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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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TUESDAY
JUNE 24, 2014

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The Standing Advisory Group convened in the Senate Ballroom at the Hyatt Arlington Hotel, 1325 Wilson Boulevard, Arlington, Virginia at 1:00 p.m., Martin Baumann, Standing Advisory Group Chairman, presiding.

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1 June 24, 2014

2
3 And then the quality control standards, we will
4 talk about that to some degree in the project I'm about
5 to introduce right now. And that is, moving onto our
6 next agenda item, I have the benefit of joining me up
7 here today to my right Helen Munter, who leads our
8 Division of Registration and Inspections, and to my
9 immediate left Greg Jonas, who's the director of our
10 Office of Research and Analysis, and to his left Keith
11 Wilson, who's the deputy director in the Office of the
12 Chief Auditor, in my office.

13 Really everything we do at the PCAOB --
14 everything we do at the PCAOB is really around audit
15 quality, from inspecting the Board's activities,
16 inspecting audits to standard setting to improve audit
17 quality and the work of the Enforcement Division to bring
18 disciplinary actions when necessary around audit
19 quality. So virtually everything we do is focused on
20 audit quality.

21 But as part of that, in working with the Board,
22 we have three very specific initiatives underway which
23 we think are linked in a number of ways, and these
24 initiatives are really focused on improving audit
25 quality in connection within the Division of
26 Registration and Inspections analyzing the root cause of

1 these deficiencies that Jim referenced earlier. And
2 many of you ask questions about these problems that are
3 seen in audits and doing some deeper root cause analysis.

4 At the same time Greg Jonas has been talking for
5 a couple of meetings at this group and elsewhere about
6 a project to develop audit quality indicators that could
7 be used by the Board, by firms, by audit committees and
8 maybe someday by investors in terms of measuring and
9 assessing audit quality.

10 And then another important leg of that is the
11 Board has on our books already quality control standards
12 that audit firms have to follow in connection with the
13 oversight of the audit practice throughout their
14 organization. And we are considering, it's on our
15 standard-setting agenda, a concept release to consider
16 how possible improvements could be made to firm quality
17 control standards. And that project can be informed by
18 the root cause analysis and the audit quality indicator
19 analysis, which can be informed by quality control
20 standards. So three very important initiatives.

21 And with that, we're going to spend a few minutes
22 in this room between now and the next 30 minutes or so
23 with Helen and then Greg and Keith talking about these
24 projects, and then we'll move to the break -- take a
25 short break and then move to our break-out sessions by
26 4:00 to begin more detailed discussions of these topics.

1 Helen?

2 MR. MUNTER: Thank you. Root cause analysis is
3 something that we in DRI have been focused on for several
4 years and we've really been focused on it in response
5 to the deficiencies that we have found and continue to
6 find doing our inspections. We find deficiencies in
7 similar areas across different types of firms and
8 different types of issuers and they are recurring in
9 spite of what we recognize are very significant remedial
10 efforts at many of the firms.

11 But for some reason those remedial efforts have
12 not been consistently successful. That's caused us to
13 think about why that might be and try to evaluate are
14 firms really getting at what the root of the problem is?
15 Are the changes to policies, the changes to
16 methodologies, so detailed and so specific on what
17 yesterday's problem was that they're losing sight of the
18 future big issue that might wind up really implicating
19 the same auditing standards, the same quality control
20 standards.

21 So we began in about 2011 looking at this
22 thinking about it for the inspections that we were doing,
23 and at that time began including in our inspection
24 reports what we thought might be the root causes of some
25 of the deficiencies that we were identifying. We
26 included that discussion in Part 2 of the report really

1 to engage in a dialogue with the firm in that regard and
2 to help focus, if you will, some of the remedial actions.

3 Starting last year in the 2013 cycle and
4 continuing into this year we've focused on -- we've taken
5 root cause sort of to the next level for us and looked
6 at the causal factors and have done cause mapping in
7 terms of identifying for audits where we found
8 particular problems and for other audits that we thought
9 were done particularly well.

10 And I should -- I want to clarify, when we were
11 trying to do this good quality analysis, we were focused
12 not just on audits where there were no deficiencies; and
13 we don't inspect to find best practices, but when we are
14 in the field we'll find audits that have no comments and
15 we'll find audits that we think are particularly well
16 done. So we tried to take those audits that we thought
17 were particularly well done and really drill down into
18 what is it that enabled that team to not just have a
19 compliant audit, but have an audit that was very high
20 quality, very good. And that is a subjective standard,
21 but it's something that we as field inspectors do
22 recognize and it's something that I think audit partners
23 do recognize, and we can really see that come across as
24 we're engaging with them in the field.

25 So for the last couple of years we've been
26 gathering a lot of data and doing a lot of analysis to

1 try to help identify what are the true causes of the
2 problems and the causes of the successes. We've been
3 engaging with firms at different levels, and I think
4 it's fair to say that different firms across the spectrum
5 are at different points in terms of developing their own
6 root cause analysis type of programs, but these programs
7 have been very helpful in terms of driving remediation.
8 Ad I think that firms of all sizes, based on an
9 appropriate scaling, can find looking and devoting
10 efforts to root cause analysis, I think looking at both
11 good and bad actions, and very effective in helping to
12 remediate.

13 And we've also found it very effective in
14 engaging with firms in an articulation of what is audit
15 quality, what are the measurable outputs of an audit?
16 The Audit Quality Indicator Project certainly
17 identifying several of those and representing, I think,
18 significant overlap with our projects her. But by
19 identifying those, I think it does help the firm to do
20 ongoing monitoring of remedial action, ongoing
21 monitoring of the audit practice, bringing really full
22 circle what is going on in an audit and how might quality
23 of the audit on average and in all the specific
24 circumstances be improved.

25 So that's at the heart of what we are doing.
26 We've spent, as I say, quite a bit of time thinking about

1 this and how we want to roll it out across the different
2 firms. We look forward to the discussion this afternoon
3 in terms of getting some additional feedback on our
4 project, on its overlap with the other projects and any
5 insights that you might have in that regard. Greg?

6 MR. JONAS: Thank you. Good afternoon. At its
7 root the AQI Project, as many of you know, tries to
8 address two questions: one is can we develop a portfolio
9 of metrics that provide new insight into audit quality?
10 And if so, the second part is how then can we best deploy
11 those measures in a way that best promotes quality?

12 Last year this group weighed in on the first
13 question. In today's break-out sessions we'll focus now
14 on the important second question. But before doing so,
15 let me briefly update you on our efforts to develop a
16 portfolio of AQIs as I know many of you have a particular
17 interest in that topic.

18 We've continued to follow seven AQI concepts that
19 we talked about a year ago. I think this group in our
20 minds affirmed those concepts. They've been affirmed by
21 nearly every other group that we've talked to. First
22 is the notion that it's useful to have a quantitative
23 aspect to the project. And so we continue to pursue
24 quantitative metrics and which distinguishes this
25 project from qualitative work, good qualitative work
26 that's been done on other projects.

1 The notion of incremental insight that these
2 metrics should inform us about things that are not
3 currently known, that these are not benchmarks. For
4 example, you would not hear from us that partner-to-
5 staff leverage greater than 15 is out of bounds.
6 Anything less than 15 is in the fairway. That's not
7 what this is about, in my mind.

8 That these things are a portfolio and operate as
9 a portfolio. So it's kind of a team sport of metrics
10 and they help users triangulate on what audit quality
11 is all about that are not formulaic. So we don't have
12 the notion of add up 10 metrics, divide by 10 and out
13 comes a score on the audit.

14 That they need context to be understood. So AQIs
15 plus context equals insight.

16 And that these metrics don't answer questions
17 themselves. Rather they help users ask the right
18 questions.

19 And as I say, I think those concepts have stood
20 the test of time.

21 What we've done is to try to first cast a very
22 broad net and identify as many reasonable candidates for
23 metrics as possible. To date we've identified over 80
24 candidate metrics. And then our notion was to winnow
25 those metrics down into something -- to a far more
26 reasonable range, and we currently are in the range of

1 25 to 30 that we think are most promising. I expect
2 that the staff will recommend to the Board that those
3 25 or 30 we would include in our concept release, not
4 in the spirit of a proposal, but rather with the notion
5 that it's food for thought that will help solicit the
6 most insightful input during the concept release
7 process.

8 You were particularly helpful to us a year ago,
9 as many of you know, in both identifying candidate
10 metrics as well as ranking the usefulness of those
11 metrics. And we've had many dialogues with many
12 different constituencies in a similar vein and we've
13 been informed by each.

14 Some of these metrics are not going to be
15 controversial. Partner-to-staff leverage is one
16 example. Other metrics I think are going to be very
17 controversial with constituents including, for example,
18 the notion of a survey, anonymous survey of firm
19 personnel to tone at the top in the firm.

20 Ultimately we think that winnowing the list down
21 to something like 10 to 15 indicators is something that
22 would be a reasonable portfolio that would provide
23 insight into quality. So the staff plans to recommend
24 that the Board issue a concept release this summer
25 consisting of three parts: objectives and background
26 definition, and candidate AQIs, and possible uses of

1 AQIs. And as you know, a concept release is not a
2 proposal, rather it just discusses issues and
3 alternatives and seeks public input.

4 So today we'd like your input on the possible
5 uses of AQIs, and this discussion assumes of course that
6 we're successful in identifying a useful portfolio of
7 indicators. We appreciate that.

8 Now deciding on the best use of the AQIs requires
9 answers to some basic questions like who can best use
10 these things and how can they use them in their work?
11 For which entity should the AQIs relate to be most
12 useful? Should an AQI program have different
13 requirements for certain firms or certain types of
14 audits? And should the AQI reporting be phased in?

15 Alternative answers to these questions we think
16 offer a menu of options from which one could devise a
17 useful AQI program. Some of these options are relatively
18 simple and could be implemented quickly. For example,
19 expanding the use of AQIs within the PCAOB. I know that
20 can be done quickly because we're actually doing it as
21 we speak. Another example of something that could be
22 done soon is encouraging voluntary discussion of AQIs by
23 auditors with audit committees. But other options are
24 more involved and would take I think longer to implement.
25 One example is possible public disclosure of AQIs.

