NOTICE: This is an unofficial transcript of the Public Company Accounting Oversight Board Auditor Independence Tax Services Roundtable that was convened by the Public Company Accounting Oversight Board at the Capitol Hilton on July 14, 2004. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript. The transcript has not been edited, may contain typographical or other errors or omissions, and is presented for convenience only. An archive of the webcast of this program can be found on the Public Company Accounting Oversight Board's website at www.pcaobus.org.

Public Company Accounting Oversight Board
(PCAOB)

Auditor Independence Tax Services Roundtable

July 14, 2004
10:02 a.m. - 3:58 p.m.

Capitol Hilton
1001 16th Street, N.W.
Presidential Ballroom
Washington, D.C. 20036

A T T E N D A N C E

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CHARLES D. NIEMEIER, Member, PCAOB
DANIEL L. GOELZER, Member, PCAOB
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ANDREW BAILEY, SEC
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BELLA RIVSHIN, PCAOB
GREG SCATES, PCAOB
DOUGLAS CARMICHAEL, PCAOB
THOMAS RAY, PCAOB
NICK CYPRUS, Interpublic Group of Companies
DAVID SHEDLARZ, Pfizer, Inc.
JIM BRASHER, KPMG LLP
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MARK EVERSON, Internal Revenue Service
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SCOTT BAYLESS, Deloitte
BRUCE WEBB, McGladrey & Pullen, LLP
ELLIOT SCHWARTZ, Council of Institutional Investors
BARBARA ROPER, Consumer Federation of America
JEFFREY C. STEINHOFF, U.S. Government Accountability Office
BILL GRADISON, Member, PCAOB
KAYLA J. GILLAN, Member, PCAOB

P R O C E E D I N G S

[Beginning time: 10:02 a.m.]

MR. McDONOUGH: Ladies and gentlemen, would you take your seats, please? Ladies and gentlemen, would you please take your seats?

Good morning, ladies and gentlemen. It's my pleasure, Bill McDonough, the Chairman of the PCAOB, to welcome you to this Roundtable Discussion on Auditor Independence and Tax Services.

In creating the Public Company Accounting Oversight Board, Congress gave the Board the job of overseeing the auditors of public companies in order to restore the public's confidence in the fairness and objectivity of auditors' opinions. After a number of accounting and other financial reporting scandals, the public had good reason to doubt the credibility of the profession, and, in particular, to doubt whether accounting firms showed appropriate objectivity in their audit work.

Shortly after the Congress passed the Sarbanes-Oxley Act, in early 2003, the Securities and Exchange Commission responded to those concerns by amending its rules related to auditor independence. You'll recall, the Act was passed at the end of July '02, and the SEC responded very quickly.

Consistent with the Sarbanes-Oxley Act, these rules of the SEC prohibit auditors from performing certain non-audit services for their public-company audit clients. And the Commission's new rules also require that all other audit and non-audit services, including tax services, be approved by the company's audit committee.

Since the Commission adopted these rules, new concerns relating to auditor independence have come to public attention. These new concerns relate to the tax services and products that audit firms provide to their clients and to senior executives of those clients, including extremely aggressive, if not abusive, tax strategies that may, by their nature, impair the objectivity of the auditor.

I believe I can speak for all our Board members when I say that we have not yet determined what, if any, changes in the rules on auditor independence are needed to address these new concerns; rather, we are holding these -- this roundtable discussion to explore the various types of tax services that accounting firms offer and to examine whether those services have an impact on the objectivity and the appearance of objectivity of an auditor who provides those services to an audit client.

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For example, we want to know whether tax-shelter work and tax-compliance work produce different auditor independence implications. We also want to understand better how tax and audit functions interact, both in small audit firms and in large audit firms.

This should be a very engaging and productive discussion, and we are delighted that so many participants from such a variety of backgrounds are here today to contribute.

I want to say a special thanks to my friend Commissioner Everson, and Cono Namorato, of the IRS, for participating in our discussion. We are very fortunate to have the benefit of your special expertise here today.

I also want to thank our colleagues from the SEC -- Chief Accountant Don Nicolaisen, as well as Bob Burns and Andy Bailey -- for joining us today. On the issue of auditor independence, the Sarbanes-Oxley Act makes us partners in our efforts to restore confidence and to protect the interests of investors. I believe it's very important that the SEC and the PCAOB work together on this issue, and your presence here today helps us join cause in that effort.

I'll be turning the discussion over to Doug Carmichael, who will chair today's meeting, who will

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guide us through our program. But, before I do that, I'd like to ask my fellow Board member and dear friend Kayla Gillan to offer a few opening remarks.

Kayla.

MS. GILLAN: Thank you, Mr. Chairman, my fellow Board members and all of our wonderful guests here today.

First of all, I really would like thank all of you for taking the time to be with us today to discuss this important topic. We know how valuable your time is, and we really greatly appreciate your willingness to give us a bit of your time and a bit of your wisdom.

The issue of auditor independence is one that has been near and dear to the hearts of many people in this room. In my previous life, I was general counsel of CALPERS, and, in that role, strongly advocated strengthening of auditor independence. In fact, during the legislative process that led to the enactment, Sarbanes-Oxley, investor advocates focused on the need for the auditor to be as independent as possible from his or her audit client. And there's no doubt, in my mind at least, that this support from the investor community is one of the main reasons that Title 2 of the Act contained a list of prohibited non-audit

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services.

If you would indulge me and let me put my investor hat back on for a second, I think it's quite clear to say that there's probably no other single accounting or auditing issue as important to investors than that of auditor independence. And why is that? Well, it's really very simple. If an auditor's opinion is not based on an independent, objective, and professionally skeptical examination of the financial statements, then there's no reason for anyone to -- in the investment community or otherwise, to believe the numbers. Moreover, if you ask investors, most of them would say that they simply do not believe that a firm can be truly independent, objective, or appropriately skeptical when they have a large economic incentive, by ways of fees for non-audit services, to make the client happy.

The next opinion I give, I have to publicly acknowledge that it's based on a somewhat biased perspective, but I cannot pass up the opportunity to acknowledge the efforts of my former colleagues in this area. It's often very easy for individuals at organizations to talk a good game about corporate governance. It's the "cool" thing these days to be a corporate governance expert. But, at some point, in my

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opinion, they either have to put up or shut up. And, too many times, internal or external pressures keep these people from following through on their principles. Well, despite much controversy and criticism, CALPERS has put up, casting thousands of proxy votes in opposition to directors who think it's okay to allow an auditor to also be a consultant.

Now, I'm not here to pass judgement on whether every negative vote was one that I would have made if the decision had been mine alone to make, but I do strongly believe that these actions are making a difference in the market.

And one need only look at last week's Wall Street Journal to see how actions by investors can change corporate behavior. According to the Investor Responsibility Research Center, the IRRC, we've seen a sharp decline in fees that companies are paying their auditors for non-audit services. In 2001, for example, it was reported that 72 percent of the fees audit firms recovered from their audit clients were for non-audit services. In 2002, the IRRC reported that this dropped to 55 percent. And last year it dropped to 42 percent.

It seems very clear to me that the reason for this 30 percent point reduction is primarily due to a recognition by corporate auditor committees that the

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owners of their companies simply see too great a risk that the auditor may provide a wink and a nod on financial statements in exchange for additional consulting work. Investors have spoken, and the market has heard them, and now it's time for this Board to do our job. And that's what today is all about, to hear your views as to whether, if anything, additional work is necessary.

And, again, I thank you all for your time and your commitment and your candor today.

MR. McDONOUGH: You will not be surprised to hear that each of our Board members has very strong views on a variety of topics. And the wonderful thing is that on every major policy issue, we have voted 5-0 in favor. The debates can be rather intense --

(Laughter.)

MR. McDONOUGH: -- before we've reached that point.

We have the great good fortune to have with us, as I mentioned, Don Nicolaisen. The Office of Chief Accountant is the major point of contact between the SEC and the PCAOB, and we're very fortunate to have such a sensible, reasonable gentleman as the Chief Accountant.

Don.

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MR. NICOLAISEN: Thank you, Chairman McDonough, members of the Board, panelists. I'm delighted to be with you this morning.

I think everyone knows that auditor independence is an important component to restoring investor confidence, and I sincerely do appreciate the invitation to participate in today's public roundtable on the auditor independence implications of an accounting firm providing tax services for an SEC audit client.

As you know, the Commission historically has adopted its own rules and interpretations regarding auditor independence issues. The Sarbanes-Oxley Act of 2002 emphasized the importance of auditor independence, codified many of the positions expressed by the Commission in 2000, and gave the PCAOB, subject to SEC oversight, the authority to make auditor independence part of its standard-setting inspection and disciplinary programs.

While the Commission's staff -- my staff, in particular -- will continue to provide companies and audit committees with guidance on auditor independence issues, I look forward to the PCAOB expanding its role in becoming the primary standard-setter and the primary source of advice and guidance to auditors on these

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issues. As the PCAOB engages additional staff with expertise in these areas, I expect that a great number of the independence interpretive issues that currently are handled by my office appropriately will migrate to the PCAOB.

The roundtable today is a welcome introduction to the PCAOB's involvement in auditor independence. By choosing to begin with the area of tax services, PCAOB is showing its willingness to address, in a public forum, controversial issues that are of interest to investors, and the PCAOB should be commended for doing so.

Tax services have been a fundamental part of the accounting firms since the inception of the profession. In recent years, however, the nature and extent of these services changed. Firms began formulating highly engineered tax products that were not designed for a particular client, but, instead, were marketed to numerous potential buyers, with the firm taking a percentage of each buyer's profits from the product. Over time, the IRS and others have found several of these products to be overly aggressive, or outright abusive, tax shelters. Personally, I believe that no accounting firm should be in the business of selling these kinds of tax products to their audit

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clients.

I look forward to the discussion today. I have to tell you, I'm particularly interested in understanding the views of the participants on the issues of an accounting firm providing tax services to executives of audit clients in a firm marketing aggressive tax shelters to its audit clients.

As always, these remarks and any others from the SEC staff today, are our own individual comments, and do not necessarily reflect the views of the Commission or our colleagues on the staff.

Thank you, once again, for allowing us to participate.

MR. McDONOUGH: Thank you, Don.

We are also very grateful that the GAO, an important ally of ours in good causes, is here, Jeff Steinhoff, representing them. Jeff, welcome. Thank you for being here.

And now I will turn the floor over to our very distinguished chief auditor, Doug Carmichael. Doug will manage the meeting for the rest of the day.

Doug, to you.

MR. CARMICHAEL: Thank you, Chairman McDonough.

We do want to get the views of everyone at

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the table on the important topics we're going to discuss. Talking with some of you beforehand, I know there's no shortage of views on this topic.

In order to have an orderly discussion, though, we are going to follow our normal roundtable-discussion procedures. We prepared a briefing paper, in anticipation of the roundtable, that includes the subjects and questions we're going to cover. Greg Scates, the associate chief auditor, and Bella Rivshin, assistant chief auditor, will briefly introduce each of these topics and related questions, and then we'll invite you to make a comment or -- and any other remarks you want. We're also going to project each question on two screens in the room to that everybody will see what they are.

If you'd like to speak, we'd ask you that you please indicate that by standing your name card on end so that we can call on you. There are a lot of people around the table, and we'll need to do that to proceed in an orderly fashion.

When you do speak, please identify yourself. It's going to be important for the other people that are in the room, not at the table, to understand who is speaking, and for those who are listening online to understand that. So while it might seem a little

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redundant to do that since your name tag's right in front of you, please do identify yourself when you speak. Try to cover the topics as efficiently as you can. We do have a lot of people, and we do want to hear from all of them.

We're going to divide our discussion today into three sessions. After we get started, momentarily, we're going to continue until noon. We're going to take a one-hour break for lunch, and then we're going to resume the discussion at 1:00. We will have an afternoon break. We anticipate that around 2:45, for five minutes. And we will conclude on time, at 4:30.

During the last 10 to 15 minutes of the program, we're going to provide people that are in the audience an opportunity to ask any roundtable participants that they want questions, and we're going to ask that, to indicate their desire to do that, they fill out an index card. Those will be provided. And you can return the index cards, with your name, e-mail address, and question, at any time during the day.

One last item for those of you who have cell phones and Blackberries, which I think is most people. Please make sure that they're silenced.

Now they want to get started.

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The Board's primary mission is to oversee auditors of public companies, protect the interest of investors. And as Don Nicolaisen mentioned in his remarks, auditor independence is a most important component of restoring investor confidence. We certainly share this view on the importance of auditor independence.

Traditionally, the SEC has promulgated rules describing independence requirements concerning accountants who perform financial-statement audits in public companies or issuers. The current SEC rules on auditor independence are based on four overarching principles, which state that an auditor's independence may be impaired if the relationship, one, creates a mutual or conflicting interest between the accountant and the audit client; two, places the accountant in the position of auditing his or her own work; three, results in the accountant acting as management or an employee of the audit clients; or, four, places the accountant in a position of being an advocate for the audit client. The SEC reiterated the importance of those guiding principles in its February 2003 rulemaking release.

So throughout the discussion, we would ask that you consider the following points in each specific tax-service area that's discussed. Are these

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overarching principles useful in considering the appropriateness of tax services performed by the auditor for its audit client? Are there other overarching principles that should be applied to tax services?

Before we move ahead and discuss specific tax services, would anyone like to comment on the overarching principles and their applicability?

(No response.)

MR. CARMICHAEL: Okay, let's move, then, into the discussion.

Okay. Sorry, Barbara. Barbara Roper.

MS. ROPER: Barbara Roper, with Consumer Federation of America. I'll jump in here, and I may talk at some length, because I probably am not going to have that much to say once you get into the details of specific services, where I have less expertise.

The argument that tax services are -- somehow operate outside these basic principles, I think, is based on a completely flawed and faulty premise. The first argument that puts forward is that Congress specifically singled out tax services as permissible. This is a misreading of the legislative history.

Congress specifically singled out tax services as being in need of review by the audit

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committee. There was a recognition on Congress's part, based on the hearings that they'd held leading up to the legislation, that tax services were complicated, that some of them were fairly straightforward and didn't appear to create independence problems, and that some of them created potentially serious independence problems. And Congress used some restraint in not trying to draw that line itself, recognizing that that was probably not appropriate to try to do through legislation, but they singled out tax services as requiring careful review by audit committees for this very purpose, that audit committees would apply the standards of -- the basic principles of auditor independence to these services.

That was the context in which this provision was added to the legislation. It was based on the letter that Chairman Levitt had written to audit committees asking them to -- you know, urging them to review non-audit services in light of these principles and other factors. It was based on testimony that indicated that that was a service that the audit committee preapproval process could, and should, serve.

The second argument that gets put forward is that there is a long history of auditors providing these services. There's two problems with that. One

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is that, as has already been mentioned, the nature of the services now being provided under the name tax services has significantly changed. The other is that the audit just simply doesn't have value if it's not independent. And it doesn't matter if these services have been provided a long time, if they compromise independence, they need to be banned.

The third argument that gets put forward is that these services are subject to particular unique laws and regulations, and that they're subject to the potential for a government audit, and that that should give us extra assurance. It does no such thing. Those laws are designed to protect the tax process, not the audit. And it may provide some assurance that conducting the audit doesn't interfere with providing the tax services, but they provide no comparable assurance that providing tax services does not interfere with the audit.

And so the basis for saying that these services are, sort of, specifically outside those principles, I think, is completely flawed, and just needs to be completely reevaluated.

MR. CARMICHAEL: Patricia Walters.

MS. WALTERS: I would definitely agree with the premise that these principles apply, and I guess

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that that was my -- and so I have -- it's somewhat of a question. I guess that was my premise in arriving and that since no one seemed to object to these the next question, my understanding was (inaudible) principles. And so in some sense, given the previous remarks, I would like some confirmation that that is the case. I certainly believe that these principles apply to tax services, and that we should use those principles in analyzing the issues that are coming forward. And if that isn't an agreed premise in this roundtable, I think (inaudible).

So I actually (inaudible) question (inaudible).

MR. CARMICHAEL: Yeah, I think that we can confirm that we'd like to apply the basic principles. Past practice indicates that there may be differences in views on how that should be applied. So I think one of the things that we're going to ask is that, in considering these overarching principles, we'd like your views on whether their application to certain tax services indicates that there is an impairment of the auditor's independence, and your reasoning in that process, as we take up each of the individual tax services.

Bruce Webb.

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MR. WEBB: Bruce Webb, Director of Auditing and Independence for McGladrey & Pullen.

I agree that the overarching principles would apply to all services provided by the auditor. However, I think we need to bear a few additional things in mind as we think our way through that, how they apply. And I'm not begging for a different application. I'm simply stating that CPAs are experts in accounting, auditing, and taxes.

That the tax services are subject to the general requirements of ethics interpretation 101-3, which was adopted by the Board as part of the interim independence standards, and under those requirements, all non-audit services, including tax services, would impair independence unless they are overseen by management, and they would impair independence if the auditor were to perform any management functions or make any management decisions.

It is my belief that issuer-specific transaction-based tax compliance and tax advisory services will generally fall within the overarching principles.

MR. CARMICHAEL: Okay, thank you.

I do want to remind people to directly speak into the microphone; otherwise, the -- your voice won't be heard on the online Webcast or to some people in the room, for that matter.

Michael Gagnon.

MR. GAGNON: Thank you. My name is Mike Gagnon. I'm from PricewaterhouseCoopers. My background and responsibility in the firm is risk management compliance, which includes independence --

Is that better? Sorry. I feel like I'm about to lean over the table here.

I think it's a very interesting and, I think, a very important discussion to have about how to apply the principles to tax services broadly. Whether it's compliance services, planning services, advisory-type tax services, I think it's very important to start with the framework of the principles.

I think that it is also important, as I think the -- certainly the Commission espoused in its rules in 2002/2003 -- that the context and facts and circumstances associated with the provision of tax services be considered and evaluated. It is very important -- and, I think, different today -- than we have experienced up to at least recent history, to recognize the responsibility of audit committees as they consider and evaluate and, in fact, pre-approve the services that auditors provide. I think it's

important that audit committees are provided with information, full disclosure for the context, the facts and circumstances associated with the provision of these services, as well as the framework of the principles so they can properly evaluate it. I think all of that is critically important.

But I do think, certainly in a direct response to some of the commentary, there is an important relationship between the provision of tax services and the auditor's responsibility, which I think, in the context of the basic principles, needs to be understood and recognized.

I do think -- I do believe -- and we're going to touch upon it, I think, during the course of the day as we discuss tax services in the context of an auditor's responsibilities -- I do think the fundamental provision of tax services does, in fact, enhance the audit process. And I think we'll get into that during the course of the day. But in the context and the framework of the principles, I believe it's very important to understand that backdrop, that the two are connected, but that the auditor has the ultimate and primary responsibility for the report on the opinion on the financial statements. But the tax services frequently enhance the efficiency and the

effectiveness of that process.

MR. CARMICHAEL: Lynn Turner.

MR. TURNER: Thanks, Douglas.

I actually like the four principles. Having been one of the people involved in actually writing them, I thought they were actually really good.

(Laughter.)

MR. TURNER: But they actually really don't come from the SEC rules. If you go back to the AICPA's Code of Professional Conduct, that's where they all came from. They actually come out of the profession. And I think, to that extent, the AICPA and profession had done an excellent job of establishing what those principles should be.

So I think the principles are good. There was no question that -- when we initially adopted the four principles, that they were to apply to work that the auditor did in the tax area. I think that Mr. Carmichael raised the appropriate question. The question is, then, How do you implement them in the tax area and make the proper determination?

To that extent, in the last year or so, the SEC staff has done, I think, a very good job of outlining the type of information that should be going to the audit committees for their consideration, the

things that Mr. Gagnon just mentioned. I think they do play an important role with respect to that. I'm not sure the audit committees today are getting that level of detail information in what's coming up to them, and I hope that that becomes part of the PCAOB inspection process, to see if, in fact, the auditors are providing that level of detail up to the audit committee so that they can exercise the type of oversight and involvement in the process -- and judgement, that Mike just mentioned, which I think was appropriate -- because I actually don't think audit committees are getting that level of detail that the SEC specified, which was actually excellent.

But, overall, no question, when we passed the rule, these were meant to apply to the tax service. Then the question became, Where do you turn around and cut the sausage, so to speak?

MR. CARMICHAEL: Mark Weinberger.

MR. WEINBERGER: Thank you. My name's Mark Weinberger. I'm with Ernst & Young. And I'm a tax guy, so my firm is probably squirming that I'm commenting on this independence issue right now. But I would agree with what Lynn Turner just said, and others. And I think, Barbara, you laid out the issue, as well, when you described the arguments, the pro and

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con. These principles, as I understood, and always understood it, were clearly part of the 2000 rulemaking the SEC did. They were part of the discussion, obviously, in Sarbanes-Oxley. They were part of the rulemaking most recently by the SEC in determining what is and is not a committed service.

And so, we would agree the real question is -- I would agree the real question is, How do you apply it to tax services? And Scott Traub recently wrote a letter and said, you know, it's -- the tax services, the application is tempered by the arguments that Barbara laid out in -- when she started talking. And for all of us around the room to have this debate is helpful, but, as Lynn said, when the audit committees sit down to try and apply these principles to tax services, which are explicitly allowed in the rule, it becomes much more complicated as they try and do it. And if there's any guidance or clarity, I think that's foremost importance in terms of this new process that was set up by Sarbanes-Oxley and the SEC rules working, because as others have said previously, the audit committees are taking their responsibilities extremely seriously, for good reason, and they're trying to work through all these issues. And the more clarity, I think, the better. So --

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MR. CARMICHAEL: Lynn, did you want to respond to that?

MR. TURNER: Well, I'd just like to follow up on one thing that both Mark and Barbara mentioned that I think is important. As audit committee member, I've gotten brochures and information from the firms that has explicitly said that Sarbanes-Oxley, in essence, approved and said you could do all this tax work, and there's nothing wrong with it. I think those statements are actually grossly misleading to audit committee members.

What Sarbanes-Oxley says is that these things are, in fact, subject to the judgement of the audit committee. It's not that Sarbanes-Oxley said they were okay, or not okay; it's that we're going to subject them to the judgement of the audit committee, which I think is why it's so important that the PCAOB make sure that the audit committees are getting the information at the level of detail that the SEC has said, so that they can make informed decisions.

And I think it is misleading when the firms come out and go to the audit committees and say, "Sarbanes-Oxley has said this is okay, so you can just go ahead and pre-approve it." That's not what was written into, and intended by, the law. And I think it

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-- while I do think the four principles have to be applied, and applied with reason, you also have to come back and say, "It wasn't that these things are okay so you can just vote and approve it," it was, "You have to exercise judgement, using those four principles, and then decide whether it's in the investor interest that these services get provided or not provided."

