

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on May 15-16, 2013 that relates to the standard-setting project, and related subject matter, discussed at PCAOB Docket 041: Firm and Engagement Metrics. The other topics discussed during the May 15-16, 2013 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at [https://pcaobus.org/news-events/events/event-details/pcaob-standing-advisory-group-meeting\\_682](https://pcaobus.org/news-events/events/event-details/pcaob-standing-advisory-group-meeting_682).

## PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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## STANDING ADVISORY GROUP

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## MEETING

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WEDNESDAY  
MAY 15, 2013

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The Standing Advisory Group convened at the Westin City Center Hotel, located at 1400 M Street, Northwest, Washington, D.C. at 8:30 a.m., Martin Baumann, Standing Advisory Group Chairman, presiding.

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1 of your folder there, Jay, that tells you where to go.  
2 And then inside there are directions to the breakout  
3 rooms. We'll also have OCA staff outside to help you  
4 direct where you need to go.

5 MR. HANSON: I'd be dangerous if I could read.

6 (Laughter.)

7 MS. ROCCA: It is important, Brian, to note that  
8 the breakout groups for the outreach on the general  
9 reports will be different from the audit quality  
10 indicator breakout groups. So make sure you're looking  
11 at the list that deals with the outreach on the general  
12 reports in picking your room.

13 MR. BAUMANN: Thanks, Helen.

14 Greg Jonas is the director of our Office of  
15 Research and Analysis, and Greg will provide an update  
16 or an introduction to the breakout session on audit  
17 quality indicators.

18 Greg is right here next to me.

19 And joining Greg from the Office of Research and  
20 Analysis are our Chief Economist Andres Vinelli. To my  
21 left, Tim Gustafson and to my far right at the very end,  
22 George Wilfert.

1 Greg?

2 MR. JONAS: Thank you, Marty.

3 When I was a kid growing up, if you were really  
4 excited to do something, you said you were fired up. So  
5 today we are fired up to seek your input on our audit  
6 quality indicator project, or AQI, as we call it.

7 So in this brief session here what we'll do is  
8 just briefly review the foundation of our AQI project,  
9 address the structure and format for this afternoon's  
10 breakout session and tomorrow's debrief session, and then  
11 answer any questions you have about the project or the  
12 sessions.

13 While our primary purpose today is to listen, let  
14 me emphasize that any views the staff express represent  
15 those of the individual staff members and don't  
16 necessarily reflect those of other staff or the Board.  
17 Indeed, the Board has yet to deliberate any conclusions  
18 about AQI. Obviously we remain in early days.

19 So with me today are Tim Gustafson, Deputy  
20 Director of ORA; Andres Vinelli, our Chief Economist;  
21 George Wilfert, who leads our AQI project. And the four  
22 of us will be the moderators that will moderate this



1 afternoon's breakout sessions.

2           So by audit quality indicators we mean a package  
3 of indicators, say 15 or so, that are indicative of audit  
4 quality and that could be useful for decision making.  
5 While quantitative indicators are most important, we  
6 envision that the package would also include a definition  
7 of audit quality and a framework for thinking about  
8 quality.

9           We believe that a project on quality indicators  
10 is important for a number of reasons, and they're shown  
11 here on the slide. I'll briefly touch on them.

12           First, the audit profession has no universal  
13 foundation for AQI currently. To be sure, firms have  
14 long used measures to manage and control their practices.  
15 Studies have proposed definitions and frameworks, yet the  
16 work is not comprehensive or integrated. There appears  
17 to be little consensus and consistent data is not widely  
18 available. So in short, we perceive some room to grow.

19           Second, quality indicators can help focus buyers  
20 and investors on quality. You know, with few measures  
21 today audit committees may struggle to focus on quality  
22 and differentiate among firms. Absent indicators, we

1 think we run the risk that buyers come to view the audit  
2 as a commodity and this could in turn result in excessive  
3 focus on factors unrelated to quality; price, for  
4 example. Obviously focusing on factors unrelated to  
5 quality can undermine quality over time.

6 Reason No. 3, we perceive some urgency for  
7 progress as current economic conditions risk distracting  
8 folks from quality. While financial statement audit  
9 revenues are basically stagnant, consulting revenues,  
10 including risk consulting is growing rapidly. Further,  
11 there may be few drivers of revenue growth of public  
12 company audits on the horizon. Work from new standards  
13 and initiatives is relatively minimal and the overall  
14 economy is growing modestly.

15 So to maintain or grow profitability, to provide  
16 opportunity for people to keep pace with consulting,  
17 firms may be incented to take action that could distract  
18 them from audit quality and audit quality indicators  
19 perhaps could promote more balance in the environment and  
20 increase attention on quality within and outside of  
21 firms.

22 A fourth reason to love AQI, indicators can

1 inform PCAOB policy and harness the market as an ally.  
2 Of course the PCAOB's long-considered audit quality in  
3 our work. Inspection findings have informed standard-  
4 setting and policy making. Indeed, our Inspection  
5 Division is focusing on the root causes of audit quality  
6 lapses, and root cause analysis is obviously a close  
7 cousin to audit quality indicators.

8           Standard-setting has occurred in areas where we  
9 believe quality needs improvement, as Marty has reminded  
10 us many times. And in particular our Standards Division  
11 is rethinking standards on quality control process  
12 itself, another close cousin to AQI. Yet, despite our  
13 historical and current efforts related to quality,  
14 indicators can mature our process, sharpen our insight  
15 and better inform our internal policies.

16           Further, enlightened regulation hopefully can  
17 find a way to encourage the market to assist in the  
18 regulatory cause for quality. Today investors may stand  
19 on the sideline because they lack data that would allow  
20 them to advocate for quality. Indicators could change  
21 that. The invisible hand of the market could be a  
22 powerful force offering auditors a carrot for quality

1 work in concert with a stick for quality lapses.

2 Reason No. 5, quality indicators can help firms  
3 improve the quality of their audit practices. Now  
4 obviously firms don't need a quality indicator project  
5 from the regulator to develop and use indicators to  
6 manage their practices. Indeed, firms are working to  
7 enhance their quality measures. Yet, many firms continue  
8 to emphasize traditional practice metrics of growth,  
9 industry share, efficiency, profits and compliance with  
10 standards. A quality project could improve best  
11 practices and offer a broader array of measures that  
12 promote quality and flag problems earlier.

13 Reason No. 6, indicators could promote helpful  
14 research. Academics have rightly called for more data  
15 about audit quality, and armed with data and rigor they  
16 can surface insight a casual analysis may overlook.

17 And finally, we perceive a window of opportunity  
18 for indicators. More and more industries have  
19 demonstrated the importance of identifying metrics and  
20 then managing what they measure. Examples include food  
21 and nutrition, health care, airline safety and  
22 manufacturing. If quality indicators can work in these

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1 industries, why not for us, too?

2 Indeed, in the audit industry momentum is building in  
3 favor of quality indicators. The briefing paper for this  
4 session listed recent professional studies and  
5 recommendations in the AQI area. And further, as  
6 mentioned before, firms are enhancing measures they use  
7 to manage their audit practices.

8 So these are the reasons that we find ourselves  
9 fired up about this.

10 And, Tim, what are the goals of our project?

11 MR. GUSTAFSON: So the goals we've set for the  
12 AQI project range from the modest but important to the  
13 aspirational and potentially transformational.

14 Measuring and tracking audit quality indicators  
15 over time can provide the PCAOB insight into the trends  
16 in audit quality, information that can help inform policy  
17 decisions. This goal alone provides justification for  
18 the project.

19 If we are able to achieve the project's second  
20 goal of disclosing reliable audit quality indicators to  
21 audit committees, investors and others, then we could see  
22 audit quality indicators informing decisions such as the

1 retention and selection of auditors.

2           Finally, we aspire to incentivize firms to  
3 compete on audit quality. Achieving that goal could help  
4 transform the profession.

5           Again, to achieve these goals we must identify a  
6 portfolio of reliable audit quality indicators.

7           Andres will discuss our near-term goals, which we  
8 believe will lead to the identification of a reliable  
9 audit quality indicators and then discuss our tentative  
10 and preliminary definition of audit quality, which will  
11 ground much of the discussion, much of the development  
12 of these audit quality indicators.

13           MR. VINELLI: Thank you, Tim. Let's turn now to  
14 how we're going about getting this done. Our objectives  
15 for this year are I would say modest but constructive as  
16 we try to avoid putting the cart before the horse. I  
17 would assert that progress rests in our ability to first  
18 identify and measure a portfolio of quality metrics that  
19 are helpful in practice.

20           In order to do this, the staff reviewed a series  
21 of studies of previous initiatives, including ACAP  
22 recommendations, the 2008 SAG Board minutes, the IAASB

1 audit quality framework, the U.K. Financial Reporting  
2 Council audit quality framework, and numerous academic  
3 studies, mostly held by members of the American  
4 Accounting Association.