26 So to assist in today's discussion during the

1 break-outs we've listed some of the possible options on
2 the way forward in a survey that we asked each of you
3 to complete. We didn't intend the survey to limit your
4 options or restrict your thinking, rather our goal was
5 solely to organize your views so we could capture them
6 this evening and play them back to you in the debrief
7 session tomorrow morning.

8 Last year, you significantly influenced our
9 thinking on the nature of AQIs. As I mentioned today,
10 we very much look forward to your input on the use of
11 AQIs and we're sure that that will influence the way
12 that we craft the concept release.

13 In closing let me offer one brief comment on the
14 relationship of the AQI project to the other two projects
15 here today. The staff has argued that AQIs and root
16 cause indicators are two sides of the same coin. The
17 AQI effort seeks wisdom from a top-down, outside-in
18 perspective, whereas the Root Cause Team seeks root
19 causes of quality from a bottom-up, inside-out
20 perspective.

21 In my view, ultimately we need to meet in the
22 middle with both projects informing the other. And if
23 we can, then those root cause AQIs are exactly the type
24 of information that firms can use to manage their audit
25 practices to ensure quality. In turn, information
26 relevant to managing an audit practice for quality is a

1 cornerstone of the QC Project. So we obviously look
2 forward to your insight on the synergies among the three
3 projects. Thank you.

4 MR. WILSON: So turning to the quality control
5 standards, as Marty said, we've had a project on our
6 standard-setting agenda for some time to look at, review
7 and potentially update the Board's quality control
8 standards which are to a large degree the same one that
9 the Board initially adopted back in 2003. And there's
10 a lot of technical reasons we could give for why we ought
11 to update the standards, but essentially what we're
12 thinking about is we're exploring the question of can
13 the quality control standards be enhanced in a way that
14 would promote firms to strengthen their quality control
15 systems to reduce audit deficiencies?

16 And so we've been looking at that in a lot of
17 ways, and from time to time we've had conversations with
18 the SAG about various topics related to the quality
19 control standards. Generally the SAG has been quite
20 supportive of the project. We have a number of new faces
21 since the last time we spoke about this topic, so we
22 wanted to try and talk about it in this particular
23 context. Obviously it's a very broad subject. We're
24 not going to try to tackle the entirety of quality
25 control systems and quality control standards here, but
26 we wanted to focus on three major topics.

1 First of all is firm culture and tone at the top.
2 There's already been a few remarks here alluding to the
3 importance of tone at the top and firm culture. Our
4 existing standards today are largely policies and
5 procedures-driven. So to use an internal control
6 analogy, it's more like they're focused on process level
7 controls and not -- don't have a lot to say about control
8 environment and tone at the top.

9 So the question that we want to try and explore
10 with you is should we have some discussion in our quality
11 control standards about tone at the top and firm culture?
12 And in the past SAG discussions have been very supportive
13 of that, but we want to take that a little step further
14 and say, okay, so we'd like your views on exactly what
15 we should be talking about, what kinds of things should
16 we be thinking about in crafting some material for the
17 quality control standards related to firm culture and
18 tone at the top?

19 Second area that we want to try and explore with
20 you today is what we've referred to as firm risk
21 assessment. So the idea here is that rather than sort
22 of the static policies and procedures model again, that
23 an idea that a dynamic effective quality control system
24 a firm would be looking at anticipating internal and
25 external risks to the effectiveness of the quality
26 control system and taking appropriate actions to address

1 those risks, being more proactive as opposed to having,
2 again, the static quality control policies and
3 procedures kind of approach, much like, again going back
4 to an internal control analogy, the risk assessment
5 process which guides the deployment of controls in an
6 internal control system.

7 So this is an area that we've had discussion
8 among our three groups at the staff level and think
9 there's a strong opportunity here for some synergies.
10 And as firms already are using metrics of various types
11 to monitor their practice are there things that they
12 could use audit quality indicators to inform, to
13 highlight risk areas that might need to be addressed as
14 part of the risk assessment process?

15 And a fairly obvious example, if they're going
16 in a part of a root cause analysis remediation efforts
17 the firm identify situations where there are risks that
18 need to then be incorporated and need to have a response.
19 So we're interested in your thoughts on whether or not
20 there should be a risk assessment component to the
21 quality control standards and how that might interact
22 with these other two areas.

23 And then the last and perhaps most obvious area
24 for synergies is in the monitoring component. Again,
25 this is another area that we think is very easy and
26 obvious for thinking about if a firm is going in and

1 evaluating its performance, its monitoring component,
2 what might it learn from the root cause analysis in terms
3 of both impediments to audit quality and drivers of audit
4 quality that should be informing its quality control
5 system and informing its quality control policies,
6 procedures, processes, et cetera?

7 And similarly, are there things that the audit
8 quality indicators might highlight areas in which there
9 might be potential matters that need to be, on the one
10 hand, addressed as risk -- are a risk to effective
11 quality controls or, on the other hand, perhaps
12 something that they need to capture and make sure that
13 they maintain, build on and measure and monitor on an
14 ongoing basis to ensure effective quality control? So
15 we think there's certainly opportunities here for
16 additional synergy. So we're very interested in your
17 views on this area and are there things that we should
18 be thinking about in the quality control standards area
19 to both facilitate a proper root cause analysis and audit
20 quality measurements, or on the other hand to be
21 informing the monitoring aspect of the quality control
22 system?

23 MR. BAUMANN: Thanks, Helen, Greg and Keith. And
24 thanks also for your very efficient presentations,
25 making up for all the extra time that I spent.

26 Sri, is that your card that's up over there?

1 Thanks. Sri Ramamoorti.

2 MR. RAMAMOORTI: Thanks for all the help from my
3 team.

4 I want to pick up on Greg's characterization of
5 AQI as being top-down, you know, RCA as being bottom-
6 up. And I think that's actually quite insightful in
7 that really needs to be done with respect to the 76 out
8 of the 208. I guess those numbers are now burned in my
9 brain since the morning presentation by Jim Doty. We
10 need really a multilevel analysis with micro and macro
11 metrics. And what I mean by that is we need an analysis
12 of these deficiencies noted at the individual level, at
13 the team level, at the firm level and at the professional
14 level. And let me be very specific.

15 So at the individual level we know when
16 competency goes down, risk goes up. At the team level
17 you need a diversity of members on an audit team so that
18 you have different perspectives, whether it's an IT
19 perspective, whether it's somebody more centered with
20 the industry and therefore issues of fraud or things
21 like that. At the firm level we mentioned culture, tone
22 at the top, issues like that.

23 And finally at the profession, I'd like to point
24 to the 1988 McDonal Commission Report from Canada which
25 addressed the expectations gap and very usefully broke
26 down the expectations gap in the profession into the

1 standards gap, the performance gap, and the
2 communications gap. And so that would be kind of the
3 profession-wide perspective on what these deficiencies
4 mean in terms of implications of how we deal with it.
5 So that's really what I want to say.

6 MR. JONAS: Thank you.

7 MR. BAUMANN: Any other comments before we -- I
8 see everybody's judicially keeping their card down to
9 get the full 30- minute break. I think that's a very
10 good idea.

11 (Laughter.)

12 MR. BAUMANN: So Jessica can give us a brief
13 update on logistics and where we're headed from here.
14 And then after that we'll meet at 4:00 in the break-out
15 rooms and otherwise see everybody back here tonight at
16 6:45 right outside these doors for a reception.

1 MR. WATT: Okay. As Marty said, that will
2 conclude our public portion, so for SAG members and
3 observers your break-out rooms will start at 4:00. And
4 your break-out room is listed on the back of your badge
5 or there is a sheet inside your folder that also has
6 which break-out room you will be in.

7 The break-out rooms are divided into the Gallery
8 Room, which is across the hall, and then downstairs is
9 the Douglas and the Marshall Rooms, and those are where
10 we had lunch, for those of you who went to lunch.
11 Otherwise, there will be PCAOB staff stationed at the
12 door and the top of the stairs to help guide you if you
13 need guidance on where to go.

14 So we'll see you at 4:00. Thanks.

15 (Whereupon, the meeting in the above-entitled
16 matter went off the record at 3:31 p.m.)

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STANDING ADVISORY GROUP

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MEETING

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WEDNESDAY
JUNE 25, 2014

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John L. Weinberg Center for Corporate
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MICHAEL J. GALLAGHER, Managing Partner,
Assurance Quality, PwC

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Director, Corporate Governance Center,
Kennesaw State University

BRANDON J. REES, Acting Director, Office of
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GREG JONAS, Director, Office of Research and
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HELEN MUNTER, Director, Division of
Registration and Inspections
GREG SCATES, Deputy Chief Auditor, Office of
the Chief Auditor
JESSICA WATTS, Associate Chief Auditor
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of the Chief Auditor

INVITED SPEAKERS

DAVE BURG, PwC
ALISON SPIVEY, Ernst & Young

1 June 25, 2014

2
3
4 So we're going to hear this morning back reports,
5 this morning will work as follows.

6 Helen will report back on generally the views
7 that she heard as she wandered around the three rooms
8 discussing the project on root cause.

9 Greg Jonas will do the same thing then on audit
10 quality indicators, including the results he received
11 from the survey that he asked everybody to fill out.
12 Keith Wilson will then talk about the quality control
13 standards.

14 Then Jeff Mahoney, Greg Pratt and Chuck Senatore
15 were nominated by us to represent the SAG in each of the
16 three rooms and to make observations on behalf of the
17 SAG members in terms of your views as they heard them
18 in the different rooms, what the SAG members thought
19 about the projects in general.

20 Is there one project more than the other that
21 seems to have a greater hope for improving audit quality?
22 Are they well linked? Could they be linked better?

23 Any observations you may have, so Jeff's at the
24 table to present the views on behalf of the group. The
25 group met. While you were enjoying a reception, they
26 were in here working hard, comparing notes last evening.

27 But Jeff will report back, and if there's

1 anything further to say Greg and Chuck will report as
2 well. So with that, Helen, the floor is yours.

3 MS. MUNTER: Thank you very much. Yesterday the
4 afternoon sessions I found really very helpful in terms
5 of hearing some good support for root cause and some
6 good new ideas that I think will help us as we continue
7 forward with the programs.

8 One of the things that we heard loud and clear
9 is that root cause is hard and important. Specifically
10 we heard that identifying the positive quality events
11 and the positive quality indicators is a particular
12 challenge for many firms.

13 But that in general firms are in a better
14 position than anyone else to identify the root causes
15 and to pursue them to the full extent.

