

**NOTICE:** This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on June 24, 2014 that relates to the Board's Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments. The other topics discussed during the June 24, 2014 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

+ + + + +

TUESDAY  
JUNE 24, 2014

+ + + + +

1           (...)

2           MR. BAUMANN:

3           The next item, or the last item actually on this  
4 page and the first item on the standard-setting agenda for  
5 March are the same and it deals with the auditor's  
6 reporting model. And we'll spend a little bit of time on  
7 this project over the next few minutes. This is really  
8 one of the Board's major initiatives, and it did come up  
9 before are we going to hear about this; I think it was  
10 Elizabeth that asked, and so I do want to spend some time.

11           So before this meeting, as part of the meeting  
12 materials sent out to SAG members -- materials related to  
13 the ARM project. And what we sent you was the Board  
14 proposed changes to the auditor's report in April -- August  
15 13th, 2013. And the fact sheet of what we proposed is in  
16 front of you. Just as a reminder, that dealt with the  
17 requirement for the auditors to report on critical audit  
18 matters, those matters that are addressed during the audit  
19 that involve the most difficult subjective or complex  
20 auditor judgments, pose the most difficulty to the auditor  
21 in obtaining sufficient appropriate evidence and/or pose  
22 the most difficulty to the auditor in forming an opinion

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1 on the financial statements.

2 We also proposed changes to the responsibilities  
3 for auditors with respect to other information in an annual  
4 report filed with the SEC that's not part of the audited  
5 financial statement, but other information that  
6 management might present. The auditor has an existing  
7 responsibility to read and consider that information.

8 We expanded that to read and evaluate that  
9 information with specific procedures as to what we meant  
10 by evaluation and also proposed that the auditor would  
11 report if they found that there was a material misstatement  
12 of fact in the other information or if they found that the  
13 other information contained a material inconsistency with  
14 the audited financial statements.

15 We didn't require really additional audit evidence  
16 or evidence to be gathered around that other information,  
17 but those conclusions would be drawn based on reading it  
18 and evaluating it in the context of the audit work done  
19 and the audit of the financial statements taken as a whole.

20 We received 246 comment letters on the proposal  
21 during the year. We received comment at the last SAG  
22 meeting. A major portion of that was getting input from

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1 the SAG members. In addition, in April 2014; and that  
2 material is in front of you as well; and many of you here  
3 participated in that, there was a two-day public meeting  
4 on the auditor's reporting model and we covered various  
5 aspects of the various components of this, the critical  
6 audit matters, issues around other information, issues  
7 pertaining to larger firms, smaller firms, etcetera.

8 But we also looked at other developments that were  
9 occurring around the world. And as part of the materials  
10 that I've shared with you I've included excerpts of what's  
11 now a requirement in the United Kingdom that went into  
12 effect for financial statements filed after September 30,  
13 2013 and periods after that. Is that right, Jessica?

14 MS. WATTS: Sounds right.

15 MR. BAUMANN: September 30th, 2013 and after that.  
16 And if you read the -- there was one page of that we took  
17 out from the U.K.'s standards was pretty principles-based.  
18 It said describe those assessed risks of material  
19 misstatements that were identified by the auditor and  
20 which had the greatest effect on the overall audit  
21 strategy, the allocation of resources in the audit and  
22 directing the efforts of the engagement team, provide an

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1 explanation of how the auditor applied the concept of  
2 materiality in performing and planning the audit and  
3 provide an overview of the scope of the audit, and few more  
4 words to that. And we've also included a couple of  
5 examples of reports that came out of the U.K. for your  
6 observation.

7 So as part of the meeting we had in April  
8 representatives from the United Kingdom who participated  
9 in some of these audits came over, as well as investment  
10 management professional came over, and it was a very  
11 positive report back in terms of the fact that the  
12 engagement teams felt, quote, "more engaged" in the audit  
13 and the fact that their reports were going to contain more  
14 useful information for investors.

15 The engagement partners felt that that was a  
16 positive impact on the audit taken as a whole and the  
17 investment management professionals who reported at that  
18 meeting felt that these more detailed reports gave the  
19 market more confidence in the work of the auditor as it  
20 spelled out some of the significant risks or critical audit  
21 matters, as we would call them here, that the auditor dealt  
22 with.

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1           But the examples in front of you -- there's two  
2 companies. One of them is -- compared to the traditional  
3 couple-of-paragraph report we see here in the United  
4 States, there's a six-page opinion of the audit spelling  
5 out about 10 different risks of material misstatement and  
6 the auditor's responses to those risks that they found.  
7 The other one I think is about a four -- about a five-page  
8 report or so on similar type matters.

9           I think the main point in that and what we heard  
10 in the April meeting is from those who in the comment letter  
11 said this is a real big challenge and for a variety of  
12 reasons can't be done. It will slow down the audit, will  
13 have other negative consequences, you know, the world will  
14 come to an end. That didn't really happen in U.K. The  
15 reports were issued pretty much timely from what we  
16 observed in a sample we've looked at, pretty much issued  
17 on about the same date as they were the prior period. And  
18 we inquired about cost, and at least in general the  
19 comments that were made at the public meeting were that  
20 the additional costs were largely minor. I mean, I'm  
21 characterizing that in my own way.

22           I don't know, Jessica, would you say it was

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1 different? No? That's about what we heard. But that's  
2 year one, and we'll have to see how these reports come out  
3 in year two. This is just a couple of them that we shared  
4 with you just so you could see that this is occurring.  
5 Reports came out in a highly principles-based way, the  
6 standard.