MR. CARMICHAEL: Jim Brasher.

MR. BRASHER: (Inaudible.)

On behalf of the KPMG, I would like to thank the Board for hosting today's roundtable discussion. We believe the public interest is well-served by having a public dialogue about the auditor's responsibilities in connection with the auditing of public registrants. We also believe that the provision of tax advice, tax services, of public registrants serves the public interest by permitting the auditor to conduct an efficient audit in respect to tax matters. We believe the public interest is well-served because the audit committee has to review and approve the provision of all tax services rendered by the audit firm, which may not be the case with respect to tax services rendered by other tax-service providers.

We look forward to an exchange of views of how we can further improve the integrity of the system

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and to strengthen public confidence.

MR. CARMICHAEL: Okay.

Jim Brown.

MR. BROWN: Jim Brown, Crowe Chizek.

I just wanted to mention, there's one other area in which these four principles are very useful. And in my firm, we agree with them, we think they're very relevant. When we took a look at the services we provided to registrants, we said, "We need to go through and scrutinize and screen everything we do." So, as a policy issue, we used these four in deciding, as our first step, what we could and couldn't do. So they're also very useful in that regard, and we would support continuing with these principles.

MR. CARMICHAEL: Jeff Steinhoff.

MR. STEINHOFF: Jeff Steinhoff, from the new Government Accountability Office. Our name was changed, last Thursday, from the General Accounting Office. So we have a new name. The same initials, though.

(Laughter.)

MR. STEINHOFF: I support the four principles. I think they set a high bar. I think the purpose of this meeting really is to help set the bar. I'm not sure if it's providing clarity to the principles themselves, or saying, "Where is that bar to be set?"

What I think is difficult here is that the auditor can bring lots of expertise, and they could bring expertise in bookkeeping, but they're not permitted to "keep the books." So I think, in looking here, at tax services, one must look at how that bar is to be applied here, and so that boards have very clear guidance as to what that means. And none of these really speak to who is the best to provide a tax service, or who is the most efficient, or who knows the most about it. They really deal with relationships. And in setting the bar, I think that these provide a very good foundation for applying against that particular service, or against any service.

MR. CARMICHAEL: Thank you.

We certainly are going to be taking up the application of the principles as we go through the services, so I'll just ask Mark Anson to make the final comment on this topic.

MR. ANSON: Douglas, thank you.

I'm Mark Anson. I'm here today to represent the California Public Employees Retirement System.

I think the final comment I'd like to make, as we go through this introductory period, is that

integrity of the financial statements is paramount to investors. I'm here representing one of the largest investors, not only in the United States, but around the world. Investors, creditors, regulators, we must be able to rely upon the information that's contained in the financial statements. Anything that impinges upon the independence of the auditor impairs the integrity of the financial statements.

And as we review the 16 questions that are teed up today, I think we should keep in mind that auditor independence is synonymous with financial-statement integrity.

Thank you.

MR. CARMICHAEL: Okay, I'd like to move to the first question. So, Greg, can you lead us through that?

MR. SCATES: Thank you, Doug.

As many of you are aware, companies calculate their liability for various federal, state, and local taxes on tax schedules that form a basis for the amounts appearing in a company's annual financial statements. In auditing these income tax accounts, the auditor is required to obtain reasonable assurance that all tax accounts are fairly stated, with appropriate disclosures, in the financial statements.

This brings us to our first question. Who prepares the tax schedules and related documentation: the issuer, a third party, or a combination of professionals? And the next question, Do the answers to these questions differ depending on the relative size of the company?

Comments?

MR. KOREN: My name's Paul Koren. I'm a partner at Goldstein Golub Kessler. We are a medium-sized accounting firm in New York City, a small, but important, SEC practice. That question is particularly sensitive to our practice.

MR. CARMICHAEL: Could you speak more directly into your mic, Paul, please?

MR. KOREN: That question, obviously, is extremely significant to our practice. Our clients generally don't have sophisticated in-house tax specialists. Nevertheless, we are very cautious with regard to accumulations of data, and we insist that our clients, or a third party, would always produce the information.

So it would be -- it would be something that we would feel challenged if we were to go past the principle of -- you know, of doing bookkeeping or auditing our own work.

MR. SCATES: Lynn Turner.

MR. TURNER: On this one, I've seen it done a number of ways. Back where -- when I was at -- a CFO, we actually had our own tax people who prepared the tax schedules and all the related tax documentation. We did our own tax return, but then had the accounting firm, who also did the audit work, actually then review the tax return in conjunction with their review on the tax accrual, although they usually got around to reviewing the tax return subsequent to the actual tax accrual, because of timing. So the process would be, we'd do the tax accrual, do all the schedules, they'd review that, then we'd do the tax return, and they'd come in and review the tax return when we were done.

Where I'm currently at as a board member, the process works pretty much the same, because the company has their own sophisticated tax department. I think the larger the companies get, that's pretty much the way my experience has been with the process. On the other hand, when I was with my former firm, I was in offices where there were only nine or ten of us in the office, or just 30 of us in the office, much like a smaller firm -- more so out in Heartland America. And in some of those cases, we would actually go through and do the audit; and then, quite frankly, at the same time we were doing the tax accrual, we'd almost do the tax return, although that really wasn't as relevant for public companies. Most public companies of any size had the sophistication to do that on their own. But there were some smaller companies that I've worked on as an audit partner where we would do the tax accrual and tax return, and help them out to that extent.

So I think it differentiates based on size and the degree that the company wants to do it. The one issue that you get -- can get into, kind of, a concern about is when the larger company decides to outsource that function to someone. You have to be very careful there to make sure that's not going to your auditor.

MR. SCATES: David Shedlarz.

MR. SHEDLARZ: As we all can probably appreciate, this is a complex undertaking, and one which is critically important to get right. And having the expertise on hand to do that properly, in terms of maintaining, as someone cited earlier, the integrity of the financial statements, is clearly one of the objectives.

For a large firm, like Pfizer, we have the internal resources, as Lynn has outlined, to do that for our own account. And so we have a fairly large

staff that has a high degree of specialization and capability in the global tax matters that touch us, given the nature of our worldwide operations.

I also can imagine, as Lynn has highlighted, that, for smaller and mid-sized companies, this is a difficult undertaking. And I think it's important, as we go through this, to understand that it's critically important to have the right expertise in place to balance out against the complexities which are inherent in dealing with these tax matters, and also in terms of ensuring the integrity of the financial statements. I can well imagine that, for smaller and mid-sized firms, it's more evenly distributed, in terms of people who have the expertise in this particular area, including the participation of their outside accounting firm.

MR. SCATES: Permit me to ask another question along these -- on this topic here. Do the answers to these questions depend on the size of the accounting firm? Does that have an impact, the size of the accounting firm?

MR. GAGNON: The size of the firm or the size of the issuer?

MR. SCATES: No, the actual accounting firm. Jim Brown.

MR. BROWN: Jim Brown, at Crowe Chizek.

I'm not certain the answer depends on the size of the firm, the audit firm. I think it's much more dependent on the size of the company. As I think Mr. Everson would acknowledge, or anybody else here, that the IRS rules are very complicated, and many small public companies don't have the expertise to properly figure out how they should comply with the tax laws. So they would rely more on somebody -- typically, in the past, it's been the auditor who's in there and has taken a look at the numbers, and has the responsibility to attest to the accuracy of the numbers in the financial statements. They would rely on the auditor. And I think there's a very clear recognition that there is a size difference. Large companies don't have that reliance on the auditor or on someone else. The small companies don't have the expertise, frankly, to get it done right. And if we want proper compliance with the tax laws, they need help from someplace. So it really depends on the size of the company, not the firm.

MR. SCATES: Pat Walters.

MS. WALTERS: Hi, I'm Pat Walters. I represent the CFA Institute, formerly known as the Association for Investment Management and Research. We are a professional organization of approximately 70,000 investment professionals worldwide. We award the

chartered financial-analyst designation.

Usually, I have lots of opinions about the questions before me. Today, I feel like I'm going to have a lot more questions for people around this table than I have opinions, although, I would expect, by the end of the day, I'll have a few opinions.

There seems to be an assumption in the answers that have been given, with respect to this particular question, that the third party or external professionals who are assisting the issuer in preparing your tax returns must be the audit firm. The only accounting experience I have, personally, other than teaching accounting, is working for a tax accountant. This tax accountant did nothing but taxes, and he would shudder at the thought of having to do an audit. He only did that until he got his CPA, and then he went to do what he thought, what was interesting.

So in some sense, in response to a statement by a gentleman across the room from me, whose name I can't read from here, I agree that audit firms or accounting firms have lots of expertise in them. They have people who know tax, and they have people who know financial reporting, and they have people who know how to do audits. Those people are generally not the same person, and that those who spend their time reading the

Journal of Taxation really aren't good at answering audit questions, and aren't good at answering financial-reporting questions. They know how to do taxes.

So it's a question for the people around the table who have been responding so far, Why can't a firm -- why can't an issuer contract with someone else, other than their auditor, to provide the expertise that they may need in preparing their tax returns? As an individual, I go out, and I have a tax accountant, and I have to rely on the fact that that person is a tax professional. If I wanted someone to do my audit, I don't see why that would have to be the same person. So I'd like a little elucidation from the auditors and tax accountants around the table.

MR. SCATES: Mark Weinberger.

MR. WEINBERGER: Thank you.

Patricia, in answer to your question specifically, I guess, you know, I think it's a commonly held view that the registrars have to prepare their own statements, their tax accounts, and, for financial purposes, the auditors cannot prepare them and then audit them. And as was said already, in the larger companies, you're finding internal expertise that can do that. We are seeing, in the smaller companies -- and smaller is not small, like five

persons; smaller is a billion to five billion, we're talking lower-, you know, middle-market kind of companies -- are actually having to go out where they don't want to, or can't, spend the resources to have an internal resource to do that -- going out and finding a third party, and the third party is not their auditors. In many cases -- in all cases, I assume -- if they're going to have a third party, it's not their auditor.

So there are actual firms that do this, specifically -- whether they're law firms or CPA firms or firms that do auditing for other clients -- that is going on in practice.

MR. SCATES: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey & Pullen. I think I'm the name Pat couldn't read.

I would just like to, sort of, comment in response to Greg's question, and something that Pat said, regarding, you know, Does size of firm make a difference? I don't think size of firm necessarily makes a difference, in terms of whether or not the auditor prepares the tax schedules. And I'm a little confused, by the way, by the question, as to whether we're talking about schedules that are involved in doing the computation and making the provision for the financial statements, or whether we're talking about

the schedules that form the basis of the return, itself. I think those are different activities and would have different rules.

However, I will say that, in our firm, which is, you know, a substantial firm, we have a lot of auditors who are also very expert in tax services, and generally supervise both services for clients, whether they be issuers or not issuers. I think the smaller the firm, the more likely it is that the CPA wears more than one hat. I think the larger the firm, the more likely it is that you'd find yourself either in an auditing or a tax -- auditing and accounting or tax niche. So that's -- for what that's worth.

MR. SCATES: The reference to the tax schedules is those schedules that are prepared in connection with a financial-statement audit.

Scott Bayless.

MR. BAYLESS: Scott Bayless, with Deloitte.

Having participated with Lynn Turner in drafting the principles, I certainly endorse use of those principles. And I think, in our experience, we've seen that audit committees are using those principles in their evaluation of tax services.

With respect to the issue of who's preparing the schedules and returns, I think it's important to

remember that, one, auditors are required, by their professional standards, to ensure that management has the appropriate expertise to do their own tax-return preparation, and that's an important element that the audit committee and the auditors take into consideration in consultation regarding the provision of services.

Secondly, in terms of the importance of having the auditor involved in the tax services, is the notion that the auditor, by that involvement, enhances audit quality. And the consultations and the issues with respect to tax compliance are certainly issues that are everyday issues. They're not issues that can be decided once a year, at the end of the year, but that involve continuous consultation as the company undertakes transactions and business events during the year. And, although the tax expertise may differ by the size of the company, each company has particular issues that they need to seek out the professional advice of tax experts.

The worst scenario that you could end up with, though, is a scenario in which the auditor, having been consulted at the end of the year by a third-party tax preparer, disagrees with that tax preparer's views, and ends up in a scenario where you have a

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financial-statement restatement or a difference in the application of taxes at a subsequent period of time.

MR. SCATES: Lynn Turner.

MR. TURNER: We just -- at Glass Lewis, we've done a couple surveys of tax services that relates to audit services, both on the Fortune 500 companies, as well as 1800 companies that go down below that, so you're getting pretty well into the Russell 3000, which would probably take you down to companies of a couple-hundred million in market caps. So you're starting to get down into -- from a public-company perspective, definitely -- smaller-sized companies, well beyond the Fortune 1,000, even. And some of our findings were interesting, in that I expected to actually see the smaller companies using their auditors more for tax services, because just my experience had indicated that was what I thought I would see. And yet when we actually ran the statistics, based on 2002 and 2003 data, that's not what we found. We found about a quarter of the Fortune 500 companies that we looked at -- we looked at 461 out of the 500, which were most of the public ones -- and the audit -- the tax work was very nominal, or zero, at about a quarter of those. And I doubt anyone around the table is going to turn around and tell us that those audits that they were

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doing on a quarter of those weren't high-quality audits. So I don't know that you've got to do this to ensure a quality audit, because there are a quarter, and that percent is growing.

But when we looked at that for the other 1800 companies, that number had gone up a little bit more, to about 31 percent were actually using their audit firm for very little or nominal tax work, and actually the tax work on the 1800, as percentage of the audit fee, was lower than it was for the Fortune 500 companies. So it was not, quite frankly, what we expected to find; and, if anything, not what you'd expect in relation to the Fortune 500 companies, who tend to have that expertise in-house. And the fact that you've got 500 -- over 550 of those companies that use their auditor for nominal tax work out of about 1800 clearly indicates that you were able to do this without using your auditor to provide that expertise in-house. It's either that or we've got a lot of lousy audits out there, and I don't think we have a lot of lousy audits out there.

MR. SCATES: Paul Koren.

MR. KOREN: I actually see that statistic from another viewpoint. Anecdotally, since we're an auditor of relatively small and usually new companies

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coming to the markets, frequently a client will come to us and say, "We're planning initial public offering. Our auditor is a local firm, doesn't have sophisticated auditing experience. And we would like you to consider being our auditor for our SEC work. But because we've had a long-term relationship with our local firm, we want them to continue to do the tax work." And that, of course, make sense.

We find, though, after a number of years, the client typically will come to us and say, "We think we'd like you to do the tax work, too, because we think it would be more efficient. You understand us better, you have more insight into what we are doing." And so it tends to morph into where we actually begin to do both services.

MR. SCATES: Barbara Roper.

MS. ROPER: Just briefly responding to something Mr. Bayless said, I can actually imagine a worse scenario, which is that, at the end of the year, the auditor disagrees with the advice given by the tax expert, but doesn't say anything, because the tax expert's from his own firm, and to do so would be to call into question the work of his firm, which is why I think auditor independence is an important consideration for these services.

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MR. SCATES: Tom Ochsenschlager.

MR. OCHSENSCHLAGER: Yes, thank you. I'm Tom Ochsenschlager, with the AICPA. I'm the Vice President of Taxation. And previously, as recently as last year, I was with Grant Thornton for almost 25 years. So I've had some practical experience, and also some experience from the association side of things.

I just want to, sort of, circle back, tagging onto to what Scott had said a few moments ago, and also I think in response to what -- the issue that Pat had raised, that -- why we don't use -- why companies don't -- it's not better to use an outside consultant on tax matters, rather than the auditor. And Scott mentioned, and just to elaborate on that a bit, the advantage -- first of all, you can do that, of course, and many firms to, and there are statistics that we've alluded to here that show that that's an increasing trend, perhaps because audit committees are being more diligent in their duties, to use outside consultants. But -- so that's clearly a choice, and I think we'll see it being made maybe more often in the future.

But one of the primary reasons for using the auditor for these functions is the point that Scott brought up, and that is that there's a continuous relationship between the auditor and the client,

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because they're required to do quarterly financial statements, there will be tax reviews that are done on a quarterly basis, so issues -- tax issues will be much more likely to be spotted during the -- during the course of the examination by the auditor than they would be if it was relied -- if we relied totally on the management of the firm to spot the issues and then call in an outside third advisor.

Now, when an audit firm does spot an issue, a tax issue -- whether it be favorable or unfavorable for the client -- during their quarterly reviews, they would bring that up before the audit committee, and presumably the audit committee could then, even after the issue has been identified, farm it out to a third party, an independent third party. But the advantage of having the auditor onboard with the tax expertise is that these issues are much more likely to be spotted much earlier in the process, and eliminate a lot of the year-end confusion, which Scott had referred to earlier.

MR. SCATES: Mike Gagnon.

MR. GAGNON: Thank you.

The -- just want to address the statistics that Lynn mentioned a short while ago, where, I think, a quarter of large companies and about a -- almost a

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third, 31 percent, of the, sort of, mid-cap companies do not use their auditor for tax services. Maybe unlike Lynn, I don't find that is particularly surprising. I don't think it impacts the point of enhancement of the audit process in auditor effectiveness where tax services are provided by an auditor, and it doesn't mean that, in the one quarter or one third that the audits are not effective. And I know you weren't suggesting that. But it is enhanced.

It's difficult for me to imagine an audit partner, who is responsible for the audited financial statements, not relying upon tax expertise within the global organization, particularly for large companies, where the environments are very, very complex, very difficult. And the transparency involved, where deeply credentialed experts in the area of taxation, in the many areas of taxation, in advising and helping and assisting the auditor in the audit process, has to enhance the audit process. And I think there's also an efficiency point, from clients' perspective, where that expertise is also brought to bear from an organization where there is deep knowledge, deep expertise of the organization, and the two work together. So I wouldn't -- I wouldn't suggest that the audit quality is detracted when they're not involved, but it's difficult

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for me to see how an audit partner wouldn't really rely and use the expertise.

I think there's also one last point of transparency, in the sense that where that is that expertise embedded in an organization, particularly in a -- when a -- when that organization is involved in the audit of a very large, complex, global organization, the transparency involved in the early notice, the timely notice of issues, in terms of the audit process, also enhances the tax-reporting process. So I think there's -- there is that benefit, as well.

MR. SCATES: Well, we have four more people that would like to speak. We'll start with David Shedlarz, and we'll conclude with Bruce Webb, and then we'll move on with the next topic.

David.

MR. SHEDLARZ: From the issuer's-community perspective, I guess I would second a lot of the things that Mike just went through. In fact, I'd be pretty concerned if the outside audit firm didn't know, pretty intimately, about the tax structure, especially of a global, complex concern. And that's not something you can do from afar. There is great utility, in terms of certain tax advice, which is actually given to the company, that enhances the working knowledge, the

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integrity, and the level of comfort we should all have, in terms of the ability to deal with inherited complexity of tax matters, not only in the United States, but also on a global basis. And so I think there is a tremendous benefit here we can't lose sight of, we can't let the statistics run counter to, and that is the involvement of the outside accounting firm. And anything of this level of sophistication is highly desirable, in terms of getting the end result we all want, and are all looking for, on an ongoing basis, which is transparency, timeliness, and integrity to the accounting and financial statements.

If my outside accounting firm is too far afield of what's going on, from a complex tax perspective, then I think their ability to deal with those dimensions is going to be significantly curtailed. You could provide for those services on the outside. I think, to a certain extent, you run the consequence, in terms of not having as close an association that you need to have, in terms of understanding the inherent complexities of what goes on, especially as it relates to global tax matters.

MR. SCATES: Colleen Sayther.

MS. SAYTHER: Thank you, Greg.

First, I wanted to say that I think most

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companies agree that having auditor independence is important for a high-quality audit. Also, I think most companies agree that having the auditor, as David so articulately put, perform some of the tax services, creates a better quality, and is more efficient.

However, I think we may be confusing those points with what the question says. And I think, Greg, when you mentioned that it's talking about tax schedules and related documentation associated with the financial statements, I know of no instance where the audit firm would prepare the tax schedules associated with the financial statements, and then audit that. So I just wanted to make sure that we were clear. And I think Mark made that point earlier, that there is a definite -- I see a definite distinction between, you know, other tax services and the preparation of schedules to support the financial statements.

MR. SCATES: Jim Brown.

MR. BROWN: Jim Brown, Crowe Chizek.

I agree we've, sort of, perhaps, moved away from the issue up there that we see, about tax schedules. But when we're talking about statistics, I guess you could look -- there's a lot of statistics out there, and you can argue that, well, the cup's half full or the cup's half empty. Or, I guess, in the

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statistics that we heard a moment ago, the cup's two-thirds full and one-third empty in the relationships, because some companies do it, and have a successful audit, and others don't. Regardless of where the statistics work out, I think we'll all be able to deal with whatever the circumstances are.

But I did want to mention -- to throw some more statistics in here. There's an interesting study by three academicians that's coming out soon in a journal, and they're well-respected academicians. They actually came up with a conclusion here, and they said that -- if I can just read this -- "third, we find tax services fees are typically negatively associated with restatements, and that the association is statistically significant." What they mean by "negatively associated" is that the higher the tax-services fee, the more tax services obtained, the fewer restatements in those companies. Said the other way, the companies that had more restatements didn't use their auditor for tax services as much.

So that's an interesting article that -- you know, like anything, you have to deal with all the different elements back and forth, and come up with a policy decision. There's a lot of stuff on both sides.

MR. SCATES: Bruce Webb, you'll have the

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final word. We'll need to move on then.

MR. WEBB: Bruce Webb, McGladrey & Pullen.

I just wanted to follow up on a comment that Tom Ochsenschlager made. And I think it's important, as we deal with this subject matter, to recognize that audits are done in a different fashion than they were 20 years ago, or perhaps even ten years ago. With the increased responsibility for management and the auditors for the quarterly financial statements and the responsibility to assert and attest to the effectiveness of internal control over financial reporting, audits are becoming much more of a continuous process. And an auditor is foolish if they don't get out and examine, not only the accounting, but the tax implications of transactions, sort of on a contemporaneous basis, as well as internal control. And, clearly, the SEC independence standards, nor standard number 2, neither preclude the auditor from consulting with the issuer or providing advice as to the application of accounting principles or advice as to improvements that could be made in internal accounting control. Similarly, I think providing advice as to the tax implications of specific transactions is part of that process.

MR. SCATES: Lynn Turner.

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MR. TURNER: Just coming back to the question you asked about, Who does the schedules? Again, I have seen, on the smaller companies, where the auditor has done the schedules and has done the tax accrual, and then has done the tax return, because the small company just doesn't have that expertise in-house. So I think it does vary by the size of the company as to how much is done until they're able to get their own people on staff that has that expertise.

