

NOTICE: This is an unofficial transcript of the Public Company Accounting Oversight Board's Roundtable on Communications with Audit Committees held on September 21, 2010, that related to the Board's proposed auditing standard, *Communications with Audit Committees*.

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1 PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD:
2 ROUNDTABLE ON AUDITOR COMMUNICATIONS
3 WITH AUDIT COMMITTEES
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9 September 21, 2010

10 8:30 a.m.
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15 Washington, D.C.
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1 MR. MARTIN BAUMAN: Good morning. I'd
2 like to welcome everybody here to the PCAOB
3 Roundtable on Auditor Communications with Audit
4 Committees. I'm Marty Bowman, the PCAOB Chief
5 Auditor and Director of Professional Standards. I'd
6 also like to welcome those who are listening in our
7 webcast. Like our SAG meetings, this meeting is
8 webcast. And so I thank all of those folks for
9 joining us as well.

10 On March 29th, the board proposed a new
11 auditing standard regarding auditor communications
12 with audit committees. And the comment period
13 closed on May 28th. As part of those comments, we
14 received many good comment letters and valuable
15 input, but an important theme that recurred through
16 many of the letters was the fact that the board
17 should consider conducting additional outreach,
18 especially to members of audit committees to gain
19 insights in terms of how they saw the audit
20 committee and auditor communication process working,
21 and getting more views from audit committee members
22 regarding the communications process.

1 Today's roundtable represents the board's
2 response to those commenters, and also, the ability
3 to get further input on some additional questions in
4 comments that were raised during the comment letter
5 process.

6 So as part of this roundtable process,
7 we've prepared a briefing paper, which you've all
8 seen. And additionally, the comment period has been
9 reopened and extended through October 21st, 2010.

10 Today, we'll discuss a number of topics
11 relating to communications with audit committees,
12 auditor communications with audit committees,
13 including which communications are useful to audit
14 committees in their oversight of the audit,
15 communications relating to accounting policies,
16 practices and estimates, two-way communications
17 between the auditor and audit committees. One of
18 the new features of the proposed standard was a
19 requirement for the auditor to evaluate the
20 effectiveness of the two-way communications. And we
21 received quite a few comments in that area as well.

22 Another important topic would be whether

1 auditor communications should with written or oral.
2 There are a lot of differing views on that aspect
3 also. And then several other topics will be
4 discussed along the way.

5 I want to extend my personal appreciation
6 for the willingness of all of you to be here today.
7 I know you all have very busy schedules. Summer's
8 just shortly over. And here you are in Washington
9 discussing an important topic with us. It is very
10 valuable to us in this standard setting process. So
11 I want to express how much we appreciate the fact
12 that you all took the time to come today.

13 Please everybody, please be engaged today.
14 We really are looking for all of your inputs. So
15 and I know I don't have to say that in most cases
16 for most folks, but I thought I'd say that any way.

17 This is a very, very important topic
18 communications, auditor communications with the
19 audit committee. It's our view that or my view at
20 least that it's one of the very, very important
21 features in terms of ensuring that the audit process
22 is working effectively. And I think Sarbanes Oxley

1 legislation saw it that way and changed the
2 relationship between the auditor and management, and
3 auditor to the audit committee. The level and
4 quality of those communications are key to an
5 effective audit process.

6 Finally, I have some -- a couple of
7 administrative items. You should have a folder in
8 front of you today that has all of the materials
9 you'll need. It has a copy of the proposed
10 standard, the briefing paper, seating chart, I think
11 copies of the slides we'll be putting up, as well as
12 the agenda. We'll be break -- taking a break around
13 10:15. Lunch will be at noon right outside the
14 doors here. And we should finish the day around
15 3:00 p.m. unless the conversations get really
16 exciting, in which case it could go on very late.

17 Before I turn the floor over to our acting
18 chairman Dan Goelzer, I'd like to go around the room
19 and ask everybody to briefly introduce themselves
20 and as well as your organizational affiliation
21 including if you are on audit -- representative of
22 audit committees, to tell us about that as well. So

1 again, I'm Marty Bauman and I'll turn to my left.

2 MS. JENNIFER RAND: I'm Jennifer Rand.
3 I'm Deputy Director of Professional Standards and
4 also Deputy Chief Auditor, the PCAOB.

5 MS. JESSICA WATTS: I'm Jessica Watts.
6 And I'm an Associate Chief Auditor with the PCAOB.

7 MR. JEB BURNS: I'm Jeb Burns. I'm the
8 Chief Investment Officer with the Municipal
9 Employees Retirement System in Michigan.

10 MS. LISA GAYNOR: I'm Lisa Gaynor. I'm an
11 Assistant Professor at University of South Florida.
12 And I served as member of a research team on audit
13 committee communications.

14 MR. ROBERT KUEPPERS: Hi, I'm Bob Kueppers
15 with Deloitte. I'm Deputy CEO. My responsibilities
16 are principally regulatory and public policy.

17 MR. ALEX MANDL: I'm Alex Mandl. I'm on
18 five boards. I'm involved with three audit
19 committees. And I chair one of those. So this
20 topic is very -- great interest to me. Thanks.

21 MR. STEVE HARRIS: Steve Harris, PCAOB
22 board member.

1 MR. HAL SCHROEDER: Hal Schroeder, Carlson
2 Capital, a portfolio manager, and until recently, an
3 audit committee member and of a Lloyd syndicate.

4 MS. KIKO HARVEY: Kiko Harvey, I'm the
5 Vice President of Corporate Audit and Enterprise
6 Risk Management at Delta Airlines. And I report to
7 the audit committee.

8 MR. MIKE COOK: I'm Mike Cook. I've been
9 a member of a variety of audit committees and
10 chaired a few over the years. Currently the
11 chairman of the audit committee of Comcast.

12 MR. DAN GOELZER: PCAOB board member.

13 MR. LINDA GRIGGS: I'm Linda Griggs. I'm
14 a lawyer with Morgan, Lewis, and Bockius here in
15 Washington. And my practice consists of advising on
16 securities regulatory matters, including financial
17 reporting matters and corporate governance. I have
18 served on the audit committee of a public company.

19 MR. ROBERT DOHRER: Bob Dohrer, National
20 Director of Insurance Services for McGladry and
21 Pullen.

22 MR. GARY KUBURECK: Gary Kubureck, Chief

1 Accounting Officer of Xerox Corporation. I've never
2 been on an audit committee, but I'm a process owner
3 for our audit committee's meeting process.

4 MS. JOAN WAGGONER: Joan Waggoner, I'm the
5 Quality Assurance Partner for Blackman Kallick, a
6 Chicago based public accounting firm.

7 MR. BRIAN CROTEAU: Brian Croteau, Deputy
8 Chief Accountant at the Securities and Exchange
9 Commission. And if I could just briefly say that
10 while anything that I would -- any views I would
11 express today would be my own, I certainly speak on
12 behalf of many at the SEC in commending the PCAOB
13 for holding this roundtable today and for all of the
14 participants in taking the time to attend. We
15 really appreciate it as well.

16 MR. ARNOLD HANISH: Arnie Hanish, Vice
17 President, Chief Accounting Officer at Eli Lilly and
18 Company. I've been involved in interfacing with the
19 audit committee for well over 20 years.

20 MS. KAREN HASTIE WILLIAMS: Karen Hastie
21 Williams, for my day job, I am a partner at the law
22 firm of Crowell & Moring here in Washington. But I

1 serve on five corporate boards and chair three audit
2 committees. So I felt this was an important meeting
3 for me to attend. Thank you.

4 MR. JIM COMR. BAUMAN: Jim Cox, and my day
5 job is a professor at Duke Law School. And I serve
6 and have served on audit committees.

7 MR. LYNN TURNER: Lynn Turner, I currently
8 serve on the board of trustees at the Colorado
9 Public Retirement System, a 3\$8 billion investment
10 fund. I also serve as a Senior Adviser to a
11 forensic and economic consultant firm, LECG. I've
12 served on a number of audit committees and chaired
13 three of them. And in a prior life, also as a
14 signing audit partner.

15 MR. CHARLEY NIEMEIER: Charley Niemeier,
16 PCAOB board member.

17 MR. DENNY BERESFORD: I'm Denny Beresford.
18 I'm a professor at the University of Georgia. I am
19 now the chairman of the audit committee of three
20 large corporations. And I served 26 years in public
21 accounting with 10 years in between as a standard
22 setter at the FASB.

1 MR. SAMUEL RANZILLA: Sam Ranzilla, I'm
2 the National Managing Partner for Audit Quality and
3 Professional Practice at KPMG.

4 MS. MARY HARTMAN MORRIS: I'm Mary Hartman
5 Morris. I'm an investment officer at CALPERS,
6 California Public Employees Retirement System.

7 MR. BILL GRADISON: I'm Bill Gradison, a
8 member of this -- of the PCAOB board. I formally
9 served on the audit committee of a public company in
10 the health care field.

11 MR. ROGER COFFIN: Good morning, my name
12 is Roger Coffin. I'm the Associate Director of the
13 Weinberg Center for Corporate Governance and an
14 Associate Professor of the Practice at the
15 University of Delaware.

16 MR. LARRY SALVA: Larry Salva, Senior Vice
17 President, Chief Accounting Officer of Comcast.
18 Been at Comcast the last 10 years. Prior to that,
19 spent 23 years with Coopers and Lybrand and Price
20 Waterhouse Coopers, including as a signing partner,
21 and also as a national accounting consulting and
22 risk management partner.

1 MR. GEORGE MUNOZ: Good morning, George
2 Munoz. I'm an attorney and CPA. I'm the audit
3 chair of Altria and the audit chair of the National
4 Geographic.

5 MR. HASNAT AHMED: Hasnat Ahmed, Assistant
6 Chief Auditor, PCAOB.

7 MS. BARBARA VANICH: Barbara Vanich,
8 Associate Chief Auditor, PCAOB.

9 MR. BAUMAN: Well thank you, everybody,
10 for taking the time to do that. And clearly, we're
11 fortunate to get a group of very qualified people to
12 talk about on the very important subject with us
13 today. So with that, I'd like to ask Dan Goelzer to
14 introduce the program. Dan?

15 MR. GOELZER: Thank you very much, Marty.
16 And good morning to everyone. I'd also like to
17 welcome everyone to the Public Company Accounting
18 Oversight Board's Roundtable on Auditor
19 Communications with Audit Committees.

20 Like Marty, I want to begin by thanking
21 all of the panelists for joining us today and
22 providing us with the benefit of your insights and

1 experience. The board appreciates your willingness
2 to devote time, effort, and thought to helping us
3 address this important topic.

4 This roundtable is a key component of the
5 board's ongoing standards setting process. I've
6 spoken in the past about the importance of openness
7 and transparency in board standard setting. Over
8 the last two years, we've experimented with the use
9 of concept releases with multiple public comment
10 periods on proposed standards, and with more focused
11 discussion with our standing advisory group of
12 standards setting projects.

13 I view roundtables like this one as
14 another tool that we can use to make sure that the
15 board receives the most thoughtful and relevant
16 input available when it writes standards, and that
17 investors, preparers, and auditors all have the
18 chance to contribute to our decision making.

19 The board's proposal to enhance auditor
20 audit committee communication was published last
21 March. The objective of that proposal was to bring
22 the standards related to auditor communication with

1 audit committees into line with the role of the
2 Sarbanes Oxley Act assigns to the committee in
3 overseeing the relationship between a public company
4 and it's auditor.

5 The provisions of the act that deal with
6 audit committees are predicated on the idea that
7 independent, informed, and proactive auditor
8 committees are central to protecting the interests
9 of investors in reliable and informative financial
10 disclosure. That vision can only be fully realized
11 if there's a robust dialogue between the auditor and
12 the committee. The proposed standard aimed to
13 accomplish that by expanding and clarifying the
14 rules of the road that govern auditor audit
15 committee communications.

16 The board received 34 comments on the
17 proposal, including letters from several of the
18 participants that around the table here with us this
19 morning.

20 The primary purpose of the roundtable is
21 to explore in more depth some of the issues that
22 were raised in those comments. One theme that ran

1 through many of the submissions was that before
2 proceeding further with a new standard, the board
3 needed to engage in additional outreach,
4 particularly to directors and others with firsthand
5 experience in the work of audit committees.

6 Along those lines, some commenters
7 suggested that the March proposal approached the
8 subject too much from the perspective of what
9 auditors thought directors should receive, and
10 without enough sensitivity to what information is
11 actually beneficial to audit committees. Others
12 warned against creating requirements that would turn
13 the communications process into a sterile check the
14 box exercise.

15 One goal of this roundtable is to address
16 those concerns, and to make sure that the board
17 understands the dynamics of successful auditor audit
18 committee communication.

19 The comments also reminded us that the
20 auditor and the audit committee have a common
21 interest in the reliability of the company's
22 financial reporting. That's why the proposal

1 emphasized two-way communication between the auditor
2 and the committee. If the auditor views meeting the
3 requirements that govern its relationship with the
4 audit committee as just another regulatory hoop that
5 it must jump through, it may deprive itself of an
6 important source of information and insight. The
7 result could be to undermine the effectiveness of
8 the auditor's work.

9 Conversely, if the audit committee treats
10 the audit as just another compliance cost, and one
11 that needs to be minimized as much as possible, the
12 committee may deprive itself of a valuable tool to
13 assist in assuring the integrity of the company's
14 financial reporting.

15 Accordingly, it's vital that any standards
16 the board adopts in this area promote a dialogue
17 between the auditor and the audit committee that
18 benefits both parties.

19 I'm certainly looking forward to hearing
20 your thoughts on how we can best accomplish that.
21 Thanks again to the panelists for taking the time to
22 be here with us today. And I'll turn the

1 proceedings back to you, Marty, to introduce the
2 first topic. Thank you.

3 MR. BAUMAN: Thank you, Dan. The first
4 topic, and we are going to pretty much -- we will
5 follow the order of the briefing paper that you all
6 have -- our first topic is communications that are
7 useful to the committee's oversight of the audit.
8 And let me ask board member Charley Niemeier to say
9 a few words to introduce this topic.

10 MR. NIEMEIER: Thank you, Marty. The role
11 of audit committees in corporate governance came
12 into prominence in the 1970s under the directions of
13 Rod Hills as Chairman of the SEC. At that time, as
14 a part of a comprehensive strategy to address
15 revelations of bribery of foreign officials and
16 other corrupt practices by American public
17 companies, the SEC directed the New York Stock
18 Exchange to require all public companies to create
19 -- all listed companies to create independent audit
20 committees to oversee the preparation of accurate
21 corporate financial reports.

22 In 2002, the Sarbanes Oxley Act added to

1 the audit committee's responsibilities to address
2 perceived problems with management's hold on and
3 control over auditors. Thus, the Act required stock
4 exchanges to require audit committees to be
5 responsible for the appointment, compensation, and
6 oversight of auditors, including a resolution of
7 disagreements between management and the auditor
8 regarding financial reporting.

9 We are here today to talk about the
10 PCAOB's proposal to update the existing audit
11 standard, requiring the auditor to communicate
12 certain information to the audit committee. That
13 standard pre-dated the Sarbanes Oxley Act. So it's
14 not difficult to envision why an update would be
15 appropriate. The purpose of this meeting is to
16 solicit views, based on the practical experience of
17 our participants about what sort of updates we
18 should undertake.

19 The purpose is also to get a reaction to
20 the draft standard the PCAOB proposed in March,
21 which in addition to updating the existing standard
22 uses new language, new communications from auditors,

1 both on audit issues and on significant accounting
2 matters beyond those required in AU Section 380,
3 which was written long before the Sarbanes Oxley
4 Act.

5 Underlying the Sarbanes Oxley Reforms in
6 this area is the idea that audit committees are
7 expected to be independent of management and would
8 need to step in and champion the auditor. That
9 said, based on PCAOB inspections and other
10 oversight, I'm concerned that there's still a lot of
11 situations where the auditor does not stand up to
12 the client.

13 Therefore, from my perspective, the point
14 of the proposal, whether it takes the form of what
15 the PCAOB proposed in March, or takes some other
16 direction, is to give the audit committee adequate
17 information about what's going on in the audit, to
18 allow the audit committee to know when to step in,
19 and what is needed to do to defend the audit.

20 Several commenters on the proposal
21 expressed concern that it would burden audit
22 committees with too much information, which would

1 increase review time and possibly obscure important
2 issues in the audit. We're seeing feedback from the
3 roundtable to understand what communication should
4 be made to audit committees to aid an effective
5 oversight at the audit. Thanks, Marty.

6 MR. BAUMAN: Thank you, Charley. The
7 discussion questions we'd like to ask you to
8 consider as part of this first topic are up on the
9 screen and in your slides. And the first one is
10 what matters related to the audit are most important
11 to audit committee members in their oversight of the
12 audit? Which of these matters should be required to
13 be communicated by the auditor to the audit
14 committee?

15 Second question is what matters do
16 investors believe audit committees need to know for
17 effective oversight of the audit? Which of these
18 matters should be required to be communicated by the
19 auditor to the audit committee?

20 We've asked a couple of members of the
21 roundtable to kick off this discussion with a couple
22 of brief comments. Please, during the session,

1 anybody else who wants to make comments, please just
2 turn your tent card on its side, on its edge, and
3 we'll call on you during the discussion topic.

4 The first one we've asked to provide some
5 comments on this subject is Denny Beresford.

6 MR. BERESFORD: I'd like to add my thanks
7 to the PCAOB for allowing this opportunity for more
8 input on this project. Among other things, I'd like
9 to observe that there are more audit committee
10 members participating in this roundtable than
11 submitted comments on the proposal. So we've
12 doubled the input simply by showing up here today.
13 I think that's terrific.

14 As Marty said, I was asked to introduce
15 this topic from an audit committee member's
16 perspective. And I'd like to put things in
17 perspective. Audit committee members consider
18 independent auditors to be a very important resource
19 obviously, a critically important resource, but not
20 necessarily the most important one in terms of sort
21 of the total package.

22 We spend most of our time both at

1 committee meetings and otherwise with financial
2 management of our companies, what I would call kind
3 of the first line of defense. And of course, we
4 have several here today, corporate controllers and
5 CFO's and so forth.

6 These are the individuals that we must
7 rely completely on to maintain the accurate
8 accounting records and controls of the corporations.
9 They must also be candid and complete in all of
10 their communications with us. In short, they must
11 be absolutely qualified and trustworthy, or we
12 should act quickly to see that they are replaced.
13 That would be one of our principal responsibilities
14 as audit committee members.

15 Of course for most companies, we have a
16 second line of defense in the internal audit
17 function like Kiko. This group reports to the audit
18 committee and can help serve as our eyes and ears
19 with respect to many of the specifics of the
20 company's accounting. The external auditors are all
21 extremely important, but from my perspective, they
22 are what I would call our third line of defense.

1 As I like to put it when speaking to an
2 auditing group, if there were an Oscar for auditors,
3 it would be for best supporting actor, rather than
4 lead actor.

5 Now none of that is intend to denigrate
6 the external audit function in any way at all. We
7 need company management audit committees, internal
8 auditors, and external auditors that work together
9 in a very cooperative way to best protect
10 shareholders in the public. But these comments do
11 influence the perspectives in my earlier letter on
12 the proposal that I'll refer briefly to now.

13 As noted in the summary document for
14 today's meeting, I'm concerned that the expanded
15 requirements for auditor communications could easily
16 lead to a checklist approach, whereby routine
17 matters tend to drive out more substantive issues.
18 We actually have a fair amount of that today as
19 present, as auditors already have to present a list
20 of their requirements each quarter or other periods.
21 Part of the duties of an audit committee chair would
22 be to caution the engagement partner to omit reading

1 them at an audit committee meeting when nothing
2 truly important has happened. Otherwise, there may
3 be a tendency for them to drone on with useless
4 words when audit committee members have many other
5 things that they want to learn. We actually have to
6 tell them to tell us what is actually new or
7 different or unusual from period to period otherwise
8 we just get a bunch of boilerplate.

9 So what do we really want to know? There
10 are several others with equal or more experience
11 than mine at today's meeting. We have five or six
12 members of audit committees here today. Currently,
13 there are others that have had them in the past.

14 So let me start with just a few. And
15 frankly, that's my emphasis is that we should end up
16 in this document with just a few basic requirements.
17 As noted in my letter, I want to hear an assessment
18 of the tone at the top of the organization, both the
19 financial management and the overall company. And
20 I'm not necessarily suggesting that that should be a
21 requirement in the final standard, but that's one of
22 most important things that the audit committee wants

1 to know.

2 And also, an assessment of the quality of
3 financial management from time to time including
4 internal audit. Again, not necessarily a stated
5 requirement, but something that's critically
6 important to the audit committee members.

7 Other things that I'd like to hear about,
8 and these are things that I think are subjects of --
9 should be the subject of specific requirements. I'd
10 like to hear a summary of the audit plan and
11 particularly any unusual procedures, things that are
12 going to be the particular topics of emphasis during
13 the year of things that have changed from year to
14 year.

15 Any sensitive matters that the audit
16 engagement partner is aware of that financial
17 management is not bringing to the audit committees
18 attention that should be. And that's obviously a
19 matter of significant judgment. An important
20 accounting or auditing issues that have been
21 discussed with the accounting firm's national office
22 because they're close calls.

1 I could probably provide a few more
2 topics, but I'd like to let other audit committee
3 members add their ideas during this discussion.
4 Also, as I said, my preference would be to not have
5 a lengthy checklist, but rather leave it to the
6 judgment of the audit partner. And of course, I
7 also leave it to the judgment of the audit committee
8 members to ask the questions that they think are
9 most important, both the judgment of the audit
10 committee chairman, who should have a very good
11 working relationship with the audit engagement
12 partner, but also the other members of the committee
13 who ask questions at the meetings.

14 I feel that they are more likely to do
15 that if they are not put off what -- by what might
16 become an overly long and boilerplate type report by
17 the external auditors pursuant to the current draft.
18 Again, Marty, thanks very much for the opportunity
19 to lead off this issue. And I look forward to
20 participating throughout the day.

21 MR. BAUMAN: Thanks, Denny very much for
22 those comments with respect to the first two

1 questions that we've posed. Lynn Turner, we'd like
2 to hear from you on these questions.

3 MR. TURNER: Thank you, Marty. And I do
4 commend the staff for their efforts to date. This
5 is obviously an important project from an investor
6 perspective. High quality audits is what really do
7 -- does give us confidence in the numbers.
8 Understand that management puts them together, but
9 it is that independent set of eyes and the process
10 that goes with it that establishes the credibility
11 and reliability of those numbers to us as investors.

12 And that information is extremely important as we
13 decide where to allocate our capital both here in
14 the U.S. and abroad in the various markets.

15 The audit committee plays an extremely
16 important part in that overall role. They have an
17 important role as overseers and monitors of the
18 process. And if the audit committees are going to
19 get their jobs done in a fashion -- in a diligent
20 fashion, that means that the audit committees have
21 got to get the type of information that they need to
22 make sure that in fact the audit's getting done in a

1 high quality fashion.

2 As I read through your proposal, Marty, I
3 find that for the most part, I think the staff have
4 done an excellent job. I think the topics that they
5 tee up are relevant. They're certainly, as I went
6 through them, I couldn't find one of those topics
7 that an audit committee in my opinion wouldn't want
8 to know if they were actually overseeing and
9 monitoring the project. In fact, I have to ask
10 myself how could it be that someone wouldn't want to
11 know that information regardless of whether you got
12 it in a list or not.

13 So I find it a very good starting point.
14 I think the two-way communication, the assessment of
15 that two way communication is an important factor.
16 Where I've sat on the audit committees, I've asked
17 auditors to give us that type of feedback. So I do
18 think it's good. And in fact, as I look through the
19 various topics, again, my experience had been we've
20 gone through all those in the various audit
21 committees I've sat on. And it's never really been
22 a problem. It's never -- if we do our job right,

1 it's never turned into a checklist. There is that
2 dialogue back and forth. And if you got a good
3 audit partner, you got good audit committee people,
4 you just don't see it turn into a boiler plate
5 checklist, which I agree with Denny on. That's the
6 last thing we want to have happen here, but my
7 experience had been those type of items don't turn
8 into that.

9 I think Denny mentioned a couple things
10 that are very good as far as things that you as an
11 audit committee would want to know the assessment of
12 the tone at the top and the quality of the financial
13 reporting team. That's always helpful. But there
14 were two things that were really in my mind missing
15 and once not so much missing, but how it's
16 prioritized.

17 But the first thing is I definitely as an
18 audit committee member want to know what the
19 staffing is on the audit engagement. You can put
20 down any firm's name on that audit report, but the
21 audit's only as good as the partner manager in
22 charge.

1 And ultimately, as an audit committee
2 member, I want to know who's on the job, their
3 experience. And then I also want to know who's
4 doing the heavy lifting on the difficult risky
5 areas? It's one thing if it's being done by a
6 partner with many years of experience. It's another
7 thing if it's being done by someone that just
8 doesn't have that experience. So I'm always
9 interested. And I've always got a schedule quite
10 frankly from our auditors about who's doing what on
11 the audit.

12 The second issue is the issue of risk.
13 And in the proposal, you mentioned back in one of
14 the appendix, I forget which one it might be C or
15 whatever, that when the auditors have a conversation
16 with the audit committee about the scope of the
17 audit, one of the components that discussion should
18 be something about risk. But you really don't see
19 that in the proposal or in the standard till you get
20 all the way back to the appendix. And it seems to
21 me, especially in light of what we've been going
22 through the last few years in this country, and the

1 focus on risk, that the priority given to a
2 discussion between the audit committee and the audit
3 with respect to the risk is very important.

4 Auditors are already required to identify
5 the risks. And typically, where I've sat on the
6 audit committee, we've asked for the auditor to tee
7 up to us, as well as the CFO independently, the top
8 five risks in the business and then how they're
9 going to go about auditing those top five risks and
10 whether it's consistent with what financial
11 management is telling us.

12 And so I think the fact that we don't find
13 much until we get to an appendix about the
14 discussion of risk and the role it plays in the
15 scoping of the audit, I'd elevate that up to more in
16 the body of the document.

17 I would note that, you know, it's been a
18 long time since we've had the blue ribbon report on
19 audit committees. It started a lot of this off. As
20 we did that report, we heard many of the same
21 concerns at the time about oh, it become
22 boilerplate, it become a list, it would cool, not

1 broaden the discussion between the auditors and
2 audit committees. And quite frankly, it just
3 hasn't, despite all those concerns, it hasn't
4 occurred.

5 In fact, we probably, I think most people
6 around the table would say the audit committees
7 today versus where they were in 1998 is the
8 difference between black and white. They've come
9 much further and are doing a much better job today.

10 So again, I commend you for where you go.
11 I think the proposal's very good. I'd make some
12 refinements to it, but I think it's about right.

13 MR. BAUMAN: Next is Mary Hartman Morris.

14 MS. MORRIS: Thank you, Marty. I
15 mentioned I'm an investment officer for the
16 California Public Employees Retirement System, but
17 in prior life, I was an accountant and an auditor.
18 And I'm here to -- as a representative of CALPERS.
19 I want to spend a little bit of time. CALPERS, of
20 course, as you know, is the nation's largest public
21 pension fund. What we're seeing in \$210 billion in
22 assets. This capital is allocated over 9,000

1 companies worldwide. I think it's important for us
2 -- me to mention that because as an investor, I
3 think we try to bring a perspective that's important
4 to our beneficiaries.

5 We appreciate the opportunity to attend
6 this roundtable and offer our perspective as -- on
7 these important issues. Of course, we look forward
8 to hearing a perspective of members of the audit
9 committee -- audit community, and engaging in
10 mutually beneficial dialogue.

11 Given CALPERS substantial global equity
12 holdings, we have a vested interest in maintaining
13 the integrity and efficiency of the capital markets.
14 As Lynn mentioned, the financial interests of
15 CALPERS beneficiaries are most effectively served in
16 an environment where investors can confidently
17 utilize financial statements to evaluate
18 investments.

19 We believe robust communication between
20 the auditor and the audit committee helps promote
21 this confidence by ensuring the audit committee has
22 the information it needs to serve as effective

1 monitor.

2 We view the audit committee as a direct
3 link or as a fiduciary to represent all of us as
4 shareowners and capital providers. In our comment
5 letter to the PCAOB, we offered support. And we
6 thought that the communications, a requirement was a
7 good thing and very beneficial to us. And we
8 commend the PCAOB for proposing this regulation.
9 And we believe that a rule of proposal will help set
10 the baseline, although, you know, this communication
11 is ongoing, but we believe -- to support and
12 establish a standard.

13 To begin, it may be beneficial to outline
14 the view of what we believe as the role of both the
15 auditor and the audit committee as an investor. I
16 spent part of my engaging companies in our
17 portfolios, and talking to some audit committee
18 members. A few of I've met -- during those
19 engagement participations.

20 We believe that the auditors' role as
21 decreasing the risk, material misstatements and
22 financial reports, you know, along with a lot of

1 other things, but we do believe that audit
2 committees' role as protecting investors' interest
3 and overseeing the integrity of the company's
4 financial reporting.

5 From an investor's perspective, not only
6 is it important that audit committees play the
7 important oversight role to ensure the integrity of
8 financial reporting, but we are very interested in
9 ensuring the auditor provides -- audit committees
10 what information deemed material to the market
11 valuation of the company securities.

12 So bottom line for us as an investor, what
13 is the value of our investment and the value it
14 provides to our beneficiaries?

15 With this in mind, we approach the issues
16 of communications beneficial to audit committees by
17 first looking at information investors find
18 important. And I think many of you have already
19 mentioned that. We then derive what we believe the
20 audit committee's information requirements should
21 be.

22 We use -- I mean, there's lots of

1 different examples, lots of different studies. And
2 I think many of you here will be speaking to that.

3 But I think that we used one thing in our
4 discussion was the Institute of Chartered
5 Accountants of England, Wales Financial Services,
6 ICAW, they entitled a report "Audit Banks: Lessons
7 from the Crisis."

8 This report addresses the role of auditors
9 in providing information to investors. And this
10 report specifically addresses banks, but we believe,
11 of course, this is beneficial for all institutions.

12 Key to this, I think in the crisis, is one
13 of the things we want to ask is, you know, where
14 were the auditors? And where was the audit
15 committee? Was it during the crisis? And I think
16 there is some issues outlined there that says there
17 might be some evidence that there needs to be better
18 communication.