7           Shortly after that -- just one other thing -- the  
8 European Union came out with requirements after that which  
9 have now become final and have included those requirements  
10 in just a short page as well, which is similar, that the  
11 audit opinion must now include a description of the most  
12 significant assessed risks of material misstatement  
13 including material misstatements due to fraud, risk of  
14 material misstatement due to fraud and a summary of the  
15 auditor's response to those risks. In both cases as well  
16 the auditor's reports would have to comment on other  
17 information accompanying the audited financial  
18 statements.

19           So we are continuing to proceed on our path with  
20 respect to reflecting on the comments on the proposal,  
21 comments from the public meeting, comments from SAG  
22 members and we're working with the Board on our next steps.

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1 I thought I'd take -- there's a couple of cards up.  
2 But before I did that -- I see Mike Gallagher was up and  
3 Bob Herz. Before I did that, I've talked a little bit  
4 about our developments and other global developments, but  
5 clearly among those global developments are developments  
6 at the International Auditing and Assurance Standards  
7 Board, as they are also in the process of developing a new  
8 auditor's report -- and Arnold Schilder, a regular  
9 observer at our SAG meetings is here today, the Chairman  
10 of the IAASB.

11 And, Arnold, could you give us an update on where  
12 the IAASB is?

13 MR. SCHILDER: Yes, of course. Thank you very  
14 much, Marty.

15 We issued our third consultation audit report in  
16 July last year, and it was a very comprehensive exposure  
17 draft that included a number of new revised auditor  
18 reporting standards.

19 Comment period closed November 2013. A lot of  
20 reactions. And we've had some fulsome discussions with  
21 our advisory group and the National Auditing Standard  
22 Setters Liaison Group, and in both the PCAOB staff

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1 participated as well.

2 Our Board had a public meeting last week and I'm  
3 very pleased with the progress that we made. It was a full  
4 week. We spent over 60 percent of our time on that. And  
5 we had our first read through the suite of revised auditor  
6 reporting standards. We are track, as Jim also said, for  
7 finalizing them at our September meeting.

8 Our Board has 18 members, 9, as you said,  
9 practitioners, 9 including myself non-practitioners.  
10 And for approval we need at least 12 in favor.

11 We essentially closed off the discussions on our  
12 overarching reporting standards, ISA 700, and this now  
13 includes new requirements to make an explicit statement  
14 on independence, naming the engagement partner for listed  
15 entities, and also placing the auditor's opinion first as  
16 the overall conclusion that should be seen immediately.

17 A bit more specific on some key components. First,  
18 key audit matters. We've made excellent progress on this  
19 new standard, ISA 701, and that addresses the  
20 communication of key audit matters. Respondents to the  
21 exposure draft strongly supported the concept of KAM being  
22 based on matters communicated with those charged with

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1 governance, usually the audit committee, firstly focusing  
2 on matters of significant auditor attention.

3 However, findings from field testing and other  
4 feedback from auditors, standard setters and regulators  
5 suggested clarification was needed to ensure that there  
6 was a robust decision making framework to enhance  
7 consistency in auditor adjustment focused on topics that  
8 would likely be relevant to users. And users have told  
9 us that communications about individual methods should be  
10 as entity-specific as possible to enable them to  
11 understand key aspects of the audit.

12 And I should also mention that similar to the PCAOB  
13 feedback from preparers and audit committees has been less  
14 supportive regarding the concept of KAM. In their view  
15 it's their role to provide original information to users  
16 other than the auditors, and auditors and others including  
17 the IAASB itself agree to that. There's no discussion  
18 about that principle. But we found therefore the need to  
19 further clarify in the standard and in our outreach that  
20 the purpose of the auditor communicating KAM is to provide  
21 greater transparency about the audit.

22 We've now refined both the requirements relating

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1 to determining KAM and the application material which is  
2 guidance that is essential to the proper application of  
3 the requirements in the ISA. It has all set out  
4 conservations for the auditor in all cases focused on three  
5 areas.

6 First, areas of higher assessed risks of material  
7 misstatements or significant risks identified in  
8 accordance with ISA 315. And you hear of course bells  
9 ringing to what Marty just quoted. Second, significant  
10 audit adjustment relating to areas in the financial  
11 statements that involve the application of significant  
12 judgment or estimation by management. Third, the effect  
13 on the audit of significant events or transactions that  
14 occurred during the year.

15 We've also picked up many of the PCAOB's proposed  
16 required considerations in our guidance to help auditors  
17 focus on which of the methods that require significant  
18 auditor attention were of most significance in the audit  
19 and therefore the key audit matters.

20 And our most substantive Board debates to date  
21 relating to KAM have been on the possibility that the  
22 auditor might conclude in what we now call extremely rare

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1       circumstances not to communicate a matter that had been  
2       determined as a KAM in the auditor's report.

3               Your feedback to the exposure draft suggested this  
4       type of requirement was necessary for the Board's  
5       continuing to explore how this could best be done  
6       recognizing that it is necessary to put proper parameters  
7       around the decision not to communicate a matter and to  
8       promote disclosure in most cases.

9               Like you said, Marty, we have heard much positive  
10       feedback through the U.K. experience and we believe we  
11       should move forward as well recognizing that communicating  
12       KAM will require all of us to take a new and innovative  
13       approach to reporting. We are now already talking about  
14       implementation support and also post-implementation  
15       review.

16              Some key audit matters briefly on other  
17       information. We're also proposing auditor reporting on  
18       other information, which in our case is part of a separate  
19       project to revise that particular standard, but dealing  
20       with of course the information included in a company's in  
21       your report.

