**NOTICE:** This is an unofficial transcript of the Public Company Accounting Oversight Board's April 2, 2014 Public Meeting on the Auditor's Reporting Model.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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AUDITOR'S REPORTING MODEL

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PUBLIC MEETING

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WEDNESDAY, APRIL 2, 2014

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The public meeting convened in the National Ballroom in the Westin Hotel, 1400 M Street, N.W., Washington, D.C. at 9:00 a.m., James R. Doty, PCAOB Chairman, presiding.

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GAYLEN HANSEN, Immediate Past Chair, National Association of State Boards of Accountancy (NASBA); Audit Partner, EKS&H LLLP
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P-R-O-C-E-E-D-I-N-G-S

9:03 a.m.

MR. DOTY: Good morning. This is an open meeting of the Public Company Accounting Oversight Board. We've assembled a distinguished set of participants to assist the Board over the next two days in an in-depth discussion of the PCAOB's proposed standard on the auditor's report and the auditor's responsibilities regarding other information in certain documents containing audited financial statements.

I want to begin by thanking the panelists for their contributions. All of us have many competing demands on time, they especially. And many of them have traveled a long way to be with us. I'm grateful for this extraordinary effort, and we want to assure all of these panelists over the next two days that their effort is appreciated and will be given very deep consideration.

I want to also thank the staff of the SEC for their counsel and support as we've advanced this standards setting project. In particular, Deputy Chief Accountant Brian Croteau is present as an observer, and, Brian, I want to invite you to participate any time as you see fit.  Raise the flag, and you'll get the floor.

Former Chief Accountant Jim Kroeker is also here as an observer on behalf of the Financial Accounting Standards Board, FASB.  It's always good to see Jim in these meetings.  And I want to thank you for FASB's interest in this initiative and invite you to participate actively over the next two days.

Finally, I want to thank my fellow Board members and the PCAOB staff for being here today and for the immense preparation that I know they've all engaged in to analyze the issues before us.

The discussions we undertake during these two days will address important issues for our financial markets and the protection of investors.  Eighty years ago, the Congress afforded a statutory franchise to the audit profession to protect the investing public's interest in accurate financial statements.  The Congress' purpose in doing so was to regain and promote public confidence in the integrity of our capital markets.

The standard form audit report used to deliver on that mandate has not changed in any significant way in more than 70 years, although our capital markets, indisputably, have. This audit report continues to serve a critical purpose, but many call for it to be more relevant in our capital markets today and to better serve today's investors and other users.

As I said when the Board issued the proposed standards to enhance the auditor's reporting model, I believe this marks a watershed moment for auditing in the United States. But this is a global initiative. We've benefitted greatly from our cooperation and coordination with the International Auditing and Assurance Standards Board.

To arrive at an opinion as to whether the financial statements are fairly presented, the auditor amasses a great body of evidence and, based on that evidence, gains unique insights. Investors are calling for these insights to anear to their benefit: to make the auditor's report more relevant and useful.

Similar calls are coming from other important users. Earlier this week, the Basel Committee updated its supervisory guidance on bank audits. The Basel Committee calls for more robust communication channels between auditors and banking regulators and banking supervisors. The proposed standards are intended to make the audit report more relevant to investors by establishing criteria and a framework for the auditor to provide deeper insights from the audit based on information the auditor already knows from the audit.

The proposed standards emerged from an unanimous recommendation of the Treasury Department's Advisory Committee on the Audit Profession. They are also based on our own extensive outreach and public comment on both what would make the auditor's report more useful, as well as what auditors are in a position to deliver.

The hearings today and tomorrow are an important part and extension of that outreach. By requiring and providing a framework to report critical audit matters, the proposed standards would keep the auditor in its area of expertise: the audit. No one wants to return to the days before the pass/fail model was instituted when auditors' free writing could obscure disclaimer of assurance on misleading financial statements.

As many commenters have confirmed, there's real public interest in retaining the binary pass/fail model of opinion.

The proposed framework is intended to set forth concrete criteria to consider and apply in light of the specific audit at issue in order to limit both the discretion to avoid disclosure, as well as the opportunity to back into and fall back on boilerplate. The proposal would also require new elements in the auditor's report related to auditor independence, auditor tenure. It would include enhancements to existing language in the auditor's report related to the auditor's responsibility for fraud in notes in the financial statements.

The PCAOB's proposal would also require auditors to evaluate certain other information besides the financial statements, such as the company's annual report and management's discussion and analysis. And for the first time, the audit would describe this evaluation and its results.

Again, thank you for being here. I look forward to the discussion. And so we should commence with the first panel, and it's a distinguished panel. Let me point out a few of their qualifications.

Gaylen Hansen is the immediate past chair of the

National Association of State Boards of Accountancy, NASBA. He is an audit partner, EKS&H. He currently serves on the consultative advisory group to both the IAASB and the International Ethics Standards Board for Accountants. He serves on the International Auditing Standards Task Force for the AICPA. He's been a member of their Professional Ethics Executive Committee and on the PCAOB Standing Advisory Group. Gaylen, we appreciate your being here.

Richard Murray is the Chief Executive Officer of Liability Dynamics Consulting, a chairman emeritus of the Leadership Board of the Center for Capital Market Competitiveness. He serves on the board for the National Chamber Litigation Center. His current directorships include the Center for the Study of Financial Innovation and Oxford Analytica, both United Kingdom institutions. And he is a current member of the PCAOB Standing Advisory Group.

Lynn Turner is a managing director of LitiNomics, a firm that provides expert research, evaluation, analyses, and testimony in conflicts and commercial litigations. He served as the chief accountant in the

United States Securities and Exchange Commission from 1998 to 2001. He is a former member of the Technical Advisory Committee of the FASB, a former member of the PCAOB Standing Advisory Group, and a current member of the PCAOB's Investor Advisory Group.

Jeff Mahoney is the general counsel of the Council of Institutional Investors. He is responsible for developing and communicating the Council's public response to proposed regulations, rules, standards, and laws that may impact corporate governance practices of companies in which council members may invest. Prior to joining the Council, he was counsel to the chairman of FASB. He is currently chairman of the Investor Rights Committee of the Corporation Finance and Securities Law Section of the District of Columbia Bar Association and a member of the International Financial Reporting Standards Advisory Council. He serves on the NASDAQ Listing Qualifications Hearing Panel. He is also an adjunct professor at the Washington College of Law at American University and a current member of the PCAOB Standing Advisory Group.

The first panel takes us back to the Treasury's

Advisory Committee on the Audit Profession and its roots. And with that, I want to turn it over to Gaylen Hansen for your statement. Thank you.

MR. HANSEN: I'd like to thank the Board. Thank you, Chairman Doty, for the opportunity to express my views on your initiative today and to I guess go back in time to reflect on the ACAP recommendation that led to where we're at today.

I'm an audit partner and director of quality assurance with a Denver-based accounting practice. I've been an auditor for over, well, nearly 40 years and have signed many audit reports. I also have a regulatory background as a former chair and member of the Colorado State Board of Accountancy and the AICPA's Professional Executive Committee. I am the immediate past chair of NASBA, as you pointed out. I've been invited to share, as mentioned, some insight into ACAP's recommendation leading to this reporting initiative.

ACAP took place in the midst of the 2008 economic meltdown five years into the PCAOB. Among ACAP's many objectives was the opportunity to reflect upon the Sarbanes-Oxley Act and the PCAOB.

We met at the Treasury Building next door to the White House. I saw frenzied late night activity at Treasury and, as I walked the hallways, noticed an abundance of looseleaf binders curiously labeled “TARP.“ Later, we would all learn much more about TARP and the economic Armageddon that our country narrowly dodged.

So against that backdrop, the handpicked ACAP members, with very diverse backgrounds, hoped to wrestle with media issues, find common ground, and, in this city of grand bargains, come up with creative solutions designed to ensure the long-term sustainability of the auditing profession. We were dealing with matters that had been kicked around for decades, and this was a chance to do something meaningful, even historic.

While auditors were not being blamed for the economic meltdown, per se, there was a general sentiment that they could have done more and why didn't they. There was also serious concern about firm concentration and over-reliance on the remaining handful of firms auditing our largest companies.

At the same time, firms coveted civil litigation reform and were willing to consider some compromises.

On the table was greater firm transparency and governance, improvements in audit quality.

Our recommendations covered a broad range, from establishing a national center to combat fraud to enhancing independence. One led to the subject matter of this meeting, and I believe it to be among our most important.

ACAP wasn't interested in change for change's sake or just because the current audit report was 70 years old. We were interested in a substantive fix, increasing accountability and transparency with real teeth.

In retrospect, ACAP's recommendations remain as fitting today as it was in 2008. Investors continue to express dismay over reports offering limited, if any, value. Specifically, audit reports are noticeably silent about audit strategy and the overall audit approach, the extent of evidence obtained, and key audit judgments that are made.

During the crisis, there were numerous instances of clean opinions immediately followed by corporate collapse. Investors saw their capital vanishing overnight, while those in the know couldn't or wouldn't share untapped insight.

I don't believe that it's realistic that investors will begin expecting less of auditors any time soon. Consequently, raising the bar on the audit is inevitable. And for this reason, I support the PCAOB's proposal.

Generally, auditors don't take kindly to change, and some have objected to certain aspects of the audit reporting model, especially related to critical audit matters, or CAM, which I'll say a bit more about in a minute. Some objections are legitimate, but others simply because the ARM will take them out of their comfort zone, and that are understandable. What we are talking about won't necessarily be easy, so some convincing still needs to take place.

On the matter of that convincing, here's some ACAP testimony of Jules Muis, a former VP and controller of the World Bank, and I quote, (I have, on various occasions in the past, thrown out a less revolutionary teaser suggesting that we should ban clean audit opinions as an audit reporting instrument for at least ten years to come just to wean the audit profession off its addiction to clean opinions and to make it recognized a public interest in having the right opinion rather than a clean opinion.

I'm sure that Jules wasn't really serious about banning clean opinions, but his insight about the lack of communication and transparency resonates. And he goes on to say the problem is client confidentiality. Confidentiality has a long and important place in the profession. However, it doesn't serve investors when it prevents auditors from calling things as they see them.

The informational wants and needs of investors supersede all others in an efficient capital market. It doesn't escape notice that, of the 232 comment letters that PCAOB received, only nine percent came from investors. Hopefully, the weight of change will come down heavily on the side of that nine percent.

I'm going to sum up. There's a clarion call for many corridors today for greater auditor accountability and transparency. Other major players on the international scene are moving rapidly to require more informative audit reports, with or without the U.S. in tow.

The audit profession has a long and storied history of excessive secrecy. At times, this can even strain the imagination. My first four years in the profession were with a Big Eight firm in Los Angeles. The firm's office was a large standalone two-story red brick building without a single window. I was told this emphasized confidentiality. Outsiders would never know what was going on within those brick walls. On the other hand, we couldn't see out.

At the time, my first job, it seemed quite normal. I knew nothing better. In retrospect, it was just plain weird.

Today's reporting standard is akin to a windowless building. It just doesn't make sense. The world has changed, and we need to change the way we are doing things to stay relevant. We can do better, and doing it is long overdue. I look forward to it.

MR. MURRAY: Chairman Doty, Commissioners, I've had the fortunate opportunity to spend more than 40 years watching the process of audit firm performance in the public company sector, both from inside the firms and from critical positions outside the firms, critical in terms of having interests adverse to those of the profession.

I've also had the pleasure of participating in every assessment of audit performance, from Trueblood in 1973 to ACAP, and am very grateful for the opportunity to participate with you here today. And thank you, Chairman.

The judgments that have shaped my views from those experiences I think should be identified before I share them. I consider auditing to be the most challenging of the learned professions and callings of our era. I think it is a process that performs imperfectly at times, occasionally in an embarrassingly flawed way. But we live in an imperfect world of not uniformly perfect people, and I believe that the role and performance of audit generally equals or exceeds the performance standards of any of the comparable learned professions and callings that address our public sector interest.

I believe that the role of auditing in financial reporting, while not yet what it can be, is at the highest level of my period of experience, and much of the credit for that surely goes to the existence and the activities of the PCAOB and its commissioners, for which I thank you.

And, finally, I believe that the unfortunately litigious culture we enjoy here in America needs to be considered as one addresses all of the issues affecting auditing, not in terms of what's good for the welfare of the firms but in terms of what's good for the welfare of the American economy because litigation, a game that is played as a means of pursuing a variety of agendas in America, differs quite significantly from conditions in the US and the UK. It has impacts on audit quality, on the financial reporting environment. It impairs innovation and strains the ties of corporate governance.

I will deal with the issues that have been presented in the Board's proposal individually to save time. Regarding critical audit matters, I don't think there can be any question that the current form of the audit report is the longest-standing, least modified, most important, least informative, and most expensive and least understood form of commercial expression that man has ever created, or woman either.

The real question is is this like democracy, the worst choice, except for all others; or is there a better way? And it is clearly time to explore that better way, and I commend the Board for having done so in a very comprehensive and challenging proposal.

There were two ACAP recommendations addressed to what is called critical audit matters. The first was a strong call, as Gaylen has well expressed, to enhance the value of the audit report through narrative about the auditor's views, views that would enlighten on the understanding the public will have about the company, not the information that the public will have about the company, which is the company's privilege and obligation to disclose.

The critical audit matter proposal seems to me overly prescriptive and overly focused and not properly stimulative for the kind of narrative that ACAP had in mind, at least that is, in my personal impression, not an extension of the views of others on ACAP.

I think it also blurs objectives a bit. If the purpose is to gain insight about the company, there is an overlay of understanding that has grown around the CAM proposal that suggests that it also ought to enlighten about the quality of the audit performance, and I think that potential for confusion is unhelpful. And I would recommend that the CAM activity, as proposed, if it is to be pursued, be delivered through the audit committee rather than directly from auditor to the public. Nothing need be lost in content, but there would be a greater preservation of the growing and important role of audit committees as the nerve center of financial disclosure and corporate governance in all its aspects. I'm concerned that the proposal currently undermines much of the great work the Board has done in enlarging the responsibilities of the audit committee.

But ACAP had a second recommendation that there ought to be no harm done to the extreme value of the pass/fail model as the backbone of the capital markets. And we were concerned, not uniformly concerned but there was extensive concern about the extent of litigation risk to undermining the stability and clarity of the pass/fail model.

I do believe that that risk is a significant concern. I note just two respects. I believe the CAM proposal creates a new and more extensive risk of exposure to private rights of action. Its architecture is broader than Sections 10(b) and 11, and, as a process matter, it puts the auditor in a devilish position in the way the litigation process moves forward. The auditor can be questioned, if whatever went wrong happened to involve something you addressed in the CAM process, why didn't you carry through and recognize the consequences? If it did not involve something addressed in the CAM process, why did you address so many CAMs and not happen to find the right one? I think that's a dilemma that the profession and the companies they represent will find very difficult to deal with.

I'll address briefly fraud and independence together. I think they are aligned and embedded in the expectation gap, and I think neither is ripe for attention at this point.

ACAP recommended on fraud that the PCAOB establish a fraud center to study and facilitate collaboration in fraud detection and to study the subject in a way that for 50 years had never been fundamentally addressed as systemic risk. The PCAOB, I understand, does have a fraud project in planning. I am pleased and commend that. It may not be exactly what ACAP had in mind, but it surely must be a proper step forward. I suggest that the fraud proposals be deferred until that is completed.

The similarities of independence. ACAP had two recommendations here: That the PCAOB lead a compilation and rationalization of the requirements and standards for independence. There are multiple authority of guidelines on the subject that exist currently. They have conflicting interpretations. They don't even really agree upon whether independence is a noun, a condition to be independent, or is a verb, the way action is to be taken independently.

So long as we don't have a road map or even a common language to address the subject, there is concern, certainly in my view, that there is no way to get from here to there and it is time, after all these decades, to do the fundamental analyses of what qualities of judgment are really being sought here and what are the appropriate guidelines to measure those qualities?

We seem to have spent all those decades in rancorous debate based on non-concentric assumptions about what is the problem. Indeed, I wonder on both the fraud and the independent issues whether we've become so embracing of debate and controversy that we have forgotten that there is an opportunity to create understanding if we do a careful job of reassessing the fundamental assumptions on which we operate and put them at risk of being modified by listening to one another.

That is my recommendation as to both the fraud and independence studies. The acts of regulation follow on the acts of enlightenment that the Board is in the ideal position to bring to the profession and to the regulatory responsibilities. Thank you, Chairman, for the opportunity.

MR. DOTY: Thank you, Mr. Murray. Mr. Turner?

MR. TURNER: Thank you, Chairman Doty and all the Board members, for the invitation here today, as well as the staff. Thank you, Marty, as well. For the sake of time, I'll just ask that you include my written statement in the record, and I'll try to summarize it quickly before the red light goes on this time.

But I would echo everything that Gaylen had to say. I thought those were excellent comments. I would echo what Mr. Murray had to say about the profession being a very, very challenging job.

I would differ from Mr. Murray on the views of the subcommittee on the litigation issue. It was a fairly split committee as to whether there was an issue there on litigation or not. Those views were clearly set forth in the report. In fact, today, I think investors are very concerned about their ability to hold auditors accountable when, in fact, there have been failed audits, and they have suffered significant losses.