19 First, the auditors' opinion of key
20 business and audit risk, we think we'd like to see
21 that.

22 Second, the auditors' opinion of key

1 assumptions used materially important judgments that
2 affect the financial statements. The auditors
3 should state whether these assumptions are
4 aggressive, conservative, or reasonable.

5 Third, the key audit issues and their
6 resolutions.

7 Four, significant changes to accounting
8 policies.

9 Fifth, unusual transactions.

10 And sixth, accounting applications and
11 practices are unique to the industry. And you know,
12 this is already key things, but I think it's
13 important to summarize this, because from an
14 investor's perspective, we want to understand that,
15 and be able to -- the auditor and the audit
16 committee be able to articulate that well to
17 investors.

18 As representatives of investors, audit
19 committee members must have access to of this
20 information. Furthermore, the information must be
21 detailed enough that committee can effectively
22 evaluate the merits of the company's financial

1 reporting process.

2 While we believe that explicit role,
3 reporting requirement benefit of auditor and audit
4 committee communication, we also acknowledge the
5 individualized nature of each audit. So we do agree
6 that should not be a check the box. And I think
7 even Lynn and Denny mentioned the importance of
8 making sure that that dialogue is consistent with
9 not a check it box process.

10 That's why we believe it's critical that
11 auditors use sound judgment and avoid the check the
12 box communication. Rather, it's our hope that these
13 regulations serve as a foundation for building even
14 stronger dialogue between these two parties.

15 We believe an audit standard will ensure a
16 baseline to foster and facilitate robust, meaningful
17 discussion between the auditors and the audit
18 committees. We reiterate the importance of organic
19 discussions between the auditor and the audit
20 committee. And we're not -- recommend this dialogue
21 be scripted.

22 And today, of course, we look forward to

1 hearing from audit committee members, auditors, and
2 institutional investors, other institutional
3 investors and others on those topics. Thank you,
4 Marty.

5 MR. BAUMAN: Thank you, Mary.

6 Well, others in the room are putting their
7 tent cards up. And please, do that and we'll call
8 on you. So please get your cards up. I would just
9 like to let one of our members of the roundtable
10 introduce himself. We went around the table
11 earlier. Don and everybody said who they were and
12 their affiliations and audit committee experience
13 and we'd love to hear from you.

14 MR. DONALD NICHOLAISEN: Well, good
15 morning. Thank you very much. Don Nicholaisen,
16 former Chief Accountant at the SEC. I'm Chair of
17 the Audit Committee at three companies, Verizon,
18 Morgan Stanley, and Zurich Financial Services.

19 So delighted to be here. Appreciate the
20 opportunity. And I look forward to a very
21 interesting discussion.

22 MR. BAUMAN: Thank you. And we look

1 forward to having your tent card up throughout the
2 meeting. I think the first card up was Mike Cook.

3 MR. COOK: Thank you, Marty. Brief
4 comments on this topic, agreeing largely with what
5 Denny said, what Lynn said about the audit committee
6 role.

7 I would like to make an overall
8 observation, though, about this. I -- as I was
9 reading into the materials, I got encouraged at one
10 point because we started talking about financial
11 reporting. And then, my encouragement disappeared
12 because we drifted back into talking only about the
13 audit. And I understand the role and authority of
14 the PCAOB. And maybe that's why that has to be, but
15 as you look at what's useful to the audit, what's
16 relevant to the audit, what relates to the audit and
17 so on and so on, it is only a part of the financial
18 reporting process that the audit committee has a
19 great deal of responsibility for, more so on the
20 audit side perhaps. Another financial
21 communications, but I think there's some evidence,
22 at least in my opinion, that the audit as part of

1 the total financial reporting package is declining
2 in usefulness or certainly not gaining in usefulness
3 compared to other forms of communication, including
4 earnings releases and quarterly information and
5 business performance information, non GAAP financial
6 information, all of which I think audit committees
7 need to be substantially engaged with and are
8 auditors of our audited financial statements also
9 need to be engaged with, and a dialogue about those
10 topics is often very important.

11 MR. BAUMAN: I, for the that reason, would
12 be inclined to not favor much in the way of
13 expansion of what we have today about communications
14 related to the audit, because I think they are quite
15 sufficient. In some cases maybe a little more than
16 they need to be. In some cases, they could be
17 enhanced.

18 But for the most part, they're adequate.
19 And I, for one, thinking about audit committees
20 responsibilities and not having unlimited amount of
21 time for these matters would not like to take a lot
22 more time away from other areas of financial

1 reporting, which are in my opinion, of emerging
2 importance and perhaps greater importance to spend
3 on the details of the audit, which already
4 sufficiently covered, I think, in the existing
5 requirements.

6 The only other point I'd make perhaps at
7 this stage is I think the whole issue of quality of
8 auditing and quality of financial reporting is
9 driven by people. And I would be very much inclined
10 to be sure that the audit committee spends its time
11 with people meaning the audit team, and I endorse
12 what Lynn Turner said about who are the people? How
13 experienced are they? What particular skills do
14 they bring that enables them to fulfill those
15 responsibilities effectively and endorse what Denny
16 was suggesting, which I think is critical.

17 I think some of the most important
18 communications that I receive as an audit committee
19 member from the auditing firm are people related,
20 and are not covered by the types of things that are
21 easy to put in a pronouncement, such as this, but
22 tone at the top is number one on the list.

1 If you said you can only talk to the
2 auditors about one subject in the course of a year,
3 what would it be? For me, it would be tone at the
4 top. And that is not covered here, because it's
5 very hard to turn it into a requirement.

6 But if we had a focus here on best
7 practices, and a focus on effective communication,
8 not requirements, I think we'd get a better end
9 product. And tone at the top would be there. The
10 quality of the financial staff, the depth of the
11 financial staff, particularly important as we've
12 been through downsizing, cutting back, resources in
13 a lot of areas. The quality of the internal audit
14 function, substantive quality of the internal audit
15 function. How good is it? And how reliable is it
16 for the audit committee and for the financial
17 reporting process?

18 So I would like to shift the -- some of
19 the discussion to maybe best practices, maybe people
20 oriented, harder to capture in requirements, but it
21 concerns me greatly that we're going to stack up
22 more and more and more required communications,

1 which are of less and less value to me as a member
2 of an audit committee, and less where I want to
3 spend my time, talking with management and the
4 auditors. And I won't give the three legged stool
5 speech in great depth, but I don't view anything as
6 two-way. I view this as a three-way process between
7 the audit committee, the management and the auditors
8 internal and external. And each having a equal,
9 roughly equal place at the table, one being too long
10 or two short, the stool likely to tumble over.

11 Anyone left out of the process, and it's
12 not an effectively process. The great emphasis here
13 on two-way communication is not the way I would go.

14 MR. BAUMAN: Thanks, Mike. If I could
15 interject with a question, because both you and
16 Denny brought it up, but I think Denny also said
17 that he wouldn't make it as a requirement. I think
18 I heard both of you say the most important thing you
19 could hear, it's one thing, to hear from the
20 auditors was about the tone at the top and the
21 quality of management.

22 But yet, I think you both said that isn't

1 something I put into the standard as a requirement
2 for communication.

3 So if that's the most important thing
4 you'd want to hear, you're saying we don't need to
5 put in there, because you're going to ask it anyway
6 as audit committee members? Is that the point?
7 Maybe Denny or Mike?

8 MR. COOK: I'll take a shot. And Denny
9 can correct me. My concern about it is like
10 anything else, if you make it a required
11 communication, you have to define it in great depth.
12 You have to lawyer-ize it before it takes place.
13 You have to document it. And all of those things
14 will stifle the communication.

15 And if we could have this in an
16 environment, where not everything had to be defined
17 in great precision, and written down, and so on and
18 so on, I think we would enhance the effectiveness of
19 the communication process. That is my reservation,
20 Marty, is I'd rather list it as a best practice, and
21 have a good dialogue, that make it a requirement and
22 kill it.

1 And I think we have ample opportunity to
2 kill it, just by trying to argue about what tone at
3 the top really means. But I know what it means.
4 And we, the audit partner, when I ask about it,
5 knows what it means. And we have a very effective
6 dialogue.

7 If I thought that that same dialogue was
8 taking place after having been cleared by six people
9 and prepared for an advance and so on and so on, it
10 would be far less effective for me. That's why I'm
11 concerned about the requirement.

12 But I think it's absolutely essential. I
13 mean, this notion that audit committees can, not
14 withstanding their very efforts and time that they
15 put in, you breeze through, you know, six, 12, 15
16 days a year. You know everybody is on their best
17 behavior. All the desks are clean. All the things
18 are what you expect them to be.

19 What I want to know is what they're like
20 when really tough decisions need to be get made?
21 And people need to show what their real standards
22 and principals are. And more often than not, the

1 auditors like you to be part of those discussions.
2 And that's what I want to hear about. I'm afraid of
3 institutionalizing that and killing it.

4 MR. BAUMAN: Thanks for expanding on that.
5 Denny?

6 MR. BEREFORD: My comments would be
7 similar. I just don't want to take the time to
8 build an infrastructure to determine what tone at
9 the top or quality of financial management means.
10 I'd prefer to work that out on a one to one basis,
11 based on my judgment and my discussions with
12 management.

13 I'd also, while I'm generally, I shouldn't
14 say generally, I'm strongly in favor of written
15 communications as a requirement for all the other
16 things in the document, I can't see this as
17 something that would be subject to written
18 communications at all.

19 And I just think it's far more effective
20 to let this be a best practice without any
21 particular framework. Just let it be something that
22 you elect people, you appoint people to be audit

1 committee chairman based in large part on their
2 experience, their judgment. And I think it's
3 something that you should allow them to use that
4 judgment.

5 MR. BAUMAN: Thanks. Hal, did you want to
6 comment on that point?

7 MR. SCHROEDER: I just want to ask a
8 question of both of them. Do you think that the
9 quality of the audit committees is up to what you're
10 suggesting? And I ask that because both of you all
11 are extremely experienced. You've been around a
12 long time. You understand the issues, but not every
13 audit committee member comes with the same
14 background that you two gentlemen have.

15 MR. BERESFORD: Well, there are, I don't
16 know what the exact number, 13,000 or 14,000 or
17 12,828 or something public companies. And I'm sure
18 that the -- that there is a variance among them, but
19 and that again is a reason for not specify exact
20 rule. I'm sure that you're going to have some
21 variety and how this -- something like this would be
22 applied, Hal. That's the best I can answer it.

1 MR. BAUMAN: Thanks. Linda Griggs?

2 MS. GRIGGS: I just want to commend the
3 PCAOB for this document. I think it's very thought
4 provoking. I think it tees up a lot of the issues
5 that audit committees and auditors need to be
6 thinking about in this two-way communication.

7 I do think that I come from sort of the
8 bias that a principles based standard might be more
9 effective in requiring the auditors to exercise
10 judgment in developing this communication tool. And
11 I wonder whether rather than a list of required
12 items to discuss, a standard that sets forth
13 recommended areas to consider and perhaps there, you
14 could put tone at the top in this list of
15 recommended areas, because I agree with Denny and
16 Mike, but I also acknowledge that there -- the
17 quality of auditors and the quality of audit
18 committees differs across the nation. And so,
19 providing this list of items for the auditors to
20 think about would be very helpful.

21 It might not be something that an auditor
22 would think about that he should be talking about,

1 the tone at the top. And you might have an audit
2 committee that hadn't really thought of that.

3 And so, I think teeing it up as an issue,
4 but without making it a requirement might address
5 some of Mike and Denny's concerns about the need for
6 an infrastructure to identify.

7 Because as a lawyer, I understand, you
8 want some precision. You want to know what the
9 requirement is, if it in fact is a requirement. But
10 if it's simply a list of areas that should be
11 considered by the auditors in talking to the audit
12 committee, perhaps you get away from that.

13 The other thing is you really want to
14 empower and make the auditors realize their
15 responsibility to exercise judgment. They've got to
16 figure out what the audit committee needs to know.
17 The audit committee doesn't need to know what's in
18 the financial statements. The audit committee
19 doesn't need to know things that are very -- have
20 been already communicated by management.

21 But the audit committee does need to know
22 what areas of risk were important enough to the

1 auditors to develop their plan, their audit plan.
2 They need to know what the auditors found when they
3 completed their audit. And you know, sometimes I
4 don't find anything bad. So there's no reason to
5 have a presentation on that.

6 The other thing I feel strongly about is
7 having been on an audit committee, I did find the
8 written materials enormously helpful. And I don't
9 think the auditors should be going through all the
10 written materials. I think the auditors should then
11 be required to talk about the important areas.

12 But having a list, I mean, for a non
13 accountant on an audit committee, it was useful to
14 me to have some of the information that, you know,
15 they had, through their eyes, they had -- they teed
16 up for me.

17 So I think there's a balancing as to what
18 is presented orally and what is presented in writing
19 that helps the audit committee in doing their job.

20 Thanks.

21 MR. BAUMAN: Thank you. Jim Cox?

22 MR. COMR. BAUMAN: As I was reading the

1 proposed statement, I was struck by a sort of a
2 historical observation that it was drafted roughly
3 about two months before Don Frank was enacted, which
4 as we know one of the many provisions in that act,
5 carves out the non accelerated filers from the
6 attest function of 404.

7 And it does raise in my mind whether this
8 document would have somewhat different content on
9 drift had it been written, you know, with that
10 knowledge that that was going to happen.

11 Now we know that the non accelerant filers
12 were not already subject to 404. They were only
13 threatened to be. And they keep getting prolonged
14 and prolonged. And so, a question that would come
15 to my mind, and has to come my mind on the audit
16 committees I served is, and I look rather foolishly
17 when I asked this because for the following reasons,
18 because the answer was that we do comply, even
19 though we're not required to.

20 And that is to say what have you done,
21 auditors, to evaluate the internal controls of this
22 organization that are different from what you do if

1 you were performing in a test function? And what
2 are the risks associated with the distance there
3 about what you would have done if you were testing
4 and otherwise?

5 When I asked this question, two of the
6 three audit committee as a serve on are related to
7 Duke University, which complies fully, even though
8 it's not required to, with all the requirements.
9 And both listing requirements for the New York Stock
10 Exchange and all the requirements for Sarbanes
11 Oxley. And so, they do have the attest function of
12 our management on internal controls.

13 So you know, I think something has to be
14 looked at here in terms that evaluating internal
15 controls, because that is the sine quo non for the
16 auditors, a test function for the financial
17 statements themselves.

18 So I just commend that for the -- to think
19 about going forward.

20 MR. BAUMAN: Thank you. Roger Coffin?

21 MR. COFFIN: Thank you, Marty. Good
22 morning. I just wanted to go back a little bit to

1 the concept that we spoke about regarding check the
2 box and the nature of the communications between the
3 audit committee and the auditors becoming too
4 process oriented.

5 I think it's helpful to remember that the
6 audit committee as part of the board historically
7 has an oversight role. And in fact, you know, the
8 board of directors is really designed to act as the
9 fiduciary on behalf of shareholder interests and to
10 oversee management, and then through Sarbanes Oxley,
11 the direct link between the board through the audit
12 committee and the auditor was established.

13 And that really, when you think about it,
14 forms kind of the fundamental basis, I think, of
15 modern contemporary corporate governance theory,
16 which is to say an independent board properly
17 incented subject to open and fair elections is a --
18 one of the best methods to protect shareholder
19 interests.

20 And I think the PCAOB in this standard is
21 really driving towards the independence and the
22 informed part of the board aspect. And I commend

1 you for that. And I largely endorse most of the
2 communications and agree with everything has been
3 said around the table.

4 I would like, though, to just amplify a
5 little bit about the board's fiduciary role here,
6 and how that fits into this mix. And I've described
7 this in more detail in a comment letter that I
8 submitted to the public file.

9 Remember, that boards as fiduciaries have
10 state law requirements to act in that way. The law
11 that applies to most of the public companies in this
12 country is the law of Delaware. Its enabling
13 statute has a section that -- section 141, that said
14 the business and affairs of the corporation shall be
15 managed by or at the direction of a board of
16 directors.

17 And what that means, and what the court's
18 have done with that statute over the past 80 years,
19 is to amplify that, and require boards and audit
20 committees to have broad discretion to exercise
21 fiduciary decisions in a flexible manner.

22 As a matter of fact, there was a very

1 significant case in 2008, the case of Computer
2 Associates versus AFNE (phonetic) in which the
3 Delaware court actually struck down a shareholder
4 initiated bylaw that would have purported to have
5 infringed on the jurisdiction of a board to make its
6 own determination.

7 And so, from this takeaway, what we see is
8 that under state laws, that boards of directors must
9 be free during their term to be flexible, and not
10 even the shareholder owners can do things to
11 influence or change that.

12 So I guess I would like to caution. That
13 was not what I would like to caution against,
14 although that was a wake-up call. And certainly my
15 comments here are not intended to be that, but to go
16 forward to this, to place this in the context of
17 state fiduciary requirements of boards, and to allow
18 the boards of directors to be able to do what
19 they're doing, remember, if you -- sometimes check
20 the boxes, as I was said, I think by Lynn Turner,
21 most good boards are going to ask for a lot of these
22 things. What I think we've seen, and I think what

1 we've seen in Enron, was check the boxes actually
2 protect bad boards. In other words, they give back
3 boards of directors something to hide behind and to
4 allow them to look like they're discharging their
5 fiduciary duties.

6 So while I broadly endorse what's the
7 nature of here, I think as you -- and I think all of
8 the communications that we describe are valid. And
9 I think you'd want to know, particularly relating to
10 risk, I think the longer the document gets in terms
11 of listing out the number of required
12 communications, the more danger you run towards
13 going down the scale of making it too much of a
14 process.

15 And I think the PCAOB really just needs to
16 be cognizant of where along that scale you'd like to
17 fall.

18 MR. BAUMAN: Roger, thanks for those
19 comments and for the loud burst in between as well
20 that got our attention. In case anybody wasn't
21 listening carefully, we suddenly did.

22 Bob Kueppers?

1 MR. KUEPPERS: Thanks, Marty. I wanted to
2 pick up on -- starting with Mike Cook's comments. I
3 think Linda took it a step further. It suggests
4 then that maybe what we do need to do, or the board
5 should think about is something that is more
6 principle based, perhaps with no more than a handful
7 of absolute musts that should be communicated,
8 things like significant disagreements with
9 management, material written communications with
10 management, uncorrected misstatements. And the one
11 that's actually no in the proposed standard, which I
12 think would be important, is related to party
13 matters, related to party matters have a particular
14 risk to them that I think should require discussion.

15 Beyond that, I think the circumstances
16 will dictate what else needs to happen. On the one
17 hand, the board is trying to prescribe things
18 auditors must do. Yet in this area, you get quickly
19 into the effectiveness of how the audit committee
20 functions, the relationship with the audit committee
21 in management, the audit committee and the auditor,
22 and the auditors and management.

1 But the board only has really authority to
2 deal with one corner of that triangle. And I
3 respect that. And I don't know what the solution
4 is, but it seems to me that, and I have the pleasure
5 of working directly with the audit committees of
6 companies like General Motors, Dow Chemical, and
7 Best Buy. All of them work quite well with all
8 parties.

9 But you know, trying to look at it through
10 this single lens, I think, puts you in a very
11 difficult place to come up with a comprehensive
12 effective standard and perhaps something principles
13 based with a handful of requirements, plus what the
14 auditors responsibilities are if something, you
15 know, doesn't get done, or doesn't work would serve
16 the same purpose as the standard as -- that, you
17 know, that you've already proposed.

18 MR. BAUMAN: Thanks, Bob. Karen Hastie
19 Williams?

20 MS. WILLIAMS: Thank you. I wanted to
21 just focus for a minute on the relationship between
22 the audit committee of the board and the auditors.

1 My practice as an audit committee chair has been to
2 meet with the outside auditor, the inside auditor,
3 and the CFO before every board meeting, and go over
4 the agenda, and raise issues that I think would be
5 relevant for the board.

6 I found that to be very effective in terms
7 of bringing out any kinds of problems or
8 disagreement between the internal auditor and the
9 external auditor. And they have occurred. And it's
10 from my perspective it's something that should be
11 taken care of or should be addressed when we have
12 our pre-meeting, so that when we go into the full
13 meeting with the board, we're prepared to state what
14 the issue is and what the proposed resolution is.

15 So I think communication is really key, as
16 I think a number of our colleagues have suggested in
17 terms of addressing the relationships between the
18 outside, the inside auditors as well as the CFO.

19 MR. BAUMAN: Would you see any changes to
20 the proposal that we're making as a result of that
21 view that you're expressing?

22 MS. WILLIAMS: No, I don't think you need

1 to make changes to the proposal. I think the
2 proposal is fine the way it is. But I think there
3 should be an understanding as this goes forward that
4 there is an important dialogue. It's not just
5 simply that the outside auditor is coming in, and
6 here's what we see, but there is a dialogue between
7 the key folks on the financial side in the company,
8 as well as with the outside auditors.

9 MR. BAUMAN: Thank you very much. Larry
10 Salva?

11 MR. SALVA: Thanks, Marty. I agree with a
12 lot of the comments that have been made around the
13 table. Probably most, though, with Bob Kueppers in
14 terms of not tying too much the hands of the
15 auditors in terms of being prescriptive on what
16 needs to be communicated.

17 Because I start with the premise that Mike
18 and Denny started with earlier. Because I view it
19 the same way is that the -- I'm the asserter of the
20 information. As management, there are financial
21 statements. I take responsibility for the fair
22 presentation that they are free of material

1 misstatement. And I'm making that assertion in my
2 management report.

3 I then rely on my internal audit function
4 as part of my system of internal control to give me
5 that assurance that I can make that assertion.

6 I also rely on the external auditors to
7 give me assurance, as well as to provide that
8 independent and objective so-called stamp of
9 approval. And we've talked about this at prior SAG
10 meetings. You know, about could the auditor report
11 be improved in terms of communication, because right
12 now, it's a pass/fail test.

13 And it seems like there is a desire on the
14 part of some to get more knowledge about what goes
15 into that decision about the pass/fail test. And
16 right now, a lot of that resides with communications
17 to the audit committee, and not directly to the
18 shareholders or to the readers of the financial
19 statements about the tough decisions that might have
20 been made along the way as to whether they -- the
21 auditors decide to give a pass.

22 I think that in addition to the -- that

1 assurance or that stamp of approval that comes from
2 the auditors, that investors get a source of
3 information in terms of where to deploy their
4 capital by observing and determining in their minds
5 the openness and the transparency with which
6 management communicates to investors. And that's
7 not just through the financial statements. It's
8 through their earnings press releases, through their
9 dealings with analysts on the analyst call, and in
10 analyst meetings.

11 So I believe companies get reputations
12 about how transparent and useful their information
13 is. So that's another source.

14 So it's, as I tend to agree most with
15 Denny that the primary line of defense for the audit
16 committee or the shareholders is the quality of
17 management and the managing reporting. It's then
18 the internal audit function and then the auditors.

19 So placing it into that context, the, you
20 know, then what's most important, it's tone at the
21 top. It's absolutely tone at the top and throughout
22 the organization as to whether the organization gets

1 it, that they're responsibility, you know, is --
2 they are fiduciaries of shareholder money.

3 And that it's not their money to be used
4 as they see fit. It's they have a responsibility to
5 the owners of the business.

6 That tone at the top just to get back to
7 that point of it's so important as a communication,
8 but it's a difficult one, and certainly, I think
9 would hamper the communication if it were required
10 to be put in writing.

11 I'm not present in the audit committee
12 meeting when that is discussed. That is in an
13 executive session. And I would expect it should be
14 there. And to require it in writing basically
15 defeats that purpose. I don't see minutes of what
16 is discussed in the executive session. It's
17 occasionally -- when appropriate, I am informed of
18 what has occurred in the executive session.

19 But one way to address that factor might
20 be to consider a required communication from the
21 auditor as to how tone at the top affected their
22 risk assessment in performing their audit. Whether

1 it was considered to be a positive factor, a
2 negative factor, or a neutral factor, because at
3 least from my experience in public accounting,
4 auditors will attempt to complete a quality audit,
5 even when the tone at the top is not the greatest.
6 And it enhances risk assessment when it's there, but
7 you know, and when it's really bad, typically, the
8 decision is that you release that client from your
9 client portfolio. Or you know, if the board doesn't
10 deal with it appropriately in terms of changing the
11 tone at the top.

12 So it's a factor. It's probably one of
13 the most important factors, I think, in giving the
14 audit committee their sense of whether they're
15 dealing with good people, at least in terms of
16 having an oversight role from external auditors and
17 the audit committee itself.

18 MR. BAUMAN: Thanks, Larry. Just a couple
19 of comments and maybe one question. For the
20 benefit, Larry made a point about the importance of
21 communications by the auditor to investors as well.
22 And some comments that the current audit report,

1 which is binary pass/fail may not be doing that.
2 Larry has the benefit of being on our SAG as well,
3 that -- where we've discussed this. And we've
4 indicated that we are taking on a project in the
5 Office of the Chief Auditor to explore changes to
6 the auditor's report in that regard. So I wanted to
7 share that with others here because of the
8 importance of the point you made .

9 But one other thing I'd like to follow up
10 in the context that you're agreeing with Bob
11 Kueppers, which is an interesting point of itself
12 that I'd to follow up, but --

13 (laughter)

14 I thought Hal Schroeder made an
15 interesting point before. And a number of comments
16 have been made about the requirements could just be
17 principles based. And you don't need to a
18 checklist, but Hal had made the point that gee, we
19 have a very talented group of auditors around this
20 table, and a very experienced group of audit
21 committee members. And do we feel comfortable that
22 we could go with a principles based standard, and

1 that all of the other auditors who are not sitting
2 at this table, who may not be part of the larger
3 organizations and audit committee members who may
4 sit on just one audit committee and not have as much
5 experience, wouldn't they benefit from the more
6 detailed requirements in here? And I think that was
7 kind of your point, Hal, wasn't it earlier?

8 MR. SCHROEDER: Yes, it was the beginning
9 of a comment that I can fill in a couple more points
10 around that. Yeah.

11 MR. BAUMAN: Okay. Well, I don't know if
12 you wanted to comment on that now or we're let that
13 thought go, but I know there is that point that was
14 brought out that I think is an interesting one for
15 us to continue to explore here.

16 MR. SCHROEDER: Yeah, I had more of a
17 question along that front. And I was reminded of a
18 senior partner at the firm I worked for years ago.
19 He said, you know, we talked about our internal
20 audit approach. And he said, well, you know, we
21 don't write these audit approaches for the 10
22 percent of us who really know how to do an audit. We

1 don't even need all this written stuff. It's for
2 the 90 percent of the people that we're trying to
3 bring along.

4 And that comment came back to mind as I
5 listened to everyone's comments around here. We're
6 trying to write a set of rules for the person who
7 has the least amount of knowledge. And I'm
8 wondering if another solution here is not to go back
9 to the earlier comments about the five key
10 principles, but in the process, leave it to the
11 individual firms to develop training courses and
12 internal programs around that.

13 If you're going to be a presenter at a
14 board, or going to be talking to audit committees,
15 you have to go through this program. And we're
16 going to teach you and train you to what needs to be
17 covered, and what are the key elements.

18 The flip side is how could you do the same
19 thing for audit committee members to bring them up
20 to a higher level of standard? I mean, there are
21 all sorts of licensing requirements. If you're in
22 the stock market, why aren't there licensing

1 requirements if you're on an audit committee? And I
2 know some of that's within your purview and some of
3 it is not.

4 MR. BAUMAN: Right. Some is within and
5 some isn't. Thanks, thanks, Hal. George -- sorry,
6 Larry, did you want to respond back to my point?

7 MR. SALVA: Yeah, just to that point,
8 because I think I agree -- I think Linda said this
9 that, you know, kind of combining Bob's comment with
10 Linda's. Five key principles and maybe some short
11 list of required, absolutely required
12 communications. And the balance of it is other
13 items to consider as they're appropriate in terms of
14 -- or you know, and that will give the -- kind of
15 the best practices or memory joggers for auditors
16 that may not be in that top 10 percent.

17 MR. BAUMAN: Thanks for that
18 clarification. That was helpful. George?

19 MR. MUNOZ: Thanks, Marty. Speaking from
20 audit committee perspective, I agree with the
21 comments that Denny and Mike made and then Linda. I
22 liked very much the principles approach to this,

1 because as an audit committee chair, I am most
2 concerned to make sure is the big question for my
3 fiduciary duty is sort of who audits the auditor?
4 Well, to me, PCAOB should be auditing the auditor.
5 So the most important thing that we can hear at the
6 committee is that in fact the auditors are well
7 qualified, well, prepared to handle all of what they
8 are supposed to be handling, so that from that
9 perspective, to me, that's the biggest area of
10 interest.

11 Once the PCAOB starts getting onto the
12 agenda of the audit committee, that raises a concern
13 because of our fiduciary duty to make sure that in
14 fact we do protect shareholder interest, and that we
15 talk at the -- on the agenda items represent the
16 most important things for the company at that time.

17 And the most important things may not be
18 whether the auditors did what they're supposed to
19 do, but rather if they say they did, and financial
20 management represents that, then we want to go to
21 the more important issue, such as risks and other
22 kinds of things that the audit committee has to

1 handle.

2 And so, my biggest concern is that what
3 happens, and we saw this in 404, is that the agenda
4 started getting crowded over -- and everybody has a
5 limited time. There's only 24 hours in a day no
6 matter what -- however you look at it. And so, what
7 happens is that an audit committee that goes beyond
8 two, three hours, four hours, it gets to the point
9 of not having a good performance in what it does.

10 So my concern is with the check the box,
11 it's going to happen because I already saw this in
12 one committee meeting that we have a very effective
13 committee, extremely top notch. And here comes the
14 auditor. And he says, well, I have to communicate.
15 I have to do this.

16 And we're all sort of like you -- to the
17 point of getting frustrated and says, look, we all
18 read the material. You don't have to tell us the
19 accounting policy changes. And we want to move on
20 to more important subject matters. So my concern is
21 that you're putting the auditor in a very difficult
22 situation because "they have to, they should, they

1 required to do these things." You're putting the
2 audit committee in difficult situation because they
3 have more important subject matters to discuss. So
4 I would say I like the principles based.

