

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on November 13, 2015 that relates to the Board's Concept Release on Audit Quality Indicators. The other topics discussed during the November 13, 2015 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

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FRIDAY

NOVEMBER 13, 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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(8:32 a.m.)

MR. BAUMANN: Well, good morning, everybody and welcome back to day two of the meeting of the Standing Advisory Group.

Tremendous energy yesterday in the breakout sessions both with respect to audit quality indicators and the emerging issues and certainly with respect to AQIs.

You gave us a lot of information to consider regarding our next steps and we'll be talking about that in a moment. But also regarding the emerging issues.

You gave us a lot to think about in terms of potential actions or alerts or guidance that we may have to give out with respect to audits and some of these emerging issues and we'll be talking about that after the break.

So we appreciate the energy and all the ideas yesterday and let's keep up the high level today. So with that, I'll turn it over to Greg Jonas.

MR. JONAS: Thank you, Marty. Good morning, everyone.

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1 First of all, thanks for the great discussions in
2 the breakouts yesterday. All the moderators reported
3 highly interactive and engaged discussion.

4 I think we have some important things to tell you
5 about those discussions and let me tell you how we'd like
6 to spend the next 90 minutes.

7 First, we'll debrief the three breakout sessions
8 going breakout group one, two and three in that order. The
9 moderators will speak for about five minutes using some
10 slides to summarize what we believe to be the main takeaway
11 points from those discussions.

12 Following each moderator's summary, there will be
13 about five minutes or so for members of the breakout group
14 to add color as you deem appropriate to what the moderator
15 might have said.

16 Then after about 30 minutes after the debrief of
17 the three breakouts that will leave us an hour to go around
18 the room and hear from each of the SAG members on your
19 personal advice to the board on what counsel you have for
20 next steps that you believe the board should take on the
21 AQI project.

22 We hope that your advice would concentrate on the

1 kind of short term, what should the board do in the next
2 year, if anything, and that your advice be directed
3 directly to the board, so not so much what should audit
4 committees do, what should audit firms do but rather what
5 should the PCAOB do, if anything, with regard to the
6 project.

7 Okay. So with that, let me turn it to breakout
8 session one for a summary of what was discussed.

9 MR. THERON: Thank you, Greg.

10 Our plan in group one was to discuss the proposed
11 listing of AQIs within the concept release and its content
12 without regard to who the customer of that information is.

13 However, our group quickly determined that the
14 question of whether a standard set of AQIs can be assembled
15 or what the optimal number of AQIs might be or even which
16 AQIs are most promising and effective depended in large
17 part on who that customer is - audit committees,
18 regulators, investors, it is not necessarily a one size
19 fits all.

20 Take action. Most in our group felt that further
21 debate was no longer constructive and that the PCAOB needed
22 to get going on this and take action, the overarching

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1 premise being that AQIs would in fact be useful.

2 In fact, some audit committees and their auditors
3 are already doing this. The view around our table was that
4 the PCAOB is in a unique position to provide valuable
5 insights and certainly some context and that the PCAOB
6 should inform while audit committees decide.

7 While there clearly is a desire for additional
8 information, data, empirical analysis about AQIs, our
9 group believed that the data would begin to tell the story
10 over time as this gets rolled out and that the AQIs
11 therefore would evolve over time.

12 George?

13 MR. WILFERT: Thanks, Eugene.

14 First, the group was generally in favor of the PCAOB
15 developing a framework using a principles-based approach,
16 organized in a manner similar to the broad categories
17 outlined in the concept release, such as under the category
18 of audit professionals, for example, having
19 sub-categories for availability, competence and focus.

20 However, as Eugene noted, the group also noted that
21 various AQIs may have different levels of relevance for
22 different users, who may also have varying levels of

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1 context available to them.

2 Therefore, the general view of the group was that
3 allowing flexibility for users such as audit committees
4 to be able to have the discretion to choose from a menu
5 of AQIs would be preferable.

6 In addition, audit committees and other users may
7 also want to add other AQIs they believe are relevant and
8 tailored to the circumstances of their audit.

9 The group generally was in favor of the PCAOB
10 providing common definitions of how to calculate various
11 AQIs in order to promote comparability.

12 There was also the caveat that audit quality
13 indicators are only one of many tools available to audit
14 committees and that they are not benchmarks, scorecards
15 or a panacea to improving audit quality, rather, that their
16 greatest use may be as generators of questions for auditors
17 leading to a more robust dialogue about audit quality.

18 The consensus of the group was that it was too early
19 to determine whether there was an optimal number of AQIs
20 that could be used to inform discussions about audit
21 quality. However, the general view was that 28 indicators
22 was too many.

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1 Eugene?

2 MR. THERON: Thank you, George.

3 Next slide please, Brian. From the investors in
4 the room we heard a clear request that AQI information -
5 a clear request for AQI information following a phased
6 rollout.

7 Others in the room were concerned whether investors
8 will in fact have the appropriate context. Though we
9 didn't reach a consensus on this, we did discuss a range
10 of possibilities to meet investors' requests for
11 information, ranging from the audit committees certifying
12 that AQIs have been evaluated in connection with their
13 auditors' appointment and performance all the way to full
14 disclosure of the subject AQIs.

15 So that's a very high level summary, in a nutshell,
16 of what we thought was a very good discussion in group one
17 and I'd like to now open the floor and invite members of
18 our group one discussion to weigh in with any added color
19 or comments, if you have any.

20 MR. BAUMANN: Sri Ramamoorti.

21 MEMBER RAMAMOORTI: Good morning. One of the
22 comments I had made as I was a member of group one was that

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1 we might usefully draw a parallel to the concepts of
2 planning materiality and evaluative materiality and think
3 about planning stage AQIs that will give an idea about
4 audit quality and evaluative stage AQIs that will give us
5 an idea about a quality audit.

6 So the planning stage, you know, is more of an input
7 consideration and the evaluative stage is more of an
8 output-outcomes consideration.

9 So that might be a useful way of thinking about
10 AQIs.

11 MR. BAUMANN: Thank you, Sri. Walt Conn.

12 MEMBER CONN: Thanks, Marty.

13 One thing I would like to add, I think our
14 discussion - I think there was a consensus that not only
15 are AQIs dependent on the broad user group, i.e. audit
16 committees, regulators, investors, but they are also
17 unique to a specific entity and their audit committee and
18 therefore I think the consensus of the group was that the
19 PCAOB at this time should not mandate use of any AQIs that
20 are in such a framework but rather let auditors and the
21 audit committees decide which ones are relevant to that
22 entity.

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1 And I think that got some validation from Joan
2 Amble's experience in piloting some of the 28 that were
3 in the concept release and they added some and used some
4 that were in the concept release.

5 MR. BAUMANN: Joyce?

6 MEMBER JOSEPH: Thank you.

7 I just want to elaborate a little bit more around
8 the points that we had discussed in the group yesterday.

9 And that is, it's clear that U.S. accounting
10 standards are directionally taking a principles-based
11 approach in its rule making for good reasons and a path
12 to consider taking forth the use of AQIs could potentially
13 be a principles-based approach as well.

14 That is, under a proposed framework of the three
15 categories, audit professionals, audit processes and
16 audit results, and the PCAOB providing a slate of AQIs with
17 definitions and allowing the use of the AQIs amongst audit
18 committees to be flexible, as over time the audit committee
19 members determine which AQIs are most relevant to their
20 company, given the particular needs, the facts and
21 circumstances, and allow it to evolve based on the
22 organization and the audit and also allow time for that

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1 process to gather actual data regarding AQIs and how they
2 provide the best indicators of quality.

3 Based on that information, based on that data, over
4 some appropriate period of time, a phase-in period,
5 consider identifying a core set of AQIs that potentially
6 could be made public for investor decision making with
7 investor input in that determination.

8 MR. BAUMANN: Liz Mooney.

9 MEMBER MOONEY: Thanks, Marty. Just on the mandate
10 point, I think that we just need - we need more data before
11 we can really decide on that. I think if we had more data
12 - were more informed and could back test, look at some of
13 these AQIs, I think we could probably come to a conclusion
14 that some of them are quite useful and I would expect it
15 would improve our data quality if there was a standardized
16 measure and mandatory AQIs.

17 MR. JONAS: Okay. Let's, for the second time,
18 move to breakout group two. The subject of discussion was
19 auditors' discussion of AQIs with audit committee.

20 Brian, the next slide, please. So on points of
21 general agreement, the first point was nearly unanimous.
22 Auditor discussion of AQIs with audit committees "would"

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1 be useful.

2 This is a stronger statement than we have
3 traditionally made. We have always used the word "could"
4 be useful. But the group was comfortable using the
5 stronger word would.

6 If we said could it would be a unanimous view, that
7 they could be useful. But a strong majority all but two
8 felt that it would be useful.

9 The rest of the points of general agreement are a
10 strong majority but not unanimous. So one, two or three
11 members really had different views. So we don't mean to
12 present this as unanimous.

13 But strong majorities felt that engagement level
14 AQIs are most useful for audit committees. The audit
15 committee is first and foremost concerned about their
16 audit team's performance than they are about the firm over
17 all.

18 That said, the group felt that firm wide level AQIs
19 did have a place but their place was to provide context
20 for the discussion of the engagement level AQIs.

21 The next point is any discussion of AQIs should be
22 determined by audit committees and firms. Let me

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1 emphasize the word "any". That means the group was in
2 favor of a purely voluntary regime.

3 That is, audit committees and auditors would decide
4 whether there's any discussion of AQIs at all and if there
5 would be a discussion what the content of that discussion
6 would be.

7 The group felt that firms should be free to
8 disclose, as they are today, firm level AQIs as they deem
9 appropriate but felt that firm disclosures of firm level
10 AQIs would be useful to provide context for AQI discussions
11 with audit committees.

12 So some of you may be wondering then in a purely
13 voluntary regime - if we could move to the next slide, thank
14 you - what is the role of an audit regulator in a voluntary
15 regime and our answer is as follows.

16 First, to share insight on possible useful AQIs.
17 So the regulator could say what we think might be useful
18 and that that insight would come largely from our
19 inspections experience.

20 But they had two caveats. First, we would need to
21 be very careful in offering what we believe to be useful
22 AQIs to avoid doing so with any implication that they would

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1 be required to be discussed and we should do everything
2 we could to not add to an already high legal risk facing
3 audit committees.

4 The next role for a regulator is based on two ifs.
5 If an audit firm provided - decided to report to the public
6 on its audit quality -and if that firm elected to include
7 AQIs in that reporting, then it would be appropriate for
8 a regulator to say;then you will define the AQIs as
9 follows. So be prescriptive as to if you make the decision
10 to disclose them you would have to follow a certain way
11 of calculating them and the benefit of that would be some
12 consistency and some common understanding of vocabulary
13 and terms across firms.

14 But at a minimum that if firms voluntarily disclose
15 AQIs they should disclose the way those AQIs are calculated
16 in the event that the regulator did not prescribe how they
17 would be calculated.

18 So the group was very much in favor of full
19 transparency by firms and voluntary reporting of AQIs.

20 Two new ideas came up in our discussion. These
21 were not points of consensus. In fact, there was some
22 disagreement about them. But I mention them because they

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1 were different than what we had put in the concept release.

2 The first is the notion of mandating discussion of
3 AQIs but without any prescription as to what the content
4 of the discussion would be. And the second idea was based
5 on the fact that AQIs have become a global sport. Many
6 audit regulators around the world are considering AQIs as
7 are the major global firms on a global basis.

8 And the thought was to avoid having each audit
9 regulator in various regimes kind of doing their own thing
10 on AQIs, sending potentially conflicting and confusing
11 signals to the market. So this is a notion of a desire
12 to have some coordinated type of AQI policy across regimes.

13 So with that, let me open it to breakout two group
14 members to add any color you'd like to these - this summary.

15 MR. BAUMANN: Chairman Doty.

16 CHAIRMAN DOTY: I think it leads to an interesting
17 question. Was it - was it a consensus or a view in breakout
18 group two that if the PCAOB exceeded or went beyond the
19 limited role that you described that we would actually be
20 working counter to our objective clearly stated to empower
21 and to enhance role of audit committees.

22 MR. JONAS: I would invite members of group two to

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1 weigh in on that question.