5           So we developed our initial views and we're here  
6 today to seek input from you, the thought leaders in the  
7 area. In floating our tentative thinking we are not  
8 suggesting that we have the answers. Rather, the staff  
9 is leading with its chin in the hope that we will trigger  
10 a substantive discussion. Further staff and Board  
11 deliberation is to be expected and with progress we might  
12 be in a position to expose initial views for further  
13 public comment possibly as early as this year.

14           Now one of the themes that we encountered in this  
15 review has been the lack of a uniform definition of audit  
16 quality. So we developed a tentative definition in a  
17 framework consisting of inputs, outputs and processes in  
18 between and about a dozen straw man indicators for each  
19 of those.

20           To do so, we based our thinking in concepts that  
21 are already established and accepted, including concepts  
22 of quality related to the business community and

1 accounting standards. The building blocks are quality,  
2 first quality being defined in an intuitive manner as  
3 meeting customer needs. And who are these customers?  
4 Well, we say investors, lenders and other creditors,  
5 directly and through the audit committee as  
6 representative. So audit quality would be meeting their  
7 needs.

8           Specifically, we assert that their needs are for  
9 reliable audit reports and robust audit committee  
10 communications on three specific areas. First, financial  
11 statements including related disclosures. Second,  
12 assurance about internal control. And finally, going  
13 concern warnings.

14           Now George Wilfert will discuss the framework and  
15 the indicators. George?

16           MR. WILFERT: Thanks, Andres. Turning to the  
17 audit quality framework, we sought to tie our tentative  
18 thinking to accepted notions. Our framework includes  
19 three segments: Audit inputs, processes, and results.

20           We believe these segments are intuitive and  
21 conceptually aligned with much of the existing work on  
22 audit quality completed by other organizations. The



1 tentative framework we developed defines the essential  
2 elements of audit quality that are candidates for  
3 measurement. We believe the array of potential audit  
4 quality indicators we have compiled provide insight into  
5 the quality of performance of the elements within our  
6 framework and we look forward to your valuable input on  
7 these candidates in our breakout sessions later this  
8 afternoon.

9           As reflected on the slide above, we modeled our  
10 framework in the shape of a house. For those of you that  
11 may have difficulty seeing some of the details on the  
12 slide above, this is also on page 6 of your SAG briefing  
13 materials.

14           At its fundamental level the framework  
15 contemplates that competent professionals, the foundation  
16 of our framework, applying robust processes, the house,  
17 will yield quality audit results. The idea for the  
18 foundation of people came from other studies and papers.  
19 We have modeled the house on current quality control  
20 standards and the COSO Framework. And of course we  
21 modeled the audit results on the requirements in  
22 professional standards.

1           The roof of our house represents the tone at the  
2 top   which drives a firm's culture and internal  
3 environment and is essential to promoting audit quality.  
4 It forms the pinnacle of an audit quality paradigm which  
5 is rooted in professional skepticism, objectivity and  
6 independence. It also relies on the underlying processes  
7 and foundation of people for support.

8           The tentative framework is not a static model.  
9 On the contrary, it's a dynamic model surrounded by  
10 external pressures driven by a constantly changing  
11 business environment. Accordingly, the people and  
12 processes in our elements operate together in  
13 relationship to ensure quality audit results.

14          For example, our standards note that risk  
15 assessment is a continuous process. Therefore, in our  
16 tentative framework if both a firm's risk assessment and  
17 monitoring processes are operating effectively, any new  
18 audit risk which manifests itself would be the impetus  
19 for the firm to adjust its inputs; i.e., its  
20 professionals' time and skills being brought to bear, as  
21 well as considering whether any adjustment to the nature,  
22 timing and extent of the audit procedures is necessary

1 to address such risk.

2           The next several slides reflect the various  
3 elements of our framework. We identified one or more  
4 indicators that might provide insight into each element  
5 and we first borrowed these indicators from ideas in  
6 previous studies and papers. We then supplemented those  
7 indicators with the staff's own thinking based on PCAOB  
8 inspection experience and our intuition.

9           This slide depicts the indicators related to how  
10 people and their professional skills are deployed  
11 including partner and staff leverage ratio, utilization,  
12 technical skills and training. For example, if partner  
13 and staff have excessive work loads and thus do not have  
14 sufficient time to execute and review or supervise  
15 appropriate audit procedures, the processes and inputs  
16 higher up in the hierarchy such as a firm's audit  
17 methodology or risk response may not be sufficient to  
18 address all of the audit risk.

19           Similarly, if staff lacks sufficient experience  
20 and/or technical training, they may not have the  
21 technical competence necessary to identify all the  
22 potential audit risk.

1           Therefore, the basic operational processes and  
2 inputs include, but are not limited to, monitoring areas  
3 such as partner and staff workloads, supervision and  
4 review, technical competence achieved by both on-the-job  
5 learning as well as through formal training. These  
6 operational inputs; i.e., the people, are the foundation  
7 for our house as they are fundamental to supporting the  
8 structure of the remaining audit quality processes.

9           This next slide reflects the possible indicators  
10 related to the processes of the six elements within our  
11 house. The structure reflected above is a hybrid, and  
12 as I previously alluded to, it is generally consistent  
13 with the PCAOB quality control standards, as well as the  
14 COSO Framework. Process indicators consist of the  
15 effectiveness of an audit firm's policies and procedures  
16 underlying personnel management, risk assessment,  
17 monitoring, control activities and information and  
18 communication. The audit quality processes can be  
19 measured at the global firm, the affiliate firm, office  
20 or engagement level, which will be one of the topics for  
21 discussion in our breakout sessions.

22           Finally, the next slide depicts possible

1 indicators related to results, which is aligned with our  
2 tentative definition of audit quality. Such indicators  
3 attempt to measure the actual results around reliable  
4 audits and robust audit communications such as PCAOB and  
5 internal inspection findings, restatements of financial  
6 statements, ICFR opinions, and material weaknesses, going  
7 concerns, auditor enforcement cases and litigation  
8 trends, and audit committee surveys, among other  
9 indicators.

10 With that, I'm going to turn it back to Greg.

11 MR. JONAS: Thanks, George. Before taking your  
12 questions, let me offer a few concluding and framing  
13 comments for the breakouts.

14 First, we are hosting four breakout sessions.  
15 Each group includes folks with diverse backgrounds. So  
16 we've tried to mix up auditors, regulators, issuers,  
17 investors, etcetera, within the same smaller breakout  
18 groups.

19 These sessions come with a survey form and these  
20 survey forms are critical to us as they will be our  
21 primary means of capturing your views. Tonight your  
22 hardworking staff will summarize and analyze what you've

1 told us on these forms and we'll play back the results  
2 to you in the morning. And that summary will provide the  
3 basis for tomorrow's debrief session on AQI.

4           So we hope that most of you have already taken a  
5 first shot at completing your form. And the purpose of  
6 the breakout is to refine your views informed by the  
7 breakout discussion. We have extra forms in the breakout  
8 rooms if you'd like a clean form to summarize your  
9 thinking.

10           Your response will remain anonymous. We are  
11 asking for your name on the form solely for the staff's  
12 internal use if we need to contact you to clarify your  
13 views or your handwriting.

14           And finally, for today's discussion we ask you to  
15 narrow your focus on the usefulness of the indicators for  
16 decision making. We recognize that the AQI project  
17 raises many other important issues, but before we can  
18 address a broad array of issues we need to first  
19 determine if we can construct a portfolio of indicators  
20 that are decision- useful. If so, then we'll have the  
21 privilege of addressing important follow-on issues, and  
22 we promise that the SAG will be an important part of that

1 discussion. So today's discussion is about usefulness.

2 And with that, we're pleased to address any  
3 questions about the project or the session.

4 MR. BAUMANN: Peter Clapman?

5 MR. CLAPMAN: Thank you, and I saw a link in one  
6 of the last slides, but I'm going to ask both as a focus  
7 question and then as a general question, and that is  
8 whether as part of this particular project you're looking  
9 at and will focus upon the transition of lead engagement  
10 partners and senior staff at an audit firm when the audit  
11 committee retains the firm, but of course the lead  
12 engagement partners have got to transition off, a new  
13 team comes in. And I guess it gets to the broader  
14 question, Marty, as to whether there's been other work  
15 that the PCAOB has done on how effectively or  
16 ineffectively -- or any problems that have come to your  
17 attention in terms of those transitions.

18 MR. JONAS: Let me address the first part of your  
19 very good question. We are offering as candidates about  
20 40 metrics, if you add them all up, for discussion today.  
21 We don't suggest that those are all the best -- they may  
22 not even be the best candidates. So part of today's

1 discussion is to include what additional candidates do  
2 you folks think we should be looking at here in this  
3 project, and you offered one area that you believe would  
4 be fruitful for progress. So the more of that kind of  
5 thinking, the better. If there's ever a time to be  
6 creative in what we think are underlying drivers of  
7 quality, this would be an excellent time.