5 And then, there's the unintended
6 consequences. To me, with these rules, especially
7 when you -- when we get to the other subjects and
8 you're seeing that somehow, the auditor is going to
9 rate the dual communication, somehow you're giving a
10 little bit more power, if you will, to the -- in the
11 three legged stool, you're giving a little bit more
12 say, more power to the outside auditor that maybe is
13 not required because somehow that outside auditor's
14 not speaking to certain kinds of things without
15 being requested to, that next thing you know,
16 management is playing up to them, because if you did
17 put tone of the talk, which I do think is extremely
18 important, but if you put it as a requirement, for
19 example, now you really are distracting everybody to
20 talk about that point.

21 So I worry about the balance. And I think
22 the most important thing that the PCAOB can do to

1 tell the audit committee is to say what I think
2 Harold just said, is the training of the auditors to
3 make sure the auditors are looking for the right
4 things that they are disclosing, are prepared to
5 disclose.

6 There's nothing to keep them from
7 volunteering, even if not asked, to say oh, by the
8 way, I think it's important that we mention that in
9 executive session or the like.

10 So in all the committee, and I sit on
11 three audit committees, in all of them, the subjects
12 that were discussed in this -- in these requirements
13 actually do come out without being required because
14 we get asked at one point or another, but it's up to
15 the committee at the right time to bring them up.

16 Having said that, I think the PCAOB did an
17 excellent job of probing these things. As an audit
18 committee member, I really liked reading these
19 things. I just don't want them to be requirements
20 because these have their place.

21 MR. BAUMAN: Thanks, George. Gary
22 Kubureck?

1 MR. KUBURECK: Thank you, Marty. It --
2 let's give a few thoughts, having listened for the
3 last hour or so here to other people. And share
4 some of the experiences I have with our board. I
5 think one place perhaps, you know, as you move this
6 process forward is to actually go to the end of the
7 process. And by the end of the process, I mean,
8 what two companies audit committee members need to
9 walk out of the room with? Sort of knowing or so
10 on?

11 And so in preparation for this meeting, I
12 spoke to some members of our senior management or on
13 another companies' boards of directors, and as
14 particularly in their audit committee roles.

15 And I would probably paraphrase the
16 feedback I got, some along these lines, is that the
17 most important thing they want to walk away from an
18 audit committee meeting with is confidence that
19 there's mutual trust between management and the
20 auditing firm and the audit committee, that they're
21 confident that there's a very open dialogue in that
22 there's a very good effective working relationship

1 or issues or teed up timely. Everyone has a say at
2 the table. And you work in a collaborative manner
3 to resolve the issue, or if the case may be, to
4 bring it to the audit committee for their decision
5 as the case may be.

6 But that's sort of what I would probably
7 say is the consensus of what they expect to leave an
8 audit committee with is that level of confidence
9 that there's a very, very good working process in
10 front of this meeting.

11 So you ask yourself the question, well,
12 how do you get there? And I think a lot of the
13 people who have said that today, it really comes
14 down to the people that were involved and the
15 process that tone at the top, if there's one thing
16 I'd probably pick tone at the top. But the -- and
17 again, other people here have mentioned it that the
18 audit committee has to have a feeling that there's a
19 high quality financial staff, both financial
20 management and internal audit management in their
21 company, that they're very comfortable with the
22 expertise of the audit -- the members of the

1 auditing firm assigned to the engagement, that you
2 got the right mixture of skills and experience, and
3 industry knowledge, and that you understand the
4 risks associated with the account, whatever they may
5 be, and that the audit effort is aligned around the
6 risks.

7 So going on, I would probably just say
8 right now that there is a lot of meeting content out
9 there already in audit committee communications.
10 And I think you need to be cognizant that it might
11 not be the best thing in the world to add a lot more
12 to it, and to allow some flexibility for some
13 judgments as to what needs to be brought forward or
14 not.

15 Just one thing, our meeting protocol, and
16 this is true for all of our board committees is but
17 every meeting has pre-read. And from time to time,
18 all the meeting participants are reminded by the
19 direct -- the chairs, the committees, is that you
20 approach a meeting content assuming all pre-read has
21 been read. And it's been understood by the members
22 of the committee and do no spend time just turning

1 the pages, going through it, but focus on the issues
2 that this case the audit committee truly needs to
3 understand as opposed to just being informed. You
4 can be informed in writing, but spend a limited face
5 to face time on understanding the issues.

6 And I'll give an example is -- I mean, our
7 audit committee has to approve from time to time
8 changes in the annual internal audit plan. And
9 things changes or understands that. But what they
10 do expect to understand is well, why is it changing?
11 Was it a delay just to due to scheduling? Or is it
12 a more permanent problem? Or do higher priority
13 projects emerge? You know, so why are they higher
14 priority and so on?

15 So I think the ED itself is a well written
16 document and a really good effort about trying to
17 pull a lot of stuff together that needs to be
18 updated, but I would just sort of close on sort of
19 advising on being careful about bulking up on
20 required communications at the expense of deflecting
21 and deflating audit committee focus on the critical
22 issues they need to either understand or to make a

1 decision with.

2 MR. BAUMAN: Thanks very much, Gary. Joan
3 Waggoner?

4 MS. WAGGONER: Thank you, Marty. I just
5 wanted to suggest that perhaps there is a place in
6 principle based standards for the smaller companies
7 in firms also. And if there is indeed a list of
8 recommendations that can certainly be used as a sort
9 of a catch all list for them in there.

10 One of the things that varies widely
11 amongst the smaller companies are all the
12 relationships between these various what do you call
13 it, legs to the stool.

14 And for instance, in many companies,
15 management and the board are very tight themselves.
16 And so, therefore, the management and the audit
17 committee can have a closer relationship than the
18 audit committee. And as they should in some
19 respects anyway, as do the audit committees and the
20 external auditors.

21 And so, this creates some odd behaviors,
22 which is sometimes management and the audit

1 committee have this open communication. And they
2 talk fairly well. And other times, management will
3 only respond to questions.

4 You also get that same sort of mindset in
5 the audit committee in the way they talk to the
6 external auditors, where there is not an openness
7 there and so forth and so on.

8 The other part to this, of course, is the
9 wide range of financial expertise of those
10 participants on the audit committees that you see
11 throughout varies widely. So I don't want to over
12 generalize here, because there are some audit
13 committees for smaller companies that are truly
14 excellent. And then there's others that are more
15 margin in terms of their participation in the
16 process.

17 As a result, the agenda for the meetings
18 and the communications between the auditors and the
19 audit committees needs to be very flexible to
20 reflect those very different skill sets. There are
21 -- there's oftentimes the discussion of the
22 financial statements and the estimates and the

1 policies are perhaps the one or three or four times
2 a year that the audit committee actually does a
3 deeper dive into those particular topics. And they
4 find it helpful. And so, I would encourage to allow
5 some flexibility to sort of decide what that agenda
6 should be in the interest of getting those good
7 communications moving forward. Thank you very much.

8 MR. BAUMAN: Alex Mandl?

9 MR. MANDL: Thank you, Marty. Well, a lot
10 of really important and good things have been said
11 here. In a way, it's almost difficult to add a lot
12 to that, except maybe to underscore a couple that
13 are at least particularly important from my
14 perspective.

15 The first one in the topic of, you know,
16 how I guess we call it the first line of defense. I
17 forget now who said it. You know, the role of
18 management in this triangular situation to me is a
19 little bit too much on the side.

20 I mean, at the end of the day, it is at
21 least from my point of view, it is management, the
22 financial management that the audit committee

1 depends on to really be assured and understand what
2 the issues are, get all the perspectives of new
3 accounting rules, of judgments, of all the things
4 that are being addressed and being concerned.

5 And to me, the responsibility of the audit
6 committee is to really make sure that management is
7 up to what it should be -- is covering the right
8 issues, has the right qualifications, is doing a
9 more than adequate job in those areas.

10 And if that is not working right, the
11 audit committee has to address it and do something
12 about it.

13 So I guess if I sort of have a not a
14 slight, but some additional thoughts on how this
15 three legged stool should work, I think it's just
16 important to really understand the audit committee's
17 responsibility, making sure -- ensuring that
18 financial management can really cover all those
19 points, has the experience, the skill set, the
20 capacity to present and address all those things
21 that need to be addressed.

22 That does not take away in any way from

1 the required communications between the audit
2 committee and the auditor for sure. But the first
3 starting point, the first element of this dialogue,
4 and the flow of information for the audit committee
5 I think comes from management.

6 And if that doesn't work, that needs to be
7 addressed. That was one point.

8 I know it's been partially said, I think,
9 by Larry and some others, but I think that is, at
10 least from my point of view, really, really
11 important.

12 The second point has also been made, now
13 this sort of underscored, I mean, if you sort of
14 step back and say what should be brought to the
15 audit committee? I mean, the bottom line is things
16 that are really significant, or potentially
17 significant make a difference. And there's lots of
18 things proposed that probably are not that
19 significant. And might be of interest, might be
20 important, but somebody said it, I guess it was
21 George, that you know, there is a very limited time
22 that the audit committee has available to address

1 issues, to address topics, to address new things, to
2 address ongoing concerns, to address risks and on
3 and on and on.

4 And therefore, the need and the critical
5 need for prioritizing and really only focusing on
6 those things that really will or could have a
7 significant impact on the financial reports or all
8 the things that goes with that, I think would be
9 important. And I think the chairman of a committee
10 has a particular task to make sure that indeed is
11 what happens. Thanks.

12 MR. BAUMAN: Thanks for those comments. I
13 do want to point out, because it's come up a couple
14 of times, and we'll have a further discussion on
15 this in our next topic, the proposed standard
16 clearly does recognize the fact that very important
17 communications are made by management and in the
18 areas of critical accounting estimates and
19 accounting policies and so on and so forth.

20 And in those areas, the auditor just needs
21 to evaluate whether the management's made the
22 appropriate communications to the audit committee,

1 and then only communicate further if the auditor
2 believes the communications were not sufficient.

3 But I've heard that the point was made a
4 number of times and we all agree with that, about
5 the importance of management making those
6 communications. And maybe we need to spell that out
7 a little clearer in the standard, because we
8 recognize that point. Thank you.

9 MR. BAUMAN: Lynn Turner?

10 MR. TURNER: Thanks, Marty. To start off
11 with, I just want to come back to a comment that
12 Mike made about the usefulness of the audit. And
13 make it very clear from investors perspective, we
14 don't think that the usefulness of the audit has
15 been denigrated in the last decade any whatsoever,
16 that in fact, the audit's probably more important
17 today than ever, especially given the corporate
18 scandals and the financial crisis. If we can't rely
19 on those financials, and if they aren't credible,
20 then we absolutely are making wrong investment
21 allocations and can't get the returns we need for
22 our investors. And that's critical.

1 So without a doubt, there is no question
2 that the role of auditors and the usefulness of
3 those audited financial statements are probably more
4 important today than ever before. So I don't want
5 to leave a misnomer out there that from an
6 investor's perspective, that those had declined at
7 all, Mike. Just a thought.

8 On audit committees, though, I think Hal
9 raised a superb question. There are about 12,000
10 public companies out there. You get beyond the
11 Wilshire 5000, and that leaves you with 7,000. It
12 means the vast majority of those probably aren't
13 able to attract the type of talent that you see in a
14 Mike Cook or a Denny Beresford or a Don Nicholaisen.
15 And in fact, the surveys have consistently shown
16 that that type of expertise, someone who has
17 actually done an audit and understands and knows an
18 audit are not on those boards.

19 And in fact, that extends not only to
20 those 7000, but that extends well up into the other
21 5,000.

22 So not all audit committees are created

1 equal. Not all of them have the knowledge base to
2 ask the right questions. That's not that they're
3 bad people or aren't going to get the job done or
4 whatever, it's just a matter of fact. We just don't
5 have that talent pool out there on the audit
6 committees at this point in time.

7 And in recognition of that, even the blue
8 ribbon committee report suggested -- I know it's
9 heresy to some of you, but they actually suggest a
10 checklist of questions for the audit committees
11 right in the report itself with a list of questions
12 that go beyond what's in the proposal.

13 And in fact, unfortunately, maybe should
14 have been in use because it gets into a lot of risk
15 assessment questions, and high risk areas, which
16 would have been helpful if some audit committees had
17 been asking those before we ever got into the
18 financial crisis.

19 So the use of a checklist at times is not
20 a -- necessarily a bad idea. And I think you got to
21 recognize that there is a great diversity amongst
22 the quality and expertise of the people out there

1 trying to do the job. And if we give them some
2 help, that's not necessarily a bad thing, because
3 ultimately, what we as investors want to know is it
4 that they've done their job. They've asked the
5 right questions.

6 When I go back and look through the
7 proposal, I have to come back and ask everyone
8 around the table, tell me which of those questions
9 that you think the audit committee shouldn't be
10 asking? Tell me which ones you wouldn't ask. I
11 don't think this is a comprehensive blown out list.
12 I think it's a very reasonable starting point. It
13 is a base list. And we've had a principle based
14 approach to audit committees since 1978 when the New
15 York Stock Exchange came out. And that principle
16 based approach quite often has not worked very well.

17 So creating at least some base floor that
18 will give us as investors some idea that the audit
19 committees are really getting the job done, I think,
20 is good. I would love to in a way, get away from
21 this and just have audit committees tell us in their
22 audit committee report exactly what it is that they

1 have done, and bring transparency and accountability
2 that way, which I think would actually even be a
3 much better approach.

4 Unfortunately, audit committees who can do
5 that today have decided not to do it. And instead,
6 give us a very boilerplate report that quite frankly
7 doesn't really tell us anything about all these
8 areas that I've just heard need to be discussed.
9 You will almost never, in fact, I might say amongst
10 the 12,000, you won't find an audit committee report
11 that tells us about any of those things that are so
12 critical to us, that people just said, we need to
13 have them asking.

14 So the information isn't there to hold the
15 audit committee accountable. And I think a lot of
16 the concern around the table is let's not create
17 something that creates that accountability, I
18 actually think it's an excellent thing. And I think
19 what the PCAOB is doing here is good. There was a
20 question about the federal laws and the role of
21 directors. I think some of the state laws we've seen
22 the shortcomings. And so, I know it bothers

1 attorneys tremendously, but we are seeing the
2 federalization of corporate governance here as the
3 state laws, especially in Delaware, have failed
4 miserably. And as a result, we're now seeing say on
5 pay and proxy access, etcetera.

6 But the courts have ruled that as far as
7 the fiduciary goes in this role, that having a full
8 heart, wanting to do the right thing, but to use the
9 courts were full heart, but empty mind doesn't work.

10 And in the context of the empty mind, if
11 you haven't asked those questions, the very basic
12 questions that the PCAOB is putting out here, I
13 don't know how you could respond to the court that
14 you didn't ask those questions. And if you are
15 asking those questions, how can this stifle the
16 conversation? I don't understand it.

17 Back to the issue of the tone at the top.
18 I think there's been some good points raised about
19 it. Certainly, no one likes to grade another person
20 and put it down in writing. It's just human
21 behavior. There's something about that, she just
22 don't like the feeling of, especially if you're

1 rating the person that's going to be writing your
2 check. There's just something that makes you
3 nervous about that.

4 But I will also add another point that I
5 think raised the question about how far you want to
6 get into that, even though it's a good question.
7 And that is if we look at the track record of the
8 auditors, in actually assessing the tone at the top.
9 They don't have a really good track record.

10 Going back to the mid 1980s, about '85
11 when we reset the auditing standards, we actually
12 required that auditors assess in essence that it's
13 tone at the top. Yet you can look at one situation
14 after another that have popped up where there's been
15 problems. And the auditors thought they were okay
16 with the management team, and rode with them. And
17 certainly didn't tell the audit committee that this
18 is a disaster. And we had a blow out.

19 So I think it could almost be misleading,
20 given their historical performance and track record
21 to be sitting there saying let's have the auditor
22 tell us about the tone at the top, and place too

1 much reliance on that. The track record just
2 doesn't support that approach at all. Thank you.

3 MR. BAUMAN: Thank you, Lynn. Mary
4 Morris? Is there -- yeah.

5 MS. MORRIS: Thank you, Marty. I guess
6 there's a couple points I just wanted to make. I
7 appreciate all the comments this morning. I think
8 they're very thoughtful. And I think that as an
9 investor, we feel that audit committees have an
10 opportunity to actually embrace some of these ideas,
11 sort of to articulate their perspectives. And what
12 Lynn was explaining, I think they can distinguish
13 themselves in well throughout the standard in
14 providing that information to investors.

15 There's a couple of key terms that I think
16 that people have brought out today, that I just
17 wrote down and I thought was really important, you
18 know, good governance, of course, you know, that's
19 really important. The articulation, the
20 transparency, the fiduciary responsibility. So as
21 investors, you know, we look to the audit committee.
22 That's their role to us. That is so important to us

1 to be able to provide that insight to us.

2 The articulation, I think the SEC has, you
3 know, proxy plumbing, the enhanced disclosure, I
4 think all of that has helped investors.

5 I think one point that, you know, it
6 doesn't relate directly to the standard, but I think
7 audit committees can understand this is and audit
8 committee members and chairs, the effectiveness of
9 audit committees. I think that question's asked a
10 lot throughout your evaluations, through your
11 perspectives. And I think there is also the point
12 brought up that not all audit committees are equal
13 and not -- the experience is not there. And as an
14 investor, I see that when I go out and I speak to
15 audit committees.

16 So I think that the standard would help
17 bring these individuals up or at least be able to
18 bring that thought process to them.

19 I think that -- I was looking at -- not to
20 throw out names, but Tapestry Networks and E and Y,
21 I think they were talking about the evaluation and
22 the effectiveness of audit committees. And I think

1 that audit committees said to themselves it's
2 important to not have any surprises, to you know, of
3 course, have their evaluation, to have that full
4 communication with their auditors, the relationship
5 building.

6 And I think that this one point I really
7 wanted to stress was that the standard provides sort
8 of teeth. It really does provide the audit
9 committee the opportunity to sort of distinguish
10 themselves and to say, you know, for investors, you
11 know, this is how you are looking and you're
12 searching for alpha. And you want to invest in our
13 company as a capital provider.

14 So I think it does provide confidence to
15 investors and from the audit committee's
16 perspective. And I think that for our search of
17 alpha, there are value. We only have -- all of us
18 have limited capital. It's our responsibility to
19 our beneficiaries. But I think this is a way that
20 audit committees can sort of embrace this new
21 standard and distinguish themselves. So thank you.

22 MR. BAUMAN: Thanks. I just wanted to --

1 so many comments had been made regarding tone at the
2 top as being -- and the importance of that feature.

3 Some discussion has been made regarding
4 that -- how that should be discussed with the audit
5 committee. And I think it's important point that
6 we'll give some further thought to.

7 But I wanted to bring out the fact that
8 the existing PCAOB auditing standards do require the
9 auditor as part of the audit of an organization and
10 their evaluation of the internal controls to assess
11 the tone at the top as part of the control
12 environment in the organization. So auditors are
13 doing that, at least they should be doing that as
14 part of PCAOB standards. And the issue here is now
15 it maybe come up one -- a couple of times, but some
16 of the members here at the table feel like that's
17 one of the most important things that I'd like to
18 hear about is that assessment.

19 Don Nicolaisen?

20 MR. NICOLAISEN: Thank you. Awful lot of
21 comments, so I'm not -- I'm going to try not to
22 repeat anything, but I do commend the board. I

1 think it's appropriate to -- with the importance of
2 the auditor's relationship with the audit committee,
3 that there be a clear description of what the
4 expectations are of the auditor in those
5 communications.

6 And having building blocks, those things
7 that are essential requirements that we all would
8 concede should be communicated is an appropriate
9 approach. And I think the listing of items is not
10 that long or that complicated that it would cause me
11 a particular concern.

12 I suspect that a lot of that, because it's
13 there ends up being check the box and also from my
14 perspective, that's not all that bad if the box is
15 checked properly, and the work has been done, and
16 there's an element of professionalism that the
17 auditor brought to the work and says to the audit
18 committee we've looked at these areas. These are
19 the ones you don't need to work on. Now let's talk
20 about those things that are really, we think, you
21 need to put your focus on those things that are
22 critical to you.

1 At the tone of the top, you've talked
2 about I tend to get at that another way with
3 auditors. I also ask them do your staff like to be
4 on this job? Is this a job within the office that
5 people are competitively trying to be the auditor
6 of? Or is it one where you're reluctantly dragging
7 people to the table? And that usually prompts
8 either the issues that are really there and
9 underlying what needs to be dealt with in
10 relationships with management. Or it's a
11 confirmation that we actually do have the best team.

12 The element of no surprises is certainly
13 what I look for in an audit relationship. Mary
14 Hartman Morris just mentioned that. I think it's
15 fully appropriate from both sides. I don't want to
16 surprise the auditor. I don't think the auditor
17 ought to be surprising us.

18 And the auditor ought to expect that if
19 there's an article in the newspaper about an
20 industry similar to the one that I'm the audit
21 committee chair of, that identifies a problem,
22 somewhere within that industry, or components of

1 that industry, that I'd want to talk about do we
2 have that concern here? Is it something that we
3 ought to be looking at? Are those issues that
4 should be raised.

5 And also, where there restatements in the
6 audit firm is involved in those restatements? Are
7 there any indications that there are problems that
8 could also migrate to our account. And in a sense,
9 what I like to do in that way is to test the
10 professionalism and the communication skills of the
11 auditor.

12 The concept that is in here of two-way
13 communication I agree with. I think it's sound. I'm
14 not sure it fits all that neatly within a document
15 that's for the auditors.

16 And so, there's probably other ways that
17 you could describe it. For instance, you could
18 describe to the auditor in a standard what to do if
19 the audit committee is not communicating with them.

20 And I think that the same three or different things
21 that you've described here, and I think there our --
22 they would be signals, red flags that you have a

1 problem, but I think it may be difficult to try and
2 put in an audit committee responsibility chart or
3 checklist in the form of a standard written for the
4 auditors themselves.

5 I think you can imply certain things. Out
6 of that, I think you can cause action to occur. I
7 also think notwithstanding what some do think is a
8 lack of guidance on best practices for audit
9 committees. I think there's a ton of material out
10 there almost every account firm, every consulting
11 and operation, endless numbers of conferences that
12 address this issue of what audit committees ought to
13 be paying attention to.

14 And I think there are some very good
15 practices and that if there's a perceived need from
16 the audit community that the audit committees are
17 not living up to their expectations, that's maybe
18 another problem, but it may be that it should be
19 dealt with in a way apart from the communication to
20 the auditor.

21 So again, I think this is good work. I
22 think you've really drawn out a lot of the thing

1 that do need to be address that are that we all
2 think about. Having guidance is absolutely
3 essential. That's your role. And I think you've
4 done a good job on what you've produced at this
5 point.

6 MR. BAUMAN: Don, thanks for those
7 comments. And some of the other topics that, Don,
8 you touched on two-way communications and others, we
9 will have further sessions today to explore some of
10 those concepts more in-depth.

11 We have I think about four cards up right
12 now on this particular topic still on what are the
13 right communications that audit committees want and
14 what are the communications that investors want
15 committee members to have? So I think I have Denny
16 Beresford, Bob Dohrer, Kiko Harvey, and Hall
17 Schroeder and--

18 FEMALE SPEAKER: Arnie Hanish.

19 MR. BAUMAN: And Arnie Hanish. Five
20 cards. And then we'll take a break, if that's all
21 right. So Denny?

22 MR. BERESFORD: Thanks, Marty. Just a

1 suggestion. If the PCAOB staff has not already done
2 this, I'd suggest that you actually ask some
3 accounting firms to show you the communications that
4 they actually have with some audit committees, both
5 for some larger corporations and some smaller
6 corporation -- well, some smaller accounting firms.
7 The -- as indicated in my earlier comments, my
8 concern is that we just get overwhelmed as audit
9 committee members. And particularly with written
10 communications, I'm all for written communications,
11 but the problem is if you think about it, we get
12 four letters of representations each year, most of
13 which frankly could take almost the entire amount of
14 time that we devote to audit committees. I'm
15 exaggerating just a little bit, but those things get
16 very long. Very little has changed. The question
17 is, is that a very effective use of our time as
18 audit committee members to read all of those things?

19 We get the annual engagement letter, where
20 audit committee -- where audit firms sometimes try
21 to sneak in CYA type paragraphs from time to time,
22 Bob.

1 (laughter)

2 Not looking at you. You just happened to
3 be the auditor for three of my four boards.

4 MR. KUEPPERS: That's silly. That's just
5 -- I can't imagine that.

6 MALE SPEAKER: That's simply baloney. I
7 can't --

8 MR. BERESFORD: But again, a whole lot of
9 boilerplate, very little changes from year to year.
10 We get typically a quarterly listing of all of the,
11 I think it's SAS 61 and 114 I believe it is, if I'm
12 not mistaken type requirements, much of which has
13 not changed from quarter to quarter. We're -- it's
14 usually exception type reporting.

15 Again, we read it all. We're not sure
16 exactly what it is that we're supposed to be
17 focusing on. Very little is being called to our
18 attention. So the totality is that we have a lot of
19 information to "read" or at least we think we're
20 supposed to read it all, but in the final analysis,
21 there probably are maybe two or three little things
22 buried and maybe, I mean, not exaggerating, maybe 50

1 or 60 pieces of paper that might be of importance to
2 us.

3 Now hopefully, if we've done a good --
4 have done a good job with -- as audit committee
5 members, and the engagement partner, the audit
6 committee chairs and engagement partners, we've had
7 them focus, at least we've had them yellow in them
8 or something like that. And that they've only
9 talked to us at the meetings about the things that
10 are important.

11 But this is part of the problem. And this
12 is part of the checklist mentality that there are so
13 many of these required things that just kind of bury
14 the time for effective communication.

15 So I really urge you to have the staff, if
16 you haven't already done it, just look to see how
17 this stuff plays out in practice now, and consider
18 the fact that you're going to add to it another half
19 dozen or 8 or 10 -- I don't know what it is exactly,
20 but how these things would just be more of the same,
21 and just add to the fact that we just have this
22 amount of paperwork that doesn't really communicate

1 -- doesn't really add to communicate -- effective
2 communications. It just is paper that's not
3 necessarily working.

4 And as I said -- as several people have
5 said already, all audit committees are not created
6 effectively are the same, I should say. And I'm
7 convinced there a lot of people -- committees out
8 there where the engagement partner just gets up and
9 reads to the audit committee all of those detailed
10 things from SAS 114 each quarter. And the poor
11 audit committee members just sit there and take it.
12 And that's it.

13 MR. BAUMAN: Thanks.

14 MR. BERESFORD: End of sermon.

15 (laughter)

16 MR. BAUMAN: Thanks, Denny. A couple
17 things. One, your point is certainly a good one
18 about getting out there and looking at things. And
19 we have looked at audit committee reports. And in
20 some cases, many of us or some of us here have been
21 involved in them in very large companies. And to
22 some extent, some of the additional requirements

1 that were in here in our view were a reflection of
2 what we saw some of the better audit committee
3 reports, quite frankly, looking like, but just
4 weren't in today's requirements. So in any event,
5 but your point of making sure we're looking to see
6 what's happening is a very important one.

7 Bob, you'll have the first couple of
8 minutes after the break to rebut that, all right?

9 (laughter)

10 Arnie Hanish?

11 MR. HANISH: Thank you, Marty. I'll try
12 not to be too redundant. But again, thank you. I
13 think that over the blast -- having been in a
14 financial management role for -- and interfacing
15 with an audit committees for over almost 25 years, I
16 think communications are clearly much improved from
17 what they were 20, 25 years ago.

18 I think that the check the box mentality
19 that I think many of us have talked about, I think
20 Denny I think articulated it pretty well there right
21 there at the end a few minutes ago. I think that
22 what you don't want is to have all of that litany of

1 activity in there, and then just going throwing it
2 page by page or line by line.

3 I think that many of the suggestions that
4 are in here are probably very positive. I think
5 that I agree with Mike Cook in the sense that there
6 needs to be a broader perspective on financial
7 reporting. And specifically, maybe something around
8 press releases and other business communications.

9 I think that -- I actually value the input
10 that an auditor provides me as a member of financial
11 management with regard to the -- their assessment of
12 our communication in press releases in particular.
13 And I over the years have found a variety of
14 approaches taken by auditors, some better and some
15 worse as to the amount of input they provide.

16 And I think that in an audit committee,
17 remember, it would be helpful to get the auditors'
18 assessment as to the -- not necessarily the
19 effectiveness, but you know, whether or not those
20 communications, particularly the press releases, are
21 in their view any way, shape, or form misleading,
22 because I think in the end, some of those press

1 releases can come back to haunt you as a company.

2 And I think it's good to have an independent view.

3 Now they're not going to audit those press
4 releases. I want to be careful, because I don't
5 want to necessarily create situation where there's
6 more opportunity for fees, but I think that the
7 opportunity here for insight as part of the normal
8 process that they go through, not just to tick and
9 tie numbers, but to give me insights as to their --
10 and give the audit committee insight into the way
11 things are being communicated and articulated are
12 very important. Woops, are very important.

13 I also agree that I know we'll be
14 discussing two-way communications later, but it's
15 very important. I don't necessarily agree that they
16 should provide an assessment of effectiveness, but I
17 think the important point is to have that dialogue,
18 and also make sure that the audit committee members
19 are versed -- sufficiently versed to answer an ask
20 the right questions as part of a two way dialogue.

21 The world of accounting and financial
22 reporting over the last 25 years has become so much

1 more complex than it was when I started in a
2 financial reporting role, and had been an auditor
3 for a number of years.

4 But many audit committee members, many,
5 many, many audit committee members do not have the
6 depth of background to even know what questions to
7 ask in an effective way from a communications
8 standpoint.

9 And it's a rare situation in my view,
10 where you get an audit committee chair that has the
11 depth, the background, to even raise those
12 appropriate questions with the auditor to the extent
13 that they need to.

14 I've seen variety of audit committee
15 chairs over the years. And most don't have the
16 effective background even, many do, but most do not
17 to even ask and engage in effective communication on
18 the topics that are so critical today and from an
19 investor perspective, I would want my audit
20 committee chairs, as well as those individuals
21 designated as financial experts to be truly
22 financial experts and understand the complexities

1 that we at management are having to deal with today
2 in order to perform their fiduciary role
3 responsibly.

