PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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INVESTOR ADVISORY GROUP

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MEETING

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WEDNESDAY
SEPTEMBER 9, 2015

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The Advisory Group met in the Ballroom of the Army and Navy Club Building located at 901 17th Street, Northwest, Washington, D.C., at 9:00 a.m., Steven B. Harris, Chairman, presiding.

PRESENT
STEVEN B. HARRIS, Chairman
BRANDON BECKER
MERCER E. BULLARD
CURTIS L. BUSER
T. GRANT CALLERY
JOSEPH V. CARCELLO
NORMAN J. HARRISON
MICHAEL J. HEAD
PETER H. NACHTWEY
LAWRENCE M. SHOVER
DAMON A. SILVERS
TONY SONDHI
JUDGE STANLEY SPORKIN
ROBERT M. TAROLA
GARY G. WALSH

SEC REPRESENTATIVES
MARY JO WHITE, Chair
BRIAN CROTEAU
JIM SCHNURR

PCAOB BOARD MEMBERS
JAMES R. DOTY, Chairman
JEANETTE M. FRANZEL
JAY D. HANSON

PCAOB STAFF
MARTIN F. BAUMANN
STEPHEN KROLL
HELEN A. MUNTER

T-A-B-L-E O-F C-O-N-T-E-N-T-S

P-R-O-C-E-E-D-I-N-G-S

8:59 a.m.

CHAIRMAN HARRIS: Okay. Well, why don't we get started. And at the outset, I want to thank everybody for participating this morning, given the volatility in the markets.

I know that a number of you are probably watching it and a couple are predisposed toward, you know, probably preferring to be there than here. So we very much appreciate your attendance and your participation.

So welcome to the Sixth Annual Meeting of the Investor Advisory Group of the Public Company Accounting Oversight Board. And at the outset, I want to extend an especially warm welcome to SEC Chair White for joining us this morning.

Chair White, we thought was going to be leaving at 10 o'clock, but she may try and extend her time a little bit until the break. So whatever timeframe you can be with us, that is very much appreciated.

And the fact that you would take time out of your schedule to attend today's meeting is not only greatly appreciated by all of us, but your advocacy on the part of investors is also appreciated by the investor representatives and community.

I also want to thank Jim Schnurr for attending, the chief accountant at the Securities and Exchange Commission and also Brian Croteau, who we work closely with also from the Commission's Office of the Chief Accountant, for attending today's meeting. So thank you both.

To our participants, I know that all of you, as I indicated, have extremely busy schedules. And we appreciate the time you have taken to participate at today's meeting.

In particular, I want to thank the members of each of our working groups for the effort they have devoted to topics that we will be discussing throughout the day.

The purpose of the Investor Advisory Group is to provide its views and advice to the Board on broad policy issues and other matters that affect investors and are related to the work of the Board. And that is why, that's what you have done, that's what this group has done in each of our previous sessions which is, as they say, much appreciated.

I believe that today we will have another highly productive meeting, and I commend you for the selection of the topics that will be discussed.

Unlike other advisory groups, the goal of the Board with respect to this group is to hear directly from you and to listen carefully to the issues you feel should be brought to our attention.

Going right to those topics and to the schedule for the day, the Board will hear the results of a survey relating to, amongst other issues, investor reliance on audit opinion, audit firm independence, the importance of potential audit quality indicators and whether audit committees adequately represent the interests of investors.

Next, the auditors' evaluation of going concern will be discussed. This will be followed by a discussion of current publications including Auditing Accounting Estimates and Fair Value Measurements, and the Audit Quality Indicators and the Auditor's Use of the Work of Specialists.

Then we will have a discussion of the

effectiveness of internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act in response to a letter from the Chamber of Commerce. And this discussion will begin with introductory remarks by Chairman Doty, SEC Chief Accountant Jim Schnurr and Helen Munter, the Board's Director of Registration and Inspections.

We will close with a general discussion of the issues each of our group members believe should be a top priority for the board to consider in the future.

I want to thank PCAOB Chairman Doty and Board Members Jeanette Franzel and Jay Hanson for participating in today's discussion. Board Member Lou Ferguson unfortunately was not able to attend, as he is on Board business out of the country.

From the Board's senior staff joining us at the table are Marty Baumann, the Board's Chief Auditor, Helen Munter, the Director of Registration and Inspections, and Steve Kroll from the Board's Office of Research and Analysis. Topics that will be discussed throughout the day bear directly on their responsibilities.

Under Board policy, we are required to make the following disclaimer. The views we express today are our own views and do not necessarily reflect the views of other Board members or the staff of the Board. Since today's meeting is being webcast, I would ask all participants to please identify yourselves before you speak throughout the day.

And now, I would like to turn to Chair White for any comments she may wish to make. And then I will recognize Chairman Doty for a brief overview of the Board's activities and then turn to Jeanette Franzel and Jay Hanson for any remarks they may wish to make.

And afterwards, as we have done in prior meetings, I would like all the members at the table to briefly introduce themselves. And then we will get on with the day's program.

Chair White?

CHAIR WHITE: Thank you very much, Steve. I was really very pleased I could join you for, I guess this is your sixth annual meeting. I think I may have been out of the country last year.

You know, you don't need anybody to tell you how important the work is that you're doing. You can tell from your agenda and just the work you've done in general, you're covering a lot of very important issues of significance to investors, work that obviously the PCAOB Board, the SEC, FASB in some instances, you know, is quite, quite interested in.

As Steve indicated, I think I will be here until your break this morning. I'm here mostly to listen. I'm obviously going to get a full report from Jim Schnurr and Brian Croteau of really the whole day's events and the feedback that you're going to be giving. Because I'm really quite, quite interested in that.

I might just make a couple of remarks on a couple of things and then, you know, get out of the way so you can get on with your agenda.

First, I want to thank Chairman Doty for his leadership and all of the members of the PCAOB Board as well as the PCAOB staff for the tremendously important work that you all are doing.

Auditors are obviously critical gatekeepers. It's impossible, really, to overstate the significance of their role in protecting investors and for our markets.

I can report that I am very pleased with the level of coordination between the Commission and the PCAOB in advancing what I consider to be our shared missions. Critical work really does occur every day in both organizations to improve audit quality and the integrity of financial reporting.

As you know and know well, the PCAOB recently issued a concept release seeking public comment on the content and possible uses of a group of potential audit quality indicators, AQIs as noted by the PCAOB Board in its release.

You know, some auditors and audit committees have made progress, I think, on this front through the voluntary use of AQIs. While this project is in its early stages, I want to commend the PCAOB's outreach and efforts to develop an issue, a very thoughtful concept release focused on improving audit quality. And I'm quite, quite interested in the feedback, you know, from your group on this.

And I know, I read with great interest your survey results, very interested in that conversation, which AQIs you think would be most useful to whom, how they should be distributed, how they can be used. Very interested in all that feedback.

You know, the last time I did attend your annual meeting, I believe I mentioned the possibility that the Commission would issue a concept release on potentially enhancing the audit committee report. We did issue that release in July the day after the Board, I think, issued your AQI and transparency releases.

The comment period on the SEC's audit committee concept release just closed yesterday. And the comments that, you know, we receive will obviously be very carefully considered, very interested in receiving those. I think there is a real opportunity there to provide more meaningful, useful information to investors.

A word about the PCAOB's inspection program and enforcement, I mean, clearly both play an integral role in really strengthening and maintaining the integrity of the auditing function.

At the SEC, we also continue to emphasize holding auditors to the duties they assume through our enforcement actions. Over the past year, I think we've brought charges against over 30 individual auditors and auditing firms. It will remain a focus.

And these are obviously against auditors and auditing firms who failed in their duties. Expect to see more cases like those going forward. And we work very collaboratively, and will continue to do so, with PCAOB enforcement to ensure that our respective enforcement resources are used effectively.

So let me stop with those just, you know, couple of remarks by extending just a couple more quick thank yous, first and foremost to all of you, the members of the IG for your time, and your effort and insights.

Investor input is critical to all of us, and I appreciate the commitment you've made to assist, in particular the PCAOB with its work. But it clearly assists the Commission and lots of other constituencies as well. So thank you for that.

And then Steve Harris, I want to specifically thank you for your leadership of the IAG and your efforts in seeking the views and the advice of the investor community. So with that, I will thank you for inviting me and wish you a very constructive meeting. Thank you.

CHAIRMAN HARRIS: Thank you, Chair White. Chair

Doty?

CHAIRMAN DOTY: Thank you, Steve, and thank you, Chair White. It has meant a great deal to me over the years to have known Chair Mary Jo White in this professional capacity and to have had the benefit of her support, her encouragement and her counsel.

And I have a special debt here, because I have always been able to get lunch with Chair White when I need lunch with Chair White. And believe it or not, that happens from time to time.

The other thing that has happened for which I've got to thank Chair White and the SEC is the recruitment of Jim Schnurr. Jim has made an enormous difference in the Chief Accountant's Office in the relations with the PCAOB and our ability to coordinate the activities that Chair White has alluded to.

And we'll be talking more with you later today about things that we are doing and where I think there's a great deal of alignment between how we are seeing problems spin out and what we intend to do.

Brian Croteau has always been a great ally in causes of public disclosure, and better auditing practices and the things that we need to do at the PCAOB to carry out the mission that Chair White alludes to. And we will say more about that.

Steve has asked me to make a few remarks on where we are and what we've done in the past year. And I think that one should start with where Chair White left it.

Enforcement, terrific coordination between the SEC and the PCAOB with the result that we've settled a record number of enforcement actions against firms last year and clearly an increase in areas of foreign activity where we're seeing problems that need to be addressed.

Inspections, Helen will talk later with Jim and myself, as Steve said, but we're well into the 2015 cycle. There are ten firms that issued reports on more than 100 issuer clients, and we will inspect portions of 50 or 60 audits of those ten firms.

There are 145 firms that are part of the triennial program, because they issued reports on fewer than 100 issuers. Fifty of those are non-U.S. And 45 of those 50 were affiliates of the global network firms and we have bilateral agreements with 19 nations in which we will be launching inspections of those 45, members of those 45 cohort firms.

The standard setting has been a focus of our work with the SEC this year, as Chair White's remarks indicate. The transparency project was the basis for a June 30th Supplemental Request for Comments on Form AP which would be the place in which we would contemplate the disclosure of the engagement partner and other participants would be made.

And we have had 45 comment letters on that Supplemental Request for Comments. And the comment period expired at the end of this month. So we are moving right along in parallel, in conscious parallelism with the SEC's own interest in this area.

And I have some hope that, with the continued encouragement and support, we're on track to get this done by the end of the year. I think Jim and Brian have given us a lot of feedback and a lot of help on how we might do this.

And if we did it, it would be something that we would be able to look back on, I think, as an example of SEC and PCAOB coordination. We would expect a new proposal on the audit reporting level in the new year. That's something, again, which I know this group has been interested in and which I would hope we would get out for your consideration and for the public's consideration.

We have existing projects for the supervision of other auditors, the multi-jurisdictional audit. The going concern issues that are part of today's program, those again are the subject of very intense research, and effort and dialogue between ourselves and the SEC. And I think there will be progress on all those in the coming months.

Consultation papers were issued on fair value and estimates and on the supervision and the use of specialists by auditors. We separated those topics, and the comment came back from you and others that the two were so interlinked that we should consider them as one overarching project. And we're going to do that.

We are going to do a lot of research on where we think the economic and other research needs to be, looking for areas where we can see what needs to be changed and where people tell us what needs to be changed.

I'm advised by a wise commenter that there's a difference between outreach and information gathering. And in going concern, and in fair market value, and estimates and the use of specialists, we intend to engage in information gathering and to find out what we can about that.

In May, as part of the focus on audit committees, we issued an audit committee dialogue which was an effort to start getting out, as we see it, patterns of conduct that we think are of interest to audit committees and managers about what we're seeing in the field.

I've got to double back and throw an additional bouquet to Helen, because one of the effects of the past years of work with this body and others has been an enormous improvement, I think, in the timeliness and the content of reporting. And that's an effort that goes on with the encouragement of Brian Croteau and others. And I think we can see more of it in the future. We're not done with that aspect of our mission.

And on the standards group, I'm always impressed by how hard they work to get it right and to get the projects done that need to be done and how good they are at identifying where you all have pointed us in areas of audit practice and audit standards that we need to be thinking about.

So I think this, in my view, has been an extraordinary year of growth. There are some new growth rings on the tree at the PCAOB. And they have been, I think, very well regarded internally. And we're going to continue to make improvements where we think improvements are needed.

I have not disclosed to the Chair, to Chair White, that I am a life-long Houston Astros fan.

CHAIR WHITE: Uh-oh.

CHAIRMAN DOTY: And --

CHAIR WHITE: I just like the Blue Jays.

CHAIRMAN DOTY: Well, this is something we'll have to discuss. But I note that she has been kind enough not to tax me with the fact that the Astros, in a recent series in Yankee Stadium, came away with a victory.

CHAIR WHITE: I was there.

CHAIRMAN DOTY: You were, that's -- right. So we appreciate your being here. And, Jim, it's an extraordinary thing to have you and Brian here for this meeting. And as I say, the collaboration this year has been essential to us, just essential. I think I'll stop there.

CHAIRMAN HARRIS: Well, I'm glad we're not going down the slippery slope of baseball. But I would like to note the success of the New York Yankees whose, probably, age limit is beyond that of all the other major league teams. And they seem to be holding their own. But let's, we'll get off that subject.

Board Member Franzel? Do you have any opening comments you'd like to make?

BOARD MEMBER FRANZEL: Yes. Thanks, Steve. I want to echo my thanks to all of you for being here and for providing us with your valuable input, not only today but during the course of the year through all the other ways that you interact with us and provide us with advice.

We very much value the advice from the investor community as well as the other outreach that we do that really gets to some of the tough questions we're dealing with.

You can see from our workload that it's extremely ambitious. We've got a lot of proposed rulemaking projects, a lot of thought leadership types of projects.

And we're really trying to tackle the tough questions dealing with the role of the auditor, and the role of the audit and even the role of internal controls over financial reporting in the audit of those internal controls in supporting our capital markets and promoting reliable financial reporting and promoting high quality auditing. Because without that confidence, our economy and our capital markets cannot function.

And so, again, I thank you for being here. I look forward to going through the agenda. I had a chance to preview some of the materials, and I look forward to further discussion on the investor survey and your input on some of our current, very important rule making projects that do, in fact, get to the heart of some of these very important questions. So again, thanks for being here. And I look forward to the discussion.

CHAIRMAN HARRIS: And Board Member Hanson?

BOARD MEMBER HANSON: I just wanted to echo the thanks and looking forward to the discussion. And I will let the activities commence.

CHAIRMAN HARRIS: Thank you. And then why don't we, as discussed, briefly introduce the membership starting actually, Bob, with you. And then we'll get on with the program.

MEMBER TAROLA: Good morning, Chair White, Chair Doty, the Board, staff. I'll take that responsibility for the whole group.

I'm Robert Tarola. My background, as relevant to this group, is that I'm a former audit partner of one of the large firms. I'm a former CFO of public companies, public reporting companies I now advise, companies that are in the public reporting area.

And I serve on the Board of Mutual Funds and two operating companies. And I'm also on the Board of XBRL International and see great things available for moving the audit from paper to digits.

MEMBER HEAD: My name is Michael Head. And similarly, I think the relevance that I bring to the table is I am a former CFO, I'm a former public accounting CPA auditor. But more recently, I was the chief audit executive for TD Ameritrade through 2013.

And currently, I'm an accounting instructor at Creighton University. And so I think I bring a lot of different perspectives, especially the retail investor's perspective from the 15 years I was at TD Ameritrade.

MEMBER CARCELLO: Good morning. I'm Joe Carcello. I'm a professor at the University of Tennessee. I've been involved with this group since its inception.

As Chair White knows, I'm also on the SEC's Investor Advisory Committee, had some years with the SAG, teach accounting, and auditing and corporate governance, do a lot of research on the effects of regulation, a number of items that the Board is considering, as well as some items that the SEC is considering. And I chair a governmental audit committee. That's probably my relevant background.

MEMBER SILVERS: Good morning. I'm Damon Silvers. I'm the policy director of the AFL-CIO. I've served on all the committees Joe has served on. And I suppose my, beyond following Joe around, my qualifications are that I represent Union members as pension fund participants and individual investors in capital markets policy discussion and have done so for so long I'm embarrassed to admit it.

MEMBER SONDHI: Good morning. I'm Tony Sondhi. I run a financial consulting and investment advisory firm. I've also, like Joe, taught for many years, primarily focusing on teaching the use of accounting information in investment decision making. And I've written books on the subject which have been used in the CFA Institute's work over the last 25, more than 25 years now.

I also currently serve and have served for more than ten years on the Emerging Issues Task Force representing, again, investors and financial analysts. And I'm hoping and helping to improve financial reporting.

MEMBER NACHTWEY: I'll echo Bob's good morning to everybody. Pete Nachtwey, CFO at Legg Mason. In terms of qualification to be here, I was with Deloitte, my final role running the investment management practice for a period of 27 years and have been the CFO, first of a private company that's also represented in this room, you know, much better by Curt Buser now than when I was at

Carlyle. But I've been with Legg Mason for the last five years.

A few weeks ago, I would have said Legg Mason was a $700 billion in assets under management firm. I can't tell you what that number is today. You'll find out Friday, but it's probably a little bit less than it was back in June. So thanks for being here.

MEMBER WALSH: Good morning. I'm Gary Walsh. I'm a partner with Luther King Capital Management, a registered investment advisory firm in Fort Worth, Texas. In addition to portfolio management work, I'm a telecom analyst there.

As far as relevant experience here, I'm not really sure. I was an auditor in a former life and chairman of the audit committee for a local Fort Worth non-profit hospital. And I'm very involved with the CFA Society in Dallas and look forward to what happens today. Thank you.

MEMBER BULLARD: Hi, good morning. This is Mercer Bullard. I'm a professor at the University of Mississippi School of Law. And I run Fund Democracy investor advocacy program. I also manage the Bullard

Account, and my advice to Legg Mason is just don't check your balance. Works for me. I do a lot of investor advocacy, testimony for Congress. I'm testifying tomorrow on the DOL Proposal.

And I also teach accounting but not as an accountant, which means I spend a lot of time trying to explain to law students why accounting is important, with a little bit of success but not much.

MEMBER CALLERY: I'm Grant Callery. And I was, a long time ago, one of those law students who didn't understand the importance of accounting. I spent most of my career at FINRA, previously to that, NASD, retired a couple of years ago as general counsel and have been doing, so obviously, a lot of investor interest there.

And for the last couple of years, I've been doing some consulting work in the higher ed governance area and other corporate governance issues.

MEMBER SHOVER: Larry Shover. I've spent about 25 years as a derivatives trader. Since then, the last ten years, I've been a commodity pool operator. I have to be vaguely familiar with accounting standards in nine different countries to where we allocate, so vaguely familiar.

I also run a liquid alternatives mutual fund which has been a dirty word the last couple of weeks, but so be it. I'm also on the board of a turnkey asset management program that caters to professional baseball players. So that's it.

MEMBER BUSER: Good morning. My name is Curt Buser. For the past 11 years, I've been with the Carlyle Group, and most recently as its chief financial officer. Prior to that time, I was an auditor partner in two of the large public accounting firms.

MEMBER BECKER: Brandon Becker, I was formerly director of what's now called the Division of Trading and Markets at the SEC where I was responsible for various programs involving the oversight of financial institutions and their derivatives books.

But most recently, and most significantly, I was the executive vice president and chief legal officer of TIAA-CREF. I think they still manage over $800 billion. And with respect to that, we are consumers of the audit information and rely upon it to a great degree. So I'm very happy to be here today.

MEMBER HARRISON: Good morning, my name is Norman Harrison. I'm the senior managing director at FTI Consulting here in Washington, D.C.

In various aspects of my career as a practicing attorney, as an investment banker and investment fund co-founder, and more recently as a consultant, I have done work on both sides of the table, if you will. I've advised audit committees on internal investigations involving financial fraud. I served on independent monitoring or compliance consulting teams in the aftermath of a fraud.

My more recent work involves working with investment funds on a wide range of issues relating to operations and compliance. I'm delighted to be here, to have made the cut for another year, consciously aware of the fact that we serve at the pleasure of the Board. So I'm glad to be here again today.

And thank you, Chair White. It's always a pleasure to see you and hear from you.

CHAIRMAN HARRIS: And I would note that, Chair White, we are committed to diversity. Looking around the room, I would note that Ann Yerger has done a terrific job for our group. She went on to Ernst and Young where we wish her nothing but the very best. Anne Simpson could not be with us today, and another member of our group has health issues which will not allow him to be here otherwise.

But diversity is important to the PCAOB. And I don't want you to get the wrong impression just because all of us look quite the same in looking around the room.

CHAIR WHITE: I didn't know that until you just told me now --

CHAIRMAN HARRIS: Now, having said that, I would add --

CHAIR WHITE: Kidding.

CHAIRMAN HARRIS: I'd be surprised if you didn't. I would ask that each working group lead introduce their group and then briefly summarize your findings, starting first with Joe Carcello, who will discuss his group's survey's findings, and then Grant Callery and Tony Sondhi.

And in terms of your comments, I would also ask that you briefly note the need for the project you have undertaken, the problem that you are seeking to address.

So with that, Joe, why don't we start with you. Thank you.

MEMBER CARCELLO: Steve, I'm going to be very, very brief here, since I'm going to be able to present our results while Chair White is still here. I think in fairness to the other two groups, I'm not going to take very long.

The main thing I would point out, Chair White and Board Members, is that these results are based on investor responses and assets on the management by the people who responded to the survey. It's over $13 trillion.

So at least in my mind, that's a very, very significant amount of assets under management. And I would say, given the mission of both the SEC and the PCAOB, at least from my point of view, and I think people on my sub-group would agree, the perspective of investors should be first among equals.

CHAIRMAN HARRIS: Grant?

MEMBER CALLERY: Yes. The, what we call the going concern working group was a late addition to the agenda. And so we've only been working together for a couple of weeks. And the group includes Joe, Pete, Anne Simpson who's not here today, Tony Sondhi and Lynn Turner who is also not here.

Basically, what we were looking at, this was generated by some comments that have come out relating, and some media relating to FASB's ASU 2014-15 talking about the standards for the going concern. And the going concern reporting has its basis in the Exchange Act.

The IAG took a look at this issue two years ago, I think it was, in 2012. And Pete will talk about that group a little when we get to our report. But a couple of points that have sort of come to the fore is that the going concern issue has not been necessarily a good early warning system for major bankruptcies. And whether it should or should not be, there are differing views. But that's an issue to talk about.

The ASU '14-15 requires management going concern determinations and gives some guidance in that area. And I think everybody seems to think that that's a very positive thing to make those obligations, which I think have always been there sort of more subtly but to give some guidance.

But the thresholds that have been put forward in there using a probability standard, there is some concern that maybe it is not exactly the same threshold that has been used by auditors in the past.

And there's an effective date coming up in 2016 in that at least those issues need to be looked at and determined whether there is some reconciliation that is necessary. And those are the issues that we want to get this group to talk about today.

CHAIRMAN HARRIS: Tony?

MEMBER SONDHI: Thank you, Steve. Our group wanted to report on and talk about these different publications that we've mentioned, that have been mentioned before.

Principally, we were talking about the two staff consultation papers, one on accounting estimates and fair value measurements and the other on the use of specialists. And the third publication is the concept release on the audit quality indicators.

The group includes Mercer Bullard, Norman Harrison, Larry Shover, Lynn Turner, Gary Walsh and Bob Tarola, of course.

The rationale and the need for this is really, primarily stems from the growing complexity of financial reporting, the inclusion and the increase in the number of new business models, the emphasis on licensing the different types of intellectual property that different companies have these days. And the changing financial reporting requirements are rather significant. And they have increased the need for these.

The other problem, to some extent, is the fact that we've had a rather, we've had a rather significant increase in the different types of reporting requirements that we see. So if you take a look at, if you take a look at some of the requirements, let's focus, say, on the estimates and the fair value measurements.

I go back many years to look at the guidance that we have. The guidance hasn't been changed in many years for many of these issues.

In 2008, I served on the expert advisory panel on measuring the fair value of illiquid securities. And the problem there is rather significant these days. It remains a significant problem. And now we have a new batch, in a sense, of illiquid securities, a new class of them, the investments in firms that are owned largely by private equity, firms that are not public.

These investments are now in mutual funds. And the estimates of those values have become critical. And certainly the SEC and other regulatory agencies have focused on them. And that's why we wanted to talk about these issues here today.

Let me just briefly mention some of the major issues that we've noted. With respect to estimates and fair value measurements, I think, and the working group feels that there is a need for more information on two fronts, primarily.

One is the area of additional information that would enable users of financial statements, those who use this information for investment decision making, it would enable them to perform sensitivity analysis to better understand where those estimates are coming from and whether they apply.

Another aspect of the estimates is that it would be very helpful if it was required, if auditors were required to actually use independent external data to perform tests on these estimates, compare them to the actual results and then report on those, discuss that with the audit committee.

With respect to the audit quality indicators, the need is fairly obvious. It's been mentioned before, so I won't go into that. We emphasize a few other indicators. In part, those indicators that we're going to talk about come from the 2013 meeting of the PCAOB and the IAG where we discussed the audit quality indicators.

And our emphasis there was on a slightly different set. And that was based on the outcome of the audits. And we think those ought to be emphasized. We also believe it's critical that we get quite a bit more information on the governance structure, on the regulatory actions against the audit firms as well as their investments in technology and training.

The third section of our work today deals with the staff consultation paper on the use of specialists. And as I noted before, given the growing complexity of both business models and the accounting standards that we have, the need for the use of specialists certainly has increased.

There again, the staff consultation paper actually does a very good job of pointing out what some of the problem areas are, what some of the deficiencies are. And what we'd like to see is more information about the use of employed versus engaged specialists. The emphasis there ought to be on how that affects the objectivity and the integrity of the financial statements.

In addition to that, we think that, with respect to the use of specialists, there has to be more guidance, more very specific and rigorous guidance on how you plan for, what the handoff issues are, that is areas where there are disagreements between the auditor and the specialist, how those are resolved.

We think it's essential that that be communicated to the audit committees and to investors. So we appreciate the opportunity to talk about all of these issues and hope to provide more detail later on in the day.

CHAIRMAN HARRIS: Tony, thank you very much. And, Joe, it's now on to you and your group.

MEMBER CARCELLO: I'm going to stand for just a moment. I spent 22 years doing it when I talk with a big group.

So again, thank you for the opportunity to be here, I appreciate it. To the Board members, and Chair White, and Jim, it's an honor to be here.

So let's see here. This is the group, the sub-group that worked on this. And I'll kind of lay out a little bit about how we went forward. I want to thank one of my students, Patrick Whalen. There was a lot of work that went into this, and his help was invaluable.

So let me first talk about it a little bit, even if you're reading this, why do we even do this? If you were here last year, you remember toward the end of the meeting there was some discussion -- did I do something wrong?

(Laughter.)

MEMBER CARCELLO: All right. Now I'm miked. Okay. So if you were here last year, you remember at the end of the meeting there was some discussion about how we had done a survey a few years ago on the audit report.

And that seemed to be very well received by both the group and the people who were listening and some sense that maybe it was time to go back to investors and do a survey. That was really the direction we got, nothing more specific than that.

So the survey initially was developed by me and Ann Yerger. And then Ann left. And the thinking was, a couple of things, one it needed to be short. Getting investors to engage on anything, Chair White, I'm sure you understand this, I mean, literally, well, I'll show you the response rate here in a second. But initially it wasn't even as good as it ended up being. And it still was, I wish it was higher.

So I had one of my students, I'm not exaggerating, for three weeks spend four hours a day calling people on our list, begging them to respond. So trying to get investors to engage, even on a short survey, is quite difficult. And so we figured a long survey, we had almost no chance. So we knew we had to have it short. We knew we needed it to be very high level.

And we also, there was a lot of concern on the committee that we would only ask questions that they really had the ability and knowledge to answer. And a lot of times, we want to get into real granular kinds of things. But often, the people we're sending this to really don't have the background or the expertise to respond to that.

So Ann and I took a first shot. The survey was heavily revised multiple times, based on feedback from our group. And the survey was mailed to the database that the Council of Institutional investors has.