16 We had some good discussion in several of the
17 rooms, or at least in two of the rooms about learning
18 from what other industries are doing, including the
19 financial services industry and the transportation
20 industry, in particular.

21 But an important caution, which I really
22 appreciated about not taking that too far because the
23 industries are so different.

24 And the other important piece of that, I think,
25 is recognizing just the number of firms that we have to
26 deal with whether it's the global network firms, a very

1 small number of firms or the non-affiliated firms, which
2 is an extremely large number of firms with very different
3 characteristics.

4 So that caution I found particularly helpful. I
5 heard a lot that one of the goals of root cause analysis
6 could be to help put pressure on firms to continue in
7 the process of improving their audit quality and that
8 root cause analysis should find the remedial solution
9 that forces behavior to dramatically improve audit
10 quality and build those metrics or actions into partner
11 evaluations and into partner compensation.

12 We heard that to improve the analysis one should
13 consider aligning root cause with the cyclical nature of
14 the economy in order to predict deficiencies in the
15 future and allow for the flexibility and the ability to
16 trend root causes over time.

17 And I think that this could be particularly
18 helpful in informing us in our own risk assessment
19 process when we're going to make future selections for
20 inspection as well as helpful to firms as they consider
21 what the most important risks are coming for the next
22 year.

23 We had a participant who told us that the only
24 thing that they cared about was whether or not there was
25 a restatement, which might cause them to lose money.

26 But they also wanted more transparency on why

1 the restatement was not caught by the firm and recognized
2 that the PCAOB is in a unique position to provide
3 information about why that happened, information about
4 staffing levels, information about AQIs.

5 We had an observation that root cause analysis
6 is focused on looking at things too much in isolation
7 since it's focused on analyzing deficiencies at the
8 individual inspection level.

9 And it's further impacted by the fact that the
10 inspection selections are risk based and the same root
11 causes might not apply to the board population.

12 And I agree with that. I think that's a risk, a
13 concern for us to consider, but a very important concern
14 for firms to consider in their own processes.

15 We had a good discussion related to the changing
16 nature of audit and the changing nature of accounting,
17 where auditing has gone, as one participant indicated,
18 from being 80 percent verification to 20 percent dealing
19 with judgments to perhaps a complete flip of that and
20 now very, very judgment-focused.

21 And that meant that one of the root causes might
22 relate, in fact, to the complexity of accounting
23 standards. And we should also consider the impact on
24 audit standards as well.

25 One of the topics that we discussed was to what
26 depth are we doing root cause analysis given that audits

1 are done by humans, and humans are not perfect, and isn't
2 that really the answer to it all.

3 And that lead into, I think, a very good
4 discussion about well, we are humans, inspectors as well
5 as auditors but that there are further reasons beyond
6 that why we might find problems.

7 I was very encouraged that we had good discussion
8 about the scalability of a root cause analysis program
9 and general agreement and support for doing root cause
10 analysis at different types of firms and different types
11 of practices.

12 We also had some very good discussion about the
13 quality of the audit committee and the extent that the
14 involvement of the auditor with the audit committee
15 could indicate something about or be an important
16 consideration in performing a root cause analysis.

17 Someone suggested that the quality of the audit
18 committee might be part of the root cause of a
19 deficiency. I think it also might be part of the root
20 cause of a positive quality event where the audit
21 committee was particularly helpful.

22 We had interest in information for audit
23 committee members about root cause analysis and
24 specifically what firms had identified in terms of
25 prevalent root causes, both positive and negative.

26 And we had one very interesting discussion that

1 focused on a firm that had identified certain positive
2 quality, common characteristics where there had been
3 particularly good work performed.

4 And an audit committee member said well, "Gee,
5 how could I know what those common characteristics were
6 and understand whether they applied at my firm as well?"

7 And I think that exploring those sorts of
8 conversations could be very, very interesting. Had a
9 question about what sort of public reporting would we
10 and could we do with respect to root cause analysis.

11 What sort of best practices that we might
12 identify could we communicate, and what sort of vehicles
13 could we use to communicate those? Really played in
14 nicely with some of the feedback we had at the last year
15 interactive sessions that DRI had with the SAG related
16 to our general reports.

17 And I'll try to take that comment and build it
18 back into that. Had another request for us to provide
19 more information on what we think might be driving
20 negative quality results in addition to the positive
21 quality results.

22 And the great suggestion that we consider
23 developing case studies based on root cause analysis, in
24 particular for the positive quality events but case
25 studies that might be used at universities.

26 Maybe there would be positive and negative

1 quality events that we could focus on in those case
2 studies. So I found that to be very helpful. So that's
3 a high level summary.

4 We tried to pull together the comments that
5 seemed consistent across the different rooms. And I
6 think at the, after we go through these we'll have a
7 chance to solicit more and more specific feedback from
8 anyone who was in the actual rooms.

9 MR. BAUMANN: That's right. I failed to mention
10 that. Please make your notes as each of the presenters
11 make their comments.

12 We'll have your questions and answers and
13 question session right after all the speakers make their
14 presentations. Greg Jonas, audit quality indicators.

15 MR. JONAS: Good morning. So the first thing is
16 the disclaimer. Normally I would say that these views
17 are my own and not necessarily anybody else's.

18 In this case, I get to say these are your own
19 views and not necessarily mine, although as you'll see,
20 I think there's a message here and it's consistent with
21 what I think we've heard from many others with a couple
22 of exceptions that I'll point out.

23 I'd like to cover what we thought were the main
24 themes that came out of the combination of the
25 qualitative discussion we had yesterday and the survey
26 result.

1 I'd like to turn then to the data and what you
2 told us about the usefulness of the data to various
3 stakeholders and then what you thought about the so
4 called near term possible actions and then the longer
5 term possible actions.

6 So we'll cover it in that order. First on the
7 summary of main points, this slide is going to talk about
8 where we thought there was a thumbs up, and then the
9 next slide will talk about the word of caution, the
10 challenges that you thought that we faced with going
11 forward.

12 First, we certainly sensed general support for
13 moving forward with this project. That's not new from
14 this group, but it is a consistent theme that continues
15 as we continue to think and debate about these issues.

16 There certainly seems to be consensus, and I'll
17 show you the data in a moment about the usefulness of
18 AQI data to audit committees to audit firms and to
19 regulators.

20 There is less consensus for other constituents.
21 Again, I'll show you that data in a moment, but for these
22 three groups there seems to be general agreement.

23 There also seems to be consensus on the notion
24 of phasing, that phasing offers the reduced risk of
25 starting with something, learning from it before
26 proceeding to something that might be more complex.

1 That seemed to be appealing to a number of you,
2 including those who might advocate more complex steps
3 that phasing would be something useful.

4 Also, discussion emphasizing, yet again to us
5 that you got to have context with these numbers. So
6 numbers without context is dangerous, but numbers with
7 context a story.

8 And comparative information can yield genuine
9 insight. That said, we certainly had, certainly
10 emphasized to us that we have some challenges ahead.
11 And we just need to be careful and prudent in how we
12 manage these challenges.

13 I don't think the message here is don't go
14 forward. It was be careful in how you go forward. So
15 the first challenge is unintended consequences.

16 And four of these were mentioned by folks in the
17 breakout. More than four people mentioned it, but here
18 are the four types of unintended consequences that our
19 notes said were on people's minds.

20 First was the possibility of managing to the
21 wrong measure, so the notion was put out data. It will
22 be a strong incentive for firms to manage to the measure,
23 which is fine if you got the right stuff.

24 And it can be dangerous if you got the wrong
25 stuff, so be careful about making sure you got the right
26 stuff. The second unintended consequence is related to

1 public dissemination of the data, which was
2 controversial.

3 And the notion was, by some, that they are
4 concerned that the public could misunderstand the data
5 and possibly overreact to the data, particularly if
6 there's not adequate context given for the data to the
7 public.

8 And it was challenging for some to figure out
9 how best to provide that context to the public. It was
10 clear, for example, in a private discussion with audit
11 committees how context could occur. It was less clear
12 how it might appear in the public setting.

13 The third unintended consequence we need to be
14 mindful of is the risk of firms running to the middle,
15 so taking cover in averages, which in fact, could end
16 up being mediocre relative to what might occur if firms
17 were just left to freely compete without the burden of
18 these measures.

19 That runs to the fourth unintended consequence
20 concern, and that is the risk of undermining innovation,
21 that we got to be careful that the measures are not
22 backward looking, kind of worshiping at the altar of the
23 past and forgetting about future and the need to innovate
24 in the audit process.

25 Again, that said, we did not interpret these
26 concerns, and folks who made them, I thought, made it

1 clear to us that they were not saying don't go forward.

2 They were just saying be careful. Another point
3 of tension is the notion of private communication versus
4 public dissemination.

5 Again as I've mentioned, and you'll see it in
6 the data, there's just some concern, particularly by
7 some stakeholders that public dissemination could
8 backfire to some degree.

9 There was strong desire and caution that, to the
10 extent we can field test this stuff to reduce the risk
11 of having the wrong measures. That's a good thing.

12 And part of field testing would be empirical
13 testing of the data that we have. We're certainly trying
14 to do that, but you certainly emphasized to us the field
15 testing is a good thing.

16 You also raised the point that there were certain
17 things that many of you feel are key to auditing, I think
18 most of us feel are key to auditing: tone at the top,
19 professional skepticism and the incentive structure of
20 the firms and what that's doing to motivate audit
21 quality.

22 Those things are very important, but they're also
23 the most difficult things to measure. And we've got to
24 be careful about just measuring what is measurable and
25 leaving on the cutting room floor some of the most
26 important stuff just because we're noodling about how

1 it's troublesome to try to measure it.

2 That's, I think, I mean we, too, wring our hands
3 over that. And we need more thinking on that topic I
4 believe. Several of you raised the notion, the concern
5 about scalability of these measures across big firms,
6 small firms and across certain types of specialized
7 audits versus other type of audits.

8 And we need to be sure that if we go out with
9 something, and it's not scalable, that we not try to
10 force round peg in a square hole here. And that was a
11 word of caution.

12 And then a couple of you raised the liability
13 concern, particularly in the U.S. market that measures
14 are certainly, particularly, of public or become
15 discoverable, can be used with the benefit of hindsight
16 and could have a somewhat chilling effect on the candor
17 of discussions and so forth. So that was another issue.