4 And I just don't see that consistently
5 across the board. And I'm not sure that that is
6 part of what we're trying to do here. And I don't
7 know how we get that into the spirit, but it's
8 certainly not part of the standard.

9 I think that the idea that the auditors
10 would comment on the quality of financial
11 management, and I think that's been discussed by
12 several individuals, is really critical.

13 I would welcome as a member of financial
14 management an in-depth review of--by the auditors
15 with my audit committee of the quality not only of
16 myself, but also of the staff and the depth of my
17 staff.

18 And I don't see that happened well and
19 sufficiently. I don't see it happen often enough.
20 And it's not just a matter of a discussion around
21 well, how many people do you have certified? Or how
22 many internal auditors are CIA's? It's really a

1 question of having an appropriate dialogue around
2 their experience level and the depth of knowledge,
3 because as, again, in the fiduciary responsibility
4 as part of this three legged stool, triangle, they
5 clearly do have responsibility to provide an
6 independent assessment. And as an audit committee
7 member, I would hope that I would be getting that
8 for my auditors as to the true depth of knowledge
9 and capabilities and experiences, because you could
10 have an internal audit group that has a whole host
11 of individuals that are CPA's or CIA's that very few
12 of whom ever spent a day of their life in public
13 accounting and understand truly what it is to
14 perform an audit.

15 Many large companies use internal audit as
16 a rotational, educational activity to enhance the
17 skills. But how many of those people have really
18 been educated by CPA firms in the precepts of
19 performing an audit and what to do look for?

20 And, again, going back to even my own
21 staff, or staffs of people that are working under
22 controllers, how many of those individuals have

1 really deep knowledge, 8, 10, 12 years of public
2 accounting experience? There's a whole host --
3 world of difference between somebody who passed the
4 CPA exam, only had a couple years of public
5 accounting experience versus someone who truly does
6 have the depth.

7 And I just don't see those questions being
8 asked of the auditors. And I don't see the auditors
9 really becoming -- coming forward with those types
10 of those comments.

11 The other aspect is really more around,
12 and I think it's a responsibility of management, but
13 if management doesn't do it, I think the auditor has
14 to step in. And that's the aspect of education of
15 the audit committee members. If management doesn't
16 do it adequately, then the auditors have a
17 responsibility to step in and educate the audit
18 committee.

19 Again, it gets back to the earlier comment
20 that I was making around in order to have an
21 effective two way dialogue, you really do need to
22 truly have audit committee members that understand

1 what questions that need to be asked. So thanks for
2 the opportunity, Marty.

3 MR. BAUMAN: Thanks, Arnie. Bob Dohrer?

4 MR. DOHRER: Well, thank you, Marty. And
5 I'll -- recognizing the time, I'll keep my comments
6 brief, but just to pick up perhaps from the
7 perspective and an auditor a little bit of what
8 Denny and Lynn and others have referred to, and that
9 is the over communication, if you will, and just
10 caution the board. I've heard some discussion
11 around in lieu of requirements, perhaps a more
12 principles based approach would be appropriate as to
13 what information should be communicated in the
14 proposed standard.

15 The caution I guess I have there is
16 knowing the animal that we auditors are, when
17 there's a principle that's indicated, normally,
18 there's a hue and a cry for some sort of guidance to
19 go along with how you implement that principle.
20 Often, that results in a rather lengthy list of
21 items that you would consider communicating. And
22 oftentimes, the way the auditor may react to that is

1 that becomes the checklist, because particularly
2 with this subject matter, the auditor would
3 certainly be very concerned with not communicating
4 something that perhaps in hindsight, you know, could
5 have been communicated. And they simply made an
6 evaluation and a consideration that they didn't need
7 to communicate it.

8 So I think that list of considers
9 potentially turns into the checklist, which results
10 in the expansive written type of stuff and bearing
11 the real important matters that need to be surfaced.

12 So I guess in summary like -- we've heard
13 tone at the top, quality of financial management if
14 the consensus is that that's important information
15 that should be communicated in substantially all
16 cases, then let's call it that, and make it a
17 requirement but be very careful about how we use
18 principles, unless the principle is that the auditor
19 should be prepared to communicate anything else that
20 the audit committee may ask.

21 But when we start down the list of what
22 that might be, in essence, we've turned it into a

1 checklist and a requirement that will lead to
2 boilerplate and over communication.

3 MR. BAUMAN: Thanks, Bob. Kiko Harvey?

4 MS. HARVEY: Thank you for the opportunity
5 to join in this roundtable. I think that clearly,
6 this has been a daunting task for the PCAOB to write
7 this, because in a lot of ways, you're trying to
8 regulate a relationship. And I think that's a very
9 difficult thing to do to get the right information
10 in the documents. And so, I commend you for your
11 efforts.

12 I have heard a lot about tone at the top.
13 I want to remind people, I think of course that's an
14 important discussion for audit committee members to
15 be concerned about. From an internal auditor's
16 perspective, we probably are in a -- in one of the
17 best roles, along with the external auditors, to
18 provide our views on tone at the top being that
19 we're in most of the management meetings on a day to
20 day basis. We see the communications that go out at
21 the company level. And so basically, we see it all.

22 And so, you know, if you're not reaching

1 out to your internal audit teams to ask those
2 questions, and you're relying solely on the external
3 audit group, you're probably just getting part of
4 the picture. So you know, an important thing to
5 mention.

6 Regarding the quality of financial
7 management, I agree that that's something that the
8 audit committees should be very concerned about. I
9 think that all in all, for most of -- large public
10 accounting or most large public companies, the
11 quality management is very good. I also want to,
12 you know, open the dialogue for the quality of the
13 internal audit team. I think it's very important
14 that that is also considered. And I think that the
15 external auditors are probably in a unique position
16 to be able to provide even more insight into whether
17 the internal audit team is really doing their job
18 correctly, whether they have sufficiency of
19 resources, whether they're actually focused in the
20 right areas.

21 And so, I think I would welcome that kind
22 of feedback from the external audit teams as well.

1 And I know that we do receive it in the company's
2 that I've worked for.

3 So I'll save my comments for later on. I
4 know we're up against a break, but thought I'd share
5 that with you.

6 MR. BAUMAN: Appreciate your comments. Hal
7 Schroeder?

8 MR. SCHROEDER: Just one quick follow on.
9 Marty, you had mentioned that in your current
10 standards, you require an assessment of tone at the
11 top. And I have to tell you, I'm in the investment
12 world. And we go both long and short stocks. And
13 some of our best short ideas have been our own
14 assessment of tone at the top. So in a perverse
15 way, I'm glad things aren't working so well in terms
16 of assessment.

17 (laughter)

18 I say that half jokingly, but truly, some
19 of our best ideas are looking at the interaction
20 between the CEO and the CFO. And I have to question
21 if I can see this, and I only have maybe -- meet
22 with a CEO or a CFO four or five times a year, see

1 him at a couple conferences, if I can see it, how do
2 the auditors and how do the audit committee not see
3 it? So something really needs to be addressed here.
4 And we've said it over and over again, but that was
5 part of a -- the quickest way to get to the point
6 that I'm making money off of people not doing their
7 jobs in terms of assessing tone at the top. So
8 maybe I'll retire after this but --

9 MR. BAUMAN: Well, I have to break the
10 rules here. There was -- those were the cards that
11 were up. And I saw one card came up late, but to
12 show you the flexibility of the organization, Sam?

13 MR. RANZILLA: Well, I appreciate that,
14 Marty. And I will be very brief and not discuss any
15 topic we're going to discuss later. As I sat
16 through this, and as I prepared for this, I thought
17 this first section was a place as an auditor it'd be
18 really important for me to hear what others want.

19 And so, as an auditor, I think that -- I
20 can stress that the relationship between the auditor
21 and the audit committee is a significant
22 relationship and plays into our ability as auditors

1 to appropriately dispense of our professional
2 responsibilities.

3 And as a result of the importance of that
4 relationship, I think as an auditor, I have my own
5 views about, you know, maybe someday I'll be an
6 audit committee, and what I think is important. But
7 I think at the end of the day, auditors want to
8 provide information to audit committees that will
9 help them dispense their responsibilities.

10 And I don't know where that is, other than
11 my own views, but I do think there is a pretty good
12 rhythm today between audit committees and auditors
13 with respect to communication. Could that be
14 enhanced? Probably. I think your standards got to
15 leave some flexibility with respect to the various
16 requirements.

17 With respect to comments around writing
18 standards to the lowest common denominator, I mean I
19 don't think I can emphasize enough how you cannot
20 write standards to the lowest common denominator and
21 expect a high functioning financial reporting
22 regime. It just -- it simply does not work to write

1 standards--it does quite frankly, it doesn't in most
2 things in life, make sense to go to the lowest
3 common denominator.

4 Ask a teacher if you're teaching to the
5 lowest common denominator, what that does to the
6 overall class? And I'm not a teacher nor an audit
7 committee member, but that hasn't stopped me yet.

8 The last thing that I will say is, and
9 something to consider is considering the varied
10 comments around too much, too little. Once you
11 adopt a final standard, whatever way you go, maybe
12 this would be an interesting topic for some field
13 testing post implementation to see whether or not
14 you've hit it right.

15 I mean, obviously, you got to give it a
16 couple of years to see, but maybe this would be a
17 place where a post implementation would make a lot
18 of sense.

19 MR. BAUMAN: Thanks. Thanks, Sam. And I
20 want to thank everybody for the value of these
21 comments during this very first session. Very, very
22 thoughtful input and very valuable input for us as

1 we go back and consider the standard.

2 We'll take a 15 minute break till about,
3 according to my watch, five minutes to 11:00. And
4 let's try to back around then. Thank you very much.

5 [break]

6 MS. RAND: All right, welcome back. Marty
7 asked that I start this session, which I planned to
8 moderate this session anyway. So that works out
9 perfectly.

10 The next topic is accounting policies,
11 practices, and estimates. And this is an area where
12 we had also received significant comments from
13 commenters.

14 And your briefing paper includes an
15 appendix, appendix A, listing paragraphs 12 and 13
16 from the proposed standard. And those two
17 paragraphs have several requirements regarding
18 accounting policies, practices, and estimates.

19 So that's our focus of the discussion
20 right now. Steve Harris, PCAOB board member will
21 provide some introductory remarks. And then, I'll
22 walk through the questions.

1 MR. HARRIS: Well, thank you, Jennifer.
2 And I'll be very brief. As you point out, for the
3 next 30 minutes, we'd like to hear the group's views
4 on what you think should be the specific
5 responsibility of the auditors to provide timely
6 observations to the audit committee about accounting
7 policies, practices, and estimates. And we're
8 particularly pleased that leading the discussion
9 will be Mike Cook and Hal Schroeder. While the
10 proposed standard retains and clarifies many of the
11 existing requirements in the current standard, it
12 also updates the standard by incorporating existing
13 SEC communication requirements.

14 Several commentators have stated that the
15 proposed required communications, and we've heard it
16 this morning, strike the right balance and include
17 important critical issues on which audit committees
18 need to focus. Others, however, and we've heard
19 that this morning as well, feel that the proposed
20 standard may be too onerous for audit committees
21 with the volume of required communications,
22 potentially taking time away from more important

1 issues.

2 There were also concerns expressed that
3 the requirements overlap with management's
4 communication responsibilities.

5 During the discussion today, we are
6 seeking your input and as specifically as possible
7 on whether the board should modify the proposed
8 requirements. And in that regard, we are interested
9 in understanding which additional matters the
10 standards should require, the auditor to communicate
11 if any, or perhaps which proposed or currently
12 required communications should be eliminated.

13 So Jennifer, thank you very much. And I
14 understand you'll start the session off with a
15 couple of specific questions.

16 MS. RAND: Thank you, Steve. We have --
17 we had three questions in the briefing papers. So
18 I'll put those up on this slide. The first one was
19 how could the communication requirements be modified
20 so that the auditor and the audit committee focus on
21 the most significant accounting issues and
22 estimates? The next one, how could the proposed

1 standard clarify the types of consultations that
2 should be communicated to the audit committee? And
3 then finally, are there matters in addition to those
4 in appendix A, which are paragraphs 12 and 13 of the
5 standard that the proposed standard should require
6 auditors to communicate. And if so, what are those
7 matters? And why should they be required?

8 If there are any requirements that should
9 be omitted, why -- what are those and why should be
10 omitted?

11 So we're not flipping back in between
12 these two slides as we're going through the
13 discussion, we have a discussion summary slide,
14 highlighting those three points on here.

15 We have asked a couple of people, Mike
16 Cook and Hal Schroeder to provide some of their
17 thoughts on these questions to help open up the
18 discussion. Before I turn it over to Mike, I would
19 like as Marty had pointed out in the earlier
20 session, many had commented on that perhaps some of
21 their requirements in the proposed standard were too
22 onerous. Most of those comments like that were

1 directed at these specific requirements. And also,
2 commenters indicated that management often has
3 communicating these -- many of these points
4 regarding accounting policies, practices, and
5 estimates. So why -- it doesn't make sense for the
6 auditor to duplicate all of that and waste the audit
7 committee's time.

8 When we had drafted this standard, we had
9 -- we recognized, as the board's current standard
10 does, that management often does communicate these
11 type of matters to the audit committee. And we had
12 a -- we think it's a fix we can make through a
13 drafting point, but many commenters seem to not pick
14 up what we had intended, which was for the auditor
15 to evaluate what management has communicated. And
16 if the auditor believes management is appropriately
17 communicated many of these items, they wouldn't need
18 to repeat it. It's only in those instances if the
19 auditor believes management hasn't done an adequate
20 job of communicating some of these items.

21 So just wanted to point that out. Many
22 commenters expressed that concern. And we are aware

1 of that. So with that said, I'd like to open the
2 discussion and first turn to Mike Cook and then Hal
3 Schroeder to provide some -- your thoughts on these
4 questions.

5 MR. COOK: Jennifer, I'll try not to
6 repeat some of the things I said earlier, because
7 some of the trains of thought are -- consist -- and
8 I always remember one of my partners said, if you
9 can't be right, be consistent. So and probably not
10 right on some of these topics, but I still have the
11 same point of view.

12 A couple of the key questions about, you
13 know, the issues of what could we add, are present
14 requirements sufficient, and so on, I have a view
15 that the present requirements are in fact
16 sufficient. It troubles me a bit that we are adding
17 as we describe on page 3, these newer requirements
18 for the auditor if management hasn't done its
19 communication job correctly. That doesn't sit right
20 with me. And somebody said, we've got the emphasis
21 on the wrong syllable here.

22 I mean, we are telling management what

1 management needs to be communicating, even though we
2 have no authority to dictate communication practices
3 to management, but we're doing that because we're
4 saying if you don't do it, the auditors are going to
5 be required to do it. And we write rules for
6 auditors, therefore, we can write the rules that say
7 if these things haven't been done, the auditor will
8 do them.

9 I don't think that's the right thrust.
10 And I appreciate what Marty said earlier. And I
11 would just say, please, do give careful attention to
12 this question about management's communication
13 responsibilities and not indirectly by writing rules
14 for auditors. If management fails, write the
15 communication rules for management through this type
16 of communication.

17 If you think that needs to be done, there
18 ought to be a forum to do it, but not back dooring
19 it through the audit communication process in my
20 judgment is not the right way to go about it.

21 Likewise, I think there are some things
22 that could be done with the focus on the audit. And

1 I continue to believe we need a broader focus on
2 financial reporting. And Lynn and I will debate
3 some parts of that later.

4 But I do think we need that broader view.
5 And but focusing on the audit, there is one thing I
6 would like to recommend be given consideration
7 because Linda and I and to some extent Denny and
8 others who were on the committee for the improvement
9 and financial reporting labored long and hard and
10 agonized over the issue of a framework for auditors
11 to use and management to use. Management to use in
12 the first instance to make judgments to make
13 estimates. And auditors to evaluate the estimates
14 and judgments that have been made by management in
15 preparing the financial statements I think that
16 would be a superb addition to this document, which
17 would be inquiry or a dialogue between the audit
18 committee and the audit firm about how the audit
19 firm.

20 It could be the firm as a whole. It could
21 be specific to the engagement or to a particular
22 accounting or auditing matter. How does the firm

1 make the judgments? What is the framework for the
2 judgments that are made on the critical issues in
3 the financial statements?

4 Seems to me that fits here, and would be a
5 nice addition to this dialogue that is not -- it's
6 probably suggested in a number of places, but it's
7 not addressed directly.

8 Present requirements in most areas, I
9 think, are quite sufficient. I -- this doesn't
10 pertain to estimates and judgments, but I would hope
11 maybe I realize some of the things we have are here
12 because of the requirements of Sarbanes Oxley.
13 They're part of the law. Therefore, the audit
14 committee gets them whether the audit committee
15 wants them or not. But it would be refreshing if we
16 could find a way to in consultation and discussion
17 with audit committees, to take away some of the
18 things we don't want, don't need, and don't know
19 what to do with when we get it. And Denny's
20 reference to the representation letters, if we could
21 get a one paragraph summary of the things that are
22 new and different in some of these documents, rather

1 than receiving full text documents. And maybe we
2 have that flexibility and we're not using it, but we
3 sure get a lot of things that I asked, and I think I
4 have a reasonable basis for knowing what to expect,
5 I asked why am I getting this? And the answer is
6 because I'm required to give it to you. And you're
7 required to take it if I'm required to give it to
8 you, even if you don't want it and don't know what
9 to do with it.

10 To the point that Hal made earlier about
11 the notion about audit committees, there are audit
12 committee chairmen who know in addition to what to
13 emphasize to what to ignore. But there are a lot of
14 people who don't have that same training and
15 background, who when they get a 40 page
16 representation letter four times a year, presume
17 that there must be something there that they really
18 need to know something about and then are encumbered
19 with the burden of reading it, and trying to
20 understand it.

21 And it would be so much better if those
22 communications could be streamlined, focused on

1 things that are new and different, which goes to the
2 point of how do you focus on the things that are
3 most important? Don't burden people with things
4 that are not most important. Or do it in such a way
5 that it is highly efficient. And best practices can
6 hopefully convey some of that information.

7 So I'd like to see us get rid of some of
8 the existing practices. I would very much like to
9 see us focus on the judgment framework being a part
10 of the communication process between the audit
11 committee and the audit firm, because it is related
12 to the audit and the process that has followed in
13 doing the audit.

14 With respect to this question about
15 consultation, I think it's a very good thing. I
16 think the idea of if there are important issues that
17 the firm has engaged others, whether they're
18 industry specialists, senior partners in the firm,
19 or the engagement team has brought others to bear on
20 reaching important judgments and important
21 conclusions, I think that's a very valid thing for
22 an audit committee to have an interest in the

1 dialogue. Trying to define it, and defining it in
2 some ways with references to things like informal
3 conversations, I really don't think, particularly if
4 the notion might evolve, that it would have to be a
5 written communication subject to 14 review process,
6 I really don't think I want to be on the receiving
7 end of a communication when the lead partner decides
8 to call somebody that they happen to know in another
9 office to get an insight on a industry issue or
10 something of that kind.

11 I would again urge that we write the
12 principle of what we're trying to achieve. We're
13 trying to achieve a high level, better level of
14 knowledge, transparency at the audit committee on
15 important issues that the firm has wrestled with.

16 And presumably, management has wrestled
17 with as well. Right the principle and let the firm
18 decide what it is that should be communicated to the
19 audit committee that meets that requirement, and not
20 try to write if it takes more than 15 minutes, or if
21 there are more than three people involved, if it is
22 somebody who's more than 100 miles away, however

1 else we might define this consultation, leave that
2 out and let the firm decide what is important to
3 communicate to the audit committee.

4 And then in the interest of trying to
5 think of something that I would like to suggest we
6 don't need, there is something, I think it's in --
7 back on page 13, which struck my fancy in this new
8 things that we're going to communicate under
9 accounting estimates. If the auditor determines
10 that potential bias exists in management's
11 accounting estimates, to begin with, I probably
12 don't think the auditor needs to be making that
13 determination, but I have never seen an accounting
14 estimate for which there is not potential for bias.
15 I mean, that is the inherent nature of accounting
16 estimates that that potential exists. And it's that
17 kind of a rule or that kind of an auditor
18 determination requirement that leads to a great deal
19 of consternation effort, cost and little of value.

20 If management is consistently making
21 judgments with a bias, which produces an overall
22 bias in the financial statements, and you feel that

1 needs to be communicated to the audit committee, I
2 could understand that and support it.

3 Every estimate that is made, that has a
4 potential for bias is every estimate that is made.
5 And I wouldn't suggest that that would be a step
6 forward.

7 Overall, I mean, I think most of what we
8 have today is good, works well. I'm concerned as an
9 audit committee member of the back dooring
10 management communication requirements and the
11 specificity that this gives to what an audit
12 committee is going to receive that an audit
13 committee may not have decided it needs in a
14 particular situation, and transferring that
15 responsibility to the standard setting process, I
16 think is going a little further than we should.

17 MR. SCHROEDER: Thanks, Mike. And I had
18 the same observation. I thought all biases are --
19 there's a bias in every single estimate. So.

20 Unlike a lot of you around this table, I
21 don't spend 100 percent of my time thinking about
22 accounting and auditing issues. I spend maybe two

1 percent of my time. And so, I apologize in advance,
2 but I'm going to give you kind of my perspective on
3 this.

4 As I read appendix A, there are three
5 things that really struck me. The first was the
6 volume of information. It was just overwhelming.
7 And it seemed to be extremely technical.

8 The ability of the average audit committee
9 member, I think it's going to be beyond the average
10 audit committee member to understand the
11 implications of what's being said.

12 I know how much I struggle today with
13 accounting issues in trying to understand the
14 intricacies, and how they affect accounting
15 estimates and other things.

16 But the thing that really struck me most
17 about this three page excerpt was that the use of
18 the word significant and critical in a three page
19 document, it was used, those two words were used to
20 combine 24 times. If you're counting, it was 10
21 significant and 14 critical.

22 So I started to think about what do those

1 words really, really mean? And I had trouble
2 answering it, because I couldn't get over the first
3 part of the question.

4 The first part is significant and critical
5 to who? Is it to the auditor? Is it to the audit
6 committee? Is it the board? Is it the management
7 of the firm? Or is it the investor?

8 And I stumbled on the word investor
9 because is it a fixed income investor? Is it an
10 equity investor? If it's an equity investor, is
11 there a long only equity investor? Or is there a
12 long short equity investor? And you can go on and
13 on and on.

14 There are multiple layers. What it
15 reminded me of is a speech I gave to my old firm
16 Ernst and Young. I had spent 13 years there in both
17 practice and national office. And then a few years
18 later, I was a sell side analyst on Wall Street.
19 And they asked me to come back, and basically give a
20 speech somewhere along the lines of what have you
21 learned that you wish you knew when were an auditor?
22 And I thought about it for a second. And I actually

1 drew a little graphic here on my paper to help me
2 remember what I thought about, but really came down
3 to communication.

4 What I did not appreciate at the time, I
5 as auditing, was the level of communication that was
6 outside the company. So you've got not only the
7 auditors talking to the audit committee and
8 management, but you also have functions within
9 management, particularly investor relations, talking
10 to the investor community, talking to fixed income,
11 talking to equity investors, understanding what
12 their issues are.

13 And it really came home to me last week
14 when I listened to a presentation last week by a
15 very well known CEO last Tuesday. And he said he
16 came back from vacation. And he sat down with
17 investor relations group and had them put down on a
18 piece of paper what were the critical issues that
19 investors were asking about? This whole wide range
20 of different types of investors. He says I want to
21 address each one of those today.

22 And in doing that, what he did in

1 literally about 15 minutes was knock off every
2 single critical issue that the large investor base
3 was thinking about.

4 And the advantage of it to the company is
5 that investors don't all think alike, but they come
6 at each company with a wide range of perspectives.
7 They talk to probably more people at a higher level
8 than a lot of audit firms do.

9 I know when I was auditor, if I got to
10 talk to the CFO or the CEO, that was a really,
11 really big deal. I was usually dealing much lower
12 in the organization.

13 As an investor, if I'm not talking to the
14 CEO or CFO, I'm talking to a head of a line of
15 business. Very, very different perspectives. And
16 the communication is very, very different.

17 So the questions that I'm asking then that
18 the investor relations people would do or diligently
19 recording give you a tremendous perspective on what
20 I think is significant and critical, what will move
21 the stock the next day when they say something.

22 So what I did was I called around or had

1 some of my team call around to a couple of the large
2 banks that I follow ask them, how do you communicate
3 information questions that we have? And some of
4 them had some very clear routines of not only the
5 CFO and the CEO, but also the board and the audit
6 committee in particular.

7 Other companies had no real routine. So
8 as I looked at this, I would focus on things like
9 significant and critical, who is it significant and
10 critical to? And how could that massive list of
11 what we think as investors is significant and
12 critical, how can that -- how is that or how could
13 that be effectively communicated, not only through
14 management, the board, and the audit committee, but
15 also to the investor or, excuse me, to the audit
16 firms, again, it comes back to that I wish I had
17 known certain things when I was auditing. It would
18 have given me a lot better sense of what truly was
19 significant and critical.

20 MR. BAUMAN: Thanks Hal and thanks Mike.
21 One thing I just did want to point out, probably
22 wouldn't beyond me, Mike, to try to back door

1 something into this, but the board wouldn't let me
2 do that.

3 These issues in paragraph 12 were things
4 that we think should be communicated by the auditor
5 to the audit committee. It's just we we're
6 reflecting our knowledge of practice. And that is
7 that in many cases, management does make these
8 communications. So rather than duplication, we
9 indicated if management makes them the auditor,
10 evaluates them, but we really weren't trying to
11 require a management communication. There were
12 things at least from our perspective in writing the
13 standard, we thought the auditor should communicate.
14 So that was the purpose there.

15 With that, is that your card, Charley?

16 MS. RAND: No, it's Denny.

17 MR. BAUMAN: Oh, Denny.

18 MR. BERESFORD: I'd like to build on I
19 think both what Mike and Hal said. In my letter, I
20 strongly recommended that you delete paragraph 12B,
21 critical accounting estimates. And there were
22 really a couple of reasons.

1 Number one, I think that, again, this is
2 part of the overall notion of there's just too much
3 in the requirements, but Hal had an interesting
4 point. And that is that to the extent that some of
5 this information is useful, it's useful on a much
6 broader scale. It might be useful to investors, for
7 example.

8 In thinking about this, these are new
9 requirements for the most part. Description of the
10 process used by management to develop the critical
11 accounting estimates, have various selections within
12 the range would affect the -- basically the PCAOB is
13 setting accounting and/or disclosure requirements
14 here, except they're not disclosing them to anybody
15 except the audit committee.

16 And it seems to me that the appropriate
17 way to go about this is that the SEC ought to be
18 thinking about these kinds of things for MDNA, for
19 example. Or the FASB ought to be thinking about
20 them for purposes of footnote disclosures. Frankly,
21 I think that it goes well beyond anything the FASB
22 should be interested in right now, but possibly the

1 SEC might be interested in some of these things.

2 But it just doesn't strike me as the kinds
3 of things that the PCAOB should be asking auditors
4 to be focusing on.

5 Now I recognize Marty has made this point
6 a couple times already that it's stated in the
7 context of we really think that management should be
8 thinking of these things. And it's only if
9 management doesn't bring in to the attention of the
10 audit committee, then the auditors should.

11 Frankly, that's stated as the last part of
12 this paragraph. I would make the change and put
13 that as the first part of the paragraph rather than
14 the last. It think that would be an important
15 emphasis change.

16 But mainly, I think that these are matters
17 that are getting well beyond what the responsibility
18 of the auditor should be, and are expanding frankly
19 requirements even beyond what management needs to do
20 with respect to most of these things.

21 These are kind of interesting things in
22 some respects. I don't really think that it's very

1 practical. I'd be interested in Arnie and some
2 other people's comments on this, but to the extent
3 that, for example, what various selections within
4 the range of estimates would be, that's -- that
5 could be an endless range of possibilities. I will
6 tell you, for example, for Fannie Mae's loss
7 reserves of \$60 billion right now on a \$3 trillion
8 book of business, there are lots of possible
9 outcomes of that. And I don't know how many
10 different possibilities that either Deloitte or
11 internal financial management could come up with
12 there, depending on different assumptions that would
13 be made.

14 And that's obviously an extreme example,
15 but even in the simplest situation, I suspect there
16 would be many different possible outcomes. And I
17 think that each of these is fairly subjective. And
18 they're kind of nice to know types of things, but
19 just go beyond I think what really is necessary and
20 add to the burden.

21 MS. RAND: Denny, I'd just like to point
22 out, many of the kind of -- and as Steve had

1 mentioned, when we were working on the proposed
2 standard, we looked to the existing standard, the
3 requirements in there now, plus recognizing Sarbanes
4 Oxley and SEC Rules. There were additional
5 communication requirements that aren't reflected in
6 the board's current standard today, but which
7 nonetheless impose a responsibility on auditors to
8 communicate to the audit committees.

9 So the requirements, I think, when we had
10 expanded on, but regarding critical accounting
11 policies and critical accounting estimates, those
12 were derived from the SEC's rules.

13 So we incorporated those into the standard
14 to make it easier for auditors to have that
15 direction in one place, make sure they weren't
16 missing any of the communications. But they're
17 largely derived from requirements that exist today,
18 but from the SEC.

19 MR. BERESFORD: Suggesting that 12B is all
20 required by existing standards? I tried to check
21 back that, and I was not able to do that. It's a
22 little confusing, but I tried very hard to go back

1 and forth between existing standards and existing
2 SEC rules. And 12B kind of eluded me, but I've -- I
3 thought that much of it was new.

4 MS. VANICH: Yeah, Denny, I just -- 12B, a
5 good part on accounting estimates is relatively new.
6 It would be B 2, 3, and 4. Those are relatively
7 new. I think 1, 2, and 3, are fairly closely tied
8 to what the auditor's required to do now to audit
9 fair value estimates.

10 It's 13B and 13E that are current
11 requirements in the SEC rules. So critical
12 accounting policies and practices and alternative
13 treatments permissible under GAAP.