Ann sent that out before she left for Ernst and Young. And then I have my own database that I've developed over the years of institutional investors. There's about 500 entries in that database. It's mutual funds, public and Union pension funds, endowments and foundations, hedge funds and private equity. So that's who it was sent to.

So why a survey, you know, kind of why the issue? At least in my mind the SEC, as the Chair knows well, we are the investors' advocate. On the PCAOB's website it says protecting investors through audit oversight. To me those words suggest that the missions of those two agencies should be heavily influenced by the needs and wants of investors. And so what we're trying to do is get high level views of investors on issues that affect audit oversight.

So who responded? I had a response, 51, so less than ten percent when you consider the two databases. Now I'm sure there was overlap, probably a heavy, heavy overlap between my database and Ann's database. But still, response rate was not overwhelming. But it was random.

And you can see who responded here in terms of endowments, and mutual funds and public pension funds being the most heavily represented but I think a pretty nice cross section of different types of investor groups.

Obviously, these are all institutions. We didn't reach out to individuals. Organizational type, in terms of assets under management, again, a pretty nice distribution, I think, in terms of size there.

As I said earlier, as cumulative assets under management approximately $13 trillion, very significant, at least in my view, pretty significant sum of money.

Job position of the people who filled out the instrument, chief investment officer, almost 20 percent, so obviously a very, very senior person. Governance officer, almost 20 percent, senior analysts heavily represented.

If you look toward the bottom of the slide there, you see accounting, auditing, treasury operating officers, eight, and chief financial officers, five. So that's 13.

So we actually, and you'll see this as I go through, analyzed the results overall. And then we broke it out by what I would call everybody else other than these 13, which is 38.

And then what I'm calling management, so people like my friend Pete here and my friend Curt over there, these are folks who have accounting type jobs, right? They're CFOs, but they work for institutional investors. So these two guys I know, and I know their heart.

But you don't know if you have a CFO responding from an institutional investor. Are they responding from the perspective of an investor focus, or are they responding from the perspective of a management focus? You're never really sure. And so that's why we did the analysis both ways.

Knowledge about external audits and audit process, as you could see, at least pretty much everybody self-assessed as moderate or higher, although the modal response was moderate. So this is not a bunch of FASB or PCAOB people, right. These are users. And they're not claiming very high or high level.

But the questions we asked, I think, are questions that even a moderate level of knowledge, they'd be well positioned to answer. So, you know, a very basic question, the kind of a question that would suggest, Mary Jo and Jim, you should still have a job. And that is does this matter to anybody?

Sometimes, you know, in being involved in these groups over the years, when it's so hard to get investors to engage sometimes I do scratch my head and say, "Am I wasting my time? Should I just be back at the University and teaching people?" Because it's very hard to get investors to engage.

But 94 percent of the respondents say they rely on the GAAP financial statement audit either a good bit or extensively. So I thought that was actually a quite encouraging response.

We asked them to, if they wanted, give us their own words around a lot of these questions. Obviously have way too much to use in a presentation today, so I picked what I thought were some of the better responses.

Financial statements would be worthless, systems built on trust, it matters a lot if the auditor qualifies a report. It's a powerful signaling device.

Less supportive, as you'll see here, the less supportive wasn't that much less supportive, right. There's only six percent who even fell in this bucket.

Audit opinions are very important, but we use other things. Well, yes, of course they use other things. And you can't necessarily trust the statements with an auditor sign-off. But you clearly can't trust them without one. So a little bit tepid support, but still it's not exactly a negative.

Then we went to ICFR, internal control over financial reporting, not quite as strong here, 72 percent, either a good bit or extensively in terms of reliance. So clearly, the numbers seem to matter more, at least to the people who filled this out. But I would say the controls and the opinion on controls is a pretty significant percentage, 72 percent.

Supportive, this is a huge red flag, presumably an adverse opinion on ICFR, somebody who's an analyst on financial institutions saying it's an excellent innovation and forces companies to invest more in risk management and compliance systems. So maybe not so much the opinion but the change in behavior that the regime introduces.

Less supportive, experience shows that most red flags are discovered ex-post. And a surprising number of firms have material weaknesses, but many of them, in this person's opinion, don't imply significant risk. It's important but not necessarily a driver of investment. I know the Chamber letter is on the agenda for later, so some of these things may surface again.

Differences between the investor group, again, remember that's the 38 people who are not CFOs, and Treasury people and so forth. And the management group, all but one of the management respondents relied on the ICFR opinion either a good bit or extensively.

The investor group responses were more evenly split. So this is, actually, I found a little counter-intuitive. In that management, the body who's actually responsible for the controls seems to rely on the opinion by the auditor more than investors which I thought was a little interesting, at least to me, maybe to no one else but to me.

Effect on confidence, there's been some discussion. Some have floated the idea of maybe we should just eliminate mandatory financial statement auditing and let the market determine whether companies have financial statement auditing or not. Lynn's not here today, but, you know, Lynn certainly has been suggesting this and has reasons for it. It's not just totally out of the blue.

But if we asked, you know, what would happen, what would be the effect on confidence if mandatory financial statement reporting was eliminated? And 80 percent said substantially reduced. That's a pretty strong response, in my view. And if you add in a good bit, it's 94 percent. So a pretty strong mandate, I would say, at least from this group of respondents, that let's not go that route.

In terms of words, we wouldn't invest if there was an audit. The system can't work without audits, the higher risk of fraud. I thought the short-seller comment was interesting. It actually went the other direction, right, without audits, short-sellers could say anything they want.

And there'd be no independent check to basically say, no, these numbers are okay. The increase of fraud would be exponential, stock market collapse, we certainly don't want that. While most firms would uphold high standards, some wouldn't. And it would taint the entire market, the classic in economics problem of lemons argument.

GAAP is complex, companies make errors without an audit, higher likelihood of errors. Non-GAAP results may be used a lot, but they are based off of GAAP results. So kind of, it's the foundation even for non-GAAP reporting.

Less supportive, market would self-regulate by applying a discount to public companies that didn't have audited. So even the less supportive person seemed to be saying, even if it wasn't mandatory, it would be there. Because the market would force it.

A question we asked, this is kind of an abbreviation of the actual question, is do you believe there are adequate regulatory safeguards to protect audit firm independence as it relates to the provision of non-audit services?

And as you can see there, I would say this is somewhat of a split, in my mind. The neutral kind of doesn't say a whole lot. Thirty-six percent think there are adequate regulatory safeguards, 24 percent think there are not. You know, different people interpret that differently. But, you know, I'll let each person in the room make their own judgement.

And in terms of differences between groups, 29 percent of the investor respondents either disagree or strongly disagree that adequate safeguards are there so, you know, about 30 percent. Only eight percent of management felt that way. So I would say that's a noticeable difference between those two groups.

Another question we asked is do you have enough information to even make this assessment? And if you add most of the information and all of the information, you had 47 percent. If you take some and none, you're at 53.

So again, that's not an overwhelming mandate or an overwhelming response that the information to even assess this exists, so probably something worth thinking about.

Agree that there is enough information, existing fee disclosures are sufficiently robust, others felt differently. Disclosure on non-audit work is not sufficiently granular for us to understand the effects on independence.

I'd like better disclosure of auditing firms' conflict policies and also detailed financial statements. There's some of this in Europe, I think less of it here in the United States.

Audit firm tenure in the name of the lead audit partner should be disclosed. Obviously some of these things are already being discussed by both the PCAOB and the SEC.

If we, again, break out by groups, the modal response from the investor group was I have some of the information I need. That was the most common answer. The modal response from the management group was I have most of the information. Again, so a different perspective between these two groups.

We asked about the scope of the audit. There's some conversation should the scope of the audit be expanded. Probably the thing that's been talked about the most is an opinion on MD&A or at least part of MD&A.

Most of the respondents seemed to think, at least right now, the audit scope's about right, three and four. But if you're going to go in either direction, it clearly is to expand, not to reduce.

Sufficient scope of the audits that I observed, balance I think is about right. If anything should be reduced, I have a situation where management is signing rep letters that limit auditor scope and responsibility anyway.

Those who think it's not sufficient get more than a pass/fail, given the money that is spent on audits. This is going to the audit report issue which Jim said is coming soon.

I think it would be useful if audits were expanded to include more tests for fraud. You'll see later, fraud is just so important to this group. Near and dear to your heart, right, Chairman? I think management and -- what's that?

CHAIR WHITE: The absence of it, yes.

MEMBER CARCELLO: Yes, yes. Right, obviously not fraud. I think management in a typically self-selected board should not hire auditors, not as worried about the scope, worried about auditors focusing on what matters to investors.

Again, differences between the groups, all but one of the 11 respondents that said the scope should be expanded were investors. So basically, to the extent there's, you know, that quarter percent that said expand, it was basically all from investors.

Do you have enough -- then we went to audit quality, and we talked this morning about the AQI project. I don't know if Greg Jonas is here, but -- oh, Steve's representing the group. Okay.

We talked this morning about the AQI project. And so this is obviously a major project. I know the SEC cares about it as well. And so do you have enough information to even assess the quality of the external auditor?

And again, a real split in my mind, right, about 55 percent said they have either most or all of the information they need. But 45 percent said they don't --

that's not again, that wouldn't give me warm and fuzzies if I was evaluating this -- agree it's hard to audit the auditor. But I believe processes he followed are adequate.

As a private equity firm, we either sit on the board or control the company, therefore we have sufficient information. Well, that's not really, I don't think, the mandate of the SEC and PCAOB.

Don't agree, greater transparency into audit quality through the use of audit quality indicators give investors more information. Need to know the name of the partner, talked about that, and how much work of other firms are used, especially in other countries like China.

No inspection, probably a problem, probably need to know that. The audits are pass/fail. That provides little information, so there is reliance on auditor reputation, again, getting back to this pass/fail.

Maybe it would help to see a scorecard of what percentage of the audits turned out to be materially wrong over time. This is getting at some of those output measures of AQIs.

Do you have enough information to make this assessment? Eighty-five percent of the management group felt they either had all the information they need or most. Only 45 percent of the investor group felt that way. Guys, that's a big difference. That's a big difference.

All right. AQIs, I didn't pick all of them, Steve, that Greg and your team had in your document, just too many. So some of this was a decision on the part of the working group as to which ones. So we picked, obviously, the ones we thought mattered more. So there's a little bit of our judgement here.

What I've put in yellow are the ones within each of the three buckets, the buckets being input measures of AQI, process measures of AQI, output measures of AQI. I put in yellow the ones that seemed to be most important within each of those buckets.

So in terms of input measures, what seems to matter is the partner, right, partner matters a lot. Industry experience of the partner, loaded most heavily. Professional experience of the partner, partner matters, partner matters an awful lot. Hardly surprising, right.

Audit team turnover, staff workload, you know, if you're working your people to 2:00 a.m. every night, probably not getting the greatest audit.

Process measures of AQIs, the ones that seemed to load the most heavily, firm tone at the top, terribly important, hard to measure. Supervision and review, focus on audit quality, and evaluation and compensation.

In terms of output measures, the two that loaded most heavily, in fact, the one that loaded most heavily in everything is fraud. If there's fraud, and the auditors miss it, that just matters so much, at least to this investor sample. Less so, but still the second most heavily weighted in the output, is restatements where the auditor missed it.

The last question, and this is really more for you, Chair White, and Jim and Brian than for Doty, Mr. Doty and the rest of the Board, is about the audit committee, right. Because they don't have the direct responsibility you do. And that is do audit committees adequately represent the interests of investors?

And it's an interesting result here, I thought. If you, again, add the completely and a good bit, you're at 65 percent. If you weigh it a little and not at all, you're at 35 percent.

Again, I think this is in the eye of the beholder. I guess if I was, if I was the NACD, I'd probably say, hey, look, they're doing a good job. And investors think so. I'd probably say, geez, if 35 percent of my students didn't think I cared about their success, I would view myself as an abysmal failure. So eye of the beholder, like a lot of things in life.

Agree, I believe they act independently to review external auditors, Sarbanes-Oxley Act strengthened the independence and expertise of audit committees. Don't agree, hard to determine, since these committees are not very transparent. Jim and Brian are going to fix that, right, guys?

Audit committees are often nominated by management. We believe directors on the audit committee should only be allowed to be nominated by investors. Difference, oh, still more don't agree.

Audit committees tend to defer to management when negotiating audit fees. I do think this is an issue. Anecdotally, I've heard this a lot from senior partners in firms. They can't say this too loudly, but it's an issue.

Corporate boards in general are weak, directors are chosen based on relationships and reputation. Most directors are conscientious, but they do not have deep industry subject expertise, not in a position to challenge management.

If we break it out separately, 77 percent of the management group are either a good bit or completely confident that audit committees represent the interest of investors. Sixty-one percent of the investors group feel that way. But that means 40 percent don't. So again, whether that's good or bad, we'll let you guys decide.

Questions? Wow, I get more questions from my juniors. Jim?

CHAIRMAN DOTY: What does the, there's a question that was not asked.

MEMBER CARCELLO: Yes. There's a lot of questions not asked, Jim.

CHAIRMAN DOTY: But in terms of what we should be following up on --

MEMBER CARCELLO: Yes.

CHAIRMAN DOTY: -- and going to Page 9 in the investor survey and the effect on confidence, the elimination of mandatory financial statement auditing, does that suggest that we should be asking what if the integrated audit, ICFR, and the registration with the PCAOB, what if that became optional? How would that affect the confidence and the credibility of the audit in the eye of a sample group like this?

MEMBER CARCELLO: Yes.

CHAIRMAN DOTY: We've got some research going in the Center that would suggest that having a PCAOB audit and having an integrated audit does favorably impact access to capital and the premium capital. But maybe we ought to do some more scrubbing in that area.

MEMBER CARCELLO: Obviously, we didn't ask that, Jim. And so I'd be speculating. And I'll wait for the full group discussion for me to speculate on that. Okay. I guess, let's throw it open then --

MEMBER BULLARD: I have one.

MEMBER CARCELLO: Yes?

MEMBER BULLARD: Do you have any insight on how these answers might apply in the context of the 404 exemptions?

MEMBER CARCELLO: So, let me paraphrase what I think you're asking me. So how would these answers matter if we were only asking people who were investing --

MEMBER BULLARD: Why might their views differ if they were to be commenting, giving answers based on 404 compliant as opposed to 404 non-compliant?

MEMBER CARCELLO: Yes. I think that's a little bit of what you were getting at, Jim, right?

CHAIRMAN DOTY: Yes. Would you have regression or would you have a continuance, maintenance of standards, something to worry about.

MEMBER CARCELLO: Yes.

CHAIRMAN DOTY: And I think our -- I would have to say, personally, I'm skeptical that you would have maintenance of standards without it.

MEMBER CARCELLO: Yes. It's a good question, Mercer. Again, it would be complete speculation on my part. Because we didn't ask that. Tony?

CHAIRMAN HARRIS: Please identify yourself.

MEMBER SONDHI: This is Tony Sondhi. Joe, I'm just wondering. I think you did a great job with the, you know, identification of the extent of knowledge the respondents have.

MEMBER CARCELLO: Yes.

MEMBER SONDHI: One of the things that I think, at least I have always believed makes a difference in here, it's not so much an issue of what their knowledge is. The question is whether the models they use use accounting information in making investment decisions.

MEMBER CARCELLO: Yes.

MEMBER SONDHI: I mean, you can have, you're definitely going to have, I mean, if you call up Curt, you know, and obviously he knows accounting --

MEMBER CARCELLO: Right.

MEMBER SONDHI: So when he says, you know, that this matters or if this has a CFO as one of the respondents on this, he knows what he's doing.

MEMBER CARCELLO: Right.

MEMBER SONDHI: But the point is, you know, if he doesn't, you know, if he's running a mutual fund, but it's based on either technical indicators, or he's running a hedge fund where they're doing it on something totally different --

MEMBER CARCELLO: Yes.

MEMBER SONDHI: -- the responses are going to be quite different to each of these issues you've raised.

MEMBER CARCELLO: Yes, yes. I think one of the things, and we've talked about this as groups before, is we talk about investors as if they're some homogenous group. And clearly they're not.

There's tremendous variation across investors, Tony, right. And there's tremendous variation in how they make decisions, and there's tremendous variation in how they use the information.

So in some sense, they may be using forward looking information to make decisions. But that's often built off of this foundation. In other cases, they're using GAAP information as a retrospective check.

And in a lot of cases, that seems to be, like in talking to people like Anne Simpson and others, often they use this really from a governance perspective to evaluate stewardship.

We always talk about that the GAAP statements are going to drive decisions, and they may be the foundation for information that drives decisions. But a lot of this whole process around reporting is really a stewardship and governance role. And that's why we tried to include lots of different people in who completed the survey. Chair White?

CHAIR WHITE: Just, I mean, it's a more methodology question a little bit. But in terms of who responded to the survey, obviously different categories of folks did.

MEMBER CARCELLO: Right.

CHAIR WHITE: Was there any direction with your survey as to who that ought to be, you know, whether an analyst, a CFO, just curious about that. And then I guess sort of the follow-up question is to ask --

MEMBER CARCELLO: Yes.

CHAIR WHITE: -- up front is, well, in some of the results on expanding the scope of the independence auditor which related to reviewing independence assessment of the audit committee, any sense of whether that's coming from, you know, mostly from sort of different types of responders who may have more or less knowledge of the field? Just curious as to your sense of that.

MEMBER CARCELLO: Yes. Great questions. So in terms of the first, because there's two questions there. In terms of the first question, any direction from us as to who should respond, so at least the database I have, the database that Ann used, I'm not as sure. But the database that I have, what we tried to do when we built the database was get the name of the chief investment officer. That's what we tried to do.

We were not always successful, because it's not always very obvious who he or she is. So if we couldn't get the chief investment officer, often we would get the chief executive officer, you know, basically the highest level person we could get disclosed if the chief investment officer was not disclosed.

Now, what we found with the telephone calls is, when we got through to people, they often would say, okay, again, what are you doing? Why are you doing this? And then they would, inside the company, so let's say the AA for the person who it was sent to, he or she would direct, based on that person's judgement, Chair White, as to who they thought was best positioned to respond within their organization.

So we didn't really control that, as in a perfect world, the way maybe you'd want. That's why we asked. The best we could do is say, well, at least tell us who you are.

In terms of the second question, which is on some of these if we were to cut separately by respondent group would our takeaways be different? I think you mentioned a couple of items, the audit committee, and I think it was maybe one other. We did not do that.

If that's something that you, or Jim, or Brian or others are interested in, just send me an email. We have the data, we can cut it, okay. All right, I'm going to sit down and open it up, Steve, I think --

CHAIRMAN HARRIS: Well, Joe, let me ask you a question which is, you know, apart from the methodology. It gets to a little bit of the substance on the issue of independence.

Forty-one percent of those surveyed were neutral as to whether they were out of the regulatory safeguards. You point that out.

MEMBER CARCELLO: Yes.

CHAIRMAN HARRIS: And I was wondering whether you could tell us a little bit more with respect to your findings here and what were some of their concerns. Or, you know, what are some of the working group's concerns on this one?

And then a related question dealt with another slide which commentator indicated I would like better disclosure of auditing firm's conflicts policy and also detailed financial statements including profit earned by division, tax consulting and audit.

And the questions on both of these, do you have any idea what types of conflicts he or she might be referring to or the independence issues that you referred to? And assuming you just have a result without the granularity, I'm wondering whether or not the working group has any views on those issues.

MEMBER CARCELLO: Yes. Steve, I think this is the slide --

CHAIRMAN HARRIS: I wanted Slide 21.

MEMBER CARCELLO: Twenty-one.

CHAIRMAN HARRIS: I think.

MEMBER CARCELLO: Okay. Yes. So that's the base results. And these are some of the differences. This was not a question that we asked them to give us three comments on. Maybe that, you know, with the benefit of hindsight, maybe we should have. We asked for three responses on do you have enough information to make this assessment. But we did not ask for three responses on what specifically they're concerned about. So, you know, we obviously can have that discussion among the broader group.

I know some of the things that I've heard discussed, and you're starting to see this in the academic literature as well, is significant growth that's still allowable in non-audit services.

So, you know, there's a long list that, Chair White, in one of your rules, obviously pre-dates you, of why it's prohibited. And the firms, to their credit, I'm not criticizing them, are very creative in finding services that there's a market need for. And they provide those services.

There's also the concern of more rapid growth on the consulting side than in the audit and tax side. And at a certain point, are the organizations, the culture of the organizations, essentially a different culture. So I think that's probably best for the group to discuss. Brian?

MR. CRATEAU: So if I could just, on that same point, I had a similar question. And as someone who spends a fair amount of time on other independents every day, we're very interested if you are hearing of examples of new, emerging services that you think might be troubling or the group thinks might be troubling. We're always interested in hearing that so we can think about them and address the. Most of what we see tends to be growth of non-audit services to non-audit clients.

MEMBER CARCELLO: Right.

MR. CRATEAU: Which might create different questions for you. But if certainly you're seeing the growth of non-audit services, of the types of services that aren't on the prohibited list but yet, for some reason, cause some degree of concern, certainly we'd be interested in hearing about those.

But it does sound like perhaps the questions didn't allow for that kind of feedback. But certainly, even if anecdotally, you're hearing about that, you know, certainly I'm always interested.

MEMBER CARCELLO: Okay. Thank you, Brian. Mercer?

MEMBER BULLARD: I just wanted to add, I think it was last year that we, I think I did the presentation on disclosure of the financial statements. And that obviously implicates the profitability of the non-audit services. I think Chair White was at that meeting. So I think that really directly ties into your findings.

MEMBER CARCELLO: Yes. Steve, I'm going to sit down so we can have our conversation. You know, I don't want it to be my opinion beyond just presenting the results. And so let me go ahead and sit down. And then let's see what the group has to say.

BOARD MEMBER FRANZEL: Joe, I have one more follow-up question on the methodology.

MEMBER CARCELLO: Yes.

BOARD MEMBER FRANZEL: Some of your results are presented, you know, for the two different groups, management versus everybody else. And we see some big differences, which is not surprising. Management is closer to the audit --

MEMBER CARCELLO: Right.

BOARD MEMBER FRANZEL: -- and may feel like they have more information about the audit. Did you run all of the results separately, you know --

MEMBER CARCELLO: Yes.

BOARD MEMBER FRANZEL: Okay. So you only presented to us the ones where there were major differences?

MEMBER CARCELLO: Yes. The ones that you don't see a slide, Jeanette, that's basically saying, at least in my judgement -- and I'm happy if you want more granularity, to send it to you. Just send me an email, because I have all of these. I have pages and pages of stuff. But on the ones that I don't, at least in my judgement, they were close enough that, in a 30 minute presentation, probably it wasn't worth highlighting.

BOARD MEMBER FRANZEL: Okay, thank you.

MEMBER CARCELLO: Thank you.

CHAIRMAN HARRIS: Bob?

MEMBER TAROLA: Joe, as usual a wonderful job. Thanks to you and your group. My takeaways on this are mostly positive, that the audit seems to be a base for all other financial analysis, at least at some point in the process of analyzing companies and one investment over another.

What's a bit disappointing is that the audit committee's role in that supply chain of information was somewhat mixed as to whether or not it's adding a quality factor.

MEMBER CARCELLO: Right.

MEMBER TAROLA: What I would like to see us do as a group maybe going forward is what would they have liked from the auditor or audit process, both in information as well as in how they get the information and then how timely they get information?

So is the audit a once a year, three months after the fact, exercise as a bedrock of everything else? Or can it also be beneficial to investors as a more real time exercise? As they consume information, can the audit be with it as a way to provide more indications of quality of the information as it's being consumed, often daily but certainly at least quarterly?

MEMBER CARCELLO: Bob, it's a good suggestion. And as you know, this group has often struggled with what's our mandate, if any, around audit committees. And it's not clear, because the PCAOB does not have direct oversight, and we're an advisory group to the PCAOB. But clearly, audit committees do affect the audit process, so it gets a bit uncertain.

For the benefit of Chair White, I have tried to get the IAAC to engage on this. We'll see if I can convince Roy to take this up in Invest Arizona.

MEMBER HEAD: This is Mike Head. And first, Joe, I'd like to thank your group. Because I think this adds a lot of insight and a lot of hard work. And I know, from doing things like this, these slides don't just come without a lot of effort. So thank you, guys.

And less of a question than a couple of observations. And we all know when we see data at least our human nature is we look for things that reinforce what we already believe. And we ignore things that don't reinforce what we already believe. And so my statements may fall into that category unintentionally.

But it made me feel better than what I thought I was going to, before I saw the information, about what seems to be the financial statements are serving as the foundation for the investment community and the investors, that they want to use a lot of other tools, but they're just assuming table stakes are there that you're going to get auditor financial statements.

And they are expecting that they're going to have a clean opinion on those financial statements and the internal controls over financial reporting and that if those weren't there, that would be concerning to them enough that they would change their investment behaviors. At least that's what I heard and saw in that. And I think that's a very, very, very positive outcome.

Where I'm concerned, and it happens to be on the slide, and I've been concerned all the way back to when we first came out with the independence rules, because I thought we chickened out originally by not just mandating you can't provide any other services other than the audit to your client. There's no such thing as allowable or acceptable non-audit services.

And if we would have started there and stayed there, we wouldn't be revisiting this issue today in the format that we are. And I think that's where we should go.

I think that's where we should have went originally. I think that if you just mandate to the firms, it doesn't matter, the dollars is what matter, not what the types service is. They're creative, they're going to find out ways to make money, and they're going to try to maximize that amount that they make.

And as long as you leave that window open, they're going to find a way to get through that window, no matter if we think those services create conflict or not. The dollars create conflict, not the type of service that you're providing.

MEMBER CARCELLO: Mike, let me just briefly respond before we go to Norman on that. And I'll probably be in a minority, I think, on this issue. And I think the group knows me well enough that when the major firms fail, I'm not hesitant to criticize them.

But I think this issue is, at least in my view, a little more nuanced than you made that out to be in the sense that financial statements and financial reporting has become so complex and requires so many different skill sets that having skill sets, in the area of valuation, and in the area of systems, and in the area of actuarial and in many of the areas that the firms have built significant skill sets, is needed to do a good audit.

And, you know, I know the argument that many would make, you would probably make as well, is the firm can just hire these people, and they're essentially just 100 percent audit support.

I'm skeptical. I know the firms say, without any doubt, that people wouldn't do it. I don't know if their blanket statements are 100 percent accurate.

But I do think that the high level people that you want inside the organizations doing this work, if all they were going to do was essentially audit support, I do question whether or not the best people or even very good people would be willing to do that.

So I do think, I actually think this is a very hard policy issue for the SEC and the PCAOB to grapple with.

MEMBER HEAD: I don't disagree with you. I just don't think that they continue to get utilized and keep those services current on consulting services with their audit clients. They do that with their non-audit clients. And then they provide that same expertise as support for the audit. But they can't do those services, none of them, zero, for their audit clients.

MEMBER CARCELLO: I got you, now I got you.

MEMBER NACHTWEY: Great thanks. And I didn't mean to jump ahead of you, Norm. Hopefully, you -- okay. But again, add the kudos to, even though my name's on the front page of this thing, in the interest of full disclosure, Joe and Ann did the lion's share of the work, well, and I'm sure some of the students at the University of Tennessee. But great job.

Because I do understand how difficult it is to get people to respond to this. And I'm guessing most of us around the table all could make careers out of responding to surveys we get almost daily. We just couldn't make a living at it. But we could make a career of it.

But I like the way you stratified the respondents, and I think, as we think about going forward, whether there's a way to do these in an even more targeted way.

And also probably the investment relations officer, well, that sounds like it's an investor. I'm guessing there was probably investor relations. You know, so I've got a guy, Curt's got somebody at his company, you know, et cetera, that just talk to our shareholders.

But it's more, I almost call it a marketing position. You know, they're really just trying to help the investors understand this and what not.

But when I look at the two layers of people that actually make investment decisions in this group that's on Page 7, it really comes down to the portfolio managers and the senior analysts.

The, you know, the CIOs are interesting, but they're typically operating up at a 50,000 foot level, they're setting macro-policies, looking at the overall portfolio, other than that, down in the weeds. And I think the director of investment operations is probably similar.

So I think it's all good info, but the more, I really liked the fact that you kind of carved out and sort of certain people are going to bring a different perspective that may not be, you know, exactly what we're looking for.

