 proposal, and it goes to a little bit the concern I had  
16 yesterday. You can't get away from your roots. Having  
17 been CFO of an insurance company that does auditor liability  
18 insurance, the fact is here what will happen -- and then  
19 if you sit on the audit committee and lawyers come in and  
20 they say okay, we have got these new rules -- what will  
21 happen I am afraid, and this is the thing I would urge that  
22 -- and I don't know how you deal with this because I

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1 understand what you are trying to get on the CAM. I  
2 understand what you are trying to get on auditor  
3 independence but the pressure toward boilerplate is going  
4 to be so strong.

5 I mean can you imagine that this new thing comes out.  
6 We have got the new CAM. We have got this, and then there  
7 ends up being a problem. It is like a roadmap to  
8 litigation.

9 So what is going to happen, I predict, is that it  
10 will go overboard. There actually is no incentive for  
11 anybody to do anything other than to throw the kitchen sink  
12 in and call it material.

13 So, unfortunately, you should never make a  
14 suggestion. On the first instance, my suggestion is put it  
15 in the proxy. On this one, unfortunately, I don't have any  
16 helpful guidance, except that I could just see this thing  
17 blowing out the auditor's report significantly into a big  
18 document, which will be almost unfathomable for the average  
19 investor to be able to understand.

20 MR. BAUMANN: That is a risk certainly we are  
21 concerned about. We are concerned about boilerplate. So  
22 the things that you brought up are good points that could

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1 risk the value that we are trying to bring. So, we will  
2 carefully think about those issues.

3 Brian's card promptly went up when you talked about  
4 the SEC. So, we will give the floor to Brian Croteau.

5 MR. CROTEAU: Thanks, Marty, and good morning.

6 I guess first I just wanted to say I don't feel beat  
7 up upon at all. I think it is really important that we all  
8 hear these comments. And again, my disclaimer from  
9 yesterday still applies as well.

10 But certainly geography can be extremely important  
11 and we do appreciate the comments in that regard and  
12 particularly when we are talking about matters that may have  
13 to do with whether you are evaluating the engagement of the  
14 auditor, versus the report and the completion of the audit.  
15 We certainly can appreciate, or I can appreciate, the  
16 differences between the two. And so I don't think people  
17 should feel restrained in offering whatever feedback they  
18 think is appropriate about either the nature of the  
19 disclosure or the appropriateness of the location. And  
20 certainly me and my staff are here and others are listening  
21 to take good notes on that. So, I appreciate the feedback.

22 MS. RAND: Okay, thank you. Oh, sorry. A number

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1 of cards are up and then I would like to try to get to other  
2 information.

3 But next on my list is Walt Conn.

4 MR. CONN: This may also feel like piling on at this  
5 point, but I will take Brian's invitation.

6 In the interest of transparency, I fully support the  
7 disclosure of auditor tenure in a place that is easy for  
8 investors to find. I would argue, though, that including  
9 it in the auditor's report, just to echo some of the other  
10 comments that have been made, implies a correlation between  
11 tenure, a sweet spot for tenure from shortly after first  
12 year, second year, whatever that may be, to whatever a long  
13 tenure is, a sweet spot between that and audit quality that  
14 I don't think is known today. And therefore, I agree with  
15 the comments that have been made that it seems out of context  
16 to be in the auditor's report and it seems like to me the  
17 best place would be in the proxy or in the Form 2.

18 Thanks.

19 MS. RAND: Thank you. Bill Platt.

20 MR. PLATT: Thank you. The point has been made by  
21 several people that the consideration of tenure really is  
22 a question of reappointment of the auditor and the audit

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1 committee's responsibility and the audit committee's  
2 focus. And many people have observed that maybe it is  
3 better placed in a proxy, which discusses the audit  
4 committee's decision to reappoint the auditor. I would  
5 actually agree with that.

6 And then others have said then that well, but  
7 because the SEC doesn't have a project currently,  
8 therefore, it will take longer to get through proxy than  
9 possibly what the PCAOB can do through mandating through  
10 an auditor's report. It kind of reminds me if the only tool  
11 we have is a hammer, we are going to think that everything  
12 is a nail.

13 And I wonder, though, whether or not there might be  
14 a way to accomplish it through saying that if it has not  
15 already been disclosed in a proxy, then the auditor will  
16 include tenure in the report. But if the company and the  
17 audit committee has included auditor tenure in the proxy,  
18 then the auditor's report would be silent to that fact.

19 So, it might be a way for the PCAOB to take action,  
20 which sort of goes along the way of encouraging proxy  
21 disclosure and many companies then will probably jump on  
22 that, and therefore, one place or the other you would end

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1 up finding the disclosure of tenure information. So just  
2 a thought, in terms of saying, you know, can you use the  
3 hammer of the PCAOB to get disclosure either in proxies or  
4 in the report itself.

5 MS. RAND: So Bill, just to make sure I am thinking  
6 about it the say way as you are suggesting it, so you are  
7 suggesting -- because generally the proxy is filed after  
8 but you are talking the proxy that was filed before for the  
9 appointment of that year.

10 MR. PLATT: Yes, the proxy that was filed before.  
11 It would be a little different than now the incorporation  
12 by reference of compensation information, which is going  
13 to be in the next proxy, because you wouldn't necessarily  
14 know what was going to be in the next proxy.

15 But if it was in connection with the appointment for  
16 that year had been disclosed, then it wouldn't need to be  
17 repeated in the auditor's report.

18 MS. RAND: Okay, thank you. Dan Montgomery.

19 MR. MONTGOMERY: Thank you, Jennifer. And just a  
20 quick comment on independence to compare and contrast a bit  
21 with the IAASB proposal because I know that many in the room  
22 will be reviewing and commenting on both.

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1           Like the PCAOB, the global stakeholders of the IAASB  
2 felt that there would be value in having a statement about  
3 independence in the auditor's report. However, the IAASB  
4 stakeholders, in particular global securities regulators,  
5 felt that there should be, along the point that Gaylen made  
6 earlier, an affirmative statement of independence. And  
7 so, the IAASB's proposal is to specifically indicate that  
8 we are independent of the company within the meaning of the  
9 relevant ethical requirements or applicable law or  
10 regulation and have fulfilled our other responsibilities  
11 under those ethical requirements. Also, it would be  
12 required to specifically identify the relevant ethical  
13 requirements.

14           And the IAASB, in formulating that language, also  
15 considered the notion of breaches. And maybe this is  
16 something that works in the international arena because  
17 there is a recent revision to the International Ethics Code  
18 that suggests that if there are any breaches of independence  
19 requirements, the auditor is required to communicate those  
20 with those charged with governance. And if the auditor  
21 believes that appropriate action can be taken and those  
22 charged with governance agree, then the auditor is able to

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1 affirm independence and issue an independent auditor's  
2 report. So the affirmative statement about independence,  
3 at least in the IAASB view, would work in that regard.

4 MS. RAND: Thank you, Dan. Roman Weil.

5 MR. WEIL: I have not necessarily been paying  
6 attention but I am confused about the auditor tenure and  
7 the disclosure that we have in mind here.

8 In the audit committees where I serve, we have got  
9 an audit partner. We have got an audit partner in waiting,  
10 the guy that is going to be the next audit partner. We have  
11 got the confirming partner. We have got the partner who  
12 resolves conflicts if something comes up. He is sort of in  
13 the background. And we have got the seniors and managers.

14 And in our audit committee reports, we have got a  
15 table where every one of these people, who they are, how  
16 long they have been serving, and when the audit company's,  
17 audit firm's rules will require that person to go off.  
18 Sometimes the audit company's rules are more stringent than  
19 the SEC rules or the regulator's rules. But they will tell  
20 us how long he has been there, when he has to go, and what  
21 the plan is for taking over.

22 Now, I can't tell from any of this discussion, when

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1 we are talking about auditor tenure, are we talking about  
2 one person or are we talking about the whole team? If it  
3 is the whole team, I think that is fine and we get it already.  
4 I just don't see what the big deal is.

5 MS. RAND: Tenure would be the firm relationship.  
6 So, there would be natural rotation of the partner, for  
7 example. But to Marty's example he used earlier, the firm  
8 may have been auditing a company for 100 years. There is  
9 rotation of the individual partners every five years, but  
10 the question is, some perceive that the 100-year  
11 relationship, even though there is the individual rotation,  
12 may have added pressure for those firms.

13 MR. WEIL: So that word "auditor" means the firm,  
14 not the person.

15 MS. RAND: Auditor means the firm, yes. Right,  
16 firm.

17 MR. WEIL: The firm, okay.

18 MS. RAND: Okay, I don't see any further cards up,  
19 so I am going to move on to other information. And thank  
20 you for your comments on both of those points. I think it  
21 was very valuable. Some good questions and suggestions  
22 came out of that.

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1           For other information included in the PCAOB's  
2 proposal, as Jessica described, there was a proposed  
3 standard regarding the auditor's responsibilities for  
4 other information regarding the annual report that is filed  
5 with the SEC. So, that would be the 1934 Act filings,  
6 generally, the 10-K.

7           So, interested in your views on the usefulness,  
8 including a statement in the auditor's report about the  
9 auditor's responsibilities for other information. The  
10 proposed language in the report would state that the auditor  
11 has read and evaluated the other information.