MR. GRADISON: Lynn, could you repeat that? I couldn't hear you. I couldn't hear --

MR. TURNER: I'd be happy to.

(Laughter.)

MR. TURNER: My -- and I apologize -- my experience has been, as you get into the smaller companies, including the smaller public companies -- and keep in mind, your own annual report just said we have about 15,000 companies out there. By the time you get past the Russell 3,000, you are into small companies these days. And not much of the market cap is there, but, in terms of numbers, it's a large number of companies being subjected to audits.

In those, because they don't have the expertise in-house, I would say people tend to -- and the other people from industry can chime in here -- but

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I would say that, once you get up probably over about a half a -- oh, maybe 300 million, half a billion in revenues, you start to build your own internal tax people that have the expertise in-house and be able to stay on top of things that are going on, and do the planning and all that you need to do. But before you hit that size, when you're smaller, it's just more efficient and easier to -- and most people -- most companies, I think, do, in fact, then just go to their accounting firm, or to an accounting firm, to get that expertise.

And I think you can get the expertise and have people stay on top of it for you regardless of whether you're doing tax or not. I've had situations where we did audit work, but not the tax work, quite often, quite frankly, when we were joint-venturing with a smaller firm. The smaller firm would do the tax work, and, quite frankly, was probably better than us at servicing and keeping them up to speed on the tax work than we could have been doing in a big firm. And so we'd do the audit, take on that piece of it; they'd do the tax work. But I've also seen where we did the tax work, and other firm turned around and did the audit work. And, in both cases, I think the auditors and tax people both did a very good job.

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I don't think that you have to have the same firm doing both audit and tax to stay on top of things and get a good service provided to the company. But as you get into those smaller companies, as you get past the Russell 3,000, certainly once you get past the top, probably four to five-thousand public companies, then you're into situations where I think you'll find that if the auditor is doing the tax work, they're also probably doing the tax accrual, and they're doing the schedule, and they go through the audit, and as they wrap it up, they'll wrap up the tax return. They're probably doing the tax work for the owners of the business, as well, if they're doing it all. And so it's probably, in those situations, a situation where they would have to figure out what they were going to do if it wasn't their auditor turning around and doing it.

That's why I was surprised by the statistics, that as we moved out of the Fortune 500 and 1,000, we actually saw that they were going out to -- in even a larger percentage, to someone other than their auditor for the tax firm, although I've got to tell you, I've seen some small firms, boutique firms that operate in tax that are just superb and excellent. And perhaps that why they're doing it.

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MR. SCATES: Let's go ahead and move to the next topic.

We would like to have a discussion of the various types of tax services that an accounting firm might provide. Although these services are grouped in general categories, there is an overlap among the various types of tax services.

Let's first take a look at tax compliance. Tax compliance generally involves preparation of federal, state, and local income tax returns. Tax compliance also includes payroll and sales tax returns, as well as returns for employee benefit plans.

Our first question, or group of questions: If a public company does not have the in-house expertise to prepare tax returns and related documents, are there benefits to the company and its investors to engage the auditor to perform such work? Are there disadvantages to engaging a tax specialist other than the auditor? And our third question, What kinds of fee structures are used for tax compliance services?

Damon Silvers.

MR. SILVERS: I'm Damon Silvers. I'm associate general counsel at the AFL-CIO.

This discussion, kind of, already happened, to some degree, and I want to, sort of, treat it as

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though it was somewhat continuous.

We have heard the concept, I think, this morning, already, that there are small companies -- small, like five billion market cap -- that don't have in-house expertise on their tax problems. We have heard that there are big companies that are so big that their tax problems are so complex that no company could have internal expertise, and that they have to go get external expertise because they are so big. We have heard that the auditor needs to do the tax work to be able to understand enough about the company to be able to do the audit.

This -- these sorts of statements trouble me, because when Sarbanes-Oxley was in the process of being adopted, the AFL-CIO was extremely concerned about the general subject of auditor independence, but believed that the sort of tax preparation and compliance services that are the subject of this question really did seem to be, kind of, sensible things for the auditor's expertise to be used in. And we were prepared to support an approach that allowed, in general, tax consulting to continue after Sarbanes-Oxley, because there would be a series of limiting principles that would ensure that this type of consulting was narrowly applied to tax compliance.

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I think, frankly, we were naive. And I think that the list of questions that follows this one, and the types of things described as, quote, "tax consulting," shows the depth of our naivete in accepting this approach and the way in which it's, sort of, been carried off into the wild blue yonder; notwithstanding the sorts of limitations that that we had thought, at that time, were in place. I think that those limitations have not been explicated enough to give them real teeth.

And we're now having this discussion about the necessity -- whether there is a necessity of doing the sort of services that we originally thought were rather innocent. And I don't think anyone can deny that there is some benefit to companies in consolidating professional services, that having two -- having one firm try to understand your firm -- your company, the issuer, is cheaper than having two of them trying to do so. Although, I think that the more heavily structured the audit firm is, the more the tax practice and the audit practice begin to resemble two firms, in any case.

The real issue is, What is the price you're paying? The real -- I think there are two issues. One is, How serious is that benefit, really? And some of

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the arguments that I just went through in the beginning of my remarks make me doubt the seriousness of the benefit, because I don't -- those arguments just don't sound credible to me, and it sounds like people are exaggerating things. And that is worrisome.

And the -- and then the second question is -- there is some -- because there is some benefit. I don't doubt that. And I think that the existence of that benefit was what led us to be more accepting of this approach originally. If there is this benefit, what is the cost? What is the cost, in terms of both the overall independence of the auditor and the audit process. And what is the cost of it with respect to the independence and the effectiveness of the audit of particular aspects of the company's financials that are related to the tax work?

MR. SCATES: Jeff Steinhoff.

MR. STEINHOFF: I want to first state that, in the discussion this morning, there's been a very broad brush placed on tax services, and I think there's many services being provided. And to the extent the board can lay out all the types of services, which I think with these first two questions you were trying to get to, I think you can be in a position to really place more clarity on this issue.

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I will say that it gets down, in many cases, to the degree. The comment Bruce made before about providing routine advice is much different than actually carrying out the function. And I think the standards and the four principles here would permit routine advice.

There is no question that the knowledge of the auditor and the knowledge of the business, in doing the audit, would provide a real advantage to the auditor in providing this service, and perhaps to management. But, as I mentioned earlier, you can take this to many areas. We faced this in GAO when we were establishing our independence standards, and we had a lot of very small local governments, small nonprofits, where they basically said the following, "These entities are so small, they can't really keep their own books. So it's better for the auditor to do that. They can't really make their own payroll disbursements; it's better for the auditor to do that for them, too." And on and on and on. And, at the end of the day, they were saying, "Federal Government, you're getting a better result because you've got trained professionals making sure the books and records are being properly maintained. They're also doing the audit, but that's all right, because they've made sure it's done right."

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And I think what you have to really make a determination here is, are these four overarching principles going to be applied differently to tax services than they are to every other service that a -- an accounting firm can provide? And I think you're going to have to take the maybe 15 -- 10, 15, 20, whatever the different types of services being provided -- and look at each type of service, because I think there certainly are some that clearly fall into the routine advice. And I would even say sometimes helping the client prepare the return, if the client doesn't know what line to put the numbers on, I think that's more of a ministerial duty, personally, and would be what I would call routine technical advice. But I think you're going to have to take the different types of services and probably address each type of service.

MR. SCATES: Nick Cyprus.

MR. CYPRUS: Yeah. Nick Cyprus, controller, Interpublic Group.

First, let me just make myself clear that I'm really addressing tax-compliance services, because there's other services we'll talk about later. But if I think about an auditor preparing original tax returns or schedules, and we all, I think, agreed that we agree to the overarching principles, then I don't know how it

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doesn't put the independent accountant in a position of an advocate for the client, in a position of management, and even in a position of potentially doing their own work. So if I think about compliance services, actual preparing returns on behalf of the client, you know, I think I'd come out -- and this is my personal view -- that says it's probably not the thing I'd want my auditor to do. I think that's very different -- and I think it's our job either to provide in-house expertise or third-party expertise to help us do that. At the Interpublic Group, we do have a tax department that does that work.

But if we go on to futures -- and I won't talk about it yet, but when we go on, later on, to advisory services and knowledge of where we do need our auditors, I would say, just like -- if I have a tax issue or an accounting issue, just like I go to my auditors to get an accounting policy, even if I come up with, "I think this is the kind of accounting we need to do," I like to know, from my auditors, "Do you agree with me?" It would be the same thing on a tax event -- if I'm doing a merger, if I'm thinking about a tax strategy -- and this is the position I want, I want to make sure that, at the beginning, not at the end, I consult my auditor, just like I do with my accounting,

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to make sure that we're in sync on this, that these are the right things to do.

And so I see it very differently when I think about the compliance services than when I think about tax planning and advice services.

MR. SCATES: Mark Weinberger.

MR. WEINBERGER: Thanks, Greg.

This really goes to this question, in particular, and a series of questions that we have coming up, which is where we evaluate or attempt to talk about the advantages and disadvantages of using your auditor for tax services. And, Damon, you said that some of the claims about the benefits seem exaggerated to you. And when you talk about it in the abstract, it's very hard to come out with a specific answer, because it is abstract and there are no, you know, across-the-board rules that are going to address every situation.

But Sarbanes-Oxley, with vesting the power in the audit committee, who has all the facts and circumstances before them to make this determination, really puts those people and the audit committee in the -- on the line to make these decisions. And, frankly, I'll be honest, from what we see going on in the marketplace -- I apologize, I'll use a baseball

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analogy, but last night was the All Star game -- that, in the past, the tie goes to the runner in baseball. If you get to the base at the same time as the ball, you -- the tie goes to the runner and you're safe. And I think the auditor got the call every time there was a tie in the past, generally, because of the relationships, the efficiencies, the understanding of the business.

Now, as the audit committees are evaluating all the services in more depth, with their new responsibilities, we're seeing the trends that we talked about earlier, where more and more audit committees are deciding when it is and is not appropriate to use the auditor for what services. And we're seeing that in the numbers that have been suggested.

In some cases, it will absolutely not be in the interest of the issuer to use their auditor, if for no other reason, the process is much more elongated. Obviously, you have to go in for preapproval, you have walk through the -- the tax function has to bring the idea to the audit committee, they have to go through it all, the audit committee has to bless it, then it goes to the proxy statement; the numbers are then put into proxy, if you're the auditor and you do the work;

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you're going to get public scrutiny from investor groups. That is a good thing. Sarbanes-Oxley thought that was a good thing. But maybe an issuer will think that that's something that's just -- takes too long, and so maybe if we don't use the auditor, we don't have to go through those processes.

But, in some circumstances, they're still going to decide to use the auditor, and, principally, it could be because geographically they're located in countries across the world where they're better able to serve them, and they have to make sure they have risk policies in place in each of those countries; and other firms may not have the operations in each of those areas to be able to serve them all across the globe. Certain firms have more expertise; in particular, regulated industries and the like. And to get the best knowledge and expertise, they may want to go to a firm that has that, even if it is their auditor; and, in other cases, they won't.

So what I would say is this. When we talk about the advantages and disadvantages, I think it's right to say -- it's hard here to sit and say what they are, but when you know the facts and circumstances, applying it to your individual issuer, it becomes easier.

MR. SCATES: Dean Uminski.

MR. UMINSKI: Dean Uminski, with Crowe Chizek. I'm in charge of our state and local tax practice. And I've been on both sides of the fence, as a consultant and, in industry, as a buyer of services.

And I guess, when I look at the issue here, with tax compliance, I'm focusing on the word "expertise." And as a buyer and as a previous buyer and as a provider of services, I think that's a key word. Who brings the right expertise to the table? Tax laws are becoming very complicated -- not only federal, but state and local. And I agree with what Mark just said, over there, in that geography plays a role. There's a lot of things that play a role in this -- cost, efficiencies. But I think the underlying concept is, Who has the right expertise to get this work done, and in the right manner, that you're complying with the law?

MR. SCATES: Mark Anson.

MR. ANSON: Mark Anson, from CALPERS.

A moment ago, Damon Silvers mentioned cost, and I think that's a good thing to focus on, particularly since it's a question that's posed here at the end of question number 2, Are there disadvantages to engaging a tax specialist other than the auditor?

Well, certainly one of the issues we hear frequently from corporations with whom we hold dialogues is that it's less efficient to hire someone other than the auditor, more costly. This same question, by the way, comes up, jumping ahead of it to question number 4, in the next discussion.

Yes, there might be a higher cost by hiring a tax specialist other than the auditor, but CALPERS, over the last year, has made it very clear that if there is a higher cost, we are willing to pay that cost, as a shareowner in these public companies, to ensure the integrity of the financial statements.

So as we talk today about independence and whether it's appropriate to hire an outside tax specialist -- and maybe there is a higher cost associated with that -- well, what's the benefit you get from that cost? What is the economic tradeoff? The economic tradeoff is preserving the integrity of the financial statements, which we, as an investor, must rely upon when we decide how to invest our capital.

MR. SCATES: Elliot Schwartz.

MR. SCHWARTZ: Elliot Schwartz, with the Council of Institutional Investors.

That last comment was absolutely correct and

very close to what I intend to say, which is, we have established a very bright-line test, which is to say that, the appropriate non-audit services that an audit firm ought to provide are zero, that the benefit of having a very clearly independent audit, one that can be trusted, one that establishes, you know, a clear level of independence, is very great. And any small cost associated with not having the benefit of auditor providing non-audit services is really relatively small compared to that higher level.

I also want to associate myself with Mr. Steinhoff's comments about auditor independence. Although he suggested that we were, in essence, I think, standing on an slippery slope, where we're about to differentiate between many, many different kinds of non-audit services, whether it's tax planning or advice or compliance or whatever it is. As I said, our standard is that there should be really no non-audit services. I am very leery of the idea that we'll be able to differentiate and find shades of gray, put one service over the line and one service on the other side of the line. And so as we go through these services, I think we ought to be aware that they don't always have very clear borders.

MR. SCATES: Lynn Turner.

MR. TURNER: The -- Mark actually brought up a good analogy with respect to baseball and last night's game, despite who won.

(Laughter.)

MR. TURNER: But the notion that the tie goes to the runner, it's interesting to listen to these conversations, because we hear people start to talk about whether it's more efficient, cost beneficial, et cetera. But I think, at the end of the day, we've got to come back to how this meeting started, and that is maintaining the investor confidence in the integrity of the numbers in the financial statements. Because even if we have a great audit done, but there's a lack of confidence in those numbers, then what we're trying to achieve with the audit is totally lost.

So from that perspective, I think we -- you need to keep in mind that when there's a tie, the tie has to go to the investor. The tie doesn't go to the company, and the tie doesn't go to the auditor; the tie goes to the investor. And, as Mark, next to me, has mentioned, time and time again we advise investors that now manage well in excess of ten trillion in capital, and time and time again they're willing to bear additional costs. But I actually don't think there is always additional cost. I've seen situations, time and

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time again, where when you go to another supplier, other than your auditor, including for tax work, you can get significant reductions in costs such that you turn around and benefit the investor by the lower cost, and you also benefit the investor by the enhanced independence of that situation, because the auditor is no longer doing the thing. And, in that case, I don't even think it's a tie; I think it's an automatic "go to the investor" in those situations. So this notion that you always are going to have a higher cost if you aren't with the firm that's doing your audit is, quite frankly, a big misnomer, and sometimes the differential in costs are substantial because you're trying to stay with one supplier. So I think you have to be careful with that notion.

When you get into these particular services, like, for example, the question that's back to tax compliance, I also think you have to understand that everything's not always black and white. Even when you're down to just doing tax returns. For example, when people -- when the firms were doing tax returns of companies where they had sold shelters, they were under obligations, under the code, to make certain disclosures in those tax returns with respect to shelters where they had taken certain positions, and

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yet we now know that, even in those situations, some of those disclosures weren't appropriately made. And so those raises -- those, in and of themselves, raise questions.

So I view it not so much as whether you're doing tax compliance or something along the lines all the way out to tax shelters; I view it more -- and I think at the SEC, they've typically viewed it -- if you've got a code in place, and it's probable, it's fairly highly likely that you could sustain your position with the IRS -- everyone, including myself, on their tax returns wants to take advantage of all the provisions in the code to minimize their taxes. We all turn around and do that. And that is fine, as long as it's clear and there's a high degree of likelihood you're going to be able to sustain that even when you're doing tax returns. But as you move down the channel from being probable -- you know, likely -- to a 51-to-49 cut and then to less than 50 percent that you're going to be able to sustain your position with the IRS, when you drop below that 51/49 cut, I don't see how anyone can say that they're not being an advocate and breaking the basic principles, regardless of the type of service.

So, more so than the type of service, I look

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to see, Is there a direct conflict with the interest of the investors? And are you putting yourself, because of the positions you're taking, into a position of having to be an advocate for the company? And if that's the case, then I don't see how you can think any investor is going to view you as independent.

MR. SCATES: Okay, we have four other participants who would like to make remarks. I'd like to start with Damon, and we'll conclude with Colleen, and we'll move into the next topic before lunch.

Damon Silvers.

MR. SILVERS: Two comments, briefly. First, just to, sort of, re-emphasize something I said earlier, we initially looked at this area, preparation of returns, in the context of, you know, genuinely very small firms with limited resources, as a sort of benign one. The problem, I think, with it, though, is -- is that, while it's, sort of, practically benign, it does completely undermine the, sort of, conception of the audit process as separate from the managerial process, and that's the kind of cost I was referring to earlier, which, sort of, suggests that maybe this shouldn't be done.

Secondly, the question has been raised, I think, multiple times by auditors who are participating

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in this dialogue, of the need for companies in a, sort of, continuous fashion to be able to consult with their audit firm on tax issues in relation to the audit. And I would appreciate someone answering the following question about this.

If a firm, an issuer -- if an issuer takes the policy of not hiring the audit firm to perform any non-audit services, as some do, and negotiates an audit fee for audit work, and, in the course of their business, is interested in the audit firm's opinion about how they will -- about how they would react to a particular tax treatment of a particular transaction, and calls up their auditor -- you know, audit partner -- and asks them that question, what response would they get?

MR. SCATES: Tom Ochsenschlager.

MR. OCHSENSCHLAGER: Yes. Tom Ochsenschlager, with the AICPA.

A lot of the discussion about whether we should use auditors for the preparation of tax returns is focused on cost savings. And I subscribe to the idea that you probably do save costs because of the efficiencies. But I think there's also a quality issue. If you use the auditor to prepare tax returns, I think it's because of the auditor's familiarity with

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the culture, if you will, of the client, the financial information of the client, you're much more likely to get appropriate tax advice for the client than you would if you had an outside firm doing it. Not to say you don't have that option. But I'm just saying that's one of the advantages of using the internal auditor, that familiarity.

And I also think that it's particularly important in most accounting firms -- it should be true in all of them, really -- if they're giving tax advice, the tax return does have to tie to the provision for the financial statements. The provision is something that's signed off by the audit staff of the accounting firm. So you have, in effect, a vetting of whatever position the tax department of the audit firm would be taking with the audit staff. That has to be tied together. That's not true if it's an outside firm that's doing it. An outside firm would just do the tax return, and come what may, and it doesn't necessarily have to -- it should tie to the provision, but it doesn't always. And I've been in that situation, where we did the financial statements, and reviewed the tax provision; another firm did the tax return, and we had terrible times reconciling the two, because they were taking positions on the tax return that we didn't

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think, frankly, were appropriate, were too aggressive.

So it can -- there can be a quality issue in addition to a cost-savings issue by using your auditor -- using the auditor as the tax-return preparer.

MR. SCATES: Colleen Sayther.

MS. SAYTHER: Colleen Sayther, from Financial Executives International.

I think I agree with Lynn's, you know, comment on using the term "always." And I think, you know, when we've used the term "always" with respect to costs and, you know, more efficient audits, et cetera. But we also have to be careful using the term "always" when we talk about all non-audit services as being -- creating lesser-quality audits. And I think Tom actually articulated quite well what -- the point I was going to make, which is basically, you know, in certain instances it makes a lot of sense to have some of the tax services prepared by the auditor. It creates -- it does create efficiency, and, for the reasons that Tom mentioned with respect to communication, with respect to the audit side, I think it's vital. And I think the current process of having the audit committee vet those tax services and make a determination as to what's appropriate and what's not appropriate is the way to keep it.

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MR. SCATES: Okay, let's, before we take a break for lunch, let's move to next topic.

Many of the accounting firms also offer a variety of tax services, commonly referred to as "tax planning and advice," that many of the participants this morning have already alluded to. This type of service includes advice related to treatment of mergers and acquisitions, executive compensation, employee benefit plans, proposed or pending tax legislation, and international tax requirements, such as trade and custom duties.

Number four here, a group of questions, Are there benefits to the issuer and its investors to engage the auditor to perform such work? Are there disadvantages to engaging a tax specialist other than the auditor? And the last question, What kinds of fee structures are used for "tax planning and advice" services?

Jim Brasher.

MR. BRASHER: I think the advantage of using the auditor in this situation is that the provision of such services, you know, clearly has to be approved by the audit committee. They have oversight on behalf of the investors in this situation, and I think they can weigh, in their judgment, whether the provisions of

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such services is beneficial. Using a third-party provider, you know, that is not expressly provided for in the Act, that the audit committee has to approve such services. And I'm sure companies with (inaudible) probably do. There's many other situations where, frankly, tax directors and others would just as soon not go through the gauntlet of having preapproval by the audit committee. So I think that expresses the, you know, advantages and disadvantages of using the audit firm versus third party service provider. It comes back to the governance aspects of having, you know, the audit committee oversight with respect to provision of such services.

MR. SCATES: Jim Brown.

MR. BROWN: Jim Brown, at Crowe Chizek.

I wanted to mention one disadvantage of engaging a tax specialist other than the auditor, and that's probably best expressed in the analogy of opinion shopping. What you're likely to do is, you're likely to see a rush to the lowest common denominator, where the company says, "I want to account for something very aggressively. Now, if I can get either my auditor or my tax specialist or another tax specialist to say I can do this aggressively, then I've got a way to fight somebody saying you need to do it

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conservatively." So the more people that you allow involved to be able to counsel the company to say, "Here's how you need to -- here's how aggressively you can handle this," the more difficulty the rest of us have by saying, "You shouldn't do it that way. You should be more conservative."

MR. SCATES: Damon Silvers.

MR. SILVERS: Jim, I'm not sure I follow that argument. Currently, the company can get anybody they want. They can get an independent -- they can get a third party, they can do it internally, they can go to their auditor. The -- that sort of shopping is wide open today. The question is whether or not, systematically, the auditor gives the most aggressive answer and that companies move -- companies use the auditor in this area more than they should because of that. I'm not certain that I know the answer to that question, but that's the question. Today you can do anything. That sort of shopping is completely available to you, I mean, as an issuer. So I just -- I don't follow the -- I don't follow that reasoning.

