

**NOTICE:** This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on November 12, 2015 that relates to the Board's Concept Release on Audit Quality Indicators. The other topics discussed during the November 12, 2015 meeting are not included in this transcript excerpt.

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[http://pcaobus.org/News/Events/Pages/Nov\\_2015\\_SAG.aspx](http://pcaobus.org/News/Events/Pages/Nov_2015_SAG.aspx)

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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STANDING ADVISORY GROUP

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MEETING

+ + + + +

THURSDAY  
NOVEMBER 12, 2015

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The Advisory Group met in the Academy Hall within the offices of FHI 360, located at 1825 Connecticut Avenue, Northwest, Washington, D.C., at 8:30 a.m., James R. Doty, Chairman, presiding.

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1           (...)

2           MR. KROLL: Thank you, Marty. Good morning. My  
3 name is Steve Kroll and I'm a member of the AQI Project  
4 Team. The team is especially happy to have this  
5 opportunity to meet with the Standing Advisory Group,  
6 because of the Group's background with AQIs. It worked  
7 through the initial set of about 70 potential AQIs and  
8 really helped us shape the project, in May 2013, and  
9 considered other aspects of the project in depth at its  
10 November 2013 and June 2014 meetings. Like most things,  
11 these issues don't go away. They're still relevant today.

12           The discussions that we've planned for today and  
13 tomorrow come at a very important time for the project.  
14 The Board has issued its Concept Release and subsequently  
15 received the comments summarized in your materials.  
16 Interest in AQIs in various forms has continued to grow,  
17 both here and abroad. And I'd have to give a nod to the  
18 IAASB in that context. The challenge though is deciding  
19 what to do next.

20           Moving the project forward involves hard  
21 questions. Some were raised in the Concept Release itself  
22 and others were raised in the comments. Most go to the

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1 possibility of achieving the release's stated purpose,  
2 which was: "creating a potential portfolio of quantitative  
3 measures that may provide new insights about how to  
4 evaluate the quality of audits and how high-quality audits  
5 are achieved." At margin the topics posed for the breakout  
6 groups later this morning try to focus these critical  
7 questions and we are eager, given the group's experience,  
8 to hear its views about those questions and about the  
9 project's future direction.

10 The next speaker is my friend George Wilfert, a  
11 Deputy Director of ORA, who will talk in greater detail  
12 about the plans for the discussions. After that, Greg  
13 Jonas, whom I think all of you know, the Director of ORA  
14 and the leader of the AQI project, will give you an overview  
15 of the broad areas of agreement and controversy that we  
16 extracted from the comments. Finally, Jane Hutchens, to  
17 my left, also a team member, will review the assignments  
18 and location for the breakout groups. Thank you.

19 MR. WILFERT: Thanks, Steve. First, I'd like to  
20 acknowledge that we found the SAG's counsel very helpful  
21 in developing our Concept Release. The comment period  
22 ended in September and the Board received 47 comments,

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1 which, as Steve noted, the staff has summarized in the  
2 exhibits to your handouts for your reference during the  
3 breakout sessions. We thought it might be beneficial to  
4 briefly discuss both the format and the goals of the  
5 breakout sessions, which will help set the stage and  
6 provide context for the discussion.

7 The format we have planned for you today consists  
8 of three breakout sessions addressing different aspects  
9 of the Concept Release. Each breakout session has been  
10 assigned specific topic and series of questions for  
11 discussion. The goals we would like to achieve include  
12 identifying the areas of general agreement with respect  
13 to the topic and questions assigned to each group,  
14 obtaining an understanding of the areas of controversy.  
15 So in this regard, we would very much appreciate SAG  
16 members sharing their insights with us so we can help  
17 discern the underlying rationale for differing views. In  
18 addition, we always greatly value new ideas and  
19 recommendations.

20 Tomorrow morning's debrief session will be  
21 presented in two parts. First, we will present a summary  
22 of the views from the breakout sessions. The Concept

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1 Release acknowledged a wide range of ways forward using  
2 AQIs to inform and promote audit quality. We would like  
3 to devote the second half of tomorrow's discussion to the  
4 topic of next steps and request each SAG member to offer  
5 a summary recommendation about how the Board should move  
6 forward.