12           The auditor's responsibilities include looking for  
13 both material inconsistencies with the audited financial  
14 statements, so looking at amounts and disclosures in the  
15 audited financial statements. If revenue is stated at \$100  
16 million, is it \$1 billion in the 10-K? That would be a  
17 material inconsistency. So, they are looking for  
18 consistency with the financial statements.

19           And the auditor also would have a responsibility to  
20 look for material misstatement of fact. They have both  
21 these responsibilities today but a material misstatement  
22 of fact could be the auditor knows through their audit that

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1 the company is a manufacturer of widgets. They are not the  
2 leading manufacturers. Say they are number three. But in  
3 the 10-K they have disclosed that they are the leading  
4 manufacturer of widgets. The auditor may believe that  
5 would be market moving information if the public believed  
6 that they were the leading manufacturer. But based on the  
7 auditor's audit, obtaining understanding of the company,  
8 they know that is incorrect.

9           So under our proposed standard, the auditor would  
10 have a responsibility to discuss that with the audit  
11 committee to have that be removed, clarified.

12           And the proposed standard also includes procedures  
13 to evaluate the other information. Today, the auditor's  
14 procedures are read and consider. That's it. It is  
15 whatever the auditor does in connection with consideration.

16           We have read and evaluate. And evaluation means  
17 four different types of procedures, such as comparing the  
18 amounts with the financial statements for consistency,  
19 looking at the disclosures, taking into consideration the  
20 other information the auditor knows, is there any material  
21 misstatements of fact, and looking at calculations that are  
22 presented in the other information.

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1           So, I will just open that up generally for views on  
2 other information and you can feel free to touch on any or  
3 all of those points.

4           Ian Dingwall.

5           MR. DINGWALL: Thank you. As I read this report on  
6 other information, it presumes the other information is in  
7 fact presented. In other words, it is a report on that  
8 which is presented. It is not necessarily a report on  
9 things that might be required but are not presented. In  
10 other words, we do require in 11-K filings or in plan  
11 filings, that a lot of other information be presented.

12           The problem usually is that it is not presented. It  
13 is not there. So, I would think that this report on other  
14 information could be more valuable if it talked about the  
15 completeness of the information, or it made some reference  
16 to the fact that none of the required information has been  
17 omitted, something along those lines.

18           Just to say what is presented is fairly stated in  
19 relation to the financial statements taken as a whole is  
20 fine but it would be, I would think, more valuable if it  
21 suggested that the information that is required to be there  
22 is in fact there.

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1           So opining that nothing has been omitted, I think,  
2 would add to the value of this report.

3           MR. BAUMANN: So let me just comment on that, Ian,  
4 just to clarify a couple of things.

5           So, the other information, of course, we are talking  
6 about is in connection with the '34 Act filing. And what  
7 has to be there is in accordance with the SEC rules in  
8 connection with that particular '34 Act filing for either  
9 a corporation, or a mutual fund, or whatever it might be  
10 in that '34 Act filing.

11           We did ask in the concept release on auditor  
12 reporting, should auditors have some further  
13 responsibility to examine the other information? And  
14 generally there was not support for that. To the extent  
15 that there was support, I think there was support for the  
16 auditors' continuing responsibility to read other  
17 information and consider whether it has any material  
18 inconsistencies with the audited financial statements or  
19 material misstatement of fact.

20           So, there is not a requirement in existing  
21 standards, and we are not proposing one, for the auditor  
22 to extend his or her responsibilities to ensure that the

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1 company has fully complied with all of the various aspects  
2 of the SEC rules as to what has to be in MD&A, what has to  
3 be in risk factors, what has to be in the various aspects  
4 of the '34 Act filing. That would be a separate engagement.  
5 Legal interpretations would be involved in terms of what  
6 would have to be included in that information.

7 And so that is not the extent of our proposal at this  
8 point. We have heard your view that you think that would  
9 be valuable to the auditor to do that. We haven't proposed  
10 that and we really hadn't heard a lot of support for that,  
11 but I will be interested to see if others do that.

12 The comment that something is fairly presented in  
13 all material respects went to something I discussed  
14 yesterday on supplemental information that is related to  
15 the financial statements that is required by SEC rules to  
16 be part of the financials. But it is supplemental.

17 With respect to the other information that we are  
18 talking about here like MD&A and risk factors, there is no  
19 opinion being expressed on that information. It is a  
20 matter of we have read and evaluated it and we are not aware  
21 of any material inconsistencies or material misstatements  
22 of fact. Now, that is some type of assurance but it is not

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1 an expression of an opinion.

2 I don't know. Hopefully that clarified it, if  
3 anybody had any confusion as to what the requirements were.

4 MS. RAND: Thank you, Marty. Denny Beresford.

5 MR. BERESFORD: I think this part of the proposal  
6 could be one of the more useful additions to the auditor's  
7 report. And in the concepts release I, and I think a lot  
8 of other people, supported it with the sort of implicit  
9 understanding that at the time the idea was simply to have  
10 the auditor report explicitly on what was already being  
11 done.

12 But the proposal, and looking at one of the earlier  
13 slides, indicates that this would enhance the auditor's  
14 responsibility with respect to other information and, these  
15 are the key words, "by adding procedures for the auditor  
16 to perform in evaluating the other information based on  
17 relevant audit evidence obtained and conclusions reached  
18 during the audit." Adding procedures, I guess, would be  
19 the key words.

20 And in looking at the releases that came out shortly  
21 after the proposal by at least two of the major firms, and  
22 I suspect the others agree at this point, they characterize

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1 this as substantial additional work that would have to be  
2 performed. At this point, it isn't clear what that exactly  
3 means but it sounds like a very major undertaking that the  
4 firms see. Reading the document, it is not clear exactly  
5 what the PCAOB has in mind. And it is not clear, of course,  
6 to me what the firms have in mind that they would have to  
7 do.

8           One obvious concern is that without a lot more  
9 specificity, this could turn into another PCAOB auditing  
10 standard number two versus five kind of situation where  
11 something is put out along the lines of what you have right  
12 now. The firms think again lots and lots, and lots, and  
13 lots of additional work. And then we find out that is not  
14 really what was necessary. But in the meantime, we have  
15 added, pick a percent, 10 percent, 20 percent or whatever  
16 to our audit fees and so forth for minimal additional  
17 benefit, if any, to the users.

18           Again, I think going back to my beginning point, if  
19 we were simply asking the auditors to report on what they  
20 were already doing, in other words, that they had, as part  
21 of existing standards, reviewed the other information in  
22 connection with the procedures that were already part of

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1 the audit and found it not to be inconsistent, and simply  
2 stated that with appropriate caveats in the report and so  
3 forth and not putting subheadings in and other information  
4 that would lead the users to believe that this was subject  
5 to a lot of additional auditing and so forth, I think that  
6 could be a major step forward.

7 I guess my major concern again is would it really  
8 be worth it to add a lot of additional procedures to create  
9 something that would not be fully audited in any event.

10 I guess my major suggestion here would be that I  
11 think that this is something that would really -- I would  
12 urge you to be very careful. And I'm not sure exactly how  
13 you do it but I think you need to do some field testing.  
14 And I don't know how you can field test something in advance  
15 but I urge Marty that you work with the accounting firms  
16 and get an understanding of what do they mean, what do they  
17 have in mind in terms of all these additional procedures  
18 that would have to be performed and compare that to what  
19 you believe are the added procedures that would be necessary  
20 to meet the requirements of the proposed standard and try  
21 to have a meeting of the minds in advance, as opposed to  
22 putting out a standard that would then be, in effect, not

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1 operational or be subject to a lot of ambiguity, again, like  
2 the unfortunate situation we had before.

3           Given the existing situation, given the uncertainty  
4 about what is going to be performed, I don't believe that  
5 it is supportable in its present form but if it can be, you  
6 might say, rolled back to just reporting on I think it is  
7 AU 550 approach, then I think that would be a very good step  
8 forward.

9           MS. RAND: I just want to react to a couple of points  
10 you made. Kind of what you are suggesting at the end, your  
11 recommendation that we just stay with the standard that we  
12 have. Our challenge in using the standard we have today and  
13 having the auditor's report on that is the auditor's  
14 responsibility is read and consider.

15           And there are no procedures about what does consider  
16 mean. So, one auditor may do all these procedures and more.  
17 And we heard a lot in our outreach because we did ask, that  
18 was one of the alternatives in the release, if the auditor  
19 should perform additional assurance. We received a lot of  
20 feedback that auditors do a lot today in connection with  
21 consideration. But what is not clear to users is what is  
22 meant by consideration. One auditor could do a lot.

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1 Another may read and not do much with it. So, we are looking  
2 for consistency in how auditors are reviewing that  
3 information. We do consider it important information,  
4 that there is no material inconsistencies, material  
5 misstatements of fact because the auditor's report is  
6 included in it. So, they are associated with that  
7 document.

8 The evaluation, the procedures in there, you  
9 compared a significant amount of work. Interested in  
10 reaction from the firms, our experience in developing the  
11 standard, we thought it was reasonable procedures. Again,  
12 it was consistent with outreach that we had conducted that  
13 auditors are generally performing a lot of work, a lot of  
14 these types of procedures, checking consistency of  
15 amounts. Checking to make sure that disclosures, what is  
16 in the financial statements, is not inconsistent with how  
17 it is being presented.

