

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on July 15, 2010 that related to the Board's proposed auditing standard, Communications with Audit Committees. The other topics discussed during the July 15, 2010 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

STANDING ADVISORY GROUP

8:32 a.m.

Thursday, July 15, 2010

The University Club
1135 16th Street, N.W.
Washington, D.C.

5 DAN GOELZER: OK, thank you, Marty. As
6 Marty's indicated, the next topic is the board's
7 proposed standard on auditor/audit committee
8 communications. And Jennifer Rand is going to
9 summarize what we heard in the comments on the
10 proposal that was published last March. And I'm
11 just going to kind of briefly set the stage.
12 As I said at the board meeting on this subject last
13 March, it seems to me that 1 of the fundamental
14 objectives of Sarbanes-Oxley is to strengthen the
15 role of the audit committee by putting it at the
16 center of the relationship between the public
17 company and its auditor. The provisions of the act
18 that deal with the committee's oversight of the
19 audit are kind of based on the idea that both the
20 work of the audit committee and the work of the
21 auditor can be strengthened to the extent that
22 there's good communications between the 2. But

1 building on that objective, we did publish a
2 proposal at the end of -- of March that would try to
3 enhance communication between auditor and audit
4 committee and also put more emphasis on it as a 2-
5 way process, not simply information transmitted from
6 the auditor to the committee, but more of a dialogue
7 between the 2.

8 We received 35 comments on that proposal reflecting,
9 I would say, a wide range of -- of differing views.
10 To me, at least 2 things came across. One is a
11 number of comments suggested that we needed to do
12 more homework, more outreach on this subject. Some
13 thought we approached the subject too much from the
14 perspective of the auditor and without a full
15 appreciation of what audit committee members wanted
16 and needed. Along the same lines, other comments
17 linked this to the subject we were just talking
18 about and pointed out that there could be
19 similarities between the information that should be
20 communicated to the audit committee and what
21 investors would like to learn or what additional
22 information investors would like to learn coming out

1 of the auditor's reporting model project.

2 Based on those comments, there were suggestions from

3 a number of people that we needed more insight from

4 investors, auditors, management, directors, others

5 with an interest in the process before we go further

6 with the -- with the project. The other point that

7 stood out to me was the several comments, many

8 comments emphasized that we needed to be careful not

9 to turn auditor/audit committee communications into

10 an exercise where the primary objective was to check

11 a lot of boxes as to what had to be communicated.

12 I think there was general agreement that the audit

13 committee benefits from the auditors' insights into

14 the strengths and weaknesses of the companies'

15 financial reporting, but that we needed to guard

16 against overwhelming audit committees with a lot of

17 information that wasn't necessarily useful to them

18 or causing the auditors' communications to become

19 more -- more scripted and more of a compliance

20 exercise.

21 So with -- with all those comments in mind, I think

22 1 thing that the board has decided is that it would

1 be desirable to have a public roundtable on this
2 topic to consider some of the things that we heard
3 in the comment letters and -- and other suggestions
4 about audit/audit committee communications. We
5 would like to hold that roundtable as soon as
6 possible. Schedules being what they are, that
7 probably means in -- well, probably in September
8 rather than next month, which is a difficult time to
9 -- to schedule meetings. We will probably reopen
10 the comment period around the time of any
11 roundtable, since there does seem to be a lot of
12 interest in this subject. And it may not be
13 possible to have everyone with an interest in
14 speaking at the roundtable to actually be part of
15 the program. But we do want to give everyone an
16 opportunity to express any additional views that
17 they may have.

18 So with that -- with that little bit of
19 introduction, Jennifer is going to be more specific
20 about what we actually heard in the -- in the
21 comments.

22 JENNIFER RAND: Thank you, Dan. I'd like

1 to first provide an overview of who we heard from,
2 who commented on the proposal. Dan mentioned 35
3 commenters sent in letters to us. And we are very
4 grateful for the feedback. I think we felt that we
5 had a wide range of feedback. And this shows you
6 the outline.