But the views I have today are based upon my experiences, almost four decades in this profession. It includes time as a preparer, as a CFO, audit partner. I've signed many, many audit reports, large, small, public, private companies. I've prepared, I can't fathom how many CAMs during that period of time and very well understand those. And I've served on the boards and chaired audit committees of public companies, as well.

And through all of that, I think it's clear that it's time to get something of value in the audit report.

The audit report today doesn't have value. That's something that I consistently hear from my fellow investors. In fact, in talking to a CIO where I sit on the board on one of the hundred largest investment funds in the world, the question was raised as to whether or not the portfolio managers even read the report because there's just nothing to be learned or gained from really reading it today.

So I would commend you all for taking on this project. It was a strong recommendation of ACAP. There are other recommendations which I wish you would also take up in short order, as well. But that's for another day.

As far as the approach, I think your approach is a good approach to tie it to the CAMs. I've sat at SAG meetings in the past that, if an investor ever saw those CAMs, if they were ever made transparent, they would understand that is what an investor really wants. It's what is critical, it's what significant to the auditor. That's why we prepared those CAMs. It lays out our strategy for dealing with them, how we dealt with them, how we resolved, and that's the type of information that investors are looking for today. That's what I hear time and time again that they want.

There are those that say, well, you should only disclose information management has. That's nonsensical. If management has already disclosed it, why does it need to be disclosed again by the auditor?

What the investors are looking for is what was the auditor's perspective on the audit? And one concern here is we've seen time and time again where the auditors were aware of very important information, information that, most typically, would have shown up in a CAM in a quality well-done audit report, and that information was hidden by the auditor from investors. And if investors had seen that information, it would have made them change, I think, their investment allocation decisions. It would have avoided costs and losses for investors and, I think, in many of those instances, would have avoided litigation and costs for the auditors, as well.

So I commend the CAM approach that you've come up with. I think, to Mr. Chairman Doty's point, I think boilerplate can be avoided. I've given some thoughts on that in my statement. I think you ought to lay out clearly your objectives, and I've given some other thoughts as to what I require in disclosure, and those are, in part, based upon what we do with similar type disclosures on related parties, which haven't worked all the time but have worked. So I think it's something to think about.

The one thing on the CAM approach that I would forewarn you about, and that is you can't leave it just to the discretion of the auditors. We did that when we did an independent standard in the past. It didn't work. It was fatally flawed, so leaving it solely to the discretion of the auditors would not be worth the time or money then because we'd get the same result. We've had that lesson once before. We shouldn't repeat it.

As far as some of your other recommendations, I think the recommendation on the auditor signing the report is very good. It's consistent with what ACAP recommended. There's no further liability to be had here. There is going to be the fact that, once you put your name out there as an audit partner, you're going to be concerned that have you got the job done right, and I think that's going to enhance, in the long run, audit quality. It's going to cause you to focus. I sign those reported, and when you're signing with your own name, you know if your name shows up in too many problematic audits, you're probably going to have a problem. And I think that's what the whole debate is about here as far as the audit partner signing the report, and so I think that goes without saying.

I think the points you make about tenure, disclosure of tenure and independence is good. I was there at the SEC when we went through the fight over the independence rules, and when those independence rules were adopted there was positive statements of support from five or six of the firms at the time in support of those standards. And the ACAP did not recommend any changes in those standards. It did suggest codification somewhat, which would be helpful.

Finally, if we've learned anything from China it's the fact that we really do need some transparency around who is doing the audit. And if a significant portion of this audit is not being done by the signing partner or is not subject to the typical examinations that you all do that have turned out to be beneficial, then certainly that needs to be disclosed, as well.

And I think, as Rich summarized about the audit report and his description of the current audit report being old and long in the tooth -- you know, it goes back now almost to the Model A, and we have had some things change in the country since the Model A came out, the assembly lines. So I suggest the time for change is now, and let's not let this get any longer in the tooth.

MR. DOTY: Thank you, Mr. Turner. Jeff Mahoney?

MR. MAHONEY: Good morning. Thank you, Chairman Doty and Board members and staff for hosting today's public meeting on the PCAOB's proposal to enhance the auditor's reporting model. The Council of Institutional Investors appreciate your leadership and willingness to pursue this important issue that has long been debated and remains controversial, particularly with some members of the auditing profession.

It was a real honor for me to have had the opportunity to serve on the Department of Treasury's Advisory Committee on the Auditing Profession on behalf of my executive director, Ann Yerger, and to participate on the Committee's Subcommittee on Firm Structure and

Finances with my three distinguished fellow panelists to my right.

As you may know the Subcommittee was ably chaired by Robert Glauber and, in addition to my fellow panelists, the Subcommittee included Timothy Flynn, the then chairman and CEO of KPMG; and William Travis, the director and former managing partner of McGladrey & Pullen. Others who devoted countless hours to the activities of the Subcommittee and, in my view, were instrumental in assisting in the development of the Subcommittee's findings and recommendations included Don Nicolaisen, who was co-chair of the Committee, along with Arthur Levitt; Alan Beller, the counselor to the co-chairs, who I understand will provide his perspectives this afternoon; and, last but not least, Kristen Jaconi, who was the senior policy advisor to the Undersecretary for Domestic Finance at the Department of Treasury at the time.

After reviewing extensive amounts of data provided from many sources, including from the audit firms, the Center for Audit Quality, and after receiving testimony and comment letters from a broad range of experts, the Subcommittee focused mainly on seven areas in need of improvement in the auditing profession and produced seven recommendations. In my opinion, perhaps the most compelling of the seven was recommendation number five, to urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model.

As the Committee final report indicated, the auditor's report is the primary means by which the auditor communicates to the users of financial statements regarding its audit of those statements. And despite the numerous instances over the years in which blue ribbon panels of experts recommended that the standard auditor's report be improved to provide more relevant information to users of financial statements, as we all know, material changes to the auditor's report were never implemented.

I believe it's also significant that the Committee's final report highlights the testimony of Richard Fleck, whose a global relationship partner for Herbert Smith. In that testimony, Mr. Fleck stated that institutional investors believe an expanded auditor's report would enhance investor confidence in financial reporting and recommended exploring a more narrative report in areas such as estimates and judgments, sufficiency of evidence, and uncertainties.

The substance of Mr. Fleck's testimony, in my view, has since been corroborated by multiple sources, including surveys at the CFA Institute and the PCAOB's Investor Advisory Group and the results of the PCAOB's own extensive outreach to investors and other users in connection with developing the proposed model.

Just a couple examples. Disclosure of the independent auditor's assessment of management's critical accounting judgments and estimates was supported by 79 percent of institutional investor respondents to a 2011 IEG survey and 86 percent of respondents to a 2011 CFA Institute survey. With respect to the latter survey, I understand Kurt Schacht will be on a panel this afternoon, and he can certainly provide more details and discuss other CFA Institute surveys and materials that may be relevant to the proposed model.

Based on those results, related findings and recommendation of ACAP, as well as the Council's own membership-approved corporate governance policies, we generally support the PCAOB's proposed audit reporting model. We would, however, revise the proposed model to provide that the auditor be required to communicate, at a minimum, an assessment of management's critical accounting judgments and estimates based on the audit procedures that have been performed.

In our view, this modest revision to the proposed model would result in an auditor's report that provides the kind of independent auditor insights that are reflected in our policies and, more importantly, are responsive to investors' information needs. In that regard, we would not support a proposed model that failed to provide independent auditor insights and simply repeated or referenced management disclosures that already are provided to investors.

We believe if our modest revision were adopted, the proposed model, as revised, would be far more likely to achieve the Board's worthy goal of increasing the relevance and the usefulness of the auditor's report to investors, who ultimately are the key customer of the auditor's report.

Thank you again for inviting me to participate in this important meeting. And I look forward to learning from my fellow panelists, the Board, and all of you here today. Thank you.

MR. DOTY: Thank you. The intention in these discussions is always to attempt to give everybody a chance and to have some structure but to preserve some spontaneity. And we now have about 15, a little more than 15 minutes to get in to that. My colleagues have permitted me to call on each of them for one question. If we have time, we'll go around again, and I want to be sure that both staff and observers have a chance to get on this.

But we'll begin. Mr. Harris, one question. Multiple parts not allowed.

MR. HARRIS: Well, you just took my multiple parts off the table. Under common guidance on economic analysis, when the Board undertakes a standard-setting project, it should identify the need and the problem. And while it may be self evident and obvious, because we're creating a record I'd like each of you to articulate the need and the problem with as much specificity as you can and why now?

MR. DOTY: Address to whom, Steve?

MR. HARRIS: The panel.

MR. DOTY: Gentlemen, should we just move down the line?

MR. HANSEN: That's fine. That's a great question. You know, I've heard over the course of my career every time there's a new standard that comes out, it layers on top of the others and that it's not going to take any significant additional time and nothing to worry about. I don't believe that. And I believe that, when it comes to the majority of the proposal, it will be pretty straightforward. It gets to the CAMs. You're talking about custom writing, custom thinking, and really thinking through the issues at the highest level of the talent within the audit organization, and I think it will take some additional time and it will involve some discussion with the audit committee. That shouldn't be overlooked.

Does that mean that it's going to be an overwhelming cost? No, because, as Lynn pointed out, I mean, those CAMs are part of the audit documentation already. It needs to be polished up. It needs to be articulated better, but I think the economic analysis is going to show that, while there's going to some increase in the cost, it's not going to be overwhelming.

MR. DOTY: Richard?

MR. MURRAY: The problem, to look at it from too high a height, is that we do not understand each other. We have continued to not understand each other on various aspects and perspectives on these issues for too many years. We've been focusing on sharpening the ability to dispute, rather than considering the possibility of agreement. And I believe why now is because we have the benefit and advantage of the established and growing importance of the PCAOB to take the leadership in exploring what can be accomplished by a search for agreement and a search conducted in a collaborative manner in which the regulator and the regulated operate in partnership, as well as in a regulatory relationship.

MR. DOTY: Lynn?

MR. TURNER: Chairman Doty, I think the crux of the issue is not one of understanding. I think the auditors understand it very well, and I think investors understand very well what they want. It's a difference over what product is going to be produced. Are you going to produce a product that the investors want, or are you going to produce a product that the auditors want?

As your own enforcement action on Medicis show and as I know full well from my time at the SEC in cases like Xerox, the auditors were fully informed about a fraud or a problem with the financial reporting, yet rolled out clean reports and remained silent and said nothing. And in those circumstances, silence is not golden. It's devastating.

And so that needs to change. The product needs to reflect what the customer wants. In this case, the customer is the consumer.

And to the question of why now, after 80 years that this report doesn't work, why not now?

MR. DOTY: Mr. Mahoney?

MR. MAHONEY: Similar to what Lynn said, we have a product that the major customers of that product are dissatisfied with it. And I think their dissatisfaction summarized in the PCAOB's staff's conclusions from their outreach, just reading from the concept release, the

PCAOB staff "observed that there was consensus among investors that the auditor has significant insight in the company and that the auditor's report should provide additional information based on that insight to make it more relevant and useful."  I think that's where we need to head.

MR. DOTY:  Mr. Ferguson?

MR. FERGUSON:  Yes, I have a question for Jeff Mahoney on his suggestion that we have the auditor assess, that management's judgments on critical accounting estimates -- I can't exactly remember what you suggested.  But if we were to do that, how would we do it?  And would it be through a grading system, A to F, or like an honor's degree or magna cum laude or summa cum laude or, you know, they were conservative or they were aggressive?  What would the criteria be, and how would we achieve comparability among audit reports so people looking at these judgments would be able to have a sense that there was a uniform standard being applied by the auditor?

MR. MAHONEY:  With respect to the requirements, I think investors are not looking for anything new here.

The type of information, as Lynn has said earlier, is information that's already being provided to the audit committee. I think investors are just looking for some of that information to be provided in the main piece of communication with the auditor in the auditor's report.

As far as comparability, I don't think investors believe that this additional information needs to be comparable across all companies. I think, as I referenced earlier, what they're looking for is insights from the auditor. And if you look at the studies and surveys, a reoccurring theme is they want some insights with respect to significant estimates and judgments.

MR. DOTY: Mr. Hanson?

MR. HANSON: Thank you all for coming and your insightful comments. Just one question related to what investors think about our proposal that's on the table, and I'd ask you to each maybe comment about it to the extent you've had direct discussions with individuals responsible for making the investment decisions about what they think in the value of what we put on the table and any feedback you've gotten around that.

MR. DOTY: Is that a question for the panel or for --

MR. HANSON: A question for each of you on the panel.

MR. DOTY: Jeff, do you want to take it and then move left, right for you?

MR. MAHONEY: Sure. As I said in my prepared statement, it's very clear that investors are dissatisfied with the product and they want more information. And as I indicated, I believe and our policies reflect that what they want is some more insights from the auditor, so then it's a question of insights about what? And as I said earlier, if you look at the many studies and surveys, a common theme is that they want more insights about the key estimates and judgments.

MR. DOTY: Lynn?

MR. TURNER: Jay, as I was doing my remarks, drafting them, I did share them with a number of investors and I did get responses back I think from five investors, and these are people who are making investment decisions. And, universally, they came back, with one exception, and said they are exactly where those remarks were that I submitted in the written statement.

The one exception was one of the investors said he wanted further information, to Jeff's point, about changes in estimates, key estimates that the auditor had audited and changes in that estimate.  So the feedback that I got from actual investors were my comments are exactly where they thought you should end up.

MR. DOTY:  Mr. Murray, Mr. Murray, Richard?

MR. MURRAY:  My perspective on the investment viewpoint comes primarily from involvement in the insurance industry, which is a major force.  Insurers worldwide own 20 percent, 22 percent of global equities currently and remain a bastion of the investment stabilization of commerce.

To be overly quick and simplistic, my sense is the insurance industry is not opposed to things requested by groups of retail investors and some of the views that have made their way into active attention in the outreach reports of the PCAOB, but they don't consider them representative of their views and interests, as fixed long-term value-oriented investors.  Their view, again simplistically put, is that there is a vast industry of intermediating advisors that can and do provide much of the insight and analysis that seems to be requested at the retail investor viewpoint. And the question that insurers would have is how can that value then be best aligned with anything that might additionally be done in the audit reporting process to produce a better net outcome?

MR. DOTY: Mr. Hansen?

MR. HANSEN: I must say that my interactions with actual investors is somewhat limited. I'm an investor myself. I don't see the critical audit matters as being a magic bullet. I don't see that it's going to solve all of the uncertainty that investors might like it to resolve. But I think it's going to contribute to them being able to make their own evaluations better.

That said, you know, there was a lot of discussion about who signs the audit report. Sometimes, I wonder whether we didn't spend enough time talking about who it's addressed to. You know, it's sort of legalistic, this addressing it to the board of directors and the stockholders. Maybe it should be addressed to the public interest or investors themselves. But those are just a couple of thoughts.

MR. DOTY: Ms. Franzel?

MS. FRANZEL: Thank you for being here today and sharing your insights. Going back to the recommendations of the ACAP and for expanding the information provided by auditors for the benefit of investors, in your view, does the CAM proposal meet those objectives based on the need that you all identified and the recommendation you made, along with everything we've learned since then? Does the current CAM proposal, as written, get us there? And if further refinements need to be made, in your view what would be the most important changes or revisions to the current proposal in order to meet the needs of investors?

MR. DOTY: To the panel, Jeanette?

MS. FRANZEL: It's to the whole panel, yes.

MR. DOTY: Gaylen, do you want to take it first?

MR. HANSEN: Sure. I believe they do meet the basic objectives of what we're trying to accomplish here. I think if the focus can be on, as it says, those few things that keep the auditor awake at night, those few things, not many things. That may be a different signal of a different problem, or, if there's no things that keep the auditor awake at night, maybe that's a completely different issue. But I think the objectives are met.

MR. MURRAY: I would go back to my brief and poorly-illustrated remarks earlier. I believe that, while Lynn and I may not have exactly the same recollections of the ACAP discussions, that the objectives we were identifying had to do with getting more insight about the company and not necessarily additional or different information about the company, and I think that is a distinction that isn't entirely well articulated in the current CAM proposal and creates some of the confusion of what is intended and how should it be performed.

And I also think that we had a focus on what can be learned through this process about the company, rather than a further standard and way to evaluate the performance of the audit. And I think that, too, could be clarified in the way this is articulated and presented.

MR. DOTY: Lynn?

MR. TURNER: The discussion at ACAP started out with the discussion, I think it might have even been Tim Flynn who brought up the issue with the pass/fail model and the shortcomings that some expressed with respect to the shortfalls in that model. And then it expanded to what about making sure that we tell investors exactly what the auditor is going to do to detect fraud and clarify that responsibility, which was an important part of the recommendation to be addressed.

And then, as we got into public hearings, then we started hearing from investors. Jeff has mentioned some. There was Tony Sondhi testifying on behalf of the CFA Institute and others. I'd urge you to go back and look through that testimony. There's binders of records of it -- I've still got them if you don't -- that lay out exactly what investors were looking for. And investors were looking not just for information about the company, if you look at that testimony, but, in fact, looking for an auditor's perspective of it.