And then the governance officers, I think a lot of what this group's dealing with is what the governance officers are focused on. And in a perfect world, they'd be involved in making investment decisions. In reality, I don't know of any firm that has the governance people involved in making the initial investment decision. But they certainly are involved in voting their shares.

And then, you know, potentially, if they see somebody that's just kind of a bad actor, eventually they're going to get that around to the investment guys and say, hey, do we really want to continue the investment here.

But I think, you know, that the governance officer group is the one that's probably the most informed about the kind of things that are important to this group. So to figure out a way to hone in on them, you know, in future surveys might make sense.

And again, since my name's on the cover, it'd have been great if I'd come up with that idea earlier, but better late than never, I guess.

And two other things going to Bob Tarola's point on the audit committees, I think I absolutely applaud the efforts that both the SEC has made and the Board have made. Again, you'd have to spend some time with our audit committee.

I just can't overemphasize the importance of that dialogue, that I kind of, you know, view the macro role that the PCAOB plays over all in the regulatory process, but then where the rubber meets the road is what's the quality of the audit committee.

And I think there's a dramatic difference between audit committees. And sometimes it isn't just based on size, although often it is. And, you know, how do we just continue to up the game on audit committees? And how do we make sure they have the right, you know, the financial expert criteria is good, but people can be a financial expert and know nothing about auditing.

So how do you make sure that the audit committee's populated with folks that have some background in audit, at least, you know, one or two of the members of the audit committee?

And then last but not least, I thought it was interesting on the Slide 31, the AQI, around audit team turnover and that, you know, almost 70 percent of the folks are saying that's very important.

I think that ought to be something we think about as we start talking about audit firm rotation. Because there's some things that are appealing intellectually about audit firm rotation.

Where the rubber meets the road is do I have 100 percent turnover of the engagement team at all levels globally when you rotate auditors. So it's interesting how important, you know, investors find that statistic. So again, great job. Thank you.

CHAIRMAN HARRIS: Norman?

MEMBER HARRISON: Thank you, Steve. I wanted to return to the independence issue for just a minute, follow-up on the recent discussion. You know, independence obviously is one of the cornerstones of the integrity of this whole process. And threats to it arise in a number of different forms.

But we've talked about this in this group two or three years ago. Three years ago, I think, there was a working group devoted specifically to the subject. And we had a good discussion about it at that time.

And I think, you know, we're well informed by the views of our colleagues who have been partners in Big Four firms or other large audit firms, have some firsthand experience.

But I think for the rest of us, where we come down on the continuum between Mike, and Joe or perhaps a broader spectrum is largely uninformed by virtue of the fact we don't have access to a lot of the information we'd need to make an intelligent decision.

You know, a lot of firms are not required to publish GAAP-compliant financial statements. We know something about revenues by segments and perhaps other high level attributes, but like any other business enterprise, you know, resources and talent, I would assume, in the Big Four follow the money.

And if there are, as I think many of us believe, you know, higher margins on the work being done in the advisory segment, I'm going to bet that that's where priorities go for resources and technology.

And Bob referred earlier to the evolution of the audit process from a paper base to a digital process. You know, where are the firms investing in technology, and resources and people? How are incentive compensation models developed in those segments?

And a lot of information we would need to form some judgements around this issue, I think, we simply don't have access to. So it, you know, is there talent flight from the audit segment to the advisory segment?

A lot of the skills are transferrable between those two business segments. Is it happening and to what degree? How many mid-level professionals who are being groomed to be engagement partners jump over to the other side, because there's more professional opportunity, more advancement or more money to be made there?

I don't know, but I think they are fair questions. And I think they should be looked at very carefully. There's an opportunity, of course, to begin to gather some information on that in the AQI initiative. And we'll talk about that in a later panel discussion. But I just wanted to get those issues on the table. Because I think it's a very important question.

CHAIRMAN HARRIS: Grant, and then we'll get to Steve Kroll, Grant Callery.

MEMBER CALLERY: Yes. Just very briefly, and then sort of maybe piling on to what Norman was saying, this issue, we did a group last year that looked at the business models. And the issue just keeps coming up, and coming up and coming up.

And somebody had circulated a couple of weeks ago an FT article mostly based on UK and the same issue of non-auditing services. And, you know, and then, Brian, you raised, if you have examples, we'd like to see them.

I think somebody really needs to take a look at it and try to get there. Because it's a confidence issue, I think, from an investor's perspective.

And the answer may be probably somewhere between Mike and Joe, that you've got to have some balance of this. And do you get the right things, and did Sarbanes-Oxley get it right? Or do we need to move forward from there?

But I think it's important to really try to get there, because it just seems like it's such a festering issue that keeps raising its head, it keeps showing up in the media. And we ought to be more comfortable with where we are and have good answers that people don't look at and say, well yes, that's just the firm, because the firm wants to make more money, so they do this. And obviously that's their answer, that Sarbanes-Oxley took care of it.

So I think it's really worth something to take, you know, in concert with the PCAOB, and the SEC or whatever, but to have a good discussion. And try to get as close to the bottom of it as possible and maybe make some of this noise go away.

CHAIRMAN HARRIS: Steve Kroll?

BOARD MEMBER KROLL: No, it is me. Joe, I'd like to ask you and anyone else who wants to comment or question about Slide 21. There was one thing in Slide 21 that I found a little surprising.

MALE PARTICIPANT: Which slide is this?

BOARD MEMBER KROLL: It's your Investor Survey, oh, 31, excuse me, 31. One of the things we've heard from a lot of people, especially audit committee chairs, is that when they drill down, they're concerned about obviously the engagement partner but also about the senior managers and managers who are the sergeants of the audit.

Now, I'm not an auditor, so you can make all the fun of me you want. But it just seemed, it surprised me. Of course, you'd care about the partner's professional experience and industry experience, but it surprised me to see a, oh what is it, a 27 point swing.

Because, you know, if I was going to audit Wells Fargo, I had the greatest bank engagement partner in the country and a bunch of managers who last year audited Best Buy, I might be a little worried about that.

And I just, I don't know, do you attribute that to the fact that a lot of people just knew about as much about auditing when they filled this out as I did before Greg Jonas taught me everything I knew? I will admit that now.

MEMBER CARCELLO: Obviously, it's speculation, Steve. I think it could be a few things. I think it could be what you said, they don't have enough detailed knowledge of the way audits work and the importance of managers and senior managers. It certainly could be that.

It could be that we didn't give them enough levels to choose from. There's always this tradeoff between more granularity and then they look at the questionnaire, and they say there's no way I'm going to do this.

So we could have asked about the partner, or the senior manager, or the manager, the senior and then the, you know, the first two year staff. And I think we would have gotten more nuanced responses, but then, you know, you just balloon the survey.

It could also be that, you know, when I think about my world I think people say do I feel good about the dean? And if I feel good about the dean, I feel good about the associate deans and the department heads. And at the end of the day, the buck stops with him or her. Because that person's responsible for their staff.

So if I feel pretty good about the engagement partner, maybe I trust him or her to make sure that the team is appropriate to execute the engagement that needs to be done. And it could be any of those, or it could be a combination of those.

BOARD MEMBER KROLL: Okay. Thank you, that's very helpful.

CHAIRMAN HARRIS: Brandon?

MEMBER BECKER: Just two quick points, one to echo again the terrific work that Joe and Ann did putting this together and really very helpful information. And we on the working group appreciate their work, as Pete mentioned.

And then what Joe just highlighted, we do look to the engagement partner as the person who's supposed to lead the team. So where there is a follow-on effect or a waterfall effect in terms of perhaps undue focus on that leadership, but that is the leadership that we're looking to to build the team that he or she can rely upon.

CHAIRMAN HARRIS: Tony?

MEMBER SONDHI: Thank you, Steve. I just wanted to actually just follow on to a couple of comments that have been made, one Norman had made earlier about this transfer or migration of the talent from the audit side over to the advisory group.

And I serve as an advisor to a number of small, you know, regional accounting firms, audit firms. And it's certainly noticeable there. When they start losing, they start developing their advisory group or portion of the firm. They tend to lose that, and that creates a, I think, it's a really serious vacuum.

And the second aspect of that is the training in there. So we think about training at these different larger firms. But training in the smaller and the regional firms is a significant problem. So from that perspective, I think it matters.

And then this issue of engagement partners, what I've noticed in much of the work that I do these days is in software, or Cloud computing, or some of the newer social media type of companies and digital media, et cetera.

And many of these firms are in places where you don't have a concentration of those types of firms. And there the engagement partner and the level of knowledge they have of that industry becomes a very critical thing. So the emphasis on the engagement partner, I think, is really critical.

But the emphasis should also be on their knowledge of what they're auditing. And that, I think, is, it's going to come up a little bit later on as well. But since it's been commented on here, I wanted to add that.

CHAIRMAN HARRIS: Joe?

MEMBER CARCELLO: Steve, I just wanted to briefly respond to something Norman said a little while ago. I do agree with Norman that it would be helpful to have more specificity around revenue and profit by service line in terms of the consulting issue, which we clearly don't have now.

I would say that I, up to probably three, four years ago I agreed with Norman 100 percent. Certainly the perception is that consulting is much more profitable than auditing or tax. I think that's the perception.

Now in private conversations, obviously I'm not going to mention the firm or the persons, at least some of the firms claim that that is not the case, that in fact audit and tax is at least as profitable, if not more profitable, than consulting which seems counter intuitive. But if you think about it, it's actually plausible, right.

Because in audit and tax it's much more of a levered model. And you have a higher level of relatively low paid people working for each partner. And in consulting, it's hard to justify that.

So I don't know if I've been given good information or bad information. But I think we would both agree we have a lack of information. So I think that's a non-settled question. I don't think it's an non-settled question as to the growth rates.

I think that's pretty clear that consulting is growing much more rapidly than audit and tax. And that definitely has an effect on where people want to go. Because if you're going to work as hard as these organizations make you work, you want to become a partner faster.

I think the other issue which we haven't talked about, Norman, but in my role now as department head, a big part of my job is staying in contact with alums for obvious, you know, development purposes.

And as I interact with these folks who have been out four, five, six, seven years and further, a lot of them have moved from the audit staff to the consulting staff. It's quite common. And --

MEMBER HARRISON: Are they writing bigger checks?

MEMBER CARCELLO: No. That's --

MEMBER HARRISON: I'm just kidding, sorry.

MEMBER CARCELLO: That isn't the reason. That may be true, but that isn't the reason they give me. The reason they give me, I think, is a hard reason to solve. They often find their consulting is just more interesting, just more fun. And I don't know how to, that's a hard issue to solve. But I don't think we should ignore that issue.

CHAIRMAN HARRIS: But how do you retain audit quality if that's happening?

MEMBER CARCELLO: Steve, I don't, it's easier to suggest a problem than to find a solution, right?

CHAIRMAN HARRIS: Jeanette?

BOARD MEMBER FRANZEL: Yes. And some of this discussion about audit services versus non-audit services, I guess, I'd like to emphasize the need for some information. And this is a question I think we need to address going forward.

We rely on an oligopoly to provide these services which, you know, are to lend competence to the market. But in the absence of information, it seems that these urban -- it's almost like urban mythology that starts floating around about assumptions about how the firms operate and what the impacts might be.

And, you know, we have done some research at the PCAOB when we hear some of this, because we want to verify is this true or not. And so I think this is a very important issue.

The lack of information can actually be impacting, you know, people's confidence, especially when different types of assertions do start floating around out there in the market place.

So just something for maybe this group to think about going forward, and for us at the PCAOB and certainly for the firms. Because these are very important questions that do impact confidence.

CHAIRMAN HARRIS: Yes. I couldn't agree with that more. And, Mike, I'd be very interested at some future point, or if you have it now or any comments of others in terms of what you see as the conflicts and what you see as the independence issues as you increase the consulting and advisory activities of these firms.

I mean, it's easy for some of us to throw these terms around, such as myself, but then the question is what specific examples do we have of potential problems out there?

MEMBER HEAD: Because I am a couple of years removed from my chief audit executive role where I served at TD Ameritrade as the coordinator for negotiation of fees for the audit committee and the director of the audit committee, some of this is anecdotal and not based on real data to support it.

But there was always the question that the engagement leadership partners would bring to the table though, because we set the policy early on that we didn't want to have to deal with the issue.

So the easiest way to deal with the issue was to make sure the firm that was doing our auditing knew that we were not going to allow them to bid on allowable non-audit work. Not because it wasn't okay, but that was just the audit committee's policy.

But constantly the partners would be coming back and saying we have this talent, we have this skill set, we have this ability that we could help your firm and we would like to do that.

And our response was we're never against you bringing someone in with subject matter expertise and sharing that knowledge with us to help us get better. We just aren't going to hire you to do it from a consulting point of view.

And the number, and so this is anecdotal, so the number of those subject matter experts that actually came and did work in the firm to enhance that knowledge was virtually non-existent, where they would have been there all the time if we were paying fees for it.

So that's only anecdotal, and that's a sample of one. And it was okay. You know, if we asked for them to bring a subject matter expert in, they always did. But it was then responding to a need that we requested versus that proactive of we're going to bring all these subject matter experts.

But I will say our audit quality was very, very high. I think the audit committee was very comfortable. And when there was a need on the audit engagement, they brought that subject matter expertise to the table to do the audit they needed.

So my evidence of why I have the opinion that I have is I think I saw it on a sample of one work very well in our case. And I think that model could work well as long as those subject matter experts had other non-audit engagements that would allow them to do that work and maintain that subject matter expertise. Otherwise, you're going to lose them to --

(Simultaneous speaking.)

MEMBER HEAD: Yes. You're going to lose them. Yes.

CHAIRMAN HARRIS: Brandon?

MEMBER BECKER: I think it's probably true that all of us in the client service business know that the best way to develop new business is with existing clients and that that momentum is there. But I don't think it's appropriate to think that the Commission's rules have been effective in the gatekeeping.

Sophisticated institutions know what those rules are. They know how to follow them, which is not to minimize the structural question. I just don't want it to be framed as -- I don't think there's, subject to my committee members' disapproval, a fraud conflict here.

There may be structural issues about talent, how talent is developed, what some of the implicit assumptions are. But I think folks are following the rules, and following the gatekeeping, and getting the audit committee approvals, and doing that and doing it on a regular basis.

Whether structurally, incentive-wise we might tighten it down is a different exercise, and one that is very challenging and not unique to accounting, whether it was broker-dealer, say, Glass-Steagall, Volcker, line of business rules are tough to draw. And it is tough to decide that you've made the right market microstructure judgement about how you're going to develop that talent over its years.

CHAIRMAN HARRIS: Gary Walsh?

MEMBER WALSH: I totally agree with Jeanette and what she had to say about independence in the visibility or lack thereof of information.

As investors, we don't have enough information to really identify conflicts. But we also don't have enough to make us feel comfortable that there aren't conflicts out. So I would encourage more awareness of what's going on in terms of disclosure at a minimum of the non-audit activities.

And I guess I'm also very suspicious about the ability to tease out the audit model versus the non-audit model with these firms. Because the whole awareness of what a firm is doing depends, I think, a lot on their audit activities.

And so if you take out, let's call that awareness a marketing type of element to their business model, if you take that out, of course the profitability looks a whole lot better on the consulting side.

So I think more work needs to be done to really tease out those two models and what would happen. The cost of an audit is not so significant that we can't make that portion as important and meaningful as it is, make that a profitable endeavor for audit firms without non-audit work.

CHAIRMAN HARRIS: Tony, in your slides later on, which Chair White won't be here to review, you raised the issue of transparency throughout virtually all of them.

And one area of transparency that I think I recall you raising is transparency with respect to revenue sources and other types of financial information of the firms.

ACAP recommended, or at least some members recommended that there be audited financial statements of the firms. And since we're dealing with four major firms in an oligopoly, and since some believe, notwithstanding the rhetoric that nobody's too big to fail, some believe that these are systemically important institutions that may not be allowed to fail, notwithstanding, you know, the contrary view of those of us who believe in America. Anybody ought to be allowed to fail.

So I was wondering in terms of the disclosure of financial types of information, why do you think that may be necessary, and then secondly, whether or not you believe that these firms ought to be required to have audited financial statements?

MEMBER SONDHI: Thank you. And any other member of the team can also, of course, contribute to this. I think that it's critical simply because it would provide information and effectively tell us and maybe even answer some of these issues that we've been talking about as to, you know, what the emphasis is.

Although I, for example, agree with Joe that one of reasons people may be moving to consulting is because it's interesting or more challenging. It certainly is. But at the same time, the question, you know, I'm not so convinced that it's not more profitable.

So it would be helpful to understand not only where the resources for these firms are coming from, but it would give us an insight, additional insight into how those resources are being used.

So from that perspective, I think that the cross subsidies, for example, if it provides or sheds light on that, that sort of thing would become much more useful.

I think it would allow the PCAOB to manage potential risk of those, the too big to fail type of problem, or too few to fail if you want to think of it that way, that perspective. I think it's very important to understand where the risks are within these companies.

I've seen some articles and some write-ups about some of the problems that they have with the funding of their pension obligations, for example, and some other aspects and how those are being done. So from all of those perspectives, it would be important to understand.

But in addition to that we also ask, for example, of their investments in technology, their investments in training.

Earlier we were talking about this growing need for various types of specialists. I think, for example, when I look at the outcome of your work, the Board's work on broker-dealers, for example, some of the problems that we have with banks, some of the ongoing problems with the areas of auditing securitizations and the different types of instruments that are being used these days for securitizations.

So the way the firm responds to these challenges, what their business models are, all of this would, there would be more light shed on it through these audits. So I think those are at least some of my reasons for saying that. And there are other members of my team and, well, and there's Mercer maybe.

CHAIRMAN HARRIS: I'd like to go to SEC Chief Accountant Jim Schnurr first.

MR. SCHNURR: Thanks, Steve. Just a couple of observations about this topic. And I know last year at this meeting we had a somewhat similar discussion around independence.

First of all, I think it's important to distinguish what problem you're trying to solve. There are two very different issues on the table, I think. First one is non-audit services to an audit client.

I think, with respect to that issue, if you look at the limitations that were put in as a result of Sarbanes-Oxley, you saw non-audit service fees go from, in some cases, a multiple of audit to, the last couple of years the information I've seen is it's roughly 20 percent of the audit fee.

So question is, you know, is that really independence impairing at a 20 percent level. And you'd have to get into the individual nature of those services. But I think as a general practice, the issue that was originally perceived has been relatively well addressed by the limitation.

I think one of the problems you have right now is you don't really have any transparency into what the audit committee does to evaluate the non-audit services on an individual basis.

The bigger issue that you're talking about is the size of the consulting practice with relation to the overall firm. That is a totally separate issue.

You're now dealing with the culture, tone at the top. And to what extent does the audit firm have in place, if you want to call it safeguards, that will mitigate the negative influence on the audit practice?

So are there factors that are now, you know, to the extent there is a disparity between profitability at a partner level, does that somehow put pressure on the audit function and the audit engagement team to do things that are not supportive of improving audit quality.

The flip side of that, as you look at some of the issues that have been, not issues but some of the discussion around improving audits through the use of, for example, big data and analytics, without the consulting practice the firms wouldn't have that expertise to explore these types of things.

So you've got to be very careful when you look at this issue and be very mindful of what you're looking at.

I do think that there, you know, particularly from a PCAOB standpoint, you know, one area that hasn't been explored is around the quality control systems that the firms have in place.

And I think that's an area that, quite frankly, you know, should be explored in terms of improving those standards around quality control, supervision and review. Those I think, are very, you know, where it would be important to look at.

CHAIRMAN HARRIS: Well, I absolutely think you hit the nail on the head when you indicated that, your question of whether or not the safeguards were in place. I'm glad that you're focused on it. We're focused on it. And I think it's something we should be working on together. But I think that's a very significant issue. Mercer?

MEMBER BULLARD: Thanks. I think, you know, Jim kind of hit on a point I wanted to bring up which is when you talk about the financial statements, at least it's my understanding financial statements would not do that separation between audit client non-audit services and non-audit client audit services.

And in my mind, what I would like to see would be, you know, a bar chart that simply showed the amount of audit client non-audit services and the amount of audit services to those clients.

And then let the market decide whether the relative size of those bars is something that might impact their conflicts of interest. Because I think Brandon is exactly right. The best way to sell is to cross-sell.

And I would think, even though it may be 20 percent of your audit fees, the job of the accounting firm is to get that 20 to 25 and then get it to 30. And the best way to do that is go to audit clients who are already clients and try to do that.

So I think just a simple matter of economics, you know, water runs downhill. And you will inevitably have some degree of conflict affecting the judgement of auditors. In my mind, the only question is how much.

But very clear disclosure of that particular relationship, I think, would go a long way toward, you know, putting in black and white the potential conflict.

CHAIRMAN HARRIS: Pete Nachtwey?

MEMBER NACHTWEY: Thanks, Steve. And this is such a complicated area. I mean, at the 50,000 foot level it would seem to be simple. But, you know, the elephant in the room is the vast majority of large public companies are paying their auditors tens of millions of dollars anyway. So which dollar taints their independence?

I think, you know, when you kind of start thinking about it that way, either we're going to go to a model where the government's going to pay for the audits, and then the question will be can we hit SEC deadlines, et cetera.

Not that there aren't a lot of great government workers, but it's just a different model in terms of -- so once you've looked at that, I'd go back to something, Jeanette, you said earlier about, you know, there's an oligopoly now.

And I grew up in the industry going back to the late '70s when there was a Big Eight and a Little Eight. And frankly, none of the Big Eight were of significant enough economic power to stand up to any significant client, anybody in the Fortune 100. The financial disparity was gigantic.

Now today, with the oligopoly, and again, no perfect world, right, the glass is either half empty or half full. It's never all full. With the oligopoly, you now have four firms that can face off against some of the largest companies from an economic standpoint and have a tremendous amount to lose.

And I don't think, you know, the lesson of Arthur Anderson is lost on anybody when they come in to work every day of, well, you know, the value of a franchise that's, you know, all these franchises almost centuries old, a century old, that if we want to get that next dollar of consulting or do we want to make sure we protect the practice, protect our client relationships, et cetera.

I think there's many, many incentives inside these firms that sometimes don't get talked about in the public forums. So what would be interesting to me is to see, you know, what's happened over the course of the two major changes that have impacted this.

One, the consolidation amongst the firms and the fact that you no longer can have -- I mean, some would say that one of the mistakes that Anderson made was not doing a merger and continuing to -- they went from being the largest firm to the fifth largest firm.

Whereas, the other firms had the scale to be able to organize nationally around industries and around functions. So the P&Ls got taken away from the local offices. That never happened at Anderson.

And Enron, who was paying them reportedly $50 million a year, might have been, I don't know, 25 percent of the revenue base in that office. And all the partners in that office would know that if anything happened to Enron that was going to be really bad for the Houston office.

But if the national audit partner, if the guy that was in charge of national audits, the guy or gal in Chicago at that time was looking at the overall P&L of the audit practice of Anderson, Enron was important. But it wasn't life or death.

So I think it's a very different dynamic that we're dealing with today, the way the industry has evolved. It's not all for the good. But I think we ought to, again, we're not going to get to perfect.

So has it been better that we now have some oligopolistic power? And has that benefitted investors? Because there have been fewer audit failures to find, broadly, bankruptcies, restatements, a number of, you know, negative deficiency reports in the PCAOB? Has that changed since the industry's changed? And has it changed, you know, post Sarbanes-Oxley? So just one man's view.

CHAIRMAN HARRIS: Tony Sondhi.

MEMBER SONDHI: Thank you, Steve? I just wanted to get back to respond to two issues, one, Mercer had raised. Mercer, my suggestion with respect to the audits of these firms was clearly based on being able to identify those distinctions. Otherwise, it's irrelevant. I don't care, you know, if that's not done.

But I'm also mindful, having been part of the CFA Institute's group that worked ages and ages ago on the segment reporting and seeing how that works in practice. So those definitions are going to be critical to the fact that they get audited correctly.

It's also, and that definition gets enforced would be critical. So if we don't get that information, certainly it wouldn't be very helpful.

The other thing that I wanted to mention was something Peter just said. It is certainly true that these are large firms now, the Big Four. But there is at least anecdotal evidence, and at least I have observed it, that there are differences in the way in which these firms question their small clients.

So I don't think that has gone away. It will be great to find some good research on whether that is a pervasive effect or not. But I see it in terms of the kinds of conflicts that my clients have with their auditors.

And I have both very large clients and very, very small clients as well. And I see that distinction every day. I just, I'm not aware of enough good empirical research that tells me that it's a systematic difference. So I don't know that. But I still there is a very serious problem there.

CHAIRMAN HARRIS: Mercer?

MEMBER BULLARD: I'll just respond quickly. Tony, as you pointed out, I wasn't really clear. You're right. The issue, in my mind, was more that if you are an accounting firm, if I were accounting firm, I'd make the argument why am I spilling my entire financial statements which they don't want to disclose at all, right, when what you really want is to focus on this one data point.

So you're right, I wasn't clear. What I would suggest is that's an alternative that would be, in their mind at least, not as onerous but would still get to the, you know, the data disclosure point.

CHAIRMAN HARRIS: Joe, one of our respondents indicated that, "I think it would be useful if audits were expanded to include more tests for fraud." And this issue of testing for fraud comes up all the time. Do you have any idea what he had in mind or what any of the group would have in mind with respect to what may be meant by that?

MEMBER CARCELLO: Yes. You know, the quote, Steve, is the full quote. I didn't truncate any quotes. So I don't know exactly what he had in mind. So I'd speculate a little.

As you know, there have been discussions in the past, I think, if I remember right, I think it was in the ACAP report, around periodic forensic procedures would be introduced into audits. I'm trying to remember. I think they said every, maybe every three years. But this is from memory. It's been awhile since I read the report.

So it could be that, you know, random forensic procedures, whether it be on an every year basis at aspects of the audit or maybe periodically, maybe every third year, more extensive.

The challenge with this is fraud is a relatively rare event. And forensic procedures done well are quite expensive. And so is the cumulative cost, if you introduced it across the entire population of public companies, even if you did it once every three years, does that meet a cost benefit test? And deep thinking would have to go into that. That would not be a snap judgement, obviously.

CHAIRMAN HARRIS: I have two final questions if others don't. You know, one is in terms of your survey, what do you consider to be your major takeaways from the survey? And what would be your view, in terms of that takeaway, what the PCAOB ought to do in response? And second of all, related, what most surprised you about your survey findings?

MEMBER CARCELLO: Well, Steve, I think you had three or four questions in there. I'm not -- yes. I'm not sure I'm going to remember all three or four questions.

CHAIRMAN HARRIS: Multiple questions so, you know, take whatever you want --

(Laughter.)

MEMBER CARCELLO: I think probably what most surprised me is just how strong the response was as to how important audited information is, both the GAAP financials, and ICFR and what would happen if it went away.

And the reason for that, Steve, as you and I have talked about and as I talked about when I presented, as the PCAOB, as the SEC sends out these concept releases, and these proposed rules and these final rules, overwhelming, who responds?

The accounting firms always respond. Well, they have partners who do that. And they're quite well paid, and they're quite good. And big corporations respond sometimes, and trade groups respond. And sometimes audit committee members respond, probably hire law firms to write the response for them.

But investors generally don't. And it's the same investors all the time, right. It's the council, it's the AFL-CIO, it's CalPERS, it's CalSTRS. So you come away thinking does anybody even care about all this stuff, or is this just a mass of tax on the economy that no one even values what we're doing.

And I think it came away clearly that there's tremendous value. Maybe they don't send comment letters in, for whatever reason, but they value it. So that, I thought, was a positive. And it did surprise me a little bit just how strong.

I think in terms of takeaways, in terms of implications for the PCAOB or maybe even the SEC, in a couple of cases, two or three at least, there did seem to be some concern about inadequate disclosure for decision making.

And, you know, I think the SEC would define itself as a disclosure agency. And so clearly there does seem to be some opportunities for improved disclosure, certainly around audit committees, as I alluded to. Jim and Brian and going to solve that problem. So we're already moving forward on that.

Some of the others I don't think are on the agenda, necessarily, of the SEC or the PCAOB right now. But maybe it's worth conversation.

There did seem to be, in terms of takeaways, and I only had excerpts here, Steve, but if I gave you the full free responses there were a number of people who commented on the audit report. You saw two or three of them up there. And if I had shown you all the free responses, you would have seen more.