18 Okay. Now let me turn to the data, and some of
19 this may be a tad difficult to see, particularly for
20 those in the back. What I'm going to try to do is tell
21 you what we got from the main points out of this.

22 So this is the chart that shows you what you told
23 us about the usefulness of AQIs to various stakeholder
24 groups, audit committees, investors, audit firms,
25 regulators, company management and academic researchers.

26 What this data tells us, I think, is that you

1 believe that AQIs could be useful to a wide range of
2 folks. Certainly audit committee came out on top with
3 audit firms close behind.

4 You felt that both engagement level data and firm
5 level data could be useful to these various
6 stakeholders. And I'll talk, I'll show you in a minute.

7 The lowest rated thing here is engagement level
8 data for academic researchers. I'll show you the
9 controversy that exists related to thinking about
10 academic research in a couple of slides.

11 But generally we interpreted, staff interpreted
12 this as being, you feel that this could be useful to a
13 wide range of folks. Now, let me apologize for this
14 busy slide and tell you broadly what it is and what
15 signals we take from it.

16 So this is a slide about engagement level AQIs,
17 and what it's doing is it's taking the same questions
18 that we just showed and its usefulness on the bottom,
19 audit committees, investors, audit firms, regulators,
20 management and academics.

21 But the bars are showing how the various
22 professional focus areas viewed it. So if you see the
23 bars all about the same height, that suggests that
24 there's consensus around the room at whatever that
25 scoring was.

26 If you show radically different bars, it's that

1 some of us feel quite differently than others about that
2 issue. Let me bring two things to your attention on
3 this slide related to the controversy.

4 First on the investor controversy, what this is
5 doing, it's rating how useful would engagement level
6 AQIs be to investors. And several groups felt that it
7 could be quite useful to investors, which means it has
8 to be made public, of course.

9 Two groups said no, and one group in particular
10 said no. The auditors are very concerned about
11 engagement level information going to investors.

12 And I think concerns about context, unintended
13 consequences are the things that I've heard in our
14 meetings about why auditors feel quite differently or
15 quite strongly about this.

16 The other is that audit committee members are
17 neutral to a little negative about the notion of making
18 this stuff public for investors. Let me turn next to
19 the far end of the slide talking about academic
20 researchers.

21 And there, investors and academics feel that
22 engagement level data to research by academics could be
23 useful about that. And a couple of folks' groups are
24 on the fence, just kind of neutral about the notion.

25 And auditors and audit committee members don't
26 like the idea. So this next slide does the same thing

1 as the previous slide except it's about firm level AQIs
2 and the usefulness to various groups of firm level AQIs.

3 And here there isn't as much, there isn't
4 disagreement like there was in the previous slide. Let
5 me just point out though, on the investor side there is
6 less interest, folks think that firm level AQIs would
7 be less interesting to investors than would engagement
8 level AQIs is what I got out of this one.

9 We also gave you the opportunity in the survey
10 to tell us if you thought that, we call this the unit
11 of account issue, but it could also be useful in addition
12 to engagement level data and firm level data to have
13 some other kind of data.

14 And you can see the number of folks who wrote us
15 with additional thinking. Two things we took away from
16 this. There is some enthusiasm for industry level data.

17 I think folks believing that maybe audits in
18 certain industries tend to look alike, and it would be
19 good to benchmark your engagement specific data against
20 that information in an audit in your industry.

21 And then the notion of office level AQIs. I
22 think some folks believe that firms don't act like
23 monoliths, that quality varies not only by engagement
24 team but offices.

25 Some offices being quite strong, other offices
26 may be being weaker and that an office perspective could

1 be helpful. Let me turn next to the nearer term actions
2 and what you thought of those.

3 The first notion, which is pressing forward after
4 the concept release, to narrow the list of AQIs to a
5 manageable portfolio of say ten to 15 and then
6 encouraging folks to voluntarily discuss with audit
7 committees those AQIs that seemed to get some support.

8 The next notion, which is PCAOB encouraging audit
9 firms to voluntarily disclose and discuss firm level
10 AQIs, so this would be public, got very mixed reviews.

11 And we asked ourselves last night why, and we
12 think for three reasons. First, some of you are fans
13 of mandated programs and wanted to emphasize that, we
14 think, by telling us that you don't like voluntary
15 programs.

16 If we were to have asked the question would you
17 support voluntary as a step toward a mandated regime,
18 you might have answered that differently we suspect.

19 That's just speculation on our part. A second
20 reason why we think this didn't get a ringing endorsement
21 is the public nature of this. And as you'll see in data
22 in a minute, some of you are quite concerned about the
23 notion of making this public.

24 In fact, we saw that already. And then the third
25 reason we thought that perhaps there was some mixed views
26 here is this is about firm level metrics.

1 And generally speaking, firm level metrics get a
2 lower score than engagement level metrics. On the next
3 one, there was a majority, a slight majority for support
4 for the notion of adding a rulemaking project to consider
5 requiring engagement teams to discuss specified AQIs
6 with audit committees.

7 As you'll see in a moment, in particular the
8 audit firm folks scored this quite lowly. And I suspect
9 the notion is look, the CAQ has said firms are supportive
10 of the notion of having discussions with audit
11 committees.

12 But let's let this evolve. Let's let this work
13 out. Please don't mandate stuff for fear of having,
14 perhaps, a chilling effect on what could be truly
15 helpful.

16 I'm just speculating that that might be a reason
17 why firms scored this lowly. I'll show you that data
18 in a moment. The next notion of requesting specified
19 new AQI data from firms and testing the usefulness of
20 the data.

21 That got a thumbs up, and on the next slide field
22 testing a thumbs up, not surprising, PCAOB monitoring
23 results of voluntary discussions and learning from it,
24 a form of field testing if you will, got a thumbs up.

25 And then we had very mixed views about PCAOB
26 publishing AQIs by firm for AQIs that can be derived

1 from public data. Now the public data generally tends
2 to be what we call the results indicators. And it tends
3 to be negative.

4 So lawsuits, restatements for errors, going
5 concerns that were missing before bankruptcy, those
6 kinds of negative things. And very mixed reviews.

7 And we speculated as to why. One, we came up
8 with a couple reasons. One is that there's no portfolio,
9 a balanced portfolio here of measures. It's what's
10 publicly available.

11 They tend to be the results measures. They tend
12 to be negative. And then this information is already
13 available. So the message here could be look, having
14 the PCAOB publish this stuff doesn't do a heck of a lot
15 for us, those of us who are interested in this stuff can
16 already get the data. And we already look at it.

17 So here is the detailed responses that you told
18 us based on constituency. I know this is hopelessly
19 difficult to read. Let me just point out a couple of
20 things.

21 Auditors voted, this is, what we circled here
22 are places where, on average, folks were upbeat. But a
23 constituency was downbeat. That's what we are showing
24 here.

25 And that occurred in three places. In two of
26 the places, it came from auditors that rated the notion

1 of adding a rulemaking project lowly and the notion of
2 publishing data publically, lowly.

3 And academics railed against the notion of a
4 voluntary disclosure regime. I think the message there
5 is you're in favor of a mandatory disclosure regime.

6 These are the longer term actions. There was a
7 thumbs up for the notion of the PCAOB making public
8 average AQIs for audits in particular industries because
9 I think many of you thought that would provide good
10 context when evaluating engagement level AQIs.

11 The next notion also got some thumbs up, making
12 public the notion of AQIs for comparably sized audit
13 firms, again, for providing context.

14 The next one got very mixed reviews and that is
15 the PCAOB investigates the possibility of making public
16 firm level AQIs. This is a story of two cities.

17 There's just very different views in the room.
18 I'll show you that data in just a moment. The next one
19 just did not get support, and that's the PCAOB
20 investigates the possibility of making public engagement
21 level AQIs.

22 This one surprised me. If there's one thing that
23 surprised me about your thinking it was this one. I'll
24 show you the detail behind this. Some folks are
25 enthusiastic about the idea.

26 Others are not, but on average, you're really

1 cautioning us here on this one. And then the last one
2 that did get a resounding thumbs up is the notion of
3 publishing a periodic report on the state of audit
4 quality, in part, based on AQI data.

5 So then when you look at this detail, again, what
6 we're contrasting here is where on average folks thought
7 we ought to say thumbs up, but where certain stakeholders
8 said no.

9 So let me focus on two lines there, one is the
10 PCAOB investigates the possibility of making firm level
11 AQIs public. There I said tale of two cities.

12 A number of the constituency were thumbs up.
13 Two, in particular, were not, auditors and academics. I
14 assume that the academic vote might be because they
15 didn't think firm level AQIs were all that useful.

16 I'm just speculating, would be interested if that
17 speculation is true. The other thing about, of
18 controversy is the notion of making engagement level
19 AQIs public.

20 And there folks were at best neutral, with the
21 exception of investor folks who scored it a 3.2. Now
22 3.0 is neutral.

23 I would have expected based on the, what we heard
24 in the breakouts, the qualitative discussion plus our
25 own discussions with investors outside of this group, I
26 would've expected that to have been a higher score

1 personally.

2 Okay. So thank you very much for this input.
3 We'll continue to study this data, may give a few of you
4 phone calls to make sure we understand the rationale
5 behind your thinking. But really, thanks for all the
6 help yesterday.

7 MR. BAUMANN: Keith, update on what we heard on
8 the quality control standards.

9 MR. WILSON: Okay. Thank you. Well, first off
10 all, I should say that my observations when I was in
11 each of the three rooms, there was a lot of very rich
12 discussion, a lot of people really engaged and some real
13 enthusiasm for the subject of the initiatives and
14 thinking about audit quality and driving audit quality.

15 I think as it relates to QC standards, I think
16 there was a general consensus that it was important for
17 us to be taking on the project, to review and evaluate
18 the QC standards with a view toward updating them.

19 There were varied levels of enthusiasm and
20 passion for that. A few were very enthusiastic about
21 us doing that and thought it was extremely important
22 that we do that.

23 But I think, in general, there was agreement that
24 we should be doing that. In terms of sort of thematic
25 points that came out of that, one point that someone
26 made that resonated with me, and I think it was made

1 initially in relation to all three of the initiatives.

2 But I think it is particularly apt here is that
3 what we should be doing is leading firms to drive audit
4 quality by design. So that should be an objective of
5 the QC standards.