When you look at the actual recommendation, the recommendation doesn't get to that detail. The recommendation says: Undertake a standard-setting process. This is your job, not our job at ACAP. It's your job to decide what should be done, so go through a thoughtful standard-setting process and go do it. And I think that's what was intended.

As far as does approach tied to disclosure of CAMs meet that? Based on my experience, having written many of those CAMs, done audits and, yet, been on the investment side, I actually think that's a good approach. It requires disclosure of all CAMs, though, and it requires that it not be discretionary. And there's been some question, as we've talked about at other meetings, about is there too much discretion or not and are the objectives around the CAMs clearly laid out?

But I think, in general, the CAM type approach is a good start and would respond, assuming you also deal with the fraud piece of that recommendation.

MR. DOTY: Mr. Mahoney?

MR. MAHONEY: Thank you. I, as well, agree the proposal can meet the objective. And as indicated in my comment letter and in my statement today, I believe it can be revised in such a way that it will get the auditor insights that our policies reflect and that investors have been asking for for many years.

And, again, we don't need to, we already have that information. We also already have rules related to that information in connection with communication. It's through the audit committee. So I think it's just a matter of refashioning those requirements to get that information into the auditor's report.

MR. DOTY: I want to ask a question back to Richard Murray because, as lawyers, we both share an interest in liability and litigation. And noting parenthetically that our re-proposal on transparency does not call for signature of the audit partner but naming of the audit partner, one of the issues that pervades all these discussions is a concern that, where we provide more disclosure, we think about the litigation and the liability issues.

And you made an arresting statement. You say that critical audit matters will lead to a new wave of litigation. If the disclosure of the CAMs appears in the context of the audit report and the audit report is good, it's a good audit, the auditor has his defenses even if the financial reporting is not good but the audit is good. That would seem to be not a problem for the CAMs in terms of what results from it.

But if the audit is not good or if there is, if there's frivolous litigation, I'm interested in getting to what you clearly see is a need for a constructive change. I'm wondering if, in fact, if we consider language both in the adopting release and in the standard to clarify the informational value of the CAMs, to clarify what I referred to in passing in my opening statement which is our intention that this be limited to what the auditor knows. Richard, you've also made a point as to communication of the audit committee and not the public, and I think that's a different issue. But do you think that by clarifying the value, the informational value of what the CAM is, that, at the same time, we diminish and really address the risk of litigation, of meritless litigation, frivolous litigation, with which we're all concerned?

MR. MURRAY: Chairman, first, I have to recognize that one of the things that's common to most lawyers is hyperbole, particularly in time pressure. My point was --

MR. DOTY: We've all done it.

MR. MURRAY: -- not to declare that this is clearly an unequivocally a problem to be accommodated but to urge the Board to pay more focused attention to explore whether the Board concludes that it is. Then at least it's apparent in the publically-disclosed materials.

In terms of what would help assist with the problem, if there is some degree of problem here, it seems to me there is a positive direction and it was explored by ACAP, not too agreement but it was explored, sometimes loudly. And that is whether or not there is some opportunity to create, by regulation or otherwise, a judgment privilege that surrounds the most sensitive and difficult judgment and expression forms.

We have a business judgment rule for the corporate sector that recognizes that you get into some gray zone issues that expose one to a double bind you're wrong if you do this, you're wrong if you do that. That doesn't exist in the audit environment in liability today. And with every more granular disclosure, whether it's the CAMs or any other formulation, that gray zone expands and deepens. And it seems to me the most promising solution would be to demand more of the auditors. But for the sake of the financial reporting process, not just the auditors, to allow that innovation to be addressed constructively and with enthusiasm, provide a degree, not full protection but a degree of accommodation to the judgment periphery on the edge of responsibility.

MR. DOTY: But do we at all, by speaking to the issue of what the CAM is and the value of it, do we, in any sense, ameliorate the risk of meritless litigation since the CAM is in the opinion and the opinion, as a whole, is what it is?

MR. MURRAY: You could, and you would, undoubtedly, have some influence. But if one considers the extent to which federal government agencies are having, generally speaking, are having their agendas rewritten and their interpretations ignored by judicial and private sector litigation, I think there's a real risk that your very best intentions, articulately expressed, would not survive the hassle of litigation.

MR. DOTY: You're not giving in on this point, and I respect it. One of the points of being chairman is I get to ask one more question before I go back to Jeanette Franzel, and it goes to Lynn Turner where you point out that neither the audit committee, nor management, knows what the auditor knows from the audit. How do you respond to Richard Murray's and others' comment that the appropriate place for what the auditor would otherwise say in a CAM is either in the proxy statement, as to which we have no real jurisdiction, or by more privileged communications directly with the audit committee, as Richard suggests.

Lynn, Jeff, do you all want to do a crisp one-minute? Isn't he right? Can't you do this by -- if the audit committee doesn't know this and this is such important information, don't you reduce the expectation gap by giving it to the audit committee and having rules expanding on the disclosures in the proxy statement and other documents?

MR. TURNER: The short answer is no. If you look at, again, the cases I mentioned, there's others that are out there, as well. In the WR Grace case that we have, the information didn't ever go from either the auditor to the audit committee. Now, assuming it goes from the auditor to the audit committee, you still haven't delivered the product that the investor wants. I've run a company, I've run a manufacturing company. The key thing is to give a product to the customer that the customer wants, values, and pays for. If you stop it at the audit committee, it doesn't go out to the investor.

This is simply a matter of are you going to give the customer what they're looking for, what they need to make sound capital allocations? If that information doesn't get to the people making those investment decisions, and that's not the audit committee, it's not management, then you aren't giving them the information. And right now that information doesn't flow.

As to where you put it in the proxy or wherever, I really don't care, as I say in my statement, where the information is put out. What I care about is the information investors want gets put in their hands in a timely and complete fashion and reflects the perspective of the auditors.

MR. DOTY: Jeanette, you want to take one last shot?

MS. FRANZEL: Sure. I want to drill down a little bit on Mr. Mahoney's suggestion of a modest change to the proposal, and I think some might take issue with the characterization of that as modest. So I just want to drill down --

MR. MAHONEY: It is a little optimistic.

MS. FRANZEL: I just want to drill down a little bit. You are calling for an adjustment where a CAM would include an assessment of management's critical accounting judgments and estimates. What do you think that would look like and how would that be achieved under this current model? And then I'd be interested in the reaction of the other panel members, as well.

MR. MAHONEY: Here again, I'm looking at the communications that are currently being provided to the audit committee today. And looking at those communications related to significant estimates and judgments, I think those that the auditor thinks are most important in the CAM should be disclosed in the report.

Going back to the Chairman's last question, as Lynn said, the information is what's important. But right now the auditor's report is the main piece of communication between the auditor and investors. And investors want more communication from the independent expert. The audit report seems to be a logical place to put it since that's the only communication that we have between the two today.

MR. TURNER: Jeanette, I've served as chair of three public audit, chaired the audit committee of three public companies. In each of those three instances, each a different one of the Big Four, so three of the Big Four, came in and, consistent with the blue ribbon panel recommendations, had a discussion with us about not just the acceptability but the appropriateness of the judgments and estimates made by management. That's part of that report recommendation. It's not the first time it's come up. Jeff's recommendation is totally consistent with what's been recommended in the past.

In all three of those audit committees, the auditor would come in and, in part of their communication to us, they presented us a slide or two each time, giving us their estimate, their view, perspective on those estimates, and they would typically do it in a graph that had aggressive on one side and conservative on the other side, and they defined that in their graphs to us and said here's where we think it lays. So the information is there. It's being communicated. It's being communicated consistent with recommendations of very well known panels in the past. It's not new information.

MR. DOTY: Reluctant as I am, we're going to leave it at that. I'm going to make sure that we start with the next panel's question with Jeanette, run through Jay, and move up and end with Steve. And I will cede my time on the next question. So we're going to do justice.

I'm going to wait for flags to go up from the wings here. But when they go up, I'll call on them.

Thank you for taking us back to ACAP, for refreshing our recollection of what all this is about, and for some very meaty insights, trenchant insights on the current issues we face. Thank you all.

Well, where to begin? We next have one of the giants of the auditing profession with us, and Sir David Tweedie will be here until 10:40. He's making a special effort to do this.

He serves as the chairman of the International Evaluation Standards Council, which is looking into many of the key issues that come up in this audit reporting model question. From 2001 to '11, he was the first chairman of the International Accounting Standards Board, as well as the chief executive officer of the International Financial Reporting Standards Foundation.

It goes on. A fellow at the Judge Business School at the University of Cambridge; visiting professor of accounting in the University of Edinburgh Management School; honorary degrees from nine British universities; various honors and awards, in addition to knighthood, for his dedication and service to the accounting profession; president of the Institute for Chartered Accountants of Scotland from 2012 to 2013; chairs the Royal Household Audit Committee for the Sovereign Grant which funds the work of the British monarchy.

He's a current member of the PCAOB Standing Advisory Group. Mr. David, we're grateful for your presence. Please enlighten us.

MR. TWEEDIE: Well, thank you, Jim. And can I say what a pleasure it is to be here and see so many of my old friends. As several people in the room will know, as I've said before, it's always a privilege to come out here to the colonies and to continue my missionary work.

But this is a particularly interesting project. Everybody knows about a bad audit. It's splattered all over the press. Very good audits you actually don't hear anything about. They're hidden.

And audit, I think, is seen as a necessary commodity. It's what you have to pay for to get access to the capital markets, and the opinion, as we've discussed already, is an on/off switch. And when I first qualified as an accountant over 40 years ago, I could look at an audit report and know instantly if it was qualified because it was only three lines long. If it was more than that, it was something I ought to read. Otherwise, I just knew it was okay.

Since then, with the expectation gap, we've lost the crispness of the audit report in a whole lot of what now has become boilerplate language. And one of the things I'm slightly concerned about in the new proposals is a lot of that is still going to be in the audit report. Personally, I'd like to see that on a website or in an appendix. You might like to ask my UK colleagues about how they deal with it.

But the investor, quite clearly, as signaled from your own papers that they would like, is they would like additional audit reporting because they don't have access to or aware of many of the issues that the auditor has raised. And Lynn mentioned that a lot in the last session.

The audit report really, in my view, should be adding value. At the moment, it's more one of limitation. You know, how many auditors does it take to change a light bulb? None because they've formed a committee to say it's not their responsibility. And that's the sort of thing that we end up getting in the audit report.

But I think you've given the auditor a wonderful opportunity to start ending the notion of the audit being just a necessity and make it a vital part of investment analysis. Developments have already taken place elsewhere, notably the UK and Europe. And if you can get Europe to agree on these things, surely it can't be difficult to get the U.S. to agree on it.

But it would be a real help, too, I think, if PCAOB and the IAASB could get together and make sure the terminology was the same so audit reports throughout the world said the same sort of thing and we knew exactly what they all meant.

I would actually have liked the PCAOB to have gone further than it did. I would like to see the audit report based on the notion that investors want auditors to ask themselves what would they like to know if they were investing in the company and make sure that's what was in the report.

The critical audit matters I think is a real step forward. But that, again, I don't think goes far enough because it asks, you know, what are the matters and what did you do about it? What I feel it also has to do is and what were your findings?

I will draw your attention to the Rolls Royce audit report in the United Kingdom, which I'm sure my UK colleagues will talk about and certainly Tony Cates of KPMG because I found it quite excellent. It talks about the problems. The findings are that the company was slightly cautious in some areas, overly optimistic in others. But you get the picture that, on balance, this was actually a fair presentation, even though in certain areas there may be slight movements one way or the other.

And when you start looking at things such as valuations, Level 3 valuations, how do we know how far the auditor has gone in the range? Is this an aggressive company? It is it a pessimistic company? I think that's information that really should be out there in the public domain.

The genesis of this change, as we heard from the last panel, has been the financial crisis. And if anyone wants to argue that the audit report was fine in that crisis, they just have to look at some of the figures that you've got in your own papers about two or three years ago where it was pointed out that the 2008 and 2009 audits of a company receiving the TARP funding was actually, word-for-word, the same. And, yet, in 2008, the audit report costs $119 million, and in 2009 it cost $193 million. So what if you learned, as an investor, for your extra $74 million, nothing. It was still the switch was on, and that's all you heard.

And, yet, as we've seen when Enron and WorldCom blew up, if there's concern about the audit, then the markets start to tumble and confidence is lost. Going concern is always difficult for auditors. It can be a self-fulfilling prophecy if they give a growing concern qualification.

And when you look, though, at what happened, certainly in the UK -- let's take our biggest casualty or the first casualty, Northern Rock. It bought it from the wholesale markets in a very major way. Three months loans from the wholesale markets. It lent out 20 or 25 years, so it was all predicated, its business model, on that market staying open. Well, it didn't. It closed, and so did Northern Rock.

It was in the notes and, in a sense, you could see for yourself, looking at the liabilities, where they were coming from. But that was a key assumption. That company could only exist if the wholesale markets stayed open, and I think the auditor should draw attention to something like that.

What are the assumptions laying behind your view that this is a going concern? It may be that investors will look at that and think this is a bit risky and I want to get out, and that's the sort of thing I think they should do it.

And you can see from your own papers that eight of the top ten bankruptcies, there was no going concern qualification during the crisis. And the TARP, major TARP receivers also had no qualifications in there. I think giving some form of assumption why you've agreed that it is a going concern would be extremely helpful.

If you want to change the audit paradigm, I think what you've done at present is a necessary but not sufficient condition. I would like to see far more being done with the audit and making it far more helpful to users. And you can see the complaints and the pressures, certainly in Europe for mandatory rotation or at re-tendering. It's coming from the view that perhaps fresher eyes are needed, and that's the good reason. The bad reason is perhaps they're too cozy. And I think it is in the auditor's interest to make it far more obvious that he is reporting to the investor and not simply to the audit committee. So a repositioning I think would be very helpful for the audit and also for the investor.

I think there's things that can be done to assist the audit. I think the auditor is under too much pressure from companies these days. I would like to see the removal of the annual appointment and the company talk about re-tendering and then appoint the auditor until that re-tendering date and only allow them to be removed by a vote by the investors, if necessary.

And if tendering does take place, I would ban the companies, the audit firms, from putting a price in there. Let the audit committee choose on quality and then ask for a price. And if it shocks, let us tell the investors how much it saved by taking the second best audit and let's see if they agree that was a worthwhile investment.

And I think there's other things starting to happen in there that, after re-tendering, as your own figures have shown, audit fees are fallen. Well, there's limits to how far that can go. I think if audit committees think one of their major proposals or major jobs is to cut the audit fee, you're really starting to get into the question of are you starting seriously to damage the audit because, if the fees are driven down and if audit partners are not of the caliber of the people they're auditing, then we're going to have a major problem.

And how do the audit firms deal with that? You can probably ask some of them as they go through this, but are they taking part in a time out of the audit to try to make it pay? And I think that is a serious problem we're having. One disclosure I'd like to see in an audit report is how much partner time has been spent on it compared to those of managers and juniors.

As I've said before, I firmly believe the auditor should sign his own name on behalf of his firm. I think that concentrates the mind. In my own firm, when I was there as a national technical partner, I remember twice an audit partner getting away with something by signing the firm's name. We ended up in court. He was protected, and we weren't. I don't think he'd had had a second chance if his name had been on the first one.

It's not what you're dealing with at the moment, but I think there's also societal duty on the auditor to act as a whistleblower in certain situations. Lynn talked about various cases where the auditor knew things. I think it would have been very helpful if the securities regulator or the prudential regulator had been informed. So I would see the audit repositioning to be much more focused away from the company and onto the investor and also onto the regulator, where necessary.

Well, maybe that was a little bit like a sermon. I was in the church not so long ago listening to the minister banging on, and the old lady in front of me turned to her neighbor and said, (Is the minister not finished yet? and back in answer, (She just can't stop. Well, let me show you I can.

Advice. I'm always reluctant to give advice. When I moved into my present home near Edinburgh, there was a rather architecturally-unusual plant in the front garden, which looked like overgrown parsley. But the neighbors who didn't like the lifestyle of the previous occupants thought it was marijuana.

So I was a bit concerned, so I got a horticulturist in, and he gave me advice I never forgot. He said, (Look, if you're worried about this plant, he said, (pick it, dry it, and then smoke it. And if you're still worried about it, then it's parsley.

Well, the advice that I would like to give to the PCAOB is I would like to see audits in the U.S. the same as audits everywhere else. I'm delighted you've had the foresight and generosity to invite international observers to these panels, and I do hope it ends up with both the IAASB and the PCAOB putting out something extremely similar.

Audit, I think, is at a tipping point. Its worth to investors in society has been questioned, certainly by the crisis. Jay, in his recent speech, made it very clear that the auditor has a unique and indispensable position in the capital markets to help investor confidence, and I think that's something that you can really assist by the audit report.

And I'd like to see you go further. I remember when I left the IASB, the London Sunday Times talked about my time there and said, (When Tweedie came to the International Accounting Standards Board, financial reporting internationally stood at the age of a precipice looking into a chasm. Since he arrived, it's taken a big step forward. And I think you have taken a big step forward, so I'd like you to lengthen your stride a bit and do a bit more. Thank you.