18 So, interested in other views on that, but just  
19 wanted to react to some of your points.

20 And Marty, do you want to add on?

21 MR. BAUMANN: Well, no, I don't want to add on but  
22 I want to concur with Denny that we don't want to create

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1 an AS 2-type environment. So, that is the reason why we put  
2 out a proposal and have SAG discussions around it. And  
3 hopefully, we will get comment letters that will -- if there  
4 are concerns around the nature of this, that it is not  
5 understandable or it is ambiguous or there is too many  
6 procedures, we will get those comments and certainly react  
7 to that.

8           There is at least some of us who have audited large  
9 companies at the PCAOB who, when we looked at this, said  
10 this is basically what we thought was pretty much existing  
11 practice in major corporations, at least, that basically  
12 the auditors felt this was part of what they did to read  
13 and consider. And certainly the audit committees and a lot  
14 of companies said we want you to read this information and  
15 make sure it is consistent with the financials. And if  
16 there is anything materially inconsistent, material  
17 misstatements of fact, certainly bring those to our  
18 attention.

19           So, I think our view is that a lot of this and these  
20 four procedures, so there aren't an extensive amount, there  
21 is four procedures, we felt was pretty much maybe a best  
22 practice that was already happening today in a lot of

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1 corporations, although we thought that there was probably  
2 varying practice among the 10,000 audits in the country.

3 But your points are all well-made and we look for  
4 comment if it is creating confusion, ambiguity or more work  
5 than is necessary. So I am sure we will hear that from firms  
6 or others.

7 Thanks, Denny.

8 MS. RAND: Brian Croteau.

9 MR. CROTEAU: Thanks very much. And it relates to  
10 these points, I think.

11 And Denny mentioned these words, and I hate to get  
12 overly technical but I just want to be sure that we are all  
13 thinking of an aspect of this that I think is embedded in  
14 the comments that were just made.

15 But paragraph 4 contains the words that Denny was  
16 reading from a performance perspective that get at the  
17 auditor should read the other information. And "based on  
18 relevant audit evidence obtained and conclusions reached  
19 during the audit" perform certain procedures. Paragraph  
20 13(c), which has the report, contains those same words.

21 And it occurs to me that users of the report may not  
22 necessarily know what all of the evidence was that the

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1 auditor obtained. And so there is a limiting principle  
2 here relative to the auditor's work that has to do with what  
3 evidence the auditor gained in conducting their audit work.  
4 They are not expected, per the standard, although they may  
5 for other reasons but not for the standard, to go further  
6 and obtain more evidence in conducting this aspect of the  
7 work.

8           So, I think there is a limiting principle built in.  
9 Whether that is the appropriate limiting principle might  
10 be a question for people to comment on. And then how users  
11 will interpret the report, given that they won't know  
12 necessarily as a user what evidence the auditor obtained,  
13 I think is an interesting question that I would certainly  
14 be interested in feedback on either today or through the  
15 comment process.

16           But I thought I would just highlight that because  
17 I think that is an important element of what is being  
18 described here, relative to the limitations and what stops  
19 this from being a full audit, another element of what stops  
20 this from being a full audit, or something that is more like  
21 AS-2 if people think of it that way.

22           MR. BAUMANN: That is a good point, Brian. And we

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1 intentionally, of course, put that limiting factor in, that  
2 the auditor who performs these procedures read and evaluate  
3 in the context of information based on relevant audit  
4 evidence obtained during the audit. And the point is that  
5 the auditor is not now intended to, supposed to -- not  
6 required by the standard to perform additional procedures  
7 to learn something about whether or not some product in R&D  
8 is going to be launched next year or not, if that is the  
9 statement being made in the other information, if that  
10 wasn't part of what the auditor obtained as part of their  
11 evidence.

12           And again, the procedures then are tied to, the four  
13 procedures are tied to what the auditor learned as part of  
14 the audit and then comparing that to what is in the other  
15 information.

16           But I fully accept your point, Denny, that we want  
17 to make sure that it is clearly understood.

18           And Brian's point goes to another issue, though,  
19 that there could be an expectation gap with this statement  
20 in here that we have read this other information and  
21 evaluated it, et cetera, that someone might think they did  
22 perform other procedures, even though it says in the report

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1 we did not audit this other information, did not express  
2 an opinion on it, and it was based upon what we learned  
3 during our audit but it has that expectation gap risk,  
4 potentially. So we wanted to get comments on all of that.

5 MS. RAND: Thank you. Richard Breeden.

6 MR. BREEDEN: Thank you. I think the objectives  
7 here are understandable and worthwhile. And certainly,  
8 the notion, as a member of an audit committee, that the  
9 auditor, in considering their work, has developed a  
10 conclusion that there is a material misstatement of fact,  
11 it doesn't seem radical that they should communicate that.

12 But the way this is drafted, material inconsistency  
13 and material misstatement of fact, to me that sounds awfully  
14 much like a violation of Rule 10b-5. That is fraud.

15 And so, asking the auditor to report on a  
16 formulation that sounds like a legal conclusion of fraud  
17 and if it is material and it is a misstatement of fact, it  
18 is unlikely to be accidental. There is almost certainly  
19 going to be an element of scienter in there.

20 Anyway, to me, I think you need to work carefully  
21 to make sure we are not creating something that becomes a  
22 rival legal review for the issues of fraud. And I am

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1 worried that this would trigger something. It could either  
2 be meaningless because the standard is such that if you are  
3 not -- if you haven't reached a conclusion, if all the  
4 element of a material misstatement are there, you wouldn't  
5 report it. And yet, the obligation to make that statement,  
6 if it is formulated in a way that is essentially a judgment  
7 of fraud -- if you want to say that auditors should report  
8 on any signs of potential fraud they have seen, that is one  
9 thing. But this is a legal conclusion that you may want to  
10 work on the formulation.

11 MS. RAND: Well, you raise a very good point. In  
12 the standard, we do point the auditor to our fraud standard  
13 when they identify material inconsistencies, material  
14 misstatements of fact. I think we recognize there could be  
15 a difference between the audited financial statements and  
16 the 10-K could be just an error. But we do point the auditor  
17 to consider the nature, you know, discuss it with  
18 management, go back to the fraud standards to consider if  
19 it is something more than that.

20 The current standard, under our current framework,  
21 the auditor reporting standard would allow the auditor to  
22 issue an unqualified report, even if there is a material

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1 misstatement of fact. They could include a paragraph and  
2 say we believe the audited financial statements are okay  
3 but we have identified this material misstatement of fact.

4 We are asking questions about the auditor's  
5 responsibility when something is identified and not  
6 corrected in their continued association. Kind of along,  
7 I think those same lines.

8 Did you -- you look like you were going to react to  
9 that.

10 MR. BREEDEN: Just the further observation that  
11 auditors are not experts in general matters of fact. And  
12 so when you go beyond the financial statements and into the  
13 realm of any misstatement of fact without qualification,  
14 that really can -- and without very carefully delineating,  
15 as Denny and others have said, what you have in mind, I think  
16 it would not be helpful to investors if you moved down the  
17 road toward competing 10-Ks. And the whole world of facts  
18 about a company's business that may be included in its  
19 reports get far afield from the financial information that  
20 the auditors are expert in reviewing.

21 So, that also is a slight concern of where this  
22 evolves to and making sure it is quite clear at the outset

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1 because that is a path that might lead other directions.

2 MR. BAUMANN: Richard, thank you. Those are all  
3 good points and we really have to consider those, especially  
4 the auditors are not in a position to reach a conclusion,  
5 necessarily about violations of 10b-5.

6 I just will point out, however, that under existing  
7 standard AU 500, which is the read and consider other  
8 information, so there is an existing standard today which  
9 requires the auditor to read and consider the other  
10 information to see if there is a material inconsistency with  
11 the audited financial statements. And it does go on to say  
12 if while reading that other information the auditor becomes  
13 aware of a material misstatement of fact, the auditor should  
14 discuss that with the audit committee and consider other  
15 actions.

16 So, there is existing auditing literature already  
17 that has this. So, we have built on that. So but  
18 nevertheless, even though we are building on that, we will  
19 take into account the concerns and considerations that you  
20 have expressed.

21 MR. BREEDEN: You might be better off having  
22 something where if the auditor is aware of an apparent

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1 inconsistency, they should discuss that, as opposed to  
2 keying it off a legal conclusion. And if the auditor is  
3 worried that what they have read is inconsistent with what  
4 they have seen, that is worthy of a discussion with the audit  
5 committee, and they shouldn't sit back and be having their  
6 own lawyers trying to evaluate has this crossed the line  
7 into an actual material misstatement of fact.

8 MR. BAUMANN: Thanks.

9 MS. RAND: Okay, Jerry de St. Paer.

10 MR. DE ST. PAER: Thank you. I seem to be in the  
11 piling-on mode today. But I hope from a little different  
12 perspective than the perspective that has been expressed,  
13 even though it supports that.

14 From the perspective of a CFO of a New York Stock  
15 Exchange company, with auditors who -- I couldn't tell you  
16 -- clearly, from their procedures, they were required to  
17 take a look at the other information, but we would never  
18 have issued it without them taking a look at it. So, I am  
19 not really sure what the chicken and the egg was there.

20 But I watched the way in which that procedure was  
21 done, and it goes to what Dennis said. There is a great deal  
22 of difference between making an affirmative statement of

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1 this kind and simply following the procedures.

2           Again, one of those companies that I was the CFO of  
3 happened to be one who wrote a lot of auditor liability  
4 insurance. And I can tell you that will cause the kind of  
5 reaction that Dennis was concerned about, where to be able  
6 to make that kind of a positive assessment, to go to the  
7 10b-5 or the SAB-99 issue, you are asking the auditor to  
8 take an additional step. So, I would just also argue the  
9 caution.