I think there's general sense worldwide that the existing audit report is inadequate. There's already been movement in much of the rest of the world to deal with that. We're lagging a little. But I think we'll get there.

There did seem to be a number of people who commented on the name of the engagement partner. This is getting so old, I can't imagine we're still talking about it. But I think we're getting close on that.

Clearly seemed to be value in the AQIs. I think there's a validation that what you're working on is useful. And probably not surprisingly, the output measures mattered the most. This group previously reported on that. I think this group said that. We see this in the survey.

They're probably also the most challenging to do well. So that's the real juggling act, right. They're the most important, but they're the hardest to do well.

So there's probably more if I thought about it longer, but I think those would be some of them.

CHAIRMAN HARRIS: And then Pete, since I know you're not going to be here at the end of the afternoon for the general discussion -- and I've asked everybody to list their number priority in terms of what they think the Board ought to address and why -- you've already touched upon it, but in terms of audit committees, if you want to expand upon it, since you won't be here.

MEMBER NACHTWEY: Yes. I think, again, recognizing this as, you know, a place that the PCAOB doesn't directly have oversight for but, you know, clearly rubs up against in terms of its mission, I think there's a tremendous difference.

I can just speak from a 35 year career of dealing with companies that have audit committees. There's a tremendous quality disparity. And frankly, there's a lot of soft guidance out there of what an audit committee should be composed of, et cetera.

It really comes down to the tone at the top, and the quality of the company and the nominating and governance committee of that company as to what quality of audit committee they have.

And, you know, figuring out how the work that this group is doing, the PCAOB is doing around making auditors better is incredibly important. But I think, you know, getting the oversight and the activities of the audit committee, you know, in sync as well with that level of quality is important.

And I know it's not going to be an overnight thing. It's not a clear, there's no clear place that, again, the SEC has oversight of this, but in terms of, you know, a clear body of expertise, and knowledge and years best practices, et cetera, it's hard to find that.

So you know it when you see it. But in terms of what I see is, you know, as Tony was indicating before, a tremendous disparity between real quality audit and the average one that exists out there today. So I think that's worth putting effort into.

CHAIRMAN HARRIS: Well, thank you very much. And if nobody has any further final comments, well, Judge Sporkin?

JUDGE SPORKIN: What occurs to me is it seems to me we're looking for the needle in the haystack. But there's the haystack out there.

You take the Dewey Ballantine case. Is someone looking at the auditors in that case as to how they got conned? And look at all these debacles.

It seems to me that those would be the first, the high priority cases to look at to find out what happened. I mean, it's there. Somebody missed it. And it seems to me that would be a top priority. If you're picking your audit teams, maybe have specialized audit teams to look at them, look at the bankruptcies.

And I know there's a question of where cases are litigation, and we don't want to touch those. But you're going to have to break through and touch them.

CHAIRMAN HARRIS: Well, you've been a strong proponent, and I'll conclude this session, with respect to the requirement of forensic accountants in certain audits. Do you want to talk about that a little bit?

JUDGE SPORKIN: Well, again, as I say that the first thing I would do, with limited resources, is to put your forensics or have special groups to look at the -- you've got a big body of companies out there. And I would get you to look into those as quickly as -- Have autopsies. You know, you have a death, someone has an autopsy. What you need is a financial autopsy in these cases.

And don't be put off by someone telling you, well, there's litigation, or this, that and the other thing. Go right in there and say, okay, this failed. Why? Why didn't -- it looked like, as I read the Dewey Ballantine, it looks like they were being conned night and day. And you find out why. Why were the auditors being conned so much? Did they do, you know, should they have done the next step? Should they have had a forensic in there?

CHAIRMAN HARRIS: Well, Joe, I want to thank you and your group for a most enlightening survey. And Brandon, Bob Buettner, Grant, Norman Harrison, Pete, Larry, Anne Simpson, Lynn Turner. I think you've added significantly to the work that we're doing and to the results that we have to take under consideration. So I want to thank you and your team very much for this presentation.

And with that, we'll take a break until 11:30. Thank you. And Chair White, thank you very much for joining us today.

CHAIR WHITE: Thank you for having me, and I commend you on the work as well. Very, very useful discussion for me as well. Thank you.

CHAIRMAN HARRIS: Thank you for coming.

(Whereupon, the above-entitled matter went off the record at 11:09 a.m. and resumed at 11:33 a.m.)

CHAIRMAN HARRIS: All right let's get started on the next working group presentation. The issue of going concern has been before us for some period of time.

It was recommended that we discuss this issue by a number of our group members. So I would ask first of all that our Chief Auditor, Marty Baumann, gives us a very brief overview in terms of the issue as it's being currently considered by the PCAOB.

And then I would ask Grant Callery, who headed up the working group, to lead us through the slides and then we'll turn to the discussion.

So, Marty, thank you very much.

MR. BAUMANN: Thanks, Steve. So just a little bit of background on the standards and reporting issue we are facing right now.

By background, historically reporting on a company's ability to continue as a going concern has been the responsibility in the U.S. of the auditor.

It's rooted in the Exchange Act Section 10A and the background of 10A really was a number of significant company failures with no early warnings, no warnings about that, and congressional concern in that regard.

Going back to the S&L crisis, for instance, then Congressman Wyden saying auditors didn't cause the S&L crisis, but couldn't there have been some warnings that they saw it coming.

And that congressional concern led to the creation of Section 10A of the Exchange Act, the requirement that the auditor evaluate whether there is substantial doubt about a company's ability to continue as a going concern and a corresponding auditing standard today, AU 341, which requires the auditor to make an evaluation as to whether there is substantial doubt about a company's ability to continue as a going concern and if there is to report that in the auditor's opinion.

Under the auditing standard substantial doubt is a qualitative assessment based upon the factors and attributes that are listed in the standard for the auditor to consider the conditions that might give rise to that level of uncertainty.

Over time data has shown that reporting on going concern has been very inconsistent.

There are many companies that receive going concern opinions, literally for a number of years and don't go into bankruptcy, recover, or get acquired or whatever else.

On the other hand, many companies do go into bankruptcy within a year of a clean opinion, so they go into bankruptcy without any kind of early warning within the next year, and that happens especially with large issuers.

So there is clearly a need for some improvement at a minimum in the auditor's reporting about going concern to get more consistency.

FASB had a project for a number of years to consider whether there should be management responsibility for reporting on substantial doubt or inability of a company to continue as a going concern.

In August 2014 they adopted a new accounting standard that now will require management to make an evaluation and then report in the financial statements when there is substantial doubt, and they defined substantial doubt using a likelihood-based threshold of probable.

So management has to report in the financial statements when it is probable that they will be unable to pay their debts as they fall due in the next year and then say that substantial doubt exists in that case.

They had proposed in addition to that level they had proposed that there be another early warning signal of when it was more likely than not that a company would not be able to pay its debts in the foreseeable future.

They decided in the final adoption not to go ahead with that more likely than not disclosure.

Many commenters indicated, well many supported that, many said, and the auditors and others said the more likely than not kind of rested on a 49, 51 percent, 49.9, 50.1 decision, very hard to justify, or hard to make.

So FASB in August 2014 came out with that. That's different than our standard, which is qualitative based, so we came out immediately thereafter with a practice alert and advised auditors that our existing auditing standard is still in effect, and that is that auditors should continue to report on substantial doubt using the qualitative-based thresholds and attributes in our auditing standard AU 341 and we said that we have a project to continue to consider standard setting.

There was also one other wrinkle when you consider the issue, and that is IFRS. PCAOB Standards apply also to audits of foreign private issuers that are done in accordance with international accounting standards.

IFRS has a different definition of going concern and that is that management has to report under IFRS when there are material uncertainties relating to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

So in thinking of what our potential new standard might be we have to think about both the gap threshold, the IFRS threshold, and what threshold we should come up with.

Typically our standards have been aligned with the U.S. accounting, you know, so some might expect that we would go to a growing concern threshold which would be at the probable level.

Some of suggested, however, that there could be a significant effect on auditor going concern reporting if it was moved to the probable threshold, so it is important that such matters not be prejudged.

So we have been laying the groundwork for a staff consultation paper and performing a lot of additional research and doing some outreach in that regard before we issue the consultation paper.

The consultation paper will seek investor and others input in terms of what kind of threshold our auditing standards should be at, should the auditor report based upon a qualitative threshold today or more likely than not, or should it be the FASB probable threshold, and, also, should there be improved auditor performance requirements so that there is more consistent auditor reporting on whatever threshold we use.

We also want to seek information on how important is auditor going concern reporting to investors, what are the factors that influence auditor going concern reporting, why is it that there have been lack of going concern in their reports and substantial doubt reports when companies do go into bankruptcy in the next twelve months, which has occurred in many cases with many large companies.

So we will be seeking a lot of information in this consultation paper that is currently been in the works for some time and we continue to research to inform it so we can put out a paper that will give meaningful input for people to comment on.

With that, Steve, let me turn it over to your working group.

CHAIRMAN HARRIS: Grant?

MEMBER CALLERY: Thank you, Marty. Okay, this is the working group we have here and I'll talk a little bit about the methodology we use, which is probably an overused word for what was a relatively short timeframe that we considered this, but this came up a few weeks ago and we put the group together to try to frame the issues a little bit, and Marty's done a very good job of doing that.

But the IAG did have a working group in 2012, as I mentioned before, that actually did a survey along the lines of the one that Joe reported on this morning and so we decided that we would try to leverage that as much as possible here, and Pete Nachtwey, who was on that group, will talk about what that working group did in 2012.

So we figured we'll use as much of that as we can. The thing that they did not have available to them, obviously, was the 2014 pronouncement that came out of FASB and which I think changed some of the assumptions that were probably thought about in that study.

And then the other thing we thought we should do is try to come up with some ideas of what the PCAOB should do because I think frequently, as people have sometimes said in these meetings, it is nice to have all these wonderful ideas, but you ought to really focus on something that's within the jurisdictional boundaries of the PCAOB so that they can actually take it from us and do something.

And you'll see at the end I'll flip it to Pete on the middle slides in here and then come back and part of what Marty talked about is exactly what we are recommending.

You know, we did note that the going concern reporting structure has not been a good early warning system, but that's a question as to is that the right way to do early warnings.

The FASB, as Marty mentioned, did take a position on that, that they should not set up an early warning system, but I think that's something that the PCAOB ought to continue to discuss and that we ought to talk about today.

It does require that the management get actively involved and do the assessment, which I think for the most part everybody in the working group thought was a good thing.

It does set up the standard that can be viewed as being different from what auditors had been using and I think that's probably the primary issue that they didn't put from this group would be important on because there are lots of things you can see as potential problems where you have auditors using one set of standards for making an analysis that management's using a different set of standards for and that the PCAOB ought to look at it very closely.

Obviously, there is a statutory basis in 10A that the audit has to look at substantial doubt about the ability of the issue or to continue as a going concern during the ensuing fiscal year, and that's not going to change.

That's got to be the basis, absent congressional action, that will be the underlying basis, but the definitions that go with that are what we need to talk about.

The prior IAG review was in 2012 and I'll hand it off to Pete and you can talk about that and if you want me to flip through the slides just tell me and I'll push the button.

MEMBER NACHTWEY: That would be great. Thanks, Grant, and thanks also for your leadership because I think it's a great metaphor that we're in the Army and Navy Building because he did a great job at generalship, going up and Steve Harris told him to take that hill and we did it in two weeks.

Anyway, so we last looked at this as a group back in March of 2012 and that working group consisted actually of Damon Silvers, Anne Simpson, Lynn Turner, and myself, so I guess I'm becoming a serial going concern person at this stage, but hopefully that never applies to an entity I am associated with.

But in any case, it was also interesting I think that that meeting, March of 2012, marked the tenth anniversary of Sarbanes- Oxley, and that just reminds me, Steve, of how quickly time has passed since that legislation was put into effect.

But just as a reminder in terms of the work that we did in '12, first we did conduct an investor survey. The results of that are included in the next several slides, which we can look at.

We also looked at the history though of the evolution of going concern and it goes back many, many decades.

We chose to start with the Cohen Commission back in the '70s and go all the way forward in terms of various regulatory bodies and other groups that have looked at going concern right up to what at that time was the FASB's project on a going concern standard in February of 2012.

The other thing we did was we looked at a list of high profile bankruptcies since 2000, I'm going to that in a second, but I'll point out before we get there only three of the top ten bankruptcies had going concern opinions.

So, you know, and that's since 2000, the top bankruptcies since 2000. Actually, Grant, maybe we'll fast forward a couple of slides. There is the list, a picture is worth a thousand words.

If you keep going there is a list of -- There we go. So those are the top ten bankruptcies since the millennium and only three of them, as you can see, with General Motors, Thornburg, down at the bottom, and PG&E that had going concern opinions.

So, yes, on the one hand you'd say well definitely it's not a very good leading indicator. I think we'd all agree with that. On the other hand I also looked at well what drove some of the other ones, and, you know, WorldCom, Enron, maybe arguably MF Global, were as much frauds as they were going concerns.

So, you know, with going concern, going concern, really the thing we should be focused on, that might have ended up just being part of the symptoms as the patient was, you know, on its last legs.

And going back to Judge Sporkin's, you know, comments about, you know, forensic accounting, et cetera, you know, could there have been more done to ferret those frauds out long before a going concern even would have been relevant.

And then the last one, well the last one I'll mention, but it's the first one up there, Lehman Brothers, you know, clearly a phenomenal failure.

On the other hand was it all a failure of the auditors or was it a failure of the whole environment in our financial system that allowed a firm like that to operate with 30:1 leverage for decades.

The, you know, flip side is the auditors are inside that place, they absolutely should have been understanding the risks.

So does that all feed into our audit opinion and, you know, other things that the auditors could have been disclosing along the way, again, long before a crisis put them out of business, because one could argue if the crisis did not happen they'd still be fat, dumb, and happy making, you know, tons of money on Wall Street.

So anyway, I didn't pre-clear that with the Committee, so, Grant, no one else is bound by those editorial comments on my part as to what might have caused those three.

But maybe we'll back up then a few slides on the survey, because I think what you'll see is -- Okay, one forward. So you can see it's very important, basically two investors, and if we flip to the next one maybe, Grant.

And then this one goes to a bit a crux of the issue as, Marty, you've summarized that, you know, what should the standard be. I mean basically, you know, of the investors that were surveyed and, unfortunately, I don't have the census data on that one.

Professor Carcello will knock me on my Ph.D. thesis here that I didn't bring that info, but I think it was a reasonably wide survey, and the vast majority came back and said we ought to have a, well more likely than not, or reasonably possible, you know.

Sixty-seven-and-a-half percent were lobbying for a standard that's even lower than what's in either the accounting or audit standards at the moment and then, you know, 22.5 said substantial doubt.

So, again, that shouldn't necessarily be definitive as far as this group deliberates because the survey wasn't of, you know, savvy audit folks, but it was of investors and what they would look for.

So in terms of recommendations that we came out with at that point in time, and then I'll hand it back to Grant, first was standard setters were at large to strengthen the definition and better define the triggers.

That included a recommendation that management had to have a role in this and, you know, bottom line is that no management can decide what accounting regime they are using until they've done a going concern analysis, because if they are not a going concern they should be using liquidation basis of accounting and not GAAP.

So hypothetically managements always have had to make a decision on this, they just never had to disclose it and didn't do it formally.

We also suggested that, you know, despite the fact that management should get involved that the independent auditor ultimately had to buy off on the assessment.

We talked about some key performance indicators and, you know, that disclosures of those could help investors and users of financial statements to develop their own view around going concern.

We talked about the audit committee role and then some thoughts about regulators and mitigating risk. But I think, you know, since that time the one key thing that has happened is the FASB did issue a standard.

I think what we'll probably spend the rest of this time debating a little bit is what confusion does that, you know, does the standard help for, does it end up dumbing down what already existed, or just simply create confusion.

So, Grant, back to you.

MEMBER CALLERY: Thank you, Pete. Okay, yes. So as Pete said the 2014/15 came out, it's effective for periods ending after December 15th of next year, so, you know, from a standpoint of, you know, what the PCAOB should do about reconciling, coming to decisions on, you know, whether they want to be at the same standard or whatever, the lead time, given the way rulemaking and promulgation of things work, is not very long and the rule does permit early application for issuers on previously unissued statements.

So that December of 2016 is not that far away and could, in fact, be found to be used in earlier timeframes.

As we've mentioned, the Board decided not to pursue the early warning aspect of this and I think that, you know, the early warning, whether it be in a context of a going concern or somewhere else is an issue that we ought to discuss.

They do provide guidance on management's responsibility to evaluate the substantial doubt issue, which previously had not been there.

So I think in the discussion, at least by our group, everybody was very much of view that that was a positive step forward because you don't want the, I mean the idea of auditor go first as opposed to management go first just logically doesn't make a lot of sense, at least to someone who is a non-accountant and a non-auditor, but could end up in, you know, some strange situation.

So I think that piece of it is very positive. The real question is this definition of substantial doubt in the probability standard that was there, that is in 2014/15.

So as we looked at issues to talk about the first is the threshold issue, what is the proper threshold, substantial doubt in the statute is undefined but is there and that their commentators have said, and there have been a number of articles that have been published in various different media talking about the fact that probability would create either a higher threshold or a lower standard than what auditors have been currently using.

And as Pete said the 2012 discussion, in the survey there was a lot of sentiment for going even below what the current interpretation of what statutory language might be and making it easier for a going concern determination.

The second issue was to who goes first and that this, as I've said, is consistent with the 2012, and is this an important thing, what does this group thing about that.

As I've said the working group generally thought it was a positive thing and that the thing, the to-do list from the PCAOB standpoint would include the things that Marty had mentioned, but, you know, amending the current standards, addressing the potential differences, decide which standard they want to go with.

I think the tendency in the group, or the feeling in the group, was that a race to the bottom is not exactly what we would like to see here.

And then the staff consultation, which Marty mentioned, and, of course, that runs into sort of the timing of the issue, can something get done to reconcile things before the effective date of the FASB ruling and if not is it feasible to look for a delay in the implementation of the FASB ruling until the audit standards can be ironed out and then what are the implications if that does or doesn't happen.

So that was pretty much the discussion that the group had had. I give Tony and Joe, who were the other members of the working group, an opportunity to add anything they might have before we open it to full group discussion.

MEMBER CARCELLO: I'll just add a couple of things. Grant, I had told you that I would try to give you some, or try to add for the group some takeaways from the academic literature and, unfortunately, I was trying to finish the questionnaire, the survey results, so I couldn't quite get it in time for the cutoff date to have it in the slides, but let me go ahead and give you at least some brief, two, three minutes here.

So there is actually a long body of -- And I have focused primarily on the usefulness of this reporting to investors, which I think is the litmus test of whatever the Board decides to do.

So there is a long history going back to 1986, Nick Dopuch and colleagues in the General Accounting and Economics, Keller and Davidson in the Auditing Journal, and that was 1983, more recently in 2010 by Krish Menon and David Williams, find that the market reacts to going concern opinions, most strongly, probably not surprisingly, to unexpected going concern opinions.

The Menon and Williams paper observed negative excess returns when the going concern opinion is disclosed and the reaction is more negative if the going concern opinion cites a problem with obtaining financing.

Also, in the same line in terms of this negative reaction, papers in 1992, 1994, and 1996.

A paper in 2011 by Allen Blay finds that the way the market values firms changes once a going concern opinion is issued moves away from the valuation, primarily being driven by the income statement and that income to valuation being primarily driven by the balance sheet and issues around assets and liabilities.

They conclude that going concern opinions provide additional company-specific valuation information to the market beyond the information that is already publicly available.

A paper in 2011 by Willenborg and McKeown around IPOs find that going concern opinions are positively related to the likelihood of subsequent stock delisting and that IPOs that have a going concern opinion before IPO affects first-day pricing.

So a number, and this is not complete, but this gives you a sense, I will tell you a very significant -- So sometimes when the Board is considering issues there is actually very little research or the research that exists is often not on point.

In the auditing space going concern reporting is arguably one of the most researched areas that exists, for obvious reasons, we have data.

And so, you know, as you talk about the, you know, Christian and his group, Jim, is well aware of this research, and so in terms of hard data and empirics to support some of these decisions and clearly to provide information on how useful these reports are to the market and to investors there is a wealth of data that exists.

MEMBER CALLERY: Okay. Tony, thoughts?

MEMBER SONDHI: Thank you, Grant. Joe is right, of course, in that, you know, what matters is the utility of that particular signal to the investors and listening to some of this and thinking about it before the meeting I was struck that maybe, I wonder if we are asking, if we are using the right questions over here as Jim had said earlier in a different context.

See, for example, one of the issues that we always seem to talk about with respect to going concern is whether the bankruptcies that we have seen were preceded by going concern opinions.

The problem is that bankruptcies are not the same thing as negative market returns. Those negative returns happen way before bankruptcies. Bankruptcies are negotiated.

Marty, in your earlier preliminary remarks you had made the comment that there are cases, many cases I believe you said, where they received going concern opinions but they never went bankrupt, they either got bought out or something.

Now there two things strike me. One is, as Judge Sporkin had said earlier, maybe we should do an analysis of what happened to those where the going concern opinions were there and were repeated and yet nothing, they didn't declare bankruptcy.

So the fundamental question really is we should be asking whether going concerns are a good indicator of negative returns. That's more -- Because the bankruptcy thing happens sometimes and sometimes you get bought out.

If you get bought out, you know, if you were selling at $100 and you get bought out at $3 it's really not a very good outcome for the investors. Presumably, hopefully, they are already gone from there by then.

But that's something that I wanted to point out and this, by the way, had been going on for a long time.

I remember almost 25 years ago seeing a study from Harvard Business School where they looked at whether cash flow-based ratios were better indicators of bankruptcy than accrual-based ratios, right, so the income statement or balance sheet versus the cash flow statement.

And those authors had said the cash flow statement ratios were wrong, which is probably along the lines of what investors would have been focusing on, but they said that they were wrong because three years before Chrysler had problems the cash flow ratios told you there were problems, well I can't see why that's wrong.

I know Chrysler did not declare bankruptcy, but that's not the point, right, because you should ask some of the investors in Chrysler what happened to them rather than whether they declared bankruptcy or not.

So from that perspective I think it's very important to ask the right questions. I also feel that management should be, because after all they should be the ones to be talking about this because after all it's their representation, the financial statements, they develop them, they put the numbers in there, and they are the ones running, they're the stewards of the money that's been provided to them by the investors.

Marty also did, I think, a very good job of laying out the way this thing seems to have worked out.

On one side you had this qualitative standard in the audit guidance and then along comes the FASB with the probable or more likely than not, and then you have the IFRS, which is on the material uncertainties.

So if you think of those and continually you have to ask yourself where are these going to be, where are they going to end up on a continuum, and the type of definition that's being used, or I should say the types of definitions being used in here are going to create problems for investors because the level of judgment involved makes it very difficult to say that this was done at the right time or not.

So the question is what is it that we should be looking at, how should we approach the question in this particular issue. I think that's something that we are missing here.

MEMBER CALLERY: Okay. I think we'll open it for discussion from the group and, again, I guess the focus being sort of the issue of the definitions, the timeframe, how should the PCAOB best use the time between now and the effective date and to make the most progress to getting to the right resolution here.

CHAIRMAN HARRIS: And, Grant, maybe we can recognize speakers as they raise their cards.

MEMBER CALLERY: Absolutely. Do you want to do the recognizing or do you want me to?

CHAIRMAN HARRIS: No, No, I want you guys -- I'm very happy, but I didn't know whether or not you see Brian's card --

(Simultaneous speaking.)

CHAIRMAN HARRIS: -- a reference to the SEC first.

MR. CROTEAU: Thanks, Steve, thanks, Grant, and thanks for the presentation. It's probably a good time just to remind that the standard disclaimer applies and these are my own views and not to be attributed to others.

Just -- I certainly would agree that utility of the signal to investors is what is very important here to be thinking about and while there is a wealth of data, Joe, to your point, what we certainly have heard over the years is that the way substantial doubt today is interpreted is different to many people and there is quite a range.

So I think that does at least cause some degree of difficulty relative to thinking about the current signal that one can get from the application of today's standard.

Not to make this more complicated than you have already described, but I think there are some other issues to think about, just a couple factual points, certainly that FASB extended the period of time that the evaluation would occur and also included a quarterly evaluation by management.

Those are probably important points to be thinking about, particularly in the context of the slide that you put up where there may be more quickly emerging bankruptcies or rapidly emerging events that might not otherwise be -- you know, coincide with the timing of the year-end audit.

So I think the timing of an evaluation is as important perhaps as the threshold that's used.

I wonder how much the group has thought about the threshold that is being applied today, or probable threshold or any other relative to the chart that was up there, because I think, Pete, to some of your points probably some reasonable questions would be raised as to whether any threshold would result in, you know, a binary conclusion of substantial doubt in some of those circumstances.

The other point I guess I would just raise to be -- to include in the mix as you are thinking about this topic is the FASB in their basis for conclusion on eliminating, or not implementing I guess I should say, the disclosures at the more likely than not level included consideration that all of those disclosures are otherwise required, at least of management, in other parts of the document. Risk factors, liquidity disclosures, et cetera, and now there may be reasonable questions to ask about the sufficiency of those disclosures and I am certainly interested in that topic as well.

So I just wanted to add, I guess, those few points to the mix.

MEMBER CALLERY: Okay. Damon?

MEMBER SILVERS: Well, first, let me say how pleased I am that PCAOB is taking this matter up.

I have I think spoken in one way or another about this question at every meeting of this body and of the SAG, when I was on the SAG, since 2008, and I think this is extremely important work, and again, just pleased to see it.

I think that the -- and I am pleased with what the working group has done as well. I want to make a couple of comments about sort of the conceptual approach here and also some of what is now the historical backdrop to this that motivated the fact that I have been sort of like Cato the Elder on this question for a while.

The conceptual background, which I don't think -- which we haven't really touched upon because of an understandable interest in kind of getting at investor attitudes and investor desires in this space, the conceptual backdrop here is that I think it's always been understood that the ability of an auditor to issue an opinion on the adequacy of the, on the -- now I've forgotten the term of art, but the accuracy of the financial statement is tied to the going concern question, all right, that without this that if there was a serious doubt as to the company's ability to continue as a going concern that that means that the entire financial statement has to be read differently, right.

And so the question of exactly how investors work with that data is an important question but it's not the core question from the perspective of the statute Congress enacted or from the perspective of the way that the public accounting system and the system of public company audits works.

The core question is is that the whole notion of an audited financial statement and an auditor's opinion on that statement is incoherent without this going concern component.

Secondly, the reason for, at least my really deep concern about this, has to do with the failure, in my view, of the auditors of our country's major financial institutions to do a proper evaluation of these questions in the context of the 2008 financial crisis.

And in particular the absence of a going concern qualification on Citigroup and Bank of America's financial statements as of year-end 2008.

And this raises -- this is tied to a conceptual issue that I hope PCAOB is looking into, which is in my experience when these issues are raised in smaller companies auditors are particularly concerned when there is a contingency that ties to the question of the going concern, meaning that there was some circumstance outside the company's control that which if it flips one way the company will be out of cash.

In the case of the two firms I just mentioned it's, I think, incontrovertibly true that as of the end of 2008 that those companies as going concerns were completely dependent on the goodwill of the federal government and in a circumstance where that was a policy decision and not a matter of -- and they had no legal entitlement to that goodwill.

That circumstance seems to me to be completely akin to the circumstances where auditors routinely will issue a going concern qualification.

For example, where a public company's survival during the coming year would be dependent on obtaining a loan from a bank or being able to execute a public offering.

Now, the -- so looking into that question I think is critical to sort of executing this body of work, is how do we understand the treatment of contingencies, that is a subset I think of what the data in this nice little presentation shows us, which is that to a large degree this issue -- and this is squarely in the PCAOB's wheelhouse, the issue here is not -- it may be in part the question of what is the definition of going concern by the FASB and potentially by the -- how does the PCAOB structure that.

But as much as that it's an issue of how is this being implemented and is there essentially a double standard, one for large public companies and particularly for "too big to fail" public companies, and another for small to medium-sized enterprises.

There is I think a strong suggestion in the data we have seen that there is such a double standard and that this is something where auditors really are treating different folks differently in a way that I think is unacceptable from an investor perspective.

Finally, I would just note that because this issue has its root in a statute, unlike a lot of what is -- well, unlike a lot of the issues we find in financial accounting and in auditing, Congress was quite specific about this, the term substantial doubt is a statutory term.