8           MR. BAUMANN: I'll only supplement that with I  
9 think something that Greg alluded to already, and that  
10 is there are many users of this project, but clearly my  
11 division is a principal user. As I mentioned earlier  
12 today, we're contemplating a concept release on firm  
13 quality controls which would deal with things such as  
14 transition of engagement teams and partners and all of  
15 that, amongst other factors. So anything we learn about  
16 what are good audit quality measures can certainly inform  
17 what would be in a concept release about firms' quality  
18 controls and another way to get comment on that in this  
19 very important process.

20           MR. JONAS: Mike Gallagher?

21           MR. GALLAGHER: Thanks, Greg. As we've discussed  
22 before, this is an incredibly important project and



1 incredibly challenging. And I think it would be easy for  
2 it to get derailed because of the indicators and the  
3 shots that you can take at any one indicator, and you  
4 can. The challenge is getting the right sweep of  
5 indicators and managing that over time as things involve  
6 and what's the process for doing that?

7           In looking at the framework, it's clear that you  
8 put a ton of time into this and I think you've considered  
9 just about every angle it possibly can. I encourage you  
10 to, as that continues to evolve, perhaps looking at  
11 simplifying the framework. It's a little bit daunting  
12 I think when people look at it. But I think it's a  
13 terrific project.

14           The other thing to think about is obviously the  
15 unit of account. You know, is this from a worldwide  
16 firm? Is it the network? Is it the firm? Is it the  
17 engagement? So there are a number of different places  
18 that this can go. You have to start somewhere. And so  
19 we'll talk about that I know in the breakouts. But I  
20 commend the staff and the Board for taking on the  
21 project. It is incredibly challenging. We are, speaking  
22 for myself, very, very supportive. I think your list of

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1 reasons to love AQIs, it gets longer every time we speak.

2 And we are fully supportive.

3 MR. JONAS: Professor Weil?

4 MR. WEIL: Mike just anticipated in one of his  
5 phrases what I want to ask about. I want to know what's  
6 on the table and what's off the table. I could conceive  
7 now that we might be able to get to good audit quality  
8 measures for a firm, or a unit, or a division, and much  
9 more difficult to do it for an individual audit. And so  
10 is it on the table that we could stop at the level of the  
11 firm or division and not go to the individual audit, or  
12 must we go to the individual audit for this project to  
13 work?

14 And related to that is is it now or never? You  
15 might say if we don't do it now, we're never going to do  
16 it, so it's got to be the whole audit. But can this come  
17 in phases where we do a firm or a division first,  
18 individual audits later, or maybe never?

19 MR. JONAS: Yes, superb question. We're asking  
20 you today in the breakouts to assume the role of an audit  
21 committee member when thinking about what would be  
22 decision-useful. And then after we talk about the

1 metrics, we're going to ask you for some concepts about  
2 what we call the unit of account. So the point you make  
3 is not off the table for today's discussion. And I  
4 recognize in saying that the complexity that we  
5 introduce, but we can't pretend this is less complex than  
6 it really is, nor should we make it unusually or more  
7 complex than it needs to be. To Mike Gallagher's point,  
8 maybe we overdid it here with our framework a tad.

9           But let's keep that on the table. But we're  
10 hoping to have that discussion about unit of account  
11 after we have the discussion about the metrics and their  
12 usefulness.

13           Elizabeth Mooney?

14           MS. MOONEY: Thanks, Greg, and thanks for this  
15 very important project. It's great to see and incredibly  
16 thoughtful, I thought, especially, you know, the  
17 definition of audit quality, the slides 27, 8 and 9.  
18 Clearly a ton of thought and work has been put into that.

19           Just a question about -- you know, it's important  
20 that it's made public. It was very encouraging to see  
21 that. You know, who makes that public or what's the kind  
22 of medium for that to be made public? Is it too early?

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1           MR. JONAS: That is certainly among the most  
2 important follow-on issues that we would need to address.  
3 What we're thinking here though is that we won't have the  
4 luxury of dealing with those kinds of important questions  
5 unless we can first get a dog that hunts, and the dog  
6 that hunts is this portfolio of metrics that we think  
7 could be decision-useful. After that there are some  
8 really heady questions, including, Elizabeth, the one you  
9 mentioned, that we would need to collectively grapple  
10 with, and we'll begin to grapple with that when we get  
11 closer to a portfolio that we think really has promise.  
12 So today is all about the portfolio, not about the knock-  
13 on questions recognizing those knock-on questions are  
14 darn important.

15           MR. BAUMANN: Loretta, is your card -- oh, I'm  
16 sorry. Charles?

17           MR. SENATORE: Just a level-setting point; and  
18 this probably will have some impact in terms of what the  
19 follow-on will be, but any collection of KPIs, audit  
20 quality indicators, by definition involve data points  
21 that are directional. And they are, at least in my  
22 experience in terms of using them myself -- you can never

1 expect to find a set of individual data points that will  
2 give you a whole picture. I mean it's critical in my  
3 view to think about this in terms of how the data points,  
4 which are directional and give you indicators, fit into  
5 a larger context.

6           And so I think in terms of thinking about this,  
7 and I just want to make sure my thinking is aligned with  
8 yours, is that I personally think throughout my -- based  
9 upon my experience, I try to find sort of a set of  
10 indicators that will tell you the whole story is a fool's  
11 errand and is not going to work. So in terms of thinking  
12 through these issues when we go through our sessions, I'm  
13 presuming that the model -- to try to look for sort of  
14 the most indicative types of indicators that might drive  
15 certain important issues but yet is in complete absence  
16 thinking about them in context, which will probably be  
17 something that will need to be a necessary function of  
18 what the ultimate use of the product will be.

19           MR. JONAS: Yes, a couple days ago the CAQ  
20 published, I thought, a very thoughtful piece and in part  
21 it addressed your very point, that any portfolio of  
22 metrics needs to be considered in context. We need to

1 look at trends. We need to look at comparative data.  
2 And even then we think its main benefit to an audit  
3 committee might be to focus them on the right questions  
4 to ask. It doesn't answer the question. It focuses them  
5 on areas to question.

6 So, yes, it's in that spirit that today we search  
7 for indicators, not in the spirit of they are going to  
8 provide the answer to the question of how is audit  
9 quality?

10 MR. BAUMANN: We have to break for lunch. We  
11 want to get these breakout sessions started promptly at  
12 1:15. I see John White's card was up. Did you have your  
13 card up, John?

14 MR. WHITE: Yes, I just wanted to go back to  
15 something that Greg had said.

16 MR. BAUMANN: And then after this, we will just  
17 -- those two questions.

18 MR. WHITE: Oh, okay. I notice you are focusing  
19 on this from the viewpoint of audit committee members,  
20 not investors, not users. I just want to make sure what  
21 chair we're supposed to be sitting in when we're  
22 answering these questions.

1 MR. JONAS: Yes, good question, John. We decided  
2 to sit in the chair of the audit committee member to  
3 provide focus to the discussion. This is a broad topic.  
4 We're worried about, you know, indefinite scoped creep  
5 and getting through this.

6 But what we have in mind is what portfolio would  
7 be decision-useful to the market, audit committee members  
8 and the market? So we do not mean to exclude investors  
9 by any means. But for today's discussion we thought by  
10 getting our minds into the perspective of an audit  
11 committee member it could focus us and provide most  
12 useful discussion. But investors are certainly not off  
13 the table.

14 Jerry?

15 MR. DE ST. PAER: Thanks, Greg. One follow-on  
16 observation. I actually thought that that was going to  
17 capture the first point, but my point was a little bit  
18 different.

19 At the beginning of this presentation when you  
20 talked about who this was aimed at, indeed it only had  
21 investors. It did not mention audit committees. That  
22 struck me right at the outset. And yet Sarbanes-Oxley,

1 the same group that created the PCAOB, gave that  
2 responsibility to the audit committee for auditor  
3 selection, etcetera, etcetera, and they are a gatekeeper.  
4 So I would -- I'm sure -- I understand why that audit  
5 standards are -- that accounting standards are done for  
6 investors, and that looked a lot like the statement that  
7 came out of FASB. But indeed I think for this purpose  
8 you need to add audit committees to who the intended  
9 audience is, or at least I would suggest you consider it.

10           And that the second thing that I just wanted to  
11 highlight I think is too many of these points look to me  
12 like kind of check-the-box. It goes to the same point  
13 about judgment that's been made. But you know, without  
14 knowing the complexity of the company, having been in  
15 companies of vastly different complexity where judgment  
16 is hugely important in the actual determination of assets  
17 and liabilities, a number of the kinds of criteria you  
18 have here, you're going to come out with completely  
19 different answers on the metrics depending on the kind  
20 of an audit. And when you add those all together, you  
21 will absolutely lose the meaningfulness of the data to  
22 a very large extent. I'm very concerned about the check-

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1 the-box or adjust the numbers aspect of what we're  
2 dealing with here.

3 MR. JONAS: Thank you, Jerry. And to be clear  
4 though -- and perhaps we didn't write it clearly, but the  
5 focus of today's discussions in the breakouts is  
6 pretending you are you an audit committee member and what  
7 would be most decision-useful to you.