I'd also appreciate an answer to my question before, which is, If you don't provide non-audit -- if you don't provide non-audit services, and you get a call asking about the tax implications from an audit

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perspective, will the auditor take the call?

MR. BROWN: Well -- Jim Brown here -- to get back and possibly to have quick answer on this, we're looking at what may happen. And there may be the situation where now the auditor is prohibited. PCAOB says we can't give tax advice, we can't get involved in these services. So now I'm facing the issue where I, as the auditor, have to express an opinion on the tax treatment of a transaction in the financials, but perhaps I'm prohibited from being involved in anything regarding the company's compliance with the tax law, or prohibited from giving advice. And now I'm put in a very difficult situation, where the company says, "Hey, we didn't engage you to do this. You can't give us advice on something like that." And some companies may -- in the world, real world out there -- try to use us as a lever against the auditor. So I'm trying to make certain that there's no unintended consequence here about prohibiting or restricting an audit firm from giving tax advice or doing tax compliance work when the company wants to use it against the audit firm and say, "I want to do something aggressively."

MR. SCATES: Barbara Roper.

MS. ROPER: Just back to the issue of opinion shopping. I think the key -- because we're talking

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about auditor independence here and not auditor efficiency -- is, if you get that advice, that aggressive recommendation, from the tax department of the audit firm, how likely is the auditor to call that advice into question? And he or she significantly less likely to call that advice into question than they would be if the advice came from a third party? And so this idea that there's a special risk to going outside to third parties to -- and you'll get aggressive recommendations, I don't think -- I don't think past experience necessarily bears that out, in terms of the -- some of the recent scandals, but also that the question is, When push comes to shove, will the auditor call that recommendation into question? And I think that becomes significantly less likely if the recommendation came from his own firm.

The other thing, on the issue of tax advice and tax planning, I'll be honest, and I don't know exactly what gets -- what gets included under these various different headings. But I think there's a clear difference between getting the auditor's advice about recommendations that were made by someone else and getting the auditor's advice on how you should structure something, so that when they then come back and have to audit that issue, that -- I mean, it's one

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thing to get your auditor's advice, say, early in the process. As an auditor, say, "What do you think of this treatment that we're being advised to take," versus, "How do you think we should do this?" Because then when they come back to do the audit, if they've told you how to do it, the idea that they're going to come back and then question that, I just think, doesn't bear up.

And then, finally, in this discussion, we talk about efficiency and all these other issues. Our view is, independence trumps every other concern. And I'll go back to what I've said before. The audit has no value if it's not independent. And so where you have certain types of services that, maybe, sometimes create independence problems, and other times don't, I think it is perfectly appropriate to have the audit committee make that evaluation. Where you have certain types of services that are always going to require the auditor to service management or always going to require the auditor to be an advocate for their client or have a shared interest or conflicting interest, then I think it's up to the PCAOB to say, these services inherently violate the basic principles, just as the other listed prohibited services do, and it's the role of the board to enumerate those and prohibit them.

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MR. SCATES: Mark Everson.

MR. EVERSON: Yeah, thank you. I'm, unfortunately, not going to be here after lunch, so I did want to say a few things. And, Bill, I want to thank you, of course, for putting this together and being able to participate in this discussion. And my remarks, as much as anything else, from our point of view, are geared towards tax administration, which is not your charge, but I think you can play an important role in improving tax administration. So I ask you to think about that.

The IRS doesn't touch every taxpayer, nor should it. It relies on the integrity of professionals to support the system of tax administration. I would suggest to you that, just as this Board exists because of the problems in corporate governance and manipulation of financial statements, as many, if not everybody in this room is aware, there was a real problem, and has been a real problem, with the erosion of tax compliance that has received growing attention and, I would suggest to you, bipartisan concern in our capital.

It's of such a degree that we, in articulating our four service-wide enforcement priorities, have singled out an element of it, this

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issue of the role of professionals. And one of our four service-wide enforcement priorities at the IRS, which guides our resource allocation and guides our actions and is why Cono is here -- he's the head of our Office of Professional Responsibility, which has been reinvigorated, doubled in size, and we're going to keep doing more -- but one of our four priorities is that we want to assure that attorneys, accountants, and other tax practitioners adhere to professional standards and follow the law, which has not been the case in too many instances.

I would suggest to you that, in looking at this issue, Barbara talked about the fact that you go down a corridor where the tax auditors worry about the taxes, and not -- they're not worrying about the book statement. I would suggestion to you, however, that the book auditors play a role in the integrity of the tax compliance, and that we lost something through the rush to what Don called these highly engineered tax products because of the natural braking influence that takes place when there are three parties involved in these discussions rather than just two. And by "three parties," I would mean the inside management, the providers of the planning or strategic services that are developing, at the extreme, these engineered

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products, and then, of course, the auditors. And it is impossible for me to understand how an auditor can have the same view of a transaction if the firm has an economic interest in the success of the transaction, which is clearly the case in many instances.

That having been said, I do recognize the great difficulty in drawing the line between the services that are planning and strategic, on the one hand, and compliance on the other, because, just as many have said, the requirement for expertise in making those assessments, from an audit point of view, is absolute and very much in our interest. So as you grapple with this problem, I share the concerns that have been expressed by many that you be not arbitrary, and that you be very careful, as you try to find where the lines are in this thorny problem that you have and that I know will be dealt with wisely, and in a way that will not just help the integrity of the markets, but, I believe, if done properly, can also further the integrity of our tax administration system.

So that's, sort of, where I see this. Thank you.

MR. SCATES: Scott Bayless.

MR. BAYLESS: Scott Bayless, Deloitte.

I think those are excellent comments, and we

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all appreciate those comments. Just in terms of following up, I think you mentioned a very important part of this process, and this is the process that was set up by Sarbanes-Oxley, in that auditors of companies, registrants, are observing in a very robust fashion, and that is, the audit committee has a brake to services. And, as you've indicated, the audit committee is a brake to the services. In the statistics that you've cited, Kayla, it is certainly evident that the provision of tax services, and certainly those services that are questionable or that tend to go against the principles, have diminished significantly over the last few years as the rules have taken weight and registrants and audit committees understand the import and the application of these rules and the principles.

When you take a model that excludes the audit committee from these considerations, what you've done is exclude an important brake to the process of these transactions and recommendations that are of concern in other avenues of our government and our tax regulation. If you have a continued involvement of the audit committee as that brake, then what you've done is, you've held each and every one of these services to a standard by which it has to be robustly discussed, disclosed, and talked about, in consideration of the principles, to ensure that auditor independence and the importance of investors in this process is maintained and (inaudible).

MR. SCATES: Walter McNairy.

MR. McNAIRY: Walter McNairy, with Dixon Hughes. I'm in charge of our firm's public-company practice. And we don't have many clients that are even 200 million in market cap. Most of our clients are small-business and smaller than that.

We have been consulted quite a bit from our public-company clients with respect to opportunities they have for specific tax-planning strategies that are pitched to them by other firms -- other professions, law firms, other accounting firms. And what we see is that our clients heavily rely on us for our advice on evaluating the opportunity, you know, what they should do -- help them sort through the issues.

And since today's discussion is on independence, I think one of the reasons why they would call us, as their audit firm, and -- whether to not we do their tax returns -- is because, in that case, we are more independent than the party that is actually pitching the idea, because we would not have any financial interest in that transaction whatsoever. We

would ultimately have to evaluate that transaction in terms of the audit and its impact on the audit, but I think that's just one example where we can assist our clients throughout the year -- quarterly basis or what have you -- on ideas that come to them, either internally generated or from the outside.

MR. SCATES: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey & Pullen.

I think Damon's asked a question, and he's asked it twice, and I think it deserves an answer.

(Laughter.)

MR. WEBB: So I'm going to give you the answer from my firm's perspective. And I think that I would expect my colleagues from the other firms represented around the table would give you a similar response.

Of course if a client calls and says, you know, "My tax advisor has advised this. What do you think," of course you're going to respond. You have an obligation, as an auditor, to consider whether that position is in compliance with the tax laws and regulations. If it's not, you have -- in your opinion -- you obviously have illegal-act considerations and a whole host -- litany of guidance to follow. If you believe it's aggressive to the point where it's

unlikely to be sustained, but not illegal, then you have a different set of criteria, and you would have to probably advise the client that while they can take that position on the return, assuming they comply with all disclosure requirements, they may have to adjust their tax provision in recognition with the fact that, in your view, it's unlikely to be sustained.

So you can't dodge your audit responsibility as a result of someone else being the tax advisor or preparer.

MR. SCATES: Thank you.

Mike Gagnon.

MR. GAGNON: I agree with those statements. And I, too, was going to address two points. One was the response to the question of, What happens if the auditor gets a call, and the auditor has not historically been involved in tax matters in serving the client? And, obviously, an auditor has a responsibility -- indeed, a duty -- to respond to those questions from the client.

A concern that I would raise, though, is the quality and the depth of the response. Frequently, questions come up, from a tax perspective, at a client that are complex, that are driven by specific facts and circumstances at that client. And it is important to

blend the expertise of an independent auditor as well as the credentialed expertise of tax advisors in properly responding.

So there's no question that an auditor, indeed, would answer and respond to the questions in a manner that would be clearly an independent and objective view. There is also a concern that goes with that, of the quality and the depth of a response, and the auditor, with the tax advisors, would certainly need to gain an understanding of the specific facts and circumstances associated with the question.

I think the other matter I'd like to address is whether or not an auditor would call into question a particular treatment for financial accounting purposes of a tax strategy or tax advice or some tax matter that the auditor might have been involved with originally, because that's a very important question from an independence perspective and from the perspective of a perception of independence, and certainly integrity of the financial statements.

And I do think, in talking about and discussing and exploring that issue, it's important to draw some distinctions. I think, broadly, we'd all agree that auditor involvement in some of the notable tax strategies that have been in the press, and there have been some failures in the past, is not appropriate. I think we'd agree with that. And I think we'd agree, certainly, with the notion that having auditor involvement with some self-interest in these kinds of matters is not appropriate. I think you made that point earlier.

That, at least in my mind, is different from what an auditor does on a global basis for global organizations, or local organization, in understanding the structure, the organization, the tax status of that organization, and making recommendations, advising the client on matters of what to do. Certainly, an auditor should and does discover matters where things may have been treated inappropriately. An auditor is -- from a tax perspective. And an auditor clearly will bring that to the attention of the client. The client needs to address that. I think there are benefits there, both from an IRS -- from a tax perspective, as well as from an integrity-of-an-audit perspective. Certainly, there are ideas -- tax ideas that an auditor or tax advisors may bring to a client's attention. And I do think certainly, it is absolutely true that an auditor signing the report on the financial statements, with audit advice, will, indeed, critically evaluate, from a financial-accounting perspective, how that particular

track -- tax issue should be treated from a financial perspective. That's clearly important from an auditor perspective, but I think -- I do think the benefits go both ways.

MR. SCATES: We're going to have to limit our remarks to three more participants so we can take a break for lunch.

We'll start with Mark Weinberger.

MR. WEINBERGER: Thank you. Barbara, I'm going to respond to your -- you've asked a couple of times, too -- and maybe, Mike, you were going to do this, as well -- the point you make about, How does the auditor come in and evaluate tax work that's done by someone in the firm? How could have independence? Aren't they just going to bless anything that's there? And what safeguards are in place to try and deal with that? And I'm not sure it'll be terribly satisfying to you, based on your question, but I'm going to give it a shot.

Obviously, the audit firm has a responsibility to the investors or the issuer, and the client is the audit committee. We are with them all the time. We serve them. We meet with them regularly. The last thing we want to do is give them tax advice that's going to let them down and somehow result in

either a penalty or result in some restatement of something that's going to happen. So there's a huge vested interested not to let that happen.

In addition, the audit practice, obviously -- if any of you have been involved in a tax firm -- you go to the auditor who's responsible for the account. They're protective of all the issues and the professional responsibilities, and are certainly not likely to roll over, at least that's not been an experience I've seen.

In addition, the PCAOB has begun rigorous inspection processes to look at all of our work that we do for our audit clients, and evaluate our tax provisions and our tax work. And there's an additional governor there. And then finally is the audit committee itself, which is that, if there's a transaction that's large, or any transaction, there has to be preapproval, and the audit committee has to get involved if the auditor does the work, which is an additional governor that, again, would not be there if the auditor did not provide the work.

So while maybe not terribly satisfying, I wanted to just have an opportunity to give you what my thoughts are and the governors that are in place.

MR. SCATES: Tom Ochsenschlager.

MR. OCHSENSCHLAGER: Tom Ochsenschlager, with AICPA. I want to make this short, because I don't want to be the one that runs us into lunch here. I'm as hungry as anyone.

But it's a principle of internal controls, of course, that you have more than one person sign off on a transaction so that you minimize the possibility of incorrect -- a mistake, or even fraud. So I think the more people you have sign off on a particular transaction, the better -- presumably, the better off you are and the less likely you're going to have problems with it.

And alluding to what I mentioned before, if the auditor is also providing the tax services, you really have four levels of review that they're looking at this transaction. You have, of course, the management itself, and tax specialist, which you have, whether it was the inside -- it was the auditor -- or outside. But if it is the auditor, you have these two additional levels of review that are very, very important, I think, and we shouldn't under-emphasize those. You'll have the review of the audit committee itself, presumably down into the transaction, we hope -- to understand the transaction to make sure they approve of it. And, secondly, you have the review that

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I had alluded to earlier, that if it is the audit firm that's providing the advice, the audit staff of that firm also has to sign off on the financial statement presentation of that.

Now, we know that -- we wouldn't be here today if that worked perfectly in the past, but a lot of changes have been made, and I think we'll find that those four reviews will work much more effectively in the future.

I submit that if you use outside tax advice -- and certainly that's anyone's prerogative to do so -- but using outside tax advice, based on my experience where I've had the clients in that situation, you will get more aggressive positions from the outside preparer, because, frankly, they don't have the responsibility -- or the onus or whatever you want to call it -- of having to report it on the financial statements. So they can take a much more aggressive position than the internal -- than the auditor -- than the auditor would permit their own tax staff to take. That's been my experience.

MR. SCATES: Pat Walters.

MS. WALTERS: Pat Walters, CFA Institute.

I think I'm last. And it would be nice if I was last, because what I'd like to do is reiterate what

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Barbara said when she first commented, at the beginning of this particular session. So far, a few themes have arisen in the discussion here today.

The first seems to me that audit firms absolutely want to be able to provide tax services to their audit clients. It also seems to me that some of the arguments that have been put forth are not very convincing. Familiarity, for example. So it would seem to me that an outside tax specialist could become familiar with the company just as easily as a new audit firm would become familiar with a company. It all depends on what the issuer wants and expects and contracts for from the various external parties with whom it does business.

There is no -- doesn't seem to me any reason why a third-party tax specialist couldn't be expected to have a continuing relationship, providing all kinds of advice and planning, as well as tax-compliance services, to the issuer. It also seems to me that -- from the discussions around the table, that it is almost self-evident that an auditor would be in a better position to argue against tax advice, tax strategy, from an external party than it would be from their partners within a firm.

It's also interesting -- and I'm glad that

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Mike brought up the whole concept -- whole concept of the financial-reporting effect. Every tax strategy, every tax decision, has a financial-reporting effect. It's inconceivable to me that companies do not want to know, in addition to the tax effect, what that financial reporting effect is. Certainly, any issuer that I have sat across the table for when arguing about a financial -- a new financial-reporting standard -- what the effect on the financial statements of every decision they make is important.

It seems to me that if the auditor is involved heavily in providing advice and planning around all of these issues, then invariably they will be violating their -- the principle that they shouldn't audit their own work. Once the client begins to take the advice that the auditor gives that provides a particular financial-reporting effect, as well as a particular tax effect, the auditor will be in that position.

Finally, I would like to reiterate one other thing that Barbara said. It would seem to me that independence always needs to trump these other issues. That's why we're around this table today. The integrity of the financial statements relies on the independence of the auditor. If there is any risk that

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that independence will be violated, then the best course of action is to not take that stance.

I also think, finally, that we are putting audit committees in very difficult situations if we do not provide them with a lot of information about how to judge independence, in addition to these four principles. What kinds of questions should they ask a particular auditor who comes to them and is probably, at this point, the only one, in addition to management, arguing that they should be the firm who is given the tax-services contract? Other outside parties are not there at the table. It would seem to me audit committees are at a disadvantage in that respect in determining whether or not the independence of that auditor will be best served by providing them with those -- with that contract.

MR. CARMICHAEL: Thank you. They're -- both of the questions on tax compliance and planning had a fee-structure element that we haven't touched on. So right after lunch, what I'd like to do is go to those questions for both services, see if we can get some information on whether there's commonality of fee structures, what are the differences between the two services.

I'm going to ask you to come back at 1:00

p.m., shorten your lunchtime a little bit, in the interest of staying on schedule and having time to cover those topics.
Thank you.
[Luncheon recess from 12:12 to 1:03 p.m.]
MR. CARMICHAEL: I know everybody's not back yet, but in the interest of staying on schedule, if you'll take your seats.
The first thing is that we do want to get some information on fee structures and what the fee structures typically are for tax-compliant services, and how they might differ, if at all, for tax planning and advice services. Any volunteers before I call on people?
(Laughter.)
MR. CARMICHAEL: Yes, Paul.
MR. KOREN: Paul Koren, Goldstein Golub Kessler. Our answer is simple. We are a standard time charge firm and any services that we perform are billed at our standard time charges.
MR. CARMICHAEL: Okay. Walter McNairy.
MR. MCNAIRY: Walter McNairy with Dixon Hughes. I'll echo that comment with my firm. Rightly or wrongly, we have never really believed in value-added pricing. Maybe we left something on the table

there, but our rate structure is just our standard hourly rates. We have one standard hourly rate for any service that we perform.
MR. CARMICHAEL: Mark Weinberger.
MR. WEINBERGER: For compliance, it's solely hourly or based on hours. Sometimes it's a fixed fee based on hours because they want to know when they sign up how much it's actually going to cost, so you estimate the amount of time and then you bill a fixed fee, but it's based on hours.
And for consulting, any work that we provide for our audit clients is hours or based on hours as well.
MR. CARMICHAEL: Scott Bayless.
MR. BAYLESS: For Deloitte, it's fixed fee or time and expense.
MR. CARMICHAEL: Bruce Webb.
MR. WEBB: Bruce Webb, McGladrey. That would be true for our firm as well, hours at rates or fixed fees.
MR. CARMICHAEL: Rich Angelone.
MR. ANGELONE: My name's Rich Angelone. I'm here on behalf of the ABA. I'm also the tax chair of our tax committee. I can speak for my own company that what we saw in the past were contingency fees, and I

think in recent times, and I'd say over the last two years, it's on a fixed-fee basis that we see tax services.
MR. CARMICHAEL: Dean Uminski.
MR. UMINSKI: Dean Uminski with Crowe Chizek. I would have to agree with Mark and Scott, primarily standard hourly rates, in some cases fixed fees.
MR. CARMICHAEL: Any other information? Okay, then let's move to the next topic. Bella Rivshin is going to lead us through that starting with tax strategy services.
MS. RIVSHIN: Good afternoon. Our next topic, tax strategy services, includes a development of tax-motivated, structured transactions, occasionally referred to as tax products. These tax products are designed to enable a company to reduce its tax liability or achieve a financial accounting result.
Let's now turn to our first question. Does an accounting firm sale of tax strategies or tax products to audit clients affect the firm's independence from the audit client? Are there different independence considerations depending on whether the tax strategy or product is designed to reduce tax liability or to achieve a financial statement result?

Okay, Mike Gagnon.
MR. GAGNON: Silence is deafening. It obviously is a critically important topic. I think we did touch upon it a bit this morning. I do think it's important to differentiate here what I'll call tax advantage or inappropriate tax strategies, tax advantage transactions. I do think it impacts a firm's independence and not in a positive way. I think that kind of activity should not be performed by an audit firm, should not be provided to its audit clients. I think the current independence rules basically touch upon it in terms of the background, but point to the audit committee in its oversight to consider these.
I would encourage a reconsideration of that, because I don't believe -- I think clarity in this area is better than, I'll call it flexibility, in terms of a discussion or a dialogue with the audit committee, because I don't believe from an integrity perspective, something we've talked about and at least believe that very, very important to the financial markets from that perspective, I do think it is inappropriate, and would urge a reconsideration of that.
The second question really talks about, well, is there a difference here between that, and if there's a tax result or something to achieve a particular

financial accounting result. Here, I don't think that's appropriate either. I think certainly tax advisers ought to be providing tax advice, they ought to be looking at facts and circumstances, understanding the organization, understanding its structure, and providing appropriate and clear tax advice on the basis of those findings.

And I do not believe that providing that sort of advice with a goal to achieve a particular financial accounting conclusion is appropriate.

MS. RIVSHIN: Colleen Sayther.

MS. SAYTHER: I actually put my card down because I just would reiterate everything that Mike just said, so I would answer yes and no.

MS. RIVSHIN: Okay. Jeff Steinhoff.

MR. STEINHOFF: I will reiterate the same thing, but to say that it seems to me fairly clear from the current four overarching principles that these things would be very problematic. And, as Mike, I don't see any difference between the tax side or the financial reporting side. You would have problems with those overarching principles.

MS. RIVSHIN: Jim Brasher.

MR. BRASHER: Thank you. We believe that in the spirit of good governance, the auditing firms

should not sell tax strategies to an audit client that lack business purpose and economic substance. We do believe that we should be continuing to provide traditional tax advice and compliance services, and of course, all such services have to be approved by the audit committee in any event, and that we think the provision of such services is consistent with sound public policy.

However, in addition, at KPMG we've instituted the following risk procedures when we bring an idea, a planning idea, to a client, which is material to the financial statements. First of all, the tax planning, of course, must be technically sound and customized to the client's facts. We're not marketing any pre-shrink wrapped or ideas of that nature. The idea must be approved by our partner in charge of tax risk and regulatory affairs who is totally independent of the tax function. That's an oversight provision in our firm.

The planning idea must have economic substance and business purpose, and we tell the audit committee of the audit client that they must obtain a third-party opinion from an independent firm of their choosing, not somebody that's lined up or recommended by us, but they need to go out and obtain an

independent third-party opinion.

And finally, we do a post-implementation review to ensure that the advice has been implemented properly.

MS. RIVSHIN: Scott Bayless.

MR. BAYLESS: At Deloitte we follow a similar procedure, have significant quality control risk analysis of products to ensure that, one, they're not provided to SEC audit clients, and two, that they go through a very rigorous process as determined from people that are not compensated as a result of those products.