22              We received significant feedback to our first

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1 exposure draft and we found the need to re-deliberate the  
2 proposals to provide greater clarity on the auditor's work  
3 effort and the scope of information to be addressed. We  
4 also then had the opportunity to consider PCAOB's  
5 proposals on the topic. We re-exposed the standards April  
6 this year. Comments requested July 18, and we hope to  
7 finalize the standard 2014 or early next year.

8 Finally, going concern. Our exposure draft  
9 included auditor reporting on going concern. Like the  
10 PCAOB, we recognize the need to work closely with the  
11 accounting standard setters towards a more holistic  
12 approach to going concern, and we have been doing so in  
13 particular at the IASB. However, it's unlikely that  
14 changes will be made to the accounting standards of the  
15 IASB, so the IAASB has decided to revert to exception-based  
16 reporting in the auditor's report; i.e., including  
17 statements about going concern when a material uncertainty  
18 has been identified, which it will be now very close to  
19 the new legislation in Europe and I think as well where  
20 PCAOB currently is.

21 And our work continues to look at how it might  
22 increase auditor attention on going concern and response

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1 to calls arising from the financial crisis. And at our  
2 meeting last week we had some lively debates around the  
3 possibility of a new requirement aimed at enhancing the  
4 auditor's consideration of the adequacy of disclosures  
5 around going concern issues, including the need for and  
6 adequacy of disclosures about underlying events or  
7 conditions where a material uncertainty does not exist,  
8 the so-called close calls. And course that's of interest  
9 to the slides from the FASB in the area of significant doubt  
10 that had been alleviated by management plans.

11 Well, that's the area that we're discussing. We  
12 believe that it is important to help to drive behavioral  
13 changes in the way that both management and auditors  
14 approach the assessment of going concern, so it's  
15 important that we get it right.

16 Two closing comments: First, the IAASB started  
17 this project in 2006 with Independent Research Commission  
18 by us and the AICPA Auditing Standards Board. We then had  
19 two global rounds of consultations, 2011, 2012, and then  
20 the exposure draft in 2013. And I really would express  
21 how grateful we are for the dialogue that we had during  
22 this process with the PCAOB at various levels, the

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1 Financial Reporting Council, but also the European  
2 Commission and European Parliament. And we appreciate  
3 that the PCAOB has to operate within confidentiality  
4 requirements, so we're very grateful for the dialogue that  
5 we could have.

6 And finally, in line also with what you said, Marty,  
7 does it work? Let me give you one quote from an investor  
8 from the U.K. who has often been very critical to the  
9 auditing profession, Iain Richards from Threadneedle  
10 Asset Management. Quote, "While we are clearly at a very  
11 early stage in the development of this enhanced reporting,  
12 we have been pleasantly surprised by the usefulness of some  
13 of the disclosures. There is a strong subjective element  
14 in how we as shareholders assess the stewardship of a  
15 business and the quality of its reporting and auditing and  
16 these reports provide an important medium that can  
17 contribute to that. In a world that is rarely black or  
18 white, they also help underpin the credibility and trust  
19 that needs to be inherent in the relationship between the  
20 leadership of a company and its shareholders."

21 Pleasantly surprised. I wonder how long ago it is  
22 that an investor was able to say that about an auditor's

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1 report. Thank you.

2 MR. BAUMANN: Arnold, thanks very much for that  
3 update. And as I said, there are a number of cards up.  
4 Mike Gallagher was first.

5 MR. GALLAGHER: Thank you, Marty. Marty, I wanted  
6 to share with this group that the Center for Audit Quality  
7 has updated its response to the project, specifically  
8 indicating the results of field tests that were recently  
9 completed with respect to the auditor's reporting model.

10 So the field tests focused on a couple of things:  
11 CAMs was primary focus and for the CAM field test nine audit  
12 firms participated. Fifty-one issuers participated.  
13 With respect to other information, it was a smaller size.  
14 Six firms and fifteen issuers.

15 Before I get into the details; and I won't get into  
16 much, I'll give a very quick high-level summary of what  
17 the field tests found, but there were clearly some  
18 limitations to the field tests, a couple of which -- and  
19 probably the most significant of which, given the desire  
20 on the part of issuers to remain confidential and not have  
21 the information go beyond the accounting firm that did the  
22 work, we were not able to get a reaction from investors.

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1 So without getting the benefits, which is clearly what we  
2 would get from an investor perspective, you know, severe  
3 limitation, and we understand that.

4 The other limitation was it wasn't done under live  
5 conditions. So we looked at 2012 audits for purposes of  
6 developing the CAMs. So we didn't have the benefit of  
7 so-called game day conditions in terms of what it meant,  
8 in terms of time, when that time would occur and the impact  
9 on the audit.

10 That said, I think there were some useful findings  
11 that came out of the effort that should be considered as  
12 a data point. And I appreciate the time that we spent  
13 with, Marty, you and your team, and Jeanette participated  
14 from the Board perspective, a couple of weeks ago to listen  
15 to what we found in the field test.

16 And so at a very high level a couple of things:  
17 One, very similar to what I heard Arnold just say with  
18 respect to refining the population from what you would pick  
19 CAM, and as we talked about in previous SAG meetings we  
20 think it would be useful to refine it down from three maybe  
21 to one key source, which is information communicated to  
22 audit committees. We think that you'd capture things that

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1 are relevant there and without having to go through a  
2 larger population, which is largely redundant.

3 The other thing to consider there would be a  
4 materiality lens. I think materiality is implicit, but  
5 if there can be some more explicit recognition that, you  
6 know, the things that would end up in CAMs, to avoid too  
7 many CAMs, should be focused on things that are really  
8 meaningful and material. And recognizing that sometimes  
9 is in the eye of the beholder, many times in the eye of  
10 the beholder, but we make those decisions every day.