10           But I want to also make a second point that I think  
11 is really important, is that we heard in the presentation  
12 yesterday about the volatility of earnings based on release  
13 of earnings. From the experience, at least, in the  
14 companies I have been CFO of -- and when I was CFO, I was  
15 pretty interested in what the stock price did relative to  
16 the release of earnings -- that volatility is almost all  
17 related to the press release.

18           What happens when the K or the Q comes out is very  
19 little additional movement. And so the whole issue -- we  
20 also, by the way, had the auditors review the press release  
21 to make sure that there was no material inconsistency or  
22 misstatement of fact, just to make sure that we were okay.

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1 But there is a lot of non-GAAP measures.

2 The things that drive the market -- which is one of  
3 the things I thought was missing in yesterday's  
4 presentation -- the things that drive the market, with all  
5 due respect to the SEC and the design of all of the reports,  
6 isn't actually materially driven. It is at least equally  
7 driven by the non-GAAP information, in most cases, as it  
8 is by the GAAP information.

9 So, I just want to say while the concern about the  
10 risk you are creating by forcing this affirmative  
11 representation, to what Mr. Breeden said, is a big issue,  
12 and I am not sure it has got the elephant in the room.  
13 Because the thing that really is creating the biggest  
14 movement of share prices for the investors that are  
15 concerned about this information, actually it doesn't come  
16 out of the MD&A. What I found astounding in meetings with  
17 investors is that the questions almost always come -- they  
18 actually come before we ever issued the K or the Q. They  
19 came from the press release.

20 So, I would just like to caution to keep our eye on  
21 the ball here, that we are acting as if this other  
22 information is really the stuff that is driving investors.

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1 And I guess maybe everybody here, all the investors, are  
2 going to say, oh, well, we look at all that stuff. I can  
3 say from my side, in talking with all my investors, that  
4 is not where the questions came from.

5 So, just in terms of priority, this will, I'm sure,  
6 involve additional scope and expense and I am not sure about  
7 the cost and the return.

8 MR. BAUMANN: Those comments we have heard from  
9 others. And I look to the left of the room over here to  
10 Mike. We have often heard about what really drives the  
11 stock price and what investors are really concerned about  
12 is probably in much earlier releases than the 10-K. So, we  
13 have heard, certainly, that comment before.

14 To some extent we are limited, in terms of the  
15 auditor's responsibility, that they have to audit financial  
16 statements and report on financial statements and what's  
17 associated with the financial statements, you know, their  
18 responsibilities can go to that, too.

19 At least right now, under our authority, I don't  
20 believe, speaking for myself only, that we could require  
21 an auditor to perform procedures on that press release.  
22 But we've heard that from Mike and from others that that

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1 would be very valuable if auditors were required to do that.  
2 But at least speaking for myself, and only for myself, I  
3 don't think we could require auditors to do that under  
4 existing authority that we have.

5 But one thing I will add, many, maybe not all, but  
6 many of the -- much of the information that gets in that  
7 press release that drives the market at that time, and the  
8 non-GAAP measures, are also in that 10-K and are discussed  
9 in that 10-K. It's usually the same type of information  
10 around a non-GAAP measure or the performance that was  
11 previously discussed in a release is in the business  
12 section of the 10-K.

13 Management, knowing that the auditor is going to  
14 read and evaluate that 10-K, which includes probably those  
15 same non-GAAP which the auditor would have to, under these  
16 standards, see how they are reconciled to the financial  
17 statements to be not misleading and create a material  
18 inconsistency with the financial statements, I think has  
19 a deterring effect on management's behavior when they come  
20 out with that release, knowing that the auditor will be  
21 performing procedures on that information later on.

22 So, I fully acknowledge what drives it. But

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1 knowing that that same information is likely to be in the  
2 10-K, to be read and evaluated at a later date, I think has  
3 a deterring effect in addition.

4 So, I'm interested in your comments on that. I wish  
5 we could have the auditors do more up-front. And I know you  
6 want to comment even further. You're anxious to say  
7 something here.

8 MR. DE ST. PAER: I am. Because of the legal  
9 environment, at least in our case, we didn't release the  
10 press release until we had virtually a complete draft of  
11 the 10-K and the MD&A done because you could not possibly  
12 have a situation occur -- well, at least I don't think a  
13 responsible person could put out a press release where a  
14 few weeks' later you are going to put out a 10-K. You  
15 virtually have to be almost at the point where they auditors  
16 are pens down by the time you issue the press release, or  
17 you're taking huge liability.

18 And, actually, I was surprised Brian's card didn't  
19 go up because the truth is what happens if you don't put  
20 a reconciliation of the non-GAAP measures in the back of  
21 that press release or the supplement information that you  
22 put out which reconciles to the audited information, the

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1 next call comes from the SEC. I mean, I have had the  
2 opportunity to have that conversation with them.

3 And rightly. That is not a criticism. That is as  
4 it should be. But there is a reconciliation and the audit's  
5 not done. So, people don't put out press releases hoping  
6 that they get within the range of the 10-K. Most companies  
7 have this stuff all come together at the same time.

8 MR. BAUMANN: Thanks for that additional color and  
9 valuable input. Walt Conn is next.

10 MR. CONN: Yeah, in my firm, we are still developing  
11 our views on parts of the standard and particularly our  
12 comfort with the words in the report.

13 But let me just circle back to Denny's question on  
14 the procedures that are in here. I think, in general, in  
15 my experience, these procedures are consistent with what  
16 we do today. However, there are a couple of words or  
17 phrases that give us pause and we're formulating our  
18 questions or recommendations on those. But we want to be  
19 sure there is clarity about whether the scope of our work  
20 should expand beyond what it is today and whether our  
21 responsibility should expand.

22 One of the changes that gives us pause is the change

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1 from "consider" to "evaluate," because if evaluate means  
2 "do these procedures that are listed," period, then maybe  
3 that is okay. If evaluate means "do these procedures and  
4 whatever else you need to do to conclude that you have  
5 performed an evaluation," then that probably lacks some  
6 specificity that is needed.

7           The other change that gives us pause is that the  
8 reference to consistency with the financial statements, in  
9 the proposal now adds consistency with the relevant audit  
10 evidence. And that seems to be a subtle expansion beyond  
11 where we are today.

12           MS. RAND: Walt, to respond to that, you asked about  
13 what does evaluate mean. The way it's phrased in the  
14 standard, we have evaluation based on the procedures in  
15 paragraph four.

16           So I don't know -- and continuing your thinking on  
17 that, if you are just concerned about how that may be  
18 perceived in the report, but at least the way it is  
19 proposed in the standard, it's based on those four  
20 procedures in paragraph four.

21           MR. CONN: Yeah, and we realize that, and are just  
22 struggling with that choice of words, whether it will be

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1 clear to all stakeholders that evaluate means "just perform  
2 these procedures." Because we think of evaluate as not  
3 being limited to specific procedures but going beyond that.

4 MR. BAUMANN: Good points and we'll think of that  
5 as we consider where to go with this. But it was  
6 interesting to hear your comment that you think largely  
7 these are the nature of the things you do today, but with  
8 a careful looking at each of the words to make sure that  
9 they are the same as what you do today.

10 MS. RAND: Thank you. Damon Silvers.

11 MR. SILVERS: I just wanted to comment on the issue  
12 of whether or not material inconsistency and material  
13 misstatement of fact are necessarily a legal conclusion.

14 I mean, I think that the issue that has been raised  
15 is an important one to get right. But that without a  
16 statement about scienter here, it's not a legal conclusion,  
17 at least with respect to 10b-5. And I can't see how you could  
18 even -- I can't see, if an auditor were aware of a material  
19 misstatement of fact under the current reporting rules,  
20 that an auditor could sign the letter certifying the  
21 financial statement.

22 So, it's not clear to me this even, at least as

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1 stated on this slide, that it necessarily even represents  
2 an expansion of the auditor's current duties. And as long  
3 as you don't add a scienter component to it, I don't think  
4 it represents a legal conclusion.

5 MR. BAUMANN: Thanks, Damon. Wally Cooney.

6 MR. COONEY: Most of the concerns that I had have  
7 been covered one way or the other. So, I'll just comment  
8 that I share the concerns about the expectation gap. While  
9 it's helpful that the opinion drafted clearly says that they  
10 did not audit this other information, I think that's  
11 important, the word evaluate, even in the context of  
12 specific procedures, I think could really cause a problem  
13 with respect to expectation gap.

14 And just in practice, now that the auditors will be  
15 commenting, at least providing negative assurance, on the  
16 other information, I think sometimes that has the practical  
17 effect of just taking on a life of its own, including getting  
18 into non-financial information, and a lot of work, a lot  
19 of discussion, a lot of higher and more experienced people  
20 spending significant time on going through all that  
21 information. And I think there could be a significant cost  
22 effect.

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1           The only other concern is that to the extent that  
2 MD&A is supposed to be through the eyes of management, it  
3 really is supposed to be management's report. I have some  
4 concern that companies may want to limit disclosure, maybe  
5 water down some of the commentary that they might have  
6 otherwise felt was more transparent and comfortable saying,  
7 but not having it subjected to the scrutiny of a long,  
8 drawn-out review process and discussion.