MS. RIVSHIN: Nick Cyprus.

MR. CYPRUS: I'm going to stay consistent to where I was this morning, as unpopular as it might have been. I think anything that puts the auditor in the form of originating, so tax strategy, if they're originating a tax strategy for a company, I think it's a problem. And whether it's a tax strategy or some other advice to get around an accounting thing, I think that's a problem.

MS. RIVSHIN: Pat Walters.

MS. WALTERS: As I said before lunch, I think it's almost impossible for a tax strategy or product to not have a significant financial reporting result, and

it's inconceivable to me that companies would not take that into account as a joint decision-making situation. And therefore, I would have significant difficult with auditors who engage in either of these particular types of advising to companies.

MS. RIVSHIN: Barbara Roper.

MS. ROPER: I agree, and I think -- earlier I said I think there are certain areas where it is incumbent upon the PCAOB to ban certain services in certain areas where audit committees need to be given guidance on how to evaluate them. I think this is an area where we need a ban on -- and then the challenge is where you draw the line between those types of tax strategies or products that are banned and what is permissible, and I think that is an appropriate area to supplement the ban with guidance to audit committees on how they make a distinction between what's appropriate and what's inappropriate.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: I want to echo what Barbara said and I want to remind people about something that predates the latest round of -- the scandal around sort of prepackaged, mass-marketed type strategies, and go back to Enron. When Enron collapsed, in the initial round of hearings, there were a series of statements by

Arthur Andersen in those hearings that Arthur Andersen was not involved in structuring the special purpose entities that were at the heart of what was wrong with Enron. These were entities that both could be characterized as tax planning structures and also obviously structures for affecting the shape of the GAAP financials of Enron.

Andersen sought to deny that they were involved in structuring them in the initial hearings. Of course, it turned out that they were lying. Much of the AFL-CIO's concern about this issue of auditor independence and particularly around tax issues arose out of that experience, and our sense that our members as investors directly and through our pension plans were seriously endangered by the practice of audit firms structuring these off-balance sheet vehicles, and then auditing their own work.

We believed that the combination of the statutory language in Sarbanes-Oxley plus the guidance that -- the principles that we were discussing earlier this morning would be a very strong signal to audit firms that they were not to do this. I just no longer have that belief and I believe that the PCAOB needs to provide exactly what Barbara said, clear -- that this sort of stuff needs to be banned and that there needs

to be clear guidance given both to audit firms and to audit committees as to where the lines are. It is not acceptable, and again I think that Nick Cyprus' comments are completely correct. It is not acceptable to have an audit firm creating the structures they audit.

MS. RIVSHIN: Mark Weinberger.

MR. WEINBERGER: Thank you. I would say that certainly I would agree that the rule that's currently out there, which says that there should be careful scrutiny of these transactions where sole motivation is tax aid without business purpose, could go further and it should be banned frankly from audit firms providing it to their audit clients or others.

I think that the audit committees are there, but clarity there would certainly not hurt. And I agree with Barbara's comment that once you go beyond that, it's a lot more difficult to define, and that's really I think where the other harder issues arise.

MS. RIVSHIN: David Shedlarz.

MR. SHEDLARZ: Yes, I would agree as well that this is inappropriate activity for the outside accounting firm. But at the same time, and just drawing back to this morning's conversation, I think it has to be done with a mind towards what is acceptable

tax advice and tax service.

A lot of discussion this morning surrounded auditor independence and the extent to which that may actually be advanced by distancing the accountant from this particular area. I would suggest to you, given the complexity of this particular area, and I draw upon the one I deal with day in and day out, operating in 140 countries around the world, filing over 1,000 tax returns, that if the outside accounting firm in terms of its advice and planning posture gets too far afield of this, then you'll find that you're actually compromising their independence. There is a heavy utility to knowledge and understanding in this area.

So I think there are a host of things that may have been sponsored in the past which are inappropriate, and this is an excellent example. But I encourage the committee to take a look at what is acceptable practice in this particular area, because I believe it is instrumental in terms of having effective independence of the accounting firms that they be knowledgeable about the transaction.

MS. RIVSHIN: Lynn Turner.

MR. TURNER: I think it's actually encouraging and a very positive sign to hear some of the firms talk about the fact they don't think some of the tax

strategy stuff goes hand in hand with auditor independence, and especially on the comments I've heard today about tax opinion letters that people have been issuing in the past. Just as we've banned them on the financial reporting side, I think they ought to be banned on this side, on the tax side as well. I do think that causes a problem.

But going back to what Barb said, I think this becomes more of a question of where you slice things and how you define things, because while people may say, we don't do tax strategy services, what they all do is they'll go in and help you with your international operations, they'll help you identify the right countries to be in, then with their foreign affiliates they'll help you identify how to structure that international operation in the right international company with the right type of royalty or other type of revenue arrangements to get those revenues outside the U.S. along with the income and get taxed offshore.

To me, everyone's doing that and that's a pretty clear tax strategy. And so when people say, we aren't doing tax strategy, that's a misnomer, because there's every one of the firms are turning around and doing that. So I think it depends upon how you define it, whereas it sounds like everyone attempts to say we

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shouldn't do tax opinion letters, maybe that's a starting point, but then it becomes how far down that path do you go?

And that's where I come back to, if there isn't clear-cut support for what you're doing in the code, if the likelihood of prevailing starts to drop, then you put the auditor in the role of being an advocate, and I think that's where you need to turn around and start cutting it off, and as I heard someone say, provide some guidance to the audit committees.

I can tell you the O'Malley Panel, who thoroughly researched this, did put out nine criteria, very good criteria, that the SEC has repeated for audit committees to look at, and I think if you applied those nine criteria to a number of these things, you'll find that they don't stand up against the test.

MS. RIVSHIN: Mark Anson.

MR. ANSON: Mark Anson from CALPERS. First, with regard to the first half of question 6, does the accounting firm's sale of tax products affect their independence? The answer is absolutely. Accounting firms' audit firms are supposed to audit the arm's-length transactions of the corporation, and in the first part of that question they go from auditing the arm's-length transactions to taking part in the arm's-

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length transaction with the public company. How can that be independent?

Second, with regard to the second part of that question, I think it's particularly, the issue of independence is particularly acute when the tax strategy is sold to achieve a financial statement result. The whole point of the auditor is to audit the financial statements, but now they're affecting the financial statement of results and they're then going to audit that? How can that possibly be independent?

MS. RIVSHIN: Mark Weinberger.

MR. WEINBERGER: I just wanted to follow up on, I guess, Lynn's point, because it is -- obviously we're all giving our opinions and it's all being interpreted and the words up there on the page mean many different things to many different people. When you described, Lynn, the situation you're talking about where an auditor advises a business on business issues that are unique to that company and they have a knowledge of that business and they're going to go in and advise tax advice on how to pay the appropriate amount of tax, I did not mean to suggest that we would say that we don't think that auditors should provide that.

What I was referring to, in my comments at

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least, was those situations where there is no business purpose, it's solely tax-motivated, and where it's mass marketed and it's not tailored to an individual client. I think those are very, very different situations.

MS. RIVSHIN: Paul Koren.

MR. KOREN: Well, I certainly think it's clear that the answer to number 6 is we shouldn't. But I'm a little -- I think I'd like to readdress something. If we say that the auditor should do nothing but audit, and that's certainly be eloquently expressed here today, then in giving our views to the Board, there really isn't much further discussion as to what are the gradations of what you could do.

If the Board doesn't turn the light off and keeps the light on, then I think it's important that perhaps we should share some of the ideas which might be appropriate, again always recognizing that the investor community has its choice of doing what it wants.

Our firm does provide tax planning. We don't do any of the tax strategy services. And I had one of our tax partners, who uses, I guess, complex phrases, kind of describe for me what we do and what we believe is, well, professional, and doesn't impact us. And his phrasing is, in discussing a service, which in his view

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and our view doesn't conflict for auditors, it's planning using methods of structuring business transactions, which are within the common knowledge of sophisticated tax practitioners, supported by the code regulations and case law with an absence of conflict that we would be sharing the benefit between us and the client, creating a partnership.

That's the way we've approached it, and obviously we wait for whatever comes out of these particular hearings to see whether that still is appropriate.

MS. RIVSHIN: Okay. Let's move on to the next question. If the IRS or other tax regulator challenges a tax strategy designed or marketed by the issuer's auditor, what, if any, should the auditor's role be in resolving the challenge?

Sure, Lynn. Go ahead.

MR. TURNER: Nothing. This gets into the defense and advocacy. If you bring in the auditor into trying to get involved with the defense or something, I just don't see how this could ever be viewed as being consistent with the auditor being unbiased. They've got to act as they aren't going to sit there and go to the IRS and say, yeah, we owe you the taxes, because it's just inconsistent that you could ever be in a

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position, and this is exactly one of the reasons we put the advocacy principle in the four principles.

MS. RIVSHIN: Bruce Webb.

MR. WEBB: If we're talking about strategies in terms of the mass marketed and everything else we just said shouldn't be permitted in the first place, then I have to absolutely agree with Lynn. On the other hand, if you're talking about an auditor assisting a client with an IRS examination or something regarding a position that was taken on the return, I don't see how that's any different than an auditor dealing with the Office of the Chief Accountant when a client's accounting position is being challenged. You've had to do the research, you've had to reach a conclusion, and you have an obligation to state the basis for your conclusions.

MS. RIVSHIN: David Shedlarz.

MR. SHEDLARZ: I hate to do this and I may regret it, but I'd have to agree with Lynn on this.

(Laughter.)

MR. SHEDLARZ: I don't think much of anything under these circumstances.

MS. RIVSHIN: Anyone else?

Barbara Roper.

MS. ROPER: I just think this question takes

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us back to the point Lynn made earlier that part of how you draw the line between what's permissible and what's impermissible is how likely you're going to end up in this situation. If you're talking about a position you've taken that is supported by case law and supported by the regulations and not considered controversial, you're in a very different position for one that's likely to put you in the position of finding yourself before the IRS.

And if I'm not mistaken, I think in his comment on the SEC rule proposal, Lynn drew a distinction between the role of being a fact witness and serving as an advocate. I don't know if that's relevant here, but I think there's a difference from being in a position of explaining the reasoning that went into a situation and actually trying to defend a client's position.

MS. RIVSHIN: Jeff Steinhoff.

MR. STEINHOFF: I think it's an extremely difficult issue. I think the auditor's already got some issues already, even before they get to this stage. So if the issue is, will they impair their independence, perhaps no more than it already has been already. And I guess from a fundamental gut feeling is, if the auditor has designed this and marketed it to

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the client, going really building in what Barbara said, I think they have a responsibility at least to explain to the IRS what they marketed. Otherwise, the client's kind of hung out to dry there.

So maybe they don't go and fight it in their day of court, but at least they have some responsibility to explain it, because it's their strategy really. It's not so much the client if it's one they've developed for the client. I'm assuming this was a packaged or marketed strategy, and it's possible the auditor has sold that strategy many times. So I would think that they would be expected to defend that under some code of ethics or something.

MS. RIVSHIN: Mark Weinberger.

MR. WEINBERGER: Thank you. I would agree. I think we have the same issue. If you believe the underlying service that the auditor is providing is one that's legitimate for the auditor to provide, and it would seem to be very difficult to then say, they've already taken a position on it, they said it works from a tax standpoint, they're going to sign off on the financial statement that they believe it works from a financial statement standpoint the way it's treated, to suggest that there's something odd that they would be of the opinion to be able to help out the taxpayer to

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get it right, I'm not sure I would agree that that's a problem.

Particularly, if you're talking about the aggressive mass-marketed, as we've just discussed, if you don't believe those should provide, it's easier to get there. But if you think about a tax return, for example, major companies, big companies are audited in the large-case audit every year. You often are involved in the audit helping that client work through the issues, and in that case you are explaining and advocating the positions on the return for the client.

To say that the auditor couldn't do that, and somebody else would have to come in and understand and grasp all those issues and everything that went into them, if the auditor did the work, did the reporting, I think it would be extremely burdensome on the issuer.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: I think it's -- it may not be that well known, but this is one very unusual exception to the general iron grip that the legal profession has on the business of representing people in litigation environments. And so there really -- it's common for audit firms, for integrated accounting firms to play the role of the lawyer before the IRS in these matters, and the -- that puts a particular edge on this question in a way that not everyone may appreciate, because the question is not -- the question as posed is not actually the question of, should the audit firm be allowed to come and explain its thinking? It's, should the audit firm be the advocate for the issuer in front of the Commission? And it's very hard for me to see how that squares with the principles, and I think it's a particularly serious conflict with those principles.

Secondly, I think that the discussion that we've just had around the kind of contradictions one gets into around this question shows that the real problem here is the notion of the audit -- of an audit firm simultaneously selling a management strategy to the audit client. That just doesn't work, and that you get into all kinds of problems, this one of advocacy being one of them, once you cross over that line.

MS. RIVSHIN: Scott Bayless.

MR. BAYLESS: I think it's important to remember in this context that taking the prepackaged offerings or strategies off the table, you're left with tax advice and whether that tax advice is provided by a third party, not the auditor, or the auditor, the auditor is going to have to reach a conclusion as to the appropriate tax treatment in that context. And the very difficulty at that juncture is whether, when

challenged, the auditor is in the position of a fact witness or an expert witness or acting in an advocacy capacity when describing its own analysis, the audit firm's own analysis, as to the appropriateness of the tax treatment, even though it might not have been the firm that provided that strategy for that tax planning issue.

It makes it very difficult in that context, and you have to keep that in mind. If an audit firm is permitted to go through its own analysis and provide its own conclusion, it ought to be able to do that whether or not it provided the tax planning advice.

MS. RIVSHIN: Colleen Sayther.

MS. SAYTHER: Colleen Sayther, Financial Executives International. And as a company, I would want an advocate sitting by my side discussing -- I'm sorry, sorry to interrupt that.

MS. RIVSHIN: Can you repeat what you were saying?

MS. SAYTHER: Yes, I was -- as a company I want to make sure I have an advocate by my side if I'm going to the IRS to defend a tax strategy. And I think that the operative words here are designed and marketed by the issuer's auditor, and I think if you look at the principle disallowing the auditor to be an advocate for

you, you get there, and you basically would not -- it's not appropriate to use your auditor for designing and marketing with respect to tax strategies if they designed and marketed.

MS. RIVSHIN: Pat Walters.

MS. WALTERS: I actually think Colleen summed it up well, because I think Mark's arguments in favor of having the auditor appear before the IRS really taken in the opposite direction argues against them doing any of these activities, because if they have designed and marketed this tax strategy, if as the auditor they have opined that it's okay, then you're right, they should be standing there saying, we think this is a good idea.

I think because I don't think that that's appropriate for them, working backwards, they shouldn't be auditing their own firm's work and they shouldn't be marketing the strategies to the companies that they audit. It just seems to me that if the final conclusion is they shouldn't be acting as an advocate for the company, which they would invariably be doing, they shouldn't have gotten themselves in the position where they had no alternative but to do that.

MS. RIVSHIN: Okay. Mike Gagnon.

MR. GAGNON: I think the discussion is a good

one and it highlights the challenges that we're facing in terms of marketed strategies and advice to a client on tax matters driven by specific facts and circumstances, and then tax compliance services in preparing tax filings. And I do think it requires an in-depth discussion, and there are differences. I think we've all talked this afternoon about the notion of abusive tax shelters and mass-marketed programs are not appropriate, and certainly if that were to have been done, the answer to this question I think is clear to most in the room that it's not appropriate.

Where I think there is some difficulty and maybe even some ambiguity is the notion of advice, tax advice, being provided by an auditor on some particular matter at the client, and a position then taken by the client with respect to that advice and a filing position made.

And it does highlight in my mind the challenges that we face here in terms of the four overarching independence principles. Fundamentally, I believe our tax system is, if you will, an advocacy system. Lynn said it this morning that we would all prepare our tax returns in a manner that's consistent with the tax laws, but in a manner that would be designed consistent with those laws to minimize our taxes. That's the way the system works and I think, at least in the basic premise, we would all agree with that.

In terms of filing positions and actions and thoughts and independent objective opinions taken by auditors, I do think under those circumstances it is appropriate to explain positions taken, bases for those positions, and authority for those positions to the IRS or other taxing authority. And here is where I think there are issues and the debate, or at least the discussion, ought to be explored, because given the inherent, at least as I would articulate it, advocacy inherent in the tax system, advocacy services are an independence issue, and it is certainly one of the four basic principles. And I think that topic is one that is difficult to reconcile, it ought to be explored, because it's a very difficult one, but under certain circumstances I think are appropriate.

Just one last comment on there. I do think today in the context of audit committee oversight, review, and approval, there are in fact -- and assuming, as Lynn alluded to earlier, assuming -- and I think it's absolutely imperative that audit committees be given full disclosure of services being provided, which I think is a very good thing, certainly in the

audit context a very good thing -- I do think that ought to bear on how we think about these things.

MS. RIVSHIN: Nick Cyprus.

MR. CYPRUS: Mike, I'm in agreement with a lot of what you said, but there is a thing Lynn brought up that probably is, at least for me, an age-old question that I deal with. Lynn, you said this morning that clients can put something they only had a 40 percent chance or less than 50 for sure on their tax return. And I get into the point is, when is it -- is that the right thing -- when is it the wrong thing to do? When you think you will not prevail with the service and it's less than a 50 percent chance, okay, that goes on your return, it just bugs me.

And then, of course, what you'll see is they'll turn around on the other side and take 100 percent provision for it, right? So we'll set up a reserve and in fact we'll accrue interest and penalties on that reserve.

Somehow that issue just really -- and you see it a lot. To me, and this is simple, so if I believe that I have a valid deduction to take on the return then I'm not so sure I want to provide for it, because how could you -- which branch of the government are you lying to? I know it's simplistic thought, but if you

take it, you believe you're going to prevail, reserving for it at the same time drives me crazy, and yet I know it's prevailing practice, so you see it out there quite a bit.

But I had to comment on that, because that's an issue that I think somehow, and probably not at the PCAOB level, needs addressed.

MS. RIVSHIN: Okay. Let's move on to our last question in this area. Is it appropriate for the auditor to audit the financial statement of facts of a tax strategy the auditor's firm sold to the company? If another firm sold the company the tax strategy, are there independence implications if the auditor's firm markets the same strategy to other companies?

Barbara Roper.

MS. ROPER: If you preclude them from selling these kinds of services to their audit clients so that they are not a potential competitor for the provision of those services, then you should, if not remove, at least ameliorate any possible conflicts that would result.

MS. RIVSHIN: Pat Walters.

MS. WALTERS: I just have a really dumb question here for the firms. If your tax department is designing strategies for your audit clients or others

to implement, doesn't the audit part of the firm have any input to whether or not those would be legitimate strategies from an audit perspective? I mean, there's just some sort of disconnect here that is escaping me. So either the strategy is legitimate or it isn't, and if it's not legitimate, nobody should be selling it, and auditors should be out there saying, this, we're just not going to give clean opinions if you implement this strategy. So what am I missing?

MS. RIVSHIN: Mark Weinberger.

MR. WEINBERGER: Pat, I think you're brilliant. I don't think that was a stupid question. I think you hit the nail on the head frankly, which is, if a tax strategy works, then the only question is, what is the appropriate financial accounting treatment for it that the auditors determine, not the tax people? The tax people determine whether or not the transaction works under the tax law. The auditors then come in and determine what is the treatment from financial statement purposes with regard to that transaction.

So looking at this question, if the transaction works and you -- it's a type of a service that you all conclude is one that auditors should provide, then I don't see any problem with the audit firm doing it, and then the audit firm obviously

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reviewing it, the audit site reviewing the financial statement consequences from it.

The second question raises an issue I'm not sure I fully understand, but I guess if it goes to -- if you provide a strategy to a non-audit client, is the -- I guess there's a suggestion somehow that could come back and impair your independence from a client that you don't even provide that strategy to. I think that would be very hard to effectuate. I don't really understand what that question goes to.

MS. RIVSHIN: That part of the question goes to if two separate audit firms are providing the same types of tax strategy, and audit firm number A provides it to company X and audit firm number B provides it to company Y, and A is the auditor of Y, then is there, since it's the same strategy, is there any difference?

MR. WEINBERGER: I think the answer is F.

(Laughter.)

MS. RIVSHIN: Okay.

MR. WEINBERGER: I think obviously the issue there is, the one I would raise is, there's no -- I mean, we're talking about strategies. Again, this is hard because sometimes you know too much about the details of some of the tax laws, but there's really not one strategy per se that you come out with if you're

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not mass marketing, which we said we shouldn't be doing, and doing a transaction for a client, kind of as Lynn described before, you may have a similar fact pattern for a client who has operations in different parts of the world that you have a structure that helps them minimize their taxes. That is totally, absolutely legal, and we all agree that you shouldn't pay more tax than you owe under the law.

If you have another taxpayer who happens to have similar facts and they have a similar, use similar parts of the tax code to reach that result, I think it would be hard to say that you would be not independent, so to speak, in either of those circumstances.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: I have two points about this. The first is that while it's true that the tax -- if you have an integrated firm that provides both tax and auditor services, the tax people do -- are responsible for determining whether, in their capacity as tax consultant, whether their tax treatment is correct. Is it not the case though that as the auditor, for GAAP purposes, you have to, you have a responsibility for reviewing the tax -- the tax line, so to speak, on the GAAP statement, and thus providing the audit side opinion that the way in which taxes figure into the

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company's GAAP financials is accurate?

It seems to me this once again goes to the point that these are indeed separate functions, but they look at the same thing, and to say that -- for the audit side to defer to the tax side on the audit implications of the company's tax behavior seems problematic.

Secondly, in relationship to the question asked, is there a conflict, I think the answer is yes, but how much the conflict, how big the conflict is depends completely, I think, on what Mark was talking about, which is how customized is this, or how mass-marketed is it? The more mass-marketed, the greater the conflict.

What is very clear though is that when -- is that the greatest degree of conflict is, of course, when it's the same firm that is marketing to the -- that is both marketing to and passing on for audit purposes the strategy. Then it doesn't matter whether it's mass-marketed or customized because then, right, you're actually looking at the real thing, not some comparable or similar thing or maybe similar thing.

I think this is an example of the -- of something that's true in corporate governance in general, which is that there are conflicts and there

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are conflicts and there are conflicts, and that it's important to get to the big conflicts first and some conflicts you'll never get to, because they're sort of endemic to the nature of the way the corporate form works or the audit function works, and that as long as we have audit firms that also provide tax services to somebody, anybody, and it's worth noting where those conflicts are and reining them in as much as possible.

But I think it would be a very grave mistake to say, oh well, you know, there are conflicts, no matter what we do there will be some conflicts left over, so then let's do nothing. That would be the wrong approach.