7 Next, I'd like to turn to Greg, who would like to  
8 share the staff's observations regarding the areas of  
9 broad agreement and the issues that may be perceived as  
10 controversial in the comment letters received to date.

11 MR. JONAS: Great, George, thank you. And good  
12 morning, everyone. You know, it's always dangerous to try  
13 to summarize the themes from comment letters because  
14 they're full of detail, they're full of nuance. To really  
15 understand them, you need to read all of them. So at the  
16 risk of generalizing, let me lead with my chin and  
17 summarize what the staff believes to be the central areas,  
18 starting with agreement.

19 First of all, we perceive, not exactly unanimous,  
20 but an overwhelming majority of folks continue to believe  
21 that discussion about AQIs, the AQI project, is a useful  
22 thing to be doing and that potentially AQIs could be very

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1 useful to informing discussions about audit quality. The  
2 second area of the, we perceived to be, strong consensus,  
3 relates to an area of the Concept Release where we kind  
4 of led with our chin.

5 And that was, we described what we believe to be  
6 the characteristics of a useful AQI. That it's  
7 quantitative. That they operate in packs as a portfolio,  
8 so we can triangulate on quality. That they require  
9 context to be understood, that is, the metric plus context  
10 equals insight; the metric alone is unlikely to yield  
11 insight. That their purpose is to inform discussion and  
12 help people ask the right question rather than answering  
13 questions themselves. And then, importantly, they are  
14 not scorecards, they're not safe harbors, they're not  
15 benchmarks. That description of what we think a useful  
16 AQI is seemed to get a lot of applause in the comment  
17 letters.

18 A third area of broad agreement is that audit  
19 committees are a key user. That doesn't mean that others  
20 may not be key users, but a strong consensus that at least  
21 the audit committee is a key user of AQIs. And that in  
22 their discussions, the most informative AQIs are likely

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1 to be at the engagement level rather than at, say, the firm  
2 level, industry level, office level, some other type of  
3 AQI. So engagement-level AQIs are the focus of audit  
4 committee discussions.

5 And then a final area of broad agreement is that  
6 if AQIs are useful at all, they're likely to be useful to  
7 the larger engagements, the more complex work and to the  
8 larger firms. It's an open and debatable question about  
9 how useful the AQIs are to the smallest engagements and  
10 the smaller firms, the so-called scalability question.

11 So if those are the areas of agreement, where are  
12 the areas of controversy? Well first, a package of  
13 controversy relates to the AQIs themselves. As you recall  
14 from the Concept Release, we teed up 28 AQIs as potentially  
15 useful. And we were quite specific in what we thought  
16 those might be in order to elicit the most pointed comments  
17 during the comment process.

18 And not surprisingly, some of those AQIs were quite  
19 controversial. And in particular, it's the ones that kind  
20 of broke new ground, the ones that are not commonly thought  
21 of or used today. So for example, AQIs about the incentive  
22 system or the tone at the top within firms. As I

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1 mentioned, the scalability question is controversial.  
2 How much testing needs to be done to verify an AQI is  
3 somewhat controversial. Everybody agrees testing needs  
4 to be done, but some of the letters said, doggone it, you  
5 almost need to prove empirically that an AQI is useful to  
6 be able to with confidence use it. Others believed that  
7 far less testing is needed, even though some testing is  
8 needed.

9 And then finally, a number of letters said, you  
10 know, all these AQIs are potentially very interesting, but  
11 what we really want to get to is the professional  
12 skepticism, objectivity, independence of the auditor.  
13 Can you help us think of some AQIs that would focus the  
14 discussion on those areas?