11 Two other things that related to documentation:  
12 One related to when auditors -- we found a pretty big range  
13 of documentation when auditors decided how many potential  
14 CAMs might there be and what's the documentation  
15 requirement. For the CAMs particularly, the CAMs are left  
16 on the cutting room floor. Making sure that we've got the  
17 right level of documentation. And even for the CAMs that  
18 go forward, how to document those going forward. Not  
19 looking for a cookie cutter, but maybe just a little bit  
20 more in terms of guidance, in terms of what the expectation  
21 would be from a documentation perspective.

22 And then the last item with respect to CAMs, again,

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1 a very broad range and diversity with respect to how the  
2 CAMs were written. Some in terms of the level of detail,  
3 the range of detail, just the volume. It was quite a  
4 range. And while you certainly want a certain range, you  
5 don't want these to be cookie cutter. We don't want them  
6 to be boilerplate. And that's one of the risks here. And  
7 so it's not a paint-by-numbers exercise, but perhaps  
8 there's an opportunity to put goal posts out there where  
9 you get an expected and a good range of outcomes, because  
10 I think there should be a range. And they all should not  
11 look the same, but is there an opportunity to kind of narrow  
12 the field from what we saw in the field tests.

13 With respect to other information, really one key  
14 finding; and again it's something we've talked about in  
15 previous SAG meetings, confusion over what "evaluate"  
16 means, and is that a higher standard than we're performing  
17 under today? Clearly, when you think about read and  
18 consider versus evaluate and report, it sure sounds like  
19 it's more. And so making sure we're capturing the intent  
20 of what the Board is trying to achieve and is "evaluate"  
21 the correct word or is there a better word that would create  
22 more clarity and consistency in terms of what the

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1 performance requirement would be.

2 But overall I'd go back and say -- you know, go back  
3 to the meetings that we had at the beginning of April.  
4 Very positive. I thought it was -- having the opportunity  
5 to participate, for which I was very grateful was -- I  
6 thought the meetings were terrific. I was there for the  
7 two days. And we're very supportive of the project and  
8 hopefully this is a useful data point that you can consider  
9 as it goes forward. Thank you.

10 MR. BAUMANN: Thanks, Mike. It is very useful,  
11 obviously any input like that that we receive to help us  
12 refine whatever our next step may be in terms of a  
13 re-proposal or whatever we do next. Hopefully we get it  
14 better. And as the IAASB has done, continue through the  
15 process of consultation, proposal, etcetera, to work  
16 through refinements to make sure we get the best product.

17 The auditor's report hasn't changed in the United  
18 States in about 75 years or so, so if we're going to change  
19 it, let's make sure we get as much information as we can  
20 and do it as well as we can. So thanks for that.

21 That letter from the CAQ I think is now up -- has  
22 been delivered to us and is available with other comment

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1 letters that we've received on our website.

2 The next card that I saw go up was Bob Herz.

3 MR. HERZ: Thank you. Again, this is on the  
4 auditor's reporting model, and for this purpose I will not  
5 include the evaluation of the other information, just the  
6 reporting on CAMs or key matters. One is an observation  
7 and one is more of a comment.

8 The observation is just to add to what Mike talked  
9 about, the CAQ, and this is a much less robust or scientific  
10 sample, but I had the opportunity to participate in two  
11 meetings, one in the U.S. and one in the U.K. of audit  
12 committee chairs and members.

13 The U.S. meeting, which was sponsored by the NACD,  
14 I think a lot of the concerns that you've been hearing about  
15 disclosure of original information potentially in the  
16 report, lack of clarity on certain things and all the other  
17 points that we discussed at a prior meeting were raised  
18 by audit committee members, or a number of audit committee  
19 members.

20 I was in the U.K. subsequent to that and at the point  
21 that they were -- had issued some of these reports or were  
22 working on them. And I'll reinforce that the reaction

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1       there among audit committee people there, particularly  
2       what I'll call the not-inside-baseball people, or maybe  
3       it should be not-inside football people; in other words,  
4       they didn't come from the profession, they hadn't been with  
5       one of the firms or whatever, they were people that had  
6       been in business or had been regulators or whatever, was  
7       extremely positive to the expanded reporting. And so they  
8       really started to get much better insight into what was  
9       looked at in the audit and what was found and the like.

10               In that regard -- and I guess kind of in the camp  
11       of you'd be disappointed if I didn't say this, Marty, but  
12       at one of the prior meetings I said when you guys had some --  
13       a couple of examples of the kind of things that might be  
14       reported and how they might be reported, I made the  
15       observation that they kind of pointed to the area and the  
16       like, but then they didn't say, well, what did the auditor  
17       do and what did the auditor find?

18               And so when I read the U.K. examples; and we've got  
19       two of them here, Rolls Royce and HSBC, I thought it was  
20       very good the way they did that. It didn't leave you  
21       hanging there. It kind of wrapped it all up.

22               MR. BAUMANN: Yes, I think all of these experiences

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1 and field testing and IAASB's outreach and those kind of  
2 comments are helpful, which we did hear at the two-day  
3 meeting about not just what was the matter, but what  
4 happened to it. So that's come across as well, what was  
5 the auditor's response to this critical audit matter?  
6 We've heard that a number of times.

7 So we've gotten a lot of good input on this from  
8 a variety of -- from a lot of outreach on this project,  
9 from Jessica and team, who continue to move along on the  
10 development of our next proposal on this.