MS. RIVSHIN: Jeff Steinhoff.

MR. STEINHOFF: First, I want to put context to the way I read this question. I saw this as a follow-on to the previous question, so when you talk about tax strategy, you're not talking about routine tax advice, you're talking about something structured to really reduce tax liability or change the accounting treatment in some manner. And I think there was pretty much unanimity that people did not think that that was a proper role.

I think in looking at the second part of your question, if someone else actually sold that strategy,

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but you were fully able to sell it yourself, because you were also marketing it, I think you have to look at substance over form. If one's going to be concerned about whether you're independent in auditing the transaction, the fact that you're marketing the same strategy, I think, would be the same thing. So I don't really see any difference in substance between those two. It really gets down to how one defines. I think it will be important for the PCAOB to properly define what these terms mean and take the 10, 15, 20 different types of tax services provided and be very clear as to what would be allowed and what wouldn't.

But if tax strategy structuring, that kind of thing would not be allowed, and your firm in fact was selling that same thing or it sold that same thing, I would think you would have some independence problems.

MS. RIVSHIN: Barbara Roper.

MS. ROPER: When I looked at this question initially, I was looking at it from one point of view, which is that if you're offering a competing product and you're an auditor, as we know has occurred in some instances, who is being strongly encouraged by your firm to market your firm's products, then you have an incentive to say, well, you know, this thing over here you're using is really inappropriate and we've got

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something comparable but superior that we think solves some of these problems.

So you have an independence problem, I think, there as a potential competitor. There's, of course, the conflict on the other side, which is if your firm is marketing something that's virtually identical, you are potentially put in a very difficult situation to say that this is somehow inappropriate. And so I think on either -- whichever way you look at the conflicts, they exist and they are a potential problem, which I think brings us back to the same thing, why we don't want audit firms marketing strategies to their audit clients.

MS. RIVSHIN: Pat Walters.

MS. WALTERS: I actually have like two things I want to say and then a question. I would like to echo what Mr. Steinhoff said about the difficulty in understanding the differences between tax advice, tax planning, tax strategy, and then tax products, and how -- where on this continuum of all of these things we might say there is some legitimacy to the audit firm being involved. I use that vague term specifically.

The second thing I would like to say is that no tax strategy only affects the taxes payable and deferred tax aspects of the financial statements.

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Every strategy designed to reduce your tax liability has other financial statement and disclosure effects. I was very -- I don't know whether the word is delighted or horrified -- to hear Nick explain about the provisions that I doubt are adequately disclosed anywhere in the footnotes about tax strategies that may be implemented but there's a less than 50 percent chance that they're going to be accepted by the IRS. I'll have to go back and look at a few financial statements when I get home.

So I think that we really have to keep in mind that all of these things have much wider effects on the financial statements than simply tax, and that the wider those effects, the more concern investors have over the integrity of the statements when the auditor is involved in the decision-making for those strategies, advice, however you want to characterize it.

And therefore, I want to go back and ask David from Pfizer a question based on his statement earlier in this session, and I hope I'm going to be able to restate it as he would have intended to be, and that the failure of the auditor to be involved in tax planning or strategies may actually compromise their independence. I still don't understand how that could

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be. I could understand how their failure to be knowledgeable about tax planning and strategies could compromise their ability to do an effective audit, but I don't understand how it would compromise their independence, and I would like to better understand that.

MS. RIVSHIN: David, would you like to respond?

MR. SHEDLARZ: I didn't even have to put my nameplate up. See what I get for agreeing with Lynn?

(Laughter.)

MR. SHEDLARZ: This in many respects may be a semantical issue. I think it is important to have some clear guidelines in terms of what's acceptable practice when it comes to tax planning, tax advice, and tax involvement on the part of the accounting firms. There are many things I would not be in favor of, and some of them have just been discussed, because I do think they do compromise the independence of the outside accounting firm.

We personally do not use our outside accounting firm for tax strategy. They're not involved in the bringing forward of any tax vehicle on behalf of the company and haven't been for some time.

On the other hand, it is critically important

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that the outside accounting firm have a viable vantage point from which to exercise their independence. If they are not involved on an ongoing basis in terms of the planning and advice that goes on in a global concern, and even a smaller concern, then that vantage point is not maximized. I believe very strongly, having practiced in this field for 28 years, that independence has a lot of dimensions. One of the critical ones is being knowledgeable enough to exercise that independence, and not being involved in the planning and advisory services in the tax arena clearly compromises that in terms of the continuity of understanding in this very, very complex and involved area.

So I think it's critically important in terms of what we're all trying to achieve, which is the independence of the outside accounting firms, the integrity of the financial statements that the accounting firms have that vantage point. In fact, it's one I demand of the outside accounting firms so they can exercise the independence and judgement which is so critical in this complex area.

MS. RIVSHIN: Mark Weinberger?

MR. WEINBERGER: Thanks. I hate to go back to this question, but it's interesting, it's fascinating,

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every time you read it, when you hear the conversations that go on here, I get a different interpretation. I actually think this question is much broader than the work you can provide to your audit firm. And again, I'm still trying to understand the AF and ZY, but I would -- if you answer no to one and yes to two, so there are certain tax strategies that you cannot provide to your audit client, whatever they are, and then you assume if you provide those strategies, however, to another firm, a non-audit client, that could risk your independence with your audit client that you never sold a strategy to, it would basically make it impossible for you to sell tax strategies to any other non-audit client because the mere fact that somebody may bring that idea to your client and cause an independence problem due to no fault of anything you've done for them. I think there are pretty broad ramifications of that. Am I reading that wrong?

MS. RIVSHIN: You are reading that actually correct.

MR. WEINBERGER: Okay.

MS. RIVSHIN: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey & Pullen. This is maybe a tangential issue, but the issue was sort of raised as to what the auditor's responsibility

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was when relying on the use of an in-firm tax specialist. And I think the response to that is that an auditor who uses an in-firm tax specialist has the same responsibility to supervise and review that work as he does for any other assistant that the auditor uses. So therefore, the partner with the final responsibility for signing that audit report has an obligation to supervise and review the tax specialist.

MS. RIVSHIN: Lynn Turner.

MR. TURNER: We had a similar question on the auditing side that the profession has dealt with, and that was, were we going to let the accounting firms continue to issue these opinions on accounting matters, including if you just issued an opinion to an investment banking firm that they could then go sell to others, and you might do it and you wouldn't be necessarily issuing it to one of your audit clients, but it could be out there and certainly run you in a position where your audit client then picked it up and what do you do with it then?

And in those situations, and I think the profession did it right, I think the profession came back and said, consistent with what our current code is, we have an obligation to the public. And the public, especially after Enron, doesn't see the

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profession living up to its obligation to the public if we're issuing those type opinions, regardless of whether it's to one of our audit clients or to another firm, so we banned them on the accounting side.

And I think the answer here, just from common sense and building upon what Nick said, gets you to the same answer. If you're, as a professional certified public accountant, going to go out and issue these type of tax opinions or take these type of positions on tax strategies, where it's less than likely that you're going to prevail, certainly if you're going to start reserving for it and saying one thing to the IRS and another thing to your investors, if you're going to take that position as a public accountant, then there's a definite price that goes with it, and the price is, if that shows up at the audit client, you're not going to be able to do that audit.

The public investors just don't buy that that is an unbiased and rational position for a certified public accountant to take and they don't accept it. And when you look at it from that perspective, I think it very well comes out that if you get yourself in those positions, you just shouldn't be doing it and it's going to cause you a problem. And so just like we banned it on the financial reporting side, I think the

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profession needs to come in and do the same thing on the tax side and say, we're just not going to find ourselves in that position anymore because it doesn't work out, it just does nothing but terrible damage to the profession.

MS. RIVSHIN: Nick Cyprus.

MR. CYPRUS: Actually, Pat, I wanted to just follow on to what David was talking about. I really believe if the auditor is not in the origination stages, but rather you use the auditor as a consultant, whether it's in tax planning, tax strategies, et cetera, just like I would use the auditor when I do accounting policy, I mean, I wouldn't think about calling up the SEC without making sure my auditors understood where I stood on accounting policy and made sure the national office was with me.

It would be the same thing if I'm thinking about a merger or acquisition and the tax implications of that, you'd want to consult your auditor and understand both the tax and accounting impacts of that. And as long as the auditor is independent, in other words, they didn't create the strategy, they didn't create the tax planning itself, but they're consulting on it, they're giving you advice on it the same way you'd get accounting advice, I don't really see a

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problem with it. In fact, I think it's really necessary.

And I know we've said this a lot, but when you're a major international player with many, many, many locations, it takes a long time for someone to really understand the quirks of your company. And if you're just bringing a third party to do it sort of on a part-time basis, even on a full-time basis, I think the audit firm, because there's so much more resource there, you have the audit resource and the tax resource, and lots of members that talk about things, there are nuances that come to the attention of your auditors that I think sometimes an outsider may not get until it's too late, you've already made a mistake of some kind. And so that's what I was really trying to get to.

I think it would kind of hurt us if we took that resource away from the consulting side of the equation.

MS. RIVSHIN: Scott Bayless.

MR. BAYLESS: Scott Bayless, Deloitte. Just in terms of addressing the issue that I think Lynn raised, and that is that in looking at independence issues, certainly we don't believe that you can provide indirectly something that you can't provide directly to

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SEC audit clients. I think it's important to understand that concept and the extent to which firms go in order to ensure that that is not the case, that you're not providing something indirectly that you can't provide directly to your SEC audit clients.

In that scenario, if there's a tax opinion that sits out there, certainly that would be an issue that would say you can't do that, it's an indirect provision of something you can't provide directly. In addition, that has to go back to this whole process of determining that we're not going to put ourselves in the positions of taking something to the audit committee that from a risk perspective we don't think is appropriate to independence, doesn't match up to the principles, and it puts the audit committee in the fully formed position to protect the investors as we are trying to do and ensure that those services don't show up indirectly.

MS. RIVSHIN: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey. I just wanted to follow up on Lynn's comment on the amendment to SAS 50. I served on the Auditing Standards Board at the time that amendment was passed and we certainly supported it. And I think that SAS 50 might be a good place to look for some guidance in this area because an

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accountant or an auditor is permitted to issue and sometimes in fact is required to issue a preferability opinion on the application of accounting principles to specify transactions, either completed or proposed, involving facts and circumstances of a specific entity.

On the other hand, an auditor or accountant is precluded from issuing an opinion on the application of accounting principles to a hypothetical transaction, that is, one that does not involve a specific transaction and specific facts and circumstances.

MS. RIVSHIN: We're going to take our two last comments. We'll start with Mike Gagnon.

MR. GAGNON: Just echoing the last comment and picking up on what Lynn said, I agree and I think it's a pretty good framework, SAS 50, in the context of tax opinions on hypothetical transactions. Tax advice, tax consulting should be driven by individual facts and circumstances, and it's the former, that is, the hypothetical tax opinions, that is an area that I don't think is appropriate, and I think there's a framework for consideration here.

To Pat's issue earlier of independence, it's important for auditors and tax advisers -- it's actually not important, it's critical for auditors and tax advisers -- to develop and have an independent

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viewpoint. In order to develop that independent viewpoint which is relevant to the particular facts and circumstances, you've got to understand the environment, you've got to know what's going on, and maybe that was the basis for your comment. I believe that enhances independence. You are advising a client on a variety of matters, some of which bear on accounting, some of which may bear on a particular tax issue. That advice does need to be developed or spring from an independent, objective perspective, but that has to be well informed, and the information that is gathered in that process is critical as a backdrop to providing it.

I think, going back to the discussion of the application of our tax code, there are benefits there as well, because clearly an auditor in an audit process in an organization that operates in 140 countries, an auditor who has the breadth and depth and capability of undertaking that assignment from an audit perspective has the expertise and develops a base of knowledge in that organization around the world, and will see things, will observe things, not just tax-driven, but other avenues as well, and clearly is in a position to provide that independent, objective advice to the client on these matters, some of which will properly

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bear on taxes, some of which will bear on other areas of the organization.

But the critical point, not only from the perspective of the auditor's responsibilities, but from an independence perspective, is the ability to be impartial and objective in rendering that advice.

MS. RIVSHIN: Jim Brown.

MR. BROWN: Jim Brown of Crowe Chizek. The last question, I was sort of trying to wrap things up or maybe return to an issue here for a moment, and that is I don't really relish the Board's mission ahead of them, which is to sort of try to figure out where to draw the line here, and that's sort of how I see this.

We've been talking about tax planning and tax strategies, and it all sort of blends together. Some of it's even, is it tax advice or is it accounting advice? And I just wanted to give you a couple of examples I had down here on some things that people don't really, I think don't see too much of a concern when you do talk to a company about this or give them a suggestion. I just say, you know, when you go to a party, somebody says, oh, you're an accountant? Well, I have a tax question for you. People expect that accountants can give tax advice.

And there are some matters, such as getting

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off the first-in, first-out, FIFO inventory method, going to LIFO, not too controversial. Another might be whether I file a consolidated tax return or a separate tax return. Forming a sub-S corporation to avoid double taxation. Hey, look at your interest income and you're paying a lot or you're having a lot of high-yield bonds but you're paying tax on it. Have you thought about buying municipal bonds that are tax free?

So there's a lot of issues here where you look at things and you say, now is this a tax strategy? Maybe to form a sub-S corporation, you know, here's the structure you need to do. There are certain things you have to do to go from the FIFO to LIFO methods to meet IRS rules. I've got something that I can help you with.

The issue here is I think there's a lot of these plain vanilla things that nobody really has an objection to, and we also read about a lot of things in the newspapers where a lot of people may have objections to. I can't really comment on that. I don't know their validity, I don't know their facts. But someplace between these two is a line where you can say, this is allowed, I think these things I mentioned are okay, but you can't go any further. And I welcome the challenge that you folks face in figuring out where

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that line is. I think we have to allow some matters. The public does expect accountants to be able to give advice on audit and tax issues. We have to as part of our audit responsibility, but at some point we get too involved.

I'll remind you of those four overarching principles, and I think those are good points to consider.

MS. RIVSHIN: Okay, due to time constraints we're going to move on to our next area, which is executive and international assignment tax services. Accounting firms may provide services to executives of its audit clients, such as the preparation of personal income tax returns and tax planning. Accounting firms may also provide specialized tax services to employees of the company who participate in an international assignment program. These services include home and host country tax compliance assistance and estate planning for expatriates.

Starting with our first question, does providing tax services to audit client executives and other members of management affect the auditor's independence from the company? Does the answer depend on whether the executives are involved in the financial reporting process or otherwise making representations

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to the auditor?

Mark Anson.

MR. ANSON: Mark Anson from CALPERS. Big problem with this question. Boards of directors and audit committees rely on the input from executive management, just like CALPERS. CALPERS' board of administration relies on the input and recommendations and presentations I make to them in their decision-making process. When you have the audit firm providing tax advice, preparing tax returns for the senior management, you've now created a mutual interest between the executive management and that audit firm which could potentially taint the recommendation to that audit committee or the board of directors.

I mean, my God, if the audit firm is going to prepare the tax returns for the chief executive, as a shareowner, I want him to come prepare mine also.

MS. RIVSHIN: Elliot Schwartz.

MR. SCHWARTZ: Yes, of course the answer is that providing tax services to audit clients compromises their independence or at least it compromises the perception of their independence, which is a lot of what's going on here. Just continuing a little bit from the last discussion, as we continue to try to draw lines, it becomes increasingly obvious that

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it's very, very difficult to do so, and again, as I've said before, that is why audit firms should not be providing non-audit services to their audit clients. We have no problem with audit firms, accounting firms, providing tax advice or providing advice to executives, but not to the same ones that are in the firm or not to the same firm where they're doing their audits.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: Not surprisingly, I agree with the last two comments. I'd like to detail a little bit more of what the problem is here with providing tax services to senior executives. I think it gets more -- I think maybe later on in the second part 2, it's more complicated when you're talking about more middle managers in the international context.

But when you're dealing with senior executives, I think there are two things going on here that are a little different than a lot of what we talked about earlier today. One is that, assuming that the firm is also providing tax services to the company, the interests of the company, the tax-related interests of the company and the tax-related interests of the senior executives are likely not to be in line with each other, and it's sort of an independence problem of a different kind. It's not the audit services, it's

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the tax services that are being compromised vis-a-vis the company. And obviously from our perspective as investors, that's what we care about.

Secondly, there's this issue of the audit now -- the audit and others and the ability of the firm to gain other services from the issuer is potentially in play as the issuer -- as the audit firm interacts on tax matters with the CEO or CFO of the company. And that adds a second layer of conflict on top of the existing tension between the company's tax interest and the company's -- and the executive's tax interest. This is -- this, in our view, is just a hornet's nest of problems, and not all of them are ones -- not all of them are problems that are of the sort the PCAOB typically focuses on, but there of extreme concern to investors.

MS. RIVSHIN: Jim Brasher.

MR. BRASHER: I guess the question on the floor here is whether or not the investment community feels comfortable with letting the audit committee makes these types of decisions, because I can assure you that's what's happening in the real world, not only with respect to executives, but also with respect to the international executive program that all of the big firms -- we all have that capability. Those decisions

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are seemingly being made almost on a weekly basis where they decide whether or not they want the auditor to provide those services.

So I guess the question is, what else are we trying to safeguard if the audit committee cannot be entrusted to make that decision?

MS. RIVSHIN: Barbara Roper.

MS. ROPER: I had a question about that. Does the audit committee -- the audit committee is obliged to preapprove non-audit services provided to the company. Is there anything that says they're required to preapprove or even know about non-audit services provided to executives of the company? Because I'm not assuming that the audit committee will be consulted or involved in that review process.

MS. RIVSHIN: Lynn Turner.

MR. TURNER: There is not a requirement under Sarbanes-Oxley that the audit committee preapprove the work done for the executives. I know, however, and I give them great kudos for this, in the case where I sit on the audit committee, the firm has adopted a policy, at least they told us they've adopted a policy and I assume they have, that before they do any work for Section 16B officers and directors it will have to be approved by the audit committee, so that's Ernst &

Young, and I give them tremendous kudos for that. And so they have brought it to us, and we, of course, declined to preapprove, so it solved our problem. But technically under Sarbanes-Oxley, no, that does not go to a vote of the audit committee.

MS. RIVSHIN: Mark Anson.

MR. ANSON: Jim, just to follow up on your question, from an investor perspective the key issue here is how much does the audit committee rely upon the input, recommendations, and information from senior management? If it's a decision made totally in a vacuum without any input from senior management, then you have a good claim to objectivity. But I know most boards of directors listen to their senior management, whether it's formally at the actual committee meeting or outside the committee meeting, and that's where the independence breaks down.

MR. BRASHER: Mark, I guess I'm not in a position to comment on what goes through their minds and how they make their decisions, but to Lynn's statement I would like to add that if the company were paying for that service, certainly the audit committee would be required to sign off on that service.

Secondly, I think we also have risk procedures that are designed in our firm that whether

or not the company paid for it we would have a disclosure requirement to go to the audit committee and advise them that we were rendering these types of services and also advise them of what policies and procedures that we would follow with respect to the provision of services to the executives. That would include other covered persons, for example, people on the audit committee that we may provide those tax services, not in connection with that audit, but certainly because they're an individual client of the firm, although they could be on the audit committee and we'd have to disclose that to the audit committee that we were doing this even though this person is not an executive of the registrant.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: I figure I better answer your question quickly. In my view, there is no circumstance under which a professional services firm that owes a fiduciary or quasi-fiduciary duty to its client should be on both sides of the executive compensation relationship, and therefore, the AFL-CIO does not believe there is any circumstance under which an audit committee should approve an audit firm or a law firm or a consulting firm representing both the executive and the company in the context of executive compensation.

It's simply inappropriate.

MS. RIVSHIN: Scott Bayless.

MR. BAYLESS: With respect to the executive compensation issue, I think that those are independence-impairing services that we do not render. However, just to follow up with Lynn's comments, Deloitte does undertake to, one, ensure that services provided to executives of the company are preapproved, and where there other services that are not required because the company does not pay for those services, that there is a notification procedure to ensure that the audit committee has the ability to take control of that relationship if they so desire.

MS. RIVSHIN: David Shedlarz.

MR. SHEDLARZ: I guess I'm a believer that you can parse what's acceptable and not acceptable. But in this particular area, I don't think is appropriate. This is not appropriate activity for the audit firm to be carrying on on behalf of the board, the senior management, or any employee of the company.

MS. RIVSHIN: Nick Cyprus.

MR. CYPRUS: This was just also getting back to Barbara. At AT&T, any expenses that were to your public accounting firm had to run by the audit committee, and when this issue came to the audit

committee, it was basically taboo, you can't provide those services. So the audit committee will exercise -- I think the audit committees are exercising their fiduciary duty. I think I just heard Lynn say the same thing when it came to him.

MS. RIVSHIN: Lynn Turner.

MR. TURNER: I will just say you don't see a whole lot of disclosure on this. I've never seen an investor institution I've talked to, I don't think I've ever talked to one that thought this was appropriate. I think it's 100 percent on the investor side that they just don't believe this one is appropriate, and what's interesting is you do have, Jim points out, makes a good point, you have those situations where in a lot of cases the executives actually pay for it themselves, and then you've got the situation where the companies are actually paying for it as well.

Unfortunately, when the companies are providing those perks, we don't see those type of perks showing up in the disclosure and the compensation tables in the proxy disclosures, so it's not forthright, and quite honestly, investors don't see that. But where investors have seen it, I think Sprint was the classic case, they just come out of the woodwork on this one and investors say just, we just can't comprehend, I think very consistent with Mark, they can't comprehend how you could do this and be on both sides with the fiduciary responsibility to the executives that's very clear, including a legal obligation there, as well as fiduciary responsibility to the company.

Early on, I was involved with the Sprint situation, and I personally think that turned into a terrible conflict and it really wasn't clearly laid out where those conflicts were on both sides, so after that situation I think it made a clear-cut case that you just shouldn't be there.

MS. RIVSHIN: We'll let Barbara Roper have the last say in this and move on to the next question then.

MS. ROPER: I was just going to say that based on this discussion it sounds like even those who advocate leaving this decision to the audit committees view that almost always or always the appropriate decision by the audit committee is to say no, in which case I think the appropriate position by the PCAOB is to say no for them and eliminate the lack of clarity.

MS. RIVSHIN: Okay. With that, let's move on to the last question in this area, and that is, does providing tax services to employees who participate in long-term international assignments affect the

auditors' independence?

Okay, Lynn.

MR. TURNER: I've had to deal with this one. This is an interesting one, because you start looking are you really being an advocate or whatever, and a lot of times you don't hit into those. One of the problems that you get into these though is as you get into the international affiliates, they're not only providing the tax service in the tax return, they're providing relocation and a number of other services that go with it. So the question is probably more simpler than what it is. It should be, does providing the tax services and all the other services that you provide to the expats compatible with being independent?