15 Another area of controversy related to the question  
16 of the extent to which investors are a key customer of AQIs.  
17 The letters we received from investors passionately argued  
18 that investors are a key customer of AQIs. And, of course,  
19 to meet that need, we would need to make AQIs public.  
20 Others argued passionately that investors should not be  
21 a key customer, direct customer of AQIs, for two broad  
22 reasons. One is understanding the AQIs requires context

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1 and it would be very difficult to give an investor the  
2 appropriate context in which to evaluate the AQIs. And  
3 then other letters noted that investors are very busy  
4 folks, preoccupied with many, many issues in evaluating  
5 companies, and doubted whether investors would seriously  
6 pore over a portfolio of AQIs in order to evaluate audit  
7 quality.

8 A third broad area of controversy relates to  
9 unintended consequences. Many of the letters warned us,  
10 as you have in the past, about unintended consequences.  
11 But where the controversy resides is what to do about the  
12 unintended consequences. What actions would we take to  
13 avoid having to make them? There the letters offered a  
14 very diverse array of views.

15 And then the final area of controversy relates to  
16 the question of, should AQIs be mandated in some way,  
17 raising the issue of, what is the highest and best use of  
18 an audit regulator in the AQI process? And here letters  
19 offered a spectrum of views. Some argued basically, "butt  
20 out," that these are early days, what we need is continued  
21 experimentation and right now we really don't see a major  
22 role for a regulator.

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1 Others argued passionately that the regulator  
2 offered a key role in helping to standardize vocabulary  
3 and have consistency of AQIs and to ensure that a robust  
4 portfolio of AQIs are discussed, not only the good ones,  
5 but the ones where there's some bad and potentially some  
6 ugly that's present. And then letters were in-between,  
7 offering that perhaps a role of regulation was to  
8 encourage, to offer insight, if not coming short of  
9 mandating the use of AQIs themselves.

10 We offer this summary because we think these themes  
11 are going to come out in each of the breakout sessions and  
12 we look forward to hearing your views on these important  
13 issues, as well as the other ones that were raised in the  
14 materials for today's meeting. So with that, let me turn  
15 it to Jane, who will discuss a little more detail about  
16 the breakout sessions today. Jane?

17 MS. HUTCHENS: Thanks, Greg. Our breakout group  
18 sessions this morning will all concern the content and  
19 possible uses of a group of potential Audit Quality  
20 Indicators. On the back of everyone's name tag includes  
21 a number: 1, 2, or 3, so that everyone is aware of which  
22 breakout session they will be participating in. The rooms

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1 are located upstairs, up the stairs to the right here.

2 Group 1 will meet in Room C, so in case it says Room  
3 C or Room 1, that will be our Group 1. Group 2 will meet  
4 in Room D and will discuss the use of AQIs specifically  
5 by audit committee members. Group 1, I don't think I  
6 mentioned, will also discuss the AQIs and the content  
7 themselves. Group 3 will meet in Room E and will discuss  
8 the use of AQIs by investors.

9 And then as George mentioned earlier, tomorrow  
10 morning we will have an 8:30 a.m. debrief discussion. The  
11 first part of that discussion will include review of what  
12 was discussed during the breakout sessions and we will seek  
13 comment from the other groups on each topic. We will also  
14 go round-robin around the table and provide every member  
15 an opportunity to provide us a brief comment regarding what  
16 you believe the next step should be for the project.

17 On each of the breakout groups, there will be a  
18 facilitator to moderate the discussion, as listed in the  
19 top row of the line there, Eugene, Greg and Marty. The  
20 bottom line there, George, Steve and myself, will serve  
21 as an AQI team member in each of the breakout sessions.  
22 We will also have in each of the breakout sessions at least

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1 one Board member participating in the discussions.

2 Since we reordered the format this morning, Jim  
3 will speak after us, before the breakout sessions. There  
4 will be a 30-minute break before the breakout sessions  
5 begin. The breakout sessions are scheduled to begin  
6 promptly at 10:30 and then will end at 12:15 for lunch.  
7 Does anyone have questions about the format or any  
8 observations on the breakout sessions that they'd like to  
9 ask? Okay. We'll turn it over to the Chairman now.

10 (...)

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