2 MR. BAUMANN: Bill Platt.

3 MR. PLATT: Well, Mike was going to weigh in on the
4 question so I'll give the floor to him first and then I'll
5 - and then I'll speak.

6 MEMBER GALLAGHER: I'm not sure I have the answer
7 to the - I'm not sure we considered that. I think the
8 reticence around having a requirement at this point of
9 specific AQIs in particular and having a more hard wired
10 approach by the regulator at least was premature, given
11 where we are in the journey, and that there may be a point
12 as this process matures where the role of the regulator
13 could be enhanced and go further.

14 But I think that there was such broad support that
15 this got off to such a good start and is stirring such a
16 good dialogue we don't want to ruin it by having - by being
17 too heavy handed-at least at this stage of the journey,
18 Jim. That was my take. Others can comment as well.

19 MEMBER PRATT: Yeah, Mike. I think you said that
20 well. I think as we - we did talk about in the - in the
21 group to the extent that you have a prescribed list that's
22 not viewed as being all - totally-relevant to an audit

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1 committee that you run the risk that it becomes more of
2 a compliance exercise rather than achieving the purpose
3 we are looking for which is really to provide information
4 that's a catalyst to a discussion about managing in essence
5 the performance of the audit to deliver high audit quality
6 and therefore focusing on things that the audit committee
7 felt were valuable would enrich that discussion and not
8 cloud it with things that they felt were just compliance
9 activities.

10 So I do think that yeah, we did feel that it could
11 be detrimental if you came up with a prescribed list at
12 this point.

13 MR. BAUMANN: Just following up on Jim Doty's
14 question and the point - bullet number one up there about,
15 let's just say, AS 16 were amended to require the auditor
16 discuss with the audit committee indicators of audit
17 quality that should be - could be considered or discuss
18 with the audit committee what the audit committee viewed
19 to be appropriate audit quality indicators.

20 Did that get - that wouldn't describe a list but
21 let's just say top quality audit committees today are
22 discussing audit quality indicators but maybe not all of

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1 them are. Would such an amendment cause any problems or
2 any inhibition?

3 MR. JONAS: Yeah. Marty, I think we specifically
4 engaged in that discussion in terms of could AS 16 be
5 amended and include this.

6 I think that was viewed negatively, certainly by
7 members of the audit committee that were in the group that
8 this is one more required communication rather than giving
9 us the latitude to, you know, decide how we're going to
10 spend that limited amount of time.

11 The other thing we talked about, again, is that if
12 you're going to have audit quality indicators, whether
13 they're mandated or not, and our preference was certainly
14 not mandated, is the importance of integrating the
15 indicators in the discussion because I think you'd find
16 that most of the indicators that would be useful would
17 probably be tied towards something that's already a
18 required communication. It would just enrich the
19 discussion around those items. So bolting it on and
20 saying in addition to the required communication is you
21 also have to do, you know, a certain number of audit quality
22 indicators I think was viewed very negatively.

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1 MR. BAUMANN: Chuck Senatore.

2 MEMBER SENATORE: Just to follow up on something
3 that Mike said. I think that there's no real disagreement
4 about the value of the discussion.

5 One thing that struck me in the room is that it
6 seemed as if the audit committees and the firms represented
7 in the room didn't need the help maybe that some audit
8 committees that might not be of the same provenance might
9 need.

10 So there's clearly a need to have - promote the
11 discussion. But the other point at least that struck me
12 was that many times a highly quantitative approach, you
13 know, with certain sort of rifle shot indicators, there's
14 a danger of kind of getting information but missing the
15 view in terms of the point of context.

16 I know that the proposing release talked about the
17 importance of context. We talked about the importance of
18 context in the meeting and perhaps, to Mike's point, as
19 experience unfolds, as we begin to perhaps learn through
20 the exam and the examination experience that the PCAOB does
21 and sort of maybe see higher correlations between certain
22 audit quality indicators and actual great outcomes.

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1 Then maybe we'd be further down the road towards
2 actually mandating something or suggesting strongly
3 something that could actually - that we know will actually
4 provide value.

5 You know, I think there's maybe a little time that
6 needs to unfold before we get there.

7 MR. BAUMANN: Sara Lewis.

8 MEMBER LEWIS: Hi. So from the perspective of an
9 audit committee chair I would say that, you know, several
10 of the indicators in the list we actually already receive
11 information on and so - and we use those in the process
12 of our annual auditor evaluation.

13 And so that, I think, is the appropriate time to
14 look at these audit quality indicators. But the reality
15 is is that I believe you get much better information from
16 your qualitative discussions with your auditors
17 throughout the year, you know, throughout the quarter,
18 throughout the year and also from the management team.

19 And I can tell you, you know, quantitative numbers
20 are not ever going to replace the importance of the
21 qualitative discussions and quantitative measures in my
22 mind are generally backward looking and really are not

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1 going to impact my particular audit, I don't believe.

2 And so I think that they're a useful tool for a
3 discussion but I think that what might be more useful is,
4 you know, the firms that provide transparency reports if
5 they're able to evolve their metrics over time to give us
6 a view of how the firm is addressing quality issues
7 themselves I think that that might be more useful going
8 forward than a prescribed indicator that might not be
9 useful in the future.

10 MR. BAUMANN: Phil Santarelli.

11 MEMBER SANTARELLI: Thanks, Marty. I would just
12 differ slightly from Mike's comment. I don't think AS 16
13 would benefit from a requirement to have an audit quality
14 discussion with the audit committee.

15 However, it might benefit by having a suggestion
16 in the - in the planning phase of discussions with the audit
17 committee that the auditor should make - should offer to
18 - or suggest to the audit committee, if they want it, the
19 ability to have an audit quality indicator discussion and
20 report out at the end of the engagement versus a mandate.

21 But kind of to Chuck's point about another way to
22 influence audit committees that may not be aware that this

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1 is something they should be considering to kind of move
2 it down that needle.

3 But I think a mandate to have a required disclosure
4 and negotiate it I think would be more of an option that
5 could, I think, be baked into AS 16.

6 MR. BAUMANN: Thanks. And I guess we have world
7 class audit committee members on the SAG and not all audit
8 committees are of the same talent that we have at this group
9 right here. So that's why there may be some different -
10 potentially different views there.

11 MEMBER GALLAGHER: Marty, I would just say that
12 opening up AS 16 to tell auditors that they have an option
13 to communicate. AQIs doesn't seem like the highest and best
14 use of our standards.

15 MR. BAUMANN: Okay, thanks. Rich Roedel.

16 MEMBER ROEDEL: Thank you. There was a
17 contrarian view in breakout group number two about
18 mandating AQIs.

19 I believe they should be. I believe they should
20 be mandated by the PCAOB who has a seat at the table high
21 enough to see the landscape and can, I think, play a part
22 in deciding what those AQIs - the best use of those AQIs

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1 and what they are, remembering that they're a tool amongst
2 many tools that audit committees have to assess the quality
3 of the performance of its outside independent auditors.

4 But that's not my point. The larger issue that I
5 think needs to be addressed is how the firms and not just
6 the big firms but all firms that service public companies
7 need to speak to both the users of those financial
8 statements and the consumers of those audit services about
9 what they're doing to improve audit quality.

10 Now, the big firms, many represented here in the
11 room - Pricewaterhouse, Deloitte, Ernst & Young - all do
12 that through the transparency reports that they issue.

13 Some have suggested that they could be improved.
14 Maybe there's a little bit more salesmanship in those
15 documents than needed to be but you could be prescriptive
16 in their contents.

17 But my suggestion - my strong suggestion would be
18 to at some point in time think about requiring those firms
19 to go on record each year about what they're doing inside
20 their organizations to prove - to improve quality.

21 That would be very helpful and as a subset of all
22 of that particular AQIs that would be particularly helpful

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1 to audit committees. While it is critically important
2 that the audit committees understand the people who are
3 actually rolling up their shirt sleeves and doing that
4 audit, their experience, their independence, their
5 knowledge of the company and its industry, while that's
6 critically important it is also important - I'd add
7 critically important - that the audit committees
8 understand the environment in which those teams operate.
9 So it's very important for them to understand what the firm
10 is doing to improve quality throughout the entirety of its
11 organization.

12 So I - while it is not necessarily a subject for
13 today, I think in the longer term, users of financial
14 statements, investors and audit committees would benefit
15 by the firm speaking to them about what's going on in their
16 practices with respect to the improvement of audit quality
17 to which we're all significantly interested in.

18 MR. BAUMANN: There's two cards up. Can we take
19 these two and then move on to the next one? Bob Hirth and
20 Philip Johnson.

21 MEMBER HIRTH: So, Marty, if it was decided you
22 didn't change AS 16 so there wasn't a mandate, I think that

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1 you do have a bully pulpit with respect to a lot of the
2 publications you come out with and a great example to me
3 is the audit committee dialogue.

4 And it got plenty of attention so my idea here would
5 be wouldn't you maybe develop an audit committee dialogue
6 piece.

7 I kind of like those words, and now it's on AQIs
8 and you have got a tremendous amount of material already
9 around all the background, all the work that Greg has done.
10 You could talk about the SAG input and the things we learned
11 here, give all the background and rationale, show the
12 example measures as example measures and then by doing that
13 you end up, I think, picking up a lot of media attention.

14 You know, Compliance Week will write about it. I
15 think you could make sure you get it to the NACD, AICPA.
16 They will all write about it. The large accounting firms
17 will probably also write about it because it's issued to
18 inform their clients what they think.

19 So maybe it's the audit committee dialogue that's
20 the way to get it all out there in a broad enough way that,
21 you know, more and more audit committees and companies
22 might pick up the idea and do something.

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1 MR. BAUMANN: Philip.

2 MEMBER JOHNSON: Thanks, Marty. We had an
3 excellent discussion and the summary does reflect what was
4 said and the other comments.

5 I think most of the - if not all the - audit
6 committee members and chairs felt that it was at engagement
7 level that it was particularly important, the interaction
8 between the client and the auditor is very important, and
9 I think also that the concern that certainly I have and
10 I there were others had a similar concern that if we just
11 focus on quantitative measures, hard measures, then the
12 less informed audit committee will see that as the measure
13 of audit quality and it isn't because there are, and it's
14 been articulated around this table, there are lots of
15 qualitative measures - the outputs, the interactions that
16 - as a consequence of those softer indicators, you get a
17 good feel as to whether it's being a quality audit or not.

18 And unfortunately, from my perspective, the
19 concept release solely focused on quantitative and it was
20 only mentioned round about two-thirds of the way through
21 that there were other aspects that could influence audit
22 quality. So I just think that the board just needs to

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1 consider the focus of these indicators.

2 But I think undoubtedly there is a need for audit
3 quality indicators to be out there. There are nine
4 initiatives, however, and some range around the world and
5 there are - and they range from six audit indicators to
6 40.

7 That's not a good place to be when we're talking
8 about, particularly when it's the larger - as Greg said
9 yesterday, it's the larger firms and the larger companies
10 that are really impacted here.

11 And so we need to make sure that we do have some
12 joined up writing on a global basis.

13 MS. HUTCHENS: So we're going to take a sharp right
14 turn here because breakout session three had very
15 different views from breakout session two.

16 There was general agreement in four areas. While
17 not unanimous, it was a majority view as it relates to the
18 use of AQIs by investors. These were the four general
19 areas of agreement.

20 First, there was an agreement that the end goal
21 should include some level of mandated disclosure to
22 investors.

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1 Secondly, the majority of investors or the view was
2 that the majority of SAG members agreed that investors are
3 capable of evaluating AQI metrics in context. In some of
4 the comment letters that were received there was
5 discussion around whether investors could absorb the AQI
6 metrics in the context and have the appropriate context
7 to understand those AQI metrics. Those in breakout session
8 three felt very differently and said investors on a regular
9 basis are reviewing very complex financial statements and
10 therefore would have the skill set necessary to understand
11 AQI metrics and the related context.

12 Thirdly, there was consensus among the group that
13 narrowing of the 28 AQIs is necessary to cull out the most
14 valuable ones. So as Philip mentioned, narrowing that
15 list down to those that are most valuable.

16 And lastly, in the area of general agreement our
17 group recommended a phased approach with a bias for action
18 and that would begin with a core set of AQIs specifically
19 around audit team mix, the competence and availability of
20 the audit team, and then there was also discussion in that
21 phased approach that the PCAOB should continue evaluating
22 AQIs through research, monitoring of the practice of AQIs

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1 currently available and through outreach.