And when you go back to those nine O'Malley criteria and you apply them in this situation, the nine O'Malley criteria turn around and say, no, the auditors shouldn't be doing this type service, so that would turn around and give you a no answer to this one. I will tell you I have seen credit rating agencies, one of the three large credit rating agencies, actually challenge companies who are doing this on their independence, so that's at least one source where people, users of financial statements, were concerned about that.

MS. RIVSHIN: Mark Weinberger.

MR. WEINBERGER: Lynn, I'm not sure all the services obviously encompassed in your comments, but a lot of the time these services are basically company-provided services to individuals to help them comply with the tax laws, they're expatriates who are in foreign jurisdictions, and to make sure they comply with all the jurisdictional laws, and since they're usually not there for a whole lot of time, the company usually takes responsibility for providing for them in their compliance.

With regard to that, I guess I don't believe there's an independence issue, and frankly I think that because we are serving the client in all those jurisdictions, and because these people are there, it enhances their opportunity to get the compliance right, and they choose us when we match up right geographically with them and know the law in those jurisdictions and can help their employees comply.

Now, that's the compliance aspect. The other services you're referencing I'm not tying them to, because I'm not sure what they are.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: This is an area where it certainly does feel like sensible for companies to be

able to get the type of assistance that they get from -- for companies and their employees to get the type of assistance that integrated audit firms provide. The problem, I think, that at least in my mind is raised is again the question of who is the firm representing in that effort? And it seems pretty clear to me that they're not representing the employee, that in reality they're representing the company, the issuer, the employer in this arrangement, and that this, in many instances, an employer and employee have a common interest in compliance obviously. But in tax, where there's a fair amount of latitude as to what you do, there may indeed be areas where there are tensions between employer and employee interests here.

And it seems that in that circumstance it ought to be crystal clear that the firm is representing the employer, is acting in the employer's interest, and that, A, there's no ambiguity on the firm's part on that matter, and thus protecting investors' interests, and, B, the employee needs to know that that's what's going on here. Again, maybe not the PCAOB's concern, but that is, I think, a genuine sort of independence issue, but it's not, it doesn't have the punch of independence issues relating to the CEO or the CFO typically. But nonetheless, I think it's -- this is

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not really dual representation. This is representing the employer's interest, the issuer's interest, and seeing to it that these matters are handled appropriately and that both the issuer and its employee complies, and it's not really a dual representation and should not be represented as such.

MS. RIVSHIN: Mike Gagnon.

MR. GAGNON: I don't know. I put my sign up and Lynn put his down. I guess I'm getting a little nervous here. A couple of points on the background of the service. I think the service itself evolved from organizations obviously sending their people around the world and the complex tax environment that people operate in who are from one jurisdiction and operate in other jurisdictions, and it does become very complicated, and our firms have the breadth and scope and capability to deal with these complex areas.

I would agree that I do see a distinction between this type of service, which is by and large, I believe, a compliance service at its core, and I'm going to get to a point Lynn raised a second ago in terms of other services, which I think provides needed assistance not only to the individual employees who are in another jurisdiction with presumably little knowledge of the local tax requirements, but certainly

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a requirement that they must adhere to them. And therefore, it's very important that a competent service provider assist these individuals, and in organizations there are frequently quite a large number of them, to make sure that they do in fact, as an individual and as an organization, because there are obviously reputational and other implications to the organization as a whole with the absence of compliance, that they adhere to the local requirements and the requirements of obviously the host country.

I do see a distinction in those types of compliance services from an independence perspective to other sorts of planning services, other sorts of relocation services, and so on and so forth, and we've got some policies that differentiate between the two, whether the service offering is to an audit client versus a non-audit client, and I think that's very important.

I do think in terms of Lynn's point on the other attributes outlined in the O'Malley Panel, I do think that's very helpful. I'm not sure if you look at all of those criteria whether they stack up in terms of this type of service. I believe in my own judgement at least that they would not suggest that the compliance service aspects, because of its implications to

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individuals and the organization as a whole, that would suggest that this is a prohibitive service.

I do think it comes back to a fundamental point that I made earlier, which is that this does still need to be approached from the perspective of being knowledgeable, impartial, and objective as to how the service is performed. But I do think there are benefits associated with organizations like ours in providing the service.

MS. RIVSHIN: Mark Anson.

MR. ANSON: First, I'll agree with Mike's comments. It's clear this is a valuable service, not only for our compliance issues but also for attracting and retaining qualified employees for the company. However, there is a secondary issue associated with question 10. Keep in mind that this tax service is just another service contract that is sold to the public company, which at some point in time must be audited by the auditing firm that has sold the contract to the company. So once again you will still call into question at some point in time the independence issue, because the audit firm will be auditing a service contract that they had sold to the public company.

MS. RIVSHIN: Pat Walters.

MS. WALTERS: And to just follow on to that,

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there doesn't seem to be -- none of the arguments that have been put forward earlier today about why the audit firm should be tax services for the issuer apply here. It doesn't seem to me as if one needs to be terribly familiar with the business operations of the firm in order to provide these services. All of the major firms can accomplish this globally, and therefore, there doesn't seem to me to be any legitimate reason for the audit firm to do this for its audit client. The audit client can very easily contract for these services from someone else without any of the efficiencies or synergies or familiarities that we have used as arguments for providing tax services to the firm itself.

And I actually would like to disagree a little bit with Damon about some of this in that one would expect that there is some negotiation when one accepts an international assignment. You're probably a management person, you may not be an executive, and therefore, you may wish to negotiate certain aspects of your compensation based on the advice that you get from your tax professional with your firm.

And so I think some of the same arguments that he made about executives and executive compensation apply here.

MS. RIVSHIN: We have four people with their tents up. We'll take their comments and then move on to the next area.

Walter McNairy.

MR. MCNAIRY: Walter McNairy, Dixon Hughes. If the Board goes down the path of putting some restrictions on tax services to executives, I would just encourage that they consider other perhaps more far-reaching ramifications from an independence standpoint with respect to related-party transactions. Would the restrictions be just for executives? Would it extend to middle-level management? Would it extend to the board? What about situations where the audit firm audits the acquiree and the acquirer, situations where the audit firm audits significant customers, the audit firm audits the parent company and audits the ESOP or benefit plans?

I just think there is a whole lot of related-party type relationships that could come into play as you evaluate all the clients that an auditor of a public company may have, and those clients may have conflicting interests with the interest of that public company. Just something to consider.

MS. RIVSHIN: David Shedlarz.

MR. SHEDLARZ: This may be in fact a

historical moment in that I get the opportunity this afternoon not only to agree with Lynn, but also Pat.

(Laughter.)

MR. SHEDLARZ: I agree. It lacks a lot of the arguments and good ones in terms of the vantage point and knowledge attendant to tax planning and tax advisory activity, and for that reason, if nothing for form but clearly for substance, it's not something that we support.

MS. RIVSHIN: Tom Ochsenschlager.

MR. OCHSENSCHLAGER: Tom Ochsenschlager with the AICPA. I think the argument here regarding expatriate returns is very similar to the argument, the issue involving whether or not auditors should be permitted to prepare tax returns in general for the company. The way the expatriate returns frequently work is it's actually a tax liability of the company. The company reimburses the employee for the difference between whatever the U.S. taxes and what the foreign taxes were plus some housing expenses and things of that nature.

So, in effect, what we're doing is -- for two reasons I guess, one, because of this reimbursement, in effect the company is filing the foreign returns on its own behalf, if you will, because it's money that it

ultimately will pay as a practical matter. And secondly is, I think, the point that Mark made earlier is it's very important for the company to make certain that these are properly prepared because otherwise they could be even potentially precluded from doing business in those various countries. So it's much more of a compliance issue, I think, than it is an independence issue.

MS. RIVSHIN: Mark Weinberger.

MR. WEINBERGER: Thanks. I just wanted to address a practical issue, I guess. There was a statement made that any of the firms could do it, so why not just move it around? I don't think it's that easy. Actually, many of the issuers could be conflicted from, based on their affiliation through either financial service firms or mutual fund complexes or with subsidiaries in other countries from being able to do work for two or three firms if we start limiting who can -- whether an auditor can do work.

But importantly, there's only, for better or worse, four big global firms left, and if you're precluded from working with one or two, the other two have to match up geographically almost exactly where you are in order to be able to provide those services on a global basis, and it doesn't work out that way for

all the companies. And so it's not as easy to say that if one can't provide it, one of the other two or three that are available can. It's in practice a little more difficult.

MS. RIVSHIN: Okay. Two other people put up their tents, so we'll let them say their remarks.

Damon Silvers.

MR. SILVERS: Well, A, I don't disagree with the comments that Mark and Pat made. I think that those issues are present in any non-audit service, and I was trying to be soft-hearted.

(Laughter.)

MR. SILVERS: The issue of whether or not you -- whether in looking at conflicts between an employer and employee in the context of tax consulting, whether that necessarily brings in the question of whether you could ever -- whether an audit firm could ever be in its role as auditor on both sides of a transaction, those are different things actually. And the reason is because of what we discussed earlier, which is the elements of advocacy involved in tax consulting and tax advisory services that is quite different than -- at least I hope it's quite different -- than the role that the audit firm plays as auditor. And I think it's important to keep that in mind that there are bright

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lines that can be drawn here.

MS. RIVSHIN: Lynn Turner.

MR. TURNER: Back to this service, first of all, there's nothing in this service that really does enhance the auditor or even ties into the audit, so that's where the O'Malley panel things start to kick it out. It's done by people, it's not associated with the audit, it's more of a compliance-type thing. So you can get other service providers, and it's not just the other three firms. In fact, having recently been associated with this process, we had to shut the door we had so many people wanting to come in and offer you the service. You could get the service -- and this is one where perhaps you can even get it at a lower rate when you go through this type of process, but there's many people out that provide this service other than just the big three, so there's not an issue with getting a service provider on this one as well.

MS. RIVSHIN: Okay, let's move on to our next area for a few minutes and then we're going to take a short break. And this is really kind of the catch-all of other tax services. This is your opportunity to discuss any other types of tax services that have not been mentioned in these categories and how they could affect auditor independence.

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(No response.)

MS. RIVSHIN: Did we do a really good job and categorize everything? Or do people want to break?

(Laughter.)

MS. RIVSHIN: Pat Walters.

MS. WALTERS: Well, I think we're still not really sure what tax advice planning and strategies are, so anything else must be in one of those three categories.

MS. RIVSHIN: Mike Gagnon.

MR. GAGNON: I do think it's important, because I think embedded in some of the questions we've talked about this morning and this afternoon have I think other related services that at least I would not consider to be tax services per se. And I think it's clear in the independence rules today that calling a service a tax service, or the fact that the service itself may be performed by a tax professional doesn't mean it's a tax service.

And I guess a couple of examples that I saw in some of the text of the questions would be some executive compensation consulting I wouldn't consider a direct tax service. There may be some unclaimed property type services that I don't believe are tax services. And so even under the rules as they

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currently exist today, I wouldn't want there to be confusion that sort of all of them would be grouped together, either because perhaps a tax professional might be providing them, or because they're sort of lumped in tax services per se. It may be a minor point, but an important distinction.

MS. RIVSHIN: David Shedlarz. Anyone else? Okay, why don't we then take a 15-minute break. That means we will be back at 3:00. Thank you.

MR. CARMICHAEL: Okay. We are going to resume our discussion on the relationship between audit and tax practices. I'd like to remind you at this point that we're inviting audience members to pose a question to the whole roundtable group potentially. If you'd like to ask a question, we'd ask that you please fill out a notecard that we've provided and return a completed card just to any member of the staff.

Bella, if you would continue with our next topic.

MS. RIVSHIN: Great. In some small firms, such as sole practitioner firms, audit personnel have expertise in both auditing and tax. In many other firms, especially large firms, there are separate tax and audit practices. The question is, is it appropriate to have tax specialists on engagement teams

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to examine tax accruals, structured transactions, and other tax-related accounting matters? If the firm uses a specialist from its tax practice to audit tax accounts, how should that engagement team supervise and otherwise relate to the specialist? And finally, should such a specialist's advancement, compensation, and other rewards be tied to the quality of his or her audit work?

And it looks like Lynn would like to comment on that one.

MR. TURNER: Actually, this is where I come back and totally agree with David and Nick on the issue of the tax people involved with the audit. Having been a CFO out there, I think it's critically important as you go through some of these transactions that their involvement is there right on at the front end advising you, because you got the attorneys sitting around the table, you're trying to put together either capital transactions or merger-type transactions, where we're doing financial statements now on a quarterly basis and each one is equally important. The Qs aren't any different than the Ks now. You don't have a chance to wait until the end of the year to get it done right. The audits have become -- and rightfully so -- have become continuous audit, so you absolutely, if you're going to sleep at night as a CFO, have to have the ability to have that type of tax expertise sitting there next to you telling you that if there going to be something that's going to have a financial impact on the business and on those financial statements, it absolutely has to be done right.

And for an auditor to show up at the end of the Q or end of the K and only then start to look at it and then tell you that something is wrong is one of the reasons we've gotten some of the restatements that we've had that have done investors damage and not good. So there has to be some interplay between the tax expertise and the auditors when it comes to those items in doing these deals, and there are many items in these deals that can have financial statement applications. And as David absolutely was correct on, it has to be done early on rather than later.

MS. RIVSHIN: Jeff Steinhoff.

MR. STEINHOFF: In the course of conducting an audit, you're going to use many specialists if it's a complex entity. I don't really see that the tax specialist is any different than the actuarial specialist, if you might have a computer security specialist, so you would manage that person in the same way. Certainly if this is what this specialist does

for most of their professional life, they should be evaluated on the quality of their audit work. That's what they're doing. If they have a wide range of duties, you would evaluate them on some kind of pro rata basis.

But I don't really see a tax specialist, which I agree with Lynn would be the type of person you would want on the audit team, being any different than any other specialist that the audit team would use on an audit.

MS. RIVSHIN: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey & Pullen. I think Jeff summed up things pretty well. I agree that you should certainly use a tax specialist as a member of the audit engagement team whenever such specialist skills are required. I think AU 311 would require you to do that. And I also agree that a tax specialist is probably no different than any other specialist or specialized skills that might need to be brought to bear in an audit engagement.

The auditor's responsibility for supervising the specialist is, as I've previously mentioned, equivalent to any other assistant. That would mean that the auditor would need to have a sufficient understanding of what the specialist is doing to

oversee that work and review that work. That would not mean they would need to have the same technical knowledge as the specialist.

Clearly, to the extent that a specialist is involved, a tax specialist is involved in performing audit procedures, the quality and effectiveness of that work should be evaluated. If that's all they do, that should essentially be all they're evaluated on. On the other hand, I would expect that most tax specialists are not solely confined to audit, otherwise they probably couldn't keep their tax skills up where you would need them to be, so rather than being the sole basis for their evaluation, I think it would normally be one element of their evaluation.

MS. RIVSHIN: Colleen Sayther.

MS. SAYTHER: Colleen Sayther, Financial Executives International. I'm not sure how you can audit some complex organizations that enter into tax strategies that may be fairly complicated without having a tax specialist. I also think that this is the area, you know, the key area where using your auditor for certain tax services is clearly beneficial with respect to the knowledge spill-over that you can get, particularly when you're talking about due diligence of potential acquisition candidates and the like.

MS. RIVSHIN: Paul Koren.

MR. KOREN: Paul Koren, Goldstein Golub Kessler. Well, we're neither a sole practitioner firm or a large firm, so we fall in between. However, we do have -- our audit people are not tax specialists and our tax people are not audit specialists. However, they -- are tax people are conversant with the standards regarding tax accrual process, and they become part of our audit team. They're actually reported to the PCAOB as associated persons of those who practice in that area, and they have powers in regard to the accrual, the accrual in the financial statements, and they have to approve of that so that we can go forward.

I think certainly in our firm our tax specialists who do that work are evaluated on that basis.

MS. RIVSHIN: Barbara Roper.

MS. ROPER: I think there's a fundamental difference reflected in this discussion between having a tax specialist who's working for the auditor and under the auditor's direction, and having a tax specialist who is working for the audit client, and that as far as auditor independence issues are concerned, that is a fundamental, basic difference in terms of the concerns raised.

I think there's obvious -- I don't think anyone would contest that there's obvious benefits to having that kind of expertise where appropriate represented on the audit team under the supervision of the audit partner. If it is true, as has been indicated, that those tax specialists are rarely going to be confined to working on audit teams, then I think it becomes very important to look at what other services they perform and how they're compensated and evaluated for those other services to ensure that they do not conflict with the audit or compromise the audit's independence.

MS. RIVSHIN: Michael Gagnon.

MR. GAGNON: I certainly -- Lynn actually passed me a note and said, should anybody be nervous if I were to sign a set of accounts or report on a set of financial statements without some tax advice? And the answer was, yes, they really should be nervous. Certainly having tax expertise assisting an auditor in carrying out an exam is vital to that examination, and it goes back to, I believe, some of our dialogue this morning.

There was, I think, a fair dialogue on audit quality, audit effectiveness, audit efficiency, and I

would bring us back at least for a minute or two to that topic as it relates to tax advice to the audit process. I think it's important to have, and while I echo the comments of the critical need for independence, what I think the Board ought to be considering in this complex area is the implications to audit quality of various levels of restrictions to tax services.

And while I think there was some unanimity this afternoon amongst this group on certain abusive tax shelter arrangements, I think there is still confusion as to definitional issues of other types of services, and some comments I made earlier about not only tax expertise, but knowledgeable tax expertise, knowledgeable about the client's facts and circumstances, the situation, particularly in complex environments of operating in 140 countries around the world. It's important not only to have the tax experts certainly at the corporate headquarters knowledgeable about how it's all coming together, but also to have the knowledge spread around the world to advise the auditors as the auditors carry out their responsibilities, but also to advise the client as well.

And to the extent services become more

bifurcated, there are two possible ramifications to that. I think one ramification could be that the tax experts -- they're still experts, that doesn't change their expertise -- the knowledge though has the potential for changing. And effective audits, more effective audits, are influenced by not only having auditor and accounting expertise, but by having knowledge, and to some degree there is an impact there.

I think a second possible ramification is having the requisite cadre of experts and people who are dealing in this area on an ongoing basis within the audit firm. I think it's vital because it's not simply income taxes that we're talking about today. We're talking about a complex array of various areas of taxation, whether it be federal income taxes or state and local in the U.S. or foreign taxes, and particularly the interplay of foreign taxes to U.S. taxation in various jurisdictions around the world, it is indeed a complex area. And the knowledge of organizations like ours is critical in order to properly carry out the audit function.

So while I think there is broad agreement that it's very important, indeed vital, to have proper specialists in this area advise the audit team in conducting the audit, I think there are at least

potential areas that the Board needs to consider in terms of audit quality, in terms of knowledge, in terms of breadth of expertise as they consider this complex area.

MS. RIVSHIN: Scott Bayless.

MR. BAYLESS: Scott Bayless with Deloitte. Just to echo some of Mike's comments, I think it is extremely important in the conduct of the audit, and we've talked about the quality of the audit and the importance of the tax function to the quality of the audit going forward, that the persons that are brought to bear in the conduct of the audit are also those persons that have been the advisors along the way throughout the year that have provided insight when the client seeks an understanding, a better understanding of how the tax laws applied, that that person that's been involved in those consultations during the year or that group of persons is brought to bear in that final audit function, because they are, having been consulted during the year, more aware of the issues that could arise or affect that determination, either at the end of the quarter or at the end of the year, whichever period they're brought in to review.

Importantly, the compensation should be geared to their contribution to the quality of the

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audit and should be considered in the total compensation during their annual reviews.

MS. RIVSHIN: Damon Silvers.

MR. SILVERS: I can't see how anyone could disagree with the notion that there ought to be some tax experts involved in auditing tax matters. I think what that tells you though is that because of the very nature of the expertise involved, it's then vital that that tax expert, to the extent that they're doing anything other than auditing, is not doing anything other than auditing that would compromise the audit.

And it comes back around -- this question is really a very deftly hidden loop back to much of this morning's discussion for that reason, that because you have to have tax expertise involved in the audit, and then the real question is, what else are these tax experts doing for the rest of their time?

I'm not satisfied, I don't think, with the notion that the tax expert is subordinate to the audit partner, because I think much of what the audit community has said today suggests that the audit partner, if they themselves are not a tax expert, may be unable to figure out when the tax expert -- if the tax expert is compromised, they may not really have the ability to oversee and correct that compromise because

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of the nature of the expertise involved.

MS. RIVSHIN: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey. I think it's just important that we recognize that issuers often come to their auditors, at least if their auditors are their tax preparers, or if they're not, they probably come to both their auditor and their tax preparer in the course of contemplating a transaction or in the course of completing a transaction, to ask their advice regarding how that transaction will be accounted for from both a tax and a GAAP perspective. And I think it would be a mistake to preclude an auditor from writing that advice. As I said this morning, I don't think auditing is something you come in and do at the end of the year after the client's fully completed their financial statements. I believe it's more of a continuous process.

I think it is the line between providing advice and performing audit procedures can get blurred at times, but I think auditors can be independent and objective in discharging their responsibilities. As a matter of fact, under our code of conduct auditors are required -- or tax preparers for that matter -- any CPA is required to be objective in the performance of any services, including tax services.

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MS. RIVSHIN: Okay, there aren't any other commenters. We will move on to the next section, and I'm going to turn it over to my colleague, Greg Scates, to tee it off.

MR. SCATES: The last series of questions has to do with independence and auditor ethics. Regardless of how well the auditor performs the audit, investors will not have confidence in the quality of the audit if they do not believe the auditor is independent. Investors may also question whether it is ethical for the auditor to provide a particular service, even if a service does not impair the auditor's independence.

That brings us to our next question. Do any of the services discussed today raise specific concerns about the auditor's appearance of independence? And do any of the services discussed today raise specific concerns about auditors' business ethics?

Pat Walters.

MS. WALTERS: I mean, how could we answer anything other than yes? I think that certainly the investor representatives around the table have been pretty consistent across most of the questions that have been raised today that everything really raises concerns for us in terms of appearance as well as fact, and it's sort of difficult to know what to say after

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that.

I guess the question about auditors' business ethics is perhaps more problematic, because it's difficult for me as an investor to listen to the arguments that I've listened to today that attempt to brush away the concerns that investors have. And I guess to go as far as to say I have concerns about their ethics is probably too far, but I'm puzzled that the concerns that we have expressed on this wide variety of issues related to providing these particular kinds of services to issuers haven't really been heard. With that, I'll let the other guys have their chance.

MR. SCATES: Barbara Roper.