11 Elizabeth Mooney?

12 MS. MOONEY: So it sounds like the U.S. is pretty  
13 behind, I mean, 75 years, you mentioned in the U.S. And  
14 the U.K. that -- the discussion. So it's encouraging that  
15 we're continuing to look pretty hard at this. But I'm  
16 curious just on the Rolls Royce; and I don't know if there's  
17 anyone here who can speak for KPMG, but what is there  
18 response and when you've talked to them about how difficult  
19 it was for KPMG to go through this exercise for the Rolls  
20 Royce audit report, for instance? The challenges.

21 MR. BAUMANN: We had some people at the public  
22 meeting, but I don't think we -- do we have anybody from

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1 that firm?

2 Yes, Tony Cates. That's right. We had Tony Cates  
3 from that firm who talked about that experience, but we  
4 didn't have a representative of the company at the public  
5 meeting. If you're asking what the company's reaction  
6 was?

7 MS. MOONEY: No, I'm just asking how hard it was  
8 for KPMG to put together this audit report, if it was --  
9 what their experience was in terms of it being -- how it  
10 was received, what challenges they faced, what they left  
11 out.

12 MR. BAUMANN: Jessica?

13 MS. WATTS: I think KPMG actually put out a survey  
14 on putting together these audit reports. And then there  
15 have been several articles about these particular KPMG  
16 audit reports. And there's this one particular auditor  
17 has done these more extended auditor's reports, Rolls  
18 Royce and then there's another that he has done. Anyway,  
19 they've -- KPMG has said that they had put out these two  
20 specific audit reports that went a little bit further than  
21 what the U.K. required. And they had done it to be  
22 provocative and try to get feedback, and the feedback had

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1       been very good about -- from investors, that they thought  
2       that this was really helpful to have the -- not only what  
3       the auditor did, but what the auditor found.

4               And so, the investors have liked it. And from what  
5       we understand from KPMG, it wasn't that difficult. But  
6       that was really from these articles is where we've learned  
7       it, and then from discussions with Tony Cates during the  
8       meeting.

9               MR. BAUMANN: What we did here during the public  
10       meetings was that -- again, I think I mentioned this, the  
11       teams were -- the engagement teams were motivated, they  
12       felt that their audit report was going to be more useful  
13       and the areas that they worked on could be more relevant  
14       potentially to investors. And the items that were  
15       disclosed, it's not as if they'd pop up at the last second.  
16       These were typically the items that were probably the most  
17       important items addressed throughout the audit, discussed  
18       probably a number of times with management and the audit  
19       committee.

20               So in terms of the extra effort, the extra effort  
21       seems to be in the writing of the matters, but not a matter  
22       of, well, what are we going to talk about as the critical

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1 matters? The engagement team, the company and the audit  
2 committee pretty much seems to have an idea that these are  
3 the issues we all talked about during the year. These were  
4 the real troublesome issues in terms of auditing. So not  
5 surprised at what was disclosed in the auditor's report.

6 Jeff Mahoney?

7 MR. MAHONEY: Thank you. I had a question and a  
8 comment. Elizabeth essentially took my question, but one  
9 add-on to that, to the extent that this group will have  
10 future discussions in connection with this project, I  
11 think it would be very useful to have Mr. Sikes or Mr. Tate  
12 or someone from the firm, someone from other firms that  
13 have issued these types of opinions to speak to this group  
14 so that we can ask them questions and get more insights  
15 from them. So that's my question.

16 My comment is that with respect to the Rolls Royce  
17 opinion, and in particular with respect to the findings  
18 paragraphs, and in particular the findings paragraph with  
19 respect to the measurement of revenue and profit in the  
20 civil aerospace business and the findings paragraph in  
21 connection with evaluation of Daimler AG's put option,  
22 that type of disclosure I think is very much in line with

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1 much of the input from the user community that was provided  
2 to the Treasury Committee a number of years ago. It's also  
3 very consistent with the Council's numerous letters on  
4 this project over the years and with many of the user  
5 investor surveys and studies, and with the PCAOB's own  
6 outreach to investors in connection with this project.

7 That's my comment. Thanks.

8 MR. BAUMANN: Yes, that finding is we found the  
9 resulting estimate was acceptable but mildly optimistic  
10 resulting in a somewhat lower liability being recorded  
11 than might otherwise have been the case, that type of  
12 language. So, interesting language. But certainly we  
13 have heard from the investor community that that type of  
14 assessment of estimates is what the investor community is  
15 interested in, in addition to a recitation of these were  
16 the most significant risks and here's how we audited it.  
17 So that's a consistent comment, Jeff, I think from the  
18 investor community over time.

19 Lew Ferguson, you had your card up a minute ago?

20 MR. FERGUSON: I just wanted to point out that one  
21 of the things that I felt was very interesting about the  
22 comments that Cates made when he said that these reports

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1 were very dramatic because they were different than  
2 anything that had ever been put out before. But he was  
3 concerned and he said in these particular companies it was  
4 likely that the companies would probably not change from  
5 year to year. So the next report might look exactly the  
6 same and people would begin to say, okay, well, here we  
7 are back to a new kind of boilerplate and this is not  
8 dramatic anymore and to sort of want ever more information.

9 MR. BAUMANN: Yes, that point was made and I think  
10 everybody acknowledged this is -- year one looked very  
11 interested in the U.K. and what is year two going to look  
12 like will be a very important experience.