7 Certainly, firms in association of accountants
8 provided -- just if you look at total count, they
9 provided the largest number overall of any
10 particular group. But we also heard from audit
11 committee members and associations, issuers and
12 internal auditors, investor representatives and a
13 couple others. And -- and we were very pleased with
14 the different type of feedback we heard. And we saw
15 some consistent themes among some of them. But we
16 also saw some different views. So with that, I'd
17 like to provide you with an overview of what
18 commenters said. And these are the types of issues
19 that as we put together what the roundtable topics
20 will be, the types of issues that we'll be seeking
21 additional feedback on as well as we hope when we do
22 officially reopen the comment period we'll get

1 additional comments on these and -- and certainly,
2 if there's any other issues.

3 Overall, what came clear to us is there certainly
4 was support for a revised standard. People
5 recognize the importance of auditor/audit committee
6 communications, also recognize the -- the current
7 standard and the board's interim standards is
8 directed that -- isn't required that the auditor
9 establish this understanding, at least with the
10 engagement letter, with the audit committee and
11 thought improvements could be made really to align
12 the board's existing standards -- board standards
13 with the Sarbanes-Oxley Act requirements. So there
14 was overwhelming support for the standard. But with
15 that, like with any of our proposals, there is
16 areas, you know, for suggestion, improvement. So
17 I'd like to go through different recommendations
18 that commenters provided to us.

19 First, as Dan mentioned, an overwhelming theme that
20 really came from not just 1 particular group.

21 Certainly, audit committee members had this view.

22 But also the Center for Audit Quality encouraged

1 additional outreach about what issues audit
2 committee members are interested in. There was some
3 view that the -- the requirements in this proposed
4 standard really geared toward maybe what auditors
5 would like to say to audit committee members as a
6 result of the audit.

7 But there may be other issues, additional things.
8 And so, they really -- commenters really encouraged
9 us to develop a standard that would be meaningful to
10 audit committee members in their oversight. And
11 that could include some additional things and
12 encouraged us for that additional feedback, which is
13 why Dan mentioned the roundtable and -- and
14 additional comment is something we're pursuing.

15 Another point was it encouraged us to clarify the
16 process related to the evaluation of 2-way
17 communication between the auditor and the audit
18 committee. Certainly, it was recognized that there
19 is the importance of effective 2-way communication
20 between the auditor and the audit committee. And at
21 previous discussions with the SAG when we've talked
22 about this topic, that's come up as being very

1 important.

2 But the comment that came through in -- or comments
3 that came through in this regard is, well, how do
4 you go about really objectively evaluating those --
5 those -- you know, whether or not the 2-way
6 communications were effective, what should that
7 criteria be. And also another comment was the
8 requirement -- proposed requirements we had in the
9 standard were not helping to promote effective 2-way
10 communication. So really just comments on better
11 ways to articulate that, better requirements, better
12 direction on -- on what we're trying to achieve
13 there.

14 Another area relates to the audit engagement letter.
15 So that's the letter that the auditor provides to
16 the audit committee and the services to be provided
17 in connection with the audit. And in that in the
18 proposed standard it -- it includes different
19 required elements. One is disclosing the auditor's
20 responsibilities and also management's
21 responsibilities. And several commenters suggested
22 to us that the audit committee's responsibility

1 should also be included in that letter. So we had
2 several different commenters express that view.
3 Just moving to the next slide, additional themes --
4 considering management's communications to the audit
5 committee to avoid repeating certain requirements.
6 We have -- have several requirements in the proposed
7 standard really around the area, most particularly,
8 about accounting estimates. And -- and we had
9 language which we intended that the auditors would
10 not be duplicative of management's communications.
11 We certainly recognized in developing the proposed
12 standard that management would be communicating
13 certain matters to the audit committee. But
14 nonetheless, we thought the auditors should evaluate
15 that, perhaps not duplicate things that they didn't
16 see if it was necessary. But there seemed to be
17 confusion around how we articulated that and thought
18 we could better describe what the auditor should do
19 in considering management's communications so that
20 it's not completely duplicative.
21 There was also a suggestion about clarifying which
22 consultations outside the audit engagement should be

1 communicated. Several commenters talked about not
2 really clear on where the lines were as far as what
3 constitutes the consultation. You know, if the
4 engagement team consults with someone else, for
5 example, they may want to just call someone to get
6 clarification on an accounting standard or how
7 that's applied. Would that be considered? Would
8 they need to communicate that? Kind of, you know,
9 water cooler conversation, national office, kind of
10 -- excuse me. What is that -- what is in the scope
11 of that. And also some were concerned that if it
12 was just too broad, it could have the unintended
13 consequence of discouraging such consultations,
14 which certainly would not be beneficial.