2 In our next slide, we've presented three areas in
3 which our group had controversy or just did not have
4 general consensus.

5 The first related to the length of time for which
6 phasing should last. There was varied discussion in this
7 area.

8 Some would say one to two years, some would say
9 three to five years. So we were not able to reach
10 consensus in that area.

11 Secondly, the nature and extent of the testing to
12 be performed. We lacked consensus in that area. And then
13 lastly, there were various opinions and suggestions on the
14 ways in which AQIs could be disseminated. Lots of ideas
15 came out of the room.

16 Unfortunately, we weren't able to give you a
17 consensus on what everyone agreed but we had lots of good
18 ideas around the ways the AQIs could be disseminated.

19 Lastly, we had four new ideas out of our breakout
20 group in this last slide, the first relating to the
21 relationship between AQIs and CAMs, or critical audit
22 matters.

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1 An example was brought up in our breakout session.
2 If you have a critical audit matter specific to an industry
3 it could be relevant to also understand an AQI measure
4 related to the industry expertise of the audit team itself
5 and their ability to handle that critical audit matter
6 relevant for that industry.

7 Second, the idea was to have separate work streams
8 for the firm level AQIs from the engagement level AQIs.
9 There was some discussion that there's been further
10 progress in firm level AQIs, especially given that many
11 are - many firms are already publicly disclosing firm level
12 AQIs and maybe that we are still progressing along on the
13 engagement level AQIs but we should not let the progress
14 of our - or we should not let the progress of the firm level
15 AQIs impact our progress in the engagement level AQIs and
16 vice versa.

17 Our third area here was to disclose firm level and
18 engagement level AQIs in separate documents. There was
19 some discussion around this new idea that commingling the
20 disclosure of these two in the same document would not be
21 preferred but to rather disclose them in separate
22 documents.

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1 And the fourth idea was around the value that can
2 come from looking at trends of AQI data over time and that
3 can be just as valuable as evaluating an AQI for an
4 engagement level-specific audit and comparing that to
5 another audit or firm versus firm.

6 So we talked about time sequencing and the trends
7 in those AQIs - in that AQI data being just as valuable.

8 So I'd like to open it up to anyone from breakout
9 session three that would like to add color to those points
10 or key takeaways.

11 MR. BAUMANN: Brandon Rees.

12 MEMBER REES: Thank you.

13 I agree with your assessment that if breakout
14 session two was from Mars, session three was from Venus
15 and we were very, very eager to see AQIs disclosed to
16 investors, investors being the ultimate third party
17 intended beneficiaries of audits that they should receive
18 audit quality indicator data through mandated disclosure
19 of engagement level AQIs.

20 And we identified, I think, three potential areas
21 that AQI information will benefit investors. First,
22 proxy voting - issuers in the United States trust their

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1 share owners to vote and ratify their selection of the
2 independent auditor at annual meetings and yet investors
3 are given zero information about the quality of the audit
4 and that this would be a very beneficial corporate
5 governance mechanism to enhance audit quality indicators
6 by improving proxy voting.

7 Secondly, improving and assisting with shareowner
8 engagement with boards of directors and audit committee
9 members in discussing audit quality to have some concrete
10 information that investors could dialogue about.

11 And then thirdly, securities analysis - that
12 investors - not all investors will trade on AQI type
13 information but it will help investors better appreciate
14 the risk of a material restatement and that by having that
15 information priced into securities will reward companies
16 with high quality audits with higher stock prices.

17 The - to add some color about where AQI information
18 should be located and disclosed to investors, there was
19 differing views - should it be in the audit committee's
20 report to investors in the proxy statement versus in the
21 auditor's report.

22 One view was that the auditor's report - that AQI

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1 data is the auditor's information and it most makes sense
2 to be disclosed through the auditor's report.

3 I don't think it's - my personal view is it's not
4 necessarily a - in conflict you could have auditors
5 disclose this information to investors and then have the
6 audit committee discuss their assessment of that
7 information in the proxy statement. So I hope that's
8 helpful.

9 MR. BAUMANN: And I guess if it was discussed -
10 disclosed through the auditor's report then the PCAOB
11 would have the authority then to get that information to
12 investors because it's coming from the audit report and
13 not the proxy statement necessarily, I think, was part of
14 the issue.

15 MEMBER REES: That's right, and I would - my
16 personal view is that as the specialized agency that has
17 the benefit of inspection reports and the data that the
18 PCAOB does gather from its oversight of the audit process
19 that the PCAOB is best in position to identify those AQIs
20 that should be disclosed to investors that are most
21 material.

22 MR. BAUMANN: Tom Selling.

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1 MEMBER SELLING: I want to emphasize the point
2 that narrowing the range of AQIs that the board would
3 consider from 28 to, say, four or five would really
4 catalyze the project and I think that was one of the most
5 valuable suggestions to come out of our - to come out of
6 our meeting.

7 Among other things, it would enable us to start the
8 process of documenting and validating the benefits of AQIs
9 and my personal vision is that AQI reporting could
10 eventually look something like the way that MD&A has
11 evolved in that there might be tabular - required tabular
12 disclosures of certain quantitative information but also
13 there would be a mix of required and voluntary qualitative
14 information surrounding that to provide the context that
15 a lot of people feel is sorely needed.

16 MR. BAUMANN: Joan Amble.

17 MEMBER AMBLE: Yes. I wasn't on that panel so is
18 it okay if I offer a question?

19 MR. BAUMANN: Yes, it is.

20 MEMBER AMBLE: Okay. I'm intrigued and don't
21 agree with the view just expressed. But is the
22 presumption if it's mandated, and I'm not sure which of

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1 the ones that are being - that were being suggested in this
2 group be mandated and provided to investors - would the
3 presumption then be that they would have some sort of
4 controls around them and they would have to be audited,
5 number one?

6 And is it - is it the quantitative data only that
7 you're asking for or would it be the - I mean, what I have
8 found through trying this out is the most important
9 element, which has been discussed, is the qualitative
10 elements to it and the trend analysis.

11 But are you thinking - is the group thinking of a
12 point measure required and would it have to be audited and
13 have controls around it and would that have to be
14 regulated?

15 MS. HUTCHENS: I think in our group the four that
16 were brought up were some of the first measures. One,
17 five, six and seven were the actual ones that were brought
18 up.

19 But specifically related to the audit team, the
20 competence and the availability, we did not specifically
21 discuss your question. So if there's someone from our
22 breakout group that would like to respond to that question.

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1 MR. BAUMANN: The question was would the audit
2 quality indicators included in the auditor's report have
3 to be audited. I think that was touched upon. I think
4 some folks didn't think so. But I don't know. Does
5 anybody - Brandon, do you want to comment?

6 MEMBER REES: Well, there was a discussion about
7 the value of having standard definitions to enhance
8 comparability and I think also identifying a certain core
9 set of AQIs that, again, would enhance comparability,
10 comparing between issuers in the same industry, for
11 example, would be very beneficial.

12 And I don't think any investor would take the view
13 that they would only want the quantitative data. They
14 would also very much appreciate a qualitative discussion,
15 a narrative discussion, of the quality of the audit and
16 interpretation of that AQI data.

17 MR. BAUMANN: Sir David Tweedie.

18 MEMBER TWEEDIE: Thanks, Marty.

19 I think one of the advantages of getting older is
20 you don't actually care what you see and having been a
21 standard setter, I notice the constituents fall into one
22 of two categories.

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1 You either get the conservatives who say don't do
2 it or you have the liberals who say do it but not yet.

3 And there's all sorts of things that you can do.
4 You can do more research. You can do field tests. You can
5 do more consulting. You can re-expose, anything that
6 delays the project.

7 Looking at this, I see it fairly clearly. I'm not
8 terribly interested, to be honest, in firms' transparency
9 documents. A lot of them have got a lot of puff in them,
10 talk about centers of excellence. Well, nobody has
11 centers of mediocrity, not that they boast about.

12 Audit committees, yes, their information is good
13 for them. But I don't like the idea of the audit committee
14 telling me on the outside what they think I might want to
15 know.

16 What I would like to know is when I look at this
17 audit and look at the financial statements I want to know
18 can I trust them - is there someone like Mike Gallagher
19 running this audit.

20 Now, I know I'm going to have to go rummaging
21 through several pages to find out since it's not going to
22 be in the audit report but basically looking at that I want

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1 to know what the audit team is like.

2 I want to know the makeup. Is it senior people?
3 Are they specialized if we're dealing with banks and
4 valuation issues? Are they specialized in that? Have
5 they called specialists in? What's their industry
6 experience? How long have they been on this sort of
7 engagement? That tells me a lot about the team. It also
8 helps when I look at the critical audit matters.

9 As I said, the fact that you can then see that one
10 of the audit's critical matters was valuation. What have
11 they got on the team to deal with that? Is it a bunch
12 having a go at it or is it someone who really knows what
13 they're talking about.

14 It also helps, I think, with the - if in the event
15 the audit changes and there's been some sort of lower fee
16 how are they going to meet that? Are they going to match
17 the team that's just left and that's a sign which I think
18 the audit committee would then feel very strongly about
19 and hopefully the fact that they're going to have to
20 publicize it would actually maybe stop some of that
21 happening.

22 Industry levels, I think you could build up. The

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1 PCAOB could collect and collate the data from this and then
2 decide that for banking this is a normal or the median
3 breakup of the team and so on so you can compare that to
4 another.

5 But what it's doing is what I think this
6 organization is meant to do is to be giving me confidence
7 and the numbers I'm going to look at are right and I don't
8 think I need the audit committee to tell me what is there.

9 Those four audit quality indicators would give me
10 a lot about the team and that's really - we can develop
11 it later. Some of these 28 have gone into the stratosphere
12 and fine, they can be developed later.

13 The audit committee will find things like
14 training, et cetera, useful. But as far as the actual
15 accounts are concerned I think knowing the experience, the
16 type of people who are on that and the prime auditors are
17 going to give me a lot more information and confidence.

18 So that's why I'm all for putting it and I would
19 go on with it now unless you want to be another liberal
20 and yes, but not yet.

21 MR. BAUMANN: Thank you, David. Sri Ramamoorti,
22 and we have - I know Greg wants to have a discussion around

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1 the room so we have Sri, David Kane and Jeremy Perler.

2 MEMBER LUKOMNIK: Could we have the people who
3 were on the breakout group speak first?

4 MR. BAUMANN: Pardon?

5 MEMBER LUKOMNIK: Could we have the people who
6 were on the breakout group?

7 MR. BAUMANN: Sure. John? Jeremy Perler was in
8 the breakout group? Okay. John.

9 MEMBER LUKOMNIK: I think that the reason that
10 this group came up with such different results and I'm
11 sorry Joan's not here to hear it is that Sir David earlier
12 on suggested narrowing the discussion around those four
13 indicators.

14 They are, I believe, much less controversial, not
15 universally applauded but materially less controversial
16 than looking at all 28.

17 It was my suggestion that we bifurcate. Sir
18 David's was even more limited and I think that's a very
19 good thing and to his plea to just get on with it I would
20 suggest that by narrowing it to the least controversial
21 that becomes part of the testing phase but in a mandatory
22 disclosure fashion and it is hard to argue that the amount

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1 of staff, the expertise of staff, the specialization
2 level, particularly when you can cross it with a CAM.

3 And I apologize for my voice. It is not useful and
4 it is something that would be beyond the ability of
5 investors to understand or to put into context.

6 And so I think that in some ways the - when you look
7 at the entire concept release there are things people can
8 argue about and to use Sir David's view, don't do it or
9 don't do it yet.

10 When you narrow it to these four specific this
11 breakout group could come to a consensus to say yes, this
12 could move forward and this could be useful and it can in
13 effect serve as the basis for part of the engagement level
14 gathering of information even while providing
15 information.

16 So I do think it is important that when you look
17 at why we took a different view, it is because we were
18 looking at a set of indicators that I think there was fairly
19 universal agreement upon.

20 MEMBER PLATT: Jon, just one question. I'm sorry
21 to go out of turn. What are the four, just for the rest
22 of us, because it might be insightful.

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1 MEMBER LUKOMNIK: One, the staffing leverage,
2 five, the persons with specialized skills and knowledge,
3 six, the experience of audit personnel and seven, the
4 industry expertise of the audit personnel. So those are
5 fairly down to earth important pieces of information.