Now I don't know if there is some special gloss that exists in the courts on this question, but as an attorney I can tell you that substantial doubt does not mean probable and I would be very concerned if I was on the board of FASB, and I wonder whether anyone asked, whether should a firm fail in the circumstance where the firm and its auditor sought to rely on FASB's definition to justify the failure to have a going concern -- an expression of concern about, you know, a going concern, language in the audit that they would be found liable, nonetheless, and this particular FASB guidance would be overturned by a court.

MEMBER CALLERY: Thank you. Mike?

MEMBER HEAD: This is Mike Head. I'm having a little bit of deja vu because this feels a lot like our discussion we had the last time, too, so I'm not going to go there again even though I guess I have a hard time not at least saying a couple of things, is I am not sure a going concern creates problems for an investor and they want to get out or if it creates a buying opportunity for them to get in.

So, again, I have trouble, I always have, even when I was a little baby auditor thinking the going concern tells us much, because I audited early in my career manufacturing firms that were small to medium that always were struggling with cash, and this was before the accelerated filing dates, so I'm really dating myself.

And so the partner would sit on the opinion until they were close enough to knowing they were at the 12-month period so that they knew they could give a clean opinion and it was going to meet -- not meet the criteria of a going concern because it was 12 months, and that's how they wrote it up in the audit work papers was all we have to do is get to such and such date and there is no going opinion by definition.

So I struggle because I am a bottom dweller when I invest. I look for blood and then I, like a shark, go look at that company and make my own personal opinion and I would've bought GM, I bought IBM way back when they got bloodied up and lost 50 percent.

The last month in the market has been wonderful for someone that wants to look for those investments. You're not always going to be right, but a going concern from an investor's point of view, I don't think it's telling them to get out, I think it's telling them to get in unless you can't assess the company as truly what's going to be the disposal.

Now, again, as we always say, this is Mike Head's opinion, but that's what you want. I think the critical issue is getting all three definitions of what is substantial doubt or the basis for giving the going concern, they have to be the same, and it's not just AU 341 and ASU 214-15 unless the convergence project has went away.

I don't even understand how FASB issued something that didn't automatically reconcile with IFRS, so we must have abandoned the goal of converging with IFRS because they just created a difference that allows -- that requires you to go back and now address it as a convergent issue, you know, I just don't get it.

It seems like 101 you got to define it the same otherwise I would assume there is going to be lawsuits, there is going to be auditors not knowing what to do, management not knowing what to do, let alone addressing IFRS.

So that's a little bit of maybe just blowing off steam, but going concerns since 1982 has never worked when I did my first audit, okay. So I'll shut up.

MEMBER CALLERY: Brandon?

MEMBER BECKER: Just one question about the bankruptcy chart. I would find it interesting, but this may just be more curiosity on my part, to have another set of data about what the rating agency said, what the analyst said, what the short-sellers said, and what the price movement is, because I'd really be curious whether all those people who are paid a lot of money to make these judgments got it any better than the accounting firms that we are now asking to do it.

Second, Joe has nicely highlighted in a variety of form that investors come in many shapes and forms and is particularly interested in what portfolio managers making decisions make.

Our portfolio managers do not think it's good news to get a going concern, so those studies are correct. They also don't think it's good news to have that stock in their portfolio.

If anything, they think they've made a mistake because they're going to get out of that company before there is a going concern, in fact, before there is a rating agency downgrade.

They are not looking to going concern judgments to make judgments about negative returns. You know, if you want to choose whether the Astros or the Yankees are better you are not looking to your auditing firm to do that for you.

You know, you are making judgments about those returns based on the information. Now, yes, to the extent going concern has the hint of fraud as opposed to bad business judgment, are PCs coming back, you know, those sorts of judgments where going concern has sort of the salad oil in the barrel, that's a different concern.

You are looking to your auditing firm to validate the integrity of those numbers, but not to make the business judgments for you about potential excess returns and whether or not that's a failure or not and whether or not electric cars are the way of the future.

But I also acknowledge that's because we've got a group of people who make their living doing that. I am not talking about the retail investor where whether it's a rating agency downgrade or a going concern it may come as news to them in a much more dramatic way than it would for an institutional investor.

So in that sense, I do think that this question of the standard is one which just needs to be clarified. I agree with Mike that you got to get that straight or the courts, as Damon predicts, will get it straight for somebody at some point.

And, finally, I think Damon and I have had this conversation before, I don't think that looking to the four accounting firms to decide whether a SIFI is going to fail or not and whether or not they should announce that a major bank is not a going concern is something that we should look to the accounting industry to do.

And I suspect that there would be many conversations with many parts of the federal government if the accounting firm decided to say that about one of the two largest banks in the United States.

MEMBER CALLERY: Okay. Bob?

MEMBER TAROLA: Thanks, Grant. I have a few comments to make from a perspective of someone who has rendered going concern opinions and someone who has been on the side of disclosing going concern issues for an issuer.

For the most part it's not the auditor that identifies whether there is a going concern risk, it's inside the company and generally it's been there for a while, it doesn't just surprise you.

The surprise going concerns are often fraud related or some sort of accounting mystique-related, but the business going concerns are generally -- they generally evolve and they generally evolve either because of the market or because of what management is doing within the company, whether it's a squeeze on cash, whether it's some sort of structural profitability issue, or whether it's a contingency that needs to be resolved.

Those are all well-known and more often than not they are in the disclosure of the issuer's financial reports one place or another. If not in the financials, if not in the MDNA, they are in the risk factors.

So I actually think the term going concern is the problem. It's a lightning rod and it makes auditors and issuers come at odds with one another quite often.

The question of if you render one then I will -- then, of course, I'm going to go bankrupt. So what comes first the business problem or the disclosure problem?

I would suggest to the PCAOB to come up with a better way of highlighting this risk by the auditor so that investors know the auditor is concerned about what's embedded within the entire financial report without having to say that the financials might be wrong, as Damon pointed out, because they are based on some false premise.

That's where I think it falls away from me, that the financials might be wrong because they are based on some false premise, just get the word out and emphasize that.

MEMBER CALLERY: Okay. Okay, we've got seven minutes, so I'm going to suggest that we go down, Joe, Damon, and Tony, and be pretty concise because then I'd like to give Marty a quick opportunity to say are there things that you would've liked us to have talked about that would help you as you look toward that December 2016 date and trying to get your consultation done, or, obviously, any of the members of the Board, that we could chime in on before we sign off on this.

MEMBER CARCELLO: So, Grant, who do you want to go, me?

MEMBER CALLERY: Why don't you go first, okay.

MEMBER CARCELLO: Okay, all right. I'll try to be reasonably succinct. There is a lot to say on this topic so I'll do my best here.

I do agree with Ryan, it is an improvement to go out essentially 15 months rather than 12, I think that's the -- right, because it's a year from the date, so it's essentially -- right, March 15th.

So it's essentially 15 months rather than 12, so I think that's an improvement. I do think it's an improvement to have this done quarterly rather than annually. I think it would be hard to argue with that.

I am concerned when you put the responsibility entirely on management if you remove the auditor and here is why. Let me use an analogy that I think we could all relate to.

So if we were sitting here with a person sitting in front of us who weighed 400 pounds, who smoked three packs of cigarettes a day, who never did any exercise, and when we said what's your risk of a major cardiovascular event in the next year I think it would be very different than if we were asking a cardiologist.

And so the reality is it's hard I think for management. You wouldn't get to be the CEO if you didn't think you could turn things around. People don't get to that role if they don't have that belief.

And I think for the CEO and the CFO to say we are in a going concern situation it's more difficult than for an outside observer to do it. I also think it's important for the Board -- the going concern reporting has been around for a very long time.

We have had SAS 59 since 1988, if I remember correctly. Before that we had SAS 34, which was a slightly different version, but close enough for at least our discussion. And that's a long, long time, and to make a major change in kind of the regime I think there needs to be very strong evidence that it's necessary.

I also would encourage the Board, which I'm sure they've done, to look very carefully at the dissents by Mr. Linsmeier -- Dr. Linsmeier and by Mr. Smith, who I thought were quite elegant in their dissents.

Dr. Linsmeier said too late to be a significant benefit to users of the financial statements, probable, typically already know about the uncertainty and Larry Smith said decrease in the number of going concern disclosures as compared to current practice.

I think it's hard to argue with that. I think most people would say probables are a higher threshold than what's been used before. Granted, that may not have been consistent across auditors and auditing firms, and maybe there is an issue there, but I think it is hard to argue that this is not going to be a different threshold.

My prediction, we'll see if this is borne out, is if all groups reconcile around probable and it's probable for management, probable for the auditor, the number of opinions will go down.

I'll be very surprised if there is any stock market reaction to most, if any, of these. So then the question becomes if you are requiring a disclosure that no one cares about why are you even doing it exactly?

It's not even obvious to me why you are doing it. So I think these are all things that the Board needs to think about very, very carefully as it considers what the right steps forward are.

MEMBER CALLERY: Damon?

MEMBER SILVERS: I think it's sort of bizarre to suggest, as I think some have, I'm not saying Joe was actually saying this, but that no one cares about this. People care about this immensely.

Anyone who has ever been anywhere near or close to this issue in real life in a firm, this is a huge deal to the firm, to anyone who invests in it, this is a very, very big issue, and so that's A.

B, I can't imagine why -- the notion that management should have some obligation to say something about this is, I think, a reasonable idea.

But the idea that management rather than the auditor should say something about it is incoherent in relationship to the role that this issue plays in the structure of the audit function.

An auditor cannot, I think, issue an opinion without having made the judgment about this question, all right, it's not -- in the way that our financial system works it's not possible to do that.

So you can't take it away from the auditor in my view. And certainly I think you cannot do it consistent with the statute that we saw earlier.

Thirdly, I really, I appreciate Brandon's comment about the too big to fail issue because it puts it clearly on the table, right, but I would just say that we all need to pay attention to the way in which this is put clearly on the table.

If, you know, the Securities Exchange Act, the Securities Act, doesn't have an exception for too big to fail firms nor do the Auditing Standards nor the Financial Accounting Standards.

Until somebody is willing to write such an exception I would suggest that this Board, the FASB, the

SEC, have an obligation to enforce the law as written.

You know, a world in which the stockholders of large financial firms, or large firms in general as the chart was put up there, so it might suggest, a world in which those stockholders are immune from losses or immune from financial distress, we could build such a world.

I don't think that the American public would support doing so.

MEMBER CALLERY: Tony?

MEMBER SONDHI: I think that the FASB's decision with respect to the early warning disclosures, given their basis that these disclosures or something similar exists elsewhere, for example, in risk factors, makes you ask that question.

Has anybody noticed how often risk factors get changed? You know, I mean I have seen stone tablets that get changed more frequently than that.

And the other issue, of course, is one should take a look at those risk factors and ask why is it that a company that is in the business of, you know, say selling something on the internet versus somebody who is running a railroad have -- you know, to what extent should their risk factors be identical and how long should they stay that way.

The other question with respect to whether the IFRS and the FASB are doing things together, as Mike had raised, in fact today I would argue that -- or I would submit, rather, that over the last three years there have been more instances of divergence than of convergence.

The number of places where divergence is coming up is building up. The revenue standard, the leasing standard, the insurance standard, the IFRS 9 on measuring the bad debts in banks, the list of the differences is enormous.

I just don't see the convergence there anymore.

MEMBER CALLERY: Jim?

CHAIRMAN DOTY: Reacting to a ruling discussion I am tempted to ask some of you what you really think.

I do take note of the fact that you kicked the hardest question to the Board originally, and that is to determine whether probable as a threshold is in investor interest.

Then going to the remarks, Bob, and Tony, and Mike as well, to ask the right question and to think of this in terms of the dynamic of what the audit does.

What is the right question? Is the right question whether the threat of a going concern opinion and recognizing that it is not a good indicator -- it's not a good leading indicator of negative returns, but is the threat of going concern an additional force that provides better conduct, read Lehman, or does it provide a change of direction in a corporate enterprise that it needs, read Citi?

Because if it is then as a lawyer, and among ourselves we talk often about the different views or the different situations lawyers or auditors find themselves in here.

But as a lawyer and having sat in some of those discussions in which you try to change or amplify risk factors to produce more transparency it seems to me that one of the utilities of the auditor's threshold is simply to create better conduct or a change of conduct.

And if that is the uniform rule and if that's what SAB 99 was saying and if that's what the statute, Exchange Act 10A was saying, then it may well be that it doesn't matter whether the threshold comes down and it doesn't matter whether there is interpretive dissonance between a FASB or an IFRS standard, but rather whether in fact it is understood that the auditors and the corporate counsel are in league to use the threat of going concern to change conduct or to change corporate policies or to get management earlier to focus on the kind of negative return threats that Tony is talking about.

Is that what we should be looking at or asking after in a consultation paper when we are trying to decide what we should do?

MEMBER CALLERY: Steve?

CHAIRMAN HARRIS: Yes. Damon, I just wanted to follow up. You were talking about the conceptual backdrop of going concern and you were also on a committee as I recall studying the financial crisis.

We hear time and again that banks and financial services ought to be treated differently and somehow or other the going concern opinion may be applicable or should be applicable to the manufacturing sector and all the other sectors, but banking is based upon confidence and, you know, banks can go belly up overnight.

I agree that, you know, one cannot ignore the specific language of 10A, which requires auditors to evaluate a going concern opinion, but how do you react to what we hear time and again that somehow or other banks ought to be somehow or other separated aside from the normal going concern opinion?

MEMBER SILVERS: Steve, I would say a couple things about this, and I was, you know, very deeply involved in this in the Congressional Oversight Panel for TARP and in the course of doing that at one particularly tense moment in private Hank Paulson said to me just what you just said.

He said, "You know, absent confidence they are all dead". And there is -- I think there is deep truth in that. I think that in the course of evaluating a financial institution's status as a going concern, I think an auditor is perfectly entitled to take into consideration the unique circumstances of that business just as any other business.

The reason why I have harped so much on the specifics of what happened in 2008 was because in general looking at these issues, and, for example, if you looked at the companies that we have on the chart here, it's a little difficult sometimes to second guess folks, right.

Look at, well Enron was a very unique case, but if you look at a number of the companies up there you have to have a lot of detailed information about who knew what and when inside the firm, what was being -- what the company's management was disclosing to the auditors, and so on and so forth, hard to judge.

The case of Citigroup and Bank of America at the end of 2008 is not one of those cases where you can't figure it out, all right. We know, you can look in the work of the committee I served on, you can look at the Financial Crisis Inquiry Commission's work, you can look at contemporaneous reporting.

We know that the management of Citigroup informed the Treasury Department Thanksgiving week of 2008 that absent extraordinary assistance from TARP they would be insolvent within days.

And that extraordinary assistance was forthcoming but it was not -- that assistance was not guaranteed, right. There was no -- Citigroup had no right to that assistance. It could've been withdrawn.

A new administration was coming into office. It was a clear but-for situation, right, without the continuation of that cash, but the confidence that came with it, all right, Citigroup was insolvent.

And that happened to occur at the moment at which the financial statement was assessing the state of Citigroup's balance sheet. The same thing was true of Bank of America.

Bank of America came to the Treasury Department two weeks after the closing of its books at the end of the year and said if we do not get extraordinary assistance under TARP we will be insolvent.

And the insolvency both those institutions faced was a cash related one having to do with a loss of confidence, all right, but in those two circumstances it does not require an insider's view of those two institutions to be able to make the judgement that at the time that the auditor's opinion was rendered, at the date the auditor's opinion was rendered, they were dependent on the goodwill of the federal government to be solvent.

And at the time the auditor's opinion was signed, which I think was in March for those two institutions, that same circumstance continued to be true.

And so, Steve, the answer I think to your question is people come to you and say banks are different are right, but they're no more different than any other line of business.

Each type of business has its own indicia of whether they are a going concern. I do not believe it is true that if you consistently apply the rules around going concern, either the ones that sort of seem to exist today or any reasonable system that the PCAOB might apply, I do not believe if you do so that you will be forced into a position of saying that all banks are not going concerns at all times.

That would seem to be kind of the implication of what maybe some people have said to you. I don't think that's true at all and I think it's pretty clear the kinds of circumstances in which a bank is dependent upon uncertain outside infusions of cash to survive.

Yes, I think that situation exists with those two institutions at that time and, for example, I don't see any evidence to suggest that it exists with any large institution today.

CHAIRMAN HARRIS: Grant, I think if we go over for five minutes I think that would be fine. I see that Mike and Judge Sporkin have their cards up and then Marty Baumann, so I don't think we ought to stick right smack to the time schedule.

MEMBER CALLERY: Okay. Marty, do you want to go first?

MR. BAUMANN: Well I thought, as you said, at the end if you wanted me to wrap up I would, but I am happy to go first if you want.

MEMBER CALLERY: Well --

MR. BAUMANN: I'm happy to hear what Judge has to say and Mike Head and then why don't I comment then.

MEMBER CALLERY: Okay. Stanley?

JUDGE SPORKIN: In listening to this it seems that we are looking for a magic bullet here to tell us when we can issue such an opinion.

And I think what just was said makes more sense is let's break it down. Suppose the auditor and management say look, for this thing, for this company to exist next year it's going to require certain things.

We got to have certain financing that has to be available, that the product has to be still received by the public.

In other words it seems to me that we can break down the elements of going concern and that the management can certainly issue its views as well as the auditor as to whether there is going to be financing, whether the product is going to be there, whether the patents that have expired, and if those things are said I think that the public can make up its mind as to what's going on and I gather that the more severe the situation is I think that has to be stated.

In other words what you are doing is you are opening the screen for the public to have the same kind of information, not in the same degree as the discussions that have been going on in the company when they look at say what are we going to do for next year.

MEMBER CALLERY: Mike?

MEMBER HEAD: I'll just be real brief that based on what I just heard from Damon, and I was the partner on Citibank and Bank of America, under the current guidelines I would not have given them a going concern because I would have said that government support is meeting the probable threshold and as an auditor under AU 341 I would've met with my management and I would've had the discussions and I would've came to the conclusion not to give them a going concern because of the strong argument you just made that the government obviously evidenced they were going to, therefore, the threshold of probable is so low, unless you change it to an early warning you are eliminating that as being a going concern not making it a going concern.

MEMBER CALLERY: Marty?

MR. BAUMANN: Well, Grant, your first question to me was have you all given us valuable input for our consideration as part of the consultation paper and the answer to that is absolutely yes.

So thank you very much to you and to your group and then to the entire Investor Advisory Group for the input you have given us for further thought as we progress, hopefully promptly, on a staff consultation paper to lay out the issues and lay out possible solutions and get that feedback.

One or two points I'd like to make. A good point was made. I think it was Bob, and we have been thinking about this as part of that, that the word going concern is a lightning rod and can there be disclosures that, and can we have emphasis paragraphs that describe a situation where there's problems where there isn't that going concern lightning rod word as well.

That doesn't mean you get rid of going concern, but can you have the disclosures at a level that would not use the lightning rod word but would still get information out there to investors. So that's one thing and certainly something for us to think about.

Secondly, another one to think about is 10A is an audit responsibility. So FASB required management to make new disclosures but they didn't do anything about 10A which is an audit responsibility.

That still exists. The auditor still has -- so there's new accounting disclosures that weren't there before, but FASB didn't touch 10A. 10A deals with this is what has to happen in their audit, this is what an auditor has to do, and an auditor has to make certain evaluations and disclosures.

It is now up to us and the Board, with them working with us together, to determine how do we make sure this continues to be done properly and how do we reconcile that with the new management disclosures.

The management disclosures doesn't make 10A go away in any fashion, it doesn't make the audit responsibilities go away in any fashion, or the auditor's responsibility to comment when there is going concern concerns about that in the audit report.

The issue is the reconciliation of these different terminologies for us and what the reporting is on our end, so we have a lot to chew on.

And I guess the last comment I will make is, and someone else said this earlier, not being a going concern does not equal going into bankruptcy, I agree with that comment.

It means you are going to go through some sort of restructuring, some sort of significant change. Conditions aren't what they were before, but bankruptcy isn't the only outcome of that and that's an important thing to remember when we look at the research and other things.

Joe, we are aware of the significant amount of academic research and we have been studying that and it will be laid out in the paper.

So we've got a lot from this discussion and I appreciate it very much. Thanks, everybody.

CHAIRMAN HARRIS: Grant, thank you very much. I thought that was an enlightening discussion. Lunch is in the Arnold and Washington room and we will reconvene at 1:45.

(Whereupon, the above-entitled matter went off the record at 12:47 p.m. and resumed at 1:43 p.m.)

CHAIRMAN HARRIS: Okay, Tony, why don't we get started with the working group on PCAOB publications. And at the outset I know this has involved a terrific amount of work.

I've read some of the email traffic back and forth so I know you've had to, you know, put together a number of divergent viewpoints in terms of your presentation, so I obviously want to thank you and your group for all the effort that you've put into this.

So with that please go ahead.

MEMBER SONDHI: Thank you, Steve. And all right, let's get started on this. So I just want to mention that this is something that we had decided to take a look at and asked to do so.

Wanted to look at these two consultation papers, the one on Auditing Accounting Estimates and Fair Value Measurements and the second on the Auditor's Use of the Work of Specialists, and also third is the concepts release on Audit Quality Indicators now.

I know that we've discussed audit quality indicators before in this forum and it's also come up a few times earlier today, but we're going to take a slightly different look at it this time around.

So let's begin then, and let's take a look. In terms of just an introduction I wanted to point out that estimates, fair value measurements, the use of specialists and the audit quality indicators are all critical because to investors, from our perspective, the issue in essence is the integrity of the financial statements. There is a growing use of estimates.

Now obviously most people, if not everybody over here, knows estimates are sort of pervasive in financial reporting, and the larger the company, you know, the more you're going to see those estimates.

And some of them are as mundane as the ones you and I have seen for ages, such as the bad debt expense or the number of returns, and some of them are as complex as the fair value measurements which go into the Level 3 type of assets. For example, are the ones that don't have the kinds of markets that we need for either Level 1 or Level 2 measurements of fair value.

And it is certainly getting more and more complex because of the introduction of many of these different kinds of businesses. And it's not limited to the Facebooks and the LinkedIns and the Zyngas of the world, but companies like Tableau Software, Splunk and so on, the ones that do huge data analytics and so on.

The kinds of analyses they use, the kinds of estimates they use, those are very critical. The number of intellectual property assets that companies have and the ways in which they use them and the number of different acquisitions and divestitures of patents and those assets that occur, these are all creating and putting on additional layers of complexity.

Financial reporting is something that has also contributed. And, you know, I won't get into whether the standards are becoming more complex, or contracting and transactions are becoming more complex and that's why the standards need to follow them, but whichever it is the result is that we have more complicated financial statements.

And so by the way I do want to point out that that last bullet point there is an error. What I wanted to say there was we wanted to provide this prospective rather than anybody else asking us to do that. So please, I do apologize for that. Okay.

Let me now give you sort of just a quick look at the major recommendations that we have for each of the three publications that we looked at. Beginning with Auditing Accounting Estimates and Fair Value Measurements, I think it's very important that we as investors get additional disclosures that enhance the transparency and enable sensitivity analyses of the estimates that are used in financial statements.

It's very important to understand, for example, how a particular estimate goes from where it was at the end of the previous period to where it is today.

Roll-forward disclosures are being required more frequently, and I can tell you that as a member of, and currently chair, of the CFA Institute committee that responds to all the initiatives -- the FASB proposals, the IASB, we also write to the SEC and often and at times to you as well and I've served in that committee for more than 25 years now -- I can tell you that we've been focusing more and more on roll-forwards because that's what we need in order to understand what's going on in financial statements and it helps with that sort of incremental transparency that results.

Currently the standards make it optional to develop an expectation of estimates, and we really think that that ought to be mandatory. The auditors should be required to use external or objective or independently obtained data in order to audit the estimates, and then they should be required to compare management-provided estimates to the actual and report on those results over time. It's very helpful to understand how well those are performing.

We also recommend audits of the internal controls of the process that management uses to generate those estimates and fair value measures.

Now with respect to the audit quality indicators, our perspective, as I pointed out, sort of adds on to what has already been proposed at 28 different indicators that are in the concepts release. What we felt we need a little bit more, quite a bit more information on, I should say, is on firm leadership and the governance structure.

In essence, we need to understand how it's being operated and what's -- you know, this is sort of an attempt to get a better sense of the tone at the top as we discussed earlier today.

We also think that it's important to get a sense, a very good sense of the regulatory enforcement actions against the audit firm, any violations of auditor independence, disciplinary actions and so on.

And then, finally, our focus, the third kind of focus is on additional information about where the firm's revenues are coming from, the different business segments, get a better sense of the cross-subsidies, and effectively how those resources have been used and primarily in terms of their investment in technology and in training.

And this, it's very important that this

information be provided both within the audit practice specifically and firm-wide, so that if there is other work that you're doing like the advisory and so on, how that contributes would be a critical component of this disclosure.

The second consultation paper and our third topic is the issue of the use of the work of specialists. Now I want to start off here, I will get into this in some more detail, but I want to point out that I think this consultation paper was really well done. It's very comprehensive and it gave me a very, very good sense of where things are. And in using the information in that consultation paper, we wanted to emphasize the following issues.

So first we think we should strengthen the guidance of and require incremental disclosure on the auditor's use of employed and engaged specialists. So an employed specialist is one that has been hired by the auditor, the engaged specialist is one who doesn't work for the auditor but may actually work for the firm that they're auditing, right.

And that's something that I think is very important because it obviously affects the integrity and the objectivity of the work of the specialist. And again as the consultation makes it very clear, the current guidance and the supervision of the work of the specialist is, you know, just isn't very good. It needs to be stronger. It needs to be more specific.

I think that the auditor-audit committee communication with respect to the work of the specialist is very critical, and this is again in addition to the audit committee. I think the investors need to be informed of where and how they're going to be used, and I think there ought to be additional disclosure for the investors of the use and the audit of the work of the specialists, and I think that is currently one of the missing components.

So now let's take a look at the issues in some detail. Estimates are often difficult. And by the way, I can tell you that the estimates that will be required under the new revenue standard are going to pose some very interesting problems.

In addition to the new revenue standard, both the Boards, the IASB and the FASB, have been working on standards with respect to bad debt measurement by financial institutions, they've been working on new standards for the insurance industry. The estimates that'll be needed there are going to require significantly greater levels of expertise than we have today.

So I understand, and we understand, I should say, that fair values and these kinds of measures are difficult to develop, they're difficult to audit, but at the same time reliability is a critical characteristic that we need, and therefore it's important to emphasize that.

The primary sources of financial statement errors, in essence, I think one is there is a management bias, and it's critical that auditors exercise professional skepticism on that. It reminds me of what is probably the first line in my book on the analysis and use of financial statements, because one of my co-authors very strongly believes as I do in this, and we say in there that it's very important to be cynical and skeptical in order to be a good analyst. Because if you're merely going to take what management gives you, then it's a different profession than that of an analyst.

And I think the same holds for auditors. It's very critical that they be skeptical, so management bias is something that you have to fight. Auditors often audit to those estimates and don't pay enough attention -- or let me make it positive. I think it's important that they should pay more attention to what management assertions are, what data management is used, and that should be assessed, should be challenged.

And the second point there is that the auditor really should develop independent estimates and have recourse to external data in order to develop those estimates.

And then, finally, it's very important to have a much, much better improved understanding of the client's business, the economic rationale underlying those transactions and the control environment at the client. And very often, you know, it's the engagement partner who needs to have this understanding, and then it should extend to the team as well.

The KPMG comment letter to the staff consultation paper does a very good job of talking about the utility of external data and the evaluation of management estimates. And as a financial analyst this is something that I do routinely, because we take the numbers that management provides, we look at the financial statements, and then we ask is there other information that tells us something different, and we're developing our own estimates, and we're always checking these.

The 2013 CFA Institute comment letter to the Board on the auditor's reporting model had already -- has cited consistent findings over many surveys over many years of the importance that investors place on the audit report, and the survey results also highlight the call for more information on the basis of the auditor's opinion.

And that's what I would extend to their audits of estimates and fair value measures. I think we definitely need more information there. Investors have long noted that the audit team and the leader should have sufficient knowledge and experience in the industry, the business model and the transaction types that are employed by the company that they're auditing.