15 Moving on to the next slide, we had mixed views in
16 certain areas. One was regarding whether all
17 communication should be in writing. And this is an
18 area that we've sought the SAG's feedback. And we
19 heard mixed views regarding SAG members about
20 permitting flexibility, permitting some -- some
21 communications being made orally, others in writing.
22 Other SAG members thought that all should be in

1 writing. That same view seemed to persist in the
2 comment letters that we received. So we -- we did
3 not -- we were not able to reach a consensus view on
4 that. And people brought up, you know, very good
5 reasons for which side, you know, that they were on,
6 whether or not there should be all in writing or
7 whether flexibility.

8 Another area of mixed views is whether all corrected
9 misstatements, including those detected by
10 management, should be communicated to the audit
11 committee by the auditor. Many had concerns that as
12 management is going through the financial reporting
13 close process that, you know, certainly their system
14 of internal controls would identify areas of
15 misstatement. And part of the controls of the
16 company's system would identify those and correct
17 them. So there was some concern about how much --
18 you know, bringing all these adjustments in. Is
19 that going to have a negative -- you know, just
20 duplication, not necessary. It's part of the
21 company's internal control system. And -- and so,
22 there were views on -- on whether or not that was an

1 appropriate communication by the auditor.

2 And then finally -- and Dan mentioned this, too --

3 there were many -- many -- there were some concerns

4 or different views that the proposed requirement in

5 the standard could just create this "check the box"

6 mentality, that it appeared to some that what was in

7 the proposed standard was a lengthy list of required

8 communications, that perhaps those required

9 communications were not getting to the heart of

10 issues. And again, kind of going back to the first

11 point, what was truly important to the audit

12 committee in connection with the oversight of the

13 audit and the financial reporting process. And so,

14 just encouraged us to kind of revisit what's

15 required so that it's not too many and that they are

16 appropriate.

17 So with that, that's an overview of the -- the

18 significant comments that came through. And thank

19 everyone here on the Web cast, you know, for

20 providing comments on that. We're certainly going

21 to continue exploring this issue. It's an important

22 issue. And we recognize the importance of hearing

1 from audit committee members and others and -- and
2 continuing to debate this and get feedback before
3 we, you know, recommend to the board that they
4 finalize the standard. So with that, I'll open up
5 the floor if there's any comments on going through
6 the comments. Doug Anderson?

7 DOUG ANDERSON: I just had a question. So
8 is the expectation that after the roundtable you'd
9 come out with another exposure draft? Or do you not
10 know at this point?

11 JENNIFER RAND: In my view -- and I see
12 Marty is about to jump in. In my view, that might
13 be premature. I think it -- it depends on -- we're
14 certainly open to the feedback. And I'd -- I'd
15 personally be reluctant to prejudge the outcome. So
16 a lot of -- you know, the commenters did encourage
17 us for additional feedback. And -- and we plan to
18 do that in 2 parts, the roundtable and reopening the
19 comment period. And so, I don't want to prejudge
20 what may come out of that.

21 DAN GOELZER: I think without getting in
22 trouble with Marty and Jennifer, I think it's fair

1 to say that if we make significant changes in the
2 proposal, then we will re-expose it. And I guess
3 you can -- you can draw your own conclusions from
4 what you've heard about whether that's likely or
5 not.

6 JENNIFER RAND: Thanks, Dan. Paul Sobel?

7 PAUL SOBEL: It seems obvious that, you
8 know, a key constituent for this roundtable will be
9 audit committee representation. Have you given some
10 thought to how you're going to make sure you have
11 sufficient representation, whether it's maybe --
12 there's a few different audit committee
13 organizations? Or would it be directly with audit
14 committee members? And would you pull the plug on
15 it if you don't think you have representation and
16 there's sufficient audit committee representation?