6 MR. BAUMANN: A couple of others who were in the
7 room had their card up. David. David, you were part of
8 this.

9 MEMBER KANE: Yeah, Marty. Thanks. Yeah, I
10 think there was some general agreement that AQIs could
11 benefit investors over time but I do think taking a
12 parallel path with both engagement level as well as firm
13 level does make some sense.

14 On the firm level transparency reports, I
15 personally do think it's important for the investing
16 public to understand what the firms are doing in terms of
17 their quality agenda, focus areas, their infrastructure
18 to support delivering quality audits and I think some of
19 the firms have already got some of those publications out
20 so the PCAOB could continue to foster and encourage that
21 type of information to be disclosed, have it on firms'
22 websites, make sure it's accessible to investors.

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1 I think, though, on the engagement-specific piece,
2 one area of caution is just that while there may even be
3 some agreement about some of the specific metrics, again,
4 just putting those out there without having the context
5 around them could actually be more harmful than
6 beneficial, you know, when taken out of context there.

7 So, we have to really kind of think through that
8 a bit more and one way to do that would be, as has been
9 discussed before, talking to the audit committees, maybe
10 even about these specific ones, what sort of discussions
11 were engaged with them -- what was the appropriate context.

12 I think the PCAOB could do something like that FRC
13 did in terms of the best practices document out there on
14 auditors' reporting. That was helpful not just for
15 auditors, but also for audit committee members.

16 We think about these AQI discussions they're going
17 to be very rich, I think, between auditors and audit
18 committees.

19 So giving audit committees and even auditors the
20 benefit of what some of those discussions look like, what
21 some of the metrics are I think will help narrow that down
22 a bit more and, at the same time, help raise some of the

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1 best practices.

2 MR. BAUMANN: Thanks, David.

3 We want to take -- Greg wants to get on with a
4 further discussion but Maureen McNichols was also in this
5 particular breakout room, and your card is up.

6 MEMBER MCNICHOLS: Thank you. I was just going to
7 comment that sort of the discussion around a voluntary
8 approach doesn't get you to getting information to
9 investors.

10 There's sort of no clear path to getting
11 information to investors along the lines that is needed,
12 is demanded to, sort of, better understand the quality of
13 audits and understand the quality of the financially
14 reported numbers.

15 So I think that was a major argument for moving
16 ahead and the idea of starting with a few -- a few metrics
17 like one, five, six, and seven.

18 I think the notion of phasing in was you start there
19 and see how that information is received and then work
20 further to develop additional indicators that investors
21 and audit committees can use in making decisions about
22 audit quality, engagements, and, sort of, investing

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1 decisions ultimately.

2 Joan Amble asked the question about whether these
3 numbers would be audited, these AQIs. To the extent they
4 come from the audit firms, these aren't assertions of
5 management and wouldn't require auditor controls. So I
6 think that was all I'm going to add at this point.

7 MR. BAUMANN: Thanks, Maureen.

8 And the last card Sri, if you could make it short.

9 MEMBER RAMAMOORTI: I want to clarify that I was
10 just trying to jump the queue, because Joan was given the
11 license earlier.

12 I will be quick. There's a 1999 white paper from
13 the Scottish Institute that talks usefully about
14 disclosure philosophy by distinguishing between expert
15 and inexpert investors when it comes to reading and
16 interpreting financial statements.

17 The same kind of comment could be made about
18 expertise on audit committees. Not all audit committees
19 are created equal. So I think if we do go ahead with
20 mandating anything, I think it is probably advisable to
21 provide guidance, so that the folks who aren't exactly
22 expert are able to interpret the information. That's all

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1 I want to say.

2 MR. JONAS: Well, thank you for that and thank you
3 for the debriefs -- each of the groups.

4 What we'd like to do, lastly here, is go around the
5 room and get your personal advice to the board. Just to
6 frame it, though, having issued the concept release,
7 having had the benefit of the comment letters, having had
8 the benefit of this discussion, I think the board finds
9 itself at a bit of a crossroads here with the project,
10 needing to take decisions about next steps, if any. And
11 so I think your advice is particularly timely to the board.

12 So Marty, wherever you'd like to start. Our
13 dilemma here is, you know, with the number of SAG members
14 we have, the budget for your comments is literally one
15 minute, and I am sorry for that, but if you can try to be
16 concise with your comments, I know all of your fellow SAG
17 members would appreciate the opportunity to speak as well.
18 Marty, where would you like to start?

19 MR. BAUMANN: Well, Philip Johnson, I just was
20 looking right at you, so we'll start with you and go to
21 your left.

22 MEMBER JOHNSON: Okay. Thank you.

1 Not much thinking time. I think -- I've said most
2 of what I said -- wanted to say with my earlier comments.
3 But I think I -- first -- I think about being cautious about
4 having too many indicators, that too many hard measures.
5 One of the issues about hard measures is people manage
6 their businesses to those hard measures and that's not
7 really where we want them to be with regard to quality
8 indicators.

9 Certainly, I don't believe they should be
10 mandated, and I had also mentioned about qualitative as
11 well as quantitative. There is a combination there.

12 But I think 28 is far too many and people will
13 report -- it will become boilerplate reporting. It really
14 won't tell us an awful lot about quality and it does --
15 it is important that we do look at those audit committees
16 that don't have the expertise that is being expressed
17 around this -- from individuals around this table.

18 MR. BAUMANN: Harrison Greene.

19 MR. GREENE: I don't really have anything to add,
20 but I did like Bob Hirth's idea about putting out a paper,
21 which could be done a lot easier than, I guess, standard
22 setting.

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1 MR. BAUMANN: Wally.

2 MEMBER COONEY: I agree. PCAOB should play a
3 leadership role, and they are in a unique position to work
4 on this. In terms of firm level AQIs, I think if the board
5 came up with a short list and mandated that at some point
6 relatively soon that would probably be feasible.

7 In terms of engagement level AQIs, I was in group
8 three. I think I was -- I don't know if I was conservative
9 but maybe somewhere in the middle of Sir David's pendulum.

10 I think they may be valuable, but my personal view
11 is that audit committees and auditors should work together
12 with the indicators and develop possible AQIs that at some
13 point in future, and I was on the longer end of a possible
14 phasing period, perhaps they should be published. But
15 time would tell whether that was appropriate.

16 MR. BAUMANN: Greg, did you have a comment you
17 wanted to make?

18 BOARD MEMBER THELEN: Thanks.

19 You know, I agree with the comments before. I
20 think rationalizing the number certainly makes a lot of
21 sense to make it more manageable. I like the idea of a
22 framework.

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1 I think that audit committees and companies and
2 firms can work real well within the concept of a framework.
3 So I would encourage moving that direction. And also bias
4 towards action -- you know, we have been talking about this
5 for a long time.

6 You know, if we can get some things decided and get
7 a few of them out there let's, you know, get it out there,
8 design and experiment something, test it out and see what
9 we get. But let's not talk about it for three more years.

10 MR. BAUMANN: Joan Amble.

11 MEMBER AMBLE: Yes. I would favor it not being
12 mandated. As was stated out of our group, I think a
13 principles-based model, which talks about objectives is
14 helpful, citing examples empowering the audit committee
15 to engage with management and the auditors and then they
16 would determine, the audit committee, which are most
17 relevant and are decision useful.

18 I think it's -- I would emphasize in any
19 principle-based model that one of the most important
20 elements would be a trend analysis and, to the extent
21 applicable, what was planned on an AQI and what the actual
22 result was and a very substantial emphasis on the

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1 qualitative discussions.

2 I would not support at this point disclosure of
3 that. I think it's way too soon, and I would say we should
4 walk before we run. And I think if you empower the audit
5 committees to be thoughtful about this, you'll get a much
6 better result and a much happier result at the end that
7 could be very constructive and productive.

8 MR. JONAS: Joan, just to clarify, what, then, is
9 the role of the regulator in a voluntary regime, in your
10 view? What do we do here in the next year or two if
11 anything?

12 MEMBER AMBLE: Actually, I don't know if you
13 realize this, but I think you've also already provided
14 value because you've got people thinking about it. Maybe
15 not everybody, but you've got people thinking about it.

16 You have people talking about piloting it or
17 piloting it, and I think what -- and I will get to your
18 exact question. The other thing which I forgot to mention
19 is a lot of these AQIs are formalizing what's already
20 happening anyway.

21 You know, it's capturing, on a formal basis, data
22 that was addressed and understood through discussions

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1 because audit committees do stuff before the AQIs were a
2 concept.

3 I think the regulators, what they could do, is
4 provide a really good principles-based document of this
5 is what we would like -- this is what we encourage and these
6 are the objectives that we think could be very, very
7 helpful.

8 I think maybe even reaching out to some people that
9 have piloted it and said which ones work and which don't,
10 I think trying to convey a message that 28 is the right
11 number -- I know when we did it, we had 12 and there was
12 -- it was more than 12 pages because there was a lot of
13 discussion, et cetera.

14 That was too many. And once you make it a burden,
15 you've lost the benefit and, like I said, there's a lot
16 more -- the other thing which we don't want to lose sight
17 of is -- and this is part of the resistance, and I talked
18 about this in our meeting -- it's a misnomer to call us
19 an audit committee, because we don't audit.

20 Okay. We don't audit, and we do a lot more things
21 and people don't like it that we're only focusing on this,
22 because there's a lot more that we have to do to do a good

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1 job.

2 MEMBER GALLAGHER: But you are a committee?

3 MR. BAUMANN: Thank you.

4 MEMBER AMBLE: We are a committee.

5 MR. BAUMANN: Mike Gallagher.

6 MEMBER GALLAGHER: Thanks.

7 I was also going to say something original until
8 Joan just answered Greg's question, but I'm going to say
9 it anyway.

10 The PCAOB and Greg, in particular, need to be
11 commended for taking on this project, and I think that the
12 behaviors have changed already. A number of the firms
13 have piloted audit quality indicators and are having
14 really good dialogues with audit committees today.

15 In addition to that, I think that this dialogue
16 that was spurred by the PCAOB has caused, you know, some
17 of the firms to speak more publicly and actually put
18 metrics into our overall, you know, whether you call them
19 quality reports or transparency reports -- put metrics in
20 these reports and, you know, being one of these firms I
21 would tell you that, you know, we struggled with how to
22 do it, and we finally said you know what, let's just do

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1 it. It's not going to be perfect this year.

2 We did it a couple years ago, and each year we're
3 adding more indicators. So I think that the project is
4 getting momentum, and I think the momentum was spurred by
5 this project, and I think it's -- you know, let's let it
6 get some more momentum and let's let -- hopefully a race
7 to the top in terms of what firms do and what firms
8 disclose.

9 MR. BAUMANN: Sandy, what do you think the PCAOB
10 should do next?

11 MEMBER PETERS: Well, I think I was in the room
12 from Venus, but I was from Mars. But I don't think ---
13 I'm probably maybe the only investor which would say I
14 don't think that these are ready to be disclosed right now.

15 I worry about them, and it may be because of the
16 fact that I was an audit partner, that they may create a
17 behavioral response that isn't what we as investors
18 actually want.

19 And I think they may at times tell you more about
20 the company than they do about the auditor and their
21 underlying people, process and technology. But that's
22 just my view.

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1 As far as proceeding, I think that focusing on a
2 core set of indicators is a good idea. I think that
3 mandatory is sort of a strong word but I think that it is
4 necessary to have audit committees have conversations
5 around these and for the regulator to understand what that
6 looks like, what the -- what the numbers are turning out
7 to be, what they actually tell us, are they really
8 measuring audit quality. So I think that there's some
9 bias to do something. I just wouldn't -- I just would be
10 very fearful of publishing them today, because I think they
11 -- we really need to know what they tell us, and I think
12 qualitative as well as quantitative are super important
13 to the conversation.

14 MR. BAUMANN: Phil.

15 MEMBER SANTARELLI: Thank you.

16 I would echo Mike's comments about congratulations
17 to Greg and his team and the PCAOB on raising the dialogue
18 related to audit quality indicators.

19 I think it's been quite dramatic and, by increasing
20 the dialogue, I think that has had an effect on audit
21 quality in a positive way.

22 As far as a path forward, I don't see the need for

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1 any specific rule-making or standard setting related to
2 audit quality indicators.