The financial reporting framework that applies to that entity is critical, and we need documentation for those transactions and framework and a good understanding of the internal controls framework that would apply to that particular economic or business model that the firm is using.

And auditors also should develop a better understanding of how investors use financial statement data in investment decisions. I've often heard that, you know, one of the most common things is the cash flow statement is not relevant, or the footnote disclosures on deferred taxes are not critical.

Well, when the IASB had proposed a new standard on taxes, the CFA Institute sent them a comment letter and talked about this, and they said we -- the board wrote back to us and said we don't understand why you're talking about this, so we sent them an explanation of how investors, analysts use different taxes.

And I still have the letter from the board that says that we're very grateful because we now actually know why this matters to people. So it's very important that one understands how the information is being used.

I think in terms of recommendations I would add to the comment that I made at the start that we need to enhance transparency to enable sensitive analysis. One relevant area would be range and dispersion measures, write up observations that are used to derive estimates. So what is the basis of that estimate? Because having a single number in a financial statement doesn't necessarily help evaluate how well it reflects what's going on.

We need additional information on the assumptions that are significant or material to different estimates in the financial statements. And then there's very often information that is material to an estimate or a fair value measurement, but at the same time, it's not otherwise required by any standards. So none of the guidance requires it, but it has become more important, and that information is a critical piece of the basis for saying that this estimate works or doesn't work.

And then, finally, on this slide I think it's important to highlight the financial statement, particularly the income statement consequences of the non-cash adjustments to reserves and other balances in a performance standard.

At times, you know, I'm surprised by the way the FASB proposes certain things. A very recent one, for example, was where they were talking about a roll-forward, it's in the new revenue standard, a roll-forward for certain costs that will be deferred.

But one of the most important things that affects it very often is if you have foreign operations. Then the exchange rate effect has an impact on the movement from the beginning to the ending balance as well, and if you don't have that, you're not going to understand how it got there, or you're going to have an incorrect assessment of how you got there.

And then I mentioned earlier the current optional development of expectation of estimates by the auditors should be made mandatory, and I've given you the auditing standards that deal with that. I think management should provide auditors with more information underlying the models that they've used that would then help the auditors to evaluate the level and the accuracy of those prior estimates.

And then, finally, auditors should be required to critically judge management estimates by using independent source data. So this is the external data argument that I have made earlier.

The audit partner and the team, I think, needs sufficient expertise in the economics underlying the business models. I think there's a need for more rigorous testing of the internal controls and that surround the development of those estimates.

And then, and I think that the, you know, it's very important that the PCAOB require the use of objective or external data in audits of estimates, so that ought to be sort of the linchpin of those tests.

Auditors should be also required to obtain the evidence needed to audit those disclosures and that assessment should then should be reported separately. And then the PCAOB, I think, should, we believe should develop audit standards using these requirements, but it's also important to work with the SEC to ensure enforcement.

And then there's a level or a stage at which this needs to go in, and that is to work with the FASB and the IASB when they're developing these standards to ensure that we don't get to a point where we don't have something that can be managed.

Okay, I'm sorry. Jump to the slide there, I believe. For the audit quality indicators, as I said earlier, I think most of these things are really well known. But they're critical, largely, I think, very importantly, because they help us measure and manage audits, and they would help investors and audit committees then compare audit quality.

They would provide much needed data for the selection of audit firms and then, finally, obviously, it would help in terms of your monitoring risks.

The three areas in which that we talked about the audit quality indicators, I think with respect to firm leadership it's, you know, how it is selected. A much more comprehensive discussion of the governance structure is needed, so we need audit quality indicators of that. And then third, a ratio of audit staff to partners.

And, you know, this can't be sort of a firm-wide thing. It has to be by different business segments and so on in order to make it to be of any value.

With respect to other information about the audit firm, qualified reports on their internal controls, any enforcement actions, disclosure of violation of auditor independence, and then also percentage of audit reports and internal controls that have reported material weaknesses.

And you can combine this with some of the other issues that we've talked about earlier. You know, some of the comments that we've discussed or issues that we've discussed that relate to going concern come to mind when talking about this particular requirement here.

And then, finally, a three-year moving average of practice protection costs related to the audit practice that would be a useful indicator as well.

Within the audit practice specifically and firm-wide, I think it would be important to understand where the revenue comes from disaggregated by business line, what profit sharing and subsidies are provided by specific business lines to others, and then, finally, the percentage of the firm's revenues that are invested in technology and in training.

And again, you know, if these are provided at a high level they're not going to help. It's important to understand some details about this.

Then our third category, of course, is the auditor's use of the work of specialists. And I've pointed out this issue of the increasing complexity, so I won't go back into it. Effectively as I said, it's complexity in contracting, it's complexity in business models, and then third, this new class of intangible or intellectual property assets and the ways in which they're being used.

Those are some of the reasons why we need more specialists these days in audits. The auditors' use of specialists certainly raises critical questions about the objectivity and the transparency in and the reliability of the financial statements.

Now the current standards require that the employed specialists be independent of the entity being audited, however, the auditor's engaged specialist is not required to be independent. And I think that's a significant issue there. We encourage the staff's efforts to learn more about audits of the clients' proprietary valuation models.

See, the problem with these types of models is that you really can't get a lot of information about them, so the way the audit gets conducted, we really need to rethink that. We need to work on that and come up with some more specific recommendations on how to change that.

But as I pointed out, this was discussed in the staff consultation paper, and I think they've done a very good job of this aspect of it as well.

Other PCAOB staff observations in that paper which I think are important, fair value measurements are often audited, they note, by testing significant assumptions that are used by the company and its employed or engaged specialists. They also test the valuation models that the company uses as well as the underlying data.

The question is whether they should stop there, of course. You know, what kind of independent assessment do you need to ensure that this works?

Hand-off issues. There are times when auditors and the specialists may have disagreements with respect to the scope of their work or the auditor may not adequately assess the work done by the specialist or at times may not have the expertise to do so.

And then, finally, you have this, you resolve the discrepancies and differences that are reported by the specialists. The PCAOB consultation paper also notes that multiple specialists, as many as five, if I remember correctly, were used in the majority of audits of large, global accounting firms, and those specialists often provide help to the auditors on more than one area of expertise. I believe the average there was two.

And then it appears as if the scale of the problem is lower in audits by smaller firms, but you'd expect that because the more complex problems are likely to exist at the larger firms.

Some more background. Currently 328 requires the auditor to evaluate the reasonableness of the company's specialist. Now standards in the supervision of the audit engagement, however, don't have specific guidance on the use of the work of the specialist. And there again, with the exception of that one footnote, there's little guidance on hand-off issues.

The 2013 IAASB post-implementation review also pointed out how difficult this exercise is. And then the paper also notes inspections where you've found issues with respect to the work of the specialist, and then there are enforcement actions in addition.

In terms of the recommendations, I think the most important one may be the need to strengthen the guidance often require incremental disclosure of the auditor's use of specialists in general, right, and specifically the use of specialists that are employed by the company being audited.

We also need more specific guidance on the use of the work of specialists by the auditor and the auditor-specialist communications and then improvements in 336. And I think you add to this that it's critical to have communications with the audit committee on many of these issues.

And so there it is, the need to specify auditor communication with and different disclosures to the audit committee with respect of the use of specialists. And particularly I think the focus should be on a communication of those hand-off issues because that's where there were disagreements.

So what were those disagreements, how critical are they to the financial statements and how were they resolved? That's something that I think the audit committee needs to be aware of.

The auditor should also be required to disclose information relating to potential impairment of the specialist's objectivity, including any fees for services unrelated to the audit, and there again, as I point out, some details would be very helpful.

So now before I go there though I wanted to -- and I hope I've left some time for the other team members to make comments. I'm working here at a disadvantage because one of my team members is ill and can't be here, but I've tried very hard to get Lynn's perspective across in these slides.

But Gary, Larry and Bob Mercer, any thoughts? Norman?

MEMBER SHOVER: I might as well start, thank you. And this is coming completely through the lens of a portfolio manager. As somebody who's acting as a CIO of a mutual fund, I appreciate, deeply appreciate what auditors and accounting people do, but it's just not my skill set.

Anyway when it comes to fair valuation, I think you need to be encouraged that the rules today have effectively telegraphed the inherent subjectivity of a valuation, something that perhaps wasn't so well telegraphed before.

And with that in mind, with fair valuation, to prove that, I guess, is that these valuations can be grouped Level 1, Level 2, Level 3, again helping the investor understand that these valuations are subject to a lot of subjectivity. It's not written in stone.

At the end of the day, investors, what do they want? They simply want to understand the approach and have confidence that the inputs were accurate. And so I think the better that that's telegraphed, the better off we all will be.

And if you don't mind, I just want to make one other point that's near and dear to my heart. I guess a challenge would be investors would benefit from having fair value measurement procedures included as a separate standard.

I don't know if that's something that you would laugh about or roll your eyes at, but I think that would be important for the investor to have. The entity must have clear guidance with regard to acceptable approaches to valuation and also providing full disclosure of the approach and the inputs utilized.

In my world I think that would solve the problem, and it sounds like it's easily solved, but again from an investor's standpoint, that's how I see it.

MEMBER SONDHI: Thanks, Larry.

Bob, do you want to go next?

MEMBER TAROLA: Thanks, Tony. Great job putting that forward. I've a few things I want to comment upon.

First of all, we need to distinguish between accounting and auditing. Much of this deals with accounting. And I certainly don't want any of the folks observing this proceeding to think that accountants can't make good faith, reasoned, reasonable estimates, or frankly that auditors can't audit in a good faith manner and come to a conclusion that the estimates are reasonable. And estimates vary in complexity from Level 3 investments where there might be little information available to the risk of complex litigation to the risk of collecting money and other risks in the financial statements.

I'm in favor of our group's conclusion that perhaps transparency and complete independence are two important elements to help investors be comfortable with the process of accountants making estimates, audit committees reviewing the accountant's work, auditors reviewing the accountant's work, regulators reviewing the accountant's work, so there's a lot of review in this process of estimation.

The use of inside or outside specialists, I think that needs to be understood better, and whether it's inside or outside, there are different risks to the audit in my estimation. Are your insiders really proficient? Are your outsiders really independent?

And so that would present some, I think, some regulatory audit standard to help to make sure that the auditing is as rigorous as it can and should be. But the idea that estimates are somehow new risks in financial reporting, they're not. They've always been there, and accountants and auditors have been able to deal with them for a long time.

MEMBER SONDHI: Thank you, Bob.

Norman.

MEMBER HARRISON: Thank you, Tony. I'll be very brief because I think you did a terrific job of summarizing our work and the recommendations.

I'd just highlight a couple of points. One is on the issue of specialists and disclosures. I think it's an important illustration of the weave of the fabric of the issues we talk about in this group because there are a lot of overlaps and interrelations. And this one in particular does come to the issue, as Bob and others indicated, of independence.

And I think failing robust disclosures, at least around the use of engaged specialists and information about their prior and other relationships with the issuer, you have a significant risk of a back-door independence issue that otherwise won't be apparent, and I think it's important that the steps be taken to address that.

On the issue of the audit quality indicators, I spoke a bit about that earlier. We'll have, I know -- I expect a further group discussion about that. The only observation I would make is that, you know, again, it's not a new issue.

I know that the Board's publication is of relatively recent origin but the issue's been around a long time. As we pointed out in one of our slides, it was one of the recommendations highlighted in the Paulson Commission's work.

I think when we're dealing with a topic like this one where it isn't an issue of this rule or that rule or this standard or this threshold that there is an array of outcomes here. There's a long list of possible indicators.

I think we've tried to give some guidance as to ones we think are particularly important. I don't think any of us believes that there is only ideal or a perfect list or a set that will ever be derived through whatever level of consultation and discussion and debate. I would urge the Board in this instance not to let the perfect become the enemy of the good and to take some action.

Let's get started on this. Promulgate an initial set that seems to have some consensus behind it with the knowledge that experience will tell you how you've done in the investing community through boards like this, and other bodies will provide feedback. But I think we've been talking about it for quite a while, and I'd urge we get to at least a starting point and get something done. Thanks.

MEMBER SONDHI: Steve, I just want to make one quick comment. I just wanted to mention that, you know, I agree, estimates have been around for a long time, but, you know, I also think that the change in marketplace needs a different focus. It calls for a different focus. You know, I'll give you an example.

A couple of years back, or maybe it has been a little less than that, one of the gaming companies announced that they actually had a profitable quarter. And the reason was that, you know, people playing this particular game would purchase long-lived assets from the company, and they would purchase perishables. And the perishables were easy, because when players purchased those you'd recognize revenue right away. But for the perishables, you had to use an estimate of how long those perishables -- I'm sorry, for the long-lived ones, you had to develop an estimate.

And what this company was doing was basing their estimate on how long an average player played the games and taking the revenue for those long-lived assets over that period. And this period they reported a profit because the number of players had declined, and they were playing for a much shorter period, so this was an estimate. It's perfectly fine. You know, we can discuss that.

But the point is that this was a place where based on that estimation technique, because their market was dwindling, because their business was declining, they ended up reporting a profit.

And I think that's the distinction that I'm trying to get at is that estimates, yes, they've been around forever, and I know a lot of people do a great job of it. The fundamental point though is that they've changed a great deal.

CHAIRMAN DOTY: This is a fascinating discussion because again as an auditor, I've just finished reading an article by a very bright professor named Steven Glover. He was at Brigham Young. And Steven's a very clever guy, an articulate, clever guy, and he argues well.

He has a paper now which is based on a laboratory hypothetical experiment in which he interviews audit partners and engagement partners. And it's about something Bob Tarola said that just clicks with it, and that is if you read Steven's paper, and you're a layman, you come away with the sense that maybe it's just too tough, that it can't be done.

Now he is arguing that our rules that the current standards, unchanged, impose perverse incentives, economic incentives on the auditor, and in fact discourage independence, objectivity and skepticism in the performance of the audit estimates.

I raise this because it seems to me the questions that are coming out of the group raise some questions as to whether his survey is well-based. I would be interested in knowing if people read Steven Glover's piece. He's very transparent about his methodology, about how he selected and what the universe of persons interviewed are.

But the conclusions that he draws or seems to me to be drawing from the persons interviewed are really quite different from the conclusions that the investment advisory group were coming up with from experience. And that is that more specific guidance that actually requires more by way of auditing internal controls are needed, that in fact auditors can do this, have been doing it a long time, and there are many estimates they could make.

He seems to be retreating into the argument that it's just so tough that whatever the auditor decides with the length of the chancellor's foot based on his judgment, based on just what he thinks, ought to be enough for an audit standard.

And that's not what I hear the investor advisory group saying, but this is a request that people read it, and let us know what you think. As I say, Glover's very, he's a very capable guy, but what you're seeing seems to suggest that maybe there's a different view, a different slant entirely on the implications he has on the standards and what auditors do in the estimate.

CHAIRMAN HARRIS: A couple of you have raised the issue of independence risks associated with the engagement specialists, and I'm wondering whether or not you have any recommendations in terms of how those issues ought to be addressed.

MEMBER HARRISON: Steve, I think what you're concerned about in the first instance is the history, if any, of the specialist with the issue or business relationship either during or preceding the audit period, have they done other work for them, and if so, what level of fees have been paid.

And I think I'd really like to know if it was a significant portion of their business, particularly if it was an individual or a small consulting firm that's been called in for a specialized task, was the issuer some meaningful percentage of their revenue over a prescribed period of time.

I think it's an issue of financial, other financial ties and dependence on the issuer as a client that would be high on my list of concerns.

CHAIRMAN HARRIS: Well, there are a number of tent cards up. I don't know whether you want to recognize them, Tony, or I will. But Chief Accountant Schnurr has his card up and Steve Kroll and Chairman Doty and Joe Carcello, so --

MEMBER SONDHI: Okay.

CHAIRMAN HARRIS: -- why don't you be the conductor?

MEMBER SONDHI: And Jeanette, do you want to, did you have -- is your card up there? Oh, it's Steve. Okay, go ahead.

MR. SCHNURR: Just a couple of questions. The first recommendation that you have is on the wanting accounting estimates and fair value is that prescribing auditor disclosures, and there are four bullets to that.

And I'm, first of all, questioning whether you meant auditor disclosures, or did you mean company disclosures? Because these are typically things that I think to some extent have been dealt with as part of the audit reporting project, and conclusions around or comments around the fact that information about the company's financial statement should be provided by management and not by auditors. So that's my first question.

And in terms of trying to better understand the bullet, you know, for example, the third bullet is information material to financial statements but not otherwise required by reporting and regulatory standards. I'm not exactly sure how you would even make that determination.

I mean, there are certainly securities and laws around information that is material that has to be disclosed, but I'm not sure how if you're trying to burden the auditor with the idea of trying to search everything to determine what's not in the financial statements is now their responsibility to try to determine what is material that's not in there. So that's kind of my first question.

There is on the following slide in terms of recommendation, the requirement that an expectation of estimates should be mandatory. And what I'm really struggling with that is, you know, if you look at a big financial institution or some others who have loan-loss models, are you suggesting that the audit firm would have to create their own model to estimate those losses? Because that would be a daunting task for them to have to do with respect to each of their clients.

And so I think, you know, there are certainly situations where it's easier for a company or for an audit firm to do their own independent estimate of a particular instrument, but if you're talking about other estimates other than, you know, financial instruments, I think it's -- you know, I'm just having a hard time understanding how that would be something that could actually be implemented and have the financial statements being audited and reported on in a timely manner.

So those are, really, with respect to, you know, the auditing and accounting estimates and fair value, those are kind of my big questions.

MEMBER SONDHI: Anybody can jump in, but I'm just going to make a couple of quick comments in response. The first issue was with respect to who is required to provide that disclosure. And, you know, I'd clarify that by saying that much of this information, if it's not already being provided by management, has to be available in order to enable the auditor to conduct a comprehensive test of these. Some of that information will have to be provided outside that world and in the financial statements in order to enable investors to better understand what the basis of those estimates is.

So what I'm suggesting is that there are places where the information available is not sufficient for me as an outsider, as an analyst, to fully evaluate whether those things are, whether those estimates, those fair value measures are as good as that.

I'd go, for example, with derivatives. There are times when I've seen derivative disclosures where it's very hard to say, you know, what direction of risk the company has taken. Those disclosures are almost completely opaque. And I was looking, I actually went to the dictionary to see if I could find a stronger word than opaque. But they're absurd. There's no way to understand what those things are saying, so there has to be additional information available to allow us to get a better sense of them.

So there are two possibilities. There's two sides of this. Some of it the auditor needs more of, and some of it we need outside need more of. You're obviously right about information that's material but not currently required. I'm not asking for the auditor to go look for every single possibility.

I'm saying where management has used something which they would not otherwise be required to disclose, I think they need to tell the auditor that, what the basis is. And then there'll have to be judgment in terms of whether that's publicly disclosed within the boundaries of these securities laws, et cetera, that you mentioned.

With respect to the auditor's replication of the models, and I, you know, I certainly agree with you that with respect to the financial instruments world and the banking, financial institutions world, that some of those requirements are going to be very, very difficult. The fundamental question for me as an investor is what is it that I'm going to need to ensure that that's reliable information?

I'm not asking for something, you know, for a complete replication, but there has to be something other and something more than simply taking what is given and performing some tests. So that's there, there's a question of what has to be done. Okay.

Steve, you want to go?

BOARD MEMBER KROLL: Thank you. First, I want to thank the group. These are, although they're not a lot of slides, I know how much thought went into this and it's going to be very helpful to us going forward. I do, I would ask, and I don't want to go into it here, but I just thought I would like to raise a question that maybe we can discuss offline at some point.

Several of these recommendations, ratio of audit staff to partners, reports on internal controls and enforcement actions, percentage of audit reports that reported material weakness, are slight, slight variations on AQIs we've already got. So the question is, is the idea that we've got to tune them up a little bit or is there something more fundamental missing?

But as I say, I just, the problem with this subject is that it gets pretty granular pretty quickly. And we don't need to do that here, but if maybe we could talk offline about that question. But thank you very much for your thoughtfulness.

BOARD MEMBER FRANZEL: Yes, I have a question on one of the recommendations for the auditing accounting estimates and fair value measurements. It's the recommendation that auditors test and report on the internal controls, relevance, reliability and appropriateness of the models, data and assumptions underlying the process of management's development of estimates.

So under our current standards, you know, this would be happening under the risk assessment model and the current assumptions of materiality and so on. Are you suggesting something beyond what's in the current standards, and what would you envision?

MEMBER SONDHI: I think it's more of an issue of -- I understand that this is supposed to be happening. The question is, are the issues whether we're being provided as investors, provided enough information about these tests? And so the idea, the objective would be to develop a way to provide this information more specifically, more clearly.

BOARD MEMBER FRANZEL: So you're really talking more about a disclosure matter rather than changing the risk assessment and internal control auditing standards at this point.

MEMBER SONDHI: It's mostly a change in disclosure, I agree, because it's not clear to me what's happening with respect to that.

Joe, you want to go next?

MEMBER CARCELLO: Thanks, Tony, and thank you to you and your group for your work here. It's a number of things, I think, are interesting, and we're talking about it.

So Jim, in response to the Glover paper, as you may know it will be presented at the end of October at the Contemporary Accounting Research Conference in Vancouver. So since you probably won't be there, there will be a discussant. I will be there. There will be a hundred well known academics there, so I can give you or Samantha a report on kind of the criticisms of that paper or the compliments of that paper, so you'll get some feedback on that. It'll be vetted pretty thoroughly.

In terms of, Tony, your slides, I think the comparing management estimates to actual results, which I think Jeanette just asked about, is one of the more important recommendations.

And I do think there is an issue of maybe better disclosure, which I guess is more of an SEC issue than a PCAOB issue. I can't think of the relevant part of, I guess it's -- I always get S-X and S-K mixed up where I am.

But there's already a requirement, I think, around accounts receivable that, I forget the number or the -- but you have beginning of the year, you know, bad debt expense for the year, charge-offs, write-offs, and then end of year. So you can basically then map the expense from prior years at least to some extent into the current year's write-offs. It's not perfect, but you can get a rough sense of that.

And so that exists right now or at least around accounts receivable. I don't think it's a GAPP requirement; it's an SEC requirement. And so maybe more of that type of disclosure would be helpful.

As you may remember, when we did the survey on the audit report a few years ago, and we asked investors what they wanted, the number one item was more information around estimates and judgments. That was the single most important item. So, you know, maybe that's an SEC issue, maybe that's a PCAOB issues, but it's a very important issue.

In terms of, Tony, your Slide A, in terms of information on firm leadership and how it is selected, I think that's really important particularly as we think about culture of firms, particularly as we think about growth in consulting, but I don't think this is granular enough.

So if, you know, pick a firm. If KPMG puts in place a new CEO or senior partner, whatever they call that person, and you give the vote, that doesn't really tell me what I want to know. What I want to know is what was the vote by the audit partners. So if the overall vote was 80 percent but the vote by the audit partners was 35 percent, that's a very, very different message, and I think a very important message.

I think someone asked you this already, maybe Steve, about percentage of audit reports and internal controls that reported a material weakness. As Steve talked about, this is already kind of a derivation of this; it's already in the AQIs.

I think, with all due respect, Tony, to you and your group, I think what they already have in their AQI is probably better than this. Because unless I'm misreading this, percentage of audit reports and internal controls that reported a material weakness, so to optimize this I'd give every client a material weakness? That doesn't make any sense, right.

So what you want is material weakness that you want ICFR reports to be adverse in advance of problems. That's useful. That's really useful. But you don't want just blanket adverse reports on internal control. That doesn't tell me a lot.

And then in terms of, I do think there's a major issue here around treating engaged specialists different from employed specialists. And in fact, as you point out in Slide whatever it is, it's on Page 10 that an auditor's employed specialist must be independent but an engaged specialist is not, the only word I can think of for that is ludicrous. I can't even think of another word that would describe that.

So if I have an engaged specialist and I do a ton of work for management that's okay, but if the specialist is employed he or she has to be -- I can't even reconcile that. So maybe someone smarter here can reconcile that.

The thing that makes me uncomfortable, and, Marty, you probably saw this in my comment letter if you've read it, is, and maybe I'm misreading your document around engagement partner identification and identification of other firm participants.

But at least the way I'm reading this, and if I'm reading it wrong you'll correct me, is on Page 11 the disclosure requirements and computation of total audit hours presented in Appendix 1 have been modified to exclude specialists engaged, not employed, by the auditor. This change -- and then they explain why.

But it would seem to me, if I'm reading that right, it would go in the direction, Tony, opposite what your group is recommending because you'd have even less visibility around the use of engaged specialists. At least the way it was written originally you'd have some visibility around the use of engaged specialists. No? Reading it wrong?

MR. BAUMANN: Well, you wouldn't have visibility around the use of engaged specialists, they would be in the denominator of the calculation of the total hours. And so if you're trying to say the total hours on the job were a hundred thousand, if you added in the engaged specialist they're a hundred and one thousand. But then you're trying to figure out, well, what percentage of the work was done in XYZ firm in London, XYZ firm in Hong Kong, et cetera, so it's really on a denominator issue. It's not a disclosure issue.

MEMBER CARCELLO: Okay, so they were never going to have been disclosed.

MR. BAUMANN: They were never going to be disclosed under that.

MEMBER CARCELLO: Okay, okay. Well, maybe they, well, I still think that's an issue, maybe not around this particular stand.

MR. BAUMANN: What the recommendation's being made here is that you think there should be some sort of disclosure when auditors rely on engaged specialists.

MEMBER CARCELLO: Yes.

MR. BAUMANN: But that was not part of the transparency disclosures ever, but that's a recommendation coming out of your group.

MEMBER CARCELLO: Okay. So those are some thoughts in response to what you have.

MEMBER SONDHI: Thank you, Joe. Let me just briefly comment on some of these things. Some of the AQI recommendations are certainly on similar issues, but one of the reasons we've drawn them out here and are emphasizing them is because we feel that additional work is needed to change the way we look at those.

So it's not that the proposals and the concepts release are not there or they're not correct or anything, it's just the point is from an investor's perspective we were looking at it a little bit differently and we'd like to see something more than that.

Similarly, as you pointed out with respect to the percentage of audit reports and so on, absolutely. I think your, I appreciate very much your adding that. because in and of itself the number's irrelevant. It's not going to tell me anything, you're right. If you combine it with something as you said, you know, then yes.

But that's what I think the challenge is. I think we need to move in that direction. We need to think about the audit quality indicators as not being percentages of this or that, just as you said with the firm, you know, the new CEO's vote is 80 percent but only 35 percent of the audit partners voted for him, then that's information. That data point has some value.

So that's the objective here is to try to point out some of these so that we can go back and take another look at them and say what is that that would make that particular indicator actually useful, even more useful, let's say. I'm not saying that they aren't. Okay, and I appreciate the comment on the engaged versus the employed, and I think that is certainly an important recommendation there. Marty?

MR. BAUMANN: Thanks. I just wanted to go back to something that Jim Schnurr said earlier. And Jim, it's really a comment that is, it was the question about accounting versus auditing issues on these recommendations. And your recommendations, really, are quite similar to many of the comment letters we received on the estimates paper in that regard, in that many of them PCAOB can only do so much in terms of improving audits of estimates. There really needs to be greater disclosure about the sensitivity, assumptions, models, measurement uncertainty needs greater disclosure.

And so the recommendation was that, from a lot of commenters, that really was an issue for PCAOB, FASB and SEC to address that, yes, we had a piece of it to improve auditing standards, but that many of the commenters thought there was the need for improved disclosures at the same time so there would be a greater understanding around how important the assumptions, how sensitive the estimate was to assumptions, how much measurement uncertainty there might be in a particular estimate.

So a lot of these things seem to sound a lot like that and they sort of, I don't want to say mix up, but the comment letters we got were both recommendations on accounting and recommendations on auditing in saying, well, I guess you all have to work together to solve them, and I think that's coming through here as well.

MEMBER SONDHI: Thanks, Marty. I think that as you said we did try to point that out that we need that. The need for disclosure is something that I, you know, I find it absolutely critical being an analyst.

But I have found that it often does get short shrift. The new revenue standard is a great example. The core principle of the new revenue standard says revenues should be recognized when goods and services are transferred in the amount, and so now you've got recognition and measurement in the amount that the seller expects to be entitled to, and then it stops. Not a word on disclosure in the core principle and I find that very odd.