MR. DOTY: Thank you. Jeanette?

MS. FRANZEL: Well, thanks for venturing out to the colonies for this important meeting. I appreciate your comments about not wanting large differences between the audit reports and the audit approaches between the U.S. and internationally. And I'm also intrigued by the UK approach in the audit report describing assessed risks of material misstatements that had the biggest impact on the audit. How far apart do you think our approaches are at this point, our proposal and the approach? And how do you think that they could come together?

MR. TWEEDIE: I think they're very similar. I would like to see a bit more about the findings. I don't necessarily think that is part of the UK approach, but I'm not an expert and you'd best ask Nick and his colleagues. But they are close. I think the Rolls Royce one went further and was an experiment, but I thought it was a highly successful experiment. I know you can ask about that later on.

But I think really we want to try and take the best. At the IASB, the idea was can we just take the best of whatever is out there? It doesn't have to be the international one. If the New Zealanders or even the Americans on rare occasions have the best accounting policy, we should have it. And that's what I think exactly PCAOB's line should be.

MR. DOTY: Jay Hanson?

MR. HANSON: I just wanted to thank you for being here and coming across the pond. Just a follow up to Jeanette's question relative to the IAASB proposal that's still on the table. If you think that a worthy goal is to have our ultimate standard align with their ultimate standard, if you think there are particular things in our proposal that theirs might be missing or particular things in their proposal that you think we should steer towards in our thinking, I'd appreciate to hear your thoughts on that.

One tongue-in-cheek follow on, have you concluded whether the plane you flew here on is on the balance sheet of the airline that you flew?

MR. TWEEDIE: Well, the one I was on yesterday has probably been written off by British Airways a long time ago, I think. But, certainly, on the issue of the IAASB, I think the main point is you move along with interaction, and it's really a question can we just get the terminology the same so that people know this is the same and it's not something that's got a variant on it.

There may be jurisdictional issues which you'd have to deal with in the U.S., and that is obviously up to yourselves. But I think the more you can get even the words the same, the happier people are going to be that this U.S. report is the same as a UK report and so on.

MR. FERGUSON: Yes, I just want to thank you for coming across the ocean to see us. But the question that I have and one of the things I've been very concerned about the CAM proposal we have is that it will deteriorate into boilerplate disclosures. I think that's happened in France where they already have certain kinds of disclosures like that, and they're not particularly meaningful.

And I'm particularly curious about your view of the KPMG opinion in the Rolls Royce matter because I read that, too, and it's really quite extraordinary. It appears to me, in many ways, to go further than the way I read what would be required under the British standards. And is this, in your view, is that simply an example of an auditor showing unusual courage, or do you think that's sort of a lamp into the future that, under these standards, that there will be auditors who actually feel comfortable in writing opinions like that?

MR. TWEEDIE: That's an interesting question, Lewis. I think, from what I gather, there was an arrangement with Rolls Royce that the firm would actually go further and experiment on that.

And I think the reaction from the investors in the UK has been highly positive, and I certainly would like to see that be made more mandatory because I think it does reflect, when you actually have to state that, okay, here's the problem, you've got a lot of Level 3 valuations, which wasn't the case in Rolls Royce, but you've got a lot of Level 3 valuations, how have they tackled it, we've tested it in the following manner, and, on balance, we feel that this is where they're positioned. And I think that is extremely helpful. It certainly gives the investor a view is this an aggressive management or it's within the bounds of acceptability but always at one end or are they somewhere down the middle? And Rolls Royce comes out I think pretty well down the middle. This little bit could be the liabilities perhaps understated. On the other hand, they're slightly overstated on balance. And I thought it was an excellent report. It taught me a lot more than I've ever learned from an audit report.

MR. HARRIS: How do you respond to those who would say that what you are recommending in your written statement would require the auditor to be the source of a significant amount of additional original information about an issuer and that is simply not the role of the auditor? We're going to hear that throughout the day.

MR. TWEEDIE: Well, you know, I was listening to the comments that this is the role of the audit committee. I really don't agree with that. I would like to see the auditor moving away from the company. He's representing the investor. He's going into the company. He's reporting to the investor in my book, and that's where he should be.

So the information that goes out there, that's what the auditor feels that the investor should know. And I feel very strongly that we should not have the audit committee giving that information and the auditor remaining quiet saying, yes, I agree. I would rather he did it, and I think that increases the value of the audit.

It's certainly interesting, listening to a few of the audit partners who have been involved in the audit report. I think it's energized the firms, and it's made those involved in the audit much more interested in it. They can see it's far more than just a tick. It's actually helping the markets. I think there's a lot more we can do. A lot more you can do. I'm out of this now.

MR. HARRIS: Well, I think that goes directly to the role and the future relevance of the profession, but you're cutting against the grain of significant amount of the testimony we're going to hear throughout today with respect to original information.

MR. TWEEDIE: Well, I'm quite used to doing that, I think. One beauty I found after 25 years of standard setting, I don't have to be polite anymore. I can just say what I think. You'll enjoy it, too.

MR. DOTY: Oh, the chief auditor.

MR. BAUMANN: Thanks very much. And, David, thanks very much for joining us today. I know you had a difficult trip over, so thanks again for doing that.

Similar to the question that Steve Harris asked, many of the objections that we've received in the comment letters are that, if additional information is needed by investors, then accounting standard setters should require new, different disclosures. If the information that investors are looking for is, well, what was, as Lynn Turner was talking about, where was the management on the range of reasonableness with respect to the estimates? Could accounting standard setters require management to disclose their ranges, their high and their low and where they came out on that?

So I guess the question is is this a, as an accounting standard setter in your great career, do you think this is something that can be solved through an accounting standard setting, as opposed to auditor reporting?

MR. TWEEDIE: You know, this is a great country, but I really despair of it at times. When you look at the quantum of accounting standards you have in the U.S., and this is no criticism of FASB who have been trying to cut it back, but it's almost you've got to get everything written down. Judgment disappears in that sense. And they're always worried. I heard at the last panel the concern about the lawyers. Well, if you had a panel of lawyers writing the Declaration of Independence, I'd suspect you'd still be paying homage to Her Majesty at the moment and trying to define liberty and happiness and things like that.

But I really would like just -- the auditor has actually got a range of experience, which, quite frankly, the company hasn't got. So if we want to find out, you know, where does this company stand, the auditor is in a much better position, having audited the industry or various companies in the industry, to be able to say, well, these guys are aggressive. I don't think the company itself could say or even would want to say that. So I suspect they might get boilerplate disclosure.

MR. HARRIS: If we've got five minutes to go --

MR. DOTY: We have five minutes, but Sir David has a 1:00 plane. So we do him a courtesy by springing him and by convincing our next panel on time. So, Sir David, with copious thanks from this board and from all of your many friends and associates here, God speed, safe travels, and we'll see you soon. Thank you.

We should commence the next panel as promptly as we can. If we could take a ten-minute break, ten minutes strict, that would get us started at 10:45, and it would be a good idea.

(Whereupon, the foregoing matter went off the record at 10:33 a.m. and went back on the record at 10:47 a.m.)

MR. DOTY: If we can resume. This of course, is the -- this is the international panel that will take us into the noon hour. This is truly a blue ribbon and distinguished panel of commenters from Europe. Sven Gentner is the counselor for Economic and Financial Affairs Section for the delegation of the European Union to the United States.

He's responsible for the coordination of the financial markets regulatory dialogue between the European Commission and the United States. Before joining the Commission, he has been working for Allianz Insurance, PLC, the Institute of Public Finance at the University of Muenster, Germany. He has a private sector and academic background, as well as his distinguished service in the EU.

Nick Land is the Chairman, Audit and Assurance Council of the UK Financial Reporting Council. He retired as chairman of Ernst & Young in 2006. He's a non-executive director and chairs the Audit and Risk Committees of Vodafone Group, Alliance Boots, BBA Aviation, and the Ashmore Group.

Nick is a director of the FRC. He's a member of the FRC's Codes and Standards Committee, and we're privileged to have him here for these proceedings.

Professor Arnold Schilder became chairman of the International Auditing and Assurance Standards Board, the IAASB in January 2009. Previously, he was a member of the managing board of the Dutch Central Bank, responsible in particular for banking regulation and supervision.

In addition, he served as the chair of the Basel Committee on Banking Supervision Accounting Task Force, and he's a member of the Public Interest Oversight Board. Arnold is also a frequent observer at meetings of the SAG, and we always benefit from his presence. Thank you all and please begin, Sven.

MR. GENTNER: Thank you. Good morning and thank you for inviting me to speak here on behalf of the

European Commission. I think this is another sign of the very good cooperation we've got between the PCAOB and the Commission, and we're very grateful for that, and we also fully support your process.

I've been invited to talk about audit reform in the European Union. I was actually looking forward to telling you that the European Parliament had just voted the reform in the EU, but unfortunately the vote has been postponed until tomorrow. It will nevertheless take place and I'm sure it will go well.

Let me just say a few words about the reform in the EU. As you know, our main objective, of course, was to increase the quality of statutory audit. The reform we are undertaking has got two pillars in EU law. We've got various legal instruments, one of which is a directive, which will be -- contain horizontal measures applicable to every audit unit and their regulation, which will contain stricter requirements for the audits of public interest entities, PIEs.

For example, credit institution, listed companies, insurance undertakings or other entities designated as such by member states, member states of the

European Union. Of course, the reasons behind that are that the consequences of misstatements for PIEs are much greater than for other types of companies.

Concerning the auditors' report, the new legal framework will only define a minimum. The EU member states have the right to impose further requirements, which is a tool for us to accommodate the specific needs of each concrete legal environment, which as you are aware, these environments differ across our 28 member states.

We don't impose a template or a model requirement in the new frameworks. It is up to the member states to define these models or templates.

Let me say a few words about what is new in our reform. All the initiatives we're taking are mostly motivated by the objective of achieving greater transparency. So we've introduced a requirement that the place of where the statutory auditor or audit firm is established be indicated.

We want a statement that indicates by whom or by which body the auditor was appointed. Typically, these are the shareholders at the annual meeting, but there are also other modalities possible in European law, as long as the independence is assured. But we want this to be made public.

We want a statement indicating the date of the appointment and the period of total uninterrupted engagement, including previous renewals and reappointments of the auditor. Again, this is to provide more information to the investors, and to allow investors to better assess the relationship between the auditor and the audited entity.

We also introduced an obligation to report on any material uncertainty related to events or conditions that may cause significant doubt about the entity's ability to continue as a going concern.

As you are aware and has been mentioned before, this is in particular a reaction to what happened during the financial crisis, where we've seen many cases where financial firms revealed huge losses just after they had received a clean audit report.

We think that the introduction of these requirements will help address these issues.

We are also introducing obligation to describe the most significant assessed risks of material misstatements, as well as a summary of the auditor's response to those risks, and finally and where relevant, key observations arising with respect to those risks. As you are aware, typical examples are the use of off balance sheet finance, changes in IT environment, et cetera.

Important is that there really is a description of the most significant risks of material misstatement in the new report, which again we hope will improve transparency in that respect.

Finally, we want that the audit report explains to what extent it was capable of detecting irregularities including fraud. This addresses the issue which has been there before, the expectation gap.

We're not proposing a model template. We're expecting the profession to develop a structure here, but we think this will be an important element to counterbalance the impression that auditors sometimes rely too heavily on management statements, and to make sure that auditors can show how they've checked the validity of these statements.

As you are probably aware, we are requiring in addition to the auditor's report, now also a more detailed additional report, which is to be made available to the audit committee of the audited entity. We expect that this additional report will enhance the flow of information between the auditor and the audit committee.

The report will not be public, but member states can allow the report to be made available to third parties when necessary, for example, courts.

Finally, we think that there is a lot of convergence and congruence between what has been proposed by the PCAOB and what is in the EU audit reform. I think we share the general principle of making the auditor's report more informative, and we share a concrete approach how to establish that.

In particular when it comes to including critical audit matters in the audit report, and also in relation to the reference to the year when the auditor began serving as the company's auditor, where you are aware that we've introduced mandatory rotation requirements.

Again, I would like to thank you for inviting me and the European Commission today, and we look forward to cooperating with the PCAOB. Thank you.

MR. DOTY: Thank you, and your work on this panel has just begun. Chairman Land, please proceed.

MR. LAND: Well good morning, and it really is a great pleasure to be here. It's actually a surprise to be here; it wasn't part of my career plan to find myself at a public hearing with such an august body. But it's a pleasure to be here.

Can I briefly start by describing the role of the UK's Financial Reporting Council, because I think it will help put into context some of the changes that have been made. The FRC is an independent regulation whose mission is to promote high quality corporate governance and reporting to foster investment, and in essence it has two legs.

The first is codes and standards. It sets the corporate governance code for publicly listed companies. It sets audit and ethical standards, and it sets accounting standards. It obviously sets those standards under the sort of general auspices of the international standard setters.

The second leg is conduct. It reviews companies' financial statements, inspects audits, oversees professional bodies and disciplines auditors and accountants. It's more or less a regulatory one-stop shop.

So what drove us to want to enhance the audit report in the UK? Well, a number of your speakers have already talked about the wider impact of the financial crisis in 2008, and of course we suffered from it very, very significantly. But just sort of narrow down one of the repercussions from that crisis.

We did see a significant increase in the intensity of focus on the effectiveness of company stewardship, and the adequacy of the communications to the market of both audit committees and auditors, and in that, I'm sure we weren't unique.

As part of this, we also detected that investors were becoming increasingly frustrated that the audit and auditors operated in a black box. They felt they had no visibility over the audit and no -- and very importantly, no hooks on which to ask questions about the audit.

As an aside, and as a number of your guests have said, it's always seemed strange to me that the audit report, which is the only truly independent voice in a set of accounts, is the one part of the financial statements that there's normally no point in reading, and you've referred to the fact that your audit report over here hasn't fundamentally changed for 80 years.

Well, you think you've got problems; it hasn't changed in the UK for about 150 years. So against this background, in the first half of 2013 the FRC, after very extensive consultations, made two significant interlinked changes.

First, it revised the UK corporate governance code to increase the disclosure in a company's annual report, about the work of the audit committee, including the significant issues that the committee considered in relation to financial statements, and how these issues were addressed.

It also required that the board should make a statement in the annual report that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

Second, the FRC revised the audit standards governing audit reports in a number of areas. First, the auditor is now required to report by exception, if the board's fair, balanced, and understandable statement is inconsistent with the auditors' knowledge, or if the matters disclosed by the audit committee describing its work do not appropriately communicate the matters that the auditor communicated to the audit committee.

Second, the audit report is now required to describe those assessed risks, material misstatement identified by the auditor, and which have the greatest effect on the overall audit strategy, the allocation of resources to the audit and in directing the efforts of the engagement team.

Third, the report should also provide an explanation of how the auditor applied the concept and materiality in planning and performing the audit. Last, the report should provide a summary of the audit scope, including an explanation of how the scope was responsive to the risks of material misstatement, and the auditor's application of the concept of materiality.

I think it's very important to emphasize that these requirements in our new standard are set at a very high level. We want to encourage different approaches, and to discourage standard paragraphs and boilerplate.

So what has the experience been in the UK so far? The new standard applies primarily to companies having a primary premium listing on the London Stock Exchange, and it was effective for periods commencing on or after the 1st of October 2012. So we now have -- we're now seeing a significant number of new style audit reports.

The reactions from the audit firms, essentially the Big Six, has been positive, constructive and very supportive. Many front line audit partners, as Sir David referred to, are genuinely enthusiastic about these changes, and have embraced the new concepts.

And indeed, it appears to be enhancing their position with management and the audit committee, and giving them a chance to demonstrate their depth of thinking and management challenge. We've not yet seen any signs of boilerplate or legalese. It is, of course, early days.

We're seeing experimentation and Sir David referred to the Rolls Royce report, but there are others.

We're seeing experimentation and real attempts by the auditor to be frank and open about their discussions of the risk they focused on, and how they satisfied themselves, the application of materiality and the scope of the audit.

Finally, initial reaction from investors has been very positive. It's given them some insight into the auditor's world, and disclosure around scope materiality has begun to generate discussions amongst stakeholders. This must be a healthy development in respect to both good stewardship and increasing stakeholders' understanding of what an audit can and cannot do, therefore potentially narrowing the expectation gap, and we hope increasing the confidence in audit, which I suspect in the UK at least, is at an all-time low.

Thank you very much for listening to me.

MR. DOTY: Thank you, Chairman Land. Chairman Schilder.

MR. SCHILDER: Thank you, Chairman Doty, and thank you very much for the opportunity to speak here about the work of the IAASB on auditor reporting. We are an independent global standard setter, and an important aim of our work is therefore to facilitate adoption and convergence of national and international auditing standards.

So I really commend the PCAOB for arranging this global panel, and I note that our collaboration with the PCAOB has been a critical part of our work to date. I also note many positive comments on how far we have come already.