3 I think the role of the regulator here is to
4 continue to encourage a dialogue between audit committees
5 and their auditors, certainly through your audit committee
6 dialogue publications and so forth, and offering the
7 concept paper as a source of data points that audit
8 committees might consider in those conversations.

9 Beyond that, I'm strongly supportive of the PCAOB
10 considering the development of a framework for audit
11 quality. I think that would be very useful for both audit
12 committees and auditors to adjust accordingly, and I would
13 encourage a sense of urgency around the agenda item for
14 upgrading and modernizing the quality control standard.
15 Thanks.

16 MR. BAUMANN: All right. Thanks. Joyce Joseph.

17 MEMBER JOSEPH: Thanks, Marty.

18 Well, as I mentioned earlier today, I do believe
19 a principles-based framework is an appropriate approach,
20 allowing the audit committee process to play out in using
21 the AQIs and the data that is derived from those learnings
22 should be used in order to make later assessments as to

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1 what are the most plausible AQIs that could potentially
2 be publicly made for investor consumption and, again, with
3 direct investor input as to what would make sense for that
4 slate of AQIs.

5 And I think that core set should have some degree
6 of being mandated simply because investors do like to have
7 benchmarks for peer comparisons and period over period
8 comparisons.

9 And so it will perhaps be more informative if at
10 that later point in time post-evaluation of the quality
11 benefits -- that they can use it. So it's very similar
12 to the remarks that Sandy has also made on this topic.

13 MR. BAUMANN: I was going to give the observers an
14 option to pass unless you wanted to speak.

15 Walt Conn.

16 MEMBER CONN: Yeah. One of the specific ideas
17 that was discussed in group one that, I think, was along
18 the lines of a principles-based framework was for the PCAOB
19 to issue a thought leadership piece that would encourage
20 auditors and audit committees to have a dialogue about
21 AQIs, would or could provide some example AQIs and how they
22 should be calculated and then that thought leadership

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1 piece could be updated after a year to discuss experiences
2 that you hear from audit committees, from auditors, et
3 cetera, and I think that will just build upon what the PCAOB
4 has already done, and it struck me that that was very
5 consistent with some of the recommendations from the group
6 two discussion and with Bob Hirth's idea for an audit
7 committee dialogue piece. So that would be my
8 recommendation to pursue.

9 MR. BAUMANN: Guy Jubb.

10 MEMBER JUBB: My personal advice to the board is
11 that it proceed with reasonable haste to require
12 engagement auditors to discuss and agree annually with the
13 audit committee its principles-based approach to
14 determining and evaluating engagement audit quality and
15 document the same. And this should be documented in
16 appropriate detail.

17 Second, I would advise the board to urge the SEC
18 to require meaningful disclosure, discussion and
19 analysis, not boilerplate and possibly by reference to a
20 framework, disclosure by the audit committee of its
21 approach to evaluating the effectiveness and the quality
22 of the audit.

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1 In both those aspects of advice I implicitly do not
2 encourage specific reference to the identified quality
3 indicators as such but rather a framework approach.

4 And finally, that the -- my advice would be that
5 they let this approach bed down over, say, a period of three
6 years but infuse, in particular in relation to the audit
7 committee engagement the board undertakes, infuse the
8 encouragement to -- and guidance to take this forward in
9 a meaningful way.

10 MR. BAUMANN: Thanks, Guy.

11 Jeremy Perler.

12 MEMBER PERLER: Thanks, Marty.

13 Just coming from the investor perspective, I'm a
14 really big fan of disclosure, and I think you'd be hard
15 pressed to find an investor who's not.

16 But I just don't see this information as decision
17 useful at all from an investment perspective. I'm not a
18 fan of quantitative metrics and especially ones that are
19 designed to capture an inherently nuanced and qualitative
20 system and especially ones that reach broadly across
21 industries and geographies, because, inevitably, they get
22 boiled down to the lowest common denominator of stuff

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1 that's just not interpretable and, more importantly,
2 Goodhart's law kicks in, which makes these measures -- when
3 you establish a measure it seeks to become a useful
4 measure, because it influences the system itself, and I
5 think, you know, setting these up would run the risk of
6 the engagements being structured in such a way around these
7 metrics.

8 And, you know, perhaps it's helpful for an audit
9 - from an audit committee's perspective, and I've listened
10 to a lot of comments and interested to hear, and that's
11 less my knowledge base, but if I were to see these from
12 an investment perspective, I wouldn't see them as helpful
13 at all.

14 So my recommendation is not -- from an investment
15 perspective, I wouldn't move forward on that side and
16 whatever on the audit committee's side. If it's helpful
17 to them, great. If not, I'd kill it.

18 MR. BAUMANN: John White.

19 MEMBER WHITE: I'm probably pretty predictable on
20 this one, but I think you should start by focusing on
21 getting information to audit committees, and I think that
22 information should be engagement level information, not

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1 firm level information, with the focus being to help the
2 audit committee members oversee their own audit, trying
3 to figure out the kinds of information really being
4 decision useful information with respect to, as I say,
5 overseeing their audit, the goal being to get audit
6 committee buy-in to the project.

7 I guess I would focus also -- that you have a tool
8 out there already, this audit committee dialogue tool as
9 a way of communicating information.

10 MR. BAUMANN: Thanks, John.

11 Tom Selleck.

12 MEMBER SELLING: Did you just say Tom Selleck?

13 MR. BAUMANN: May have sounded that way.

14 MEMBER SELLING: I don't know. I think I'm --
15 never mind, never mind. I was originally skeptical about
16 --

17 MR. BAUMANN: Does that mean I didn't call you
18 then? It's a --

19 MEMBER SELLING: I'm having cataract surgery
20 soon, but I need ear surgery also.

21 I was originally skeptical about this project, but
22 I know think it's extremely important. Even the best

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1 intentioned and most highly motivated audit team is not
2 sufficient to ensure a high-quality audit. Competence
3 and resources are key and investors are entitled to have
4 information about that.

5 I'm very pleased with the consensuses that came out
6 of our group, and I have very little to add to Jane's
7 summary. I think it was excellent. I encourage the PCAOB
8 to marshal the impressive academic minds it has placed at
9 its disposal to produce an evidence-based foundation for
10 any guidance that it will issue.

11 And I do agree with Sandy and Jeremy that the
12 question of the response by issuers and auditors to the
13 new requirements is extremely important.

14 I think it is certain that there will be a
15 behavioral effect. But I think that research and good
16 thinking can maximize the possibility that the response
17 by the issuer community will be a positive one.

18 MR. BAUMANN: Richard.

19 MEMBER ROEDEL: It's hard to follow Tom Selleck,
20 but I'll try.

21 MEMBER SELLING: The mustache. You've got the
22 mustache.

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1 MEMBER ROEDEL: Sorry. And at the risk of piling
2 on, I'm going to start by saying I do, like a lot of people
3 have mentioned, think that this was a project very much
4 worth the time and the energy from the PCAOB and thanks
5 to Greg Jonas as well, I think it is both highly relevant
6 and as many people have said already I think it is added
7 to the discourse about a very, very important subject.

8 I would encourage the board to do two things, to,
9 first, in the short term --- and remember this is a journey,
10 and we're certainly in the very early innings of this --
11 just like other disclosures required of registrants, all
12 of us can go back in time and look at the first MD&As and
13 the first CD&As that came out.

14 I think that with time and attention on the part
15 of the PCAOB, the audit firms, and the audit committees,
16 this process will get better with age. I would mandate
17 a short, highly relevant, highly correlated group of AQIs
18 to be published by the firms. But as I said earlier, to
19 me the most important thing is to, at the end of the day,
20 whether it's now or later, to wind up with a required
21 communication by the firms.

22 And remember, there are so many firms that are --

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1 that audit registrants that are not represented in this
2 room that I think we need to hear from -- investors and
3 consumers, audit committees.

4 I would mandate that communication, which now
5 takes the form of a transparency report, be proscriptive
6 about its content, and I think that that will be of enormous
7 use to investors and to audit committees in particular who
8 have the responsibility to making sure that not only the
9 people who were doing that audit are qualified in however
10 you describe that but are doing work in an environment
11 which is conducive to audit quality at the highest level.
12 Thank you.

13 MR. BAUMANN: Thank you. Elizabeth Mooney.

14 MEMBER MOONEY: Thanks. I do applaud your team,
15 Greg for all the good work on this project. I do think
16 it's important, and we have a, you know, a very extensive,
17 robust, in-house process and effort around proxy voting,
18 and I know this -- I believe this information really would
19 be useful.

20 We do, you know, extensive fundamental analysis of
21 the financial statements, and it would really help inform
22 our discussions and our decisions especially from that

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1 perspective. So I would also urge the mandatory
2 disclosure in the proxy filings.

3 MR. BAUMANN: Thanks.

4 Peter Clapman.

5 MEMBER CLAPMAN: Apart from applauding the PCAOB,
6 as everybody else is going to do and has done, my
7 recommendation is to move quickly to implement the process
8 of AQIs basically to recognize that the primary focus of
9 it, certainly at the beginning, is between the audit
10 committee and the audit firm, and I would permit a lot of
11 flexibility in terms of exactly what factors are involved
12 in those discussions.

13 But I believe the process of doing something in
14 this area in that engagement between the audit firm the
15 audit committee ought to begin right away.

16 Ultimately, I think investor disclosure has got to
17 get into this process. We've had other situations where
18 some disclosure, and I think the disclosure should be
19 around what is happening in terms of the audit firm and
20 the audit committee reviewing the AQIs that seem to make
21 sense for that particular company and that particular
22 industry, to have some disclosure along those lines.

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1 Since this is the PCAOB, I would prefer the PCAOB
2 to do it in the auditor report. If the SEC wants to take
3 it over and put it in the proxy statement, I don't have
4 any objection to that.

5 But too often we wind up in a situation where
6 there's a question of which agency should mandate a
7 particular disclosure, and I think investors need this and
8 investors need to know that a process along AQI is
9 happening, and I think the point earlier that this gives
10 real meaning to the role of investors finally to ratify
11 the selection of the audit firm, they need this
12 information, so I would encourage the PCAOB to get started
13 with it right away and to have some kind of disclosure that
14 the process is occurring.

15 MR. BAUMANN: Thanks. Brandon Rees.

16 MR. CROTEAU: Sorry. Just --

17 MR. BAUMANN: I was going to give you the
18 opportunity to pa --

19 MR. CROTEAU: And I appreciate that, but I'll take
20 the opportunity this time and really, I just wanted to
21 recognize the project team here.

22 I think what Greg, Steve and others are doing --

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1 George and others are doing is incredibly useful here, very
2 transparent in terms of developing the AQIs, and while
3 there's a range of views around the table, I think the
4 transparency that they've really afforded this project has
5 enabled the SAG to really provide some very useful feedback
6 here. And so I just wanted to take a moment to recognize
7 them.

8 MR. BAUMANN: Thanks. Brandon Rees.

9 MEMBER REES: Thank you.

10 So, if the breakout session of investors was on
11 Venus, then I'm living on the surface of the sun.

12 My view is that the problem with voluntary
13 disclosures is that only those issuers that have high
14 quality audit committees and high quality audits will be
15 -- will really benefit from that, and it's the low - it's
16 the companies that have problems that will benefit the most
17 from having mandatory AQI -- an AQI at firm level and
18 engagement level disclosures.

19 I would like to see the PCAOB move forward as the
20 specialized agency to identify those AQIs and to require
21 disclosure in an audit committee -- I'm sorry, in the
22 auditor's report and then the SEC could supplement it by

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1 requiring an audit committee discussion of the AQIs, but,
2 at the end of the day, AQIs are the auditor's information
3 and my view is it is most appropriate to appear in the
4 auditor's report and I -- I guess I would just close that
5 if -- you know, if AQIs are not measured, then they won't
6 be managed, and, in my view, sunlight is the best
7 disinfectant and that by disclosing AQIs, you will help
8 those companies that are most in need of improving the
9 quality of their audits.

10 MR. BAUMANN: Sir David.

11 MEMBER TWEEDIE: I would echo what Brandon has
12 just said. I think this is a stewardship issue. I think
13 it's very difficult to argue against showing the skill,
14 competence, and experience of an audit team.