8 Marty, thank you.

9 MR. DE ST. PAER: I got that, but I think you  
10 need to go back in this beginning in terms of the way you  
11 defined who the project is for to also include the audit  
12 committee, because they're not included there.

13 MR. BAUMANN: Thanks, Jerry. Being a flexible  
14 chairman, I said just two more questions, but, Jeff,  
15 we'll have you pose your question.

16 MR. MAHONEY: Thank you. Just following up on  
17 what Mr. White said, will there be another breakout  
18 session at some future date where the focus rather than  
19 on audit committees will be on investors' use? As you  
20 know, the Treasury Committee pointed out not only that  
21 this might be used for audit committees, but for  
22 investors in their ratification decision. If you look

1 at like the Russell 3000, more than 90 percent of those  
2 companies have an annual ratification vote, and yet  
3 there's very little information for investors to use to  
4 make that vote. And it was thought by the Treasury  
5 Committee that this might be a way to give them some more  
6 information so they can make a more knowledgeable vote.

7 MR. JONAS: Thank you, Jeff. And we don't mean  
8 by saying we're going to focus today on audit committees  
9 to take off the table investors at all. Investors are  
10 very much at the heart of this, so observations you have  
11 today about investors and their use -- decision-  
12 usefulness of this toward investors are very much on  
13 strategy for us. So, thank you.

14 MR. BAUMANN: Okay. Thanks, Greg. Jay Hanson  
15 asked a very good question before. I don't think he  
16 realized how good it was, and that is where are you going  
17 to go?

18 (Laughter.)

19 MR. BAUMANN: We don't want to lose any of you.

20 So first of all, for lunch, lunch is in 1400  
21 North on the restaurant floor, which is one level up from  
22 the lobby. So that's one level up from the lobby, 1400

1 North. That's lunch. And Barbara Hannigan will be  
2 giving a brief ethics update at that lunch.

3 We're going to try to stay on schedule and start  
4 these breakout sessions at 1:15, so we're a little bit  
5 behind schedule.

6 Now where are the meeting rooms? Well, on your  
7 folder you have the identification of what meeting room  
8 you're in, but where are those meeting rooms is a good  
9 question. So for those who are in the East and West  
10 Rooms, they're on this floor adjacent to this room, if  
11 you're in the East and West Rooms. The Ashlawn North and  
12 South Rooms are located on the lower mezzanine level,  
13 lower, which is one level up from here. We don't want  
14 to lose anybody, so we might have to repeat these  
15 instructions after the first breakout session. So East  
16 and West Rooms adjacent to here. Ashlawn North and  
17 South, one level up from here. And I think you'll see  
18 that you're in different rooms often for the different  
19 breakout sessions.

20 So with that, please break for lunch and we will  
21 -- I'm sorry. Did we lose somebody?

22 MR. WEIL: Do we take these with us to those

1 rooms, or leave them here?

2 MR. BAUMANN: No, you can leave those here. But  
3 you're going to come back here for one thing only, and  
4 that's for the break at 2:45 is the break will be in this  
5 room, but otherwise you're not -- we're in the breakout  
6 sessions for the afternoon.

7 PARTICIPANT: Marty, the completed  
8 questionnaires, what do we do with those?

9 MR. BAUMANN: The completed questionnaires?  
10 That's Greg's question.

11 MR. JONAS: The questionnaire relates only to the  
12 AQI discussion. Ideally at the end of the AQI  
13 discussion, hand us your questionnaire. We'll take care  
14 of it from there.

15 MR. BAUMANN: Okay. Please enjoy lunch, which  
16 again is one floor up from the lobby level, 1400 North.

17 (Whereupon, the above-entitled meeting was  
18 adjourned at 12:28 p.m.)

19

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21

22

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+ + + + +

THURSDAY  
MAY 16, 2013

+ + + + +

The Standing Advisory Group convened at the Westin City Center Hotel, located at 1400 M Street, Northwest, Washington, D.C. at 8:30 a.m., Martin Baumann, Standing Advisory Group Chairman, presiding.

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1 (Laughter.)

2 MR. BAUMANN: So we'll take our break now and be  
3 back at 11:00 a.m. for the session on the audit quality  
4 indicators. Thanks very much.

5 (Whereupon, the above-entitled matter went off  
6 the record at 10:36 a.m. and resumed at 11:02 a.m.)

7 MR. BAUMANN: Great. Thanks for getting back  
8 promptly. We're about ready to begin our last and very  
9 important session of this day-and-a-half meeting, and  
10 that's the report back from the breakout sessions on the  
11 discussion of audit quality indicators. Again, the  
12 session I participated in was lively and a lot of good  
13 input.

14 And Greg Jonas kicked it off. And tell us what  
15 you heard.

16 MR. JONAS: Great, Marty. Thanks. You should  
17 each have in front of you a document that summarizes what  
18 we believe we captured yesterday during the breakouts.

19 Before proceeding, let me remind you that the  
20 views in that document and what we're about to discuss  
21 are only the views of individual staff members and don't  
22 represent necessarily the views of the Board or the other

1 staff.

2           Also let me observe, this is not a public  
3 document. It is for our use here in this debrief  
4 session. You can take it with you, but if you could  
5 please keep it confidential as a SAG member. When we do  
6 present to the world the results of input that we've  
7 received on this project, we'll do it in the normal way  
8 that we do it at the PCAOB, and this is just for our use  
9 today.

10           So what we did last evening to collect this  
11 information was two things: First, we got all the forms  
12 from everyone. And thank you very much for completing  
13 those. And we had one team working on tabulating the  
14 data. We also had, as you know, note takers in each of  
15 the sessions, the four breakouts. And we had a separate  
16 team of folks who were in those sessions who reflected  
17 on what were the themes that came out of the discussion.  
18 And then after we had the data tabulated we stepped back  
19 from the totality of all of it, put the two teams in the  
20 same room and then brainstormed about what we thought  
21 were the common themes, as well as what we thought was  
22 the most interesting of the data. So that's what we have

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1 in front of you now.

2           The deck starts with a summary of main points and  
3 then we look at the top 15-ranked metrics and we show  
4 that to you in two ways. And then the bottom 15, again  
5 we show that to you both ways. And then we looked at the  
6 AQIs that were most controversial. And what we meant by  
7 "controversial" is had the largest standard deviation in  
8 the scoring that you all gave us. And then we'll play  
9 to you what people suggested as additional kinds of  
10 metrics that we should think about. And then finally,  
11 the last three things are some qualitative commentary  
12 about unit of account, the audit quality definition and  
13 then the framework definition.

14           So what we planned here is George Wilfert will  
15 walk us through the deck at a high level. We're going  
16 to take only about 10 minutes for that. We'd like to  
17 spend the vast majority of our time here hearing from you  
18 and your reaction to what you're seeing in your reaction  
19 now to having thought about this more over the course of  
20 the day.

21           So, George?

22           MR. WILFERT: Thanks, Greg. So the summary of

1 the major themes based on your responses were that SAG  
2 members were generally supportive of the PCAOB efforts.  
3 The SAG identified about a dozen metrics which have merit  
4 and approximately a dozen that did not have wide support.  
5 SAG members generally thought that the audit quality  
6 definition was directionally correct. However, the  
7 suggestion was to consider incorporating compliance with  
8 standards within the definition itself. The majority of  
9 those who responded supported the framework, but some  
10 suggested simplification. The nature of the AQI should  
11 dictate the unit of account which would be most  
12 appropriate. That was another theme. And then the need  
13 for context when interpretation quantitative metrics.  
14 And I don't know -- how many of you have seen or read  
15 Michael Lewis' book Moneyball?

16           It was a movie about baseball. And anyway, I  
17 thought one SAG member responded, "Don't bring Moneyball  
18 to the accounting profession." So the movie was about  
19 how quants have taken over the game of baseball. So I  
20 thought it was an interesting analogy. But that's not  
21 quite where we intended on heading, but anyways.

22           And finally, beware of unintended consequences

1 was another major theme.

2           Okay. So reflected on the next slide is the top  
3 15-ranked AQIs. I'm not going to go through all of  
4 these. There's a lot of detail here and we're going to  
5 go through this fairly rapidly to allow time for your  
6 input, but I'll just go through the first several of  
7 them.

8           Number and nature of PCAOB inspection findings  
9 was the clear winner here, and we thought that was  
10 important, too. You might notice it's reflected in 1 and  
11 3. And the reason for that is we thought it was so  
12 important that we had it as a process indicator and as  
13 a results indicator. And so obviously the SAG members  
14 agreed with that because it was also one and three in our  
15 ranking.

16           Partner, manager, executive quality review hours  
17 and timing relative to the total audit effort was another  
18 major one. Frequency in market impact of restatements.  
19 Trends in PCAOB and SEC enforcement actions. Industry  
20 expertise and proficiency was another one that ranked  
21 highly. And average years of experience and head count  
22 composition.

1           Along the horizontal axis you can see that this  
2 reflects the dispersion of the SAG member responses. And  
3 then there's a weighted average. And that's how we  
4 ranked it was based on the weighted average.