6 And that drive should be both currently and
7 ongoing as the state of auditing evolves, as the business
8 of auditing evolves. There should be a continual drive
9 toward audit quality.

10 I also heard through a lot of the discussion
11 about, that it was indeed appropriate to be linking the
12 quality control standard project with AQIs and root
13 cause.

14 A lot of the discussion, and I'll mention that
15 when we get to particularly risk assessment and
16 monitoring. There was a lot of discussion that
17 reinforced those concepts.

18 In general, in terms of what we should be doing
19 with the project at a high level, we had advice on
20 focusing on updating the standards for the new
21 environment.

22 We talked about standards being quite old.
23 Practice changed a lot. There was a caution about don't
24 discard the time tested elements of the quality control
25 standards but focus on making them more relevant, more
26 up to date.

1 And another very important point was to make sure
2 that, I think, some of the remarks that Helen mentioned,
3 also make sure the standards are scalable, that they
4 would fit firms of all sizes and all characteristics.

5 Another important point was to make sure that
6 they're flexible, that they're adaptable to a dynamic
7 environment. Again, more focus on the environment and
8 as auditing changes that the quality control standards
9 should sort of serve the test of time and should drive
10 firms to continue to adapt and improve.

11 There was a lot of discussion on tone at the top
12 in firm culture. A lot of agreement that it was a very
13 important part of the quality control system and that
14 the tone at the top and firm culture should be that it
15 should focus on audit quality.

16 It should drive ethical behavior, and it should
17 reinforce the importance of the audit practice to the
18 firm, especially as firms evolve and get into other types
19 of business.

20 It should continually reinforce the importance
21 of the audit practice. Now, one thing that was also
22 consistent among the groups was be careful when you start
23 talking about tone at the top because a lot of times it
24 just becomes empty words.

25 This can be empty words. This needs to be
26 something that is backed with action. So walking the

1 walk, not just talking the talk, to use the vernacular.

2 And that it should be something that should be
3 consistently applied through all levels of the firm. It
4 should be applied from this senior leadership of the
5 firm cascaded all the way down to the engagement teams,
6 the national office, the regional office, the local
7 offices.

8 It should be consistent and aligned, and it
9 should be reinforced through the incentive systems, the
10 compensation systems of the firm and that all people
11 should be held accountable from the highest levels of
12 the firm through the lowest levels of the firm.

13 People should be held accountable for non-
14 compliance with the firm's culture and the firm's
15 policies and procedures. We also had some advice on
16 some things to look at in trying to decide what we would
17 say in the standards about tone at the top.

18 Some referenced us to the COSO framework. It
19 was also mentioned the U.K. has an audit firm governance
20 code that they're looking at and also the professions'
21 ethics code in dealing with serving the public interest.

22 So those were some of the things that we should
23 be looking at. As it relates to risk assessment, there
24 was a lot of conversation that was very relevant to risk
25 assessment. And even in cases where we weren't talking
26 specifically about risk assessment, a lot of the

1 conversations seemed to be reinforcing the importance of
2 having a robust risk assessment element to the quality
3 control system.

4 For example, this idea of having the dynamic
5 environment and having the quality control system
6 adapting and driving quality through change. A lot of
7 that comes through assessing risks and developing
8 responses to risks.

9 Also, there was a lot of talk about linking,
10 about linkage of the root cause analysis and audit
11 quality indicators. A lot of that discussion was then
12 reinforcing the idea, even if we didn't explicitly say
13 that, there was a lot of talk about well, you're going
14 through root cause analysis.

15 It raises issues that then the firm needs to
16 respond to. Well, a lot of that would take place through
17 a risk assessment component.

18 And similarly, AQIs, especially if you separate
19 the idea of some of the thornier issues about whether
20 something should be publicly reported, reported to the
21 audit committee, the firm's own use of AQIs should be
22 an important feedback indicator into the risk assessment
23 of the firm and drive responses to that.

24 There was some acknowledgment that the risk
25 assessment component exists today. One person says well
26 you can't really run a practice without out it and some

1 general acknowledgment that it's done at varying levels
2 of formality.

3 But I think general agreement that we'd be remiss
4 if we didn't think about saying something about risk
5 assessment in our quality control standards.

6 And then as we turn to monitoring, again, a lot
7 of discussion that generally reinforced the idea about
8 the root cause analysis today has its nexus in some sort
9 of monitoring process.

10 So there's an important part of that, and again,
11 AQIs can play an important part of monitoring the ongoing
12 part of the quality control system.

13 There was important points made about monitoring
14 should encompass all aspects of the quality control
15 system. And there should be a particular focus on making
16 sure there's proper alignment with all the elements in
17 the quality control system pointing toward driving audit
18 quality in the firm.

19 In one of the sessions, the last one I was in,
20 there was an interesting discussion about quality
21 control systems and how they manage and monitor quality
22 and strive for a real time or near term turn.

23 And especially if you think about it in a
24 manufacturing environment where you're running several
25 iterations through an assembly line, you may be able to
26 detect something in that environment and be able to

1 correct it by the end of the day.

2 Audits, by the their nature, are annual events.
3 You can't approach them in quite the same way. So it's
4 necessary for firms to adapt some in-flight monitoring
5 systems and other processes to be able to try and track
6 and identify those issues on a realtime basis so that
7 they can make corrections as needed.

8 So, overall, a lot of very valuable discussion
9 and a lot of real discussion about the interaction of
10 these three elements.

11 MR. BAUMANN: Thanks, Helen, Greg and Keith. So
12 now we know we got to report back first from Jeff, who
13 is representing the SAG and then any comments that Greg
14 and Chuck essentially want to add onto that.

15 But at the same time then, the floor is open to
16 all of you for putting your tent cards up and giving us
17 other thoughts, or if your views are different or you
18 want to embellish upon what you heard today. So right
19 now, Jeff, you start.

20 MR. MAHONEY: Great. Thank you Marty, and good
21 morning everyone. Like Greg, before I begin, I'm going
22 to make a disclaimer.

23 Unlike Greg, however, my disclaimer is that at
24 best my summary of the comments is incomplete and at
25 worst it's inaccurate. So as Marty said, I'm going to
26 rely on Greg and Chuck to correct me and provide,

1 supplement what I say as well as the other members on
2 the SAG are welcome to do so.

3 I'm going to focus mainly on the discussions
4 surrounding linkage and the linkage issues. Well, there
5 are certainly different levels of discussion on linkage
6 among the three groups.

7 Of the discussions that did occur, it appears
8 that many of the members agree that the three PCAOB
9 initiatives are indeed linked. Some members commented
10 on how the three initiatives each individually are very
11 important but that all three of them can and should work
12 together.

13 One member commented on the root causes analysis
14 as kind of being at the ground level of identifying risks
15 and improving audit quality with the quality control
16 standards being at a much higher level and then the AQIs
17 being somewhere in between.

18 One member indicated that the combination of all
19 three of them, in his view, form an ecosystem in which
20 each of the three individual initiatives feed into and
21 complement or should complement each other.

22 For example, one member noted how root cause
23 analysis could be very useful in both updating and/or
24 validating the AQIs.

25 And that results of the AQIs could inform a firm
26 and the board about firm level or engagement level risks

1 that could assist the firm and the board in better
2 monitoring the risks and improving audit quality.

3 More broadly, some members indicated that the
4 overarching goal of the three initiatives should be to
5 drive competition in the industry on the basis of quality
6 rather than on the price of the audit or some other
7 factors.

8 As was mentioned earlier, there was some caution
9 that it was important to consider scaling when it comes
10 to the AQIs and the quality control standards, scaling
11 for the different sizes of firms.

12 With respect to AQIs, some from the user
13 community, and this would include me, believe that more
14 transparency for the AQIs is better than less and that
15 the AQIs certainly would be useful or could be useful
16 to investors in making better decisions, including
17 making more informed decisions in connection with the
18 election and reelection of the members of the audit
19 committee and the chair of the audit committee as well
20 as the annual vote taken at most companies with respect
21 to ratification of the auditor.

22 Some members also commented that the board needed
23 to be cautious in its roll out and adoption of AQIs to
24 ensure that they do provide a value and that the board
25 would obviously need to actively monitor the
26 implementation of the AQIs and the results of the AQIs

1 and would probably need to revise them over time as
2 experience is gained with their use and analysis.

3 With respect to quality control standards, some
4 members commented that any changes to the standards
5 should not be overly prescriptive but rather should
6 continue to recognize that there are different and
7 acceptable methods and tools for monitoring firms'
8 engagement activities.

9 One member suggested that perhaps what is needed
10 more so that significantly changing the standards, what
11 maybe would be more helpful is to provide some more
12 guidance on how to apply the existing standards, again
13 rather than making significant changes to the standards
14 themselves.

15 So Marty, that completes my very brief,
16 incomplete and probably inaccurate summary of the
17 comments. And, again, I invite Greg, Chuck and the rest
18 of you to correct me and supplement my summary. Thank
19 you.

20 MR. BAUMANN: Chuck or Greg?

21 MR. SENATORE: Well, we're very thankful that
22 this is going to be a concept release because we ended
23 up realizing there are a number of thorny questions that
24 needed to be vetted, not just among us here in this room
25 but to actually get the wisdom of the crowds, if you
26 will, in terms of commenting.

1 Just a couple of points. Jeff did mention the -
2 -- sort of the bedrock principle at least that we heard
3 in our room in terms of this being about having firms
4 compete on quality.

5 So what that sort of meant to us was that a lot
6 of what we're talking about here, while we can certainly
7 discuss whether there should be public disclosures and
8 all that kind of stuff, sort of fundamentally really
9 sort of goes to how do you drive quality in a firm.

10 And so that raised a couple of other questions.
11 First of all, what is quality? There was, some thought
12 well look, as long as there's no restatement and I have
13 transparency, I'm good.

14 But again, another question was well, does that
15 mean, I forget who said this, but it was sort of funny
16 when you think about it. If I'm speeding at 120 miles
17 an hour, and I don't get caught, is that quality?

18 It's easier to get our arms around what's bad.
19 For example, if there are clear behaviors where a
20 standard is violated, that clearly can be a root cause
21 that can end up resulting in some kind of a quality
22 measure.

23 So this question is what is goodness, and I think
24 frankly, if we're going to have AQIs that are reflecting
25 behaviors that we want to promote, we'll need to get a
26 better handle on what the "it" is that will end up being

1 the foundation of those behaviors.