15 I think it will put pressure on teams that are weak
16 to come up to scratch for the reasons Brandon gave.

17 I would mandate in the audit -- with the auditor
18 reporting it, the ones that we talked about earlier, the
19 four, and you can have qualitative things later on, and
20 it'll just build, I think, like the MD&A did, and that's
21 the way I'd go forward.

22 As far as the audit committee is concerned, I think

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1 the first dozen or so of these indicators are useful to
2 them. They can always ask for more if they wish it.

3 I would have some sort of a dialogue with the audit
4 committees, but I would act now and mandate for the audit
5 report, the one who's dealing with the makeup, and
6 competence of the team.

7 MR. BAUMANN: Jim Cox.

8 MEMBER COX: First of all, I wanted to just
9 associate myself. I thought Guy had a great three-prong
10 approach and I think that's right and I want to just address
11 a couple of issues.

12 One is about whether it's mandated -- whether it's
13 an appropriate time to mandate anything, and I want to
14 point out the fact that, whether you're going to mandate
15 something or not, depends on what the objective of a
16 mandated disclosure would be.

17 My way of thinking about this is to the audit
18 committee and to the audit firms themselves. But
19 disclosing it to investors provides an additional impetus
20 for that.

21 Now, whether you mandate it or not mandate depends
22 on what you're going to mandate, okay? And so we've heard

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1 several reports that the genie's already out of the bottle.

2 A lot of developments are going on. A lot of
3 buy-in from the Big Four firms and other firms with respect
4 to audit quality indicators.

5 If that's the case, then it seems appropriate that,
6 minimally, you can have a kind of disclosure much like
7 we've seen the SEC do early on in its governance things.
8 For example, do -- does the audit committee employ audit
9 quality indicators.

10 If not, why not? If so, what are they? Okay?
11 You know, that would be something. It would actually
12 serve a very useful purpose on exactly the same lines you
13 were talking about over there of getting things out in the
14 atmosphere so people can then learn from others.

15 And then if you follow disclosure, which is a
16 history of disclosure, of it being iterative and hopefully
17 sensible, which is not always the case -- admit that --
18 but an iterative process, then I think that would be a very
19 useful process.

20 So yes, mandated, general at first, perhaps not
21 quantitative, but just simply asking the question what are
22 you doing. And by doing that, you'll get a dialogue going

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1 which, I think, is going to point things in the right
2 direction.

3 MR. BAUMANN: Thanks. Sara.

4 MEMBER LEWIS: So just echoing my comments
5 earlier, again, this is from an audit committee
6 perspective.

7 I do think that the qualitative discussions
8 between audit committees, the audit firms and, you know,
9 your engagement partners and your management team is the
10 most indicative of a quality audit from the
11 engagement-level perspective.

12 But I do think that the thought leadership piece
13 on the audit quality indicators that we deem most important
14 would be very useful to audit committees and, you know,
15 keeping in mind that we do already receive -- I think you
16 mentioned numbers one, five, six, and seven -- we already
17 do receive and discuss those indicators on a very regular
18 basis as well as several others on the list.

19 So, you know, continuing to have those
20 conversations through the audit committee dialogue and our
21 thought leadership piece, I think, would be very useful
22 for audit committees.

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1 But I do think, you know, one area where the PCAOB
2 is in a very unique position is if over time, you know,
3 through your inspection process, you can find an
4 evidence-based causation between some audit, you know,
5 audit quality indicators and things that actually do
6 result in a very high quality audit, you know, if those
7 are causation, not just correlation but causation that
8 would be very useful, again, in another audit committee
9 dialogue piece, because those things, in theory, would
10 evolve over time and if you, again, with your root cause
11 of failed audit, you know, work that you're doing I think
12 that also could be very useful. And so those are the areas
13 where I think the PCAOB can be very helpful to audit
14 committees.

15 MR. BAUMANN: We've been saying that these
16 projects are linked --- the root cause and the AQI project
17 and the quality control standards we want to get working
18 on.

19 All right. Greg Platt.

20 MEMBER PLATT: Yes. I would like to first add my
21 voice to those who have congratulated Greg and his team,
22 and I think Jane did an excellent job of summarizing the

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1 work done in the third group.

2 I fall on the side of identifying a handful of
3 universal metrics that would be immediately mandated for
4 all issuers.

5 I would require adoption over the earliest
6 practical time. I would also permit and encourage
7 companies to report on and explain how the AQIs used
8 actually improved and enhanced audit quality.

9 I also believe that a framework for developing
10 audit quality indicators is necessary, and I believe that
11 the PCAOB is uniquely positioned to facilitate that.
12 Thank you.

13 MR. BAUMANN: Thanks.

14 Maureen McNichols.

15 MEMBER MCNICHOLS: I think it's a great project.
16 I think it can have very positive impact and better
17 information for investors and potentially better
18 incentives for audit committees and their auditors.

19 In terms of proceeding, I think the next step would
20 be to start a process that ultimately leads to mandatory
21 disclosure of some AQIs. So which ones?

22 Well, in terms of the metrics in Attachment B, the

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1 28 metrics, many of the audit results-related metrics are
2 actually already public.

3 So from the investor standpoint, and, actually,
4 investors do find those informative. We have data on
5 that, evidence on that.

6 So, I think from an investor standpoint the
7 greatest potential benefit is going to come from things
8 that aren't already being publicly disclosed, and I
9 support the recommendations Sir David made in terms of
10 focusing on understanding better the qualities of the
11 audit team.

12 So I would recommend a phase one that develops the
13 AQIs in the phase one the audit professionals category in
14 Attachment B taking an evidence-based approach and say
15 relating it to the evidence and inspections to document
16 why these would be relevant and proceeding to establish
17 that they would be informative.

18 MR. BAUMANN: Thanks. Doug Maine.

19 MEMBER MAINE: I am a member of three public
20 company audit committees. There are ten individuals in
21 total. We are former CEOs, CFOs, Wall Streeters, and two
22 generals.

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1 None of us have ever worked in public accounting.
2 None of us have ever managed an audit engagement team. So
3 I view these as not only helpful, but I view them as
4 necessary.

5 My one plea would be let's get on with it. Don't
6 study it to death. Let's get something out. I'm not hung
7 up in what form or how they're communicated. Let's just
8 get them out.

9 And the last point I want to make to the PCAOB is
10 that Jeanette was in -- I was in group one, and she was
11 in group one as well, and she gave us her vision, and I
12 would say that resonated very well with all the members
13 of group one. So my advice is listen to Jeanette.

14 MR. BAUMANN: That sounds good. That's a
15 decision then. We'll have to hear that for the entire
16 group, Jeanette. So --

17 MEMBER HAMBLIN: I want to thank the other Jane for
18 an excellent summary of what we discussed in group three.

19 I would just highlight my agreement that we should
20 move forward, that the PCAOB should move forward with
21 mandatory disclosure of a limited number of AQIs, and that
22 those AQIs should relate to, as others have discussed, the

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1 experience, the expertise and the availability of the
2 audit team and that it's -- would also be very helpful for
3 the PCAOB to establish definitions of the AQIs that will
4 be reported so that there's consistency and comparability.

5 You know, in my experience representing an
6 institutional investor, it is important to be able to
7 evaluate the quality of the audit and whether the audit
8 committee itself is doing its job and this information
9 would be a step toward enabling the investor to do that.

10 MR. BAUMANN: Great. Bill Platt.

11 MEMBER PLATT: Well first, I'd like to, as many
12 people around the table have already done, congratulate
13 Greg and his team on, really, an unprecedented level of
14 transparency and a number of firsts as his project has
15 evolved.

16 I mean, his -- the openness, and the discussion,
17 and the dialogue including at the SAG meetings has been
18 extremely valuable, especially in an area that is new to
19 all of us.

20 And among the first, though I don't think it's been
21 mentioned at this meeting, and I don't know -- I don't know
22 how many people in this room have actually clicked on the

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1 PCAOB website and looked -- listened to, I guess, the first
2 podcast that they have in the series, which Greg actually
3 has an excellent podcast on audit quality indicators from
4 the perspective of an audit committee chair.

5 So if you haven't done that, I'd encourage you to
6 do it. It's certainly a good -- it's well worth the time
7 you would spend listening to it.

8 This is an area where I still believe that we can
9 and should, at this point, in the project create demand,
10 and let demand pull from an audit committee perspective.

11 I think many people around the room who are audit
12 committee members or chairs have, once they learn about
13 audit quality indicators, are wanting to embrace them,
14 wanting to incorporate them and in the way they work with
15 their auditor, manage the audit relationship.

16 And I think the continued outreach that the PCAOB
17 has, whether it's through audit committee dialogues or
18 speaking on panels or at events of the, you know, NACD or
19 other opportunities for directors, things like the podcast
20 are ways that I think we can create demand that will
21 encourage and drive incorporation at the audit committee
22 level.

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1 I don't think we need regulation right now, and I
2 think we should let, in essence, the activities you engage
3 in drive that. Another thing that came to mind that, as
4 an opportunity to engage individually with audit
5 committees, as I know your inspection team, at times, do
6 talk to audit committee chairs. It would be an
7 interesting question for a PCAOB inspector to ask about
8 what that audit committee chair's either experiences with
9 audit quality indicators or whether they thought about him
10 or whether they've engaged in discussions, just another
11 way to, you know, maybe plant the seeds for demand in this
12 area.

13 I've listened very carefully to the group three in
14 terms of reporting to investors, and I've listened very
15 carefully because it is -- it's not the conclusion I would
16 come to.

17 I don't think we're ready for disclosure to
18 investors, and I've tried to be open minded as I listened
19 to the proponents of having a limited list of reporting
20 to investors and while a limited list takes away some of
21 the fear and uncertainty I would have, I still worry about
22 the unintended consequences of it.

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1 I do think that if we're going to have reporting
2 to investors, I do think it's very important to have either
3 the correlation or causation done, and I worry that, in
4 essence, what we do is we drive everybody to an average
5 in those five indicators, and we end up doing more harm
6 than good to audit quality on the population at large.

7 MR. BAUMANN: Thanks.

8 Sydney Garmong.

9 MEMBER GARMONG: Yeah, I too would like to -- I
10 thank the PCAOB for starting the dialogue, and there really
11 is the opportunity to have a meaningful impact just from
12 starting that dialogue.

13 We obviously have varying views around the table
14 and I would ask the PCAOB to be particularly mindful when
15 thinking about the implications for the middle market
16 smaller filers.

17 I think that you're looking at a very different
18 investor base. I think you're looking at -- well,
19 somebody already made the comment that not all audit
20 committees are created equal, and I think that I would
21 encourage the PCAOB to keep that in mind.

22 In terms of -- in terms of moving forward with

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1 something mandatory, I do get concerned that we might be
2 introducing a lot of cost and effort into the system when
3 maybe it's just not going to be valued by everybody.

4 So what should the board do? I think the board
5 should continue the dialogue and, encourage, I think, just
6 by -- I think, Bill, maybe you made the comment about well,
7 guys just -- once they learn about it, there just becomes
8 demand. And so I think encouraging dialogue with audit
9 committees and investors would be -- would be very useful.

10 The other thing that came to mind for me is, and
11 I know transparency reporting has been mentioned a couple
12 of times, maybe the PCAOB would reach out to the firms and
13 try to understand just how are people using the
14 transparency report.

15 So, maybe that's something that could be done
16 during the inspection process.

17 MR. BAUMANN: Thanks, Sydney.

18 MEMBER HIRTH: Okay. I like, Bill, your idea of
19 this create demand program. So I think the speeches,
20 whether it's through the audit committee dialogue or
21 whatever just get the message out, and I'd just encourage
22 maybe to go one step further and kind of think about it

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1 from a marketing perspective and spend a little bit more
2 time thinking about the NACD and the organizations I
3 mentioned to get that out there. So the demand kind of
4 -- create demand gets exponentialized around that.

5 And then yeah, continue the research and the
6 considerations and the project itself that Greg and others
7 are running and consider all the comments that are here
8 today and then, you know, I think, to some extent, if you
9 can find them, watch what happens and identify the leaders
10 and the laggards and learn from that.

11 But here's something that's new that we haven't
12 talked about. So, if the goal of AQIs is to improve audit
13 quality, and if evidence of a lack of audit quality are
14 the deficiencies in the inspection reports, and I know
15 you're working on this root cause, so really tie that, and
16 the idea would be as AQIs go up, deficiencies would go down.