14 MR. BERESFORD: I was speaking more of the
15 communication requirements, not what the auditors'
16 requirements were.

17 MR. BAUMAN: One of the -- I appreciate
18 the input, again, Denny. It's very valuable. We
19 are observing some of the ways in which FASB's going
20 and communicating to investors is emphasizing the
21 importance of disclosures to investors around
22 ranges. To your point, very difficult to get to

1 that one number of \$60 billion I think you said on
2 the multi trillion dollar portfolio. And there's
3 probably a number of reasonable estimates, other
4 than that number. And similarly with respect to
5 fair value and FASB's most recent proposals, is a
6 requirement proposed for disclosures to investors of
7 other reasonable values that could have been
8 selected in addition to the one that was selected.

9 And I guess the point in there is in
10 communicating to you the audit committee or
11 shareholders that none of these numbers is the
12 precise number. And there are very wide ranges
13 today with these areas of measurement, uncertainty
14 and the better informed that either audit committees
15 or investors to understand how wide those ranges
16 might be, and why management selected the number
17 they did is -- seems to be an important factor in
18 where FASB's headed with some of their disclosures
19 and informing our thinking to some degree here as
20 well, but thank you for those comments.

21 MS. RAND: Okay, we have several tent
22 cards up. So I'd like to get everyone's thoughts.

1 Jim Cox?

2 MR. COMR. BAUMAN: I was going to address
3 Hal's concern. When I read this, and this could be
4 just the wisdom of the parable about the blind man
5 and the elephant, because we want to make sure the
6 language overcomes the parable.

7 And that is that when I read and have read
8 significant or critical, I thought it was vis a vis
9 a fair presentation of the financial statements. Not
10 the end user, or not to management, nor to the audit
11 committee, but for the matters for which the
12 auditors are rendering an opinion, which is that the
13 financial statements fairly present the financial
14 position and performance.

15 And then, on Denny's point, I think it is
16 true, Denny, that this does not -- is not a mirror
17 image of the SEC rules about this question, which is
18 implementing not just Sarbanes Oxley requirements,
19 but it goes back to earlier to the exchange listing
20 requirements that were there before SOX mirrored
21 this same requirement.

22 But I think what it's really seeking, and

1 again, I -- this may just be the blind man and the
2 elephant and maybe we see if we want to clarify that
3 with language, is to make sure that this discussion,
4 which is mandated between the auditor and the audit
5 committee is as intelligent as it possibly can be
6 under the circumstances. And I think that that's
7 why you want to have some emphasis here as to the
8 accounts.

9 Now the devil's in the details. And about
10 what we mean by significant and critical. And
11 there's lots of methodologies that could be employed
12 there.

13 And -- but the important thing is that the
14 auditors engage the audit committee in a discussion
15 about how a handful of estimates or judgments or
16 assumptions could very much change the presentation
17 of the firm's performance and position. That's the
18 point, I believe.

19 MS. RAND: Thanks, Jim. Arnie Hanish?

20 MR. HANISH: Thanks, Jennifer. A couple
21 of points. So I think that as it was pointed out
22 that these are suggestions and that if management --

1 these are management's responsibility to a large
2 extent. And if management doesn't do it, then I
3 think the auditor clearly has the responsibility to
4 jump in.

5 But one of the points on -- as far as the
6 requirement to get to I think it's your second
7 question there around consultations by the auditor
8 outside of the engagement team on significant
9 matters, I'm troubled by what's written on page
10 four, where it says proposed standard also added a
11 new requirement for the auditor to communicate to
12 the audit committee any consultations by the auditor
13 outside the engagement team related to significant
14 accounting matters. I'm really troubled by the use
15 of those words, any consultations. I mean, again,
16 there ought to be a degree of materiality,
17 significance.

18 There are many requirements today that
19 auditors have to go to their national office for
20 consultation on matters that at least with regard to
21 the companies believe may not be as significant, but
22 they are required to go to their national office,

1 because it's a CYA to some degree.

2 And so, I would be very cautious with the
3 way these words are written by saying any
4 consultations. So I would suggest that be modified.

5 I think that I am extremely troubled by
6 the reference with regard to the range of outcomes
7 on accounting estimates. Whether the FASB is headed
8 in one direction or not, I think it's a -- I don't
9 think we've seen the last of the discussions around
10 that as far as providing ranges of outcomes in our
11 financial disclosures. So I think that is fraught
12 with issues. And I would hope that we wouldn't
13 necessarily see alternative numbers appear in our
14 financial reporting disclosures around accounting
15 estimates because then that just opens up a whole
16 can of worms as far as the litigation issues around
17 well, why didn't the company book this number versus
18 this number versus number? These are generally
19 accepted -- these financial statements are fairly
20 presented under GAAP. We all know there's a bunch -
21 - there's a whole host of estimates that embedded in
22 these numbers. And we believe they're reasonably

1 materially correct. Auditors audit those numbers.
2 Agree that they are materially correct and in
3 accordance with GAAP. And that really should be the
4 end of it, in my view.

5 Again, I think if the audit committee
6 wants to understand what were or what were the
7 thought processes that went into a determination of
8 judgment, whether it's Fannie Reserves or in our
9 case, you know, it was reserve set up for a
10 litigation on product liability cases. It's
11 certainly within the purview of the audit committee
12 to challenge us as management to sit here and review
13 with them the rationale behind how we came to the
14 numbers that we came to, because there are a whole
15 host of assumptions that -- and outcomes that can
16 take place.

17 But I think for the auditors to have to
18 provide judgment on that, they have provided
19 judgment. They've certified our financial
20 statements. And that should be sufficient in my
21 view. Thank you.

22 MR. BAUMAN: Thanks, Arnie. Just one

1 clarification, and you did pick up a good catch with
2 the addition of the word "any" in the briefing
3 paper, which is not in the standard itself. So that
4 was a good catch, reading catch on your part.

5 But it does go on to say that any
6 consultations related to significant accounting
7 matters. So I agree with you, it's not -- it's any
8 consultations didn't belong near the word any, but
9 the word significant accounting matters does belong
10 there.

11 But still, I think the point is we did get
12 a number of comments regarding what you said. And
13 that is that there's a lot of consultations that
14 maybe required by firm policy that the audit
15 committee doesn't need to hear about. So it's still
16 an important point for us to rethink as we go
17 through this. Thanks.

18 MS. RAND: Thanks, Marty. Hal, I think
19 you were trying to get my attention earlier. Maybe
20 to respond to Jim?

21 MR. SCHROEDER: I just wanted to respond
22 to Jim's comment about significant. When I think

1 about significant, it really varies from period to
2 period, quarter to quarter, week to week, month to
3 month. I've been somewhat cynical about this. When
4 I talked to our investors, I tell them that, you
5 know, the market generally can only think about one
6 issue per quarter. And that may be even being a
7 little generous.

8 So significant and I'm thinking about MPAs
9 for banks or net interest margin, they'll pick one
10 issue and really hone in on it.

11 So if you're -- if the management is
12 dealing with is this a nonperforming asset or not,
13 small -- the degree of significance drops a degree
14 or degree of materiality drops tremendously if the
15 entire market has built up an expectation about
16 something.

17 If the market is not focused on it, you
18 can actually argue that materiality can widen out
19 and in less will bother the market.

20 So you're going to map this fair
21 presentation concept against I think market
22 expectations. And then I, again, operate under the

1 assumption that all things are estimates in the
2 balance sheet anyway.

3 So you know, we may be looking at MPA's
4 and looking for a call in the turn of a market. And
5 we saw this earlier this year. MPA's started to
6 stabilize. And all of a sudden, people got all
7 excited. And they ran banks up for a short while.
8 Was that the right answer? I think that if I were
9 an audit committee, I would be looking at that
10 number and that estimate in that quarter a lot
11 harder than I would have in the middle of when times
12 are very good. So it's a moving -- basically
13 significant and critical are moving targets.

14 MS. RAND: Okay, thanks. Just for a time
15 check, as I'm sure you're all aware, we are over our
16 estimated time or our agenda for this morning, but
17 this is also very important area that we received
18 comments on. So we want to continue this discussion
19 until noon and then we'll reevaluate our agenda for
20 the afternoon after lunch.

21 So moving on, Joan Waggoner?

22 MS. WAGGONER: Thank you, Jennifer. A

1 couple of things. I first wanted to say that I
2 really enjoyed Arnie's comments on the range of
3 outcomes. And certainly, I'm in agreement with
4 those.

5 I would also say that with respect to this
6 item alone, I believe there would be a significant
7 cost factor associated with being responsible for
8 the developing of that data should we need to do so.

9 Secondly, as I was going through
10 paragraphs 12 and 13, I was trying to picture myself
11 in an audit committee meeting on either side.
12 Didn't matter which side it was going to go on. And
13 I was trying to sort of see how is that meeting
14 flowing along? And so, I'm picturing a conversation
15 starting to develop with the discussion of
16 accounting policies and moving on to critical
17 accounting estimates.

18 And then it comes back, again, to another
19 concept of critical accounting estimates in the next
20 section, and so forth and so on.

21 And so, I found that I could get really
22 kind of muddled up in terms of what I'm talking

1 about at any particular point in time, and whether
2 or not this section of the meeting would actually be
3 effective in terms of actually achieving a good
4 communication.

5 What it seems to me that could be done to
6 really significantly improve paragraphs 12 and 13 is
7 to integrate them, so that there is a more natural
8 flow between this concept of significant and
9 critical as you organize it to have just one
10 discussion on the topic, rather than having to go
11 back and forth in terms of identification versus
12 what the auditor thinks about them, and so forth and
13 so on. That just might make for a little bit better
14 of a flow.

15 And lastly, with respect to consultations
16 outside of the engagement team, and for my size, we
17 are a single office firm. Basically, I kind of am
18 the national office. No disrespect to Mr. Ranzilla,
19 of course. But --

20 (laughter)

21 And so, what we have on our publicly held
22 engagements is we have an engagement partner. And

1 we also have the engagement quality reviewer. And I
2 am neither one of those. So I always consult on the
3 financial statement side and review the filings.

4 So we have three partners that associated
5 with our publicly held filings. And so, just as a
6 matter of course, since we are all in one office,
7 and we can easily find each other, I am consulted
8 fairly frequently in terms of let's just talk it
9 out. Have you ever seen this? I also have what I
10 would call a consultation network, which is outside
11 of the firm, that I also bounce things off, which is
12 calling someone else and said have you experienced
13 this before? And what would you do, which is more
14 in what I would term educational rather than saying
15 in the set of circumstances, what would you do?

16 And so, someone earlier had suggested that
17 the -- it be written more in terms of the principle
18 involved. What is it -- what issue is it that you
19 really want to address here? What is it that the
20 audit committee wants to know? And I would say what
21 the audit committee probably really wants to know,
22 whether -- which were the close calls, which were

1 the tough call, which were the ones? And certain
2 things about consultations are just going to emanate
3 very naturally from such a discussion like that.

4 And so, one of the things that struck me
5 in various places throughout the standards that
6 sometimes, you know, the standard -- proposed
7 standard is asking about the source of the issue,
8 rather than the issue itself. And I would say if
9 you wrote the principle to just address the issue
10 itself, it might focus things a little bit more in
11 the meeting. Thank you very much.

12 MS. RAND: Thank you. Linda Griggs?

13 MS. GRIGGS: Thank you, Jennifer. I just
14 wanted to point out, I think those criteria in 12B
15 are really consistent with the SEC's MDNA
16 requirements for disclosures about critical
17 accounting estimates. And given that I think
18 critical accounting estimates are the most important
19 thing for the financial statements, it doesn't
20 offend me in one bit to have these identified in the
21 standard as being very important items that should
22 be addressed if either management has not addressed

1 it, or there is something that the auditor wants to
2 supplement.

3 I do agree with the points about the
4 different outcomes. And unfortunately, the SEC has
5 tried over the years to get good disclosures about
6 what would happen if the assumptions used in
7 critical accounting estimates were changed. How
8 does it -- how would it differ? And by and large,
9 those disclosures are pretty weak. And I don't know
10 whether this is an exercise that management
11 typically goes through or not. I don't know, I
12 mean, in the first instance, it should be managing
13 making a judgment as to whether it should be going
14 through that exercise.

15 I agree that it shouldn't be the auditor
16 going through that exercise, but to the extent
17 management didn't go through that exercise as an
18 audit committee member, you probably want to know
19 why, and whether or not withstanding not having gone
20 through the exercise. Everybody was comfortable
21 with the judgment made. Thanks.

22 MS. RAND: Thanks, Linda. Don

1 Nicholaisen?

2 MR. NICHOLAISEN: I'd like to support
3 Mike's comment, which I think other's have as well
4 about the consultations and what's the reason for
5 the consultation as opposed to trying to dictate
6 something too finite.

7 I also say that from a slightly different
8 perspective. And it may just be my own oddity, but
9 I would be -- one of the things I always do want to
10 know is who else did the auditor consult with?
11 Because my expectation is that there would be broad
12 consultation in areas that are difficult or complex.
13 And that would take place. And it's sort of
14 reaffirming to me to know that they bounced off
15 their national office. They've also talked to some
16 of the other firms. And they have a pretty good
17 idea of what the key elements are that ought to be
18 considered, and that they've thought about it, then
19 they can give a reasoned professional judgment as to
20 why our company is in a range of acceptability.

21 The other thing that I would comment on is
22 that I think we're looking for those things that are

1 really out of the mainstream. So if there's an
2 oddity in the accounts that were not where'd you'd
3 expect it to be, that that conversation would take
4 place as well, and that it wouldn't just be so
5 mechanical sounding. I don't think that's the
6 intention here, but you could get there.

7 It's not the mechanics. It's the really
8 living discussion of what took place, what was
9 critical, and what wasn't important, and what was
10 thought about, and how do we go through those
11 estimates?

12 The last point that I would make, and it
13 may be outside the parameters of this document, but
14 it troubles me that in financial reporting, in the
15 public world, audited financial statements, that in
16 things like we've lived through in subprime
17 mortgages and other areas, there are incredibly
18 different ranges of estimates for precisely the same
19 characteristic securities that appear in financial
20 statements all labeled fair value. And all
21 receiving a clean audit opinion.

22 And same audit firm for I'm sure signs off

1 many different values for the same security,
2 depending upon what their client is.

3 And I think that denigrates the value of
4 financial reporting. I think it causes people to be
5 skeptical about what the process is, how it works,
6 why the auditors don't have stronger views, how it
7 gets articulated.

8 I certainly would want to know where our
9 company falls in the range of what is acceptable to
10 that particular firm

11 And also, within the industry, but I think
12 so does the investor. But I think it's critically
13 important that at some point, where we have this
14 range of estimates that are out there, that there be
15 sufficient guidance to the audit firms. And I think
16 it has to come from the PCAOB as to what do you
17 accept and what do you not accept? And how broad
18 can that range actually be?

19 And I know in the early days in '08, that
20 the ranges were just incredibly broad on what was
21 accepted. And it's probably narrow it down now, but
22 that's troubling to those who are trying to rely on

1 financial information.

2 MS. RAND: Thanks, Don. Gary Kubureck?

3 MR. KUBURECK: Thanks, Jennifer. It -- in
4 the interest of time, I'm going to limit my comments
5 to only your fourth question about how to clarify
6 what consultations are required to be brought to the
7 attention of the audit committee. And I'll spend
8 almost all the time on I'll call it management
9 consultations as opposed to auditor consultations.

10 And some of this included in my comment
11 letter, but I would repeat some of it as well, is
12 that I would advise the board to be very careful on
13 how you define who is an accountant that management
14 might have a consultation with. I think it's a no
15 brainer if it's in the form of someone who is a
16 potential to be a new auditor, the opinion shopping
17 type role. And I don't think anyone here would
18 disagree with that.

19 But then as you start going down to --
20 there's other accounting firms out there. There's
21 boutique firms that only do accounting research.
22 They have no ability, no intent to practices and

1 auditing CPA firm. Is that the type of accountant
2 you have in mind.

3 So a company might decide it's cost
4 effective to in effect outsource the really
5 technical research is their view of cost and benefit
6 and skills that are available to them.

7 I would submit, as long as the managing
8 committee or the board sort of knew that's generally
9 how finance was operating, or organized, I would
10 that would probably be sufficient.

11 And your question 12 in the March release
12 talked about non accounting firms such as consulting
13 firms. And again I think in the ordinary sense,
14 maybe not in every instance, but the ordinary sense,
15 I wouldn't think those consultations would normally
16 be advised, would not normally need to be advised to
17 the audit committee.

18 Give you an example. Actuarial firms as
19 you very well know, FAS 87 and 106. And the largest
20 actuarial firms, I would submit, know it better than
21 the national offices do. So that's their job to
22 understand this thing. Likewise, I think the large

1 law firms understand FAS 5 and range of possible
2 outcomes in remote and regional probable litigation
3 settlements and so on.

4 So I think that's all part of the
5 management process of who you engage to help support
6 your business. And I think there's other examples.
7 There's valuation firms, who may or may not know FAS
8 157 very well, but they certainly presumably, if
9 they're a proficient firm, understand how to value
10 in some capacity the instrument in front of them.

11 So, again, I don't think that's something
12 the audit committee would not normally need to hear
13 about absent some significant problem in that area.

14 One thing I did wrestle with, it's not in
15 my comment letter, is what do you do when you've got
16 a firm on contract to you, who might have an
17 independence issue, but you consult with? Might be
18 best to explain by example. And we've got our
19 independent accounting firm, but we've outsourced a
20 large portion of our internal audit work to another
21 big four firm. And we do routinely talk to them.
22 We actually don't go to them for accounting advice,

1 but it doesn't mean those questions don't come up
2 from time to time, the context of an audit finding.

3 And we have another big four firm who does
4 various go to market activities with us at the
5 moment. So again, I would think in either of those
6 cases, the go to market or the internal audit, they
7 would have a significant independence issue today of
8 which some of it might be able to resolve if I stop
9 into work tomorrow. And some of it might need a
10 block of time before they could potentially, you
11 know, pick up the audit.

12 So, again, I'm not suggesting what the
13 answer should be, Marty. I'm suggesting it should
14 be addressed if -- otherwise could do an audit, but
15 it'd block from independence reasons that may or not
16 be curable.

17 And then, with respect to the auditor
18 consultations, I'll just make it very quickly, I
19 think many of the people in the room have made the
20 point. You really want to hear about the things the
21 audit engagement team wrestled with and lost sleep
22 over. And there's a lot of routine stuff that goes

1 on, including education amongst the staff members
2 and so on.

3 And we as a multinational, we view it that
4 we hired the firm. And all the firm's resources, in
5 fact, would strongly encourage national office and
6 other specialty consultations, but it doesn't
7 necessarily immediately follow the audit committee
8 needs to be advised every one of those, because a
9 lot might be routine or ordinary course of business.

10 And again, you're back to you want to hear
11 about the ones that the firm engagement partner lost
12 sleep over. Thank you.

13 MS. RAND: Thanks, Gary. I had a just a
14 -- just to make sure I was clear in your point, I
15 think I am. The -- you were talking about
16 management consultations with other accountants,
17 which in paragraph 15 of the standard, I think. And
18 you know, just so everybody's clear, we did not
19 specifically ask that -- we weren't considering that
20 to be included as part of this discussion. And
21 certainly appreciate your views. But we didn't
22 specifically tee that up in the roundtable specific

1 question because we got pretty consistent feedback
2 similar to the comments that were --

3 MR. KUBURECK: I'm sorry, that's the only
4 place I saw consulting with outsiders in the
5 document. And I just didn't read that closely. I'm
6 sorry.

7 MS. RAND: Okay, very good. All right.

8 MR. BAUMAN: Can I just add one more
9 comment. I -- what I've been hearing from a number
10 of parties is it's the language that becomes a
11 little tricky, whether it's the word significant or
12 something else, many of the people around the table
13 are saying they want to hear about that matter
14 that's the close call that's being discussed with
15 national office. And audit committee members want
16 to hear that. They're trying to wrestle whether
17 that all significant consultations on significant
18 accounting matters equals that or not. And so, it's
19 -- I think the important aspect for us to take away
20 on that is, yes, a lot of people want to hear about
21 those close calls. How we articulate what that is
22 in this standard is the challenging thing. So thank

1 you very much for those comments.

2 MS. RAND: Sam Ranzilla?

3 MR. RANZILLA: Well, I think that -- I
4 want to make just a couple of points in this area.
5 And I think this was a really opportunity that maybe
6 could be lost of revisiting some of the terms that
7 are used in here. I mean, Hal, I think your count
8 was 24 significant and critical. I'm going to do
9 this at the danger of having two former chief
10 accountants at the SEC in the room, one really
11 close.

12 (laughter)

13 But exactly what is the difference between
14 a critical accounting policy and a critical
15 accounting estimate? What is the difference between
16 a critical accounting policy and a significant
17 accounting policy?

18 And I will tell you having been involved
19 with writing guidance for our people over the years,
20 you know, people will get into debates for days
21 about whether it's a significant accounting policy
22 or a critical accounting estimate, and whether or

1 not you fit into this bucket or that bucket with
2 respect to a particular matter. And then, you know,
3 most of the time, is it important? Yeah. Well,
4 then just get on with it, right? And let's go
5 ahead. It doesn't matter if it's A or it's B. It's
6 important.

7 And I have struggled with this. I think
8 critical accounting estimates, critical accounting
9 policies have been added to the vernacular as a
10 reaction to a situation. And I just wonder if we
11 could, because I think we all agree, I shouldn't say
12 that, I think some people agree that what paragraphs
13 12 and 13 really go to, however you structure them
14 is where is an auditor? Did you devote the most
15 significant amount of your time? And where at the
16 end of the day did you, this is a very eloquent
17 term, but did you go?

18 I say this is a close call. This --
19 there's a range. I'm not big on ranges, but there's
20 a range with respect to a matter. I might have
21 consulted outside the audit team. I might not have.

22 But what was the most significant

1 decisions that you made, and the ones with the most
2 measurement uncertainty associated with it? I think
3 that's what we think audit committees ought to know.
4 And I just think we've cut and paste from a number
5 of different places. And I just think maybe we've
6 lost an opportunity. I think that includes a
7 discussion with the SEC about some of their terms.

8 As it relates to -- I don't think you've
9 asked this question, so a little value add. I'll
10 tell you one of the things that does concern me
11 about the standard is trying to apply paragraphs 12
12 and 13 four times a year on each interim period.

13 I mean, if you just pick out one critical
14 accounting estimate, any significant change to
15 assumptions. I don't know what's critical
16 accounting estimate doesn't have a significant
17 change in assumption?

18 At least quarterly, maybe not -- maybe
19 actually more often than that. And I think on a
20 quarterly basis, we could have toggled this thing
21 way too tight in terms of compliance on a quarterly
22 basis.

1 Last item, consultations and reporting. I
2 think the standard as its written, I can implement
3 it to make sense. The only thing I would caution
4 you is for those that do have concerns, we shouldn't
5 do anything in an auditing standard that will reduce
6 people's comfort with consulting outside of their
7 engagement team. Because I have read some comment
8 letters that said, you know, we think this might
9 cause people, because they don't want to communicate
10 when they consult outside the team. They have
11 discomfort with that, that it might reduce
12 consultations.

13 I have never seen an issue that is
14 benefited by reducing consultation within our firm.
15 There's always limits to what makes sense. But at
16 the end of the day, the more people you talk to, the
17 more knowledgeable people you talk to about an
18 issue, usually, you end up at a better place. And I
19 wouldn't want to see us do anything whether -- I
20 don't feel that concerned within my own firm that
21 that would happen, but I read enough comment letters
22 that I would make sure that that didn't occur in --

1 whether it's smaller or different situated type
2 firms. Thanks.

3 MR. NICHOLAISEN: Not responding as former
4 Chief Accountant, but this -- the thing that as an
5 audit committee member, that I am extremely
6 interested in is does the auditor understand the
7 issues? And did they deal with them? And did they
8 reach a -- did they have the basis? Can they
9 articulate the basis for their considered
10 professional judgment as to the conclusion that they
11 reached.

12 And so, while in a sense, you're talking
13 about that level of communication, the communication
14 that I'm trying to understand is I want to be able
15 to evaluate did this audit firm do the job that I'm
16 expecting them to do? And have they covered the
17 areas that I'm particularly interested in? And if
18 the answer to that is no, then we're back to, you
19 know, it's not a communications issue. It's a
20 matter of you got to go back and convince me.
21 You've got to build that trust. That relationship
22 really has to be there.

1 And a lot of that is hard to write in an
2 auditing standard. And I know that the auditors may
3 take offense at, you know, an attempt at
4 communication as being at least one person's tool to
5 use to understand did they get it? Did they -- are
6 they doing the things that they really need to do?

7 And I just throw that in because I wanted
8 to respond to Sam's point.

9 MS. RAND: Thank you. Roger Coffin?

10 MR. COFFIN: Thank you. When you look at
11 over the past 25 years, what are the jobs of the
12 board of directors, probably the first one is to
13 select the CEO and the management team, and to make
14 sure that the CEO and the management team have the
15 proper ability to do their jobs.

16 And really, nothing in Godfrank (phonetic)
17 or Sarbanes Oxley has supplanted that role. And so,
18 when I look at, and it was discussed a little bit,
19 but to come at it from the -- a perspective of a
20 board member, this concept if management has not
21 adequately communicated some of these disclosures,
22 if I'm a board member, and I'm hearing that, reading

1 this standard, I'm saying to myself, somewhere along
2 the line, my auditing firm has made a judgment that
3 my auditor has not done a good job of either
4 disclosing or has not communicated in some way. And
5 I think what that really get the point to is that I
6 would almost be duty bound at that point to ask why
7 as an audit committee member. Does management not
8 have the appropriate tools, you know, do they not
9 have the budget? Do they, you know, what are they
10 missing? Why am I getting this from you when we all
11 agree that these are good things to understand. And
12 I need to know this to be informed. Upon what basis
13 is your judgment made?

14 So I'm wondering if there could be some
15 drafting or there could be, I don't know, maybe the
16 way to put it almost like the gateway question into
17 this is that the gateway question is, you know, does
18 in the auditor's judgment, does management have the,
19 you know, what I'd call the suite or the tools to be
20 able to make all of these things? And it gets a
21 little bit I think to what Don was walking about,
22 the peer group, too, because that's another thing

1 that I would like to know. You know, how are our --
2 how is this being made in relation to peer group
3 estimates and so forth? So I guess that I think
4 from a standpoint of oversight, you would want to
5 know one, why this is happening in this context.
6 And then, the broader question of are there any
7 structural deficiencies in this process from the
8 auditor's perspective? Thank you.

9 MR. BAUMAN: Thanks, Roger. I wanted to
10 go back to one thing that Sam raised before, if I
11 may just to clarify a little bit for the rest of the
12 group. And I'm sure Sam knows this. We were -- we
13 tried to be relatively careful not to change the
14 responsibilities of the auditor with respect to
15 interim reporting and the responsibilities on
16 quarterly reporting. But I guess your point is to
17 the extent we changed some of the requirements here
18 in this proposed standard, compared to existing AU
19 380, that makes the communication at interim some
20 additional communications possibly.

21 But the context, though, is similar to
22 what is in existing auditing standards today. The

1 standard with respect to interim financial
2 information deals with communications to audit
3 committees. and the existing standard says that,
4 you know, when conducting a review of interim
5 financial information, the accountant should
6 determine whether any of the matters described in
7 existing AU 380 communications with audit committees
8 relate to financial information that the audit
9 committee needs to be aware of, such as how
10 management formulated particularly sensitive
11 accounting estimates, etcetera.

12 So the concept is still there in the
13 existing interim review requirements by auditors,
14 but I guess the point being that to the extent the
15 requirements are more extensive here, it just makes
16 the interim burden a little bigger. But there is a
17 similar requirement today.

18 MS. RAND: Lynn Turner?

19 MR. TURNER: First on the consultation
20 issue, I think Don's comments I definitely
21 reiterate, and he probably said it better than I
22 could, but on the comments by Sam, I think it

1 probably would be beneficial if you included a
2 sentence or two in here that said something to the
3 effect that the PCAOB does encourage consultation
4 when appropriate.

5 And actually make a positive statement,
6 because you certainly don't want to reduce
7 consultation at all.

8 I don't think you want to limit, though,
9 just to the national office. I can think of
10 situations where I was chairing audit committees.
11 And it was Bob's firm. And we went to tax
12 specialists. It was Sam's firm and we went tax tax
13 shares or valuation specialist.

14 And it was a good thing. I mean, it
15 wasn't a weakness in the audit partner. We were
16 trying -- these firms turn around and tell you that
17 they bring a firm to the table, not just an
18 individual audit partner.

19 And so, when you reach out to other pieces
20 in that firm, and you get that expertise, it would
21 seem to me as an audit committee member you want to
22 get informed about those situations. So having them

1 come with that information to you is extremely
2 helpful. So, again, I really echo what Don was
3 saying in respect to that.

4 With respect to paragraph 12 and 13, in
5 particular 12B, I'll reiterate and note that the
6 counsel for institutional investors in their comment
7 letter, they were -- there were three things or so
8 that they actually commented on. This was one of
9 them.

10 And they were extremely supportive, as am
11 I, of the provisions in 12B. In fact, so much so
12 that if someone told me as an audit committee member
13 they aren't getting 12B I 2 through 4 there, I would
14 serious questions about whether that audit committee
15 member is actually doing their job.

16 Investors have said, and they've clamored
17 more and more for this, because they haven't been
18 able to get the information because the thing Linda
19 teed up about the disclosures, that they want to
20 know what the auditor thinks about where their
21 numbers are coming out in the range.

22 And in fact, the existing auditing

1 standard on auditing estimates has a provision in it
2 that says the auditor may very well actually have to
3 do their own calculation of that number, and compare
4 it to what management has done, and make an
5 assessment about that. That's in the existing
6 standard. We aren't creating new things. We aren't
7 creating new costs. In fact, if people aren't doing
8 that, it raised the question as to whether they're
9 complying with GAAS.

10 And so, as Don said, again, where you have
11 a wide range, and you've got a possibility of
12 picking a number in that wide range, it's not to say
13 that management's picked a wrong number, but
14 investors do like to know where it is. And
15 investors told us on the Treasury ACAP Committee we
16 heard testimony from a number of them, that it's
17 very important to them. We had to -- heard
18 testimony from investors that they want to know what
19 the investor or where the auditor came out o those
20 estimates and what they thought.

21 Well, if they aren't even sharing that
22 with the audit committee, who's supposed to be

1 overseeing the process, I think very consistent with
2 the council letter, there's something missing here.
3 And there's a big disconnect, a huge disconnect
4 between what investors think the audit committees
5 are doing in their oversight and monitoring role and
6 what is actually occurring.