5           MR. JONAS: And, George, can I add just one  
6 observation? For the top dozen or so metrics I was  
7 impressed with how relatively few SAG members put these  
8 metrics in the one and two category. So not only were  
9 the average scores fairly high, but the dispersion seemed  
10 to be weighted heavily toward the upper end. That  
11 surprised me a little bit.

12          MR. WILFERT: Okay. The next slide is again the  
13 top 15-ranked AQIs, but this time we've reflected the  
14 weighted average by thought leader category. So you can  
15 see how the academics voted on this. And this is the  
16 weighted average of that particular group. The audit  
17 committee members, auditors, investor or investor  
18 advocate, issuer and then other.

19          Next is the bottom-ranked AQIs, and we've  
20 reflected this in descending order. And again along the  
21 horizontal axis it reflects the dispersion of SAG member  
22 responses and the weighted average.

1 MR. JONAS: And just at the risk of piling on,  
2 you know, generally if you didn't like a metric, you all  
3 didn't like a metric. I've noticed that.

4 MR. WILFERT: Yes.

5 MR. JONAS: And we do have a slide coming up that  
6 George will walk us through about the controversial  
7 metrics, but just generally speaking looking at this  
8 dispersion there seems to be a fair consensus on some of  
9 these.

10 MR. WILFERT: And again, the next slide is the  
11 bottom-ranked AQIs, but again reflects the weighted  
12 average by thought leader category.

13 And then moving along, the AQIs ranked as the  
14 most controversial. And here what we did was we  
15 calculated the standard deviation for all 40 AQIs and  
16 then we ranked them. And one of the things you can do  
17 is you can look at the dispersion of the responses and  
18 cross-reference this to pages 5 and 7. So for example,  
19 one of the most controversial AQIs was the number and  
20 size of auditor resignations. So if you go back to page  
21 7, you can see that shows up as rank 28. Remember, it's  
22 in descending order. And you can see how it's got a very

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1 wide dispersion. And so that's why it's reflected as one  
2 of the more controversial.

3 Same thing, you can look at percentage of work  
4 outsourced to service centers. If you go back to page  
5 7 you'll see that reflected as No. 32, and you can see  
6 the wide dispersion there among different -- and then to  
7 follow on, you can go to the next slide and you can see  
8 how different thought leaders voted. So I'm going to  
9 give you some time to study this.

10 And then let's move onto the next slide, selected  
11 proposed indicators. We received a total of 27  
12 additional suggested indicators. The examples are  
13 reflected below. Timing of engagement partner hours  
14 during the audit; absolute and relative investment in the  
15 audit practice versus other service lines; ratio of non-  
16 audit services to audit services; percentage of  
17 professionals that are CPAs by each level, segment  
18 results by market cap, sector and geography; number of  
19 clients in industry sector; restatements by industry  
20 sector. So that's the list.

21 We appreciate all the feedback. We didn't  
22 reflect all 27 here. This is just the top third that we

1 reflected. Some of them were similar to each other, so  
2 we tried our best to consolidate these into groups. But  
3 we do appreciate your input on this. And even if it's  
4 not reflected on the slide, we're still giving all the  
5 feedback consideration.

6           The next slide is the unit of account. And most  
7 SAG members supported the unit of account at the  
8 engagement team level. The second was at the affiliate  
9 firm level. And I think the overall consensus was that  
10 the nature of the AQI would dictate the unit of account  
11 that was most appropriate. I think in hindsight, when  
12 we passed out those surveys, probably what I should have  
13 done is had a call on that said -- you know, and allowed  
14 you to designate which unit of account you thought was  
15 appropriate for each AQI. But again, we received a lot  
16 of great feedback in the sessions and we appreciate that.

17           Next theme was different professional groups may  
18 want a different account. That's very intuitive. An  
19 audit committee would want specific engagement-level  
20 information. Investors may be interested in metrics or  
21 AQIs at the firm level. And then lastly, cost-benefit  
22 analysis would be important for any AQI consideration.

1           And then when it came to the audit quality  
2 definition, the most common suggestion was to include  
3 language about compliance with PCAOB standards. And  
4 other comments included references to robust  
5 communication with audit committee, responses wasn't  
6 clear. There were a couple that suggested perhaps that  
7 the going concern wasn't necessary for the definition.  
8 And the definition should not be only considered from the  
9 audit committee perspective. That's not really what we  
10 intended, but you know, of course we intended this to be  
11 for investors. And so, you know, that would certainly  
12 be a change that we'll add to our definition. Definition  
13 should mention compliance with accounting standards as  
14 well. That was another remark.

15           And then, when it came to the framework, the most  
16 common suggestion was that the framework should be  
17 simplified. And then the other comments were aligned  
18 with PCAOB QC standards. We did our best to do that  
19 within, you know, the house. If you recall, the house  
20 was kind of a hybrid between the COSO Framework and the  
21 PCAOB QC standards, but we can do back and take a look  
22 at that. Measuring audit quality quantitatively can be

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1 challenging. Yes, that's a fair remark.

2 But with respect to that, Greg, I don't know if  
3 I want to turn it back to you and if you have any remarks  
4 before --

5 MR. JONAS: Great. Great, George. Thanks. No,  
6 I don't. We want to spend most of our time listening  
7 here and seeking your reactions. So this is what we  
8 thought we heard yesterday and welcome your reaction,  
9 counsel, suggestions, points of amplification, any place  
10 you thought we got it wrong.

11 (No response.)

12 MR. JONAS: I could tell a few jokes.

13 (Laughter.)

14 MR. JONAS: They're not good jokes.

15 (Laughter.)

16 MR. JONAS: Peter?

17 MR. CLAPMAN: I think you have enough going with  
18 just the particular issues that received the most  
19 positive and then the most negative, but there were  
20 certain nuances that came about in the conversation where  
21 something might have gotten a low response or maybe it's  
22 a controversial response where it was because the way it

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1 was stated could cut either way. And I was wondering if  
2 maybe you could restate some of these to make a clear  
3 direction or maybe parse the question a little bit  
4 differently so that instead of cutting both ways at the  
5 end of the analysis it has a clear connotation. I think  
6 you have enough to do even without doing that, but I'm  
7 wondering whether some of the more controversial, or even  
8 in some cases some of the lower-rated questions or issues  
9 could, with a little tweaking, be elevated.

10 MR. JONAS: Excellent point. At least in our  
11 group I saw the following thought processes: One was  
12 some of the metrics were criticized because whether the  
13 metric was high or low, you could interpret that either  
14 way, that that was good or bad. And folks thought that,  
15 look, if you're scratching your head and wondering what  
16 it means, that's the sign of a really bad metric. So,  
17 you know, people took those off the table. And I think  
18 a number of these that you put on the kind of bad list  
19 I think fall into that category.

20 But another notion we saw with some of the  
21 metrics was the notion of outliers are bad, but between  
22 the outliers there's this kind of fairway where play in

1 the fairway kind of felt right. But if the score was  
2 extremely high or low, that could be a sign of trouble.  
3 And those I think people tended to keep in but just  
4 wanted to note that outlying is the concept that seemed  
5 to be worthy for those metrics.

6 And then the third class of metrics are the  
7 obvious ones where, you know, a high score is always  
8 perceived as say better than a lower score.

9 I'm sorry. Roman?

10 MR. WEIL: And my response is, as you know, since  
11 I signed it, I was concerned about what's objective,  
12 would be measurable and which requires judgment on this  
13 list of the top 15. I have circled No. 5, No. 6, No. 10  
14 and the first No. 11 as not objective as currently  
15 stated. I have no idea what you mean by "trends" and  
16 "enforcement actions."  
17 Industry expertise and proficiency, is that binary, yes  
18 or no? If that's what you mean, then it is objective.  
19 No. 10, relative emphasis, that's not objective. And  
20 excessive turnover, is that binary?

21 So I'm really pleased that only four of these as  
22 stated appear not to be objective and at least two or

1 three of those could be turned into objective, but I  
2 don't know what you might get when you don't have  
3 objective measures and you have to use judgments.

4           MR. JONAS: Thank you. Just one reaction is: I  
5 agree with you; I think we all do, that we have work to  
6 do on the metrics that appear to have promise. We have  
7 work to do to ensure that they are objective. And we  
8 intend to try to develop an objective metric in these  
9 areas and then do some testing, and ultimately once we  
10 have confidence in the metric itself, to see if the  
11 metric is indeed correlated to some output measures of  
12 quality as a means of testing.

13           But, Roman, your counsel strikes me as very  
14 right, that we have work to do to improve the objectivity  
15 of some of these metrics.

16           Arnold?

17           MR. SCHILDER: Yes, thanks and thanks for sharing  
18 all this data in such a quick time.

19           Part of the discussion in our group involved also  
20 then what to do about it, and that was against a  
21 background of some of the comments that already have been  
22 made. How should you read indicators? Would some be a

1 positive or a negative signal, et cetera? And I think  
2 the group concluded more or less that therefore the  
3 context in which it is discussed, in particular of an  
4 audit committee, is very important, I mean compared to  
5 the draft framework of the IAASB. There is a lot of  
6 emphasis on the process and therefore it should inform  
7 an audit committee and of course the auditors themselves  
8 for an informed discussion in order to assess audit  
9 quality.