13 Guy Jubb?

14 MR. JUBB: Speaking as a major U.K. investor, I  
15 wasn't so much pleasantly surprised by the enhanced  
16 auditor reporting, but I was certainly very encouraged by  
17 where we are going for many of the reasons that have already  
18 been discussed. But I would like to highlight in terms  
19 of feedback and therefore to help the PCAOB -- is the use  
20 of specificity in terms of the auditor reports that have  
21 been used. We have two very good examples in Rolls Royce  
22 and Barclays. I should add that the Rolls Royce one is

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1 generally regarded as the high bar in this and it wouldn't  
2 be suggested that all auditor reports in the U.K. have this  
3 transparency. But the willingness to refer to the Daimler  
4 option that Jeff mentioned earlier, that gives the  
5 investors of itself a degree of greater confidence in the  
6 audit approach that was taken.

7 Another example is the BP audit report where the  
8 auditor by name tells us that he went to Moscow three times  
9 to verify the accounting treatment that was used for the  
10 Rosneft interest in BP, and that enabled my firm, Standard  
11 Life, to go to the BP AGM and ask a question about that.  
12 If we had not had that disclosure, we would have not been  
13 able to ask that question and we would -- it enhances  
14 accountability.

15 We have also seen -- and I think we haven't referred  
16 to this here, but we have also seen a parallel improvement  
17 in audit committee reporting as well. This has been on  
18 the go for some time, but it has had a step up in terms  
19 of seeking to provide greater transparency. And when we  
20 as users are looking at the auditor report, we are also  
21 in -- on the one had have that. In the other hand we have  
22 the audit committee report. And the more that one can

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1 actually develop this framework of reporting between audit  
2 committees and auditors in a joined up way, I think that  
3 that will be valuable for investors and we'll also avoid  
4 some degree of inappropriate duplication.

5 Thirdly, it has enabled a dialogue to take place  
6 about audit issues. This year so far I have had  
7 discussions, face-to-face discussions with the chairman  
8 of seven FTSE 100 audit committees about their auditor  
9 report. That is seven more than I have had in my 20-year  
10 career at Standard Life in dealing with engagement. But  
11 importantly, I'm using the word "having a conversation,"  
12 because this isn't about hard engagement at this stage.  
13 It's about having a conversation about what is being used.

14 What hasn't actually landed so well yet is  
15 disclosures about materiality. And I know that whether  
16 or not materiality should be disclosed is a sensitive  
17 issue. We have certainly found in principle it is a good  
18 disclosure. The terminology that is used has still got  
19 a high degree of technicality to it, but there's one number  
20 that keeps on resonating, and that's the number five.  
21 Everything is five percent of something. And I didn't  
22 know that until we had these auditor reports and I'm now

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1 starting in my conversations just to ask, well, -- why is  
2 it always five percent and what should it be five percent  
3 of, or what it should be of? So there's a whole dialogue  
4 that's taking place there.

5 Now having said all that, whilst I am having the  
6 conversations and no doubt other investors in this room  
7 are, I'm not entirely convinced that audit reports are  
8 being well communicated into the capital market system.  
9 They are not featuring in the slide decks that are used  
10 by investor relations programs in going out to see  
11 companies, and therefore I think it is a very narrow pool  
12 of people who are actually reading these auditor reports  
13 at this stage, and one of the encouragements that has to  
14 be given is how to broaden that. And I think in terms of  
15 the -- as time goes by and the engagement that the PCAOB  
16 has with audit committees it is to encourage audit  
17 committees, as I shall be, to actually get the executives  
18 to bring this into mainstream investor relations and not  
19 the narrow pool.

20 Two final points, if I may. It has increased  
21 interest among investors. I have been struck by the  
22 increasing number -- still quite small, but amongst the

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1 U.K. institutional investor community. There are now  
2 more investors who are willing to step up to the plate to  
3 have a discussion about this. And when two becomes four,  
4 four becomes eight and I am confident that that will  
5 progress slowly.

6 And finally, the year-two issue which was being  
7 mentioned as to how this is going to be kept fresh, how  
8 it is going to be updated. I feel mildly optimistic that  
9 we'll get some useful reports coming through. It will  
10 require a little bit of hard work and to have -- the one  
11 area which I would like to see more transparency on that  
12 we have not seen referenced is the contextual factors such  
13 as any pressures that there might be on the management to  
14 meet market expectations, which should perhaps in  
15 exceptional situations sharpen the auditor's pencil or the  
16 impact of executive incentives if they are target-related  
17 and how the auditor perhaps has assessed those.

18 But this is part of the journey, to give this rather  
19 long comment, but while it's fresh in my mind I wanted to  
20 share it.

21 MR. BAUMANN: It was a long but very worthwhile  
22 comment, so thanks for that real live input from a user

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1 of these reports in the United Kingdom. That's very  
2 valuable, Guy.

3 Tom Selling and then Barbara Roper?

4 MR. SELLING: Thank you, Marty. I thought this  
5 would be an appropriate moment to make some quick  
6 observations about three topics we're talking about today,  
7 because I think they're highly interrelated. The auditor  
8 reporting model is one, revenue recognition is another,  
9 and also the root causes of the audit issues reported by  
10 IFIAR. I want to make three points and I want be extremely  
11 brief.

12 The first point is that one of the root causes of  
13 the problematic audits we're all concerned about may  
14 indeed be a lack of transparency about what an auditor  
15 actually does and the ARM project may help with that. I  
16 for one would be extremely pleased if the audit reports  
17 on critical audit matters would be along the lines of the  
18 samples that you gave us, Marty, even if they devolved into  
19 the boilerplate that we're speaking about or that we're  
20 concerned with.

21 My point is that CAM reporting is perhaps more  
22 important from a control perspective, even as important,

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1 as Guy points out, the informational perspective is. The  
2 old phrase about sunlight being the best disinfectants,  
3 I think this takes this actually to an additional degree  
4 where we're actually asking the auditor to shine the  
5 spotlight on them as they do this. And the remarks that  
6 I've heard so far seem to indicate that when an auditor  
7 does this that has an additional effect on, number one,  
8 the pride they take in the audit, as well as the quality  
9 of the audit.