2 So one of things we mentioned in terms of the
3 concept release is that we would urge the staff when
4 they go out to try to define this and help define this
5 a little bit better.

6 Another thought was that the AQIs, it would be
7 some wisdom in terms of seeing how they're validated
8 over time.

9 This goes to what Greg mentioned in terms of a
10 sense of a support for a phased approach because it would
11 be probably a less than optimal outcome to sort of start
12 from Day 1 and assume that these AQIs are driving
13 behaviors only to find out that they really weren't on
14 the mark.

15 Let's see. On the question of, let's see. Oh,
16 tone at the top. Let me just sort of talk a little bit
17 about that.

18 There was an element, when you think about the
19 linkage point in terms of root cause analysis, in terms
20 of AQIs, in terms of monitoring, in many respects it was
21 at least the sense that I heard in our room, these are
22 elements of what any healthy firm would do in terms of
23 doing things well, doing its job well.

24 And that also created a sense of the danger of,
25 as Greg mentioned, in terms of focusing too much on
26 individual metrics.

1 I think we have all sensed and I think we agreed
2 in the room that we've all had the experience of an over
3 reliance on metrics has an outcome where you don't see
4 the forest for the trees and when you sort lose the
5 context and the story.

6 That was a lot of the concern at least as I heard
7 it in terms of sort of having a very metric based set
8 of public disclosures that could end up sort of missing
9 the point in terms of what the real quality points were.

10 So in terms of the tone at the top piece, there's
11 some caution, and it would be wonderful to hear what the
12 respondents to the concept release think about this,
13 because in many respects, tone at the top is a function
14 of governance.

15 It's a function of having the information that
16 we were talking about sort of roll up to responsible
17 members of the firm. Plus, in terms of culture, being
18 sensitive to not just what your code of conduct might
19 be.

20 I mean we all remember how Enron had a wonderful
21 code of conduct, but the question is what kind of
22 behaviors are being modeled and what are the employees
23 actually thinking about it in terms of what their
24 experiences are.

25 So we talked about would it be a good practice
26 to have things like surveys or anonymous sort of feedback

1 loops.

2 But the point being that just turn that into some
3 kind of a measure that ends up being publically discussed
4 could end up actually being counterproductive because
5 you want to be able to drive those behaviors.

6 Lastly, in terms of risk assessments, clearly in
7 the materials there was discussion about the wisdom of
8 process flows, understanding your processes and going
9 through that kind of rigor in order to be able to
10 understand your environment.

11 The only caution I would, I think the room had
12 on this that would also sort of play out and seeing what
13 the views are in terms of people in the concept releases,
14 I would caution the board to sort of require a certain
15 outcome in terms of what you expect for what kind of,
16 how you do your risk assessments.

17 There are many ways to do them. There are very
18 resource intensive ways to do them. There are very
19 expensive ways to do them. This may not necessarily
20 maximize the utility to smaller firms.

21 But that could still get to the outcome that
22 you're looking for without a described and mandated
23 process. So net-net, I heard support. I heard caution.

24 I heard firm focused in terms of using this as
25 an opportunity at its foundation having firms sort of
26 be able to sort of improve their own quality to enable

1 them to compete on quality versus price.

2 And to the extent the regulators or other
3 stakeholders are involved that perhaps there's sort of
4 rolled up observations versus sort of too much mandate
5 and too much detail in terms of what you expect. So
6 I'll tender to Greg.

7 MR. PRATT: Thank you very much. I think that
8 Jeff and Chuck did an admirable job in summarizing the
9 flow of discussions and concepts that were discussed in
10 our session as well.

11 The only thing that we did not mention that I
12 think was important, we had a pretty robust discussion
13 about the interaction of the SEC, PCAOB and the FASB in
14 rulemaking.

15 And there is a lack of visibility, I guess, for
16 many of us on SAG that these groups actually are working
17 together. But it's not something that we can see.

18 So the perception was that because these groups
19 aren't working together as harmoniously perhaps, and if
20 they are, the information coming out of those meetings
21 aren't sufficiently shared.

22 So we were walking, there was a standing
23 presumption that if there was a better interaction, that
24 that could advance the integration of these three key
25 initiatives.

26 And I think that's probably the only thing that

1 we did not mention in the group. That's my comment.

2 MR. BAUMANN: And I guess the point that was
3 being made there was that maybe the complexity in the
4 accounting is not, and the related auditing that should
5 take place in connection with the complexity of some new
6 accounting aren't linked at the same time.

7 And the view of what you heard, if it's taking
8 place, you don't know about it, but maybe it could be
9 taking place better because maybe that's having an
10 impact on audit quality, accounting complexity not
11 necessarily being closely tied to auditing standards to
12 deal with that accounting complexity.

13 That was the point being made.

14 (Off-microphone comments.)

15 MR. BAUMANN: Well, since Bob's card is up, but
16 since you're a former leader of accounting complexity,
17 you get the floor.

18 MR. HERZ: Actually, I kind of agree with that
19 observation, but and I assume it still goes on. The
20 three organizations meet quite frequently and talk with
21 each other quite frequently, both at the senior levels
22 and the staff levels.

23 And there are formal quarterly meetings and all
24 that kind of stuff and whatever.

25 But one of the key recommendations of the CIFR
26 group, the Committee on Improving Financial Reporting,

1 which looked on improving financial reporting in our
2 system and reducing complexity was that there be
3 something called like a, I think they're called the
4 financial reporting forum or something like that.

5 And it was trying to kind of, I think a little
6 bit like emulate in a non-mandated way what you have in
7 certain countries in the U.K., where you have a financial
8 reporting counsel that formally brings all of the whole
9 financial reporting system together under one mandate.

10 We don't have that under our laws and statutes,
11 regulations so you have to kind of create synthetically
12 something like that. And the recommendation was that
13 the SEC do that.

14 Now the SEC, to my recollection, had one meeting
15 like that, maybe two or three years ago. I can't
16 remember what the issue was, but it might have been fair
17 value or something,

18 MR. DOTY: Measurement uncertainty.

19 MR. Herz: What? Measurement uncertainty. And I
20 still think that was a key recommendation of that group,
21 and it's still something that I think is very important,
22 would be very important in our system, not that the tri-
23 party meetings that occur already between the three
24 organizations and their staff aren't helpful and useful.

25 But these were also going to bring
26 representatives of the key constituents into a

1 particular discussion on issues that were kind of
2 pressing or emerging in the whole system. And I'm a
3 little chagrined that the SEC has not kind of sustained
4 that.

5 MR. BAUMANN: Well, Brian Croteau from the SEC
6 has his card up, so we'll go to the next player in this
7 chain.

8 MR. CROTEAU: Thanks very much. I just wanted
9 to add. Certainly when the organizations work together,
10 I think the outcome is always better for everyone.

11 And I know that we try to do that as best as we
12 can, and I think the criticisms are fair, relative to
13 continuing to do more of that.

14 We certainly had some very good examples, I
15 think, of situations where working together has resulted
16 in better outcomes, certainly recent examples between
17 the SEC and PCAOB include improving the internal control
18 reporting regime back in 2007 and more recently
19 implementing new rules relative to broker dealer
20 reporting.

21 You'll see, this afternoon, Dan Murdock here with
22 me to hear the discussion relative to revenue
23 recognition. And we've been working closely together
24 with the FASB and the PCAOB thinking about the issues
25 in that space as well as going concern the discussion
26 in the space.

1 So we certainly, I don't want it to be left
2 unsaid, we certainly try to spend as much time as we can
3 working together in a collaborative way. And I think
4 the outcome is always better.

5 I don't want that to mean that I'm being
6 defensive about it. From that perspective I think
7 there's always room for improvement and appreciate the
8 criticism and frankly, constructive feedback. So thank
9 you.

10 MR. BAUMANN: Brian, before I turn to the others,
11 Bob made the point about the financial reporting forum
12 recommendation. That came out of CIFR.

13 If we recall, there was a meeting on measurement
14 uncertainty that brought a lot of parties together both
15 the PCAOB and SEC and FASB, as well as players in the
16 financial reporting chain, et cetera, preparers and many
17 others.

18 Are there further thoughts to bring that back?
19 Is that under discussion?

20 MR. CROTEAU: Certainly when Jim Kroeker was
21 chief accountant, under his leadership, we did move
22 forward with the meeting that was described.

23 Obviously there's a change coming up again with
24 chief accountants, and I think it's very much dependent
25 upon that to some degree.

26 I think the idea though was to think about it as

1 opposed to a formal there will be X number of meetings
2 per year, to begin to think about it more from the
3 perspective of topically when it made sense to do that
4 type of a thing and to think about frankly, who ought
5 to host that kind of meeting depending on what the topic
6 is.

7 And so, obviously as you know Marty, we've stayed
8 in contact between the three organizations to try to
9 think about those kinds of things and certainly the
10 suggestion is a welcome point.

11 MR. BAUMANN: All right, I agree. Thanks a lot
12 Brian and Bob. Barbara Roper?

13 MS. ROPER: So as one of the people who raised
14 this issue, I just wanted to, and I appreciate your
15 mentioning it. I wanted to clarify. I don't care
16 whether you have more meetings.

17 The concern here is that accounting standards are
18 being written without adequate consideration for
19 whether they're auditable. So you get a revenue
20 recognitions standards, for example, that makes it, that
21 is already a source of a huge percentage of failed audits
22 or problem audits, that has made substantially vaguer,
23 more subject to judgment, more subject to, looser is
24 going to create more problems in terms of audits.

25 That, to me, is a problem where the PCAOB and
26 the FASB are working at cross purposes. Similarly, if

1 you think about a root cause of failed audits, one of
2 the root causes has to be bad audit committees where the
3 financial expert on the audit committee isn't a
4 financial expert.

5 That's a problem with SEC standards for financial
6 expertise on audit committees. Those kinds of issues,
7 where there are big impacts on the quality of audits
8 exists outside the realm of PCAOB authority.

9 And there needs to be more thinking about if
10 you're going to drive audit quality, how those processes
11 together need to work to drive audit quality.

12 MR. BAUMANN: Thanks. Just one comment, and I
13 know Larry Smith from FASB has got his card up as well.
14 During the entire process of the rev rec development
15 there were many conversations between FASB and us about
16 reviewing drafts and our views on auditability.