9           MS. RAND: Thank you. Professor Cox?

10          MR. COX: I think it would be helpful if you could  
11 separate these two issues out into two things. One is the  
12 process. Exactly what are the documents that are to be  
13 looked at and what the procedures are to be by the outside  
14 auditors, what they are supposed to look at, in which they  
15 are going to formulate some sort of opinion.

16          And then the other question I would say, separate  
17 from that, is how and to whom you communicate that. Richard  
18 Breeden made the observation, and never underestimate the  
19 power of a modifier: appropriate. And I think that that's  
20 something worth thinking about.

21          But the other idea I would put out there to take also  
22 some of the steam out of the process and some of the angst

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1 out of the process, is to work this a little bit through  
2 the existing legal framework and think that maybe investors  
3 are not the group. That a big full-blown evaluation or  
4 reporting on the evaluation to all the investor community  
5 is not where you want to go. You would say add to your  
6 standard that conversations have been had. That your  
7 duties are to see if there are any apparent inconsistencies,  
8 and part of your obligation is to communicate those to the  
9 audit committee. In which case I would think that that then  
10 triggers the existing format for what happens to auditors  
11 in certain situations under 10(A) of the Exchange Act.

12           And that could be a way of at least making this  
13 initial step. I'm not sure where we are going to be ten  
14 years from now in terms of this process, but maybe this would  
15 be a somewhat more palatable process to going through.

16           But I do think it is going to be useful to you to  
17 unpack, first of all, what you want the auditors to do from  
18 the question about how that then gets communicated and to  
19 whom.

20           MS. RAND: Thank you. We have talked, just  
21 reflecting on the comments so far on this subject, talked  
22 a lot about the procedures, what does read and evaluate

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1 mean, the work effort. I haven't heard that much, though,  
2 on the point regarding usefulness of reporting.

3 In our outreach we had heard, in one of the  
4 alternatives presented in the concept release on whether  
5 or not the auditors should provide additional assurance,  
6 was not to provide additional assurance, was really just  
7 describe the responsibilities that the auditor does with  
8 respect to the annual report. So, that was our intent. It  
9 initiated from a reporting element, thinking that might be  
10 useful.

11 So, I'm interested in feedback on that. We did feel  
12 that the current version of the report, just the read and  
13 consider with no procedures, wasn't robust enough to  
14 support a reporting statement in the auditor's report. So,  
15 we felt we needed to make some enhancement, have some  
16 minimum set of procedures regarding what the auditor does,  
17 their procedures over the other information.

18 But interested very much in is having the auditor  
19 report on, whether it's consideration, evaluation, is it  
20 used in the auditor's findings, is that useful to investors.  
21 So, hopefully, any other comments or if anyone that has  
22 their comment cards up now has any reaction, I am interested

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1 in thoughts on that.

2 Next, is Gaylen Hansen.

3 MR. HANSEN: Jennifer, I absolutely think that it  
4 would be helpful to clarify this aspect of what auditors  
5 do. And I agree with what has been said. A lot is done now,  
6 and I think that what you have done here is responsive in  
7 large part to addressing that issue.

8 I will try to bring out just a couple of other things  
9 really quickly, though. Who does this? And it's not the  
10 firm. It's people within the firm. And I think for it to  
11 be meaningful it needs to be senior individuals on the  
12 engagement team. And all too often I have seen this  
13 delegated to lower level staff people.

14 And that tends to be a focus on the numerical  
15 aspects, as opposed to the qualitative, the nuance, and the  
16 spin and the tone. You read the financial statements and  
17 they have one tone. And you read the forepart of the 10-K  
18 and it is almost a completely -- it seems like it's written  
19 from a completely different perspective. And particularly  
20 when it comes to minimization and exaggeration and the  
21 wording in which you couch certain things I think does  
22 impact the way investors might approach things and consider

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1 the company.

2 To your example, making widgets and characterizing  
3 yourself as the leading manufacturer of the widgets when  
4 you know you are the third, well, a lot of times what I see  
5 is someone saying we are a leading manufacturer of the  
6 widget. And you know perfectly well that's not the case.  
7 It's a misstatement but it's not numerical. And for a lower  
8 level staff person to be able to pick up on that, I think,  
9 is asking a lot of them.

10 So, I think that who does this and the tone and the  
11 spin and focusing on the qualitative is just as important  
12 as the numerical.

13 MS. RAND: Thanks, Gaylen.

14 Steve Buller.

15 MR. BULLER: Thank you. First of all, just a  
16 couple clarifying comments. One is I thought there was the  
17 inference earlier that a material misstatement may be  
18 fraud. And, certainly, there are conditions where you may  
19 have errors or typographical issues that of course, you  
20 know, occur. And as long as there is not intent or  
21 knowledge of the misstatement, I don't think, as a  
22 non-attorney, that would be something I would classify as

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1 fraud.

2           And secondly is with respect to just the timing of  
3 press releases and 10-Ks. There are some companies that do  
4 produce a 10-K and a press release concurrently, but quite  
5 often it is because they material information that they  
6 need. Quite often it is codependent upon a third party and  
7 they can't obtain that in time to provide an earlier press  
8 release. But most companies do a press release two to three  
9 weeks after quarter-end or period-end. And so that does  
10 proceed to 10-K in most situations.

11           But they do, of course, make sure the information  
12 that is in the press release is, in fact, accurate because  
13 most of it does, as you said, Marty, appear in the 10-K.

14           So, the main question is we do support clarifying  
15 the responsibility for other information. I think it's a  
16 good idea. I think, generally, I am concerned it could be  
17 an expansion of scope, especially if the other information  
18 includes documents that are incorporated by reference. I  
19 know when I go through our 10-K and through others,  
20 incorporated by reference documents often are two or three  
21 pages long of listings. And our concern, of course, is that  
22 it would take auditors just time to read that listing, let

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1 alone to read the documents that are included in there, just  
2 to see if there is information that may in fact be relevant  
3 to the audit.

4           Then, lastly, is I think that as part of the auditor  
5 performing their work, even though I know they are supposed  
6 to consider and evaluate information that's based upon  
7 evidence that has already been obtained. If I were an  
8 auditor and I saw, for example, information that had a  
9 number of factors, one of which was information that was  
10 based upon audit information that I had obtained to do my  
11 core financial statements, but there was other information  
12 I had not obtained, or did not have, I would make sure my  
13 audit planning included getting that information as part  
14 of my audit.

15           So it may in fact be that there would be an expansion  
16 of the scope just to CYA, in part, to make sure that where  
17 there is information presented with information that would  
18 not otherwise -- would only be obtained as part of an audit  
19 that now becomes part of the audit planning process and  
20 therefore is obtained as part of the audit.

21           So, again, it's probably just the discussion of the  
22 expansion of scope. Thank you.

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1 MS. RAND: Okay, thank you, Steve. Elizabeth  
2 Mooney.

3 MS. MOONEY: Okay, thanks. I think it would be  
4 great if the earnings release and the 10-Qs would come out  
5 at the same time. That would be fantastic. And some  
6 companies do do that.

7 Obviously, investors do respond. Marty, just to  
8 echo your comments, I mean, they do respond to the most  
9 recent information, whatever that is, and the earnings  
10 release is significant.

11 But my experience, I had the great fortune of  
12 working with the best and brightest. I believe, investors,  
13 analysts, and for the long-term, fundamental research is  
14 all we do. And they do read the 10-Qs extensively and the  
15 10-Ks.

16 So, I think, in terms of the other information, I  
17 said this earlier, but the goal, and we're getting a little  
18 sidetracked with a lot of this, but the goal is if the  
19 auditors are aware in their work of material misstatements  
20 otherwise, like Gaylen mentioned, that there is some  
21 responsibility to fix it.

22 I mean, I think that's the end goal and not just be

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1 silent. And I think that is the spirit of the project and  
2 just I would encourage you not to lose sight of that.

3 MS. RAND: Thank you. Rick Murray.

4 MR. MURRAY: Jennifer, a question, and a brief  
5 explanation of why I ask. The question is is it correct to  
6 understand that if the additional information that's at  
7 issue is itself not material, then it is impossible for that  
8 information to produce a material inconsistency or a  
9 material misstatement?

10 And the reason for the question has to do with the  
11 rapidly emerging movement now called integrated reporting,  
12 which really has two prongs. One of which is the view of  
13 many, that there should be more attention to  
14 sustainability-related information included in financial  
15 reporting as a voluntary, non-material election by  
16 reporting entities. And the second prong, best  
17 illustrated by the work of the Sustainability Accounting  
18 Standards Board, suggests that all sustainability-related  
19 information should in fact be recognized as material.

20 And it's that duality of position at the moment, and  
21 what will be, I think, a very rapid evolution to  
22 sustainability reporting issues arising in the next few

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1 years, that I direct the question. Because those issues  
2 would be a great deal easier to deal with if there were two  
3 points of clarity. One is the answer to my question and the  
4 other is what standard of materiality will be applied in  
5 making the determination of what falls within the scope.

6 MR. BAUMANN: I don't think I have an answer to your  
7 first question, whether or not one could conclude that if  
8 there is no other -- if the information by itself is not  
9 material, could you have a material misstatement or a  
10 material inconsistency.

11 There is requirements of what has to be included in  
12 a 10-K under the Securities Act. And I don't think we've  
13 thought through whether that information, or some of that,  
14 is by definition not material and therefore it wouldn't be  
15 subject to a consideration of a material inconsistency or  
16 material misstatement of fact, or whether a company decided  
17 to put in other sustainability information and how that  
18 might fit into this equation.