10 My second point is that audit quality is directly  
11 related to the number of tough judgments that managers have  
12 to make and auditors have to somehow certify as reasonable.  
13 That seems to be the clear message from the IFIAR report  
14 that we'll be discussing and I found that virtually all  
15 of the audit flaws were driven by the auditor's inability  
16 to reliably state that management's estimates of future  
17 events appear reasonable.

18 We're going to be talking about revenue  
19 recognition, and I think it's clear from the materials we  
20 received in advance that revenue recognition will be  
21 increasing the number of judgments that auditors will be  
22 required to make. It's not clear what the PCAOB can do

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1 about this acting alone, but the question needs to be  
2 asked, and in answering we're discovering that another  
3 root cause of the flaws is our standard-setting  
4 infrastructure.

5 Revenue recognition as a project took 12 years, but  
6 yet today -- only today, it seems, the PCAOB is going to  
7 be asking what challenges to auditing the new judgments  
8 that will be required will present to auditors? The FASB  
9 has recently stated in Concept Statement No. 8 that  
10 cost-benefit analysis is a pervasive constraint. And  
11 when we are asking now after 12 years how auditors should  
12 respond to that new standard, I wonder and I hope we'll  
13 consider whether we're putting the cart before the horse.

14 My third point is that the auditor's reporting  
15 model should provide information about choices of  
16 accounting policies when non-authoritative GAAP is the  
17 source. One of the things I noticed about the Rolls Royce  
18 report is that the opinion paragraph is qualitatively  
19 different than what we have. The report separately states  
20 that the financial statements are true and fair. And  
21 separate from that the report states that the financial  
22 statements are in accordance with IFRS as adopted by the

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1 EU.

2 We use the term "fairly presented" in context with  
3 the standard. In addition to that, we recently have a new  
4 codification that has changed the status of the financial  
5 statement accounting concepts and it's not clear to me that  
6 people actually know what GAAP means. Just last week I  
7 was at a meeting of the Accounting and Assurance Standards  
8 Committee of my state's CPA Society and they asked me to  
9 put together a one-hour presentation on what exactly does  
10 GAAP mean? I thought that's pretty interesting coming  
11 from a group of CPAs.

12 And so I think I would like to encourage us to  
13 consider when we talk about the audit reporting model what  
14 GAAP means within the context of a particular audit. When  
15 non-authoritative GAAP was relied on significantly, I  
16 think that that's part of the judgments that ought to be  
17 disclosed within the auditor's report. One of the reasons  
18 I bring that up now is because the Rolls Royce report  
19 doesn't have quite the same problem because the status of  
20 the conceptual framework within IFRS is different than it  
21 is under U.S. GAAP. Thank you.

22 MR. BAUMANN: Thanks, Tom. Thanks for all those

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1 comments.

2 We have a number of cards up. This session was  
3 scheduled to end at 2:45, then we begin discussion of audit  
4 quality indicators -- I'm sorry, audit quality  
5 initiatives. So we're going to continue for a few more  
6 minutes to try to answer -- get a few more cards up on this  
7 issue. And I have one or two more comments to make on the  
8 agenda, so we're going to try to do this in about 5 to 10  
9 minutes, all of this, and then we're going to move on.  
10 That's going to shorten the break to about a -- maybe just  
11 grab a beverage or something as you head out to your  
12 break-out sessions. So we're taking time away from our  
13 break here, but I think the discussion is lively and worth  
14 it.

15 So, Barbara Roper?

16 MS. ROPER: So I'll be very quick. Add my voice  
17 to those who think this is very responsive to what  
18 investors have been saying for years they want to see in  
19 the audit report. I don't know that you have to be this  
20 prescriptive in how you would adopt the standard, but I  
21 found particularly useful the approach that says this is  
22 the risk, this was our response, these are our findings.

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1 So in some ways I would hope that the standard would ensure  
2 that all of those points would be addressed in this kind  
3 of reporting. I think that in part drives the kind of  
4 specificity that makes this useful.

5 The risk was always that if you did this, went this  
6 route, that it would devolve into something that was so  
7 general or boilerplate as to be meaningless. I find these  
8 to be really -- I thought the samples that the Board  
9 prepared for an earlier SAG meeting were encouraging. I  
10 found these to be really very high quality useful for  
11 investors.

12 MR. BAUMANN: Thanks. We did, too.

13 Steve Buller and then Rick Murray.

14 MR. BULLER: Thanks, Marty. Just a couple brief  
15 comments as I also found the reports very useful and I'd  
16 encourage you to include additional examples as you find  
17 them, even between now and the next SAG meeting just  
18 because they're of great interest.

19 I actually found the Rolls Royce report fairly  
20 useful. The Barclays report seemed to have a lot of  
21 boilerplate and it looked a lot to me like a significant  
22 risk factors disclosure in MD&A. So if you look at some

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1 of the topics, provision for uncertain tax positions, IC  
2 systems and controls, risk of fraud and revenue, risk  
3 advancement, override of controller controls, litigation  
4 of regulatory claims, they read boilerplate. I'd be  
5 curious if when people did their examination of individual  
6 firms if those same paragraphs were recurring in reports  
7 issued by the same firm.

8 MR. BAUMANN: Yes, there's definitely variation in  
9 the reports, and that's -- we did put two reports in here  
10 that were I thought both interesting, but different  
11 characteristics as well in terms of the depth of one and  
12 focused more just on the significant risks in the other.  
13 But I agree with your observation.