7 And so, I think what you've got there is
8 very consistent with the SEC rules. It's very
9 consistent with what investors are asking for. I
10 kind of share Sam's view about critical -- what do
11 you call it, critical or significant, or you know,
12 important. But that's water over the dam. The SEC's
13 got a lot on their plate this year. And so, the
14 possibility of going through that, it's probably,
15 and it shouldn't be a priority to them.

16 So I think staying consistent with what
17 they've got is probably the best thing you can do,
18 short of just saying talk to us about dam important
19 items.

20 So -- which I suppose if you did that way,
21 then people would probably understand it.

22 MS. RAND: Thanks, Lynn. Bob Dohrer?

1 MR. DOHRER: Thanks, Jennifer, I can be
2 fairly brief here, because actually, very much in
3 line with Roger's earlier comments. And thank the
4 staff for acknowledging perhaps some shortcomings in
5 the drafting around management's responsibilities
6 for some of these communications.

7 But perhaps to take it a step further, I
8 think it would be very helpful -- nobody disagrees
9 that the audit committee should be provided with any
10 and all information that they need to discharge
11 their oversight responsibilities. But to gloss over
12 management responsibilities, I think is a problem.
13 And I would ask the staff to consider embellishing
14 around the importance of that management
15 communication from a couple of different aspects.

16 One, not the least of which being is
17 certainly is a deficiency in internal control over
18 financial reporting that shouldn't be glossed over.
19 But equally as important, I think the real value to
20 the audit committee would be having management's
21 perspective, and then the auditors' evaluation or
22 the auditors perspective on these issues, such as

1 what does critical mean and what is significant?

2 And where are we going with those types of things?

3 And just to simply say that, you know,
4 it's the auditors' responsibility to step in, if
5 those communications aren't made, don't disagree
6 with that, but really impacts in my mind anyway the
7 effectiveness of how the audit committee can
8 discharge their oversight responsibilities in the
9 absence of management communication.

10 MS. RAND: Thanks, Bob. Arnie? I'll let
11 you have the last word.

12 MS. HANISH: Thanks, Jennifer. Just --
13 hopefully these won't be redundant, but you know, I
14 think that responsibility with regard to this 12B
15 and I'll go the little 4, again to reiterate that
16 management has this responsibility. I think it's
17 important, however, for the audit committee to
18 understand what decisions and what assumptions where
19 there might have been close calls. And I think
20 either Mike Cook or somebody alluded to that. I
21 don't recall who it was who made the statement, but
22 I agree that the audit committees need to understand

1 where there were close calls.

2 One of the things that concerns me as a
3 member of management, however, is that are wide
4 outcomes and wide ranges of outcomes with multiple
5 assumptions. I would hope that if management do an
6 adequate job of communicating changes in basic
7 assumptions, whether it's been changes to the
8 consistency of those assumptions, that the auditors
9 would step in and disclose that appropriately. And
10 that wouldn't trouble me if I as a member of
11 management at least failed to communicate to my
12 audit committee where there were significant
13 changes.

14 One of the concerns I have is that where
15 those changes, however, where you get into a
16 disagreement, or a judgment factor with your
17 auditors as to where those changes could result in
18 different numbers, then it's a matter of a debate
19 inside of an audit committee as to which number is
20 better. These are management's financial
21 statements. And in a estimate for a liability that
22 could be an outcome which ranges anywhere from \$50

1 to \$100 million, you've chosen a number that you
2 think is reasonable and accurate within a framework.
3 What I think would be difficult would be to get into
4 the dialogue within an audit committee discussion as
5 to the distinction between why the auditors felt one
6 number was better than the other, if the assumptions
7 clearly were not wrong on either party.

8 But it was management's judgment to go one
9 direction versus another. But that's one of the
10 concerns that I have when I read 12B that you can
11 find yourself potentially getting into that debate
12 within an audit committee structure that may put the
13 firm in an awkward position with not only the audit
14 committee, but also with the auditors.

15 MS. RAND: Thanks, Arnie. Mike, it looks
16 like you had -- you wanted to add something?

17 MR. COOK: And a suggestion having to do
18 with this area of management responsibility and
19 management communication versus the auditor's
20 communication, just a -- something for you to think
21 about is whether the term adequately is going to be
22 sufficient. It's going to be understood. And

1 whether it is clear here that if the auditor has a
2 different view than management, even if management's
3 communication is complete, that that disclosure
4 requirement would come into play. Just take a look
5 at that.

6 And I was taken by Rogers comment that if
7 the auditor is doing the communicating, because
8 management hasn't or whatever the reason might be,
9 seems to me that ought to be brought to the
10 attention of the audit committee specifically.

11 I'm talking to you about this because I'm
12 required to do so, because somebody else didn't.
13 And leading to the question of well, why didn't
14 somebody else? And whether it's a lack of
15 competence, an unwillingness, whatever it might be,
16 that's a really important piece of information for
17 an audit committee to have.

18 So as you focus on this redrafting as
19 Marty referred to it, and I agree with it, about
20 different responsibilities, if the auditor
21 responsibility comes into play, because management
22 has not carried out their responsibilities, there

1 are implications to that that need to be
2 communicated. I thought it was a very good point.

3 MR. BAUMAN: Thanks, Mike for that
4 comment. One other point I'd just like to mention.
5 The question was raised earlier during this
6 discussion as to what critical and significant meant
7 -- critical and significant to whom, to the
8 investor, to the auditor, whatever. And I think the
9 answer was in my view was given by Professor Cox
10 that I agreed with. And that was these matters are
11 significant or critical to an understanding of the
12 fair presentation of the financial statements. And
13 so they are critical to an understanding of the fair
14 presentation of financial statements by the auditor,
15 by whomever.

16 So I think that's the context of which I
17 understand those words. And I just thought I'd
18 share that I think that was the comment made by
19 Professor Cox that I wanted to join in with that
20 interpretation of significant and critical.

21 MALE SPEAKER: Might be worthwhile to add
22 those words then.

1 MR. BAUMAN: With that, I think we're
2 ready to take a break. And let's -- we were
3 scheduled to break at 12:00 and get back at 1:00,
4 but let's -- we're a little late on that, but let's
5 still try to get back at 1:00. Thank you.

6 [break]

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1 nothing in this standard that an audit committee
2 can't get now if they ask for it, nothing. It would
3 suggest to me that maybe the challenge here is
4 education. I mean, perhaps we could accomplish the
5 goal by the issuance of an audit alert or something
6 and then encourage the auditors to share the audit
7 with members of the committees and get past some of
8 these difficulties of definition but that's a
9 personal thing. That's not why I was asked to start
10 this thing off.

11 But I do get to vote on it, if I'm not
12 replaced before we -- those comments in no way
13 lessen the value of effective two-way communication
14 and it's important in assisting the auditor and the
15 audit committee in understanding significant
16 matters, however you define them, related to the
17 audit.

18 On matters of material misstatements or
19 concerns about accounting and auditing matters, the
20 discussion might contribute to audit quality. I
21 have been struck by the discussion so far. I think
22 I'm the first one to use the term "audit quality."

1 I may have missed something earlier, but since
2 that's what we're in the business of encouraging, I
3 think that might even be a significant observation.

4 The Board included a requirement in the
5 proposed standard for the auditor to evaluate the
6 adequacy of the two-way communication between the
7 auditor and the audit committee to emphasize that
8 effective two-way communications are beneficial to
9 achieving the objectives of the audit.

10 I think it's kind of striking that our
11 goal is effective two-way communications but we're
12 going to do this without two-way evaluation. The
13 evaluation of the audit committee is going to be
14 made by the auditor but nothing is coming back the
15 other way.

16 Now there's a reason for that because
17 that's up to the SEC. That's not within our
18 purview, but it has led me to think that since our
19 role is limited to the auditor side and the SEC's
20 very comprehensive role includes not only oversight
21 and approval of whatever we do but also the role
22 with regard to the issuer, the Board, the audit

1 committee, I have wondered whether we would be
2 better off in the long run, if this project moves
3 forward, if it were done jointly with the SEC.

4 In other words, if they were moving
5 something parallel that had to do with the
6 responsibilities of the audit committee, for
7 example, evaluating the communication from the audit
8 committee's point of view which we can't do, at the
9 same time we were doing it from the other direction.

10 In any event, the purpose of the upcoming
11 discussion is to seek feedback from all of you
12 regarding the importance of effective two-way
13 communication and how or whether these requirements
14 before us should be modified to support the
15 objectives of the audit.

16 MR. BAUMAN: Thanks, Bill, and there was
17 some questions in that regard in the briefing paper
18 which pretty much went to what Bill has just said
19 that is, how important is effective two-way
20 communications to the audit committee's
21 responsibility and the oversight of the audit.

22 If it is important, how can the

1 requirements in the proposed standard be modified to
2 promote effective two-way communication?
3 Additionally, considering that the PCAOB does not
4 have oversight of audit committees, what other ways
5 can the Board promote effective two-way
6 communication without being able to impose
7 requirements on the audit committee?

8 I should add that when we were thinking
9 about proposing this as a standard, we had a
10 discussion with our SAG and the SAG felt that
11 promoting effective two-way communications was a
12 very important part of any standard we might put out
13 and so that was certainly in our thought processes
14 as we issued this proposed standard.

15 Some of the other questions are how could
16 the requirement for the auditor's evaluation of
17 whether the communications with the audit committee
18 have been adequate be modified to support the
19 objectives of the audit and, finally, which came up
20 in some of the comments, should the auditor's
21 evaluation of effective two-way communications be
22 expanded to include an evaluation of the

1 communications between management and the audit
2 committee?

3 Bob Kueppers, I think you want to begin
4 the discussion here.

5 MR. KUEPPERS: Yes. Thanks, Marty, and I
6 don't want to alarm the group, but I've actually
7 been thinking about this.

8 You know, let me just remind you quickly
9 what Paragraphs 26 through 28 require and it's under
10 the rubric of adequacy of two-way communications, as
11 we just teed up, but as you go through it, to Board
12 Member Gradison's point, this is really a one-way
13 evaluation. It does not require any, you know,
14 evaluation of the audit committee of how well the
15 auditor is communicating.

16 So it leads me to believe that the
17 entirety of it will rest on the auditor's perception
18 of whether they're getting information they need to
19 complete the objectives of their audit, of their
20 examination, and if you take it the full distance,
21 through Paragraph 28, it goes to, okay, what happens
22 if the communications have not been adequate and it

1 tees up a couple possibilities: communicating with
2 the full board, perhaps a scope limitation in your
3 opinion, or, you know, the ultimate vote with your
4 feet, withdrawing from the engagement.

5 As I look at this and just take the
6 construction of those paragraphs and forget the
7 title for a minute, this actually works pretty well
8 if you change it to say consequences on the
9 engagement of inadequate audit committee
10 communication. In other words, what is an auditor
11 to do if they're not getting the engagement they
12 need from the audit committee? Either they're
13 unwilling to talk about fraud risk, they're
14 withholding information that you somehow through
15 your corroboration find out was an issue that they
16 were aware of. All of these things would be very
17 concerning to an auditor.

18 If that were -- I know that's not your
19 objective in the standard, Marty, but if that were
20 the title of the section and you did a little
21 tweaking, it would all make sense to me. You know,
22 these are the kinds of things you'd look at. If you

1 become aware that you're not receiving adequate
2 communication from your client, from the audit
3 committee, there are consequences of that, and these
4 are the steps you might take.

5 And the first one, while it's viewed as an
6 option or should consider, to me would be mandatory
7 as it would if I were having difficulty with
8 management, is to communicate with the full board,
9 that that shouldn't be -- I mean that's -- to me,
10 that's step number 1. If the audit committee's not
11 working with you, the next place I go is the full
12 board. If management wasn't working with us, the
13 first place I'd go is the audit committee and I
14 don't think that should -- I think that's absolutely
15 necessary.

16 Now, where it goes from there could
17 ultimately determine whether you ever get to an
18 opinion, whether you have to modify your opinion or
19 hopefully you would resolve the issue.

20 My point is, as I look through all the
21 comments from some analyses I saw, you know,
22 investor comment letters, auditors, corporate

1 governance folks, folks on boards, I really didn't
2 see any group that embraced this as a meaningful
3 additional element, but it might be helpful from an
4 auditor's standpoint again if there was some
5 specificity about consequences once you concluded --
6 you might have some indicia of inadequate
7 communications and say if you conclude they're not
8 adequate, then these are the things you either must
9 do or should consider.

10 So as I looked at this, it struck me that
11 this really had little to do about two-way
12 communications and the most important thing is
13 what's the end of the story on my engagement if
14 there's this problem?

15 MR. BAUMAN: Thank you, Bob. Karen Hastie
16 Williams.

17 MS. WILLIAMS: Thank you. It's important
18 for the Board to make an evaluation about a
19 particular issue. You're hearing one perspective
20 from the person making the presentation but do you
21 see other issues and do you want some feedback from
22 other parts of the corporation, the company that

1 you're dealing with, and I think that's something
2 that audit committees should feel open to raise
3 issues and to get as much information as they can
4 and whether it comes from the external auditor or
5 internal auditor, I think that the issue is you want
6 your board to have as much information as they can
7 absorb with respect to an issue.

8 And I agree with you, that if you're not
9 getting cooperation from particular individuals or
10 officers in the company, then you go to the CEO and
11 say, look, this is important to us, we need to get
12 this information. So I think that's the way that I
13 would interpret that.

14 MR. BAUMAN: I'm sorry. Linda Griggs.

15 MS. GRIGGS: Thank you. I find this part
16 of the standard very confusing. The release talks
17 about the promotion of effective two-way
18 communications as a goal but then Paragraph 3 tees
19 up this evaluation of the audit committee and I'm
20 confused about how this effectiveness of the audit
21 committee two-way communication relates to internal
22 control of financial reporting.

1 There's a very effective mechanism, it
2 seems to me, for the evaluation of the audit
3 committee's oversight, or the board when there's no
4 audit committee, through the audit of ICFR.

5 Now, I recognize with Dodd-Frank, we've
6 got a slightly different issue there and I don't
7 know, I haven't thought through how it would affect
8 small businesses, but it does seem to me that the
9 mechanism now in place to evaluate oversight is an
10 appropriate one.

11 If in fact there's a concern about the
12 effectiveness of two-way communications, does that
13 mean that there is a material weakness in internal
14 control of financial reporting? If so, I'd like to
15 see AS-5 revised. I think AS-5 should provide the
16 guidance.

17 If in fact we now think that rather than
18 the audit committee's role being incidental, which
19 is the way Auditing Standard 380 talks about the
20 audit communications as being incidental to the
21 audit, we now think these two-way communications are
22 critical, then I think we need to be a little bit

1 clearer about that in the standard.

2 I think the standard should be to promote
3 effective two-way communications. I agree
4 completely with Bob. If there is a problem with
5 those communications, the auditor needs to go
6 immediately, as soon as he discovers the problem, to
7 the board of directors.

8 If the board of directors doesn't do
9 something, then I think, you know, the consequences
10 are you've got ineffective internal control because
11 clearly there is not an oversight mechanism to the
12 financial reporting process and then maybe the
13 auditor needs to resign because they can't be
14 comfortable that they can even conduct an audit.

15 But I think the consequences -- I think
16 that the consequences laid out in Paragraph 28 are
17 really not the focus that the standard should have.

18 I think the standard should be focused on promoting
19 this communication and if there's a problem have a
20 discussion and maybe actually I was wrong.

21 Maybe the first discussion is the auditor
22 sits down with the audit committee and says, look,

1 we don't think we're really getting this free flow
2 of discussion. We think that's the best way to
3 assure that the financial reporting process works
4 first. So that's really the first step.

5 If that doesn't work, then you go to the
6 board. If that doesn't work, all right, then there
7 isn't effective oversight, it seems to me, but I do
8 think we need to somehow integrate AS-5 with this
9 standard, if you're going to leave the effectiveness
10 in here, because I just think it's very confusing.

11 If this yet another standard or is this
12 the same as AS-5? Thanks.

13 MR. BAUMAN: Thanks, Linda, for those
14 comments.

15 Let me just make a brief comment and then
16 I'll pass it on to Barbara.

17 I think your points are good ones and
18 raise interesting challenges for us as we look at
19 the standard. I think, as I said in my opening
20 comments, it clearly was a strong point from our
21 Standing Advisory Group that this standard promote
22 effective two-way communications.

1 So an interesting comment. I'll be glad
2 to be trying to -- I hope to hear from others, would
3 be are there other ways in which this standard might
4 be able to promote effective two-way communications,
5 other than the manner in which we've done it in the
6 standard so far. So I'll be interested in further
7 comments in that regard.

8 Barbara, maybe you could just comment very
9 briefly on the intersection between this and AS-5.

10 MS. VANICH: Sure. Thank you, Marty.
11 Yes. Just to follow up, I guess in the staff's
12 view, this requirement is more narrow than the
13 assessment of the control environment that the
14 auditor would do as part of an integrated audit in
15 AS-5.

16 The standard does refer the auditor back
17 to AS-5 if the auditor were to determine that the
18 communications haven't been adequate. For this
19 standard, it's really just a part of your overall
20 assessment in AS-5.

21 Just a couple other points to note. This
22 standard would apply to all audits, whether they

1 would be integrated audits or audits of smaller
2 issuers that would not be subject to AS-5. So this
3 really, I think, is not anywhere near the full
4 scope, the scope of AS-5.

5 MR. BAUMAN: Thanks, Barbara. George
6 Munoz.

7 MR. MUNOZ: Thanks, Marty. In terms of
8 another alternative, I would say that, first of all,
9 promoting two-way communication is crucially
10 important. So another way is to simply, if you want
11 to put a standard on the auditors, simply require
12 the auditors to request an executive session at the
13 audit committee, period, and in that executive
14 session, then the auditors should do all of the best
15 practices, all of the kinds of things that are
16 important because in that way that's the only time
17 that -- that's one way that the auditor can force
18 issues, bring up issues and see the reaction and the
19 like, instead of this other way, which I think is
20 more complicated.

21 So let me address a few things that are on
22 this communication, but before I do, I don't get

1 many opportunities to speak to the PCAOB. So let me
2 expand on this opportunity.

3 I actually look at PCAOB as a very good
4 check mechanism for the audit committees; that is,
5 if the audit committees know that somebody's
6 auditing the auditors, that is, that the auditors
7 are meeting high levels of certification,
8 qualification, training, education, that there's
9 competition in the profession, that there's more
10 people in the pipeline, that the schools are
11 teaching the right things, that's great for the
12 audit committee. Somebody's doing -- somebody's
13 taking care of that.

14 We know it's not the SEC. We know it's
15 not the Congress. We know it's not everything else,
16 but the PCAOB to me is a wonderful opportunity. So
17 I have -- the reason why this is relevant is because
18 I have to gauge the priorities and importance of
19 what's before us against what I and from the audit
20 committee would look to.

21 For example, IFRS, the position that PCAOB
22 -- it has to speak up on IFRS. It has to, because

1 that is going to affect how audits are done and what
2 is looked for and the like and therefore to me
3 that's a higher priority. I'm not saying you're
4 not, but I'm just saying I would hope that this kind
5 of conference is held on that.

6 On competition, there's only four major
7 companies. I would love to have the PCAOB speak to
8 is there enough competition in there so that we have
9 more auditors to work with. Are they prepared? Are
10 they well-trained? Are the colleges teaching what
11 they're doing?

12 So in that context, as I look at this
13 rule, I say, all right, so now we're putting a
14 standard out there. Is this the kind of thing that
15 I expect the PCAOB to give some precedence to?

16 I look at Item Number 10 in
17 Communications, which is -- let me get to it. 10
18 says, "The auditor should communicate the following
19 matters to the audit committee." That means I'm
20 going to have to put it on the agenda or it's going
21 to take up time and here's Item Number A, "The
22 auditor's determination of whether persons with

1 specialized skill or knowledge are needed for the
2 audit."

3 Well, of course, I would hope that the
4 auditor is always going to use a special skills,
5 special person, but he doesn't have to take up the
6 audit committee's agenda time to tell us that he's
7 going to call on some special skill. He's got -- we
8 look to the auditor to do that.

9 The second item is, and this is on the
10 agenda again, "The auditor's consideration of and
11 planned use of the company's internal audit
12 function." That's a judgment call. You know, these
13 are things that now the PCAOB's requiring that there
14 be communication on. So is that the two-way
15 communication? I'm sorry, but it doesn't rise to
16 the level of importance for what that audit
17 committee's fiduciary responsibility is.

18 I go to Item Number 15 and it says,
19 "Management consultations with other accountants.
20 When the auditor is aware that management consulted
21 with other accountants about auditing or accounting
22 matters, accounting matters is a lot, the auditor

1 should communicate to the audit committee his or her
2 views about significant matters that were the
3 subject of such consultation."

4 Why? I don't see the relevance, unless
5 the auditor thinks that a particular discussion may
6 be of relevance, but this requires that they do it
7 pretty much regardless of whatever they consider to
8 be significant. So if these were not requirements
9 but, rather, considerations, I would be supportive
10 of it.

11 So then I go to your question, which is
12 26. So in Paragraph 26, it requires that somehow
13 the auditor evaluate this two-way communication and
14 that evaluation is going to be in writing, it's
15 going to be the like, and it's almost like the audit
16 committee's the one who's hiring, if you will,
17 engaging the auditor and yet the auditor's going to
18 "report on" the audit committee.

19 I wonder what -- how that plays in
20 people's minds because that auditor's going to do --
21 be writing some report card, if you will, and I
22 don't know if that's the way it should be. I'd like

1 the audit committee to be writing the report card on
2 the auditor and I'm not sure that it should work the
3 other way around. Not to say that that's not
4 relevant.

5 So I would say that I would substitute all
6 this with one standard that says auditors in any
7 case where any of these things exist should request
8 an executive session with the audit committee and
9 speak to that issue.

10 MR. BAUMAN: Thanks, George. Don
11 Nicolaisen.

12 MR. NICOLAISEN: I think when you get to
13 the area of effective communication, it's a tough
14 area. I think of the businessman who wants a one-
15 page memorandum that cuts to the chase of what's
16 important, what are the decision points, what do we
17 need to deal with. I think of the general that gave
18 a 28-page memo to his superior that had a covering
19 comment that said I'm sorry this memo is 28 pages, I
20 didn't have time to reduce it to one.

21 What we've been talking about today is
22 very complicated communications from the auditor to

1 the audit committee that goes on for pages and pages
2 and pages. Typically of the ones that I see,
3 they're 50 to 100 pages. Not all of that is of
4 equal importance. Not all of it, I would think of
5 as conveyance of communications or effective
6 communications, and so I think part of the problem
7 starts there of how do you have effective
8 communication and if one of the requirements is a
9 bookload of information that gets dumped on the
10 audit committee with a view that that's the
11 communication from the auditor, now it's the
12 communication back from the audit committee
13 something that can be effectively evaluated.

14 I watch my son and his buddies will come
15 over. One of them will look up, three of them will
16 grunt and they'll all go because they know exactly
17 what they're going to do. I see my son talk to his
18 girlfriend for hours and then I see his girlfriend
19 come to mom and say I'm not sure we're
20 communicating.

21 And so what is effective communication?
22 How do you get there and how do you measure it and

1 if you're asking this party that writes 50-page
2 documents is the communication from the other side
3 effective, I'm not sure they're the right people to
4 be asking that question and then you get into, well,
5 should we have somebody who's actually a moderator
6 who can help the audit committee talk to the
7 auditor, and I don't think we want to go there.

8 So my view is pretty much I think what
9 I've heard others express. Effective communication
10 is necessary, it's desirable, should be encouraged,
11 but I don't think you can write rules that say if
12 you do this, this, and this, you've had effective
13 communication because I think you can still fail
14 miserably.

15 MR. BAUMAN: Thanks, Don. Mike Cook.

16 MR. COOK: Marty, thank you. Maybe a
17 little bit along the lines of what Don was
18 suggesting but then I have a question, also, at the
19 end.

20 I'm kind of the same place. I could see
21 putting a requirement in place for the auditors to
22 obtain an evaluation of their effectiveness as

1 communicators from the audit committee. I don't
2 quite understand why we would empower and through a
3 standard require auditors to evaluate the
4 effectiveness of somebody else communicating with
5 them in the ordinary sense.

6 I can understand if there's a breakdown,
7 you need to talk to people and you need to have open
8 dialogue and I'm all in favor of promoting
9 communication. It'd be un-American not to be in
10 favor of promoting communication, but if the burden
11 is on anybody here, we ought to put the burden on
12 the firm to obtain an evaluation of its
13 effectiveness, not the other way around, and I think
14 this is just ass backward, excuse the French, and, I
15 mean, and I don't think it's going to be effective
16 and it's another requirement added on top of others
17 that I don't think is going to stimulate better
18 things but it will certainly take more time, more
19 cost, and I don't know what you get at the end of
20 the day.

21 I did have one question, however. What we
22 have here all seems to be talking about

1 communication in a non-litigious/non-threatened
2 environment and that is the way the world should be
3 98 percent of the time, but when you get into
4 special investigations and matters of that type, you
5 get into some very tricky issues, of privilege
6 issues, of timing, of public disclosure, and there
7 are times when it's appropriate for there to be two-
8 way communication and there are other times when
9 people are not free to have two-way communications
10 in advance of other things taking place.

11 I don't know if you can make that
12 distinction if you choose to retain this notion, but
13 somewhere it ought to say that these broad and
14 general rules about evaluating communication and if
15 you don't get back what you want, you do what Bob
16 Kueppers said you're going to do, you think about
17 whether you have to quit and all those kind of
18 things.

19 Some of those rules don't work well in a
20 special investigation-type situation where the audit
21 committee is working with outside counsel and
22 there's counsel engaged for the audit committee

1 itself, not for the company, not for other people,
2 and not for the purpose of informing the auditors,
3 and the audit committee understands you've got to
4 keep them informed. You can't shut them out, but you
5 don't just invite them in to these highly-private
6 sessions prematurely and so I don't know if you can
7 make that distinction.

8 But somewhere this can't be just a general
9 rule that says Bob Kueppers should come visit me in
10 the midst of a special investigation and tell me he
11 wants to know everything that's going on because
12 that doesn't work and Bob would be -- having been
13 involved in a number of them, he'd be the first one
14 to recognize it.

15 MR. BAUMAN: Thanks for those clear and
16 unambiguous comments, Mike.

17 Next, we have Alex Mandl.

18 MR. MANDL: Well, ditto to Mike, frankly.
19 Took the words right out of my mouth.

20 I think it is backwards, candidly. I
21 mean, we talked about the three-legged stool earlier
22 and the balance of that and the necessary balance of

1 the three-legged stool, and I think this would
2 actually, you know, throw it off balance, would
3 offset that balance in a way that could actually
4 impair or impede the communications that are so
5 important and I fully agree.

6 I mean, communications between those two
7 groups are critical and if they don't go well, you
8 know, something has to happen. There's no doubt
9 about that. You know, the governance committee can
10 get involved if something doesn't go right. I mean,
11 there are some other means but to have the authority
12 for the auditor to give a report on the audit
13 committee which has implications, you know, of
14 various kinds, I think, throws the whole system out
15 of balance and is -- I would urge us not to do that.

16 MR. BAUMAN: There is a number of other
17 cards up, but I would want to ask a question. Maybe
18 Bob Kueppers or Sam possibly could add some insight
19 into this. If you can't, then I'll continue with
20 the rest of the cards.

21 But this is a requirement in the
22 International Standards on Auditing under the IAASB,

1 Communications with audit committees has this same
2 requirement.

3 I'm wondering. Can you shed any light as
4 to whether this is working in any effective way on
5 audits outside U.S. jurisdictions where this
6 requirement exists already or not?

7 MR. KUEPPERS: This clearly is a Sam
8 Ranzilla question.

9 MR. RANZILLA: I don't have an answer to
10 either of those.

11 I have not -- Marty, I will couch this
12 with it's a question I did not ask in either
13 preparing -- helping our guys prepare a response or
14 preparing for today.

15 I have not heard any noise out of the
16 system that would lead me to believe that this has
17 been a significant issue. You know, I think it's
18 important to recognize -- well, I don't dispute any
19 -- quite frankly, I don't feel real strongly on this
20 particular, whether it's in or it's out, because
21 auditors already today are required under AS-5 to
22 consider the effectiveness of an audit committee and

1 its assessment as to whether or not internal
2 controls are effective.

3 This is just one slice of the
4 effectiveness of an audit committee but already that
5 system exists where an auditor is making an
6 assessment and, quite frankly, when AS-2 came out,
7 you know, we had some chuckles thinking that's going
8 to work really well. Those are going to be some
9 interesting conversations if you determine the only
10 material weakness your client has are the people
11 you're delivering that message to.

12 So I -- and again, I don't think that has
13 been an impediment to effective communication and
14 again we believe audit committees are really
15 important in the conduct of our audits and I don't
16 think that's gotten in the way of it.

17 So I'd be happy to get back with you with
18 an answer. Unfortunately, I won't be able to share
19 it with everybody, but I'd be happy to follow up on
20 that, if you'd like.

21 MR. BAUMAN: Thank you very much for that.
22 Because again, like in other aspects of this,

1 trying to get further information about how it's
2 working elsewhere or what are the things that are
3 working is always useful to know.

4 But as you point out, very appropriately,
5 AS-5 does require the auditor to evaluate the audit
6 committee internationally with internal controls of
7 financial reporting and this is, if you will, an
8 element, an element of that.

9 Bob Dohrer.

10 MR. DOHRER: It just strikes me, as we're
11 having this discussion, that perhaps evaluating
12 effectiveness of two-way communication really is
13 somewhat of a fancy way of asking for two separate
14 evaluations.

15 It seems to me that the audit committee
16 needs to evaluate whether or not they are receiving
17 the information they need from the auditors and I
18 don't think there's much argument about that.

19 At the same time as an auditor, I don't
20 think it's inappropriate for an evaluation to be
21 made of whether the audit committee is responsive
22 and provides the auditor information that may be

1 relevant to the conduct of the audit going forward.

2 I'm not sure that's all wrapped up in
3 something we can call effective two-way
4 communication, but perhaps if there was more of a
5 spin to it of both parties need to evaluate whether
6 or not the information required to discharge their
7 individual responsibilities are being obtained, that
8 information is being obtained throughout the
9 engagement, would be a better way to go about it.