17 And I think the profession probably commented, I
18 think a lot, and if somebody wants to, from the
19 professional institute get involved in this debate, they
20 can about comments to FASB about auditability.

21 That doesn't mean that at this point in time,
22 we've developed what the new auditing or amendments to
23 our auditing standards should be. It was whether or not
24 we thought we could develop amendments to appropriately
25 deal with the changes.

26 So, can we do better? I think the points are

1 being made that we should all work to do better, but
2 it's not as if we're ignoring the accounting standards
3 as they're being developed and think about auditing
4 later or thinking about auditability at the time, but
5 what the actual audit procedures might be still have to
6 evolve.

7 MS. ROPER: Well then I'll just add that I think
8 there's a huge amount of skepticism in a lot of the
9 investor community that resulted in an effectively
10 auditable standard at the end of the process, regardless
11 of what the process was.

12 MR. BAUMANN: Yes, and I appreciate that's an
13 observation that's being made that this needs to be
14 either improved, more transparent or a lot of those
15 things. Larry, you had your card up, Larry Smith.

16 MR. SMITH: Yes, and I will preface this by saying
17 that this is going to sound very defensive, but I have
18 to say it. To say that accounting standards are created
19 without any consideration of auditability on the part of
20 the members of the FASB, I think, is just wrong.

21 We have three members of the FASB that are former
22 auditors, well, we have more than three. A number of
23 the members of the FASB are former auditors, but three
24 of them specifically were partners for a number of years,
25 including myself.

26 And one of the items that we consider in creating

1 standards is the auditability, which results in changes
2 to people's views, et cetera.

3 I mean if you take a look at, and we're going to
4 talk about the judgment areas that are embedded in the
5 revenue recognition standard right now.

6 And while they may appear to be, it may appear
7 that there is considerable amount of judgment, there's
8 a considerable amount of judgment in revenue recognition
9 today.

10 But people have been doing this for years, and
11 they feel a lot more comfortable with those judgments.
12 And a lot of the judgment areas that I'm going to
13 highlight, or that will be highlighted this afternoon,
14 are areas of judgment that exist today in recognizing
15 revenue.

16 So the board considers a lot of the comments that
17 come in and makes changes in response to those comments.

18 And clearly the audit firms express concerns over
19 auditability, et cetera, while at the same time,
20 investors express concerns about how revenue gets
21 recognized and what information is provided to them.

22 So I just, I think for, it would not be
23 appropriate for me to let a comment like the one that
24 you made that there's no consideration auditability
25 being made in the creation of accounting standards go
26 without comment.

1 MS. ROPER: I'd just like to clarify that that's
2 not the comment that I made. I didn't say that there
3 wasn't any consideration. I said that there is a concern
4 that the standards that come out don't give adequate
5 consideration. So that's a difference with, I think,
6 actually some importance.

7 MR. BAUMANN: Brian Croteau, SEC.

8 MR. CROTEAU: Thanks, and just on the audit
9 committee piece and appreciate the point you're raising,
10 Barb, I thought this just might be a good time to mention
11 that recently Chair White did mention in public remarks
12 that she's instructed the staff to spend some time
13 thinking about updating existing audit committee
14 disclosures, which haven't been updated, thinking about
15 how they can be updated since prior to changing
16 responsibilities for audit committees under SOX.

17 And so from staff perspective we're very excited
18 to work on this and think about the audit committee's
19 role relative to auditor oversight. Understand you're
20 raising a point beyond that, Barb, that goes to the
21 technical competence for some audit committees.

22 And obviously there's a range, but certainly I'm
23 hopeful that at some point in the future there'll be
24 some opportunity here for some public comment as we move
25 ahead with a project in that space as Chair White has
26 announced. And so, just wanted to mention and put a

1 plug in for that.

2 MR. BAUMANN: We were really glad to hear that
3 there was great consistency about our audit quality
4 initiatives and great commonality of views, but Greg,
5 you really opened up something else about when you
6 brought up the impact on audit quality of accounting
7 standards and auditing standards and regulators working
8 together.

9 But it's a good point. We want to make sure we
10 do better on that. We'll keep thinking about that
11 together, all of us. There are some other cards up.
12 Steve Buller and then Bill Platt I think.

13 MR. BULLER: Thank you, Marty. First of all,
14 thank you for the summaries. I thought those were
15 excellent and certainly made our groups sound much more
16 articulate than we were, but I appreciate that.

17 So just a few related comments. One is depending
18 upon how widely you decide to disseminate the AQIs, I
19 think it's important that they be defined in a way so
20 as to ensure that users can leverage the data properly.

21 And our group spent a lot of time discussing
22 this, in a way that it is relevant to audit committees.
23 So audit committees obviously want information on
24 engagement level and want to be able to stratify by
25 industry and by size.

26 And the firms obviously, a lot of firms want to

1 be able to drill down and correlate that with their own
2 quality indicators. And so it's important that the data
3 be able to be stratified and analyzed in that fashion.

4 Related to that, I think it might be useful to
5 spend some time just looking at the experience of XBRL
6 because they were very careful in how they had to define
7 the information and spent time redefining once it was
8 up and running.

9 It might be useful to avoid those pitfalls. And
10 thinking about the technology they use and the user tools
11 to ensure adequate accessibility and flexibility and the
12 whole support infrastructure around this to allow them
13 to answer questions, to analyze the data with adequate
14 precision and then also to make sure they're gathering
15 data, which will be flexible for future use.

16 And the last comment is, again related.
17 Yesterday we spent a lot time talking about the general
18 discussion of the 70 some audit failures of the 208
19 audits conducted yesterday and some of the risks in using
20 high level statistics and kind of broad terminology.

21 And that's one of the risks I think we may have
22 with some of the AQI data, where someone may take this
23 and extrapolate that to a broader universe without
24 understanding the precise issues behind each of the
25 AQIs.

26 So it's important to understand the underlying

1 data. So, for example, in those 70 some I don't have
2 the information or all the details, but I know some small
3 handful were restatements.

4 A number were related to internal control of our
5 financial reporting, and so it's useful to have, again,
6 some context around that to understand where a firm is
7 on the continuum of quality and what the specific aspects
8 are of the AQIs, which may indicate that there is a
9 fundamental problem or that it's a rifle shot for a
10 specific aspect of their performance that needs to be
11 addressed. Thank you.

12 MR. BAUMANN: Thanks Steve. Bill Platt?

13 MR. PLATT: Thanks Marty, and first a comment.
14 I always find the breakout sessions to be the most
15 insightful and informative, engaging in a dialogue
16 around a topic with a smaller group is very productive
17 and very constructive.

18 So I'd encourage you to continue to do that.
19 Also found it very interesting that you took three
20 initiatives, group cause or causal factor analysis, the
21 AQIs and quality control standards and put them together
22 in a group because I think part of the concern that many
23 of us have is that projects like this could be operated
24 in silos.

25 But these really are one large project and need
26 to be very integrated, sort of, as you go through. And

1 so it was good to see that the staff's views were aligned
2 at least in the need to have alignment.

3 And I encourage you to continue to be integrated
4 as you go through this process. The other thing though
5 that came up, and this is maybe a little bit of a follow
6 on from the discussion that you've had here, but I think
7 a little different focus is I think as we look at root
8 cause analysis or causal factor analysis today, we
9 largely look at what is within the control of a firm to
10 drive compliance with current standards.

11 And I think we're missing an opportunity to say
12 well are there patterns of deficiencies. There might
13 be things outside of the control of the firm. Are there
14 environmental factors?

15 Are there standards factors? Can we have
16 improved interpretations or standards in an area? And
17 I think right now our focus, and I realize I'm talking
18 about expanding.

19 And we shouldn't expand it if it's going to
20 create a delay necessarily, but we shouldn't lose sight
21 of it either that there are things outside of a firm
22 that can help firms drive a lot of quality as well and
23 not just what the firm can do within the firm.

24 So I'd encourage you to sort of think about that
25 as you think about going forward is can you use causal
26 factor analysis or root cause analysis as a way to inform

1 where standards maybe could be better and whether that's
2 from auditing standards standpoint.

3 Or could there be better accounting standards or
4 could there be better guidance for issuers, either about
5 books and records or about controls or other things?

6 I think it's the kind of things we should all
7 keep top of mind because collectively, I think we're all
8 trying to improve the quality, transparency and
9 reliability of financial reporting.

10 And I think if we keep that broader objective in
11 mind, I think we'll be better at the end of the day.

12 MR. BAUMANN: Are some of those factors, I know
13 you talked about accounting standards and related
14 auditing standards, are some of those factors also
15 factors outside of your control?

16 I think that's what you said, auditor's control,
17 the environment at a company itself and their commitment
18 to quality reporting and the audit committee's
19 commitment to quality financial reporting, things of
20 that nature?

21 MR. PLATT: Yes, they would include all those,
22 Marty.

23 MR. BAUMANN: I know that IAASB has a document,
24 I think, Arnold, that you put out which talks about an
25 audit quality framework that takes those three legs and
26 three stools, the three legs of the stool and puts them

1 together as an important element for audit quality. Is
2 that fair?

3 MR. SCHILDER: Yes, that's fair, Marty. And I
4 think the overarching message in that framework is what
5 I fear what we heard a lot of and now is well, the
6 importance of interactions between the various
7 stakeholders and everybody taking a role in stimulating
8 audit quality so that leads also to the positive stimulus
9 that was mentioned earlier.

10 And that's a key message there and what we're
11 hearing so far also from national standards is that it's
12 helpful in further taking the issue and stimulate the
13 discussion. So I think we're much in the same area
14 there.

15 MR. BAUMANN: Jennifer Paquette?

16 MS. PAQUETTE: Thank you. I wanted to make a
17 comment on the AQIs, and I regret that I missed the
18 sessions yesterday. So I didn't have the benefit of the
19 breakout discussions, although I appreciated the
20 summaries.

21 We got here this morning. From my perspective,
22 understanding the link between the three initiatives,
23 the AQIs, the root cause, quality control certainly is
24 obvious.

25 I guess my concern relates to the size of those
26 initiatives and the link between the three and what it

1 might mean in terms of how the work on AQIs would
2 progress.

3 From my perspective representing an investor,
4 seeing the AQIs have some momentum and move forward is
5 important to me.