MS. ROPER: Rather than reiterate what I've said earlier, because I haven't exactly sat here quietly, I'd just like to add one area that we haven't discussed or haven't discussed much, which is how you look at the question of audit and non-audit fees. And in at least one instance we've seen an audit firm advising its audit clients to lump the audit services, the fees for audit services, audit-related service, and tax services on one side of the equation, except for tax shelter services, and then leave just the little bit that's left on the other side when they're balancing whether the fees for non-audit services

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create a potential independence problem.

And so in addition to questions about method of compensation, which we touched on briefly, I think this issue of how you balance the auditor's financial dependence on that client needs to be measured very differently, and it needs to be measured with only those services that are directly related to the audit on one side of the equation, and everything else on the other side of the equation, when you decide whether the audit firm has too much at stake in other services to risk losing this audit client.

MR. SCATES: Elliot Schwartz.

MR. SCHWARTZ: Well, of course I agree with Pat that the answer here is, of course, all of these services raise questions. And one thing I wish I had raised at the very beginning when we were talking about the four principles was the first one, which is the principle of whether a relationship creates a mutual or conflicting interest, and I would have added the appearance of a conflicting interest, because I think the appearance is one that is also important, it's one that we've talked about. And I don't want to impugn anybody's ethics, but it's very difficult for investors to know with certainty that an audit is independent, that it is done consistent with integrity of the

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auditor, and I think actually toughening up the initial standards would help some.

MR. SCATES: Colleen Sayther.

MS. SAYTHER: Colleen Sayther, Financial Executives International. I think we have to keep in mind we all have the same goal, and that's to enhance the quality and integrity of the financial statements and the audit. And I think that having the audit firm perform certain tax services enhances the quality of the audit, as we've stated several times today. It enables the knowledge spill-over and enhanced communication between the tax side and the audit side, and in most cases -- I won't use the term always -- it's more efficient.

I'm also familiar with the study that Jim Brown mentioned earlier by three well-respected academics, which correlated the provision of tax services with less audit restatements, and I encourage the Board to take a look at that study as they determine what route to take going forward on this, keeping the goal of enhanced quality and integrity of the audit in mind.

I think some of the issues that came up today relate also to the ambiguity in what's compliance, what's planning, and what's tax strategy in consulting,

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and I think some guidance around, definitional guidance around that, would also be helpful to companies.

And I think lastly we can't forget that the audit committee, that that sort of stopgap of having all of this go to the audit committee is a relevant and important piece of the puzzle here.

MR. SCATES: Pat Walters.

MS. WALTERS: There is something I would like to add and it does have to do with a conversation I had with David during the break. I think that, well, at least I have been persuaded that there are activities that occur in decision-making about tax and other strategies that happen during the year that the auditor needs to be -- and I'm going to use this term again, even though it's fuzzy -- involved in, so that they have the requisite knowledge in order to perform an effective audit, and an effective audit would be an independent audit.

Part of that obviously would be to have a tax specialist as part of the audit team. To me, all of those activities are audit services, they are not tax services. And it's important to get to the fee question that Barbara raised that those kinds of services be included in the audit fee and not in a tax services or some other fee, so that it is clear that

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when the tax professionals are engaged in these activities, that they are engaged to the benefit of the auditor and the audit, and not to the benefit of the company necessarily and its decision-making as managers, and that those particular aspects of the discussion today I think is the important aspect for the Board to define and describe so that there's a clear understanding, not only by issuers and auditors, but by investors, as to what particular tax activities is appropriate for an auditor to engage in in order to enhance their independence and objectivity and to enhance the effectiveness in the audit, and what kinds of activities are inappropriate because they compromise the independence and objectivity of the audit.

MR. SCATES: Mike Gagnon.

MR. GAGNON: I think that the discussion now about appearance or appearances related to auditor independence is an important one, and would go back actually, Pat, to some of the comments you made before the break at lunch in the context of -- as well as this afternoon -- in that some of the appearance concerns appear to be downplayed or brushed aside. And I would tell you, at least from my own perspective, that couldn't be further from the truth in the sense that these are very serious issues. I think they're

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acknowledged by virtue of the fact of the people in the room this afternoon that we all consider them very serious issues, but nonetheless, very complex issues, and complex in the sense of the intertwine between some of the independence issues that we've talked about today, which are very difficult to sort of get your arms around in the context of tax services broadly, but more specifically, the interplay between those services and what is also critical to investor confidence and protection and integrity, that is, the basic audit itself and the integrity of the audit and the quality of the audit. And the interplay between those two -- they're not separate concepts, they're intertwined -- are very important.

If I have it correctly, I think that part of the -- perhaps it's an impression that sort of audit firms are here this afternoon wanting to do this work, I think was some of the commentary -- and there's no question that firms like ours do possess and have deeply credentialed expertise to provide the service. Providing that service though in all instances to all audit clients, at least for my firm, is not the driving force here. The marketplace is certainly shifting these services, and it is important, as Colleen just mentioned, that audit committee oversight here and

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consideration of the very important independence matters we've talked about this afternoon is changing the way businesses operate.

In my judgement at least, some of those considerations are -- need to also encompass the basic principles of independence we've talked about as well as the O'Malley principles that we've also alluded to earlier. I am concerned about what I would guess I would call unintended consequences in the sense of we want to make sure that to serve the public interest in this market, that we continue to preserve the required and knowledgeable expertise in our firms to make sure that we can get the job done and get the job done properly and correctly. And that's a balancing factor in my mind that complicates this question, complicates it significantly.

But I wouldn't want the impression provided that this is sort of all about business. It's not. Audit quality if of paramount importance here. Independence goes hand in hand with audit quality. But it is a very complex and a very difficult discussion that at least in my mind wouldn't lend itself necessarily to sort of bright line tests.

One last point. In terms of fee disclosures, I would certainly echo and agree with the comments made

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on fee disclosures that I think today there is very clear guidance provided, requirements provided, in terms of the categories of fee disclosures. I personally believe that those disclosures are very informative in the manner that they are now presented today. I certainly believe they ought to be full disclosures, and to the extent that there's an ambiguity or an interplay there, that ought to be corrected. But I do think the disclosures today in terms of the categories are fairly clear and fairly uniformly applies.

MR. SCATES: Scott Bayless.

MR. BAYLESS: Scott Bayless, Deloitte. In terms of just responding to some of the comments that have been made, certainly the firms are here today, particularly Deloitte, because of the importance of independence, because of the importance of audit quality, and the importance of tax services in connection with audit quality. We believe that they're integrally tied together and that we want to protect the integrity of our audits, protect the importance of investors of these audits.

Certainly the firms have undertaken and continue to expend millions of dollars in funds and resources to ensure independence and to maintain

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independence with respect to SEC audit clients, and we would encourage the Board to consider, as it reviews these issues, certainly that there are scenarios in which services, we believe, are strictly out of bounds. I think we've talked about various provisions today, transactions that would include no business purpose, or that were purely tax motivated with no basis in the code, as criteria that would clearly place services out of bounds, but that the Board be measured in terms of looking at those services that are tax compliance, tax advice oriented, because those are integral, we feel, to the conduct of audits.

MR. SCATES: Lynn Turner.

MR. TURNER: There's been a number of business ethics raised on the front page of the newspapers in recent years because of some of the auditors' involvement with compensation or tax shelter-type issues, and I don't think any of those have played out well for the profession in the public eyes. And I think there are some very significant business ethic issues here that go beyond even where you decide, if you decide to make a cut, that are very important. I've heard people, Chairman McDonough, give a speech more than once about getting it done right, and I think that ties into the ethics side of things.

But you're also asking an awful lot of people here, because you've got a very regulated entity on the audit side now underneath the same corporation and within the same -- under the same roof as you do a non-regulated entity, and that's the tax people. And you're now asking -- talking about asking the tax people to switch that hat from time to time between when they are advocating the interest of a particular tax client vis-a-vis advocating the interest for an investor. That is not an easy switch to make as they go about their business day to day. That's a difficult thing to ask of very good people.

And so I think part of what you need to think about as you decide what to do here is not only where you might make some cuts on tax services that are not okay, but how do you also provide the support for some of the tax people to make sure that they are able to switch that hat back and forth in an appropriate fashion. Give them the right environment in which to do it and I think they will do it right. But if you don't create the right environment for them, I think that will also have some negative ramifications. So I think quality controls and ethics go with this, and that's an important part of it.

MR. SCATES: Jeff Steinhoff.

MR. STEINHOFF: I think the issue you're really addressing today, independence, is really part of a broader issue, and that ties back to greed, morality, I think gave rise to this body was much broader than whether people were independent to do their work or not. I think there were large grey areas in terms of what was allowed and what wasn't. People continued to push the grey areas out and if there wasn't some rule that said I can't do it, then I'm permitted to do it. And I think the profession has paid a big price for that and saw the rule as being the floor and the ceiling at the same time.

I think you're talking about cultural change, and I think some of the people participating today spoke about some of the things their firms are engaged in doing now. But it will be very, very important to push forward in a permanent basis that kind of cultural change.

At the same time, all this has got to be balanced out, and it struck me that we were speaking today about types of services that were very, very broad. We were talking about structured transactions, we were talking about cases where auditing firms pulled together themselves very aggressive, questionable, if not illegal structures, and sold them to the clients.

We didn't talk about the fee structures for those, but some of them weren't based on an hourly rate, it was based on you're getting so much back, so I share in that largess. And there's something frankly fundamentally wrong with that.

On the other side of the spectrum today, we were speaking about preparing a tax return for an expatriate, which I guess I view somewhat as a ministerial duty. We've asked this employee to go abroad, you know, there's a lot of complex issues, they already have enough on their plate, so we'll provide this service to the employee. It's not quite like day care, but it's like providing a fringe benefit or a benefit to the employee.

I think the Board is going to have to kind of focus in on what are the more important areas, what are those things that really drive behavior. One thing the Board has that was never really in play before is a process where one can be disciplined, and through the inspections and the work you all are doing, you can look at the range of issues that affect audit quality, including this one, and you can act when you see that type of behavior that in its totality is not acceptable.

But I certainly think ethics are a big part

of this and I think changing the cultural focus on, let's say, a firm or an entity's bottom line to more of the public interest focus is probably what's needed.

MR. SCATES: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey & Pullen. There's been a lot of statements today that imply that when an auditor prepares a tax return, he's being a client advocate, when he signs an audit return he's being an investor advocate. I'm just not sure I buy that. My firm hasn't let me sign tax returns other than my own in 15 years, but I can assure you that when I sign tax returns on behalf of a client, I read that statement that I was signing and I took my responsibility very seriously.

I think that what I said, to the best of my knowledge and belief, the representations contained in that tax return were true and correct. And I will tell you that if I was the auditor of that client, I had a much better knowledge and belief on which to base that representation.

MR. SCATES: Tom Ochsenschlager.

MR. OCHSENSCHLAGER: Tom Ochsenschlager with AICPA. I think much of the impetus that we are here today actually probably relates to some of the abusive tax shelters that we had. We've talked a lot about

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mass marketing of products and abusive tax shelters and things of that nature. I think had it not been for that unfortunate occurrence over a period of a few years we probably wouldn't be having this meeting today.

And so I think we need to look at it from the perspective of is that still an issue or is it an ongoing issue and what is being done about it that might correct those problems so that we wouldn't necessarily need a draconian measure to eliminate all tax services that could be provided by a CPA firm?

In that regard, the world has really changed. I mean, we now have audit committees that I can't imagine would approve any of these transactions going forward. The audit committees have only been in existence for about a year and a half now, and they're still on a learning curve as to some of the more technical tax issues, but based on anecdotal evidence, I think it's starting to take hold and we're starting to see the turnaround and them to be more effective.

Secondly, there was an allusion earlier that there were different standards for CPAs in the audit function and relatively few standards for CPAs in the tax function, and that probably was true up until very recent -- relatively recently. But our friends at the

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Internal Revenue Service are strengthening up -- dramatically strengthening the circular 230 regulations, which will make it much more difficult for tax preparers or tax specialists to perform any of the sorts of activities that we think of in the more negative sense.

Additionally, the AICPA, you may not be aware, has recently made its standards of tax practice to be mandatory, they're enforceable now, so that anyone violating, found to violate those standards, would be expelled from the AICPA. To take even a step further, we recently made those not only enforceable, but automatically enforceable in circumstances where any member of the AICPA has been sanctioned by either the SEC, the IRS, or the PCAOB. So we have standards now, and I might add that we've done a second interpretation to those standards that is very specifically related to tax opinions and taking tax return positions, so we've -- in a question and answer format and also a monologue format.

So there's been a lot of changes that have happened that have yet -- that are starting to take effect and I think are having positive effects, and I see these changes being more dramatic going forward in the future, having more effect as we go forward. And I

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would think that that should temper any major change now in a policy as to whether or not auditing firms should be permitted to do tax work for their -- various types of tax work for their clients.

MR. SCATES: Mark Weinberger.

MR. WEINBERGER: Thanks. I guess I'd just maybe -- Tom stole some of what I was going to talk about, but I do believe it's all of our responsibilities, us as audit firms, certainly investors, to keep us focused on what the investors care about, regulators to write the right rules, to stay focused on these issues. These issues aren't brand new. They were around before Sarbanes-Oxley, they were around during the debate, they were around during the rulemaking, and they're still here today.

I think there has been a lot that has changed though, and as you decide where to go next, I think you do have to view it with that filter, at least I would hope we all would. The world operates differently, and as we decide in our firms what to do to try and make ourselves from an ethics standpoint more aligned with where we should be, we put in numerable changes in our processes, and I'm sure the other firms have as well.

In addition, you can't ignore -- I mean, one of the issues that was put on the table was the abusive

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tax transactions, which we all wish never happened and which we hope will not happen again, and that's not to say that there won't be differences of opinion on tax transactions as companies enter into them and they're reviewed by the IRS. But the mass marketing of these transactions that are tax motivated without business purpose, what is out there now to prevent them from happening again? It's something we all care about.

Well, Cono and the IRS have taken a lot of steps that we need to be cognizant of if you all think through the rulemaking. Not only are there brand new regulations out there that require a whole web of transparency that didn't exist before, whereby now the issuers and all the way down to the individuals have to, if they meet certain requirements, file additional information with the IRS that they never had to before so they can better identify and target these transactions early on.

Most recently, and something very pertinent to our discussion, is a new form that's going to be required to be filed with the 1120, with the corporate tax return. It's called an M-3, and the purpose of that is to highlight very specifically, not en banc but in transaction by transaction, book and tax differences between all aspects of the accounts on an issuer. That will allow the IRS obviously to go in more quickly, identify where there are problem areas, and try to address it either through rulemaking, through challenging it through audit, or going to try to get the law changed if they find problems.

The audit committee involvement is clearly a new element. Sarbanes-Oxley and now the regulation of the profession is something that we're all grappling with and trying to understand day in and day out and getting better and better at trying to effectuate is brand new, and it's taking hold, and we saw that the audit committees are speaking loudly, significant reduction in the type of services, the amount of services we're providing to auditors.

I think the real question is, over just a year after we have the new rules in effect, what is the next step? Do we come in and decide to do rulemaking? Do we see how these IRS rules, how the audit committees take their charge, how the audit firms frankly respond and step up to where we need to step up to to do the right things? Or do we come up with new rules, which will undoubtedly raise new issues? Because these issues, every time we write rules, create new issues. I think it's a tough issue that we're going to have to grapple with as we all move through this process, and I

think we all want to be constructive and appreciate the opportunity to be here today to talk through the issues.

MR. SCATES: Barbara Roper.

MS. ROPER: On this issue of the world's changed, I see it somewhat differently. I hope audit committees are being more responsible in making these decisions and I hope firms are abandoning practices that have created problems in the past, and I believe that that's likely to be the case. But I also believe that memories fade and that you have a window of opportunity while memories are fresh to institutionalize the changes you would like to see as permanent changes.

And if we have identified changes where there are clear independence problems with tax services, I think the opportunity is now to write those rules. And if we have identified areas where there are sort of questions about independence problems, the opportunity is now to clarify those issues for audit committees so there's something that they can look to going forward that will direct the decisions that they make and hold them accountable for making good decisions, even when memories of the recent pain in terms of the audit scandals have faded.

MR. SCATES: Let's now take a look at the last two remaining questions. Are there any special factors that an audit committee should take into consideration before approving an engagement of an auditor to perform any of the services discussed today? Are there other ethical issues an audit firm should consider before providing tax planning advice, strategy, and other tax services?

MR. CARMICHAEL: It looks as if all souls have been saved.

(Laughter.)

MR. SCATES: Tom Ochsenschlager.

MR. OCHSENSCHLAGER: I'm not quite ready to respond here. I'm asking Sue here -- Tom Ochsenschlager with the AICPA. The AICPA does have a practice guide that we've published, an audit committee -- I'm sorry, late in the day, I guess -- an audit committee tool kit, which provides very specific bullet points that audit committees should consider before engaging an auditor to do services that are outside the scope of the audit. So there is such an item out there, which I'd be glad to supply anyone that wants to get in contact with me.

MR. SCATES: Bruce Webb.

MR. WEBB: Bruce Webb, McGladrey & Pullen. I

just simply want to state that I believe it's incumbent upon both audit committees and auditors to consider the overriding principles and the spirit of the rules, not just the letter of the rules, before agreeing to engage the auditor for any non-audit services.

MR. SCATES: Any other comments on audit committees or these two remaining questions? I've got one question here. Mark Weinberger, you alluded to the M-3, new schedule M-3. I have a question on this, not directed to you, but anyone. With the new schedule M-3 requiring certain reconciliations to financial statements and characterization of book to tax differences as either permanent or temporary based on financial accounting principles, is there enhanced efficiencies by having the audit firm prepare the issuer's income tax returns, including the new schedule M-3?

MR. WEINBERGER: Oh, wow. It's a tough question, and without my independence person here telling me what we can and cannot do, I'm a little leery to answer it. I certainly think -- I think the M-3 generally, and again, for those who aren't familiar with it, it is a brand new schedule that I think goes into effect -- I don't know, Cono, if you know the answer as to when -- but next year, not this year.

It's a limited effect for the first year and then it will be fully in effect the year after, but it really is going to highlight the -- all the book tax differences that -- per account. And obviously, to the extent that the auditor is working with the books and records and the work papers, they would have efficiency to work on the M-3 schedule for sure. I just don't know when you come to a situation where we can't prepare it because it's somehow used in a financial statement and where that issue arises, so I'm going to leave the independence issue to somebody else. But at first blush, it certainly seems like the information would be at the auditor's fingertips.

MR. SCATES: Pat Walters.

MS. WALTERS: I'm certainly not talking about the M-3. I would like to go back for a minute to the audit committee issue and sort of throw something out on the table which I'm not sure falls within the purview of the PCAOB or not, and that is, what would be the minimum level of due diligence that an audit committee should go through in determining whether to award a tax services contract to their auditor? For example, should they be required to do an RFP, a request for proposals, from others? Should they be required to consider some of the issues that we have

placed out on the table today with respect to concerns about providing tax services and document their discussions and decision-making surrounding those issues?

Those are just some thoughts that I've had in terms of what a reasonable investor would expect the audit committee to have done before they award such a service to their auditor. And certainly I would be interested in hearing what others around the table might say about that.

MR. SCATES: Mark Weinberger.

MR. WEINBERGER: I just don't want you to have an unanswered question, Pat. I guess my view would be we certainly have all circumstances in our firm, some do issue RFPs regularly routinely and some don't. And again I think this, because of the diversity of clients and the diversity of taxpayers and the issues they face, that I would suggest that that's probably best left to the audit committee as under current processes.

MR. SCATES: Scott Bayless.

MS. WALTERS: Can I?

MR. SCATES: I'm sorry. Pat Walters.

MS. WALTERS: Going back to everything that Barbara said, and I really wish I had said that, your last series of comments were absolutely perfectly right

on, I think investors need more confidence that the audit committees are going to do extensive due diligence around these issues. And to say we're going to just leave it to the audit committee means that audit committees who don't do requisite due diligence will become lazier and lazier, and those audit committees who see that others don't have to do that, because I would expect that a lot of these people are on at least one other audit committee in life, they will get lazier and lazier, and I'm really not encouraged by let's leave it to the audit committee. I would like there to be some document, documented best practices issued by some authoritative body that says, we think that these are the minimum steps that an audit committee should take on issues that reflect on the independence of their auditor.

And I think that the simple fact that we've had a day-long discussion around this particular topic, and there's pretty much unanimity on the part of the investor advocates in these rooms that tax services is an issue for them, that someone, if it's not the PCAOB maybe it's the SEC, or someone should come out and say, we think these are minimum best practices in this area.

MR. SCATES: Scott Bayless.

MR. BAYLESS: Just to address the M-3

question, in terms of the process, of course, the process is typically that the client has gone through and prepared books and records that incorporate its tax position that's weaved into the financial statements. The auditor then comes in with the assistance of a tax expert that works for the firm to assess whether the positions laid out by the client in their books and records with respect to taxes are accurate and reflect the auditors through the tax eyes, tax expert's eyes, views of what is appropriate in the financial statement disclosures.

We heard Lynn Turner describe that the tax return typically is not done at that time, that the tax return is typically done months later, and it's the ministerial act of filling out the form, putting numbers that the client has generated into a reporting format, that then is filed with the SEC -- or excuse me, filed with the IRS.

The significant intervening event is that management is ensuring that the numbers that are placed in that form are consistent with what they're reported in their books and records to ensure that they can then sign the return, that it reflects the information that they believe is correct and accurate. So significant management involvement in both the process of generating the books and records that are then placed into that format, it's a form. The auditors are not responsible for maintaining that information that is set forth in the M-3. That is the management's responsibility and they keep the books and records to ensure that those -- that information is reflected in their books and records.

MR. SCATES: Bruce Webb.

MR. WEBB: The Board may wish to consider an amendment to ethics interpretation 101-3 that was adopted last June, became effective last fall, so therefore is not included in the interim independence standards. But I think it represents a significant strengthening of the overall non-audit service requirements in that it requires a number of things that the old interpretation didn't. Perhaps first and most importantly is a documented understanding regarding several aspects of the engagement, the members' responsibilities, the client's responsibilities, the objectives of the engagements, some of the things that I believe Pat was getting at that the audit committee should want to understand as they approve those activities.

Secondly, it requires that management designate a competent employee to oversee those

services so that -- make all management decisions in connection with those services. So that might be useful to the Board.

MR. SCATES: Any other comments?

MR. CARMICHAEL: Okay, we're ahead of schedule. That's fine. We would like to thank you all very much for the information that you've provided to us today. Many of you have traveled a long way to get here and we appreciate your willingness to do that and wish you safe travels as you return home. Thank you.

(Whereupon, at 3:58 p.m., the meeting was adjourned.)