19 I think you've raised some things for us to think  
20 about with respect to that, but I don't think we have really  
21 explored that thought as part of this proposal. So, I will  
22 just say we will take your comment and note it and give it

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1 some thought.

2 MS. RAND: Okay, Wayne Kolins.

3 MR. KOLINS: Yeah, thank you. With respect to the  
4 reporting and the relationship of that to the limited nature  
5 of the procedures. And the procedures are more than read  
6 and consider and probably is similar to what is done  
7 currently in practice. But the conclusion is the negative  
8 assurance that was mentioned before is something that you  
9 see in a review engagement.

10 These are not review procedures. I think they are  
11 probably something less than review procedures. And I  
12 wonder if a way around that would be to specify that these  
13 are limited procedures, describe what the auditor's  
14 responsibility is to see that the information is revised,  
15 and if it's not, to refer to it in his or her report. And  
16 the absence of any such revision would be implicitly that  
17 they auditor did not have an issue with it. That the  
18 auditor did not become aware of anything.

19 Just an approach to take care of the very limited  
20 nature of the procedures and the ultimate reporting on it.

21 MR. BAUMANN: We understand that point and  
22 understand the careful line between the nature of the type

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1 of assurance being expressed and whether or not the  
2 procedures are the right procedures in connection with that  
3 type of assurance.

4 So, we gave a lot of thought to that in putting this  
5 out, but we'll continue to do that based upon those kind  
6 of comments. Thank you.

7 Who was next? Bill Platt.

8 MR. PLATT: Thanks, Marty. Just as I listened to  
9 the discussion, I sort of have two observations around this.  
10 And this is one area of the proposal that we spent a lot  
11 of time thinking about.

12 One is the performance of the work. And I think  
13 largely I would say that the procedures that are laid out  
14 in paragraph four may in fact be fairly consistent with what  
15 people are doing today in read and consider for a portion  
16 of the other information.

17 And when I say that, you really think about the other  
18 information. There is other information that is derived  
19 from the company's accounting records, was subject to the  
20 company's internal controls, and has been the subject  
21 matter of the audit. The audit tests have been performed  
22 around it. But then there is other information that is not

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1 related at all to the company's accounting systems or  
2 systems of internal accounting control.

3           And I do think that in 4(C), I think, would be this  
4 characterization of other information not directly related  
5 to the financial statements. I don't know that it is clear  
6 enough for me to know what I would do as an auditor to that  
7 information.

8           And right now you sort of would say, well, if an  
9 underwriter asked me for comfort and started circling a  
10 bunch of items for me to give comfort on, I would give  
11 comfort on the items that are derived from the accounting  
12 records or subject to the internal accounting control, but  
13 I would say that the other information is outside the scope  
14 of my audit, it's outside of the areas of my expertise and  
15 I wouldn't give comfort on it.

16           So, I guess I worry a little bit about this other  
17 information and what the expectations are and are we  
18 changing kind of the performance expectations or standards  
19 around that information. And if we are, I think we need to  
20 be clearer than this simple reference that's in 4(C) right  
21 now. So, that would be the performance side of it.

22           The other side that I had is in the reporting now

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1 of what's been done. And we are creating maybe a new  
2 byproduct level of service called an evaluation. We  
3 evaluate it. And, to me, I think evaluation implies  
4 something more than I considered in relation to the  
5 information that I had as an auditor. And I wonder whether  
6 or not the report is actually being set up in a way that  
7 will create an expectation gap, notwithstanding what the  
8 standard requires, which is consideration of consistency,  
9 but evaluation getting to a point that one would say, well,  
10 that to evaluate then you just have drawn a conclusion,  
11 which might then go beyond and actually start having  
12 piecemeal opinions on pieces of information that are in the  
13 other.

14 And this might go a little bit to Rick's question  
15 about immaterial information. Say you had a \$10 billion  
16 company that had no real estate at all, 10,000 square feet  
17 of office, it just happens to be a very virtual company,  
18 and it was misstated by 2,000 square feet. It's material  
19 to the square footage of office space but is it material  
20 to an investor as you sort of look at that?

21 So I think some of those questions about materiality  
22 may actually come into play here if there's going to be an

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1 explicit statement that there wasn't an identification of  
2 a material misstatement.

3           So, I think that those would be my two places that  
4 I would suggest further thought around. One, is what do we  
5 need to do around information that's not from the either  
6 accounting records or subject to the system of internal  
7 controls over financial reporting? And, secondly, to make  
8 sure that we don't create a reporting format that is  
9 creating an expectations gap but truly is providing  
10 informative information to users of financials.

11           MS. RAND: Bill, do you have the paragraph 4(C)  
12 which you referenced, which is other information not  
13 directly related to the financial statements? That could  
14 be the example I gave about the leading manufacturer of  
15 widgets and the company purports to be that but you know  
16 that they are not. They are the third.

17           MR. PLATT: So, what if --

18           MS. RAND: Do you have a view as far as should the  
19 auditor ignore that or, you know, kind of what should the  
20 responsibility be?

21           MR. PLATT: But what if we have two auditors that  
22 one happens to know that and the other doesn't? Is the

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1 inference that you always should know that? And what  
2 happens if, for example, there is a lot of different ways  
3 to measure leading?

4           So, they manufacture more widgets than anyone else  
5 in the world from a unit perspective but they are the third  
6 in revenue because they manufacture cheap widgets and other  
7 people manufacture premium widgets. Is that something  
8 that is a material misstatement of fact or not? There are  
9 two leaders, depending on what metric you use, if you use  
10 total revenue or you use total units.

11           I think it introduces a lot of interesting concepts.  
12 And I also don't know -- I mean, I might think that I know  
13 that they're third, but I really don't know from my audit.  
14 I only know from other public information that's out there  
15 that everybody else can see, too.

16           So, I think even though you have a simple example,  
17 I'm not sure it as simple in the real world when you really  
18 try to apply it.

19           MS. RAND: So I'm assuming, and I'm not sure if it's  
20 a correct assumption, that you may be more supportive of  
21 the responsibility today, just if the auditor becomes aware  
22 of something. But I think what I'm hearing is you are

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1 concerned about the reporting on that aspect, the material  
2 misstatement fact.

3 MR. PLATT: Or the pieces that go -- for the pieces  
4 of information that are not derived from accounting records  
5 or subject to internal controls. I think I would say yes.

6 MR. BAUMANN: So, of course, we do say -- so, these  
7 are in context of you should read this other information  
8 and, based on relevant audit evidence obtained and  
9 conclusions reached during the audit, evaluate things.

10 So, it's not requiring you to evaluate that other  
11 information not directly related to the systems, based upon  
12 some new procedures. It's whether or not, when you were  
13 reading the minute, understanding the company and its  
14 environment, as part of those risk assessment procedures,  
15 you became aware of aspects of the company and their  
16 position in the marketplace, et cetera, or the growth  
17 opportunities or other things that when you finally read  
18 the other information, based only on procedures you  
19 performed during the audit, the risk assessment procedures  
20 and all of that, you became aware of it.

21 So, we do have that limiting factor. It may not  
22 ameliorate your concern but that was the intent of those

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1 words. You don't perform additional procedures. It's  
2 based on what you know.

3           So, the answer to your question would be one auditor  
4 might know with respect to a statement management makes that  
5 that is an inconsistency or a misstatement of fact, and  
6 another auditor might not know that because they didn't come  
7 upon that in their risk assessment procedures. So, that is  
8 a possibility, because it would be based upon what you  
9 learned as part of risk assessment. So, that is a  
10 possibility.

11           But the other point, I think, and you've made a lot  
12 of good points there, Bill, is there is different ways to  
13 understand leading. We just hope that that would trigger  
14 a conversation. If the auditor thought there was a  
15 misstatement, it doesn't mean the auditor is going to report  
16 that. We just hope that would trigger a discussion. And  
17 I would hope it would trigger a discussion between the  
18 auditor and management about let me understand the context  
19 in which you've said that. I thought I understood  
20 something different. And maybe it would trigger a  
21 conversation. If that wasn't satisfying with the audit  
22 committee, et cetera. But hopefully that would be resolved

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1 before somebody reported something.

2 MR. PLATT: Yeah, and I think those conversations  
3 largely take place today, Marty.

4 Just on the point of the other information, though,  
5 you know, and I think sometimes, in terms of a layman, and  
6 to say that there is other information that I don't have  
7 anything in my knowledge base to know anything about and  
8 therefore I say, well, I don't know whether it's true or  
9 not true but because I don't have any information from my  
10 audit to evaluate it, I'm going to be okay it. And then to  
11 characterize that as you have evaluated, it seems to me it  
12 may be setting up what I described before as that  
13 expectation gap. It's sort of odd to say that is an  
14 evaluation just because you didn't know anything.

15 MR. BAUMANN: I completely understand your point.  
16 Thanks.

17 MS. RAND: Okay, Dan Montgomery.

18 MR. MONTGOMERY: Thank you, Jennifer. And just  
19 getting back to your earlier point on just some input on  
20 the usefulness of reporting on other information, and just  
21 to give a little bit of international perspective on that.  
22 The IAASB did consider the alternative of simply

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1 acknowledging in the auditor's report the auditor's  
2 responsibility for reading the other information, reading  
3 and consider, reading and evaluate, whatever the  
4 terminology, and perhaps indicating a responsibility to  
5 discuss any issues identified with the audit committee.