17 And I think you have a very interesting opportunity
18 here now, as the regulator, in the inspection process not
19 saying that any of this would be reported in the future
20 inspection reports but when you now do an inspection why
21 don't you collect certain quantitative AQIs as part of the
22 inspection process? So let me give you the example.

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1 You now take a U.S. LLP, and there are 56 audits
2 that are inspected. You ask for x AQIs that are
3 quantitative for the 56 inspected audits. Now what you
4 watch is you see is there any correlation.

5 So I've done the 56 inspections. I have these
6 deficiencies around ICFR, around IPE, around this and
7 that, and then look at the AQI information, and you might
8 say there is no correlation.

9 But interestingly, where we had these eight same
10 deficiencies, they came from engagements that this was the
11 AQI amount or measurement. So I think there's an
12 opportunity to sort of pilot that a little bit stealthily,
13 keep the dialogue going to get that.

14 But I think you got this great lab opportunity,
15 especially around the quantitative stuff, to do that as
16 you inspect the firms.

17 MR. BAUMANN: That's an excellent point.
18 Certainly, our inspectors have this kind of information
19 available at their fingertips and look at these types of
20 -- who's on the team, leverage and all those kinds of
21 things, and they are tying that in with root cause, but
22 it's a great recommendation.

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1 Thanks. Jeff Tate.

2 MEMBER TATE: Great. Thank you.

3 A couple of comments here that I'll just make as
4 I'm very happy to hear some of the comments that are made
5 around not necessarily making a mandate synonymous with
6 action.

7 I think you can get a lot of the actions from a
8 thought leadership piece. I think we've got a great
9 foundation of data and information here, and I'd love to
10 see the project team continue to look at the tangible
11 benefits that this can derive for the key stakeholders.

12 In my opinion, the key stakeholders are obviously
13 the audit committee, the firms, and the investors when you
14 talk about the AQIs.

15 So looking at the tangible benefits, also looking
16 at the potential behaviors that this will drive for those
17 stakeholders as you go through the project.

18 And then coming up with some of those key, as we've
19 talked about before, AQIs that we can really use and find
20 valuable while at the end of the day also assessing what's
21 currently being done from a qualitative perspective
22 between the firms and the audit committees and how this

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1 could complement that.

2 I think that builds a lot of credibility with all
3 of those that we have been focusing on here as we look at
4 the project outcome.

5 MR. BAUMANN: Great.

6 David Kane.

7 MEMBER KANE: Yeah, Marty. I will break it down
8 into three parts. For me, it feels like a lot of has been
9 accomplished in a very short period of time.

10 So the PCAOB wants to continue to encourage and
11 foster communications and discussions between audit
12 committees and auditors on that.

13 Second is really monitor what those discussions
14 look like -- what are the factors that were specifically
15 considered and why, which AQIs, what's the context needed
16 in order to understand those and then really use that to
17 get smarter around and more educated around what the real
18 next steps should be.

19 I don't think we're at a point right now where that
20 should be mandated. I think that could be potentially
21 down the road as we collectively get better and smarter
22 around some of this, and I think the challenge is, again,

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1 a lot of credit goes to the board and Greg and team on this.

2 How do you keep the momentum going, but not stifle
3 the innovation around this? So I just caution you to think
4 about that.

5 MR. BAUMANN: Thank you.

6 Charles Elson.

7 MEMBER ELSON: It's always good going fortieth.
8 You learn a lot.

9 A couple things. Number one, I think the notion
10 of the AQI is actually a pretty good one for a lot of
11 reasons. I do think that you have too many categories,
12 because I think the more categories you have, the less
13 focused you become on the whole project.

14 So I would concur with the earlier comments that
15 it's probably better to have fewer than the 20 some odd
16 you've got now.

17 That being said, the question is what is the value
18 of this thing, and I think that any time you force someone
19 to be introspective and review what they're doing, that's,
20 to me, the real value of it.

21 The fact that a firm has to think about these things
22 in reviewing an audit I think is the value. Vis-a-vis

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1 making disclosure mandatory, I would be against that
2 simply because I think when you create mandatory
3 disclosure, the whole exercise ends up as legal
4 boilerplate and you lose a lot of the effectiveness of it.

5 People, you know, do the disclosure to meet the
6 legal requirement as opposed to thinking about what went
7 behind the project to begin with, and I would keep it
8 voluntary because, I think you'll ultimately get better
9 audits out of it as opposed to a mandatory requirement.

10 Now, the bigger question, though, and I think the
11 end question is does this really mean anything to audit
12 committees and to investors? And I think any transparency
13 is always good, and it's frankly good to have it. The more
14 information an investor has, or committee, the better
15 they'll be.

16 The question, though is, and this is probably a
17 little more on the controversial side, ratings are only
18 helpful if you have a real choice in who you can pick. In
19 other words, you know, higher ratings, lower ratings
20 suggest a competitive market place.

21 And, you know, at this point, in the large CAP
22 companies, there really isn't all that much choice.

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1 You're really down to, you know, a couple of firms
2 and with conflicts and what not that makes it a lot tougher.

3 So I think ultimately the bigger question is, you
4 know, competitiveness and choice, if you will, for
5 committees the ratings only really matter if you can really
6 -- if you really have a choice, and I think choices today
7 are much more limited than they used to be and something
8 to think about.

9 That's why you have a couple of us academics here.
10 We're supposed to, you know, throw in the -- throw in the
11 controversial stuff. But that I do think it's a great
12 project, and I think very thoughtfully done and eager to
13 see it to its conclusion.

14 MR. BAUMANN: The value of that academic thinking.
15 Next, Mike Santay, you have as an observer the option to
16 comment.

17 MR. SANTAY: Just a couple things. I do -- have
18 observed that I think it would be difficult to have a broad
19 impact without mandating some type of discussion, and I
20 think that the ideas out of group three, principles-based
21 with some themes might be helpful.

22 I do take, I think, Sydney's point about being

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1 cautious with the impact on the smaller and mid-size firms
2 and watching the administrative burden that this might
3 join. I do think that their level of engagement might
4 improve, but I don't think we want this to be a huge burden
5 for those firms.

6 MR. BAUMANN: Thank you. Sri?

7 MEMBER RAMAMOORTI: I would also like to applaud
8 Greg and his team for their diligence and focus. But let
9 me also take this opportunity to appreciate Marty and his
10 team for this SAG meeting to have these breakout sessions
11 that has brought us to this juncture this morning.

12 I think this is probably the best input that we
13 could have gotten, and that's because of the process by
14 which we've arrived at this point. So let me put that on
15 record.

16 I particularly appreciate Brandon and Sir David
17 for their cogent arguments and influencing me this morning
18 in supporting a bias for action.

19 So I would suggest that the PCAOB move ahead. And
20 quoting Victor Hugo, audit quality is an idea whose time
21 has come, and many audit committees in the past perhaps
22 have been guilty of picking auditors based on cost rather

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1 than audit quality.

2 So audit quality does need to become a topic of
3 conversation between auditors and audit committees.

4 I would say that a principle-based approach to the
5 extent possible, you know, should be adopted and then
6 seriously considered. Additional guidance should be
7 provided for the inexperienced user community among the
8 investors as well as, you know, audit committees that may
9 not be, you know, really ideal for this.

10 I also want to observe the PCAOB is uniquely in that
11 leadership position to become the tide that lifts all boats
12 and improve audit quality worldwide by doing something
13 like this. This is an effect that will echo around capital
14 markets around the world. Not just here. And that's the
15 influence that the PCAOB can have with this kind of a
16 project. So that is something to be considered, too.

17 And, in that spirit, and continuing the quoting
18 penchant that I have, I shall quote G.K. Chesterton, who
19 did say today's heresy is tomorrow's orthodoxy.

20 MR. BAUMANN: Well said. Thank you.

21 Chuck Senatore.

22 MEMBER SENATORE: I see Jeanette's to my right.

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1 But I was hoping for the opportunity to listen to Jeanette,
2 but I guess I'll have to wait for that.

3 I think we're in a situation where we're thinking
4 about two things. One, how to empower an audit committee
5 and, again, sort of talking about what we talked about
6 earlier, all audit committees aren't created equal and we
7 really want to empower and give the tools to audit
8 committees to engage -- have great audit engagements and
9 benefit investors.

10 So this needs to be driven towards that end. So
11 the question is, in terms of the role of the regulator,
12 do you mandate, or do you sort of let the marketplace take
13 its course and have some different level of engagement from
14 the PCAOB.

15 It's my own view that, sometimes, regulation can
16 tend to be a blunt instrument. I've had experience with
17 it on both sides of the table, and what I get concerned
18 about is it can actually stifle innovation and, sort of,
19 have unintended consequences such as, sort of, check the
20 box kind of outcomes and some of the points raised earlier,
21 sort of, doing it just because the rule requires it as
22 opposed to actually trying to deal with what the outcome

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1 should be. So that being said, so what does the PCAOB do
2 about this?

3 First, I very much like what Sir David said in terms
4 of the importance of narrowing. Although I wouldn't
5 mandate it, I would not underestimate the power of the
6 bully pulpit.

7 I think we see some examples where, when you
8 consider the -- sort of, the incentives that exist today
9 in audit committees, they are not without liability. They
10 certainly have enough self-interest to make sure that
11 they're doing their jobs well.

12 They recognize their duties, and the pain and the
13 consequences for not doing them well is a very, very great
14 incentive to, sort of, having the bar be raised. So that
15 being said, I think that if they were to hear from the PCAOB
16 pretty much along the lines of what the SEC has done with
17 its risk alerts, people listen to it.

18 People drive behaviors toward it. People
19 actually make changes based upon them, and they're very,
20 very conscious of them.

21 So what I would do is, sort of, borrow from the Bob
22 Hirth idea in terms of really thinking more directly and,

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1 frankly, putting a thumb on the scale in terms of stating
2 the views of the PCAOB, using the PCAOB's point of view
3 in terms of seeing the landscape in terms of suggesting
4 and giving thoughts about audit quality indicators, and,
5 sort of, going down that road.

6 I suspect because of the incentives that are there
7 that there will be a race to the top. However, if there
8 is not a race to the top, the mandatory regulatory card
9 is always available to be played.

10 A separate point is something that Jim Cox said.
11 Actually, I made a note on this when I was reviewing the
12 materials -- I think, although it's sort of outside the
13 scope of the PCAOB, that considering in order to, sort of,
14 have a issuer-based kind of incentive here, have an audit
15 committee or an issuer disclose whether or not they use
16 audit quality indicators is a very, very interesting thing
17 to think about in terms of driving behaviors to having
18 better audits.

19 So net -- net, I wouldn't mandate. I would
20 shamelessly and aggressively use the bully pulpit and see
21 how it goes.

22 MR. BAUMANN: Thank you.

1 Megan, option to comment or not?

2 MS. ZIETSMAN: Thanks, Marty. Just real brief.

3 I think that some tremendous work has been done by Greg
4 and his team in really highlighting issues and moving this
5 on and I think I would encourage the team to listen to some
6 really good ideas that have been put forward around the
7 table around developing a framework, pushing forward,
8 using all the vehicles available to the PCAOB to really
9 publicize this, draw attention to this and I think like
10 Chuck just said people do pay attention to what the PCAOB
11 says in whatever form.

12 So I think that there's a lot of pay to be done in
13 terms of looking at things like the audit committee
14 dialogues, like the podcast that Bill mentioned to really
15 keep this alive.

16 But always a caution around being overly
17 prescriptive and too many rules because that will stifle
18 the innovative thinking and I think this will need to
19 continue to evolve and the danger really is that if you
20 try to box it in the unintended consequences or the - I
21 think it will build negativity rather than a real positive
22 atmosphere that is around it today.

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1 So I think there's some tremendous work being done
2 and really scoped to take it to the next level.

3 MR. BAUMANN: Thanks, Megan.

4 Larry, option to comment?

5 MR. SMITH: So when I look at the list of AQIs I
6 basically divide them into two buckets - those related to
7 the firm and those related to engagements.

8 And quite frankly, the firm wide AQIs I think are
9 part and parcel of your inspection process and should guide
10 you in your inspections and you already gather a lot of
11 that kind of data. So I would stop talking about that with
12 the SAG and just have that be part of your inspection
13 process.

14 In terms of the firm wide or the engagement wide,
15 I am extremely fearful that to mandate et cetera would have
16 unintended consequences that aren't necessarily the best
17 consequences.