Why is the IAASB seeking to change the auditor's report? This topic has been on our radar screen for some time already. In 2006, we commissioned academic research jointly with the Auditing Standards Board of the AICPA, and Professor Ted Mock, a panelist this afternoon, and others, provided us with global input about user's perceptions of the auditor's report.

And then of course the financial crisis has heightened the demand for more communication from auditors, and has highlighted over-arching concerns about the value of an audit and the relevance of the accounting profession.

Well that sparked the IAASB and our work to consider how best to respond to the needs of users, and audit reporting has been our top priority for the past two years. We issued two public consultations on the topic, and note the continued support for moving forward to enhance the communicative value of the auditor's report.

In our most recent consultation and exposure draft package in July 2013, unanimously agreed by the IAASB, focused on audit reporting, on key audit matters, other information and going concern. It also included other initiatives to increase transparency about the audit and the auditor's responsibilities.

Overall, as we learned, there's strong global support for the IAASB finalizing its proposals this year, and we have determined to do that.

Now the topic we refer to as key audit matters or KAM, similar to your critical audit methods, also CAM; it's just a K or C so far as we have come already. That topic is viewed by many as the most significant enhancement to audit reporting, and we propose to require auditors of listed entities to communicate KAM in the auditor's report, and others of course are encouraged to review that on a voluntary basis.

We define key audit matters as those methods that in the auditor's professional judgment they're of most significance in the audit of the financial statements of the current period. KAMs are selected from methods communicated with those charged with governance, the audit committee, and thereby providing transparency about communications that investors have said are important to audit quality.

Looking now at the common levels, investors, regulators and auditors largely support what we have proposed. But they've asked for more guidance and more specificity on how auditors should apply the decision framework, and they've also urged us to take steps to ensure that both the methods identified and how they are described in the auditor's report results in meaningful communication to investors.

Robust application guidance in our standards, as well as revised examples of key audit matters, will give an indication of how the IAASB expects the concept of key audit matters to be applied in practice. Preparers and others who do not support the concept of KAM often cite concerns with the auditor providing original information, that is, information that is not otherwise required to be disclosed in the financial statements.

Auditors have asked for more guidance on how to deal with circumstances that might result in the auditor communicating about sensitive matters. So our Board is exploring how to find an appropriate balance between auditors providing useful information about the most significant methods in the audit that was performed, while at the same time respecting the important concepts of client confidentiality.

We are very pleased to support. We have heard from global groups like the International Corporate Governance Network, IOSCO, IFIAR, the Basel Committee, World Bank - for our concept of KAM, and including KAM in the auditor's report will be a significant change in practice.

So the IAASB will do all it can to support effective implementation to achieve its intended aims. Now similar to the PCAOB, we have also substantively revised our standard addressing the auditor's responsibilities for other information.

Investors and others have emphasized the importance of information included in MD&A and other areas of a company's annual report. While this information is not audited, the auditor's attention to it helps to increase user's confidence in such information.

Our proposals included required auditor reporting on other information, including identification of which information has been read by the auditor. We will re-expose this proposal in mid-April for a 90-day comment period.

Our project also addresses the topic of auditor reporting on going concern. Feedback to our proposals has highlighted the need for a holistic approach, that is, that changes in auditing standards need to be considered in tandem with changes or clarifications to accounting standards.

We know the PCAOB's separate project in the area is closely tied to the FASB, and we have had similar liaison with the IASB to understand how they addressed this topic and are following their developments with interest, as we seek to finalize our proposals.

In relation to other improvements, the Board supports requiring disclosure of the name of the engagement partner in the auditor's report for listed entity audits, and we note, of course, the PCAOB has a similar proposal in process, and we look forward to hearing about the Board's plans for a way forward.

We also, of course, are taking into account relevant developments in Europe. I think, simply said, Europe is a done deal with regard to audit reporting. You heard from Nick about the UK FRC, and there are now more and more examples of this new style of audit reporting.

They are coming into the market, providing it can be done, and does result in helpful information for investors and others. I must say in my own country, where it's not in law but on a voluntary basis, already almost half of listed entities' auditor's reports also show this new model with great enthusiasm.

Stakeholders, including bodies such as the CFA Institute and the Center for Audit Quality, have encouraged us to take every opportunity to seek to minimize differences among the various approaches to auditor reporting, and we heard it this morning again.

We take that, and you do as well, very seriously, recognizing that we all have a duty in the public interest to respond to what we have heard through our multiple consultation processes.

So in conclusion, through its work on audit reporting, the IAASB believes it has a unique opportunity to increase the relevance of the audit, and to trust in the profession. Not only will the auditor's report become more informative, but we expect that this increased reporting could change the behaviors of not only auditors, but also management and those charged with governance.

A renewed focus by the auditor on matters to be addressed in the auditor's report, together with the increased attention by management and those charged with governance on financial statement disclosures, stands to benefit investors, and have a corresponding effect on audit quality and the credibility of financial statements. Thank you very much.

MR. DOTY: Thank you. We have ample time in this panel for all the questions, and I want to therefore begin with one for the panel.

Whenever one proposes a change in the audit model that involves additional disclosure, additional information, whether it's the name of the engagement partner, critical audit matters, there are objections in addition to different litigation regimes, which we'll talk about later and which will occur.

There are objections made which are difficult, and for which we must take account, we have to think about. Your experience bears on this. The objections are message-mixing. If you include information in the audit report, the message that this is the firm's report, the message that the binary opinion conveys will be somehow mixed and confused and obliterated or obscured. Investors won't understand it.

You run the risk, if you include information of the kind that your regimes are doing and that we are contemplating, of mixing message.

The second is one that is less of a problem for you, with your legal regime, but is a problem for us, and that is mission creep. Who are you as an audit regulator to tell audit committees what they need to know about or what they need to worry about, in terms of additional information that you're asking the auditor to comment on, such as the CAM?

That really leads -- that collapses into a very important argument, that by doing any of these things that we propose in these disclosure releases, we are compromising the authority, the independence, the effectiveness of the audit committee. This is a very big issue for us.

What have you found about this? Has -- you have all got the regime now. You're doing it or you're outreaching to find out about it.

To what extent are you concerned and to what extent should we be concerned about message-mixing, obscuring the message of the binary opinion, putting pressure on audit committees that properly is within their business judgment, and essentially getting over the line into compromising the effectiveness of the audit committee?

Is this something that should block us from -- should keep us from modernizing an audit reform model? What's happened, and what does your experience tell you? I'm sorry for the sermonette, but you'll hear some other sermonettes from my colleagues as we go forward.

MR. LAND: Shall I kick off, Chairman? Of course in the UK we do have an advantage, as you are well aware, because we set the corporate governance code, which covers the responsibilities of audit committees, and we set guidance for audit committees. So we were able to do these two things in parallel.

The truth was we were changing the rules of engagement for audit committees about the transparency of their work, and then it suddenly, as far as I'm concerned at least, I suddenly realized this would be a great time to change the audit report, so there was a little bit of serendipity in all this. So we don't -- we don't have that fundamental problem that you're dealing with.

Having said that, I mean there is no doubt, and I've seen it to a limited extent on one of my boards, that the new auditor reporting in the UK can create some additional tensions between the auditor and management. I personally think that's a good thing in principle. I think that, you know, increasing in the right way.

I don't think we should be worried about tensions being increased, as long as they're done in a mature and sensible way, and as I said, I think it's given the auditors in a sense, if I can put it like this, more authority.

I suppose the naive answer to your question vis-a-vis the USA, which I'm not really very qualified to comment on, is of course there's nothing to stop an audit committee or board inverted commas responding to what's in a new form audit report in the UK.

I mean the logic to me, if I was chairing an audit committee in the USA, and I say this with very little knowledge, so forgive me, and your proposal, as I hope they are, are enacted, my response I think, hopefully not defensively, would be to consider what more I needed to say in my audit committee report. So it seems to me that there's a remedy there.

MR. DOTY: Other panelists? Sven?

MR. GENTNER: Yeah. I can't yet talk about the implementation, of course, of our reform because it's just about to be decided.

But I think what has come out of the negotiations in Europe we feel is a good compromise between a realistic view on what the audit report can convey, but at the same time also taking into account more the needs of investors, who are an important audience for the report, and of course also the needs of the audit committee.

I don't think we're worried about message-mixing when it comes to our reform. The things that I've mentioned in terms of the tenure, the length of the period of the auditor is active there. The issues about addressing the expectation gap and other things, if anything, will make it clearer and better understandable what an audit report can do and cannot do, which I think are two important elements for investors to understand.

There is a risk that you do too much and there's a risk that you do too little, and I think it's very important that the investors know exactly what they can get out of such a report.

Finally, I don't think that there is a risk the audit committee will lose in terms of its importance will be bypassed or whatever, because both the audit committee and the investors play an important role in this respect, and I think these roles will be preserved.

MR. DOTY: Thank you.

MR. SCHILDER: When you talked about message-mixing, Jim, what struck me most is the quote "investors won't understand it." I find that -- it's not your quote, of course -- I found that almost offending to investors. Maybe that was true long, long time ago, but nowadays, I think that will be a completely unfair argument.

Because investors, as we learned from all the consultations and dialogues, are very interested, and they are really willing to do a lot of exercise and effort to really understand.

That's behind -- I mentioned the examples in the Netherlands, which is on a voluntary basis, so companies have chosen to invite their auditor to already report this new style, and just that public report from senior partner from one of the large firms, and I, as did my clients, in this case, made that choice.

So it's not so much about international compatibility, because these reports will be very unique per company. But it's also very important to fulfill and to accommodate outspoken wishes of investors, and investors have been much engaged in this dialogue.

Last year, we saw that in many examples where auditors spoke publicly in the AGM, and then they got feedback, of course, from investors.

So I think we have to take investors' wishes, as they now have expressed over so many years in so many ways, to take very seriously, and therefore it will be very interesting to see the analysis that of course will come, as so many reports come into the marketplace, how investors, analysts and others will comment about that, what is most helpful, what is less helpful.

On the other point, on the audit committees, well a similar observation, that actually these experiences reinforce the dynamics, the positive dynamics between management, audit committees and the auditors.

It's not only a challenge to the auditors; it's the other way around as well. It may result in better and more informative disclosures from management and audit committees, and certainly the UK is a very interesting example.

So rather than compromising, it's I think respecting regarding the independence of each of these stakeholders, and as we learned from our work on audit quality, as additional published in our framework for audit quality, these interactions between the various stakeholders are very important, and the more we can stimulate it, the better.

MR. DOTY: Steve Harris.

MR. HARRIS: Well Chairman Schilder, first of all I want to commend you for making the audit report the top priority over the past two years for the IAASB, and I commend you for all the work you've done on that. I also encourage you to finalize the audit report and what you're doing at the IAASB if possible in 2014.

I know it's been a very aggressive schedule, but I think you've outreached. I applaud you for all the work that you're doing and have done. Before I get to the questions, since time does run out, I just want to make a point somewhat separate, but a point that Rick Murray brought up on the last panel, which I'd like you to think about, because I think we ought to think about it.

It's not directly related to the audit report. I will get to the question on the audit report. But Rick Murray encouraged, as has the ACAP, that the SEC and the

PCAOB should compile independence requirements into a single document, and make this document website-accessible.

So on this issue of independence, I wish you internationally would consider doing the same thing.

Now with respect to the question, in your remarks, you mentioned the IAASB as exploring how to address concerns raised by some commenters, about the auditors providing original information. So would you please clarify what type of information the IAASB would consider to be original information, and then for instance, would the auditors, the disclosure of key audit matters be considered original information, since it's not disclosed by management as such?

Additionally, would you please expand on how the Board plans to address this matter. Finally, in encouraging you as aggressively as I have, to complete your project in 2014, that's with the caveat that it has support from users and investors.

MR. SCHILDER: Thank you, Steve. Thanks for the compliments. It was hard work. I can only refer to Dan Montgomery, my deputy chair and many on the Board and staff that have worked so hard, but inspired by the many comments that we received.

The independence requirements is something that we are discussing at the moment, and in our proposals, we also proposed a statement about the auditor being independent, but then also referring to let's say the sources of these independence requirements.

Now for a multinational group that can be quite a lot, and the same is true in the public sector. So we're discussing what is the best way forward there, and certainly the suggestion from Rick is an interesting one, whether it would help that you would have somewhere a combination of all the many requirements.

But again, if you take that from a global perspective, it's not easy, because it will basically point to the many ethical requirements, not just in, let's say, the ethics code of the ethics board, but many national requirements and very specific ones.

So there's probably a bit in between, an option that we will be discussing, whether it would make sense to focus on the group engagement partner and which requirements are applicable to him and his team, rather than all the component auditors.

So that's basically where we are. So we have not a final answer yet, but it on one hand needs to be practical and not result in a long list of many pages. On the other hand, it needs to be informative.

But as we are thinking about the concept of using that size also for let's say the kind of boilerplate, relevant boilerplate about responsibilities, this might be another interesting option.

Original information. Maybe the simplest answer will be what is -- what the company is required to disclose by the applicable accounting standards. That's the original information that has to come from management and the board, and it may not just be accounting standards.

It could be more, national requirements, et cetera. So that is management's and the board's responsibility. Therefore, the focus on key audit matters is what the auditor can comment upon that, from the auditor's work. And as I mentioned, we start with what the auditor has reported and will report to let's say the audit committee.

It's quite clear if the auditor would come to the audit committee and tell them information, where they immediately say well, we expect that to come from management or we have already received from management, that's not what is expected from the auditor.

What is expected from the auditor is sharing significant judgments that the auditor had to make, and that may include many comments, how that, of course, relates to specific items in financial statements or whatever.

The point, of course, is that there can be a bit of a gray line there. If the auditor wants to explain why certain audit conclusions or certain significant auditor work was done, you may want indeed to explain a bit more than already at that point has been in the draft financial statements or MD&A, whatever.

That, we think, would just reinforce the dynamics between management, the audit committee and the auditor, and that's why we also think that this should not be something that is only discussed at the very end of your reports.

It should already be part of the beginning, and focus on what might be key audit matters, and how then is management disclosing about that, and how the auditors would help in deciding about it.

But again, it's a bit of an area now of starting experimentation. So I think it's difficult to have a very black and white response. At least that's how we approach it.

MR. DOTY: Lewis.

MR. FERGUSON: Thank you, and thank you all for coming here from Europe. I just want to re-ask a question that I asked Sir David Tweedie again, which has to do with the potential for these additional disclosures to generate -- to degenerate into a form of meaningless boilerplate.

Clearly, that does not seem to have happened in the early days in the United Kingdom. I mean it's almost like a thousand flowers, let the thousand flowers bloom and that seems to be what happened. Do you see that as a continuing trend, and how in the IAASB proposal did you consider that issue, and what have you done to try to guard against it?

MR. LAND: With regard to the UK, well I mean it's a lovely expression. I think we are at this moment seeing a thousand flowers or at least a hundred flowers sort of blossoming, and they're all a bit different. So I think we are very, very encouraged so far.

We are seeing, which I think is good, I think we are beginning to see some healthy competition. It's obviously it's new. I think we are seeing a bit of competition between the firms, who can come up with the most appropriate audit report.

You've heard Sir David refer to Rolls Royce, which I think is a shining example at the moment. So I think, you know, I think we are going to see some competition there, which I think is healthy.

I mean, the other thing that we were very conscious of is our amendment to our audit report standard, which obviously is based on Arnold's standard, but our amendment to encompass these new requirements. It was very short indeed.

I mean we really did not, you know, it's no more than a page. I mean we kept it at a very high level, you know. We've refused in the consultation process to define too much, and we've made it very clear that we, you know, we expect them to use, you know, use their judgment and not to revert to boilerplate.

I think in terms of managing expectations, one thing that is inevitably going to happen is you're not necessarily going to see next year's --

I mean if I just take the board I'm on, which is Vodafone, its key financial risks and therefore the critical audit matters have basically remained the same, ever since I've been on the board for seven years, impairment because the mobile phone industry in Europe has spent a lot of money and gets impaired.

It's tax risk, because we have big fights with jurisdictions, particularly in India, audits, deferred tax assets, because we have huge amounts of losses.

So next year's audit report from Deloitte, and Deloitte was the very first to do, to produce a new style report, isn't likely to look that much different, I would judge, from last year's report. So we have to manage expectations there. There's not going to be a new Vodafone plan necessarily next year.

But we've genuinely seen the firms, effectively the Big Four so far, embrace this, want to -- want to comply with the spirit underpinning our standard, and to date, I think, should feel very proud at the way they've tackled this, quite frankly.

So I think all that bodes well for the future. I mean time will tell is the honest answer. But so far, it's way ahead of our expectations.

MR. DOTY: Jay Hanson.

MR. HANSON: Echo the thanks to the panelists for coming today, and I've got another question for Mr. Land, and the requirements or the -- I think you hesitate to call them requirements -- but the guidance for auditors for what to put in the report includes some of the details about the conduct of the audit.

What were the risks assessed, what was the materiality level applied, how was the scope responsive to the risk? We've chosen at this point to not go that direction, to have the details of the holistic conduct of the audit included, and we've gotten mixed feedback on some of the outreach about whether investors would find that useful. So for now we've chosen to not go there.