6 But the IAASB heard very strongly through two public  
7 consultations, three public roundtables, and a significant  
8 amount of outreach that there is value to an affirmative  
9 statement by the auditor in the auditor's report on the  
10 auditor's responsibility for other information and the  
11 outcome of the auditor's work effort.

12 So, just the point in terms of usefulness, the IAASB  
13 is firmly committed to moving forward with an affirmative  
14 statement on other information in the auditor's report.  
15 This was something that was supported not only by investors,  
16 but there was strong support from regulators, from national  
17 standard setters and from other stakeholders globally to  
18 move forward because of the value of that statement in their  
19 view.

20 However, I also would point out that the IAASB will  
21 continue to look at the wording of the reporting language  
22 so as to not create any confusion or misunderstanding or

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1 certainly not further expand the expectation gap, and will  
2 be doing so in connection with its further work on  
3 finalizing the revision to the IAASB other's information  
4 standard, ISA-720.

5 MS. RAND: Thank you, Dan. That's helpful.

6 I see a couple of other cards up and I don't know  
7 if they're just up from previously: Steve Buller and Wally  
8 Cooney. Okay.

9 I have according to my watch that it's 10:30, which  
10 is break time. We've got a 30-minute break scheduled. I  
11 wanted to see if there was interest, anybody had any other  
12 topics -- I see one card up -- on other matters. So I see  
13 a couple. I would like to take those because I think, even  
14 if we have a little bit shorter break, we would still be  
15 okay. So Mike Cook?

16 MR. COOK: Thank you, Jennifer. I just have a sort  
17 of overall observation about a lot of the things that have  
18 been talked about, sort of the question you haven't asked.  
19 And I guess I think it's okay to answer it if you didn't  
20 ask it, but it's not a definitive answer. But one of the  
21 questions to me, an important question, is cost-benefit.  
22 What are the costs that we're going to impose by whatever

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1 we end up doing? And what are the benefits going to be? I  
2 know the economists get involved, and a lot of other people  
3 get involved in that. But that is a very important issue.  
4 So I'd like to take the opportunity to comment on that.

5 Many of the people who offer comments say, "I  
6 appreciate the opportunity to talk about this subject." I  
7 have talked about this subject, the auditor's report, for  
8 so long I don't know for sure that I appreciate the  
9 opportunity anymore, but that doesn't keep me from offering  
10 a few thoughts.

11 And then I would like to give you one suggestion from  
12 the perspective of an audit committee chairman that might  
13 really produce a benefit with whatever you ultimately  
14 decide to do. And I'll save that for the last.

15 As I look at the cost-benefit of this, like a lot  
16 of things, the costs are more obvious than the benefits.  
17 If you accept, this will make investors better informed as  
18 an overriding consideration that drowns out any cost  
19 issues. You can get to that answer pretty quickly. I  
20 don't think of it that way, and I don't get to that point.  
21 But for me, the cost, the dollar cost, of implementing what  
22 we have here or some modified version of that is going to

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1 be significant. So the benefit has to be significant, and  
2 I can't quantify either one of those for you.

3 We will divert audit attention from things that  
4 matter in terms of audit quality. We may do it depending  
5 on how this gets implemented at a time of the year after  
6 the end of the year when we need all of the attention we  
7 can get to the critical things that need to be done to  
8 complete an audit. And doing this, critical audit matters,  
9 writing them up, getting them reviewed, talking to 14  
10 different people, I don't think is going to meet a standard  
11 of adding to audit quality.

12 I think there is a real risk of obscuring the key  
13 messages that do need to be delivered. I happen to like the  
14 pass/fail. I don't think we are abandoning that. But if  
15 you have a hard time finding it or when you find it, you  
16 are not sure that you did pass because you got so many other  
17 things in there that might indicate that you really didn't  
18 or you barely passed, I think that is a serious issue.

19 I am quite concerned about the issue of original  
20 reporting, auditors reporting things that are not being  
21 reported through management, through the financial  
22 statement process. I am very concerned about some of the

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1 discussion about disclosure and essentially creating new  
2 disclosure standards through a requirement here, such as  
3 with respect to material weaknesses and significant  
4 deficiencies. I don't think that it is in the prerogative  
5 or the parameters of the PCAOB to be writing disclosure  
6 standards indirectly.

7           So I would point all of those things out as being  
8 costs that are of concern to me. Then I get the benefit.  
9 And I'll make a prediction, which I can't substantiate, but  
10 I think a lot of people might see it the same way. And I  
11 have heard it described.

12           I will predict that this will become lawyerized  
13 boilerplate. And what we are trying to achieve, like a free  
14 hand where the auditor gets to sit down and write how they  
15 did the audit of company X and what bothered them in doing  
16 that, will be totally overtaken by the need for uniformity,  
17 legal considerations. And what we will see two or three or  
18 five years from now, when we look at it, is going to be  
19 boilerplate that is not particularly informative. I might  
20 be wrong. That is my opinion of the way this will play out.

21           And I then put all of those points together and say,  
22 does it meet the cost-benefit test for you? For me, it does

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1 not. And so I just offer that. It's not quantitative  
2 conclusion. But I think the need to step back and really  
3 ask what costs we're imposing, financial costs and  
4 diversion costs and unnecessary information costs, the  
5 kitchen sink that we're going to get, which I happen to agree  
6 with, when you start adding all of those up, the benefits  
7 have got to be very clear and very direct.

8 I also would observe, however, that I think this  
9 train has left the station, meaning I think I've heard it  
10 said often enough in the last day or so "We have to do  
11 something." I'm not compelled to conclude that we have to  
12 do something if we're not doing something that meets the  
13 cost-benefit test and is the right thing to do. But there  
14 apparently is a conclusion that we've got to do something  
15 here. So if you have to do something, then I would just say,  
16 you know, think carefully about the implications of what  
17 you're doing.

18 This last discussion about other information is  
19 very much on point, I think, with that issue. I didn't  
20 really want to get into it because it was being well-said  
21 by others. But the word "leading" is not a fact. And if  
22 you're leading people, using that word, into challenging

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1 that as a statement of fact, there are many accounting firms  
2 in the United States who claim to be the leading firm. That  
3 is not a statement of fact. Largest is a statement of fact.  
4 That is quantitative and could be challenged. It is just  
5 an indication of the areas that you can be leading people  
6 into that are going to be very problematic. And I like to  
7 know about these things as an audit committee chairman.

8 I would like to go to one other phrase that is used  
9 by members of the Board and others. I want to know what  
10 keeps the auditors up at night. And this is now my request  
11 to you. As an audit committee chairman, I want to know what  
12 keeps the auditors up at night, but I don't want to find  
13 it out next February or next March. This is my standard  
14 pitch. I'm not going to give you the big story about  
15 timeliness. And for the auditors to be writing next  
16 February or March about what kept them up at night in this  
17 year, when it's relevant to know that, from an audit  
18 committee standpoint is not satisfactory.

19 So I would urge you please if you are going to go  
20 forward with this, either in this standard or by rewriting  
21 or amending the standard on required communications with  
22 audit committees provide for this information to be given

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1 to the auditing committee on a timely basis. I want to know  
2 today what is keeping the auditors up at night. I hope they  
3 don't have anything like that, but I really am not  
4 interested in finding that out next March. And I represent  
5 the investors in our company. And I need to know that  
6 information now. And I don't see any reason why you can't  
7 build a requirement to that effect into whatever  
8 conclusions are reached about critical audit matters, but  
9 timeliness is very important.

10 Thanks for the opportunity.

11 MR. BAUMANN: Thanks, Mike.

12 Obviously we will clearly explore the economic  
13 rationale behind all of this. We have done that and  
14 discussed that to some degree in the proposal itself and  
15 certainly as we think about next steps, whether it's a group  
16 proposal or adoption, we'll clearly have to articulate the  
17 economic rationale of the need for this, various  
18 alternatives you may have considered to solve whatever the  
19 need is and, you know, what are the costs and related  
20 benefits. So that is something that's, without a doubt,  
21 things that will -- we will definitely do that. And  
22 whatever we ultimately issue and adopt will certainly

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1 reflect a very thoughtful economic rationale behind it.  
2 That's part of our mantra to do that.

3 I don't want to cover too many -- you made a lot of  
4 good points. And certainly we'll think about all of them.  
5 To your point about hopefully no auditors would keep this  
6 from the audit committee until the time of the annual report  
7 being issued and the opinion, AS 16 has in it already the  
8 communications with audit committees a statement that  
9 communications with the audit committee should be done on  
10 a timely basis. We can always think of reemphasizing that  
11 and making requirements in a different way to ensure that  
12 they are timely if that is not occurring, but that is  
13 certainly built into AS 16. So this in no way contemplates  
14 that the audit committees wouldn't hear about the issues  
15 that keep an auditor up at night on anything other than a  
16 timely basis.

17 But thanks for the comments. They are the valuable  
18 things for us to think about.

19 MS. RAND: Okay. I see three cards up. So I'll  
20 take those, and then we'll go to break. So Bob Hirth?

21 MR. HIRTH: Thanks, Jennifer.

22 I had one comment on critical audit matters from

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1 yesterday. In the draft standard on page A1-8, item 10, it  
2 talks about when financial statements are presented on a  
3 comparative basis and talks about where critical audit  
4 matters from the prior period might be restated. It talks  
5 about for the first time that information is presented  
6 publicly and also where there's a prior period where the  
7 auditor's report could no longer be relied upon.