10 For example, in Mike's situation with the
11 ongoing special investigation, you know, one could
12 argue that if Mike responded that he couldn't
13 discuss something that we had not had effective two-
14 way communication, but I think what's more relevant
15 is that the auditor understand the ramifications to
16 the conduct of the audit and the outcome from Mike
17 being in the position that he is at that current
18 time as an audit committee member.

19 So I wonder if there's a way that we could
20 accomplish, I think, what we're all aiming to get at
21 here, without trying to wrap it around something
22 that's as nebulous as sons talking to girlfriends

1 and trying to evaluate whether communication has
2 been effective or not.

3 MR. BAUMAN: Thank you. There is two more
4 cards up and as part of our grand plan to get back
5 on schedule, if we can limit the discussion on this
6 particular question to the two cards that are up.
7 Joan Waggoner and then finally Lynn Turner. Thanks.

8 MS. WAGGONER: Thanks very much, Marty. I
9 think in terms of our practice and the smaller
10 company practice, the issue really kind of drills
11 down what would be on our big wish list here. Our
12 big wish list basically is does -- to understand or
13 to have the audit committee understand is do they
14 feel that it is their responsibility, if they become
15 aware of something that affects financial reporting
16 or the internal controls of financial report, that
17 they have an obligation to share that with the
18 external auditors, and in my view, I think they do.

19 I think most people would agree that they
20 do. I don't know that all audit committees feel that
21 way, especially in the smaller companies. So that
22 is my big focus in terms of evaluating two-way

1 communication, the one big thing that I would like
2 to see a bit more solidly placed in terms of a
3 communication between the audit committee and the
4 external auditor.

5 Thank you.

6 MR. BAUMAN: Good. Thanks. And Lynn.

7 MR. TURNER: Marty, I think the correct
8 term for this is an upward evaluation and companies,
9 like General Electric, have used upward evaluations
10 for years very successfully.

11 I have twice on audit companies of public
12 entities used an evaluation where we not only
13 evaluated the auditor but we actually had the
14 auditor do a formal evaluation of the audit
15 committee and at the start of the audit each year,
16 everyone knew that we'd be evaluating them and we
17 also told them they'd be evaluating us. So we asked
18 them to take a look at what we're doing and if we
19 weren't doing things right or could do it better,
20 we'd want to know about that and the evaluation
21 provided them an opportunity to do that.

22 In both those instances, it actually had a

1 very significant positive impact on the
2 communication between the two sides and actually
3 probably impacted the timing of that communication
4 and brought some of it forward, if you will. So
5 I've found from my experience where we've actually
6 done these type of evaluations, it has been very
7 positive.

8 I also think that an auditor -- the audit
9 committee just plays a phenomenally important role
10 in the financial reporting process. There's just no
11 question about that, no denying that, and with that,
12 the audit committee oversees not just the auditor
13 but that audit committee oversees the internal
14 auditors, oversees the financial management that
15 we've all talked about, and is a critical, very
16 important control here, and if you're an auditor, I
17 look at these four questions and the actual standard
18 says the auditor's just going to evaluate, but it
19 doesn't say you're going to issue any type of
20 special reports.

21 So all it does is say the auditor's going
22 to go evaluate that extremely important piece of the

1 overall control and it's not just to deal with the
2 audit but it's to deal with some other very
3 significant parts of the financial reporting process
4 and I looked through the four questions:
5 appropriateness and timeliness of actions taken by
6 this very important audit committee, the openness of
7 it to communicate with auditor.

8 I mean, the audit committee will not
9 communicate with them. I as an auditor probably
10 have some grave concerns. The willingness and
11 capacity of the audit committee to meet with them in
12 executive session. If they won't do that, there's
13 got to be a problem.

14 These are very plain Jane, very simple,
15 basic things that are not that difficult, and the
16 fourth question, the extent to which the audit
17 committee probes issues raised by the auditor. You
18 know, as an investor, I certainly hope the audit
19 committees are doing that. If not, we're probably
20 wasting some of our money on those board of director
21 fees.

22 So there are very simple things and it

1 just says the auditor's going to go through and
2 evaluate those things and come to a conclusion about
3 where that very significant control is working
4 adequately or not and so to say there's an issue
5 with that, I think, tells you just from a common
6 sense perspective we're missing something in the
7 system and if we're so worried as audit committee
8 members about the auditor looking at those things,
9 then there's probably a bigger issue here that we
10 don't have on the table.

11 So I think what's here is fine. I've done
12 it before and it's worked well and, if anything, it
13 enhanced and brought the communications to an
14 earlier stage and was very beneficial for us on the
15 audit committee and I think benefited the auditor,
16 as well.

17 So I think it's very, very solid, very
18 simple, very easy thing to do, and something as an
19 auditor I can't comprehend how you wouldn't do it
20 anyway.

21 MR. SCHROEDER: Did you do it more than
22 one year or is it just the one year deal?

1 MR. TURNER: Yeah. The way we actually
2 started this out, the first time I did it was when I
3 was a CFO and to Don's question, I wanted to find
4 out if the auditor thought this was really a good
5 audit to work on. So I required that the auditor,
6 including the staff that actually had to work on the
7 audit, the junior staff even, to fill out an
8 evaluation and you never know. You know, when you
9 do that, you're sitting here going to myself, I'll
10 just get the bejesus beat out of me or not, but if
11 it was, I wanted to know, and I figured it was
12 better to manage the issue and know about it, if
13 there was one, rather than not know it.

14 So we did it for several years as the CFO
15 and then on the audit committee, yes, we did it each
16 year then. It just became part of the evaluation
17 process and after the first year, what I found was
18 that butterfly feeling in your stomach about how
19 it's going to turn out, after the first year and I
20 did have those concerns, it always went away. It
21 just -- the communication just became very natural.
22 You know, it just -- no one gave it a second

1 thought after that. It just became part of what you
2 did.

3 MR. BAUMAN: Thanks, Lynn. One more
4 comment.

5 MR. NICOLAISEN: I just wanted to ask one
6 question. At least the audit committees that I'm
7 on, there's a client satisfaction process that goes
8 both ways which is maybe not as direct as this, but
9 it is more comprehensive, deals with all the issues
10 and hence the surface things, and there's no mention
11 of that any place. Is that -- I just wouldn't -- if
12 you have a process that works and it's effective,
13 I'm not sure that you need to introduce another one
14 and at least if that's done comprehensively, you
15 might want to at least in here, if you decide to go
16 ahead with the requirement, that you acknowledge
17 there may be other ways to accomplish the same
18 objective.

19 MR. BAUMAN: Thank you very much.

20 MR. MANDL: The only point was there ought
21 to be some mutuality on how this process works and I
22 guess what you're describing is a mutual process.

1 What this says, at least the way I read it, this is
2 a one-way process and that was my main concern with
3 the whole issue and I'll stop there.

4 MR. BAUMAN: Thank you very much. I
5 appreciate it. A lot of very constructive input on
6 an interesting topic that was introduced into this
7 standard that was not an existing standard. So
8 thank you for all of the good feedback.

9 Another topic where we had a lot of
10 comments again was whether communications should be
11 written or oral and again this was led by a lot of
12 discussions at our SAG meeting, again with some very
13 strong views from our SAG members about this topic.

14 So, Jennifer, why don't I turn this to
15 you?

16 MS. RAND: Yes. Thank you, Marty.
17 Actually, I'm going to turn it over to Dan Goelzer,
18 who's agreed to provide some opening remarks.

19 MR. GOELZER: Okay. Thanks, Jennifer.
20 Like the existing standards, the Board's proposal
21 would allow the auditor, with a few exceptions, to
22 choose between written or oral communication of the

1 information that he or she is required to
2 communicate to the audit committee and, as Jennifer
3 suggested, we did ask for comment on whether that
4 was the appropriate approach.

5 Views were quite sharply split. While
6 there were exceptions, I would say that, in general,
7 auditors favored the idea of continuing our
8 flexibility to choose between written or oral
9 communication.

10 On the other hand, audit committees and
11 investors tended to support the idea that the
12 required communications should be in writing.

13 The proponents of written communication
14 argue that writing provides a record that permits
15 committee members to refer back to what was
16 communicated and avoids the risk of future disputes
17 or misunderstanding. Writing, we were told, is also
18 a more effective way to communicate complex
19 information about topics like critical accounting
20 estimates. Moreover, people pointed out that
21 written communication is more efficient since
22 committee members can consider the information at

1 any time and then use their time at committee
2 members with the auditor to ask questions.

3 In contrast, those who urged flexibility
4 pointed out that a choice between written and oral
5 communication allows the auditor to determine what's
6 going to work best, based on the facts and
7 circumstances and will best lead to open
8 communication.

9 In some cases, oral communication may also
10 be more consistent with candor and oral
11 communication minimizes the risk that points will
12 simply be communicated as boilerplate in writing.

13 So we're hoping that the roundtable will
14 give us some insight into how we ought to resolve
15 this split in views. I would point out that all
16 communications that are required would have to be
17 memorialized in the workpapers, so there would be a
18 record of what was communicated from a workpaper
19 perspective, but beyond that, whether the
20 communications themselves should be written or oral,
21 appreciate your views on what would be most
22 effective.

1 Thank you.

2 MS. RAND: Thanks, Dan. We have three
3 discussion questions here and these questions are
4 intended to probe further in trying to get behind
5 the reasons. You know, if you think it should be in
6 writing, what are those reasons? Or orally, if it's
7 made orally, then, you know, what are the reasons to
8 continue with that?

9 So let me go through the questions and
10 we'll get into the discussion.

11 First one is should all matters be
12 communicated by the auditor to the audit committee
13 be in writing or only certain matters? If only
14 certain matters should be communicated to the audit
15 committee in writing, what are those matters? And
16 the last one, what are the risks of allowing some of
17 the communications to be made orally?

18 So if you're in the camp that you believe
19 all communications should be in writing, why do you
20 have that? What risks do you perceive would be out
21 there if some of them are made orally?

22 Next question. So if the standard

1 required all communications to be in writing, should
2 the auditor document oral discussions that relate to
3 such written communications?

4 So we've heard today about robust dialogue
5 and open discussions. If you're someone that
6 believes everything should be in writing, then
7 what's your view on those open robust dialogues?
8 Does that mean that the auditor should go back and
9 document exactly what was said in those oral
10 discussions? Is that what you're intending, as
11 well, if you believe everything should be in
12 writing?

13 Next question. If all required
14 communications to the audit committee were required
15 to be in writing, would there be any effect on the
16 dialogue between the auditor and the audit
17 committee? Would the dialogue on key matters
18 continue to be robust? In other words, would those
19 discussions still be open and frank or would there
20 be some concern if I've got to document everything,
21 then, you know, you might not want to have -- you
22 know, pass along something that you think is a harsh

1 evaluation but -- for fear because it's in writing
2 or how that might be interpreted.

3 So would there be any effect? Would it
4 chill, if you will, some of the conversations if
5 everything you said needed to be in writing?

6 I've asked Don Nicolaisen to provide some
7 opening views to open up the discussion and then
8 we'll open it up to everyone.

9 So Don.

10 MR. NICOLAISEN: Great. I think the
11 issues have been well described, Mr. Chairman.
12 Thank you for your comments. I'm somewhat
13 indifferent whether the communication is in oral
14 form or writing for the most part, but when you come
15 to a standard that requires all significant
16 communication to be documented and part of it is
17 shared, documented to me means you've written it and
18 so if you've written it down and you share only a
19 portion of that written piece with the audit
20 committee, and then another portion is maintained
21 somewhere else and the audit committee is not aware
22 that those things were considered significant by the

1 auditor because they were communicated in a
2 different format and perhaps the writing was
3 different than the actual discussion took place, I
4 could imagine situations where certain people are
5 tepid about raising difficult issues but they're not
6 hesitant to put in a memo that I raised it and I
7 discussed it, even though it might have been very
8 cryptic in its explanation.

9 And so that's my primary concern with this
10 and I'll leave it with that.

11 MS. RAND: Thank you, Don. I don't see
12 any other tent cards, but we did get significant
13 views.

14 Here's Linda. Linda Griggs.

15 MS. GRIGGS: I just had a question. I
16 mean, what are you contemplating, PCAOB, would need
17 to then be documented in the workpapers?

18 I guess I need to understand what the
19 purpose for that documentation is and would that
20 have to be very extensive or is it just we had a
21 discussion about, you know, the CFO's transgressions
22 and that would be it? I mean, how detailed would

1 that then have to be?

2 What the standard says is it's to enable
3 an experienced auditor to understand that
4 communications were made to comply with the
5 provisions of the standard.

6 Well, it might be enough to just say we
7 had this very difficult discussion, but if it has to
8 get into the details, then I guess I'm with Don.
9 I'd want to know what those details were. If it's
10 going to be written down, it seems to me that's
11 something the audit committee should be aware of.

12 MR. BAUMAN: Well, I'll take a shot at
13 responding to that.

14 Again, we had lengthy discussions at the
15 SAG meeting and many of the SAG representatives
16 thought that requiring all communications to be in
17 writing would stifle some of the natural dialogue
18 that takes place among the auditor and the audit
19 committee and so in drafting this, we decided to
20 permit the matters to be communicated either in
21 writing or orally.

22 However, we felt that certainly from an

1 inspection perspective, if nothing else, if the
2 communications were made orally, we would have no
3 idea whether or not the communications were made or
4 what they might be and so we established a
5 requirement that if they are made orally, they would
6 at least have to be documented to the extent that
7 somebody, an experienced auditor, having no previous
8 connection with the engagement, could understand the
9 communications in sufficient detail to know
10 essentially what would be communicated if the
11 required communications were made in writing.

12 So, in essence, it would be they could be
13 made in writing or, for one reason or another, if
14 the committee and the auditor decided that some of
15 the communications would be made orally, that we at
16 least felt that the substance and the importance of
17 that still needed to be documented in the auditor's
18 workpapers such that we could understand that the
19 objectives of this standard were met by being able
20 to read that documentation.

21 I understand the point that Don's raising
22 is, well, then I as an audit committee member, if

1 you didn't send me the written report, well, then
2 maybe send me the memorandum that went to your files
3 because I might not agree with how you characterized
4 them that I think is the issue here.

5 MS. GRIGGS: If I could also add, I think
6 when we were drafting that language, we were also
7 considering the fact that the engagement quality
8 reviewer needs to be able to determine that the
9 engagement team has complied with the standard and
10 these are matters that are very important for that
11 reviewer maybe to be aware of, also.

12 MS. RAND: Well, and I also just want to
13 point out that the way our standard is drafted now
14 about if it's made orally, then you document in your
15 workpapers, that exists in the standard today. So
16 that isn't a new concept that we would be adding.
17 The auditors have that today.

18 MR. BAUMAN: Lisa Gaynor.

19 MS. GAYNOR: A few years ago, I took part
20 in this research synthesis team and we were asked to
21 address this very issue as to these questions and
22 looked to the academic literature to see what had

1 been done and what we had discovered is nothing had
2 been done in this area, specifically in accounting
3 and auditing.

4 However, we did make the statement that in
5 communication and there's called communication
6 richness theory and here we keep talking about oral
7 versus written and we've heard throughout this
8 morning that there's so much information that's put
9 in writing, the reports are 50 to 100 pages, that
10 clearly we don't want to add more written
11 information just so it's documented.

12 But if you go to theory, theory would say
13 that we should be talking not necessarily about oral
14 versus written but about the richness of a
15 communication versus the leanness of the
16 communication.

17 So you've got the distinction here maybe
18 between effectiveness and the efficiency of a
19 communication. More complex -- I mean, it's pretty
20 simple. More complex thoughts and messages should
21 be in a richer format and a richer format isn't
22 necessarily -- it's usually face to face where you

1 can see expressions.

2 As you were saying, as Don was saying, you
3 have -- we discussed during a meeting and then they
4 go to -- and they kind of just like skirted the
5 issue in the meeting, but then they get into the
6 documentation stage and so a rich format would
7 include both a face to face or an oral, if that's
8 how you choose to call it, as well as a written
9 format, as well, or just even including the face to
10 face. It's not even just oral because you get into
11 looking at people and seeing expressions and making
12 your own intuitions from there.

13 So more complex, more rich, less complex,
14 leaner. Thank you.

15 MR. BAUMAN: Thanks, Lisa. Lynn Turner.

16 MR. TURNER: Marty, on the committees I've
17 sat on, we have asked auditors to give it to us in
18 writing and they've used graphs or it's taken
19 various forms, whatever worked best for everyone
20 involved. So I think you've got to give flexibility
21 to that. Some of this can be graphed better than it
22 can in just a written word.

1 So I'm a big fan of putting it in writing.
2 I get very nervous about the point that Don raised
3 about something sitting in the audit workpapers
4 about me as the audit committee that I've never seen
5 before that talks about what they were telling me in
6 a conversation.

7 There's just something about that I don't
8 like and so I'm a strong supporter of having it in
9 writing. The Blue Ribbon Panel Committee on Audit
10 Committees recommended this type of stuff be in
11 writing.

12 There was actually some language in it
13 that I think is very good that I'd suggest you
14 consider. It says, "This requirement should be
15 written in a way to encourage open frank discussion
16 and to avoid boilerplate."

17 I think having a sentence in there like
18 that, even if you leave it optional, is very good to
19 put that in there because I think that's what you're
20 trying to get at.

21 MR. BAUMAN: Thanks, Lynn. If I can
22 follow up, so if all the communications are in

1 writing and as you know, of course, then there's a
2 robust dialogue and oftentimes there's further
3 inquiry by the audit committee about what the
4 auditor meant by something that he or she put into
5 writing and if there's additional obviously
6 explanations by the auditor about the matters during
7 the committee meeting, would you expect then that
8 those matters would also be then documented in
9 writing and further shared with the audit committee
10 or not?

11 MR. TURNER: Oh, I can think most recently
12 of a conversation about what the auditor documented
13 on the quality of the accounting practices, the very
14 key critical accounting policies and where they set
15 the line and in that particular case, there was one
16 audit committee member disagreed with the auditor's
17 assessment and at the following meeting there was
18 follow-up by the auditor on that particular point.

19 So, you know, I think it depends upon what
20 the particular situation is as to what goes with it.

21 I think some of Denny's comments are very relevant
22 in this area. I don't think you want to get a 100-

1 page document necessarily here. I think you want to
2 get a document that really focuses on the key things
3 and again I think a lot of your questions, a lot of
4 your points are very key things. So I think they'll
5 flow.

6 But you don't want to have it turning into
7 a CYA document. You want to have it turned into a
8 real dialogue between the audit committee and the
9 auditor and then if there's things that are set up
10 for follow-up, then so be it.

11 In that particular board, we had a
12 standard process for if something was -- like that
13 got teed up, we would note it in the section of the
14 audit committee minutes or the board minutes, note
15 for follow-up, and the first thing we did at the
16 next board meeting or audit committee meeting was
17 always take on the follow-up items because they're
18 the things that people tend to forget about and drop
19 through a hole. So we had a process for doing that.
20 So we got back to them.

21 MR. BAUMAN: Thanks very much. Gary
22 Kubureck.

1 MR. KUBURECK: Thanks, Marty. I'm going
2 to sort of share some thoughts that were in my
3 comment letter but also reading many of the comment
4 letters here, I think, generally consistent with the
5 preparers of the audit committee members here.

6 I think as a starting point, I would
7 recommend anything of critical importance, you know,
8 should be documented as a very strong general rule
9 and going back from experience, more than once in my
10 time as a preparer and going back far enough when I
11 was an auditor, I can assure you more than once
12 auditors documented something in a private
13 memorandum in the file that no one else in the room
14 remembered or, if they did remember, they didn't
15 agree with the conclusion. We thought the answer
16 was left and they thought it was right or whatever.

17 So I think, if nothing else, to avoid
18 misunderstandings, to have a shared sense of the
19 facts of the matter, it's important to have things
20 documented.

21 Now, I think there's some flexibility in
22 level of documentation. So as an example, you know,

1 four times a year we do our quarterly earnings
2 review with the audit committee and they get the
3 thing the night before and it's a bulletized list of
4 the things we're going to talk about, you know,
5 reserves, taxes, cash flow or whatever, but there's
6 no details, but at least it's memorialized that you
7 are going to talk about these subjects, you know,
8 earnings release, 10-Q type releases, real-time
9 stuff, and we have five standing meetings a year,
10 couple hours long each, and the pre-read goes out
11 two weeks earlier and there's plenty of time for
12 robust documentation.

13 Again, I think it can take a lot of forms,
14 a lot of levels of detail. So I would suggest if
15 you're going to write rulemaking on this, the
16 beginning assumption is it is documented and maybe
17 there's exclusions.

18 I think of executive committees or you're
19 talking individual staff qualifications and stuff.
20 Maybe it's sufficient that you memorialize that the
21 subject was discussed but not necessarily in detail
22 and process that in due course.

1 But the other thing is I can truly see
2 problems for the PCAOB, for the auditors and
3 management down the line if you allow some things to
4 be done orally and then there's a blow-up a year or
5 two later and there was no requirement to share this
6 critical dialogue in writing with the audit
7 committee or the board of directors, as the case may
8 be, again along the lines of there's a shared
9 understanding of the various views of the issue and
10 the assessment of the facts, the issues of
11 substance.

12 So I err on the side of more writing is
13 better. Again, I think some flexibility about the
14 level of detail.

15 MR. BAUMAN: Thanks, Gary. Denny.

16 MR. BERESFORD: I obviously prefer less
17 than 100 pages of written documents, but having said
18 that, if there is something that's important for the
19 auditor to communicate, I think it's well to have it
20 be in writing and I think specifically of something
21 like an important accounting that was communicated
22 or consulted with the national office.

1 Generally speaking, when that is the case,
2 I ask the accounting firm or the company, usually
3 the company, to write it up for the accounting firm,
4 so that we can have it in advance, so that we can
5 read about it before the meeting.

6 These things are complicated, as I think
7 Arnie indicated before, and, generally speaking, if
8 these things are just foisted upon the audit
9 committee verbally at the meeting, the chances of
10 the audit committee members fully understanding and
11 being able to ask intelligent questions are fairly
12 low.

13 If we've had a chance to look at the
14 material in advance and particularly then ask
15 questions, maybe call or e-mail in advance and ask
16 for a little bit more elaboration, if we wish to,
17 there can be much more robust discussion and more
18 effective discussion at the meeting.

19 I think, Marty, the idea of having an
20 after-the-fact follow-up with the material, in other
21 words, having the audit committee receive the
22 documents of the accounting firm confirming the

1 discussions kind of defeats the purpose.

2 It seems to me that if we're going to have
3 something in writing, those materials should go to
4 the members of the committee in advance so that they
5 can be part of the effective communication to lead
6 to better discussions at the committee meetings and
7 enhance the entire process for everyone.

8 MR. BAUMAN: Great. Thanks, Denny. Kiko.

9 MS. HARVEY: Yes. Thank you, Marty. I'm
10 having difficulty, having sat in the room with audit
11 committees and auditors and trying to figure out how
12 we're going to operationalize this documentation of
13 oral communications. It just seems problematic,
14 generally speaking, that, you know, there's a free
15 flow of communications. There's a lot of back and
16 forth and questions and answers, and I don't see
17 anybody, other than the secretary, taking the
18 minutes of the meeting, you know, who's a scribe in
19 that process. So I find it difficult to do.

20 That being said, so I'm a big proponent of
21 having material matters in writing. I don't like
22 this thought of the auditors going back to their

1 desks and documenting a whole bunch of discussions
2 they had with the audit committee and then not -- or
3 with management and then not sharing that
4 information. So I would caution against that.

5 I do think the matters that should be in
6 writing, if they were oral, if you were going to go
7 down that path, anything that's obviously audit-
8 related, audit conclusions, discussions about issues
9 that they've settled in on, one way or the other,
10 and I do think that it should only be the important
11 communications, certainly not the back and forth and
12 casual communications that we have or we'll have
13 hundreds and tens of hundreds of documents to go
14 through.

15 MR. BAUMAN: Thank you. Sam Ranzilla.

16 MR. RANZILLA: I think you run the risk
17 of, if everything's in writing, maybe reducing --
18 one is I think you run the risk of some boilerplate
19 with some of the more sensitive issues, and I don't
20 think it's boilerplate around things that would
21 already be in the workpapers. The thing that sort
22 of comes to mind for me that would be boilerplate

1 might be around a discussion around your overall
2 view of the quality of the company's financial
3 reporting. You know, is it aggressive, ugly,
4 whatever terms you might use. It's that sort of
5 thing.

6 I'm not -- I don't -- oral or written, I
7 mean, if you're reaching a conclusion that the loan
8 loss allowance is appropriately stated within the
9 context of the financial statements taken as a
10 whole, you're going to -- that's going to be in your
11 papers just dead on. You're not going to be
12 uncomfortable with reaching that conclusion.

13 So I think it's around the more subjective
14 areas. I think you run some risk associated with
15 some boilerplate language around it. I don't know
16 if that's the end of the world. We live in a legal
17 environment where boilerplate is sort of a fact of
18 life.

19 If all the communications were required to
20 be in writing, you know what, at some point we got
21 to stop documenting everything that occurs. I mean,
22 I think that's excessive, to say here are the

1 requirements, put them in writing, and that anything
2 -- discussion that you have around them also has to
3 be documented. I could see -- I mean that's just
4 anarchy.

5 And again, you know, I think I'm making
6 almost no progress on this, but again am troubled by
7 the writing of auditing standards meant to enhance
8 the inspection of auditors. I don't think that's
9 why -- you write auditing standards to make it
10 easier for your inspectors to do their work and I'll
11 leave it at that.

12 MR. BAUMAN: Were there any other
13 comments? I'm sorry.

14 MR. COOK: I just wanted to make one
15 suggestion and I agree with most of what was said
16 about the value of written communications, but would
17 you please, as you put this together, be practical
18 and think about the realities of spontaneous
19 communications and the advantages of something other
20 than a written letter reviewed and all of those
21 things?

22 Maybe a PowerPoint slide or two might get

1 the job done in a particular case. Just try to keep
2 this as general as you can, still meeting whatever
3 objective you're trying to accomplish and
4 particularly, while I agree 100 percent with what
5 Denny said, it's so much more effective if you have
6 it in writing in advance, a chance to read it, but
7 spontaneous communication in executive sessions and
8 elsewhere is invaluable, and the last thing you want
9 is somebody who says, well, I'm sorry, I can't talk
10 to you about that because I have to go put it in
11 writing and I'll send it to you next week.

12 So allow for subsequent documentation of
13 conversations or as much flexibility as you can if
14 you're headed down that road.

15 MR. BAUMAN: Thanks, Mike. Arnie Hanish.

16 MR. HANISH: Yes. Marty, just one
17 comment, and I went back and in preparation for
18 this, I went back and looked at our auditor
19 communications that take place already and I guess
20 it wasn't clear to me, and I haven't commented
21 previously, as to what problem are we trying to fix
22 here with this issue because I look at the

1 communications that take place between our auditor
2 and the audit committee.

3 It's, for the most part, everything fairly
4 detailed and in writing in advance, goes out in
5 advance. It covers most of what everything
6 everybody's talked about here and I guess I question
7 what's really broken in my mind with the way the
8 communications are today in writing.

9 You know, there may be ad hoc
10 communications that take place that are not part of
11 this document that take place -- that get sent out
12 in advance, but, generally speaking, the corporate
13 secretary will minute a lot of that at a reasonably
14 high level as to what takes place in the course of
15 the conversations inside the audit committee meeting
16 and that seems to be, at least in my mind, an
17 adequate level of documentation.

18 If there was something additional that was
19 critical that maybe wasn't captured, maybe that
20 could be incorporated inside the minutes of the
21 audit committee by the corporate secretary. I'm
22 just not sure why you need to have the auditors

1 writing voluminous additional memos for the files
2 documenting maybe what was said in an ad hoc manner.

3 MS. VANICH: Arnie, just to respond to
4 that briefly, we appreciate your comments. One of
5 the things we considered in drafting this language
6 was some findings that were reported in the Board's
7 4010 Report on Triennially-Reviewed Firms and there
8 were some instances where firms were not making all
9 the required communications or it wasn't evidenced
10 in any way in the workpapers. So I think we tried
11 to strike a balance between some firms that we see
12 do a pretty robust good presentation and a good job
13 versus those who are not doing even what's required
14 now.

15 MR. BAUMAN: I think I see two more -- one
16 card and one hand up here. So in keeping with the
17 spirit of trying to get all these topics covered,
18 George Munoz and then Bob.

19 MR. MUNOZ: Just very quickly, Arnie,
20 Arnie asked about, you know, what's broken, and I
21 think we always have to ask ourselves that, but just
22 did the PCAOB do a study on whether the accounting

1 firms that audit the public firms that got in
2 trouble, whether the accounting firms had any issues
3 with their requirements that the PCAOB oversees was
4 part of the problem?

5 MR. BAUMAN: I'm probably not going to
6 answer the question anyway, but I wasn't sure I
7 understood it.

8 MR. MUNOZ: Okay. I guess we got a
9 proposal before us because somehow somebody thinks
10 something's broken or could be greatly improved and
11 that's why it's worth a cost and worth all these
12 extra procedures and putting things on the agenda.

13 So I assume did that stem from a study
14 that the PCAOB did in terms of the fiasco that, you
15 know, our companies went through a year and a half
16 ago or so?

17 MR. BAUMAN: I'd say that the standard,
18 the proposed standard on auditor communications with
19 audit committees reflected a number of things and
20 that was observations from our inspections process,
21 observations of some of the best practices we were
22 seeing where there were communications with audit

1 committees, but they weren't in our standard that
2 some firms were doing but on certain engagements but
3 not on all, and observations from what other
4 standard-setters were doing.

5 So there were a variety of things that
6 input into our thinking as to this proposed
7 standard. So I wouldn't say there was a particular
8 study done but just a lot of variety of factors that
9 influenced our thinking.

10 Alex, you okay? Well, thanks for the
11 lively discussion on this topic. I think it gave us
12 a lot of things to think about regarding a subject
13 that doesn't sound that complex about whether it
14 should be written or oral but there's a lot of
15 strong views on it and a lot of different views and
16 balancing, I think, that comes into play, as well.
17 So thanks for your thoughts.