18 I think from an engagement level perspective,
19 context is the most important thing that's needed in order
20 to understand the particular responses to quality
21 indicators and I think if we were to require disclosure
22 of those it could lead firms to make not the best decisions

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1 in order to come up with certain metrics.

2 So an example of that would be if you believe that
3 the amount of experience in a particular industry is
4 important but you have two audit partners or audit people
5 being considered for an engagement, one of which as a
6 decent amount of experience in that industry, another of
7 which doesn't but yet has proven themselves to be very
8 adept at leading audit teams and finding things out, et
9 cetera, the firm might select the lesser of the two
10 qualified candidates but yet in communications with an
11 audit committee they can explain why that person might be
12 more appropriate. So I'm really fearful of that.

13 So therefore, I really think that this should be
14 a voluntary type of an endeavor by the PCAOB. But as a
15 standard setter, I personally am against putting in words
16 of encouragement in our standards because it raises really
17 questions on the part of people as to whether it's
18 something that needs to be followed or not be followed.

19 So I was curious as to exactly what your mandate
20 was. So I went back to Sarbanes-Oxley and saw in 101(c) (5)
21 under the duties of the board that in fact one of your
22 functions is to, you know, to effectively foster the

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1 improvement in audit quality. So it falls into your
2 bucket.

3 But I think what you're doing in terms of
4 developing these things and perhaps working with the SAG
5 and working with the CAQ or others in terms of voluntarily
6 recommending the use of these AQIs and engagement level
7 is something that can raise the quality of audits.

8 But, again, I would not mandate it nor would I
9 publish the results of them.

10 MR. BAUMANN: Thanks. Jean Joy.

11 MEMBER JOY: Thank you.

12 Based on all of the discussions surrounding this
13 over the last 18 months or so, there is such difficulty
14 in adopting a prescriptive defined set of AQIs and there
15 is still the fear of having them being taken out of context.

16 So as a result of that, I would not be in favor of
17 a mandatory approach or making such information publicly
18 available at this time.

19 However, I am very much in favor of a concept where
20 there is some type of tool or framework that is
21 principles-based that would foster the continued
22 discussion with audit committees and provide further

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1 information for their use.

2 I continue to look at that tool as being surrounded
3 on one hand by the QC standards themselves and believe that
4 we do need to pay particular attention to those QC
5 standards and based on the information that you're getting
6 from your inspections are those QC standards where you want
7 them and where you believe they need to be.

8 And on the other side of this framework would be
9 the inspection results themselves and that root cause
10 analysis so that we do get back to the cause and effect
11 of some of these audit quality indicators.

12 I also think if there is a framework sitting in the
13 middle where the standards are feeding into the framework,
14 the root cause analysis is feeding into the framework that
15 we have the principles-based framework and that also goes
16 to the scalability issue, that I think if it is a
17 principles-based framework working with smaller companies
18 that that is something that we would be able to deal with
19 in smaller companies would be able to deal with and say
20 what is appropriate at their level.

21 MR. BAUMANN: Thank you very much.

22 Richard Breeden.

1 BOARD MEMBER BREEDEN: Thank you. I would add my
2 voice to those others who have commended the PCAOB for
3 initiating this project and to the exceptional quality of
4 the staff work that has gone into this.

5 I think you have done a real service to the country
6 in this entire process. As a former regulator, and I
7 suspect former prosecutors would say the same thing, the
8 hardest challenge is having the courage not to act when
9 action is premature or inappropriate.

10 It is far easier when a snowball is rolling
11 downhill or an avalanche globally to go along than to say
12 no, we're not ready - this cake is not ready for prime time,
13 half baked. And I think that's where we are here.

14 This issue reminds me very much, and I think the
15 risks are similar, to the risk-adjusted capital rules of
16 the banking system. Forty to 50 years ago, bank
17 regulators were wrestling with the problem of bank
18 failures and how to prevent it even though failed audits
19 and bank failures will go on to the end of time no matter
20 what regulators do.

21 But it is certainly something they were worried
22 about and they came up with the idea well, shouldn't

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1 capital rules be variable based on the risk of the bank.

2 And whether academics or people in the practical
3 world they all said well, it's kind of hard to argue against
4 the proposition that capital rules should vary based on
5 the riskiness of assets, except for two problems. One,
6 no human being and no group of human beings is capable of
7 measuring prospectively risk and financial markets
8 accurately.

9 It takes the collective judgment of millions of
10 participants in the market to do that and so there was a
11 built-in hubris to the exercise.

12 And two, even if one came up with something that
13 was relatively close to an assessment of risk it can't take
14 into account the fact that people will then respond to the
15 rule and will engineer to any rule that is produced.

16 And so in 2008, after multiple efforts at this,
17 bank failures in Europe were exactly inversely correlated
18 to regulatory capital.

19 Those banks that had the highest level of Basel
20 Tier One capital failed most often and those who had the
21 lowest levels of regulatory capital did not fail.

22 And I worry that - I mean, I think this illustrates

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1 the problem of a concept. It is impossible to argue that
2 audit quality isn't important and that audit committees
3 and investors and users in the markets don't want all the
4 information they can get about audit quality.

5 But can you really regulate it and can you mandate
6 anything that will end up not being counterproductive and
7 I don't think it can be done.

8 When we wrestled with the commission in my era with
9 things like pay ratios and disclosure - transparency about
10 well, what's the ratio between the CEO's pay and the
11 average worker's pay and we asked the question, well, then
12 suppose we're going to have that ratio published for AT&T
13 with 350,000 employees and also published for Albert
14 Einstein & Company, which is a small IPO company consisting
15 of Albert Einstein and one lab assistant.

16 And the fact of the matter is one size fits all
17 ratios do not work well in the real world. So I believe
18 that audit quality is an elusive and complex thing that
19 is composed not only of the numeric indicators, which are
20 relevant - they're just not dispositive - but also things
21 like character of the engagement partner and character of
22 the managers and the other participants on the audit team

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1 and the culture of a firm, and those things don't get
2 measured when you start coming up with quantitative
3 indicators.

4 And in fact, as you've heard before, I've strongly
5 supported the PCAOB's effort to have disclosure of the name
6 of the engagement partner and that's because it is the
7 character and culture and experience and history of the
8 engagement partner that is highly relevant to the quality
9 of a particular audit engagement and firm level AQIs are
10 in a sense, inconsistent with that.

11 So forgive me for going on too long. I believe you
12 should not mandate any AQIs. I believe you should require
13 each registrant to publish not less than every five years
14 or not more frequently than biannually a statement
15 regarding what it deems to be the most relevant audit
16 quality indicators for their firm.

17 And then I believe the PCAOB should publish a
18 summary and archive this and so that it is any audit
19 committee can easily obtain the publication of every audit
20 firm on audit quality and if a firm chooses to have a
21 one-sentence report that says we don't believe in audit
22 quality so be it and then let the market decide. Thanks.

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1 MR. BAUMANN: Thank you. Richard Murray.

2 MEMBER MURRAY: We quite regularly celebrate what
3 Greg and his staff have done on this subject but I go more
4 broadly than that.

5 I personally found this meeting to have been a most
6 satisfying - probably the most satisfying in several years
7 I've been on SAG in a couple of respects - in a personally
8 stimulating occasion and it has given us an opportunity
9 as a group to begin to hear each other and I appreciate
10 all that - the work that has gone into that by Marty, the
11 staff and the board to help get us to this point.

12 To the - to the issue. My views were part of the
13 group two consensus that Greg described so well yesterday.
14 I won't repeat the details.

15 I will address the question of what should the
16 PCAOB do now and I probably - this is a superficial version
17 of the Richard Breeden school of advice.

18 The PCAOB should declare victory, should remind
19 the world that thought leadership is a valuable tool of
20 regulation and that regulators are not limited to standard
21 setting in what they can do and monitor for three years
22 and see where nature takes this issue.

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1 I have to acknowledge and thank Brandon for an
2 observation that I think deserves a bit more attention when
3 he reminds us of the misalignment of the planets in our
4 particular universe.

5 Mars and Venus are not well aligned today, and I
6 think the misalignment is a critical issue for quality of
7 financial reporting and the orderliness of improvements
8 that we all want to achieve there.

9 I think the biggest problem is not difference in
10 objective but difference in perception.

11 The Mars community looks at auditors and audit
12 committees and assumes that given a choice they will most
13 of the time elect to be self-serving rather than public
14 serving.

15 And the other community looks at the investor
16 community and assumes that it's not really
17 investment-related decision making for which they seek
18 additional information but other investor-oriented
19 initiatives that are not really part of the capital markets
20 process.

21 I'm sure there is fault in both of those
22 perceptions and some truth. I think reconciling to the

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1 extent possible, sorting and filtering out the perceptions
2 that are mistaken and can be corrected is something that
3 SAG can be useful to in the broader community of U.S.
4 financial reporting.

5 So I would urge that we find a way to communicate
6 toward the objective of aligning the planets into a little
7 more harmonious state than they seem to be at the moment.

8 Thank you.

9 MR. BAUMANN: Thanks, Rick.

10 And John, you have the final word.

11 MEMBER LUKOMNIK: Going last is even better than
12 going 40th. I'd like to add my congratulations and I think
13 it's important to note amid all the disagreements how much
14 agreement there actually has been around the table and I'll
15 get to that.

16 I'm not going to restate my opinion. That was
17 clear before. But I do want to take the charge to us which
18 is what should the PCAOB do now, seriously.

19 When I was growing up, there was a play on Broadway
20 called "Gemini" which was about a dysfunctional family.
21 No implications. And the teenage son used to belly up to
22 the dining table and just grab the food and shove it in

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1 his mouth and the mother would say, "Take human bites."

2 I think that's good advice for the board. We heard
3 Chairman Breeden talk about basically firm-level
4 disclosure.

5 We've spoken about engagement level disclosure -
6 Professor Cox gave a great idea for the advisory to the
7 SEC. I would move for unanimous approval.
8 Unfortunately, it's not in terms of disclosure at an audit
9 community level.

10 I think these are two very different sets of
11 indicators. I do think you should bifurcate your
12 processes as they go forward. It will result in less
13 confusion and less controversy.

14 It will also enable you to focus. I also - so to
15 what the agreement has been, I have heard no one say the
16 industry - the public issuer community or investors do not
17 need audit quality indicators. AQIs were not a term of
18 art five years ago. That is a pretty amazing progress.

19 The boundaries of the discussion are should you
20 mandate a small set of indicators allowing audit
21 committees, auditors and members to disclose more of them.

22 No one has said mandate all 28. Or should you take

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1 action to encourage voluntary adoption and perhaps
2 disclosure. No one is saying prohibit disclosure. That
3 is actually a relatively narrow range and you should be
4 proud of the process which has gotten us all to that.

5 Professor Cox says towards what end do you
6 regulate. I think the clear end here is audit quality
7 improvement which has an intermediate step which is
8 marketplace adoption and marketplace disclosure.

9 As Richard said, it is a process. I have no doubt
10 that we will get there. I think that those of us who are
11 arguing for mandating a small group and allowing
12 flexibility around them versus those who are arguing don't
13 mandate but encourage wide adoption are trying to get to
14 the same place - perhaps through different routes at
15 different speeds but to the same place.

16 And so what I would encourage is whatever you do
17 on this, please keep up the momentum. They are not
18 mutually exclusive.

19 For instance, were you to choose to mandate there
20 is nothing that prohibits you from issuing an audit
21 dialogue or using speeches or the bully pulpit, generally,
22 in addition. If you didn't choose to mandate there is

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1 nothing.

2 We have a great momentum on this. I don't think
3 the range is that different. Ten years from now every
4 audit committee, every auditor will be using AQIs.

5 There will be disclosure to investors. However we
6 get there, whether it is through - I mean, it's majority
7 voting. It's proxy access. The lineage is clear.
8 Whether it is mandated or voluntary we'll get there.

9 I would urge the PCAOB to bifurcating it by
10 narrowing the focus to take a leadership position and
11 getting us there as quickly as possible. I think the way
12 you do that is by narrowing the conversation.

13 MR. JONAS: Well, to say the least, I know all of
14 us on the project team and the board feel that we've
15 benefitted hugely from the SAG's input in the past and I
16 can assure you we have benefitted hugely from what has
17 occurred here in the last two days. So we can't thank you
18 enough.

19 (...)