10           And that's what I'm missing a bit on these  
11 slides, that it's not just on the indicators themselves,  
12 but then also how they will be used and how they will  
13 stimulate let's say a very highly qualitative assessment  
14 of audit work and in the event we know that that might  
15 be shared in a kind of summary analysis with investors  
16 and shareholders as well. Thanks.

17           MR. JONAS: Thank you, Arnold.

18           Bob Guido?

19           MR. GUIDO: The project is not easy, so I would  
20 first of all congratulate you and your team for a great  
21 summation. But the work has just started, I think. And  
22 again with the end point being audit quality, I think



1 that's our objective.

2           The way you've formatted this I congratulate the  
3 team, too. There's a lot of in-between messages here as  
4 we look at them and analyze them, and I'm sure you all  
5 will take a lot of care in that. I focused on one real  
6 quick though, and that's the top-ranked AQI items sorted  
7 by thought leader category. And items 3 and 4 jump out  
8 with a disconnect amongst the audit committee, the  
9 auditor and the quote, "investor advocate." And that may  
10 go back to the communication and transparency of your  
11 reporting that we talked about before and the education  
12 process to what really the results mean. So I would  
13 really focus on, you know, bridging the gap there because  
14 obviously there are some stories with that with the  
15 different weighting.

16           And last but not least, whatever we do here,  
17 whatever you all decide on audit quality indicators, I  
18 would strongly encourage some, quote, "pilot testing and  
19 field testing" on an interim basis with a lot of evidence  
20 around it before you drive it across the profession. So,  
21 thank you.

22           MR. JONAS: Thank you, Bob.

1           Jeff Mahoney?

2           MR. MAHONEY: Thank you. I just wanted to  
3 express my support for the -- on page 12 the third  
4 comment relating to the definition, given the PCAOB's  
5 mission to protect investors. And I think that it's  
6 widely recognized that the audit is mainly to serve  
7 investors. I think that's an important point that should  
8 be emphasized in the definition. Thank you.

9           MR. JONAS: Elizabeth Mooney.

10          MS. MOONEY: Thanks, Greg. Yes, I would echo  
11 that comment, obviously, but also just, yes, encourage  
12 that the results be made public, the indicators be made  
13 public and at the engagement level that there be -- you  
14 know, I'm sure you're going to provide more clarity on  
15 what's at the firm level, what's at the engagement level.  
16 But that will be a really important area we focus on.

17          And I'd like to also echo the suggestion of the  
18 ratio of the non-audit to audit services provided by the  
19 firm.

20          And I think another area that would be important  
21 to include in the discussion by the audit committee on  
22 the audit quality indicators would be, you know, the

1 duration or tenure of the relationship. If it has only  
2 been one year, you're going to have a different sort of  
3 context for looking at the quality improvements, but then  
4 I think it's also very important to know if it's been a  
5 long-term relationship. I think that's real important  
6 in the quality discussion, but also in the independence  
7 work that the PCAOB is considering.

8 MR. JONAS: Elizabeth, thank you. I noted a few  
9 minutes ago that George, when talking about how the unit  
10 of account might depend on who the user of the data was  
11 and he observed that, for example, audit committees might  
12 want, at least for the engagement they're directly  
13 involved in, engagement-level data in addition to some  
14 other-level data, but at least engagement-level data.  
15 And he observed that perhaps investors might want firm-  
16 level data. Maybe you could relate to this group the  
17 conversation you and I had outside here a few minutes ago  
18 when you, as a user of financial statements --

19 MS. MOONEY: Yes.

20 MR. JONAS: -- had a different view about what  
21 unit of account you would like.

22 MS. MOONEY: I was just saying that, you know,

1 the firm-level data, I'm not sure how useful that would  
2 be. I mean the only way I can imagine, you know, using  
3 it would be set to if, you know, one of the top big four  
4 firms or big six firms, you know, ranks last, you know,  
5 not ratifying the auditor on every proxy vote is just not  
6 a real, you know, good outcome for investors or anybody.  
7 So the firm-level data I don't really feel like investors  
8 will pay a ton of attention to that. It will be  
9 interesting, but I think the engagement level-data is  
10 critical.

11 MR. JONAS: John White?

12 MR. WHITE: Yes, I mean just to state the  
13 obvious, but you do get what you measure. And so as you  
14 decide on which of these indicators you're going to use,  
15 the result will be that the audit firms and the audit  
16 committees, their behavior will change and they will move  
17 on each of the indicators doing whatever it is to get  
18 higher scores. And just I guess that's stating the  
19 obvious. It may not always be. You know, there are lots  
20 of ways of gaming the system on many of them, and you may  
21 have a profound effect on a variety of things as you  
22 choose the indicators.

1           MR. JONAS: Let me ask the three of you, plus  
2 myself, who moderated: In my group the tone of the  
3 discussion I felt was that these metrics will matter.  
4 To John's point, that people will react to them. It's  
5 not that people will look at these and find them  
6 irrelevant, and they will agitate for some direction.  
7 We don't know exactly what that direction is and we  
8 suspect with a portfolio of metrics there may be  
9 conflicting signals about what's good and what's bad, but  
10 there will be some level of agitation. That seemed to  
11 be a theme in our group.

12           Other groups?

13           MR. WILFERT: Well, John was in my group, so yes  
14 that was a theme and a topic of discussion.

15           MR. VINELLI: There were two others themes. The  
16 first one was, well, if you observe and you measure it,  
17 it will change, right? And there were a couple of  
18 examples. Insurance costs, the transfer of partners,  
19 client retention were three areas that were discussed in  
20 several groups as plausible of changing when you observe.

21           The second point was that we need to take caution  
22 because observing and measuring might undermine the

1 effectiveness of other processes. And there one of the  
2 examples was consultation might be best in an informal  
3 basis. If we're measuring consultations, well, people  
4 might drive a frivolous call, say, to national office.  
5 So that was another unintended consequence that the folks  
6 mentioned.

7           The third one is if we take it too far, whatever  
8 that exactly means. There might be some issuers that  
9 might not be able to find an auditor at all. That was  
10 a theme that was in at least one or two groups mentioned.

11           MR. GUSTAFSON: Yes, I know one of the things, a  
12 comment made by Roman was what you measure will affect  
13 behavior. So I think that's exactly on point with what  
14 we're talking about. And I think that, you know, part  
15 of the discussion that flowed from that was maybe you  
16 want to affect behavior, but be careful of the unintended  
17 consequences. So I think that that was a general theme  
18 within our group.

19           MR. JONAS: Brian Croteau?

20           MR. CROTEAU: Thanks very much. Just in looking  
21 at the data that you have here, I noticed that one of  
22 them that didn't show up is the metrics related to

1 independence testing and compliance. And it did show up  
2 as one of the more controversial. I was a little  
3 surprised it didn't show up in the top 15 perhaps,  
4 although it's not also in the bottom 15. So maybe you'll  
5 tell me it would have been No. 16.

6 But I was just curious given it was one of the  
7 more controversial if anyone in the room had any feedback  
8 on why that would be controversial or why that one  
9 wouldn't perhaps be one that would have made it to the  
10 top 15.

11 MR. JONAS: Do the moderators have a point of  
12 view on that? And if not, maybe I could ask those who  
13 felt strongly about that one way and the other to  
14 articulate their view.

15 But, George, did you have a --

16 MR. WILFERT: Yes, I'm not sure. I think it may  
17 just have not been top 15 or bottom 15, so there's a  
18 possibility that some could have had a wide dispersion  
19 but yet not been in the top or bottom 15. But I can  
20 follow up on that, Brian.

21 MR. JONAS: Those who thought that metrics  
22 related to independence compliance were important, does

1 someone want to stand up for that view?

2 Denny, were you responding to that or did you --  
3 you were going to talk to another point?

4 Okay. Anyone want to make the argument for that?

5 MR. GALLAGHER: Greg, we felt or I felt that it  
6 was important, but perhaps, you know, maybe I understand  
7 why it didn't make the top 15 is maybe there is a sense  
8 that that's a given, right, that it's assumed. And, you  
9 know, there were others that maybe were not and therefore  
10 should be ahead of it. I certainly thought it was  
11 important.

12 MR. JONAS: Steve, are you going to make the  
13 counterargument?

14 MR. BULLER: Well, I'll just add a couple points:  
15 One is I think that, you know, it can be interpreted many  
16 ways because most independence infractions probably are  
17 minor ones where someone at staff level, for instance,  
18 owns a security which is a proscribed holding because  
19 it's, you know, a client of the firm or they're in the  
20 chain of command or something and weren't aware of it.  
21 So I think most of the transgressions are small. So just  
22 having an absolute criteria of violations is problematic.



1 I think if they had a criteria that said the number of  
2 violations that resulted in a determination that the firm  
3 was not independent may be a threshold which might be  
4 more appropriate and understandable.