Now it so happens that the new revenue standard has a lot of disclosure proposals and so on and it actually does a very good job, but I think it's indicative when the core principle is silent on one of the three basic components of financial reporting. So I find that, you know, that happens a great deal.

And I don't, you know, I agree with you with respect to the accounting versus the auditing issue. I think there are places where it's very difficult to draw the line. It is very important that the three entities work together to ensure that they're talking about the same thing.

As you said, you've got one piece of it, the SEC's got another piece of it and the FASB has a third piece of it. And it's critical that they all work together. This is a lot of our investments at risk in the way this whole thing works out. You're too close, that's why.

MEMBER SILVERS: That's all right. Really, in the spirit of the last two comments, and going back, Jim, to a couple of the questions that you posed. You know, this body and the SAG have been talking about problems around both estimates, fair value estimates and, fair value measurements and estimates for some time for some years, and as has been noted, there is a kind of interweaving here of different people's jurisdictions.

And I was sort of curious, you know, what your view is. I understand you don't speak for anybody but yourself, but I'm curious as to what your view is sitting over at the Commission as to what ought to be done in this area to strengthen the audit in light of the growing prominence of these two features.

MR. SCHNURR: You know, in looking at -- particularly, let's talk about fair value measurement, certainly there have been hundreds of comments that the PCAOB has issued in Part 1. But if I step back from that and I look at how many restatements have come out of that there's virtually none and very little. There haven't been a lot of enforcement actions. There are no, you know, restatements.

So certainly we need to focus on the implementation of the, or the execution, performance of the auditing standards, and I do think there is confusion around the various sections in the audit or in literature that deal with accounting, auditing of these estimates.

So I think there is certainly room for improvement in the auditing standards, but when I step back and say, is there a really big problem here with the actual estimates that are being made and are in the financial statements, I don't see any manifestation that those estimates have been materially misstated, because we haven't seen restatements coming out of this. And eventually though those would have to manifest themselves over an extended period of time. They just don't, you can't just, the auditors couldn't get lucky that many times with respect to not performing the audit procedures.

So I think this is, it's a complicated area. I do think there's certainly an area that needs to be improved and I have been very supportive of the PCAOB moving forward with this project. But I'm questioning whether or not there's a big financial reporting problem here as opposed to an auditing problem.

MEMBER SILVERS: If you don't mind, I can't resist asking where do you think that type of problem currently exists in the financial reporting system?

Meaning, if this issue isn't driving restatements, what do you see as driving restatements and what steps are you taking in those areas?

MR. SCHNURR: Well, as I said, I haven't observed a lot of restatements as it relates to measurements of fair value. So I'm not seeing those, so that's why I'm saying I don't see it as a financial reporting problem. That companies are doing a reasonably good job of making the estimates and, you know, they're doing it based on the standards.

There might be deficiencies with respect to valuation methodology, and that's a whole separate discussion that, you know, that probably could be addressed at some time, but that doesn't relate to the auditing of the estimates.

MEMBER SILVERS: That's not the question I'm asking you. I'm asking you what are you doing in the areas that you do see as driving restatements? I want to be reassured that you're doing something about something.

MR. SCHNURR: Well, obviously when a restatement occurs there are several things that the, you know, our

Commission staff would do. One of the things that we --

MEMBER SILVERS: But I'm not asking what you would do, I'm asking what you are doing.

MR. SCHNURR: No, as I'm saying what that we do.

MEMBER SILVERS: Because what I have the impression of is the answer is always no. That the Commission's accounting staff is standing in the way of meaningful action on issues that have been before the PCAOB and where investors have been advising the Commission this is serious stuff for a decade. That's what I see. So tell me, what is it you all are actually doing?

MR. SCHNURR: Well, what we do when there is a restatement is, first of all, we will question around the question so whether the controls were in place. There's also the enforcement obviously, we would then take a look at that and --

MEMBER SILVERS: Again, I'm not asking you what you would do.

CHAIRMAN HARRIS: Damon, actually, I don't want to get into too much of the contentious back and forth here.

MEMBER SILVERS: Okay, I've made my point.

CHAIRMAN HARRIS: I think your point is well taken, and Jim, unless you want to, you know, respond --

MR. SCHNURR: No, I'm happy to take this offline with Damon at some point, but I don't think it's constructive in this.

CHAIRMAN HARRIS: Yes, why don't we do that. And then Curt --

MEMBER BUSER: If I could though just add to what Jim has said, just in terms of the work that we've been doing from an internal controls perspective, focused on with Corp Fin and enforcement, the areas where we are seeing the highest degree of restatements, areas of cash flows, certain areas relative to revenue.

We have in fact been very active relative to Jim's points, making sure that companies are identifying on a timely basis material weaknesses and disclosing those. I think you'd find that there are more enforcement actions and more investigations in this space than we've had ever before.

You know, I think it's unfair to suggest and inappropriate to suggest that where there are areas of problems in financial reporting we're not taking action. I think the record is very clear on that.

CHAIRMAN HARRIS: Tony, why don't we move to you and then, well, no, Curt had his tent card up for ten minutes. And then Tony, and then I'll ask a question, and then Mike, and then we'll break.

MEMBER SONDHI: I just wanted to make a comment in response to this issue that's been going around here as to whether there are restatements of fair value. And I think that may be in part due to the nature of that particular estimate of fair value. It's not because you don't have remeasurements and you don't have restatements, I think the question, if you're looking for restatements I think you're looking at the wrong thing. I think you have to ask a very different question. And, but I will take your point and we can do this differently later and offline.

But let me first go to Curt, and then Mike. Did you have, do you still have your -- okay. You can leave it down. I'll come back to you. But Curt, would you go ahead please?

MEMBER BUSER: Sure. So, first, thanks to the team for putting these together, because these are important topics. We need to address them. We can't wait. But a couple thoughts, and I will try not to repeat what others have already said.

First, we've got to be very clear what the specific problems that we're solving. And in this area of fair value and in estimates there's a broad number of types of instruments or types of fair value estimates and a broad number of just estimates in general that management makes.

And so I would contend that be careful with blanket standard setting over all of those types of items. We need to be very specific as it relates to the specific problems and how then do we solve that through standard setting, be it, you know, financial reporting, disclosure, or through improved audit procedures.

Second thought, there's a lot of comments around added disclosure and some of which is around kind of specific audit procedures. We ought to ask ourselves, are we still asking for the audit to be done of the financial statements taken as a whole, or are we asking for audits of individual elements? And if we're asking for audits of individual elements of those financial statements, well, then I'd like a report on those individual elements.

If we're asking for kind of to keep where we currently are on audits of the financial statements as a whole, then guidance around materiality, and sensitivity, and the like becomes all that more important.

I also think that, you know, the comment that Larry made before on inputs is incredibly important, incredibly important. Because if you have a complex instrument or asset to value and the inputs are wrong, guess what, it's wrong. And I don't care what kind of market, corroborative data or other sort of stuff, but the underlying input's wrong.

The thing you then have to get to is, okay, well, what is fully in control of all of the parties and how might then, you know, might there also be sensitivities around that or other things, because some of that may not be accessible.

So, you know, let's say you make an investment in a company and you only own 19 percent. Maybe you have board rights, maybe you don't. Maybe you have influence, maybe you don't. I'm talking kind of real influence, not, you know, accounting speak. And so then the question is can you get that data, and then the question gets into, you know, how much of that data might be uncertain. Because it's coming from, maybe, parts of the world where the standards are very different, or prone to corruption, or prone to other issues, and what's the criteria there?

Now let's take it to the other place. Let's say that you do control it, and you do have that data. Well, does that then mean that the auditor has to audit that data or is it suffice to say that it's audited? Now all of that would then be historical information.

Now let's assume your valuation is based on prospective information, i.e., future cash flows, next 12 months' expected earnings. Now, how then does the, now obviously it's the base, obviously, but then those kinds of guidance for that go into the process, I think, are key to kind of think through. But it's not simple.

Then, you know, in terms of the valuation guidance, how do you kind of encourage kind of multiple approaches and multiple approaches that corroborate, I think, is another way to kind of get at this in terms of often, you know, providing guidance to solve issues.

The disclosure issues I agree with. The question you then have to ask yourself is, okay, the disclosure issue is just to give a parameter of what's the range of outcome, or is the disclosure sufficient for the user to recompute, redo whatever, or come to a different answer? So those are two different criteria.

Then you have to ask yourself questions around aggregation. So a lot of financial institutions are going to have lots of financial measures and lots of Level 3, and so how then to package all of that so that it is consumable can be often very trying. Or is it just the significant items, okay, now which ones are the significant ones and which ones aren't the significant ones?

Well, then how do we think about conservative anymore? Because fair value to me has always been fair value, not conservative value. Is that still what we want? So do we want, you know, a conservative bias and stuff, I'm not saying that we should because there's different problems with that. But when you then go to kind of its true fair value, be careful, you know, then we have to be able to expect errors on both sides of that equation.

And if we're not willing to tolerate errors on both sides of that equation, then ask yourself whether or not you still want true fair value, or you want something different.

And then you've got to think about, you know, often the financial statements that are being used, are they private versus public, and usually I'm pretty clear that I don't think there should be any distinction. But I could make an argument for a closed end fund where you've got to, you know, an audit of that where the discrete set of investors that are sophisticated, if you had retail investors in the mix you'd get a different situation.

But there's a lot of, all my comments are really getting to there's a lot of complexities here, be it as we've talked about financial reporting or auditing, and we've got to make sure we know what problem we're solving before we write a standard, because otherwise you're never going to get the cost-benefit right on it.

MEMBER SONDHI: I certainly agree with that. Let's see. Mike.

MR. BAUMANN: I just wanted to remind the advisory group that, and Chairman Doty mentioned this, this morning, that we intend to re-propose the standard on, the proposed standard on the auditor's reporting model in early 2016.

And while that doesn't deal with all of your disclosure issues that you hear, and a lot of the disclosure matters as I said I think you're talking about some are potential disclosures the accounting frameworks could pick up. Some investors, I think, did want the audit reporting model to have the auditor to have more disclosures about the financial statements, but at least, as proposed, that was really more about the audit.

The enhanced auditor reporting that's taking place already in the U.K., and the IAASB standard, I think those are somewhat, and hopefully what I think I'll be asking the Board to re-propose, goes partially towards some of your concerns here, which would be what were the critical auditing matters, what were the most subjective complex matters the auditor dealt with, disclose those as critical audit matters and then disclose, or comment on how the auditor addressed those critical matters.

So I think that information will go somewhat towards helping investors, I believe, understand what were the most subjective, challenging issues in the audit in the financial statements, and then how the auditor addressed those. So again it won't provide new information about the financial statements, but it will at least provide information about the audit and how the auditor dealt with those. And I think you're seeing some of these reports already in the U.K. and elsewhere.

And generally what I'm finding in looking at academic papers to date is that they're finding that information to be useful and valuable in terms of this content in terms of providing investors with new information, useful information to pursue further with management, as they wanted to make inquiries about those complex estimates.

CHAIRMAN HARRIS: And then, Tony, a final question, you know, following up on what Curt mentioned with respect to this specific problem and the need, and it's following up on a question I asked this morning.

Why are you recommending greater transparency, and this is on Page 80, within the audit practice and firm-wide of total revenue and revenue disaggregated by business line, profit sharing and such that is provided by specific business segments to other segments, and percentage of firm's revenues invested in, A, technology, and B, training? What do see as the problem there that needs to be addressed, and the need?

MEMBER SONDHI: I wanted to just start by saying thanks, Marty, for that clarification. I appreciate that. Steve, you know, we've talked about this aspect before and that is, the essential question was how is the inherent conflict in the audit versus the advisory role affecting things?

So part of what we're looking at in terms of the revenues, in terms of, you know, what the cross subsidies might be and so on in the discussion that Mercer and I had earlier, comments we exchanged, the whole objective is to see if whether we can better understand this conflict and do something about this issue.

Because we've talked, you know, other people have mentioned, Joe mentioned earlier about consulting work being better, this that and whether the profitability is changing or not, changing, et cetera. And these types of disclosures will help answer those or help with some of those questions.

Now, overall, I did want to say that one of the things I will -- you know, certainly appreciate in this discussion that has followed the presentation is that, and we've done this in the morning as well in the previous two sessions, that it really is critical that we understand and ask the right question and then just as critical that we employ the right methodologies to address them. We ask the right questions with respect to that. So I appreciate all of that. Thank you.

CHAIRMAN HARRIS: Norman, we'll give you the last word.

MEMBER HARRISON: I'll be brief. I know we're trying to get to break. I apologize. I think we all recognize, just to follow up on Tony's response, and I know, you know, the staff has taken the same view in the paper, in the concept at least on indicators, that part of what we're trying to do here, an important part of what quality indicators are designed to do is not to address problems as such but to arm consumers with information to make a better educated choice about whom they engage as their auditor.

So this really goes to the process of auditor selection and-or renewal on an engagement to have additional data points in hand including the ones Tony just, or that your question pertained to, so that consumers of audit services can make better informed judgments about which of the firms has the resources, has invested in the resources, has the expertise and the capacity to develop a high, and to deliver a high quality audit with, you know, on a timely basis with independence and all the other requirements that are associated with that.

So I think that's how in looking at these I think many of us view them as the, and this is like a Consumer's Digest for audit committees. It's information data in hand to ask questions and facilitate a more, a better informed decision making process.

CHAIRMAN HARRIS: Well, Tony, thank you and your group. I know the tremendous amount of effort that went into this and the email traffic that went amongst members. And so I want to thank you and Mercer and Norman, you and Larry and Bob, Lynn in absentia and Gary, because I know these have been difficult issues. But you've certainly given us an awful lot to think about and we appreciate it very much. And with that why don't we just take about a seven-minute break, come back at 3:15 so we can catch up and get everybody out of here on time.

(Whereupon, the above-entitled matter went off the record at 3:06 p.m. and resumed at 3:19 p.m.)

CHAIRMAN HARRIS: All right, we've got our essential participants in the room, so let's turn to the next subject which is a discussion of the letter from the Chamber of Commerce dated May 29th relating to the effectiveness of internal controls over financial reporting under Section 404 of the Sarbanes-Oxley Act.

This topic was mentioned by a number of you for discussion, and I will turn first to Chairman Doty and SEC Chief Accountant Jim Schnurr and then to Helen Munter who will discuss our inspection process and give an overview. So Jim, thank you.

CHAIRMAN DOTY: Thank you, Steven. Well, first of all, we are fortunate in that we are joined by Helen Munter, who has absolute authoritative and crisp information to impart to any questions you all may have. And it's in our view a very good sign that there was an interest by Curt Buser and others in the room to hear what we have to say about this.

As Steve mentions, Jim Schnurr and I were recipients of a letter dated May 29 from the Council for Economic Competitiveness of the United States Chamber of Commerce, the Center for Capital Markets Competitiveness of the U.S. Chamber.

The letter is, as Steven says, long. It's 19 pages long and it's been distributed to you. What might not be apparent from the letter is that we had met with the Chamber, with Tom Quaadman and financial preparers who were brought in to discuss some of these issues with us as early as February of this year. It would not be correct to infer from the letter that we have been turning a deaf ear, or a blind eye, or merely rejecting out of hand any attempt by the Chamber to call to our attention important aspects and effects of our inspection program.

Second, I will employ a rhetorical advice that Paul Gunson used to use as the general counsel of the SEC, and that is without commenting on this letter from the Chamber in any specific way, I would merely note that to have the PCAOB and the SEC take seriously a public concern and to address that concern does not require that the spokesman or the spokesperson of the concern be either well-informed or necessarily well-motivated with respect to the issues being raised.

We assume both good information and good motivation in this case from the Chamber. We also have ongoing good relationships with the Chamber. We see them often. We are around the corner from them. And our relationship I would characterize as being cordial, if as the letter demonstrates sometimes challenging.

Now, the interesting aspect of this also is that we have a meeting tomorrow with the Chamber and with eight other preparers of financial, you know, financial reports are being brought in. The ground rules that we wanted to set for these meetings were that we should have people who had actually experienced the issues that were being discussed.

It was our view, Jim and I, I think Jim Schnurr and I share the view that in this case hearsay is not helpful. It's a little bit like the 30 Years War in Europe, in which the atrocities were always well reported in the province that was across the border. And, you know, the people telling you about it really hadn't been there, when they were there.

So what we want to know is where preparers of financial statements and reporting companies really have been engaged with their auditors in issues of the type that are raised in the letter and have an incident to report or details to report that should cause either us, the regulators, or the audit firms to consider the process of internal control auditing. And with that I think I will defer to my colleague Jim Schnurr for additional comments.

MR. SCHNURR: Thanks, Jim. Just to, you know, follow up on Jim's comments, we did meet with the Chamber and the preparers back in February, and it was at actually before we finished that meeting that I suggested that in order to address their concerns we would need to get very granular about the fact patterns.

Because if you step back and look at the issue there could be a number of different potential problems. For example, there could be a problem with the actual auditing standards. There could be a problem with how they're being interpreted by the inspection group. There could be a problem with the firm's execution of those standards. There could be a problem with their guidance and how it's being implemented by the engagement team.

And there also could be a problem where there might be a disconnect between the auditing standards and the management guidance that the SEC issued for preparers, and there might be a couple of others. But, so in order to understand where there might be a problem and whether it was let's call it systemic, the only way to do that would be actually get very specific fact patterns from the preparers, and understand what their control structure was, and where they were having issues with their auditors.

So in the context of that Jim and I got together and agreed that it made sense for the PCAOB to take the lead on this and invite the firms in, or with the firms as well as the companies, we're going to do this kind of sequentially, and then decide what we needed to do additionally beyond that. But certainly I think we're going in with an open mind in terms of whether there is a problem here or not, or if there is some problem somewhere else in the system that needs to be addressed.

So we've essentially been waiting, quite frankly, on the Chamber to come and meet with us for eight months. The letter that was issued in May was a surprise. We weren't aware of it, wasn't aware of it was coming. We actually read about it in a newspaper before I received my copy. But that doesn't really change anything. I mean we're, you know, we're trying to approach this in a very professional manner.

And we're, you know, in terms of our nexus we obviously have, you know, oversight over preparers, we have oversight over the audit firms and we have oversight over the PCAOB, so that's one of the reasons we're kind of at the table here. So we're looking forward to starting the dialogue tomorrow and, you know, we're going to see where it goes.

CHAIRMAN DOTY: And tomorrow the PCAOB will be ably represented by Jeanette Franzel who's devoted substantial attention to this issue. Helen?

MS. MUNTER: Thank you. And thank you all for letting me be here this afternoon to talk a little about internal control over financial reporting. It's in particular from an inspection's perspective. And I think ICFR is a really hot topic now. Almost every day that I read the newspaper there's an article about ICFR, AS5 or even inspections, and shockingly to me not all of those articles are flattering.

But I think that it's great to be talking about ICFR and I wish that more people would talk about it from a positive perspective, because when ICFR is effective it absolutely provides an underlying foundation for the financial statements for the quality of financial reporting and provides investors with a very good basis to make their decisions as they evaluate the financial statements of any company.

And when ICFR is not effective that integrity in the system is damaged, is impaired. So I think the ability to rely on the internal audit, on the internal control reporting is really critical and is very important.

When we do our inspections we are doing an integrated inspection of an integrated audit, so when we pick an area to look at we drew that based on a risk assessment that we have. We're looking at what we believe are the most risky audits at any firm, and we're looking at the portions of those audits that we believe have the greatest level of risk.

When we identify a deficiency in the internal control opinion there's frequently a knock-on impact to the opinion on the financial statements themselves. When the auditor scoped their audit they assumed they'd have a certain amount of reliance from the internal control testing that they did, and if they failed to get that reliance it likely has an impact on the financial statement audit itself, and could result in an unsupported opinion on the financial statements as well.

From an inspection's perspective, our focus with respect to ICFR, I think, is just to be able to clearly evaluate whether the firm was able to comply with the standard. Were there any deficiencies in the work that the firm did in that regard?

We come to this with a team of very experienced inspectors. On average, our inspectors have more than 17 years of professional experience. And one of the things that I think is interesting to understand is we have grown over the last ten-plus years in doing inspections.

We've continued to recruit people with extensive experience working at the largest audit firms. We've also been very fortunate to be able to add some individuals who come directly from industry and who bring that experience as a preparer to their job at the PCAOB as an inspector.

We've been able to have some employees who have experience at other regulators or working in foreign countries. So we have a diverse group of employees with varied experience that they bring to the evaluation of the work that they're looking at in all areas, but I think in particular in considering the work done around ICFR that can be very, very informative.

When we do our inspections, we focus on individual issuer audits all with a goal to forming an opinion and a view on the firm's system of quality control. And you all are familiar with the Part 1s of our reports that really call out the deficiencies that we identify on the individual issue or audits that we look at.

I think the more interesting, and to me the much more important part of our report is Part 2 which remains non-public as long as the firm's able to take successful remedial action, and that is where we discuss potential systemic defects and actual defects and potential defects in the firm's system of quality controls and that's a very important part of our report.

And the deficiencies that we've identified around ICFR have driven commentary in that way in Part 2 of a report and those are the areas where the firms have taken some really significant action. In looking back over the last several years, ICFR has been at the top of the list of findings that we have had. In 2013, approximately 36 percent of the integrated audits that we looked at we determined that they had failed to support their opinion on internal controls.

All of the 2014 reports are not yet issued, but many, many of those reports are issued and if you've had the chance to review those you've noticed that some firms have recognized a significant improvement in their results. That does not extend across all firms, across all audits or across all engagement teams, but that improvement is very encouraging.

Much has been accomplished by the firms through the remedial actions that they have taken, but there's still more to be done. I'm most pleased by the fact that when we go out and we do inspections we encounter a number of engagement teams who are very clearly doing it right who have done a very good job at performing a risk assessment, scoping the work to be done and performing that work. And we've come away from those inspections, you know, with no comments and with a view into how an auditor can do a good, high quality job in this very difficult area.

I think, overall, as firms continue to work on ICFR, and there's still quite a bit of work to be done, we're looking to gain a deeper and more holistic understanding of the sorts of changes that a firm can make, can implement in order to be more successful.

As we've looked at the work, I would bucket today the three big areas where engagement teams and firms tend to struggle in doing their ICFR testing. The first area is in understanding a company's flow of transactions. And, you know, this is just a critical first step in planning an effective audit, and without this understanding the team might well fail to identify appropriate controls to test and might fail to test controls that are responsive to actual fraud risks that have been identified.

One of the things that we've found in teams who have failed to link controls to identified fraud risks, where that has happened it has tended to happen more often in the area of revenue than in any other area. So clearly a critical area to the testing.

The second big area of deficiencies that we still find are in the testing of management review controls. Management review controls serves as a detective control, meaning intended to ensure that management is able to identify errors, inaccuracies or fraud in the financial statements before they are finalized.

In order to rely on management review controls, the auditor needs to understand the control and to test to see that it is operating and operating at an appropriate level of precision in order to detect material misstatements.

So, for example, if the auditor is looking to test a management review control related to a budget to actual review of financial statements that occurs on a monthly basis, merely ensuring that that control took place is not sufficient for the auditor to do. The auditor needs to understand and what matters, what the management actually did, what they looked at, what was the result, what additional inquiries were made and what changes if anything resulted from that.

Where we found this deficiency we've talked to engagement teams, and we're spending a lot of time on root-cause analysis and talking to engagement teams about what happened in this particular circumstance. And one explanation in this area that we've heard quite a bit is a concern raised about a lack of documentation that exists at management.

Sometimes management will say that they have appropriate documentation of the control for their use, yet it's not enough for the auditor in its current form, and it might not be enough for the auditor to use if they want to rely on this control to a significant degree in performing their testing.

I think that this represents an area where increased discussion between the auditor and their issuer client is very important. You know, the auditor needs to explain what it is that they are looking for and what that additional documentation will help them with what audit objectives it will help them to achieve, and the management can consider whether it in fact has that documentation in a different form, in a different place, or whether it would be worth it to increase the available documentation.

But I think that dialogue is a very important part of solving this problem. And, you know, if the answer's flat out no that the issuer is never going to provide that documentation, the auditor needs to understand that and then think about what controls they should be testing. Maybe they should be different controls.

The third area where we've had a number of deficiencies is related to the testing of system-generated data or reports. And in this area the problem that we have found is the auditor is relying on a control and doing testing of the control, but a significant part of that control is in input that comes from a system-generated report.

So, for example, if the control relies on sales prices coming from a price list, the auditor needs to understand that that price list that is looked to is the correct price list and needs to do some testing of that, or understand what controls exist to ensure that management is testing that.

This is an area that I think is a very discrete area, and it is an area where we've seen discussion with engagement teams about the specifics of it, I think, have resulted in some very focused changed work in the following year. So this is an area that I see as very remediable in terms of the auditor being able to do some specific procedures in order to address this.

I also think that this is an area that's a good example for us of where discussion at the individual engagement team complements well discussion at national office about tools and templates and guidance. Because I think sometimes with these deficiencies, until they are real, such as the goal of, you know, hearing from issuers about what are the real and specific problems, it's more difficult perhaps for an engagement, audit engagement team to adjust the nature of their testing if they don't necessarily see themselves in the mirror when they hear the problem that is out there.

What could be the cause of these deficiencies that we find? I think many times in taking remedial action firms have updated their methodology and guidance, and where they have done this they have tended to see good results come from that.

Some of the other problems that we suspect is root causes relate to staffing and turnover. And going back a few years, there were periods where hiring was at a lower level and resulting in, you know, smaller classes, if you will, of auditors able to do the work going up the ranks, and that we think has had an impact on the quality of audits in certain situations.

And we've also noted other situations where we have identified concerns about the appropriateness of the supervision and review in a particular engagement situation. We've also heard from auditors about concerns as to the issuer's processes and the issuer's controls and documentations.

And I appreciate that that is a very, very real concern. In a situation where an issuer client has particularly good systems, good controls and well documented process it's a whole lot easier to do a very good audit. And where that is not true it's very difficult to do the audit.

One of the important parts of the dialogue we have with firms and with the engagement teams is, well, in those situations what was your consideration as to whether there were significant deficiencies or even material weaknesses at the issuer client, and if those existed those should be reported. So I think that that's an important part of this.

Firms have clearly taken various actions coming to address the remediation. Enhanced documentation has been one result. Additional layers of review have been another result, including monitoring activities from firms with respect to some of the templates and other tools that they have implemented. And I think it is very important for a firm to take appropriate monitoring action when they implement changes to their quality control system in order to ensure that those changes are effective and really taking hold.

Going forward, I think better ICFR auditing can be achieved not necessarily with more work or with exponentially more work. I would hope it is with smart work. I think that in situations where testing was not being done, the wrong testing was being done and being done in barely being done, more work will be required.

But there are certainly situations where auditors have devoted substantial time to work that could be reengineered in a different format and performed in a more effective and performed in a more effective and more efficient fashion. I think that applying a mechanical approach to the audit, and, for example, just checking that a management review control was performed without proper planning can lead to ineffective testing of controls and procedures and that with appropriate planning and an appropriate understanding of the risks and of the company's processes the audit can be done very well, and we certainly see a number of engagement teams doing that.

It's important to appropriately scope the testing that is done. Our root-cause program that we have is very focused on ICFR testing, and most of the large firms have their own root-cause initiatives and then they are also very focused in this area. And I think we'll be seeing some real improvements coming into the future.

I find it reasonable that making improvements in this area has taken time, has taken years and that these findings have continued to recur. We have seen improvement in the kinds of findings that we have. So they're getting a lot closer to the bar, even if not all teams are meeting the required level of effort that is required.

I think continued dialogue is very important between audit teams and their issuer clients, between us and the audit firms. We have been very active with firms in the remediation cycle, and for us the remediation cycle is that 12-month period following the issuance of an inspection report, where firms are working to address the criticisms we've included in Part 2.

We have dedicated teams of people who work with each of the firms in that effort. We're available to review draft submissions that they might make. We can provide feedback as to the suggested course of action that they are choosing, what has worked for others, what has been difficult for others in going down certain paths in terms of remedial action. But we've been very, very focused on being available and being willing to review drafts prior to a firm's final submission, for both the largest firms but for any firm.

So for the smaller firms as well, I have a dedicated team of people who do nothing but review the remediation and engage with those firms as often as they would like. Not all firms want to talk to us during that period at all, and there's a bunch of them that submit their final response on the 364th day of the year, and that's fine. They certainly can do that. They'll get reviewed after the period, but we are available to engage with the firms during that period.