17 JENNIFER RAND: We have, but that has been
18 a significant consideration for us. Given the
19 composition, we do want to -- we've had -- we do
20 want to have a good number of representatives from
21 audit committees. And -- and also we heard from
22 constituent groups of audit committees. So we're

1 interested in that as well. Broad feedback, the
2 types of entity, who they may be audited by,
3 different industries -- so we are looking -- because
4 the audit committee members or views that were
5 provided weren't necessarily always unanimous. They
6 had different views, too, about what may be
7 important to them in connection with the oversight
8 of the company. So we are very much interested in
9 that. That's a key driver in -- in the roundtable
10 composition.

11 MARTIN BAUMANN: Yeah, I'll echo
12 Jennifer's point there. We would expect to have
13 significant representation of audit committee
14 members and a diverse group of audit committee
15 members and -- and seeking such groups such as the
16 NACD to recommend, for instance, certain audit
17 committee members to -- to attend. So -- so we'll
18 be doing some outreach to get the right -- right
19 constituency at the roundtable. Damon, is your card
20 -- yes?

21 DAMON SILVERS: I commend you on that,
22 what you just said in terms of reaching out to a

1 diverse and -- and sort of engaged group of audit
2 committee members. But I think it's probably
3 important to keep in mind here that the interaction
4 between auditors and audit committees is that they
5 are -- they are all agents, meaning that you
6 wouldn't want to get into a situation where the
7 mutual desire not to be -- to, A, not inform and, B,
8 not to be informed is viewed as the last word on the
9 -- on the matter.

10 MARTIN BAUMANN: And I think we've heard
11 mixed views on that. And that's a good point, that
12 there are some audit committee members that express,
13 "I don't need to get all this information, I don't
14 need to hear all of this." And there are other
15 audit committee members who say, "I can't get
16 enough." So that's -- our standard is somewhere
17 between there, I guess.

18 DAMON SILVERS: Well, perhaps I'm being --
19 perhaps I expressed myself in too cryptic a way. I
20 mean, I think that -- that the -- the point here, I
21 think, is that the board in looking at a standard
22 here needs to be mindful that -- I mean, there are

1 some situations where you -- in -- in public policy
2 making where you have essentially 2 constituents and
3 there isn't much else to the story. Right? And
4 then you take their views into account and try to
5 figure out a fair way of balancing them. In this
6 matter, there are -- although you're -- you are
7 prescribing a standard for communications between 2
8 parties, the -- the -- the -- it's the -- it's the
9 broader investor and public interest that is being
10 served by this communication. And that's what the
11 board ought to keep in mind.

12 MARTIN BAUMANN: One criticism we got
13 about the proposal was that some communication got
14 back to us that, "This is terrible. Audit committee
15 meetings are going to go from 30 minutes to 3
16 hours." We -- we wanted to know which companies had
17 the 30-minute audit committee meetings. Barbara
18 pointed out that, yes, the roundtable will include
19 not just audit committee members and auditors, but a
20 broad constituency, including, clearly, investor
21 groups as well. Yeah, absolutely.

Meeting of the Standing Advisory Group

July 15, 2010

8:30 a.m. – 3:45 p.m.

Communications with Audit Committees - Summary of Comments Received

Jennifer Rand

*Deputy Chief Auditor, Office of the Chief
Auditor*

Proposed Standard on Communications with Audit Committees

□ Comment Letters Received

■ Firms and association of accountants	19
■ Audit committee members and associations	6
■ Issuers and internal auditors	5
■ Investor representatives	3
■ Others	<u>2</u>
Total	35

Proposed Standard on Communications with Audit Committees

□ Overall support for a revised standard

□ Respondents recommended –

- Engaging in additional outreach to learn more about what issues are of most importance to audit committee members
- Clarifying the process related to the evaluation of two-way communication
- Including the responsibilities of the audit committee in the audit engagement letter

Proposed Standard on Communications with Audit Committees

- Respondents recommended –
 - Considering management’s communications to the audit committee to avoid repeating certain communications
 - Clarifying which consultations outside the engagement should be communicated

Proposed Standard on Communications with Audit Committees

- Respondents had mixed views regarding –
 - Whether all communications should be in writing
 - Whether all corrected misstatements, including those detected by management, should be communicated to the audit committee by the auditor
 - Whether there were too many communication requirements that created a “check the box” mindset