14 I think we have on this subject three more cards  
15 and then we just -- you pointed to four more cards. Rick  
16 Murray, Doug Maine, Brandon Rees and Rachel Polson, and  
17 then we need to get on.

18 MR. MURRAY: Thank you, Marty, and just very  
19 briefly, just a quick observation. It's clear that there  
20 is considerable encouragement in the British experience  
21 with first-year exercise that needs to be pursued and  
22 understood. At the April event and subsequently we've

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1 also had a number of comments, both from the U.S. and the  
2 U.K. to be cautious about the enabling value in the U.K.  
3 of an integrated regulatory regime and a benign legal  
4 culture. I don't suggest that those would necessarily  
5 change the outcomes in the U.S., but we hadn't heard any  
6 comments about it in this discussion and they were the two  
7 most significant additional comments that came forward  
8 from April that hadn't made it to the floor and I just  
9 wanted to note that they should be considered going  
10 forward.

11 MR. BAUMANN: Valuable point and certainly made at  
12 the April meeting with the different legal environments.

13 MR. MAINE: I am an audit committee chairman and  
14 I'm generally supportive of this. Guy's point though  
15 about conversations with seven audit committee chairmen  
16 resonated with me, and I'm curious to know whether you're  
17 considering the practical consequences of this for audit  
18 committees, particularly in light of Regulation FD and  
19 where it's taboo to have selected disclosures. Does this  
20 end up with audit committee conference calls with  
21 investors I have interested in accounting and auditing  
22 issues? If so, don't know. Want to point that out.

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1           MR. BAUMANN: Yes, I think that those are important  
2 questions. What we think is that it gives investors and  
3 audit -- investors, not audit committees, because these  
4 are things that are not new to the audit committee, we  
5 hope -- investors an idea of what were the most significant  
6 judgments the auditor had to make as part of the audit.  
7 That could trigger, I think, as in the case that Guy pointed  
8 out, investors talking to management as part of an earnings  
9 call or whatever that might have been, is to tell us a  
10 little bit more about the auditor's challenge in this area.  
11 But certainly all legal ramifications are -- all  
12 consequences are to be considered on our end as part of  
13 this, so thanks for that.

14           Brandon?

15           MR. REES: Thank you, Marty. I wanted to pick up  
16 on a comment you made in the introduction regarding the  
17 value of CAM disclosure and audit reports for proxy voting  
18 by investors, and I think this also speaks to the goal of  
19 encouraging investor audit committee dialogue.

20           I want to encourage the Board to think about the  
21 parallel of executive compensation disclosure, which of  
22 course we as investors get in great detail, and the

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1 adoption of say on pay advisory votes and the success of  
2 that process post Dodd-Frank in encouraging both  
3 improvements to the executive compensation process here  
4 in the United States as well as dialogues and  
5 responsiveness by compensation committees to investor  
6 concerns and contrast that with the lack of attention paid  
7 to audit firm ratification votes here in the United States.

8 Before this meeting I pulled the vote results from  
9 this year's proxy season for the Russell 3000, and the  
10 average vote, average ratification vote was at 99 percent,  
11 which was a largely meaningless -- in my mind, largely  
12 meaningless vote because investors have nothing to vote  
13 on. We have no information besides the level of fees and  
14 the ratio of audit to non-audit related fees to guide us  
15 on. And that's why I'm genuinely excited about the  
16 inclusion of CAMs in the audit report.

17 And I also want to encourage the Board to consider  
18 as a long-term goal the inclusion of audit quality  
19 indicators in the audit report or some other form of  
20 disclosure as being beneficial to that process, to use the  
21 audit vote as a mechanism to encourage both dialogue as  
22 well as accountability for effective audits.

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1           MR. BAUMANN: I think that's very valuable input,  
2 but having said that, when I was an audit partner I took  
3 great excitement and pride in that 99 percent.

4           (Laughter.)

5           MR. BAUMANN: So now you've shattered me here. I  
6 thought it meant something about my work. Oh, well.

7           MR. REES: If I could just briefly respond to that.  
8 For the 50 companies that lost their say on pay vote, the  
9 sky did not fall, and in fact many of those companies have  
10 responded by improving their executive compensation  
11 process. And they are just advisory.

12          MR. BAUMANN: Last word on this topic, Rachel  
13 Polson.

14          MS. POLSON: One is a comment and one is a question.  
15 One relates to the proposed other information standard is  
16 definitely would appreciate from the auditor's  
17 perspective clarification on the steps related to evaluate  
18 what you specifically want us to do, because I can see  
19 auditors taking the approach of spending time actually  
20 doing a lot of additional audit procedures and there would  
21 be a lot of excess cost for the companies related to that.

22           And then the other one is more of a question. You

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1 know, we talked about the audit deficiencies reports that  
2 are out there that are being issued by the inspection  
3 reports, and is the thought that if these critical risk  
4 matters are included in the report, that that will have  
5 the auditor's reflect more closely on where the audit risks  
6 are to make sure that they do have the appropriate findings  
7 and the responses documented so that they aren't missing  
8 that information. Is that one of the outcomes you're  
9 hoping with this?

10 MR. BAUMANN: Yes, I think that's another benefit  
11 of the enhanced auditor reporting is by the auditor  
12 pointing out the most significant risks. I do think the  
13 auditor naturally will pay more attention to those  
14 matters, I believe, as part of their audit work. And maybe  
15 management will pay more attention to their related  
16 disclosures in those areas as well. So I think there's  
17 potential positive intended consequences that come out of  
18 enhanced auditor reporting.

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