I'm curious if you, in all your considerations for adopting what you put in place, if you had feedback from investors about what they would find useful, and if -- obviously you chose to go this path, but maybe the decision points that you're weighing and whether to go this route about the details of the audit versus some other route, it would be helpful to hear some insight about that.

MR. LAND: I could certainly do that, and I mean first, it seemed to me -- I mean I was an auditor 20 years ago, but things have changed a great deal. But it seemed pretty obvious to me that if you are going to reform the audit report, and it badly needs reforming, that getting some idea of what the input into the audit is what is the output seems to me very logical, which is not just me; which was our starting off point.

But in some very extensive consultation, we had a lot of extensive consultation. We had an open hearing, such as yours. To the best of my knowledge, the investors, and you'll be hearing from investor reps from the UK tomorrow, were pretty unanimous in saying they thought this would be helpful.

Certainly in discussions that we've had post the adoption of this new audit report, investors have continued to tell us they found it very helpful. It's quite interesting that there is already a debate that's started, not that I'm aware at a company level.

But there's already a debate started in the UK amongst investors, amongst stakeholders about the whole concept of materiality. That's been driven, I'm sure, by the disclosures that we require and is a requirement, but also because the FRC has produced a sort of thematic review on materiality.

But it has begun to generate that debate, and I think the truth of the matter is, and I'm not in any way being rude about investors, but you know, I suspect that investors were somewhat surprised when they read in the Vodafone audit report that materiality right at the very top is 500 million pounds. I mean that's a lot of money, as it were.

So I think that they've welcomed it. We got very little pushback from the firms. A little bit of reservation from the firms, but very little pushback from the firms, and I think it's led to this sort of debate, and I think it's a civilized debate.

It's not the sort of pointing of finger at a company. It's really raising questions about the whole concept of materiality. In opening this black box, which frankly the audit is in, has always been in, I think it's very, very healthy.

I would also say, and this was not scientific, as part of our consultation, one of our senior staff members, McMarrick, who spends a lot of time working with Arnold and his team, we informally -- he informally rang 13 U.S. investors that he had contacts with, just to see what their reaction was.

You know, it was pretty unscientific and he's not here to report. But the report back that he gave to us was yes to materiality, yes to scope and yes to critical audit matters. Now I'm not suggesting that in any way is that significant, but when we put it to them in our language, those 13 were, I'm told, positive.

MR. DOTY: Jeanette Franzel.

MS. FRANZEL: Thanks for being here today.

I'd like to ask to what extent did each of your organizations analyze costs and benefits of the proposal before, you know, during the development of the proposals, and then in particular in the UK, what kind of post-implementation analysis is also being done on costs and benefits, and what were the results of your various analyses, and if there are any really important things that came out of there that we should be considering as we go through our own analysis of costs and benefits?

MR. LAND: We did consider cost, of course. We will be doing an analysis at the end of the reporting season. We haven't done it yet. Our own -- my own view, and that of my counsel and indeed I think the feedback from the firm, was that -- it's not scientific because we haven't done the appraisal, was that the cost implications are pretty low.

I mean at the end of the day, what are they reporting on? Well you know, in the audit plan, the audit strategy document, at the beginning of the audit, they set out the critical audit matters they're going to focus on.

At their closing report, they will report on those critical audit matters and if those critical matters have changed will tell the audit committee and report on it. I'm not sure where the other costs should be.

I mean essentially, put very crudely, I'm afraid in my language is the new-style UK audit report is not -- I mean the part that has to be written a bit more carefully is basically what the executive report in the audit plan says update that the audit committee get.

So I just don't see the argument why, apart from a bit of cost, of a bit more sort of checks and balance within the firm on this new-style audit report, I don't really see where the costs, where the new costs should be.

I mean if -- you know, they should be focusing on these things, whether or not they're reporting on them. So I just don't buy the cost argument, and I don't think -- it was certainly nothing -- certainly none of the firms put it forward as a major impediment.

MR. DOTY: The wings have been very quiet, both from the staff and the observers.

MR. SCHILDER: Just adding a bit to what Nick said, the consultations he mentioned were of course part of ours as well, and in a way the various consultations and research was all the time about pros and cons, because all the time the question is why are you doing this? Certainly in the beginning, there was more hesitation than now, I think.

To some extent, of course, there is intangible benefit, the failure to use is not something that you can easily quantify. You can't think about costs. We thought like mixed standard usually that should not be too much of extra cost.

But one thing to help this would be the starting point of what you have communicated with the audit committee, because there you have the issues as a gross collection, and also how you have communicated that to them.

So they're deriving something about of that for external users. It could be not that complicated, and actually we're pleased to hear feedback from partners who have done this in practice, and also the results from field testing that we got and said well, the audit partners almost intuitively knew what they had to report about it and how --

There can be, of course, special circumstances, where there are very sensitive issues, difficult issues, which certainly will take more time. But then the argument could be that it's worthwhile to spend that time, because it's just a matter of reality, and again, relevant to users.

MR. DOTY: The dilemma we face coming out of the concept release stage and going into our proposal was that where other information was concerned and the CAMs were being suggested, along with the auditor obligation to evaluate and to discuss the evaluation of other information.

What I actually heard in these meetings was a very strong investor endorsement of where you were, and a suggestion that we were really coming in with less than investors would want and could use, and that investors might want more from us.

On the other hand, we had equally strong voices suggesting that this was going to be a real departure. "A significant departure in practice" was the term that I think you used, Arnold, in terms of getting into evaluation of other information and discussing or revealing what our evaluation was.

To some sitting here, it might seem with these two polar opposites of where we were, that we might have gotten it just about right, that we might be just where we need to be in terms of coming forth with an augmentation of the audit report, and new information.

But given where you are and what you're hearing and what you have described to us today, how would you reply to people who say look, once you cross that line and once there is other information contained in what the auditor says about his evaluation or its evaluation of other information in the audit report, you have really crossed the Rubicon. You've made a change that has a slippery slope implication and you won't stop.

Is this something we have to worry about, in terms of any sip of the cup of other information, is fatal? Leading the witness is something that lawyers have a bad habit of doing, and chairmen are especially prone to it. But my colleagues are going to pay me back later with other panelists.

MR. SCHILDER: Thanks. In a way, I'm in an easy position. I've mentioned in my introduction that we very soon will re-expose our revision of ISA 720, which deals with the other information, and it's a difficult subject.

You can very much simplify it; that's how we start with a standard already, and you have that as well, and that deals with the auditor's responsibilities. There's to be a certain amount of work to be done, and the only thing we would like to add is to make the conclusion of that work explicit to users, whereas nowadays it's implicit. Nobody knows about it.

But we have published and exposed the draft to revise the standard, and we got a lot of critical feedback, in all fairness, because what exactly is the other information that you're talking about? What is the kind of work effort that you're expected to do?

That all has been part of our deliberations before re-exposing. In my now six years as chairman, it's the first time that we re-exposed something. So it just illustrates how complicated that is.

I hope that we now have struck a reasonable balance between on one hand the need for transparency that we see here as well, so making explicit the conclusion of the auditor's work here, without on the other hand making it a complete new assurance engagement or so.

So basically, the construct is the intelligent read by the auditor of the other information, and that's just a matter of reality. You cannot just have the French statement, but you see the whole context, and you have to do that with all your knowledge of the company, and what you have learned during your audit, and then you have to see where there are inconsistencies or maybe misstatements, an item that has to be addressed appropriately by management or you have to make a comment about it.

So that's what we soon will be re-proposing, this basic concept of this intelligent read. I hope that by that we have struck a reasonable middle position.

MR. DOTY: I didn't mean to goad the wings into action.

MR. BAUMANN: I was just waiting for all of you to finish your questions, and take my turn. In our proposal for changes to the audit report here in the United States, and in the responses to it, there's wide support from investors for change.

The audit profession, like in the UK I think generally is largely supportive of change. Maybe some differences on the details, but largely supportive of change to the audit report. Academic research, I think, largely supports the need for change.

The one objection really coming through us is from preparers, who are throwing a lot of reasons up as to why changing the audit report is a bad idea and will have bad consequences. I'm just wondering if any of you can respond to that, but certainly in the UK, since you've already had the experience.

Was there opposition from management about the changes to the audit report, or in the EU when your proposals went out, and in the UK then, what's the reaction been since you got a report from management? So both was there opposition and how is the reaction now?

MR. LAND: There was no opposition to this from preparers. Now let me then -- that sounds great. The truth of the matter is that the preparers, whether to their credit or not, didn't actually choose to take a lot of interest in this standard.

So from memory of the sort of hundreds of responses we got, we only got two from preparers. So I can look you in the eye and say it hasn't been a problem. But I do have to put an auditor's caveat on that.

But reaction, I mean I think post, I can just talk about my four boards, and I appreciate it might be a little -- a little not exactly fair to the preparers, because they probably know or some at least know that I'm, you know, I'm involved in this.

But it hasn't created, in my experience, any problems. That's obviously very limited. I haven't heard of the 30 or 40 reports out there. I wouldn't obviously necessarily hear. But I haven't heard of big issues.

I mean it has -- you know, you can well see it will create some tensions, and on one of my boards, you know, the CEO was a bit sort of uppity about when he saw the audit planning document, and saw that they were worried about a particular area of judgment, which -- you know which was about revenue recognition, which his first reaction, he wasn't crazy about it.

But I think -- I mean that's a good and healthy tension, I think, as long as it's amongst mature people. So no. The short answer is we haven't had any problems with preparers and no problems have come through, and indeed I think the Rolls Royce one, which everybody is instancing, I mean you know, that style audit report in the real world would not have been produced in the way it has without, in effect, the agreement of the company, because it was pretty pioneering. So they were happy to live with it.

MR. BAUMANN: I wonder in the proposals in the EU, in comments that you received, did preparers weigh in on that and what type of -- and the IAASB, what kind of reaction did they have?

MR. GENTNER: As far as I'm aware, and we've had an extensive public consultation, and you know, we've had long negotiations in the European process, where all sorts of parties also contributed, it was not a major issue that preparers came up with concerns.

Obviously, there were some concerns from the audit industry. But I think we found a good solution. So my feeling is that no, this is not -- this is not a key issue, and we believe that the reform will actually help companies by receiving more information, better targeted information, and also in their dealings with investors.

MR. DOTY: Mr. Kroeker, former chief accountant, current FASB member.

MR. KROEKER: Thank you, Chairman Doty. I know you've mentioned it's early days and the number of reports is dozens, not hundreds or thousands yet. But have there been examples where investors have come back and said this is important market-moving information, or information that surprises us?

The one example that's been cited, that's been more forward-leaning, also tends to at least possibly put the company in a favorable light, and whether or not there's been other examples, that might put a company in not such a favorable light, and whether those are the types of opinions you're seeing in the early days.

MR. LAND: I find it very hard to answer that question, and I think if I could suggest perhaps leave that question to the panel tomorrow from the UK. Liz, who is here from a very big investor association, may have a better view.

I honestly couldn't answer that question at this stage. Certainly I'm not aware that anybody's share price has sort of plummeted, but it really does raise the question of when should the audit report appear? I mean at the moment, it appears in the published financial statements annual report. Maybe it should appear when the premier announcement is announced.

MR. DOTY: Any Board members have any other questions?

MR. HANSON: Professor Schilder, I'd like to ask you another question on the other information proposal that you've yet to come out with, and I noted in your statement that you I think said something to the effect that you're trying to better identify what information the auditor essentially looked at, or had the ability to consider against the audit evidence.

I know that that's a concern that I personally have, is investors won't know the information that's in an annual report, what was subject to the auditor doing something to. It might be the most important information that they -- that an investor might consider the auditor might not have done anything with, because it was forward-looking information.

I know we're going to hear -- he stepped out of the room now -- from the esteemed Alan Beller this afternoon about sharp concerns about investors won't know what information was really subject to some procedures by the auditor and what wasn't.

So I was intrigued by your comment that you're trying to identify what it was, and I'm just curious as to where you're heading on how you would do that? I think about in the context of a comfort letter, and those of us who have been involved with it, it's a very extensive process, of actually circling individual sentences and numbers that the auditor did something to, and just kind of --

How cumbersome that is for somebody to actually read and understand, and how it's probably not possible in this context of the audit report? But just thoughts on where you're headed with this.

MR. SCHILDER: In the previous exposure draft, we had wider concept of what possibly could constitute other information, including press release, website information and what have you. What we learned from the consultation and the feedback is that we should narrow that down in a more manageable concept.

So we have brought that back basically to what we call the annual report, recognizing that not in every jurisdiction that is just one booklet or one publication, but it can be comprising more and several. So that's why at least it might be better doable to identify it by starting with the concept of the annual report, but nevertheless pointing to various publications that would be constituting that definition of annual report.

That certainly would include, if you just take the MD&A as an example, forward-looking information. That's why it's also important to explain the work effort, and there we make a distinction between on one hand, the inconsistencies between the financial statements and the other information that of course the auditor has clearly audited that, and has to perform some limited procedures to be sure about no material inconsistencies.

But on the other hand, the intelligent read is more important here. At least you can, as an auditor, read the other information, even with a forward-looking nature, with all your understanding of the company that you have acquired during your audit.

Then if you're dealing with restatement, you would say well, I really can't reconcile that with my understanding or my assessment of this company. At least it would take a further discussion. So it's not an explicit assurance or an additional work to let's say specifically assure all forward-looking information.

But at least you cannot ignore it, and that's why you have to apply this intelligent read.

MR. DOTY: Steve Harris.

MR. HARRIS: Chairman Schilder, could you summarize for us what the key differences are between your key audit matters and our critical audit matters, and why you think yours are better in terms of the investor or the user benefits?

MR. SCHILDER: Well at least we like more the term "key" than "critical." But it is kind of a just little joke. I think in essence, we do think that both of us are aiming at providing investors with the most relevant information coming from the audit, and the PCAOB in-depth concept has defined it in a bit more detail.

We focus on, as I've mentioned, starting with what has been communicated to those charged with governance. You can discuss whether that includes everything. But this is just an example of some detail about how you define it.

But we are currently discussing how we should adjust the language that we have proposed, the exposure that have to do better justice to the comments that we have received, and to make it even more clear. Also, on Lou's earlier point, avoiding to every extent possible boilerplate language, to really focusing on what is of relevance to users.

I think, Steve, that's exactly what you are aiming at as well. So we really look forward to our further mutual discussions on how we are moving forward, and certainly having had our Board meeting in March with on one hand a lot of support; on the other hand, a need to further redefine and going forward to do, I think, some in May or so.

That's a matter for some in-depth discussion. But very much starting from -- well, what many have said to us. There is a lot of similarity, and I'm not aware of a serious difference of opinion in this matter. But I'm always a bit of an optimist.

MR. FERGUSON: I have a question. This grows out of a just a position I made as I listened to the comments here. One was Nick Land's comment, that he thought that in the UK, one of the things that might be happening is that the various forms of reports could be leading to a potential kind of competition among the firms, which might be useful.

Then Jim, Kroeker's comment, that the one he did read, which involved a forward-looking one, appeared to be, you know, to give a very favorable picture of the company.

Is there a risk here that an auditor who begins to write a lot finds this a way of sending a quite favorable message that, you know, these people really did a great job? They were very thoughtful. We had to look at all these areas, but they did a very great job.

There's a way of sending this kind of subtle message to not so much users as other potential clients that, you know, if you hire us, you're really going to get -- we can say some really good things about your report. Is there a risk inherent in this approach, that that's what could happen, particularly if there variability among them?

The short question is discuss the negatives and positives of the variability argument and competition.

MR. LAND: That's a very good question. I don't want to -- I don't want to, as I said earlier today, I don't want to overstate that sort of firms are going to hire a tong who can produce the sort of -- either the most explicit or longest or most granular audit report.

But I mean I do think the firms are very conscious of what everybody -- what their competitors are doing, and they're no doubt weighing that up and balancing it. I suppose, I mean it is a very good question, because I think if you took it to the extreme in the way you've described, I mean I think there is a potential risk there if you took it to that extreme.

I mean my own view is that that won't happen, that the auditor will be -- continue to be responsive to its obligations. I'm readily confident about that, and it was -- we don't have, I mean we do have pending litigation against sources in the UK, but we don't have class actions, thank goodness.

I mean, you know, the back of -- the dagger or the sword of litigation, I mean, is hanging over them. So I don't think we've seen anything, based on one's knowledge, that I would consider to be a sort of reckless or over-optimistic statement.

I mean the Rolls Royce one, I know we keep referring to it, but it is, you know, it is a bit of a sort of mini-landmark in this short period. I mean as Sir David, it did talk about -- a lot of it was about revenue recognition, because it's in the aircraft engine business.

You know, on one it said well, on balance we thought the view the company had taken was sort of marginally optimistic, and on another key financial risk, they thought they were being marginally conservative. I mean it's very early days, but that struck all the readers as sort of a very balanced view of an audit report that was pretty granular.

I think it's something where you obviously have to guard against, but I personally don't see there's a big risk.

MR. DOTY: We're going to first thank Chairman Land, Chairman Schilder and Councilman Gentner for one of the more illuminating panel discussions that you can imagine, given the task at hand. We greatly appreciate -- we're in your debt for what you have brought to this by way of perspective, and I'm sure it's not the last time we will hear from you.