8 I think what is missing there and I think you might  
9 add as a third point, where there are meaningful or  
10 significant differences in critical audit matters between  
11 reporting periods. What I mean by that is financial  
12 statements are generally presented in pairs.

13 And if you only have the critical audit matters of  
14 the most recent opinion, you're going to ask me to go back  
15 and find last year's opinion, which was the current year's  
16 opinion, and look at those critical audit matters. So if  
17 I had five critical audit matters that were exactly the same  
18 between both years, fine. What if I had five in one year  
19 and six in the previous year or five and some of them were  
20 different? So I think you need to ask the question, where  
21 you have that, should that be considered in the standard?

22 My second point was we've had a great discussion

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1 over the last two days. And this is a really, really  
2 important change. And, to Mike's point I think on the costs  
3 and benefits, I would really encourage the Board to think  
4 about how you monitor this with, you know, multiple parties  
5 but clearly the investors, the filers, and the audit  
6 committees, and get some feedback but also think about  
7 whether or not this is so important that we go back and  
8 report back to the SAG in a year or two on what the findings  
9 were from those studies on the costs and the benefits  
10 because this could be a standard that either continues or  
11 gets revised or when you really sit down and look at it and  
12 look at all of the benefits, you know, they weren't there  
13 and that becomes superseded in some way.

14 MS. RAND: Thank you, Bob.

15 Elizabeth? Oh, go ahead.

16 MR. BAUMANN: Just one comment to Bob's. And that  
17 is we have already announced that after the comment period  
18 is over, which is December 11th, we'll analyze those  
19 comments. And they certainly have a SAG meeting next May,  
20 but we also have already announced that we plan to hold a  
21 roundtable, some type of forum to discuss the comments that  
22 were received and a focused meeting just on the auditor

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1 reporting model as well as probably a SAG discussion in May.  
2 So we intend to get continued outreach and reaction beyond  
3 the many comment letters we get to make sure that we get  
4 all of that kind of input you're talking about.

5 So those are valuable points, Bob, and we plan to  
6 do that.

7 MR. HIRTH: And maybe just one step further. So  
8 would the idea be because we have these different parties  
9 that have, you know, different viewpoints? Would you even  
10 think about seeing that a third party does some kind of study  
11 or engaging some third party to really look at the costs  
12 and the benefits, you know, a year out or two years out or  
13 three years out?

14 MR. BAUMANN: Well, as Jim mentioned yesterday --  
15 well, first of all, we have economists on board. And we'll  
16 be thinking, as I clearly stated, I hope, that nothing would  
17 go forward until we did a thorough economic analysis of why  
18 we're doing what we're doing, what's the problem we're  
19 trying to solve, and making sure that we're solving it in  
20 an economical way.

21 But we're also building the capability in the Center  
22 for Economic Analysis at the PCAOB to look at ways in which

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1 after we issue standards, the effectiveness of the  
2 standards and the benefits of the standard vis-à-vis the  
3 cost. So we want to continue to build that capability at  
4 the Board.

5 So thanks a lot.

6 MS. RAND: Elizabeth, I had you next on my list.

7 MS. MOONEY: Yes. Okay. Thanks. I just wanted  
8 to go back to the point I made earlier just about the  
9 critical accounting matters and encourage you to be clear  
10 in defining that and use the existing standard that is  
11 required. So auditors should report the matters that are  
12 significant in accordance with the accounting rule. So  
13 it's already defined in the documentation standard. And  
14 that should be -- you know, so going back over what work  
15 has already been done, what has already been identified as  
16 significant, and then talking about that. Rather than  
17 introducing a significant amount of additional unnecessary  
18 judgment, we have, you know, lots of different  
19 perspectives, even in just this room.

20 And I think, with all due respect to, you know,  
21 auditors having lots of different views, I think if you  
22 introduce that into this, then it is just going to be a huge

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1 loophole that is unnecessary.

2 MS. RAND: I am not sure I fully understand your  
3 point because you made reference to the documentation  
4 standards. So in my mind, I was thinking about the  
5 engagement completion document, which auditors document  
6 significant issues and findings --

7 MS. MOONEY: Right.

8 MS. RAND: And in developing the proposed auditing  
9 standard, it would have the auditor look to that engagement  
10 completion memo, the matters discussed with the audit  
11 committee, any matters communicated to or reviewed by the  
12 engagement quality reviewer. And then we have a definition  
13 of critical audit matters, which would be helping the  
14 auditor to identify not that entire population but those  
15 that are most significant to be communicated to investors  
16 in the report, rather than have a lengthy list of everything  
17 that might have otherwise been communicated.

18 So I wasn't clear on if you're thinking that our  
19 definition as proposed may be sufficient for purposes of  
20 communication or if you're --

21 MS. MOONEY: No. I think the proposed definition  
22 is insufficient because it doesn't -- it should say, I

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1 believe, that what should be reported is what is significant  
2 in accordance with the current standards, now, not  
3 everything but the completion engagement memo to the extent  
4 that that talks about what is most important.

5 MS. RAND: Okay. Thank you. I understand.

6 And Arch?

7 MR. BAUMANN: Final word.

8 MR. ARCHAMBAULT: Thanks, Jennifer. There was an  
9 item on the slides yesterday we didn't get a chance to talk  
10 about in detail. And that is the documentation. And there  
11 was an aspect of that. And, again, my firm is still in the  
12 process of developing our letter, but one thing I have  
13 raised in connection with this documentation is that it  
14 seems like an extremely onerous requirement to document not  
15 only those matters that you have identified and believe are  
16 critical audit matters but those, and I think the words are,  
17 that appear to be a critical audit matter but are not treated  
18 as one. So you're trying to document the negative. And  
19 the current documentation standard of the Board in my view  
20 is very robust.

21 I am not aware of anything where we have to document  
22 the negative. In other words, we will do a risk assessment.

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1 We document those areas that we feel have a higher risk  
2 material misstatement. We have to document how we respond  
3 to those risks. We don't have to document those areas that  
4 we don't feel have a higher risk of material misstatement.  
5 And that's what this standard is directing us to do from  
6 the way I read it. And to me, that is going to lead to a  
7 situation where I think auditors are going to get extremely  
8 cautious to avoid any second guessing.

9 So I ask you to take a careful look at that and really  
10 decide whether that kind of a requirement is necessary here.

11 MS. RAND: I am glad you raised the documentation  
12 requirement. In developing that requirement, we  
13 considered whether it should just be only document those  
14 in your work papers, where the auditor did report a critical  
15 audit matter.

16 Our concern was the determination of critical audit  
17 matters is judgmental. It's those that were most difficult  
18 in forming the opinion, most difficult obtaining evidence,  
19 just had subjectivity and difficulty. So that  
20 determination is judgmental. And so if the auditor just  
21 determines, leaves something critical off, then what would  
22 be the safeguard to prevent a matter from appearing in the

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1 report?

2           We thought that if there is an issue that would  
3 appear to an engagement quality reviewer, that would  
4 otherwise appear, which is an experienced auditor, to have  
5 met their criteria, then that would be -- and was not  
6 communicated in the report, then that matter or matters  
7 should be documented so that the engagement quality  
8 reviewer would understand the rationale.

9           So we thought having that, kind of requiring the  
10 auditor to document it, it may have been something that was  
11 discussed significant with the audit committee that an  
12 experienced auditor would otherwise say. That should have  
13 been in the report. Why wasn't it? We felt that was a  
14 safeguard. We didn't think that the nature of the list  
15 would be extensive in our view.

16           And I know Marty is jumping up. So I don't know if  
17 you have anything further to add.

18           MR. BAUMANN: Well, I just want to -- you raised a  
19 very good point. And we expected to hear commentary on  
20 that. So we're glad you brought it up. And I'm sure it's  
21 going to be in the letters.

22           I think Elizabeth's point was require specific

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1 things to be reported and have what's reported as critical  
2 audit matters based upon specific things that are mandated  
3 in our standards that you have to report on all of these  
4 things in the audit report. And that's one way to go.

5 And so her comment was standards-based, write  
6 rules, pretty much like AS-16, communications with audit  
7 committees, take a subset of that, and say these have to  
8 be communicated in the audit report. Then that's one route  
9 to go.

10 The other route was the way we went, which was what  
11 was in the auditor's view the most difficult, subjective  
12 matters that he or she faced. But the problem with that was  
13 that there is a risk that Jennifer pointed out. What is the  
14 safeguard that the auditor will not under pressure or  
15 whatever, decide that I'm not going to put this matter in  
16 because management and the audit committee don't really  
17 want me to. What is the safeguard around that risk?

18 And so we had to think about that risk, that that  
19 could occur. And, therefore, maybe a documentation  
20 standard, something that might appear to an experienced  
21 auditor, to meet this, the standard, has to be documented.

22 So we understand your point, that it gets to whether

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1 or not we keep this as a judgmental based upon what the  
2 auditor believes are the most difficult matters to be  
3 reported or really change our threshold to say it is  
4 mandated that these items have to be reported and go to what  
5 Elizabeth said. Just put it in the standards, "This has to  
6 be reported in the audit report."

7           So that is a threshold decision for us. And the way  
8 we put it out in the proposal was one way, but based on  
9 comments, we'll reflect on maybe what some others have said.  
10 Do this according to standards and rules.

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