So I think with that, I'd like to open it up to any, you know, questions or comments that you all might have. I think the planning of the audit, and the planning in particular of the approach to ICFR, is what is very important here.

CHAIRMAN DOTY: Just one point before I recognize questions. Helen, I take it our position is, yes, we know auditors are doing more work. We know that more work is being done on internal controls. We know that in many cases the firms are doing it differently. But we have not raised the bar. We have not changed the standard, and we have not amended what we think is a good audit or what is a defective audit.

MS. MUNTER: Yes; thanks. AS5 came out in 2007, and it hasn't changed. And we haven't changed in terms of how we evaluate the work that is done. Our evaluation really is on the compliance.

I think that in the, you know, last eight years that we've been looking at AS5 -- and in the ten-plus years we've been doing inspections -- we've gotten better, right? We've gotten better at being inspectors and better at doing our jobs and understanding the work that it is that we are evaluating, but that doesn't mean that we're moving the bar.

MEMBER TAROLA: Thank you, Jim. And thanks, Helen. I have a question and then a comment. I'll take them one at a time. The question is: to what extent are your concerns and exceptions coming from the auditor not properly assessing the design of internal controls over financial reporting versus finding that their compliance testing was inadequate?

MS. MUNTER: I wish I knew the answer to that off the top of my head. But it is absolutely a mix, and we look at both as we're doing our procedures.

MEMBER TAROLA: Yes, because if they're assessing the design as being adequate and then coming up with problems during the test for effectiveness, probably the client and the auditor have misconceptions about how the thing is working. So I think that is important. I also would say that if the design isn't sound, why bother testing the compliance?

The second, this is more of a comment than a question. I have to say that when Steve shared the letter with the investor advisory group, I said that I'm experiencing similar issues, as expressed in the letter, as a CFO and an audit committee member.

And almost every year I have to say to auditors, 'Do not dismiss my involvement in the reporting process. Do not assume that things must be wrong because something didn't happen down here. Please check with the person who is responsible for signing off before you make that conclusion.’ You cannot dismiss the value of experience in the reporting process. And even there may be situations where either design or effectiveness is somewhat either compromised or not as effective as it can be, that can mitigated with a knowledgeable person looking over the numbers.

MS. MUNTER: I agree; right. I think that management review controls are critical, are fundamental, and I think they can be a great way to approach the audit. It's just important that the auditor communicate well with the client about what exactly is the control, how it operates, and then set forth to test that.

MEMBER BUSER: Helen, thank you. I thought your report was very good. I thought, you know, putting this letter in front of this group was important, and I, you know, applaud the actions that the SEC and the PCAOB are taking.

I also think it's good to kind of reflect back, you know, ten-plus years ago as Pete Nachtwey said, I think the audit standards, or really the audits that are being done today are far better than they were 2002 and prior.

And whether that's, you know, Sarbanes-Oxley or ICFR or the inspection process, I don't know. But all of it together is making a difference, so I think that's really good. And I think anyone -- from a management perspective -- who doesn't believe in internal controls or the importance thereof, probably shouldn't be in management.

And, you know, the internal control process and having that subject audit, I think, is good, and that's part of being a public registrant and you sign up for it, that's part of the duty to do it. Does it achieve all of our goals and objectives in terms of pre-warning signs? I don't know. Probably not. But having it there is important.

However, we continue to get a lot of noise. Some of it valid, some of it not valid. And I encourage the approaches you're taking, kind of like where are the errors occurring in that communication process and then dealing with specifics.

And as a question/thought to consider, while AS5 hasn't changed in a number of years, my sense is that, you know, the inspection process or interpretations or, you know, just as the inspections have gotten better, that auditors are now clearly approaching things differently, and as preparers or issuers they're frequently left to kind of being educated by the auditors who are being educated by their firms in the inspection process.

And so as a question I kind of say, well, should we think about doing, you know, a review of the standards/guidance and the SEC's issued guidance for management? And there's a COSO framework. But does it make sense to take that and align that with, I'll say, AS5 as interpreted?

So, you know, AS5, plus however it's being inspected, align it with the standards that management have, or should we have a new standard written for management, and then therefore, you know, because look, management's got to assert to it first, right? You know, before the auditors, you know, as a CFO I'm signing off on it first.

So, you know, it's one thing for me to kind of go higher, you know, people informing on your staff, and that's a good thing for me to have, which I've done. But you then also, you know, you kind of really what's the standard that I'm looking to.

So when, you know, an auditor raised something that object to that we can have an honest, good discussion around the standard and the approach to it. I think that might take -- because, you know, I think about it even in terms of Generally Accepted Accounting Principles.

We often, you know, we'll have disagreements, but then, you know, two reasonable people can talk it through and come to the right kind of position. I think the same thing might be helpful in this area to get rid of some of the noise. Just a thought, but thank you.

MS. MUNTER: I appreciate that, and I do think it is important, you know, to have the dialogue between the auditor and the issuer client about, you know, what is the auditor trying to achieve, and what is the best way to do that? Management knows a whole lot more about what controls exist, documentation exists, et cetera. Thank you.

MEMBER SILVERS: I feel like deja vu here. I was involved at the SAG in advising the PCAOB -- first on AS2 and then on AS5 –- and I was part of investor group together with Ann Yerger, who it's unfortunate is no longer -- who's changed jobs and is not with us -- in talking with Chris Cox and John White, who at that time chair in Corp Fin at the SEC on AS5, and trying to find a good mean, a good balance -- which I think is language referred to in this letter -- around the burdens around getting internal controls right, but also not doing so at a prohibitive cost or distraction to management.

And, you know, it's always been clear, I think -- from an investor perspective looking at this -- that there are a bunch of different competing kinds of incentives here, and virtue doesn't lie a hundred percent in anybody's corner.

At that same time, it was clear coming out of the passage of Sarbanes-Oxley and the events of the early 2000s that the concept of strong internal controls and strong enforcement behind them, which really kind of had a lot of its roots in the Foreign Corrupt Practices Act, was absolutely essential in order to have the process of financial reporting and auditing be meaningful.

And unfortunately, after this process around the drafting of AS5 in 2007, we then had a set of events that said to me that really this area was not being properly enforced and not by the -- and I think whose fault that was I have no line of sight to, but it was absolutely clear that the country's major financial institutions had grossly inadequate internal controls, and nobody said or did anything about it -- both before and after the fact.

And that, I'll give you two anecdotes about this. I had a meeting with the board of Citigroup -- with the audit committee chair of Citigroup –- in the spring of 2008, after it was clear that Citigroup was in a very bad state because of its exposure through special purpose vehicles, to subprime mortgages.

And I was told by the audit committee chair that he had been told by the head of the mortgage department that they had no exposure to subprime mortgages. Now somebody didn't explain to the audit committee chair that there's such a thing as a secondary market. And there were no internal controls processes to ensure that that information was in front of the audit committee chair.

Similarly, two years later it turned out that there was wholesale fraud in the execution of the fundamental documents involved in the mortgages during the subprime bubble. Meaning that the representations were made throughout the financial accounting process that people had actually executed deeds, you know, mortgages, literal mortgages, and they hadn't.

Now this was pursued eventually by attorneys general in various states, Justice Department and so forth. But the internal controls issues, in my mind, were never satisfactorily excavated.

What I see happening here is that the PCAOB is doing its job and asking hard questions about internal controls. Everything that you guys said -- excellent presentation -- reiterates that to me. People who are used to these standards not being enforced are unhappy. It's hard work to meet them, and it may be that here and there, there have been, you know, things that are not really useful that have happened; incentives have been created and so forth.

The investor community was always of the view that it was worthwhile to engage in a conversation about those dynamics. This was true at the time of the enactment of AS2 and at the time of the enactment of AS5. But having been through all this, I have a certain suspicion about exactly what is going on when PCAOB receives a letter like this in terms of motivations.

And I think it's very important that the PCAOB and the SEC do exactly what it sounds like you're doing, which is sit down with the folks from the Chamber. And I should note, by the way, the AFL-CIO -- like you -- deals with the Chamber all the time in many respects and constructive ways.

Sit down with these folks and, you know, do the Missouri thing. Show me. Bring people who are not paid lobbyists, right, and have them tell you that exactly what they have experienced. And then go through this letter with a big black Magic Marker, and anything that anybody can't actually point to a company-specific instance of, draw a big line through it, right. And then the ones where people can bring company-specific instances to the table, engage.

MEMBER HEAD: Again, it's Mike Head. And this one probably is as dear to my heart because of my role prior to, you know, leaving, or retiring from TD Ameritrade as being the chief audit executive.

And one, I share that you guys are doing wonderful work, and there's a time lag between the inspection results and the firm's remediating those, and a lot of it, I think, can come about from Part 2 is not public. The audit committees don't see it. We hear what the firms want to share, but we don't see the document.

So, you know, we've talked several times that we think, for the investors and the audit committee, that Part 2 shouldn't be non-public, and that would address early on with management why they're getting these requests from the audit firms. Because a lot of what's in here, I think, is noise that's occurring.

In fact, I know, prior to my retiring, our firm was coming and saying, well, now our firm has set a new standard because we want to fully embrace compliance with the audit of ICFR. And our firm has said now for us to have adequate documentation -- even though we didn't require it last year, we require it this year -- and we know that.

And so these, there's examples in here. They will be able to bring examples to the table, but it's that transition of we're remediating and what they feel comfortable sharing and transparency they're willing to have with their audit clients, and then the requests and what they're bringing to the table as now what are firm standards.

And where the rub really hits the road is they get in a situation where they say for firm standards they have to have this documentation. They use an example in here of flow charts versus narratives or other things.

And what that feels like to the client, the registrant, is we now have to provide documentation to the firm to meet their required documentation standards when nothing has changed in how they test or how management documents. And they're not saying anything is wrong; they're just saying for their files to adequately document their audit, they now need that, and that's requiring their clients to do more work.

And I think it's this transparency and transition and timing difference. The wrong thing to do is to say there's anything wrong with AS5 or the inspection process or what you're asking the firms to do. I think it's a communication between the firms and their clients and more transparency and ensuring everybody understands.

And then who shares the burden? Is it something that has to be absorbed by the audit firm, or is it something that's shared by the audit client because maybe their documentation needs to be enhanced a little bit also.

So I maybe sound like I'm defending you, because I think that this is purely communication transparency, and there's nothing wrong with the standards, and they're doing what they're supposed to be doing is my humble opinion.

CHAIRMAN DOTY: Thank you, Mike. The Chamber has not been entirely comfortable with the communications -- with the publications of the Board encouraging audit committees to get behind Part 2, as you know. But that seems to be catching on, and I think more and more audit firms are saying well, we do it. We do it regularly.

Brian, you've had your card up for a while.

MR. CROTEAU: Oh thanks, and I almost hate to say anything after hearing what Damon and Mike have had to say, and this seems to be going so well. But let me just chime in here.

In context of on the 2007 reforms and AS5 and management guidance being put in place, I was -- you know, in a prior role at the SEC -- but in the middle of all of that in some ways. And I think it's important to distinguish that from what we're talking about here a bit, which maybe is not so surprising that this many years later, an area that is probably one of the most judgmental, difficult areas -- thinking about management review controls, the precision of those controls and how they operate -- is an area of focus and an area that people struggle with.

And so different from what we saw, I think, back in 2007 which were a fairly broad list of concerns that we, I think, mostly addressed. I think we're now down to something that's much more narrow here, although highly important relative to an effective reporting on internal controls -- having effective controls, reporting on controls in the audit.

You know, I don't want to prejudge the discussions we'll have over the coming days, but I certainly do think that there's probably something for everyone here relative to thinking about what management can be doing, what the auditor can be doing, and what we as regulators can be doing differently to improve things in this space and make sure that we're doing it in a way that focuses on risk at a reasonable cost.

So I'm optimistic in that regard, and I do think another aspect of the timing and where we are now is that from time-to-time it's good for management to step back and reassess their own controls and reassess how they know that they've got adequately precise controls and that they're operating effectively.

And some of the questions that we ask -- working with Corp Fin or enforcement -- through our work we find at times some of the answers surprising in that regard from a controls perspective, and it tells me that there may be some amount of deferred maintenance or at least deferred thinking relative to maintaining controls.

And so I'm optimistic about these discussions, and I just thought I would add a little perspective from where I sit.

CHAIRMAN DOTY: Brandon Becker.

MEMBER BECKER: I suspect this will be a long conversation that will at least continue until the arrival of the next administration. But I do think that one problem area that is hard to distinguish is the communication issue that's already been alluded to.

It's very easy as an intermediary to invoke the SEC made me do it, or the Board made me do it, whether or not they did or they didn't. And it's easy to protect yourself by layering out additional processes and procedures in the name of somebody else required you to do it, and it's hard to sort that out. It's very hard to sort that out.

However, what I have seen creep in is increasing documentation where it feels like the documentation is for the sake of the documentation, or for the sake of somebody being able to look at the documentation, as opposed to it can't be done that way.

Now some of that is inevitable. We have increasingly moved from a world where goodwill and good intent is insufficient. You've got to be able to show that you actually follow the proper procedures and that's acceptable, but I think to the extent that in the dialogue you do have, you can try and sort some of that and ask yourself, 'Are these levels of documentation really furthering our substantive goals collectively in terms of investor information and the adequacy of our testing of the controls?'

That's probably a worthwhile question to pinch yourself about, and also to ask yourself whether or not the intermediaries -- you know, the fault is in our stars.

CHAIRMAN HARRIS: Well, Chairman Doty, Chief Accountant Schnurr, and Helen Munter, thank you very much. I think this has obviously been a very constructive and positive and helpful discussion.

Now to conclude in terms of the final discussion, I asked each of you to give us what you would consider to be the top priority you think the Board should be focusing on and why.

So Larry, if we could start with you and go right the way around the table, we can conclude in a timely fashion.

MEMBER SHOVER: You're starting with the wrong guy.

CHAIRMAN HARRIS: Well, we can come back. Mercer, you know.

MEMBER BULLARD: Well, this is Mercer. Coming from a securities background I always put a lot of emphasis on enforcement. So I would revisit something Chairman Doty has pushed for, which is a greater transparency in the enforcement process and the adjudication and making that public.

CHAIRMAN HARRIS: And you can also indicate the why, if you choose to, as we go around the table.

MEMBER BULLARD: Because, yes, I think that kind of transparency like with respect to Part 2 -- although I'm not exactly sure what Part 2 is -- the effect that it has on behavior is undeniable. I mean I'm a big believer in, you know, you tack a few hides to the door, you change behavior.

And there's nothing like exposing the basis on which agencies act in order to get people to think hard about, you know, whether they want to have to deal with those consequences or going to change their behavior.

CHAIRMAN HARRIS: Grant.

MEMBER CALLERY: I hadn't put that on my list, but actually when Mercer mentioned it, that is, I think, something -- and I know it's got a statutory basis and you have difficulty in becoming more transparent in the enforcement process.

But having lived through 30 years at NASD/FINRA, where we started with the "businessman's forum," that was all behind closed doors and moved very slowly until bad things happened to the organization toward more transparency. I think that any organization that is quasi-governmental but is using governmental type powers or authorities over the lives of people and the businesses of people -- even including the National Football League -- need to have a greater degree of transparency to get the credibility that they really need for the process, because there's always a feeling when it's not the government that there is an inherent conflict that is there, and the less transparency there is the more that is going to prevail.

And along a similar line, I think the issue that we talked about this morning and that we talked about last year and this whole thing about firm business models and the consulting practices -- again, without prejudging where on the spectrum, whether they're in the right place or the wrong place -- I think, again, looking into that, getting some transparency to it between the PCAOB and the Commission, so that you can -- and as Jeanette said this morning -- you don't have the information to do a lot of that. You should get the information, analyze it, and then come out and say here is where we are and this is why we're here. Because again, as long as these articles just keep showing up, people are going to always have that nagging feeling about it. So that would be my second one.

CHAIRMAN HARRIS: Curt.

MEMBER BUSER: So the issue that I think really as a whole kind of framework we need to be always mindful of is relevance. I find it amazing the amount of materials that we publish, put out, and what exactly gets consumed, read or used by the investing public.

Now I get it that the SEC and the regulators and the auditors read it all, but in terms of the questions, comments that I get back, it's always kind of interesting. And where it generally goes to is what they really want is something simple.

They want to be able to assess is the current price of whatever we're talking about. Is that the price they should buy at, or is that the price they should sell at? And so what they want is really information to speak and help them do that in a simple way.

And so increasingly what's happening -- my observation, and I may not have a full appreciation -- is that folks are looking at earnings releases and non-GAAP financials increasingly more than, really, the rest of the materials that are put out. And only after the fact they go looking back through the rest of the materials to kind of see whether or not it had been explained or disclosed or what not if there was an issue.

And so that just leads me to the conclusion around: do we have the right models, both from a reporting standpoint, an auditing perspective and the like? And so it may lead one to the conclusion of more assurance on some of these other reports -- whether it's more assurance on MD&A, assurance on the earnings release, assurance on what have you. It may lead you to, you know, really -- as Tony has talked about before -- you know, more of a cash flow focused.

You know, because one of the things that I often do as I'm looking at our portfolio companies I'm thinking, well, is this business producing cash, and how much cash is it producing, and what's the cash that I can see coming off of it?

And so I want evidence of that. Is the cash on hand going higher? Are the distributions and cash available to take out greater? Is that being paid down, or is it being reinvested in the business? And if it's being reinvested and stuck on the balance sheet someplace, I've got a whole bunch of other questions.

But ultimately I want to kind of how do I free that cash up to get it back out? And that is, I think, fundamentally what all investors kind of want to know. And so, you know, the comments that we had before on fair value, was it reporting or was it auditing, and I think that part of the consensus was it was some of both.

I think that comes back to the model that we have here, too, in what is it that will enable investors, and especially I think what's important is institutional investors versus retail investors. And the more that we're also seeking to protect the retail investor, how do we make it simple and transparent and easier for them to get at?

And quite frankly, you know, you wrestle with the same issues with your management teams, your board members and what not, how to get the material to them so that they can consume it quickly and understand it and focus on the key items.

So that's really what I leave with is, you know, how do we collectively kind of get at relevance of what we're doing? Otherwise, you know, I'm concerned that, you know, the question, the survey that we had before on importance of audit, we'll get different answers at a different point in time.

CHAIRMAN HARRIS: Brandon.

MEMBER BECKER: With all due respect to Jim, if we are going to be facing a period of heightened macro-volatility -- whether due to interest rates or commodities or China -- I really think that Tony's Slide Number 4 -- the fair value of the estimates, the quality of earnings –- is what the game is about as amended by Curt's very useful comments about context and the specificity of how you apply that materiality, whether it's an accounting issue.

But as -- and this may reflect my background over my career dealing with financial institutions or public companies that are de facto hedge funds -- we need to be able to rely upon these numbers on a going-forward basis. And I just think that there is more to be done in that area, and I thought that Tony's slide captured it very well as an agenda.

And if anything, without trying to reprise my conversation with Damon about going concern, I think this gets to many of those issues because this is where you see a lot of the volatility in your ability to know what's going on with subprime, to know what the netted positions are, to know what the derivatives book is, even if it's written in stone.

CHAIRMAN HARRIS: Norman Harrison.

MEMBER HARRISON: Thank you, Steve. At first, very briefly, I would never presume to speak on behalf of this entire group about anything except to thank Nina and Tope and everybody on your staff for all their great work. This is a large group of cats to herd and get all in one place on the same day and ready to go, and so we're grateful to have them.

CHAIRMAN HARRIS: You totally preempted me.

MEMBER HARRISON: It matters more from you because you're the boss, but on our behalf I wanted to say thanks. And to you, Steve, for your stewardship. I mean you've been a faithful and energetic leader of this group for six years now, and those of us who are charter members in particular, I think, have really been privileged to work with you. Appreciate what you have done.

Two things on my list, and I'll be brief because I'll be largely repeating myself. I was very delighted to hear Marty say that there will be a re-proposal early next year on the auditor reporting model.

I think, you know, we saw in the -- I guess Joe's gone. But in the survey, this year's survey and certainly in the survey two years ago, you still get a feel and a flavor for some cynicism or skepticism in the investor ranks about cozy relationships between audit committee members and management teams, and the whole process by which nominees are stood up, and how the relationships actually function.

And I think the more guidance and the more light you can shine on, you know, the workings of the audit process and relationships between the auditor and audit committees and improved reporting around the audit, I think, will be welcomed by investors.

The other one -- just to repeat myself -- again full speed ahead, pedal to the metal on the audit quality indicators, both as a worthwhile tool in their own right to educate consumers of audit services, but also because they overlap and will provide data for other issues that we've discussed today and in other settings around transparency, around independence, and a lot of the other issues.

I was looking in preparation for today at the list of topics we have discussed at our meetings going all the way back to 2010, and in five of the six years there's been a specific working group that had something to do with firm transparency and governance, global networks, audit firm practice, the audit firm business model and incentives. We've talked about this year in, year out.

And I think that collecting data and requiring reporting in the form of those indicators will bring a lot of transparency to bear on all of that and, I think, to the good of the capital markets.

CHAIRMAN HARRIS: Thank you. Bob.

MEMBER TAROLA: I'll endorse the moving forward with the auditors reporting model as quickly as you can; I think that would close some of the gaps that you heard, particularly from Tony as an analyst.

And I would extend it one step further, and that is between those bedrock audit reports that seem to be the basis on which analysts and investors rely or get comfort with the integrity of the system, there's numerous other reporting that goes out that is not subject to any auditor association in the way it's digested.

So whether it's earnings releases or other bits or elements of financial information, I think it would be important for investors to know that the auditors did something with it, some sort of imprimatur, and that the audit be intertwined with the release of issuer information on a regular basis, not just once a year.

CHAIRMAN HARRIS: Mike Head.

MEMBER HEAD: The good thing about going this late is you can say, "Yeah, me too" on a lot of things. But the three things I had down, which has been mentioned already, is I really think the more public disclosure of the inspection and enforcement process, and trying to figure out a way to get past that legal hurdle in a productive way, I think, will go a long way to resolving a lot of the communication issues that were raised symptomatically in the Chamber's letter.

I definitely think we're way overdue on the audit reporting model, and I was glad to hear it was going to be re-proposed too. I think it's going to tie a lot of what we were talking about disclosure accounting if we know what the auditors considered material and how they approached them, and most of those are going to be those judgment and estimate areas that are material to that company, I think, is a very, reconciliation, and Marty said it better than I could say when he summarized it.

And I'm not a big fan of just performance indicators for the sake of performance indicators, but to the degree it will increase transparency and provide information that will help the investors, I'm all for the AQIs. I just think it should be less and not more; those things get really unruly if you just add one after another.

So I would encourage it to be very focused to encourage transparency and not you spend a day just trying to figure out what they're all telling you.

CHAIRMAN HARRIS: Damon Silvers.

MEMBER SILVERS: You know, like Mike said, you can just say "me too" now, and so I will. Me too on the importance of audit quality indicators and of putting some thought into getting them right, having the right ones. You know, similarly, the inquiry -- and just, at the end of the day, my grasp on the terms of art is fading -- but the inquiry into audit reporting model, I think, is a similar exercise.

These are areas where if you get them right you give investors -- particularly investors with a more sort of buy and hold model -- the tools necessary to monitor their investments. The folks I represent, that's where we're coming from.

And in the audit space we just to date don't have enough of the right information to be able to do that work in that space as compared, for example, to how much we have in some other critical sort of governance junctures like executive comp, right.

We have tons of data, and we're getting pretty good at figuring out what works and what doesn't. So the PCAOB investing in those areas and Commission support of work in those areas is, you know, what we're looking for.

CHAIRMAN HARRIS: Tony Sondhi.

MEMBER SONDHI: Thank you. Steve, I also wanted to extend what Norman had said earlier, and that is I appreciate your encouragement of the team undertaking this particular project that we did today. It was very helpful.

In terms of what I'd like to focus on is something that I did say in our group's recommendations, and the essence of it is, you know, more transparency around those disclosures about those critical areas, such as the estimates, the fair value measurements, the use of the specialists, and so on.

And I just wanted to add a couple of comments to something that was said earlier. I too have noticed in earnings conference calls -- as Curt pointed out --

there's very little emphasis or discussion of actual financial reporting issues. People are, most of the time, talking about non-GAAP measures and so on, although the power of the financial statements and the information in them was, just again an anecdote last year.

One of the largest companies in Europe, in the middle of a lot of congratulations on non-GAAP measures, an analyst happened to ask about a disclosure on securitizations, and the CFO got it wrong in explaining it and it turned out it cost them about 40 percent of their share price. And this is now -- I think it's about 16 months since that happened, and it hasn't recovered.

So getting the information right, getting those disclosures right, still, I think, makes a big difference. So, again, I encourage you on these things that you're working on to focus on greater transparency, better disclosures.

CHAIRMAN HARRIS: Gary. Gary Walsh.

MEMBER WALSH: Yes, thanks a lot for including me in the activities. I was going to say transportation and disclosure, and since I was -- since Tony beat me to the punch, I think I should share that I've been trying to pay attention to all that's gone on and the conference calls with Tony, and I've really been absorbing as much as I can.

I'm a CPA, a CFA. The only thing I can really think of is: Heaven help the retail investor. I don't think we can make it that simple. Ours is an interesting business in that you have to be licensed to sell securities or mutual funds, but anyone can buy them. And, you know, I think that's part of the problem. A requirement to make it so that, you know, everyone has to use an investment advisor, I think would be perfect.

So, at the very least, I think what we need to do is make sure that we have an awareness of the skills that are needed, and we portray an awareness of the skills that are needed, and we make the game as fair as possible, and that a knowledge that failure still occurs.

And I like Judge Sporkin's comment about having more investigation about what's going on. I think the

PCAOB should take the model of the National Transportation Safety Board and come up with, you know, a root-cause analysis very soon after any failure, and I think that would solve a couple of things.

I think we'd get to the heart of what really went wrong, but I think we would help the awareness of the fact that this isn't a risk-free endeavor, and I think that awareness would be healthy for everyone and not leave people with the unrealistic expectation that there's always a safety net.

CHAIRMAN HARRIS: And then Larry Shover.

MEMBER SHOVER: Thank you. This is a time to dream big and not to manage expectations, for me anyway. So after being on this committee for three years, I really have noticed how much more visible the PCAOB has become in three years' time. It's great. I think investors have greatly benefited, especially from the 123 evaluation approach. And I'm just really happy about that, and I can't say enough.

When it comes to dreaming big, as an investor I'd like to see some working towards like a standardized rating system, or template of sorts, that would capture the various and sundry questions, allowing investors to obtain, you know, just a better understanding of what's going on in the plumbing of the financial statements, like how the valuations were computed, also to help investors assess the risks or the perceived risks.

The bottom line is let investors understand that there is subjectivity, which the PCAOB has done a great job at, and have information -- allow them to have information to decide on their own how much value to place on the numbers that are in front of them. Thank you.

CHAIRMAN HARRIS: Well, with that I want to extend a heartfelt thanks to all of you. It's been a real pleasure working with you. I think you all know that your three-year terms end this year, but you can all re-up for another three years. I very much hope that you will do that. I've found this participation and your involvement to be extraordinarily helpful.

Even though a number of these issues keep on recurring year in and year out, they have caught the attention of the PCAOB and the SEC. I think we are making progress on a number of them.

I would once again extend particular thanks at this point with respect to today's session to Grant Callery and Tony Sondhi and Joe Carcello for leading their sessions. I think they were all productive, and I know they involved a terrific amount of work.

So I want to thank them especially, but all of you for participating in those working groups. A large number of you have been stalwarts over the years, and I hope you'll continue to be so over the next three years.

And finally, and maybe most importantly, these sessions are -- as Norman pointed out -- somewhat challenging to put together in a productive fashion, and I want to commend the terrific work of Nina Mojiri-Azad and Tope Folarin, who have done yeoman's service in terms of helping you with the materials and facilitating the working and the productive sessions.

And so with that I want to thank everybody very much and the SEC for their observation and participation. Thank you.

(Whereupon, the above-entitled matter was concluded at 4:30 p.m.)

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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Investor Advisory Group

Before: Public Company Accounting Oversight Board

Date: 09-09-15

Place: Washington, DC

was duly recorded and accurately transcribed under my direction; further, that said transcript is a true and accurate record of the proceedings.

Neal R Gross

Court Reporter