18 The next topic is audit committee
19 responsibilities and the engagement letter.

20 The existing PCAOB standards require that
21 the auditor establish an understanding with the
22 client regarding the audit and given changes in

1 Sarbanes-Oxley where the audit committee was put in
2 the middle between the auditor and the audit client
3 with the responsibility of the auditor dealing with
4 the audit committee, we made a change, proposed
5 change in the standard that the auditor should
6 establish a mutual understanding of the terms of the
7 engagement with the audit committee in connection
8 with the audit as opposed to typically that letter
9 was so the engagement understanding was with
10 management, and the mutual understanding includes
11 communicating to the audit committee the objectives
12 of the audit, the responsibilities of the auditor,
13 responsibilities of management, etcetera.

14 Several commenters actually stated that
15 the mutual understanding should include the audit
16 committee's responsibilities related to the audit,
17 as well, and that those responsibilities should be
18 included in the engagement letter and one commenter,
19 included a briefing paper here on Page 8, gave a
20 number of suggestions as to what should be included
21 in that letter.

22 So that's the next topic of discussion and

1 that is, the question is should the engagement
2 letter include the responsibilities of the audit
3 committee, in addition to those of the auditor and
4 management, and, if so, what should those
5 responsibilities be?

6 And I've asked two people to address this
7 topic, Bob Dohrer and Jim Cox and maybe, Bob, you
8 could start us off.

9 MR. DOHRER: Sure. Thanks, Marty, and
10 actually I think this dovetails nicely with some of
11 the prior discussion we've had around the
12 effectiveness of two-way communication and other
13 issues surrounding who does what in an audit and
14 who's responsible.

15 As we know, the proposed standard
16 includes, among other objectives, objectives for the
17 auditor to communicate to the audit committee the
18 responsibilities of the auditor and to, as Marty
19 alluded to, establish a mutual understanding of the
20 terms of the engagement, as well as to evaluate the
21 adequacy of the two-way communication.

22 Today, the engagement letter essentially

1 lays out the responsibilities of the auditor and of
2 management, but, of course, is currently void of any
3 description of the responsibilities of the audit
4 committee and I harken back to earlier today, the
5 description of the three-legged stool and one of
6 those legs are completely missing in the engagement
7 letter.

8 So in the spirit of promoting effective
9 two-way communication, I think the question needs to
10 be asked whether or not a well-articulated and
11 mutually-agreed-upon description of the
12 responsibilities of the audit committee contained in
13 the engagement letter would actually facilitate or
14 enhance in any way the effectiveness of the two-way
15 communication, and if the answer to that is yes, I
16 don't think -- you know, I'm quite sure the
17 Sarbanes-Oxley Act doesn't go into any detail about
18 what the responsibilities are, other than for
19 oversight of the audit process, but actually taking
20 -- drawing from the proposed standard some of the
21 items that were discussed there, I think the list
22 potentially for the audit committee responsibilities

1 is not long and not prescriptive, other than, you
2 know, naturally to provide oversight to the
3 financial reporting process, to inform the auditor
4 about anything the audit committee knows that would
5 be relevant to the audit would certainly be expected
6 and then getting into kind of some of the elements
7 or criteria that were laid out that would be useful
8 and effective in evaluating the effectiveness of the
9 two-way communication could also be included perhaps
10 in the engagement letter.

11 Things like taking timely and appropriate
12 actions and willingness to meet in the absence of
13 management with the auditor, so on and so forth. So
14 the question then in our mind is whether or not
15 clearly-articulated and mutually-agreed-upon
16 responsibilities of all three parties in this
17 scenario would actually enhance more effective
18 communication.

19 Thank you, Marty.

20 MR. BAUMAN: Thank you. Jim Cox.

21 MR. COX: Yes. Thank you. I think I can
22 be brief.

1 All the letters did point out what Bob was
2 saying and that is, that all the letters commenting
3 on the proposal, the importance of the engagement
4 letter generally and the audit committee's missing
5 from that, for perhaps historical reasons.

6 In a way, the audit committee's really not
7 missing from that at all because audit committees
8 customarily have -- I think the percentages are very
9 high -- a charter that sets forth what their
10 obligations are.

11 So when I looked at this proposal and
12 thought about it, I was trying to figure out what
13 would really be added by adding something to the
14 engagement letter that was already in a charter at
15 some location. You know, the only thing I could
16 come up with is that the ritual is important, but I
17 think that that's of momentary importance.

18 It did make me think that what would
19 happen in the instance in which there was an audit
20 of a firm that for some reason a very small group
21 that didn't have a charter at which point that then
22 I think a reasonable auditor would then ask the

1 questions about, well, what do you envision your
2 role as since it's not memorialized, etcetera, and
3 if you just visit our website we can provide you
4 with a charter and we can take care of this in a
5 nanosecond.

6 So at the end, being an academic, I'll end
7 on this ponderous note and that is, I'm not sure
8 what this would really address that wouldn't be
9 already addressed in any fashion anyway through
10 reasonable standards. It's not clear to me that
11 it's a problem that's broken nor is it a problem
12 that's really missing something, this third prong of
13 the stool, because it's in likely the charter.

14 MR. BAUMAN: Thanks for those comments and
15 let's take some cards around the table. I think,
16 George, yours was up first.

17 MR. MUNOZ: Yes. Thank you, Marty. I
18 think I'd question if the engagement letter which is
19 a contract now includes some obligations on the part
20 of the audit committee on a contractual basis,
21 whether there's a potential conflict with the
22 fiduciary duty that the audit committee has to the -

1 - and this contractual arrangement that it now has
2 with the auditor and what the real purpose of that
3 is and throughout this whole thing what we have to
4 keep in mind is that there are maybe 90 percent
5 other ways that the audit committee is engaging with
6 management, engaging with the board, engaging with
7 the other parties that the auditor's not in the loop
8 for and does not need to be in the loop for.

9 So somehow, you know, these requirements
10 of reporting and communication and assessing seems
11 to indicate as if the auditor needs to be present
12 throughout all those situations and I just would be
13 cautious.

14 I don't know what the answer is, but if
15 there's a potential conflict of fiduciary duty with
16 the contractual agreement, I think we have to be
17 cognizant of that.

18 It also sets a precedent; that is, once
19 you include something in that engagement letter of
20 "obligation" on the part -- a contractual obligation
21 on the part of the audit committee, you've opened up
22 the door to that kind of add-ons and it doesn't take

1 long before the audit team -- the auditor starts
2 saying you know what, I want them on the hook, I
3 want this, I want that, and the next thing you know
4 -- so there's a potential conflict.

5 Isn't the bottom line that the auditor
6 here is supposed to be independent; that is, they
7 call it as they see it. It's like an umpire. They
8 come in, they do the work, they assess everything
9 else, and they call it as they see it. There's a
10 weakness or there's a problem or the audit committee
11 is weak, there's an issue, and they report on that,
12 and I think that's the way it should be stated as
13 opposed to a contract, the way it's proposed.

14 MR. BAUMAN: Thanks. Well, just to be
15 clear, in the proposed standard, there was not a
16 requirement for the engagement letter to include
17 responsibilities of the audit committee. That was a
18 suggestion that was made by several commenters to
19 us, just to make sure that that point was clear.

20 Roger Coffin.

21 MR. COFFIN: Thank you. I think that the
22 innovation in Sarbanes-Oxley to put the audit

1 committee in control of the audit process in my
2 judgment was probably one of the most significant in
3 corporate governance in a long time and therefore
4 when I approached this standard and what we're
5 talking about now is the concept that you mentioned,
6 Marty, of defining the roles of the audit committee
7 in an engagement letter, I think in a perfect world,
8 it has some attraction and it sounds like a good
9 idea, but the more that I thought about it, the more
10 that I thought that the concept of the charter, for
11 example, and which, by the way, I mean anyone who
12 takes a look at audit company charters will know how
13 long and how defined they are.

14 When I teach this in my class, I'll take a
15 bunch of audit company charters and go through them
16 with students and they'll say you mean this is not a
17 full-time job. I mean, they're very lengthy.

18 And when I think about how this might play
19 out and given that there are over 12,000 public
20 companies and thinking about what all these
21 contracts might say, I guess I come down on that
22 this might be a box that you might not want to go

1 down.

2 I think it's a fair question to ask
3 whether or not, you know, because you do want to
4 have this concept that's clear and delineated, what
5 the roles and responsibilities of all sides, but I
6 think you have to leave the audit committee's roles
7 and responsibilities to the governance process; that
8 is to say, to the shareholders as it's set forth in
9 their charter, subject to various, you know, other
10 rules of perhaps the SEC or the listing standards
11 and leave that piece out of it for want of just
12 getting into something that is going to cause I
13 think ultimately the PCAOB more trouble than it's
14 worth.

15 Thank you.

16 MR. BAUMAN: Linda Griggs.

17 MS. GRIGGS: My only observation is that
18 often these engagement letters are not actually
19 something that's negotiated, unlike most contracts
20 which are negotiated and the words are worked out.

21 You normally are handed an engagement
22 letter by the accounting firm and you take it or

1 leave it and when you try to raise comments, they're
2 frequently rejected because this is our form.

3 So while I think it would be a great idea
4 if you really did have a back and forth and you sat
5 down and the auditors said to the audit committee
6 I'm really expecting you to do this, that, and the
7 other and you actually had a meeting of the mind and
8 a mutual agreement on responsibilities, that would
9 be great. In the real world that won't happen.
10 We'll be handed the engagement letter and we'll take
11 it.

12 So I think I'm with Jim. We've got a
13 charter. The charters are very robust. If audit
14 committees aren't fulfilling the terms of their
15 charter, like I said before, it seems to me the
16 auditors should sit down and talk with them and say,
17 look, we think there's some inadequacies in our
18 communication, but I don't think this is the way to
19 do it.

20 MR. BAUMAN: Okay. Thanks. I think we've
21 gotten some pretty clear views on that question and
22 in keeping with our grand plan to get us on schedule

1 and out of here by 3 o'clock, Topic 6 on Management
2 Communications which we're going to ask Gary
3 Kubureck to lead the discussion. Gary agreed with
4 us that we probably covered management
5 communications extensively this morning, as our
6 entire discussion about communications and what
7 should be communicated by management versus the
8 auditor.

9 So we're zooming right past Topic 6,
10 unless there's any objections. If somebody was
11 really, you know, waiting to get a comment out on
12 that, and we're going to Topic 7 on -- I'm sorry.
13 Larry Salva.

14 MR. SALVA: Can I just ask a question
15 because I noticed that in between Paragraph 12 and
16 13, you had the note after 12 basically
17 acknowledging things communicated by the management
18 need not be repeated, but to the extent that
19 management has covered anything in Paragraph 13,
20 shouldn't that same guidance apply?

21 MS. VANICH: Larry, I think that the way
22 it's bifurcated now leads to we do believe what's in

1 13 should be communicated by the auditor because in
2 most instances it represents the auditor's views and
3 so the auditor's views should be coming from the
4 auditor.

5 A few of the other matters in Paragraph 13
6 are similar to the SEC requirements. The SEC
7 requires the auditor to report critical accounting
8 policies and alternative treatments under GAAP and
9 therefore we picked up the same type of language.

10 MR. BAUMAN: So Paragraph 12 was more
11 about the financial statements, critical estimates
12 that were in the financial statements. 13 is more
13 about the auditor's qualitative assessment of the
14 adequacy of disclosures and the propriety of the
15 accounting policies given the situation in the
16 industry, etcetera.

17 MR. MUNOZ: I guess maybe I just -- I'll
18 take issue with that and think that, just as a
19 general matter, especially if it's a collaborative
20 kind of, you know, working relationship between
21 auditor, audit committee and management, that to the
22 extent that the management has made a presentation

1 and often the audit committee will turn to the
2 auditors and ask them if they have additional
3 comments, that's when we hear them and if we don't
4 hear them, then I assume that they're going in
5 executive session and supplementing the comments if
6 they don't want to make them in front of me.

7 But, you know, I just think that, to the
8 extent they're made by management, they need not be
9 repeated.

10 MR. BAUMAN: Thanks. And I agree. We've
11 had a lot of input today about Paragraph 12
12 requirements and who should make those
13 communications and Paragraph 13. So we've gotten a
14 lot of valuable input on that during the day.

15 Moving to Topic 7, Jennifer.

16 MS. RAND: Thanks, Marty. So the next and
17 last discussion topic is on Uncorrected
18 Misstatements.

19 Just to remind everybody, the proposed
20 standard requires the auditor to provide the audit
21 committee with the schedule of uncorrected
22 misstatements related to accounts and disclosures

1 that was presented to management.

2 We included this requirement in the
3 standard because we believe it's consistent with the
4 requirement of the SEC which requires the auditor to
5 report to the audit committee material written
6 communications to management and they include
7 unadjusted differences as one of those items.

8 In addition, although management and the
9 auditor may have concluded that these misstatements
10 are immaterial to the financial statements,
11 misstatements could be material in future periods,
12 especially to the extent they result from a control
13 deficiency which is not mitigated.

14 So that's another reason we thought it was
15 appropriate to share those types of issues for the
16 audit committee's considerations.

17 A number of commenters didn't object to
18 this requirement. However, some did object to it
19 and felt that the requirement resulted in providing
20 the audit committee with too much detail on
21 adjustments that do not have a material effect on
22 the financial statements.

1 So we're seeking views on whether or not
2 the schedule -- you know, this requirement should be
3 included in the final standard and we'd asked Arnie
4 Hanish to open up the discussion with his views.

5 MR. HANISH: Thank you, Jennifer. I'll try
6 to be brief, and the issues that at least I see
7 around this center more on clarification of
8 materiality. While I don't disagree at all, it's
9 important that auditors provide a list of unadjusted
10 misstatements, uncorrected misstatements to
11 management as well as the audit committees.

12 I just want to make sure that it's
13 perfectly clear and concise within the proposal that
14 this will be done based upon materiality levels. We
15 all have thresholds that are provided to us.
16 Auditors go through an analytical analysis as to
17 what those thresholds will be as to what would get
18 communicated. It varies from company to company,
19 based upon the size of the company, income of the
20 company, relative size of the balance sheet.

21 I just believe that we need to be
22 consistent in keeping with those levels of

1 materiality and not necessarily encumber the audit
2 committee with a degree of detail that would be,
3 quite frankly, inappropriate as far as a level of
4 some items which might be uncovered as part of the
5 audit as uncorrected misstatements.

6 I do believe that items that result and
7 would have resulted in, if left uncorrected,
8 significant deficiencies, material weaknesses, or
9 could have suggested that there were trends from
10 year to year clearly need to be communicated and
11 that's something that I believe needs to be made
12 clear in the statement, as well, with regard to the
13 impact that these left uncorrected would have on the
14 degree of controls relative to significant
15 deficiencies or material weaknesses.

16 So that is pretty much the degree of
17 comments that I wanted to make as far as
18 introductory remarks to try to set the stage. It's
19 not that I would necessarily personally object. I
20 believe that it's important to have communications
21 of that sort to the audit committee. It's really
22 the degree and the amount and the number of

1 uncorrected misstatements and I guess one other
2 point is I would -- I don't believe it's necessary,
3 again unless it would result in a controlled
4 deficiency and a significant controlled deficiency
5 to report to the audit committee those items that
6 management has corrected that were discovered by
7 management during the normal course of their audit.

8 I think, quite frankly, if management
9 finds things during the normal course -- I'm sorry -
10 - not of its audit, of its closing process. To me,
11 that's a positive in the sense that management has
12 the appropriate controls in place to detect items
13 and has found them and corrected them appropriately
14 and again, unless it was pervasive and suggested
15 that there was a control breakdown or a significant
16 deficiency or material weakness in internal
17 controls, other than that, I really don't believe
18 it's necessary for an auditor to communicate those
19 items that management has detected during its
20 closing process.

21 MS. RAND: Thanks, Arnie. Denny
22 Beresford, you had your card up.

1 MR. BERESFORD: I think this is a useful
2 disclosure for audit committee members.

3 The one thing I would ask you to consider
4 adding in this case is some guidance on disclosures;
5 that that is, I've seen remarkable amount of
6 inconsistency in my limited board experience on what
7 information auditors feel they have to provide to
8 audit committee members with respect to omitted
9 disclosures and I just don't think that people
10 understand right now what the ground rules are and
11 in theory, I guess, if you went down the typical
12 GAAP checklist, there could be scores, if not
13 hundreds, of omitted disclosures on the basis of
14 materiality and that's clearly not going to be very
15 helpful to audit committee members.

16 But I think it is something that's not
17 covered at all in the existing auditing standard and
18 I suggest that it's something you should give some
19 consideration to.

20 MS. RAND: Arnie, can I ask a follow-up
21 question regarding your last point on disclosures?
22 I'm just curious if you've seen any or had any

1 communications or best practices of how omitted
2 disclosures would have been presented to you as an
3 audit committee member, chair, any suggestions in
4 that area?

5 MR. BURNS: What I can say is that in one
6 of my boards, one of the firms has simply listed
7 omitted disclosures, said that these were ones that
8 they thought were technically required under GAAP
9 that were omitted on the basis of immateriality. On
10 the other boards, there was no such listing. They
11 just never said anything about any disclosures that
12 were omitted. I don't know if any of the other audit
13 committee members have seen any listings of omitted
14 disclosures.

15 MS. RAND: Thanks, Denny. Kiko Harvey.

16 MS. HARVEY: Yes. I generally support the
17 submission of the uncorrected misstatements to the
18 audit committee. I think that's probably pretty
19 common practice anyway.

20 But on this matter of corrected
21 misstatements, I agree that if management is
22 identifying them as part of the normal closing

1 process, I don't believe that those require any
2 disclosures of the audit committee.

3 The ones I would be a little bit more
4 concerned about, though, are those that are caught
5 that relate to a prior accounting period that's
6 already been filed. Obviously that would beg the
7 question of whether or not that's an issue under
8 ICFR, but I really -- you know, I -- because of the
9 materiality, I just don't know how that's captured
10 in practice, as well, and I would like to see some
11 emphasis in that area.

12 MS. RAND: Thank you. Just as far as your
13 point on corrected misstatements that are picked up
14 through the normal close process, we didn't include
15 that as a requirement. It's just ones picked up by
16 the auditor. So I think that's come up a couple of
17 times.

18 George Munoz.

19 MR. MUNOZ: This is, I think, a good
20 requirement and that's because the audit committee
21 is not only looking at the financial statement, the
22 current financial statement but it's evaluating --

1 it's evaluating management and it's evaluating the
2 outside auditor and so as it gets information about
3 uncorrected misstatements or the like, over time, so
4 I would favor that it doesn't have to be material
5 because over time the audit committee can be better
6 positioned to evaluate or judge the work and the
7 interactions between management and the outside
8 auditor and even qualifications.

9 So from that perspective, I would not
10 restrict it only to materiality but this is a good
11 requirement.

12 MS. RAND: Thank you. Gary Kubureck.

13 MR. KUBURECK: Thanks, Jennifer. I'll be
14 quick. First of all, I'd echo Arnie's comments on
15 stuff found by management in the ordinary course of
16 the close which will be hard to define what is
17 ordinary closing adjustment versus sound controls
18 versus something that's significant deficiency
19 material weakness which probably should be brought
20 to the auditor's attention, to the audit committee's
21 attention.

22 I do support a SUD, you know, being

1 presented to the audit committee. I'm actually
2 hanging on the one word, "the same schedule of
3 uncorrected differences." I would -- I don't think
4 that they really mean the same schedule, looking at
5 us as a multinational company.

6 There's many schedules, subsidiary and
7 business unit levels, and some of which you've got
8 postings significance of very small dollars, small
9 subsidiary because, you know, a statutory audit
10 report's coming versus what affects the consolidated
11 financial statements taken as a whole.

12 So I would be careful in the use of the
13 word "same" and then likewise even if it's the same
14 items, the one presented to management might be the
15 more granular level of detail as what specific
16 account number does it belong to and again that's
17 sort of irrelevant at the consolidated level. So
18 just be careful on the use of the word "same."

19 My last comment is regarding disclosure
20 omissions. The FASB, as you may know, has a project
21 on disclosure framework and what should a disclosure
22 framework look like and one of the things that

1 working group is wrestling with is what is the
2 answer to the question.

3 As you know, every FASB standard, the last
4 box said, you know, this can be omitted, you know,
5 doesn't have to be applied to individual items.
6 Well, does that mean if you omit it, it's perfect,
7 it's GAAP, or does it mean no, it's still not GAAP,
8 even if it's small, but we're just not going to make
9 a big deal out of it, and they're wrestling with
10 what is the answer to that question.

11 If you say if it's immaterial and the
12 conclusion is it's GAAP to omit it, if it's
13 immaterial, then there is no issue. So they're
14 wrestling with that and my only advice, Jennifer and
15 Marty, would be to sort of stick close with the
16 FASB's project team on this. I don't know where
17 they're going to come out but they are working it.

18 MS. RAND: Thanks, Gary. I wanted to
19 comment on one of the things you said which was the
20 word "same." I think you were suggesting that maybe
21 not the same schedule needed to be presented to the
22 audit committee as management and the way we drafted

1 the requirement in the proposed standard is it is
2 the same.

3 We are aware of some instances, have
4 concerns or could be others, that a different type
5 of schedule might be -- you know, would be presented
6 to the audit committee that is misleading to the --
7 you know, that may net some of the adjustments that
8 appear better than it really may have been or just
9 isn't giving a true or fair presentation of what
10 happens. So that's a reason why we use the word
11 "the same" so that that might not happen.

12 Lynn Turner.

13 MR. TURNER: I'd just like to say I agree
14 with what Denny was saying about a list of omitted
15 disclosures. I think we've seen times where people
16 have left information on pension plans out of
17 footnotes and that type of stuff and so requiring
18 that, I think, would be helpful, in addition to the
19 unadjusted entry score sheet, which I would have
20 just the auditor things on it. I wouldn't -- I
21 agree with Arnie. I wouldn't throw everything on it
22 that management finds. I think that's part of the

1 overall internal control analysis.

2 MS. RAND: Okay. Thank you. Mary Hartman
3 Morris.

4 MS. MORRIS: Thank you, Jennifer. I just
5 wanted to point out a couple things that people have
6 said and that was, I do agree that it should be
7 included, uncorrected misstatements, and it should
8 be provided to the audit committee because I think
9 that all of us have gone through, you know,
10 different divisions have to go through and correct
11 or look at some of these issues and deal with it
12 through management and I don't know necessarily the
13 audit committee sees the big picture and, you know,
14 cumulative effect and so I think that that would be
15 helpful because I think it was brought up about
16 whether or not there's some trends or pervasiveness.

17 So I think that, you know, just seeing
18 that, you know, is not something that the audit
19 committee has to deal with a lot or work with it,
20 but just seeing that year over year they might get
21 that feeling of, okay, are there some issues that
22 are underlying that need to be addressed. So I

1 think that is important.

2 MS. RAND: Thank you. Arnie.

3 MR. HANISH: Jennifer, just one point of
4 clarification and just to make sure that I didn't
5 misrepresent anything in my opening remarks, that
6 we're talking about here, at least what I'm talking
7 about are those items that are above what I'll call
8 the threshold, that I mean I would hope that we're
9 not looking to have the auditors -- again just to
10 restate what I said earlier, that I'm hoping we're
11 not looking to have the auditors provide whatever
12 detailed lists there might be of things that are
13 below a certain threshold.

14 I think it's important to, in the
15 aggregate, maybe indicate to the audit committee
16 what those items were. I think it's important to
17 indicate if they're all going one way, but if it
18 nets out if they were below the threshold and the
19 aggregate was not above a threshold that had been
20 established for levels of materiality, I guess it
21 troubles me that we would provide that kind of list
22 of what I would consider to be very immaterial,

1 especially if it was in the aggregate below the
2 level of materiality that had been established,
3 either at the balance sheet level or the income
4 statement level.

5 MS. RAND: Our standards on evaluating on
6 differences of materiality would indicate that the
7 auditor would record those things that are above
8 being considered clearly trivial. So if it's
9 clearly trivial, it does not need to go on the list,
10 but otherwise individually in the aggregate if it's
11 above clearly trivial, then those type of things
12 would be recorded. So that might help some of your
13 concerns.

14 Harold Schroeder.

15 MR. SCHROEDER: I was just going to add,
16 having gone through that enough times in my 13 years
17 of auditing, there tended to be some games that get
18 played with this type of issue, oh, well, we'll put
19 this on the schedule, we won't put this on the
20 schedule, what are we going to say, is it judgment,
21 is it just application, is it a factual error, is it
22 a misapplication of accounting.

1 There are all sorts of different types of
2 these misstatements and I'm clearly in the camp of
3 this is a good -- some type of summary level,
4 telling an audit committee we had generally these
5 types of issues, half of them fell in the judgment,
6 half of them fell in the systems or cutoff issues,
7 whatever, just to give them a sense and feel because
8 I think it's a strong educational purpose, you know,
9 certainly not providing all of the individual layers
10 and detail, some high level, I think just a good
11 education.

12 MS. RAND: Don Nicolaisen.

13 MR. NICOLAISEN: I would just echo that.
14 I think one of the things that is helpful -- one of
15 the things that's not helpful is a whole lot of data
16 that gets provided, photocopies of schedules that
17 are uncorrected errors and misstatements and
18 omissions and whatever else that are just sort of
19 dumped on the audit committee. It's sort of the
20 same thing where there's random walks through we've
21 got a lot of estimates and the estimates are
22 difficult and it could be this or it could be that.

1 What you're really looking for, at least
2 what I'm really looking for, from the auditor is
3 some interpretative guidance that says this is
4 meaningful. We've never seen this many errors that
5 have gone uncorrected in our history of our firm.
6 You really ought to deal with this. That's helpful.

7 To just dump them on us and say here's a
8 bunch of stuff that we found during our audit and we
9 photocopied it and here you are and we're required
10 to give this to you, I'm not sure is a particularly
11 meaningful exercise.

12 MR. BAUMAN: Don, was that a real-life
13 experience you were --

14 MR. NICOLAISEN: No, but it could happen.
15 You never know.

16 MS. RAND: Charley.

17 MR. NIEMEIER: Yes. Just one follow-up
18 comment related to disclosure and I appreciate,
19 Gary, your comments about FASB's project.

20 I just want to highlight this because I
21 think disclosure is going to become a big challenge
22 when it comes to determining materiality. I'm not

1 sure there's any real set rules on that the way that
2 we deal with misstatements and correcting numbers
3 and one thing about FASB -- I'm not sure that FASB
4 has the ability to actually determine what is
5 material in that regard, even though it may present
6 some interesting information about that.

7 In the end, I think what a reasonable
8 investor believes is material under the securities
9 laws is what's going to be governing and it's just -
10 - I only point that out because I think this is an
11 area that's going to be a moving target.

12 What may have been deemed to be not
13 material as a disclosure item may actually become
14 material in the near future.

15 MS. RAND: Larry, you had a comment.

16 MR. SALVA: Yes. I would just make the
17 point in terms of summary of past disclosures, if
18 you will, is that I think what drives that, at least
19 in my experience, in seeing what the auditors put on
20 our lists, are the things that are clearly not the
21 ones that are getting there because they're
22 immaterial disclosures and they agree with that

1 conclusion and that it's not a tough conclusion to
2 get there.

3 It's the ones where there is a bit of
4 judgment involved in reaching that conclusion that
5 that omitted disclosure is not significant to a
6 potential user of the financial statements.

7 I think there's a judgment being made by
8 the auditors as to what they post on to that
9 schedule. There are clearly -- like we've taken
10 approaches that I've discussed with the SEC staff of
11 not making every required disclosure in our pension
12 footnote because we have frozen pension plans and
13 it's just not all that significant, but we make
14 certain disclosures there and the auditors, you
15 know, will reference that point because that's kind
16 of, you know, somewhat aggressive position, not
17 quite -- I don't think it's aggressive at all. I
18 think that's using the box at the back of the
19 standard that says if it's immaterial, don't include
20 it, but that makes it on to the list.

21 There are a couple -- a few minor other
22 things that make it on to the list, but they're

1 clearly not putting every item that shows up on the
2 disclosure checklist where they've made a note that
3 said it was immaterial.

4 MS. RAND: Thanks, Larry. Mike.

5 MR. COOK: Very quick observation on this.

6 I could have made this observation on at least a
7 half a dozen items before this, would be I think it
8 would be just fine to say that the auditors should
9 reach an understanding with the chairman of the
10 audit committee or with the audit committee on the
11 degree of information and detail prepared here or
12 provided here to meet the needs of the audit
13 committee within the boundaries of the standard and
14 then if you wanted to go on and say in the absence
15 of such an agreement, you can or can't give the same
16 schedule.

17 It's true of so many things, I think we've
18 been talking about, is really kind of wonder why the
19 auditors or the standard-setters for the auditors
20 are deciding what the audit committee ought to get,
21 as long as the standards are complied with, and I'm
22 not suggesting anything different than that, but

1 right in this one, just talk about it, see what it
2 is that the committee needs and provide it. It
3 doesn't seem too difficult.

4 MS. RAND: Thank you. I think, Mike, you
5 ended the session on that for us, and I don't see
6 any other tent cards.

7 We are getting close to 3, which is our
8 closing time. So we'll move into the wrap-up
9 section, and I'll turn it over to Dan Goelzer to
10 provide a wrap-up and summary.

11 MR. GOELZER: Well, thank you, Jennifer.
12 Marty did have to leave early because of a family
13 matter and asked me to do the wrap-up, but I am
14 going to be mercifully brief. I think we've had a
15 very busy and active day and so the only wrap-up I
16 would like to give is to thank everyone for their
17 participation, for their advice and for the ideas
18 that you've given us.

19 I think we certainly have a lot to think
20 about in terms of the standard. I don't know if I
21 would go so far as to say that there was a consensus
22 on anything, except possibly whether the audit

1 committee's responsibilities ought to be described
2 in the engagement letter or not, but we certainly
3 will carefully consider everything that we've heard
4 here today, and I think you'll see the results of
5 this meeting as we go forward with this project.

6 As I said in my opening remarks this
7 morning, I think the success of our standard-setting
8 is very much dependent upon the willingness of those
9 who have firsthand experience in the matters that we
10 deal with and give us the benefit of their views and
11 advice and from that perspective, I think this has
12 been a very effective roundtable.

13 So again, thank you very much to all of
14 you and I will adjourn the roundtable. Thank you.

15 [Whereupon, at 2:56 p.m., the roundtable
16 was adjourned.]

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