MS. FRANZEL: Do we have time for one last follow-up question?

MR. DOTY: It has to be a very quick hit. You have the last hit.

MS. FRANZEL: Great. I just wanted to follow up on Steve Harris' question, on the differences. We seem to be moving in the same direction, but there seem to be some pretty important differences between the CAMs, the KAMs, you know, and the other approach of the assessed risk of misstatement and disclosure of those.

How important is it, in your minds, for us to try to minimize differences now at this point in the process, or is this something that can be done several years down the road, after several years' worth of experience?

MR. SCHILDER: The answer to that is very straightforward. Everything that we can do to minimize differences now is a response to what many have said to us and I know about to you as well. As I said, I don't think there are important difference in concepts, but for example of course, there's differences in style. We have high level principles based in the application material. You have to have straightforward requirements.

But if you combine that with a detailed analysis, that gives rise to optimism. Nevertheless, we are not there yet, and therefore I think what we can do in the next couple of months to further bring that together, respecting of course your confidentiality requirements, that will be very helpful.

MR. DOTY: We will reconvene at one o'clock. With that encouraging -- that's an encouraging note on which to close. We should not let the perfect be the enemy of the good is what you hear you saying.

Thank you all. We'll reconvene promptly at one here. We have a panel coming on that has a very high yield rate. So please come back quickly.

(Whereupon, the above-entitled matter went off the record at 12:01 p.m. and resumed at 1:01 p.m.)

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

1:01 p.m.

MR. DOTY: Well, it is slightly after 1:00 p.m. PCAOB time. So it's with pleasure that I welcome a truly distinguished panel. We're moving now into academic opinion, legal advisory and firm policy matters.

Ted Mock is the Distinguished Professor of Audit and Assurance at the University of California-Riverside. Prior to joining the University of California-Riverside, Professor Mock served as a professor of Accounting at the University of Southern California, professor of Auditing Research at Maestricht University in the Netherlands, previously, the Arthur Andersen Alumni Professor at the University of Southern California.

In 1983, he helped found the University of Southern California Audit Judgment Symposium, now an international symposium on audit research. His interests lie primarily in the areas of audit judgment, assurance service, evidential reasoning.

Alan Beller, partner, Cleary, Gottlieb, Stein and Hamilton. He served as the Director of the Division of Corporate Finance at the United States Securities and Exchange Commission, and as senior counsel to the Commission, from January 2002 until February 2006.

But the years tell only half the story. Among the accomplishments of this extraordinary tenure and service were the implementation of corporate provisions of the Sarbanes-Oxley Act of 2002, the adoption of corporate governance standards for listed companies, the successful completion of comprehensive securities-altering reforms.

Alan is a frequent commenter and contributor to the PCAOB's thought process, and we are grateful for it.

Douglas Skinner is the Eric Gleacher Distinguished Service Professor of Accounting at the Booth School of Business, University of Chicago. Professor Skinner is a leading expert in corporate disclosure practices, corporate financial reporting, corporation finance with a focus on payout policy.

His research addresses topics such as the causes and capital market effects of managers' corporate disclosure choices; how the legal and regulatory environment affect managers' corporate disclosures; managers' incentives to use their discretion in the financial accounting and reporting process, to manage reported earnings.

Prior to his appointment at the University of Chicago, he was the KPMG Professor of Accounting at the Roth School of Business, University of Michigan, where he had been on the faculty since 1989.

Joseph Ucuzoglu, the national managing partner, Regulatory and Professional Matters at Deloitte in Washington, D.C.  He's a member of the firm's Executive Committee.  In his current role, Joseph Ucuzoglu participates actively in the management of the audit practice, serving on both the board of directors and executive committee of the firm's Audit and Enterprise Risk Services subsidiary, Deloitte and Touche.

Previously, he served as senior advisor to the chief accountant at the United States Securities and Exchange Commission.  In that capacity, he advised the chief accountant on complex auditing and public policy matters, and interacted frequently with other government agencies and Congressional staff.

He serves on the executive committee of USC's SEC Financial Reporting Institute.  So we have a group of truly heavy and thoughtful commentators, and with that, Professor Mock, welcome.  Please continue.  The floor is yours.

MR. MOCK: Okay. I thought I was third. Well Chairman Doty and the Board, thank you for the opportunity today, and you're welcome for bringing California sun to Washington yesterday when I came.

MR. DOTY: We'll grant you that. We'll give you that.

MR. MOCK: Okay. So my comments today are founded on research I conducted myself, and the citations are at the end of the formal comment. I have some PowerPoint here, if I get this to work and you can see my opening slide, with has my information.

My presentation is actually in four areas. There's five points listed there, but a little background, the objective of my comments today, some key findings in the research that I've tried to help synthesize, and then some limitations and conclusions of what I'm going to talk about today basically.

As far as background, and Arnold Schilder mentioned this, I've done research a long time, as you mentioned in your opening comments. But I started in this area most with a study that I helped do, that's sponsored by the AICPA and the IAASB, about ten years.

But more importantly, I've chaired a group, a team that the Triple A audit section put together, at the invitation of the PCAOB, to synthesize research. The team that has continued doing work on this project for a long time is listed there. So we have a team, originally six, but of five of us who put this together.

I'd like to, before I go into my discussion objectives, I'd like to commend and highlight the critical importance of the PCAOB in supporting the work of the academic community, by among other things, formally considering research and I think in most of your activities.

I think this actually is an example of divergence between what the IAASB is doing and you are doing. So that's one step forward, I suppose. Okay. As far as the next section is my primary objective and my comments.

My main goal today is to address today's main topic, which is to consider the need for change in the auditor's report. I was specifically asked to focus on the proposed changes to the auditor's report, based upon published or relevant economic research. So that's the focus of my research.

This objective has been addressed in the team, I'll say our basically, papers and comments that we have put together. Firstly, it is a synthesis report that was submitted to you and eventually published, and actually five other related instruments, including comments to the Board and also to the IAASB.

We organized our research in these three research areas, research questions that we tried to address, and everything we've done is kind of organized along those lines. What specific information do investors and other stakeholders want to be included in the auditor's report, based on research.

A second research question, how do investors and other stakeholders use proposed additional auditor communications in their decision-making, and third, to what extent can the proposed disclosure be expected to close the communication and information gaps.

The third research question was kind of a forecast, because research doesn't often lend much insight on that.

The research framework underlying our analysis is based on communication theory, and basically the expectation gap, looking at that, and particularly looking at it from the standpoint of an information gap and a communication gap. The end of my comment is our framework.

Over the time that we've reviewed research, we've looked at about 130 research studies. In addition to that, our synthesis built upon an earlier study that was done by Church, et al. So it's based upon a lot of research.

Key findings. These are findings based upon published research, and trying to abstract this is a challenge, but this is what I'd like to say. There are three overall findings I would like to highlight.

Number one, users of financial statements do not appear to carefully evaluate the current standard audit report, because it is such a standardized product. Of course, that's been said many times. The reports are basically viewed as being the same.

However, reports that augment the standard audit report with information, such as going concern, uncertainties or internal control weaknesses, do seem to contain additional relevant content.

Number two. Users do want -- do seem to want more information on risk materiality and other information surrounding the specific audit. In particular, information -- users are more interested in information about the audit, like risk and materiality, than information about the audit process. This is what research basically says.

Number three. While significant research exists in many areas, there are many areas where a research gap exists. That is, where there seems to be lack of sufficient research evidence. A lot of things talked about today are in that domain. For example, is there message-mixing? Well, you know, there's no direct research I've seen dealing with that issue.

Oh, okay. Before I go to limitations, I'll make a couple of comments. Well, limitations and conclusions. Similar to a financial statement, one should not draw solely from bottom line. I've given you kind of bottom line summaries here in this formal concept. But you have to consider the details provided in various research that we're looking at, and the comment letters.

The research synthesized has both research methods limitations and sampling limitations, and there's no generally accepted research synthesis methodology. Our group had a real challenge in doing this.

Lastly, as has been mentioned earlier, much of the research -- the topic's been mentioned -- does not explicitly account for litigation risk or cost versus benefits in general.

To conclude with perhaps the most important finding of our review, academic research is fairly consistent across different research methods, time periods and economic settings, and suggesting that an important way to improve the communicative value of the audit reporting model is if it is not boilerplate. Thank you for the time.

MR. DOTY: Thank you.

MR. BELLER: Chairman Doty and members of the Board, I'd like to thank you for -- the Board and the staff for the opportunity to participate in the Board's public hearing regarding the proposal to advance the Auditor's Reporting Model. I'd also like to thank the chairman for that kind introduction.

I would mention that in addition I did, as was I think mentioned this morning, also serve as a member and counsel to the co-chairs of the Treasury ACAP in 2007 and 2008, and I am a member of the board of directors and the audit committee of a public company.

Having said all of that, I'm going  to of course speaking this afternoon only for myself, and not for any of my current or prior affiliations, and my remarks today are a distillation of a and summary of the views I presented in a paper for these hearings, that I think will be published on the PCAOB website after this session.

I'm a strong proponent of changes to the auditor reporting model, that will improve financial reporting or improve the understanding of financial disclosure by investors, other users and markets and, as was also mentioned this morning, the ACAP recommended that the Board undertake an initiative to address the auditor reporting model.

Preparers, auditors, advisors, users and regulators should all be striving for better disclosure and understanding, especially of the material aspects of financial reporting and financial disclosure. More information is not necessarily better. Indeed, where the more overly fact focuses on immaterial items or is confusing in nature, it is not only not an improvement, but it also distracts from the usefulness of the overall disclosure.

In my view, the Board's task was to achieve the better, and not just the more. Today's sessions focus primarily on the proposal that auditors report on critical audit matters or CAMs, and I'll concentrate my remarks on that subject.

I also included some observations on the other information standard in my written presentation, and will address questions on that subject if anyone is interested. I regret that in my view, the CAM standard as proposed would lead to uncertain improvement at best, in either financial reporting or investor understanding.

I have two principle concerns in reaching that conclusion. First, the audit is a means to an end. Procedures that in the case of unqualified opinion at least, provide reasonable assurances that will improve and increase investor confidence in financial statements, coupled with an audit report that improves investors' understanding and enhances that confidence.

But the CAM standard only gets at financial reporting indirectly, and targets material financial disclosure imperfectly. As proposed, the standard will require disclosure in the auditor's report regarding audit difficulties, but may not be material to financial reporting or its understanding.

Second, the proposed standard will necessarily lead to disclosure made, or at least dictated, not by the issuer but by the auditor. The standard is designed either to require auditors to disclose information about issuers, or effectively force issuers to disclose information that they do not consider material, and that need not be disclosed under the current securities law regulatory framework.

This hodgepodge approach runs a risk of confusing rather than informing. In one of the Board's own examples, an auditor reporting on a hypothetical CAM identifies and discusses an issuer's significant deficiency in internal control over financial reporting, that is not a material weakness.

Why is this helpful rather than potentially confusing to investors, where by definition it is less likely than reasonably likely, i.e. remote, that the significant deficiency will result in a material error in the financial statements.

Further, under the disclosure framework, significant deficiencies are not required to be disclosed to investors, but rather to auditors and audit committees, in order to avoid conflating the material and the immaterial.

The Cleary comment letters and my written presentation suggests an alternative approach, because I really would like to see an improvement in the reporting model. To summarize that approach, we recommend that the Board focus on the disclosure of critical accounting policies and estimates, which is directly applicable to and by definition material to the quality of financial reporting and investor understanding of that reporting.

Auditor attention could be applied through a standard regarding critical accounting policies and estimates, and a statement could be included in the audit report to the effect that (a), the correct critical accounting policies and estimates are disclosed and (b), the description of the critical accounting policies and estimates is accurate and complete in all material respects.

This approach directly addresses core material elements of financial reporting, rather than proceeding indirectly to address auditing matters that may or may not be material. It would leave disclosure to issuers, where it belongs, and have auditors report on issuer disclosures.

Auditors and issuers would in fact, I think under this proposal, discuss critical accounting matters and estimates, and there would be more attention and more robust disclosure about those items. Auditors would have to make disclosure if they disagreed with issuers about what the required disclosure was, but otherwise the disclosure would be issuer disclosure. Discussions between auditors and audit committees could be fostered around issuer disclosure, and unquestionably material matters.

On another point, I've also been asked to address the proposed new standards from a legal point of view. Both standards, CAM and other information, carry legal implications and impact legal costs. Legal costs and issues are not in themselves reasons not to adopt new standards.

Indeed, they are acceptable and often necessary consequence, where the resulting changes bring benefits. However, the Board should consider the proposed new standards do raise some significant legal issues that should be on the table.

First, under Section 10(b) of the Exchange Act, and Rule 10(b)(5) thereunder, an auditor can be liable if it makes a statement in its auditor's report included in an annual report of filing that is misleading, where the requisite scienter standard is met.

Both proposed standards would require those affirmative statements. The requirement of the proposed other information standard raises more novel issues here, because the auditor under the proposal must make affirmative statements about its evaluation of that information, where the scope of other information is extremely broad.

As I read the proposal, all information, other than audited financial statements and notes and some supplementary financial information, must be included or incorporated into the reports, and secondly, where the proposed quote-unquote "evaluation procedures" involve a significant volume of evidence obtained by the auditor during the course of its audit.

Under the Supreme Court's decision in Janus, the auditor's affirmative statements could be the subject of a private right of action under 10(b)(5), predicated on any material inaccuracy or incompleteness of those statements. The potential liability would be new, because it does not currently exist on AU 550, where statements by the auditor as to other information are made only to the issuer.

Under the proposed CAM standard, the auditor would similarly be required to make a number of additional affirmative statements, and those statements could similarly give rise to a private right of action.

I readily concede and agree that the affirmative statements made by an auditor under the proposal we have suggested, regarding critical accounting policies and estimates, would also give rise to that potential set of issues, and the real question is whether the current proposal or the other approach would provide greater benefits to evaluate against those legal issues.

A particular litigation concern is raised by the proposed requirements under the CAM standard, that the auditor retain audit documentation with respect to each non-reported matter that would appear to meet the definition of a CAM, but was not reported as a CAM.

While this may be useful to some, including the Board, it also creates and requires an auditor to retain an additional detailed documentary record. This may accomplish little benefit to investors, while providing a potentially discoverable road map in litigation, and should be considered in that light.

One last or a couple of last points or issues under the Securities Act. The proposing release explicitly notes that consistent with existing AU 550, the other information standard would not apply to documents filed with the Commission under the Securities Act, but rather existing standards would govern auditor responsibilities for those filings.

There are, of course, other provisions of the Commission's rules and the Board's standards that apply to Exchange Act filings and not Securities Act filings. Perhaps the most apposite example involves management's evaluation of and auditor's attestation of internal control over financial reporting, which is required in an annual report, but which is not required in a Securities Act registration statement.

But Section 11 of the Securities Act would apply to an Exchange Act filing incorporated by reference into a Securities Act registration statement. This anomaly does not seem to me to be one that should overly-concern the Board in its standard-setting exercise. There is precedent for it.

The proposing release does create and does not address certain implications for incremental auditor liability under Section 11 of the Securities Act. In particular, it's not clear whether the statements regarding CAMs would or should be viewed as statements of an expert under Section 11(e), which would make them subject to Section 11 liability.

It's even less clear whether statements regarding other information, based on a quote-unquote "evaluation" rather than quote-unquote "audit," would or should be viewed as statements of an expert.

In the absence of clear guidance by the Board and particularly by the Commission regarding these new statements about CAMs and particularly other information, Section 11 litigation uncertainty will persist upon the adoption of such standards, and settlement dynamics, which are absolutely key and particularly important in Section 11 cases, will be affected. That's another consideration that the Board should keep in mind.

MR. DOTY: Thank you. Professor Skinner.

MR. SKINNER: Thank you. First of all, I very much appreciate the invitation to contribute to the important discussion about the Board's proposal.

To begin, let me state that I think the Board is to be congratulated for investing significant resources to understand whether the current reporting model, which as the Board observes has been in place without significant modification since the 1940's, needs to be modified, given the extent to which our capital markets and economy have changed since that time.

Further, I think most will agree with the general proposition that expanding the amount of disclosure about the audit process is potentially beneficial to investors. My comparative advantage in these proceedings is perhaps to inform the Board and other interested parties about the academic literature on disclosure, and offer some words of caution about the general thrust of the current proposal, that significantly expands the disclosures required by, as well as the role of auditors.

By way of background, I'm a professor of Accounting at the University of Chicago, and have served as editor of the Journal of Accounting Research since 2006. Prior to that, I served as editor of the Journal of Accounting and Economics for seven years. JAR and JAE are generally considered, along with The Accounting Review to be the top academic accounting journals in the world.

So I mention this because I have extensive knowledge of the accounting literature. My research interests span financial accounting, auditing, disclosure and corporate finance, and I generally take a strong empirically-oriented economic space approach to problems in these areas.

I also have consulting experience in these areas, and have in the past provided input to policy deliberations at both the FASB and the SEC. I may also mention that I started my professional life as an auditor at Coopers and Lybrand in Sydney, so David mentioned this morning the Colonies. Australia, of course, was originally a penal colony, so I'm hoping that after my remarks this afternoon I'm not going to be sent back there.