5 MR. JONAS: Okay. That's all I was thinking on  
6 independence. We have other cards up on different  
7 topics.

8 MR. RICCIARDI: I have something on independence.

9 MR. JONAS: Independence point?

10 MR. RICCIARDI: Yes.

11 MR. JONAS: No?

12 MR. RICCIARDI: Yes. Yes, I think I was one of  
13 the people who was urging that it be a consideration.  
14 And if you go to the New York City policing philosophy,  
15 which was you're trying to prevent major crimes, but if  
16 you're careful about noticing who's jumping the  
17 turnstiles at the subway and track those people and keep  
18 an eye on them, it might tell you something in terms of  
19 better police protection.

20 And so if someone is not careful and cautious and  
21 taking seriously their obligations to comply with the  
22 independence rules -- and I'm not saying, you know, one,

1 because their spouse has a mutual fund and they didn't  
2 realize that it was an issue, but if you have people who  
3 are not carefully being certain and trying their best to  
4 comply, that might be indicative of a broader problem.  
5 And so you might want to track that. And hopefully the  
6 firms may be doing that.

7           Where you track people who aren't as  
8 conscientious about following the independence rules,  
9 maybe that's an indication of a broader problem and  
10 they're not as careful about collecting sufficient  
11 competent evidential matter to support their own opinion.  
12 And so you might see a correlation between folks who are  
13 less than careful with regard to independence compliance  
14 and less than careful in performing audits.

15           MS. MOONEY: Greg, I would just echo that comment  
16 on independence. And I'm not sure how you couldn't  
17 incorporate independence evaluation in an audit quality  
18 assessment. I'm not sure how you could leave it out.  
19 It would be, yes, pretty integral I would think to audit  
20 quality.

21           MR. JONAS: Okay. Denny Beresford?

22           MR. BERESFORD: I don't know that this is related

1 to audit quality indicators as an unintended consequence,  
2 but I hear fairly frequently from some of the senior  
3 partners at accounting firms that a disturbing number of  
4 bright, younger partners are leaving the profession  
5 because of the pressures that they feel are being imposed  
6 upon them as a result of the inspection program, because  
7 of the increasing pressures that they feel are being put  
8 upon them by being second-guessed through the various  
9 processes. It seems like it has the potential of adding  
10 to that burden.

11           And I just wonder to what extent that is  
12 something that the PCAOB takes into consideration in its  
13 thought process. I know you're not going to pull your  
14 punches, if I can put it that way, but at the same time  
15 there has to be some concern about driving the best and  
16 the brightest out of the profession if that is the result  
17 that's taking place. I'd be interested in knowing from  
18 the firms if what I'm hearing is anecdotally not just a  
19 few examples or if it's happening in large number.

20           MR. JONAS: Yes, Mike?

21           MR. GALLAGHER: So clearly there is a level of  
22 anxiety, no question about that, Denny. Is it showing

1 up in turnover? The answer is no. We have not seen a  
2 spike in the turnover. We think it's been manageable.  
3 One could argue it's because the economy is tough, but  
4 we have found that the anxiety is manageable. We're not  
5 losing people in any, you know, spike or any large  
6 numbers.

7 MS. MOONEY: May I respond to that? Can I offer  
8 a comment?

9 MR. JONAS: Elizabeth?

10 MS. MOONEY: Just that, you know, I've never  
11 heard of investors complaining about the audit fees being  
12 too high. I've heard them complain about them being too  
13 low just in terms of audit quality. Maybe there needs  
14 to be a look at compensation if there is going to be more  
15 demand on audit quality or more of a focus on, you know  
16 -- more of a discussion about it and -- I was surprised  
17 to see the compensation aspect, I think, controversial  
18 on here. Did it rank in the top in terms of  
19 compensation, you know, relative to quality of the audit?

20 MR. BAUMANN: Elizabeth, it's your first meeting  
21 here, but it's interesting,  
22 it's a consistent theme that we've heard over the years

1 from investor representatives at the SAG meeting that  
2 they hear that audit firms are under a lot of pressure  
3 with respect to fees. And the investors consistently say  
4 at this meeting; and as I said, it's interesting that  
5 it's your meeting, that we're not putting pressure on  
6 fees. We want to see high-quality auditing. That's what  
7 we want most. And so it's an interesting anomaly that  
8 the audit is for the investors and the investors are not  
9 expressing that concern, but yet we understand that  
10 there's fee pressure. So an interesting observation.

11 MR. JONAS: Steve?

12 MR. BULLER: Yes, I was just looking at the top  
13 15-ranked page and it was interesting to me -- first of  
14 all, it's a very small sample, so I'd encourage you to  
15 further vet this, because if you look at the numbers of  
16 the academics, I mean you can back into the number if you  
17 -- it looks like three academics, and five audit  
18 committee, and eight auditor. And I'm not smart enough  
19 to figure out the number of investor advocates there  
20 were, four issuers, somewhere around there. So a broader  
21 sample would be good.

22 But what I found to be interesting though looking

1 at the numbers is, looking at the number of times that  
2 each thought leader category voted the highest or the  
3 lowest. So the auditors and the academics were the  
4 hardest raters. And I understand what the auditors were  
5 not necessarily positively inclined towards some, and I  
6 can only assume the academics used a forced distribution  
7 to get their numbers. But the investors and audit  
8 committee members actually were favorably inclined, and  
9 the audit committee in particular voted the highest  
10 rating by far of any of the categories. So I think it's  
11 very positive that the audit committee members thought  
12 these had value and were so positively inclined toward  
13 the attributes.

14 MR. JONAS: Bob, follow-on comment?

15 MR. GUIDO: Yes, two follow-up comments, one  
16 regarding fees. It's kind of interesting and it goes  
17 back again to the outreach. This has got to be a topic  
18 of discussion because in my audit committees there is a  
19 difference between the level of understanding of what's  
20 happening at the audit committee level even versus senior  
21 management. Again, senior management is driving the  
22 operations and watching cost, all costs. We're trying

1 to manage risk at the audit committee level.

2           And in the grand scheme of things I have no  
3 problem with increase in fees if we're getting better  
4 audit quality and value. So again, I would keep focus  
5 on that message as you all do the outreach, because I  
6 think it's really important. In between is the firm.  
7 They're caught in the middle here.

8           The second is going back to what Denny's comment  
9 was, because I've also picked up on that, and it's almost  
10 the analogy of employed versus unemployed out there in  
11 statistics. I'm not sure how you measure the senior  
12 managers observing inspection and what, quote, "the  
13 partner" is going through and therefore they don't want  
14 to be a partner.

15           So again, I think inspection has to be very firm  
16 in what we're trying to drive on audit quality, but it's  
17 the transparency of inspection and the communication of  
18 that that really drive behavior in the trenches. So I'm  
19 just asking you to look at that. Thank you.

20           MR. JONAS: Bob, let me ask a follow-on question  
21 on this. We've looked at some data that suggests that  
22 when companies change auditors, audit fees fall by on

1 average 12 percent. Do you think that if audit  
2 committees received a portfolio of metrics along the  
3 lines of, say, the top 15 -- do you think that that would  
4 alter an audit committee decision about fees? Would it  
5 change the debate at the audit committee level, or not?

6 MR. GUIDO: Well, I can only answer that in my  
7 experience on both sides of the fence, but I think if you  
8 lead with quality of service and communication, the fee  
9 issue becomes very minimal in the conversation and  
10 decision process, or it should be anyway, because I think  
11 that people are willing to pay for outstanding quality  
12 and communication. And I just think we all have to be  
13 messaging that because I think the firms are caught in  
14 between right now and I really don't want to see quality  
15 go backwards.

16 MR. BERESFORD: Can I follow up on that?

17 MR. JONAS: Denny has a follow-up point.

18 MR. BERESFORD: I would say to respond to your  
19 question that, certainly not all but of the top 15 --  
20 that, looking quickly at them, probably half of them are  
21 the types of things that the audit committee would be  
22 looking at in terms of the things that would be



1 considered in a proposal process right now. We certainly  
2 wouldn't be looking at specific numbers of hours and  
3 things like that, but we would be interested in  
4 inspection findings if we realized that there had been  
5 a lot of negative findings against the firms and so  
6 forth. And we certainly look at industry expertise and  
7 things of that nature, so many of these things would be  
8 exactly the kinds of things that the audit committee  
9 would be interested in now. And if something like this  
10 was available, quite possibly others would be on the list  
11 going forward.

12 MR. JONAS: Thank you. Scott Showalter?

13 MR. SHOWALTER: Yes, in the interest of again  
14 stating an obvious fact, following up on John's, is one  
15 thing, it may create -- some of the controversy or  
16 standard deviation you saw was when you looked at some  
17 of these was could you actually come up with the measure?  
18 I know you're looking for whether the dog hunts to begin  
19 with, but depending on whether they hunt or not depends  
20 on whether you can come up with the measure as well.