6 And I would like to express that if the phased
7 roll out is something that is pursued, this caution from
8 certain areas about making information on AQIs public
9 and available to investors, if there were a phased roll
10 out, I would encourage that.

11 If it were to start and it would not be available
12 in the public realm that we work on them in a way that
13 there was an eye towards them becoming public and being
14 valuable to investors eventually, perhaps later in a
15 roll out.

16 I certainly appreciate, while I'm not in the
17 audit community, I appreciate the sensitivity to wanting
18 to be able to provide context to quantitative measures
19 that meet qualitative comments.

20 However, I wouldn't underestimate investors'
21 ability to be able to read and decipher and understand
22 that context if it's provided in a robust and valuable
23 way.

24 MR. BAUMANN: Great. Thanks. Sridhar
25 Ramamoorti?

26 MR. RAMAMOORTI: I just want to revisit what Bill

1 Platt just brought our attention to, the influence of
2 environmental factors that are beyond the audit firms'
3 control.

4 There's a name for this in social psychology.
5 This is called the fundamental attribution error where
6 you end up attributing the result of some observations
7 to the wrong cause.

8 And it's also a bedrock principle of what we know
9 as accountants as responsibility accounting where you
10 cannot hold people responsible for factors beyond their
11 control.

12 So I think it's a very important angle of inquiry
13 and should be taken into account in any sort of policy
14 making or standard setting because we certainly don't
15 want to be punishing the wrong parties for something
16 that they're not responsible for.

17 MR. BAUMANN: I just want to understand that
18 comment, Sridhar. Let's just say that management
19 doesn't care about its financial reporting quality or
20 quite frankly wants to report something, manage earnings
21 or whatever it is, and the audit committee is not a high
22 quality audit committee.

23 I guess in my view as a standards setter at the
24 PCAOB, that doesn't change the auditor's responsibility
25 to do a high quality audit and report on the financial
26 statements in a way that they present fairly or they

1 don't.

2 In other words, if the auditor's in that kind of
3 environment, they have a couple of things to do. They
4 can tell management if they don't improve, the audit
5 committee if they don't improve that they're going to
6 have to find new auditors.

7 Or they'll greatly increase their scope to get
8 the work done and to present an audit report to investors
9 that investors can rely on. But I don't think a poor
10 quality management or a poor quality audit committee
11 should result in anything less than a high quality audit
12 nevertheless. That's maybe my perspective of life.

13 MR. RAMAMOORTI: Let me just be very, very clear
14 then. I'm saying it would be the problem that we would
15 have if we attribute every business failure to
16 necessarily also being an audit failure. Not true.
17 That's the point.

18 MR. BAUMANN: I agree with that point. Yes, very
19 much. Brian, your card is up again.

20 MR. CROTEAU: Yes, I just wanted to mention, I
21 know yesterday Chairman Doty made mention and certain
22 breakout groups may have talked about it, but obviously
23 there's been a significant change in addition to
24 inspection reports that are coming out.

25 Certainly I think at least one of the large firm
26 reports is out that has a new appendix in it now with

1 much more detail relative to referencing of auditing
2 standards.

3 And I think that has relationship to all three
4 of these projects. I personally have been a strong
5 supporter of moving in that way, and I know that that
6 was a lot of work to get to the place that you're at.

7 But for those who haven't had a chance to look
8 at that aspect of the reports, I would strongly encourage
9 it.

10 And I think it allows for a much deeper
11 discussion, I think, of the inspection findings beyond
12 just the number of deficiencies but better understanding
13 of the nature of the findings and the aspects of the
14 standards that auditors are struggling with.

15 And so I just wanted to add that to the discussion
16 because, again, I think it has relationship to all of
17 these projects.

18 MR. BAUMANN: Great. Thanks Brian. I see three
19 cards up, and let's take these three and then we can
20 take a break before we get onto cybersecurity. So Kevin
21 Reilly, Doug Maine and Maureen McNichols, in that order.

22 MR. REILLY: Yes, Marty, I have two quick
23 reactions, first on one of Helen's observations coming
24 out of the meetings was somehow attributing inspection
25 problems to the audit committee.

26 And Marty, like the comment that you just made

1 before, I hope that view wasn't being expressed by a
2 member of the profession. That seems to me like a
3 copout.

4 We have to take charge and responsibility for
5 the execution of a quality audit. We are all for
6 stronger audit committees and the initiatives of Chair
7 White in that area.

8 But to somehow link the inspection problem rate
9 across the profession to audit committees seems to be
10 an unfair characterization of what's going on, at least
11 in terms of what we're seeing in practice.

12 Secondly, relative to the issue of the FASB's
13 outreach in terms of the auditability of standards, I've
14 worked closely with the FASB.

15 And if you could have seen and continue to see
16 the outreach done relative to the developing standard on
17 the allowance for loan loss and auditing credit losses
18 and accounting for credit losses, the outreach has been
19 really expansive, very detailed.

20 Perhaps it could be better advertised, to Greg
21 Pratt's observation, but it is really happening. It's
22 been very helpful, and I believe it is changing the
23 dynamics as to how the FASB thinks through the standard
24 setting process.

25 And again, I found it to be very, very helpful.
26 That's just an observation of seeing how it's been

1 working in practice.

2 MR. BAUMANN: Good. Thanks Kevin. Doug?

3 MR. MAINE: This is a question for Greg. I have
4 personally talked to a couple dozen audit committee
5 chairmen, so this is admittedly anecdotal.

6 But I think there's universal support for the
7 AQIs, particularly by the way, as it relates to the 404
8 audits. And my sense is there's a real thirst to get
9 going.

10 My question to you, Greg, is would it be helpful
11 or harmful if audit committees at the engagement level
12 go off on their own right away and start asking for this
13 type of information.

14 MR. JONAS: I think it would be nothing but
15 helpful, and I would invite Mike Cook to offer an
16 observation to the group because he said a couple things
17 in a breakout yesterday that were certainly eye opening
18 to me in that regard.

19 And he has some personal experience with this,
20 but I personally would see no downside and every upside
21 to folks getting comfortable and learning from this and
22 particularly if audit committees then would feed back
23 their observations to us.

24 We're trying to listen very closely these days,
25 and we would be very eager to get more contact. But
26 Mike, you have some personal experience.

1 MR. COOK: Greg, I do, a little bit, and I would
2 say maybe more a general comment to introduce the idea
3 as I think we all want audit committees to be active.

4 We want them to be engaged. We want them to do
5 the right things. I often respond to things that come
6 from the PCAOB by essentially saying leave it to the
7 audit committees.

8 We can do it on a timely basis. We can do it in
9 a meaningful way as opposed to other forms of
10 communication. And I think we, just to use as an
11 example, in one particular circumstance I've already
12 been actively engaged with critical audit matters.

13 Having said that we don't favor the auditor
14 reporter those after they are no longer particularly
15 relevant to the audit under way, but let's get into it
16 timely and get those things to the audit committees.
17 Let's see what they are. Let's deal with them, and we
18 have done that already and frankly have had quite a good
19 experience with that using the PCAOB framework.

20 I think the same approach applies here. Doug
21 made the point. I think everybody thinks this is a good
22 idea. I'm sure there's not unanimity as to what the
23 items are.

24 But as I commented to the group, I think most of
25 us would probably agree on what the first five items on
26 the list would be. You might have a debate over one or

1 two of them.

2 But the idea that we don't know what these
3 quality indicators are doesn't work for me. I think
4 we've got a pretty darn good idea of what they are. But
5 I'd like to hear from the firms.

6 So we have already scheduled a meeting in July,
7 which is a regular audit committee meeting and asked in
8 addition to our team for the senior partner in charge
9 of audit for the firm.

10 And this happens to be a meeting where the CEO
11 of the firm visits, so we don't like people to just
12 visit. We like them to work when they come. And so
13 we've said please come and talk to us about your view
14 of audit quality indicators generally.

15 Talk about your view of audit quality indicators
16 specific to us as an entity. Tell us what they are and
17 then tell us how you're going to report them to us and
18 how you're going to give us results in relation to those
19 indicators.

20 And let's start now. Let's not wait for, and
21 you're moving on, I think, a very strong pace forward.
22 And I applaud that, but let's not even wait for that.

23 Let's get the dialogue going. Let's see what we
24 come up with. Tell us what matters in your eyes. To
25 us in judging the quality of your performance and let's
26 have a dialogue about that.

1 And let's start in 2014 not at some future date.
2 I don't see any impediment to doing that. There will
3 be differences. There will be indicators that we might
4 identify at the front end that might not match up with
5 your initial inventory.

6 We might change one here and add one there. I
7 doubt that we're going to be very far off. And I think
8 the dialogue will be very interesting. I'm not sure the
9 firm is overjoyed at the notion of coming so soon.

10 But that's what we pay them for, and let's get
11 them in and start talking about this now. So Greg,
12 that's my plan.

13 MR. BAUMANN: That sounds like a great
14 initiative, and hopefully that message gets out to
15 others. That's really good. I think Maureen you have
16 the final word on this topic.

17 MS. MCNICHOLS: There we go, thank you. I'd like
18 to echo Jennifer Paquette's comment that we wouldn't
19 want to underestimate investors' ability to process
20 data.

21 Clearly that's the foundation of the rationale
22 for providing financial statements, which clearly
23 contain vastly more complex kinds of disclosures that I
24 think what we're considering with the AQI.

25 I'll also echo the substance of the Mike Cook's
26 comments. So I encourage the PCAOB to dig deep on

1 possible negative consequences that are raised for
2 arguments against disclosure to see if there's workable
3 compromises.

I'm hoping that the lack of support for disclosure of engagement level data to academics is really based on lack of support for public disclosure of these data perhaps for other reasons.

And I suggest that as a compromise, a possible compromise first step might be engagement level data where it's fractals of the distribution of engagement level data without actually identifying information.

I think that there's a distinction between public disclosure, and there's a range of alternatives in terms of ways that disclosure could be made.

So you could have fractals of the distribution of engagement level statistics that actually don't identify any specific firm or issuer. And so I'd encourage you to think about those kinds of possibilities to sort of make progress toward public disclosure. Thank you.

MR. BAUMANN: Thanks, professor. So thanks everybody for a very lively discussion. And thanks to the reporters from the SAG, Jeff, Greg and Chuck. I think we learned a lot from the breakout sessions and from this discussion this morning.