21 For example, if you look at 9, 14 and 15, you're  
22 assuming you can come up with what a good utilization

1 percentage is, what is an indication of a good investment  
2 and how many hours should we get. And so sometimes in  
3 the room the discussion was around whether -- could you  
4 even come up with something that would -- so that may  
5 have an indication on why you got diversity. I just  
6 wanted to point that out, because that was in the room.

7           Sometimes people said, well, I just don't think  
8 you can come up with an item that would be meaningful in  
9 that case. So you want to think about that in some of  
10 your deviations here and whether the nature of what you  
11 are measuring -- there's an assumption here on the  
12 findings that if you have one finding or more, it's bad.  
13 Well, I don't think this is a zero-defect game we're in  
14 here. So what is an acceptable level of findings that  
15 you can have before it goes -- so you may want to keep  
16 that in mind as you're evaluating these criteria, because  
17 I think in a lot of people's minds it depends on what  
18 that -- are you able to come up with the number. And  
19 that will be part of your research, probably, to figure  
20 that out.

21           MR. JONAS: We've had some dialogue with some  
22 thoughtful folks recently who feared that one outcome of

1 this effort could be a benchmarking in certain metrics  
2 by, say, the PCAOB who would argue that, say -- I'm  
3 making this up, but a staff-to-partner leverage of 10:1,  
4 anything north of that would be deemed problematic, and  
5 they thought that benchmarking by the regulator would be  
6 a severe mistake.

7           Speaking for myself, I know of no part of our  
8 effort that would try to go to benchmarking. I think our  
9 philosophy is: let's get meaningful data to relevant  
10 people and let them use it to help ensure quality rather  
11 than benchmarking.

12           Scott?

13           MR. SHOWALTER: I understand that, but we just  
14 had a session on reaching out to audit committees. If  
15 you don't think audit committees are going to follow up  
16 with a question, what's the good number? That's kind of  
17 unrealistic. So there's going to be some good follow-on,  
18 maybe a lot of good academic research along the way that  
19 will be conducted in this area, but I think someone's --  
20 I know that's not where you want to go, but it will  
21 become a very natural part of the conversation.

22           MR. JONAS: Rick?

1           MR. MURRAY: First of all, I think a great deal  
2 of value came out of this exercise, and particularly the  
3 massaging of data last night. I find this much more  
4 enlightening than, looking at the pre-meeting materials,  
5 I anticipated I would. So congratulations.

6           A quick observation on benchmarking. I don't  
7 understand how you can avoid it. If someone is expected  
8 to apply a consistent AQI from company to company on an  
9 issue as clear as the one you mentioned, the partner-to-  
10 staff ratio, either you're telling them, make up your own  
11 benchmark and rate against it or find out what is the  
12 typical average or the PCAOB's view. It does seem to me  
13 that benchmarking is an almost inescapable consequence  
14 of many of these.

15           The other comment more briefly is I assume that  
16 in order to plan for success, if we're going to pursue  
17 this AQI concept, it is terribly important that in its  
18 early phases it be seen to be a success. One of the  
19 success criteria would be a relative absence of  
20 controversy, a list that generally is understood by all  
21 of the constituencies to be appropriate. And this  
22 discussion today has illustrated that there are some

1 issues on which there are strong feelings. They aren't  
2 necessarily new. But to embody them into an AQI is to  
3 establish them as a debating center that will put the  
4 Board and the AQI process into a more controversial light  
5 than I think is your intent, which is to try to gain  
6 congruency of view for consistent measurement and for  
7 motivating behavior.

8 MR. JONAS: And, Rick, would the implication of  
9 your observation be then that you would advise us to  
10 start with a small group of metrics that have wide  
11 support and we can add to them over time, but start with  
12 consensus-type metrics first? Could I imply that from  
13 your comment?

14 MR. MURRAY: Absolutely. When you get through  
15 eliminating the things that would either be  
16 controversial, too subjective, too context-oriented, too  
17 likely to produce adverse unintended consequences, if  
18 what remains is 5 or 10 in the context of a start-up  
19 process, I think that is far preferable than having 20,  
20 of which half will suddenly become the center of a new  
21 set of controversies surrounding the process.

22 MR. JONAS: Thank you. Gaylen Hansen?

1           MR. HANSEN: I happen to agree with Rick's  
2 comments on this. I think it's not the quantity. But  
3 just stepping back and an observation, I think the only  
4 reason to do this is to raise the bar for audit quality,  
5 and I happen to believe that audit quality has increased.  
6 That bar is higher today than it was 10 years ago. I  
7 think it's improved, but it's almost inevitable that what  
8 you're doing is going to be viewed as a benchmarking  
9 exercise.

10           We were told way back when the inspections  
11 started that they shouldn't be viewed necessarily as a  
12 scorecard, but I can tell you they are used as a  
13 scorecard right now today. So the inspections themselves  
14 are a manner of benchmarking and, you know, it's just  
15 simply an observation. I'm not against this at all. I  
16 support this effort and moving forward with it, but those  
17 unintended consequences I think that Rick was getting at  
18 are very important to keep your eye on.

19           MR. JONAS: Elizabeth Mooney?

20           MS. MOONEY: Yes, I'm a lot more positive I think  
21 on this. And the focus on the unintended consequences,  
22 I think that this is a really great effort. I think it

1 will be informative. I think we're going to have a lot  
2 more good-quality information than the negative. And I  
3 think I would encourage you to start with a broader  
4 sample. I think it's a lot easier to remove than it is  
5 to go back, reopen and add. So I think you should try  
6 a lot more than you might be comfortable with or receive  
7 feedback on and then go from there. I think this is  
8 going to be a great project and not a big negative.

9           MR. JONAS: All right. Let me just observe two  
10 things: One is, we got out of this meeting exactly what  
11 we had hoped we would. We wanted you to help us  
12 differentiate these metrics. You've done that. We  
13 wanted your insight as to why some of these seemed to  
14 work in your mind and others did not. We wanted your  
15 insight as to where we needed to focus our time. I think  
16 all of that will help us greatly as we move forward.

17           I also, personally speaking, am encouraged by  
18 your enthusiasm for what this project could be, provided  
19 that we're diligent and careful with what we're doing.  
20 I sense a general sentiment that this is worth making a  
21 hard run at this and I can assure you that we will.

22           And then finally, I would just like to thank my

1 colleagues in ORA, particularly George Wilfert and Chris  
2 Vanover who carried much of the water for us on this, but  
3 also my colleagues in the other divisions. Each division  
4 in the Board has had helped in a big way and I sincerely  
5 appreciate the efforts, as well as Board members are not  
6 uninterested in this project, as you might imagine, and  
7 have offered thoughtful suggestions and help along the  
8 way. So thank you very much.

9           And, Marty, back to you.

10           MR. BAUMANN: Thank you, Greg. I thought that  
11 was a great discussion. And I agree, just like every  
12 other session we've had, on average with audit  
13 committees, discussion on the standard-setting agenda  
14 yesterday, the discussion on input with respect to the  
15 Board's general reports and audit quality indicators, the  
16 SAG has certainly exceeded our expectations in terms of  
17 valuable content, in terms of things for us to think  
18 about. So I think it was a great meeting in terms of  
19 what you have given to us. So I thank you for that.

20           The next meeting of the SAG should be on your  
21 calendars. We think we posted it a while ago. It's  
22 November 13th and 14th. Between now and then I'll



1 communicate with you at least twice, and you should feel  
2 free to communicate with us as often as you like about  
3 anything you're seeing, observing and want to tell us.  
4 And I encourage you to do that.

5           But shortly after this meeting I'll send out a  
6 message to all of you and ask for your feedback and input  
7 with respect to this meeting, its content, structure,  
8 subjects and things of that nature and any other views  
9 you might want to share about this meeting. And you can  
10 also take the opportunity to talk about things you'd like  
11 to see on the next meeting agenda or upcoming meeting  
12 agendas. And then again, I'll probably do that shortly  
13 before the November 13th-14th meeting when things are  
14 little down the road a bit to see if there are other  
15 things that you want to make sure we discuss at the next  
16 meeting.

17           Receiving input from you about what should be on  
18 these agendas is very valuable to us so that we're  
19 getting input on things we need, but we're also listening  
20 to you about important subjects that you think we should  
21 be talking about. So again, I will do that a couple of  
22 times.

1 I'd also just like to remind folks that we have  
2 a couple of proposals out, one on the framework for the  
3 standard-setting for standards and a re-proposal on  
4 related party transactions, significant unusual  
5 transactions. And we're looking for comment letters with  
6 respect to those, so I'd love to hear from all of you  
7 with respect to those standards and the framework.

8 We'll be having other ones. As I mentioned, we  
9 expect to roll out a few other proposals in the next  
10 couple of months, and again we'll be looking forward to  
11 you seeing them. We'll make sure they get into your  
12 hands and we'll look for your comments and observations.

13 With that, we have nothing else on our agenda  
14 today and it's about noon. And we wish you safe travels  
15 and thank you for very much for your participation in  
16 this meeting. Thanks again.

17 (Whereupon, the above-entitled matter was  
18 adjourned at 11:57 a.m.)

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