There's a very large literature in economics, finance and accounting on disclosure, both mandated disclosure; that is required disclosures such as 10(k) filing requirements, and voluntary disclosures, such as managers' decisions to provide earnings guidance.

I'll focus my comments on what economists have to say about mandated disclosure, since that is what we're talking about here. As a general proposition, I think it's fair to say that economists agree that increasing disclosure has benefits.

As the proposal observes, there is much theoretical work that shows generally that increased disclosure of information, assuming that information is in some sense relevant and informative to investors, has benefits in terms of reducing information asymmetries in capital markets, and can result in improvements in market liquidity and pricing, including a lower cost of capital.

However, there are also costs of mandating additional disclosure, both direct costs, such as proprietary and litigation costs, and indirect costs, which we might refer collectively to as unintended consequences.

In the case of the current proposal, I think these costs, which are inherently hard to observe and quantify, could be very significant. Moreover, I have some skepticism about the potential benefits of these disclosures, which are perhaps even more difficult to quantify.

This makes it hard to assess the cost-benefit trade-off involved in making a decision about the proposals. Let me expand on these points, focusing on the benefits first. Professor Mock and his co-authors have prepared a very useful and thorough summary of a particular part of the auditing literature in accounting.

Given Professor Mock's participation here, I will not reiterate the conclusions of that research. However, I will observe that as the authors of these studies acknowledge, much of the evidence offered on the espoused benefits of the new disclosures is based on survey and experimental data, as opposed to empirical archival data.

There is not much we can do about this. It is exceedingly difficult to design studies using real world data, that is, non-experimental or archival data, to assess the costs and benefits of disclosure.

However, in my view, we should be very careful placing too much weight on survey evidence from investors, who say they want more disclosure. Given that there is no cost to them, what else would we expect them to say.

I'm not sure we learned very much about the benefits of disclosure from this type of evidence. The logical extension of this idea, that the world will be better with more disclosure, is sometimes known in economics as the nirvana fallacy.

I would also point out that there is perhaps reason why the audit report in its current form has survived largely unchanged for many decades, not only in the United States but essentially throughout the world. As the economics literature makes clear, auditing generally, including the traditional pass/fail model, plays a central role in validating the information in a firm's general purpose financials.

This role predates regulation that mandated the disclosure of audited financial statements. Audited financial statements have been used for hundreds of years, dating back to at least medieval times in England. This implies that the basic attestation role of auditors, which includes the pass/fail model, serves an important economic function as currently configured.

Thus while surveys may indicate that certain users claim not to use the audit report very much, we should take care in inferring from this that the report, in its current form, is not fulfilling an important economic role, given the very strong survival value of the current model.

I worry that tampering with a model that has survived for so long will have consequences that we cannot easily predict. Let me turn to some of the potential cost disclosures. First, it seems to me that the proposed requirement for auditors to report critical accounting matters or CAM could expand the set of information disclosed about firms beyond what is currently required under the securities laws.

This seems like a very significant change in the whole financial reporting model, because it means that the audit report would potentially become a disclosure mechanism in its own right, beyond what is currently disclosed by issuers in their financial statements and related disclosures.

Thus an important element of the current model that management takes responsibility for preparing financial statements and that auditors then attest to the reliability of that information would change, because now the auditors potentially would actually be disclosing information about the firm directly.

To the extent that the new auditor reporting model expands firm disclosures, it seems likely that proprietary costs come into play. These are the costs to firms of additional disclosures that provide information, that provide important competitive information about the firm's operations and strategies to competitors, suppliers, customers or other entities.

For example, a bank's risk management strategies and procedures are likely to be one source of its competitive advantage.

To the extent that the auditor now provides additional detailed and specific information about the financial instruments the bank uses to implement that strategy, other banks may be able to infer useful information about the bank's risk management program.

Auditor litigation costs are also a concern. There is an extensive academic auditing literature that examines the determinants of audit fees. It is clear from both the economic arguments and empirical data that expected litigation costs are a big driver of audit fees.

By expanding the auditor's role and disclosures in the manner envisioned in these proposals, I think we can confidently predict that the plaintiff's bar will not have to work very hard to expand both the extent to which auditors are held liable for client firm problems, and the magnitude of the associated damages claims.

These are the obvious costs. However, the more pernicious problems engendered by these proposals fall under the general label of what economists call the real effects of disclosure. The idea here is fairly straightforward.

By changing the mandated disclosure regime, the underlying actions of the affected economic agents are not held constant. That is, if agents know ex ante that the information they will have to disclose after the fact ex post has changed, it will change the way they play the game.

The implication here is also straightforward. Once auditors and client firm management and personnel know that the auditors will be reporting additional more detailed information about the auditors as CAMs, it will likely change their incentives going into the audit process, and may even change how managers make operating and financing decisions.

For example, if managers now know that auditors will be reporting detailed information about how they get comfort about certain of the entities' transactions, managers and their personnel may well be less open and forthcoming in providing information to the auditor about these transactions, and may even change the transactions themselves.

This in turn will change how auditors conduct their audits, as they find the need to find alternative audit approaches. Moreover, even if we assume that the actions of the firm and its personnel are held constant, it seems likely that auditors will extend additional effort to either avoid having to disclose a CAM, or to support the required CAM disclosures.

Without much doubt, the actions of firms and auditors will change under the new requirements in ways that are hard to predict, and that are likely to vary across firms. This leads me to a suggestion with which I will conclude.

As a reasonably sophisticated consumer of financial statements for a variety of purposes, one of the major improvements I have seen in financial reporting over the last decade has been the addition to the MD&A of the critical accounting policies discussion.

In the interest of minimizing the extent to which the new audit model expands disclosure, which as I have argued could have a number of potentially costly effects, I wonder if the CAM proposal could not be modified to require the auditors to comment just on the critical accounting policies discussed by management in the MD&A.

Presumably, the auditors are focusing attention and additional work on these already, so that the real effects problem, as well as the expanded disclosure problem I have identified above could be minimized. Thank you.

MR. DOTY: Thank you. Joe Ucuzoglu.

MR. UCUZOGLU: Thank you, Chairman Doty, members of the Board and the staff. You should be commended for the leadership role that you're playing in this important dialogue.

At Deloitte, we have been engaging with a variety of external parties, exploring the ways in which the auditor's report should evolve, to meet the information needs of the capital markets and we're of the perspective that there is a critical need for action.

The profession has been talking about the need to enhance the auditor's report for over a half century, yet every time the subject is raised, a myriad of challenges seem to stand in the way of progress. In the late 1960's, the AICPA's Committee on Auditing Procedures suggested that the prospect of revising the standard form audit report was much like Moses smashing the tablets containing the Lord's Commandments.

This is not an easy task, but we shouldn't need divine intervention to make modest changes to the auditor's report, in response to the information needs of investors. This can be done.

In fact, if one looks back far enough in time, there are examples of tailored audit reports to the stockholders of major U.S. corporations in the early 1900's that make specific reference to areas of the audit that were presumably important in the judgment of the auditor, one could say a primitive form of reporting CAMs.

Somehow during the past 100 years, we've managed to go backwards with respect to the information content in audit reports. Investors are now expressing concern that the standardized model currently in use is not meeting the information needs of the capital markets.

So in our perspective, the status quo is not an option. We need to combine the benefit of an unequivocal pass/fail opinion with the transparency associated with providing some additional color. Frankly, your project is a pivotal moment to reverse the trajectory of the past century away from boilerplate, and towards an era of informative, tailored, transparent communications from auditors to the capital markets.

Enhancing the auditor's report will play an instrumental role in ensuring a vibrant audit profession rooted in quality. We've heard several of the panelists this morning speak of the benefits of enhanced auditor communication, extending beyond the additional information content in the report. I would wholeheartedly echo that sentiment.

The very act of an auditor crafting a tailored communication to external constituencies stands to enhance the connection of the auditor to the user of the audit report, the investing public. Reinforcing the auditor's public interest responsibility and fostering the healthy exercise of independence, objectivity and skepticism, attributes that lie at the foundation of a high quality external audit.

As the proposal moves towards finalization, it is important to be sensitive to the concerns that have been raised by several stakeholders, as to the appropriate source of original information about a company. Management is and should remain the primary voice of a corporation's financial performance.

But the auditor must be the voice of the audit that was performed, and there is much that can and should be shared with investors about the performance of the audit, without infringing on the role of management and the audit committee in the financial reporting process.

Our field testing of the PCAOB's proposal to identify and report on CAMs indicated that with modest refinements, the exercise is relatively intuitive and capable of being exercised. The starting population for potential CAMs under the proposal is quite broad, and it could be narrowed to ensure the auditor is focused on the limited subset of items of greatest importance to investors.

We also did observe the possibility that some environmental forces could drive the reporting of CAMs in the direction of standardization. I would like to believe that the market forces that were discussed earlier would cause auditors to strive for informative crafted communications.

But I do believe it's also necessary for the PCAOB to make clear, in any final standard, that the information content is intended to be customized to the particular facts and circumstances of each engagement.

The focus today and tomorrow is appropriately on the currently proposed changes to the auditor's report. But I believe it's important to also begin exploring more fundamental changes that may be necessary to provide investors with the information they'll need in the future.

When one thinks of the changes in our capital markets in recent years, including technology, the way stocks are created, the size, complexity and geographical scale of corporations, and changes in the investor base itself, you can't help but think that more fundamental changes in the public company reporting model are on the horizon, along with corresponding changes in the performance and reporting of independent audits.

Perhaps auditor assurance on information will be demanded on closer to a real-time basis, and the focus of auditor reporting may shift away from a point in time opinion and towards the integrity of the processes and controls that govern the information that companies disclose.

The type of information that auditors are associated with will also likely need to expand, and the PCAOB's proposal has begun an important dialogue.

As other information outside the financial statements becomes increasingly important to investors, we need to explore the extent to which auditor assurance and related auditor reporting should be provided on market-moving information, such as earnings releases, key performance indicator, non-GAAP information and at some point even forward-looking information.

Now I recognize I've ventured into several areas well beyond the scope of the PCAOB's proposals, and this is not to imply that all of this can or should be accomplished in the context of the current auditor reporting project.

But if we can't get this project done, how are we possibly going to tackle some of the additional challenges that lie ahead? We need to make this successful, to set the profession on a positive trajectory towards an ever-expanding and valuable flow of information from auditors to the investing public. Thank you, Chairman Doty.

MR. DOTY: Well, question time. Mr. Harris?

MR. HARRIS: Well first of all, thank you for that extremely positive statement, in terms of moving this project ahead, and your enlightened vision of the future. I couldn't agree with you more, in terms of some of the other issues that you mentioned, which are not directly related to today's assignment. But I do think that those are issues that the profession's going to have to focus on as well.

You talk about a subset of items of greatest importance to investors, and I know you've done a lot of investor outreach. Could you talk a little about that investor outreach and what, in your opinion, are the subset of items of greatest importance to investors, and then getting back to a point that I think that all of us have raised in one context or another, how do you avoid creeping boilerplate?

MR. UCUZOGLU: With respect to the feedback from the investor community, I'd suggest that there are two broad themes, one of which is you the auditor shouldn't ever forget that we, the investing public, are the customer. You the auditor learn a great deal of information during the conduct of the audit.

Some of that information would likely be valuable, in terms of sort of what you thought was important, how you scoped your audit, what risks are most significant, where you spent your time, what you did in response to those risks.

We, the ultimate customer, ought to have access to some summary of that information, and it's a proposition that's sort of difficult to argue with.

The second major theme would be sort of a concern that the basic financial statements comprise a smaller proportion of the total mix of information that investors are using to make decisions, and I don't think we should lose sight of the fact that the basic financial statements and the auditors reporting on them still forms the building block for everything else.

If those are compromised and there's questions about their veracity, the foundation for everything else is impaired. But the basic financial statements and the reporting on them isn't enough, and that as a result, we need to explore the possibility of reporting on the broader set of information contained outside the financial statements, with the caveat and the concern from the investor community that having the auditors involved with that other set of information shouldn't lead to that disclosure for management becoming boilerplate, the concern that if the auditors are involved, it will drive management's disclosure towards standardization, which would be a bad outcome.

MR. FERGUSON: Yes. Thank you all for coming, and thank you for the very thoughtful papers you have presented to us. They were both interesting reading and very thought-provoking.

I want to ask the panel to -- you know, one of the things that makes this process interesting for us right now is we are doing this while other places in the world have actually moved beyond it and it's being tested. We are seeing how it works -- maybe not exactly the same proposals we have, but proposals that involve the auditor saying much, much more.

And I'd like to have your comments on how we should look at particularly the experience in the UK right now. I realize it's a different culture. I'm reminded of that a little bit in some of the objections that are made in this proposal of the French intellectual who was asked to assess an idea, and he said, (Well, you know, it may work in practice, but does it work in theory?

(Laughter.)

And, you know, the question here, you know, is the UK has an experience that appears to be positive. Investors do not appear to be confused by this individual, this extra information. What do we make of that? How should we take that into account? Anybody? I mean, all of you. All of you. Whoever.

MR. BELLER: I'll take a first crack at that. I guess I have two observations. One, and I have not read anywhere near all, but I have read a couple of the UK reports. I think the guidance that the standard provides is very high level, much more high level than the PCAOB proposal.

I think that gives scope for auditors who are trying to do what Joe suggested, to really write customized disclosure about the most important matters. I dare say those most important matters -- the couple of ones I have read, those most important matters do come down to, in many cases, critical accounting estimates and policies that we talk about in our somewhat different regulatory framework.

So I think the way they have gone at it is one of the explanations for why you've gotten what I think are pretty beneficial results.

The second thing I would say is more cautionary, which is I know how to run Compare Right. Every company in America knows how to run Compare Right. I dare say they know how to do it in the UK as well. And I do worry that Company A will see something that Companies B, C, D, and E and its industry have done, and they have disclosed a little less information or they have disclosed a little more information.

And my unfortunate -- I won't call it a prediction because I'm not -- I don't think it's fair, but my unfortunate concern is that over time -- and we've seen this with risk factors in the United States, and we've seen it with MD&A in the United States. The tendency is towards uniformity and boilerplate and away from customized and original disclosure.

You and I should have this conversation in three years, and we'll see how they did. That's my --

MR. SKINNER: Could I add a couple of things? This will -- I was very interested this morning to hear Mr. Land's comments, and one of the interesting things about what he said, based on the initial experience in the UK, including his own experience, he talked about what I had mentioned, you know, using this language of real effects. He actually mentioned that there was tension between management and the audit team as a result of the new disclosures.

And, you know, to follow on what Alan just said, I think looking at the first year's experience is actually not going to be representative of what we see going forward in the sense that I think going through this process once management will learn some things about what is going to be disclosed that they didn't think about the first time around. And it may be very interesting to see how this disclosure evolves in the next two or three years.

The other thing about the UK model that is different to the proposed model here, of course -- and Mr. Land also talked about that -- was that there was a corresponding change in the Audit Committee model of disclosure that was paired with the auditor model that is not going to occur here.

So in the U.S., under the current proposals, unless something happens at the SEC or the FASB in conjunction with this, there is going to be an expansion of disclosure by the auditors and through the audit report that we have not seen in the UK. And I think that's a pretty significant difference.

MR. DOTY: Ted Mock, you had a light on?

MR. MOCK: I think actually that school is out on many of these issues, and that is one of the difficulties, isn't it? In the synthesis we sent to the board, we identified research gaps basically, and there is lots of them. But we are slowly seeing some things happening, right? I mean, we have some experience in France as to what -- some commentary about auditors, what effects they may or may not have, basically.

As I learned this morning, what, half of the reports in Holland now have some sort of expanded disclosure. So we will slowly get evidence we need, but it takes time. And eventually we will see them published in JAR and JAE I think.

MR. DOTY: Jay Hanson?

MR. HANSON: Well, thank you all for coming, and I want to especially thank our two esteemed professors for all the hard work you do in shaping the young minds that will be sitting at this table years from now giving us their views on the projects or issues of the day, as well as the research that you do.

I think this is a unique opportunity to have two professors with very different views of what their research suggests about the need for additional information in an audit report. With Professor Mock's research and Professor Skinner's research and views -- kind of taking a little different view on that. And I realize that academics, when given the chance, will usually take up the opportunity to critique each other's views and positions.

And so since I've got the two of you sitting here, and you seem to be on kind of different pages, I'd like to hear your perspectives on each other's views and get a little discussion going about how we reconcile your two positions.

MR. MOCK: I should go first because Professor Skinner commented a bit on our study. I'm not sure we disagree so much. I think he said basically that required disclosure has positive effects potentially. I believe you said that basically, and so I think that's kind of confirming of the general results that we see in our research.

It is a tremendous challenge integrating mixed evidence over a bunch of studies. That's for sure. But I'm not sure -- I mean, I would agree with him that the data often we look at in terms of surveys, these kind of things, is not the strongest evidence you would like to have. You'd like to have stronger evidence in different ways.

But I think in general we have the same conclusion. Do you agree with that?

MR. SKINNER: Pretty much. So, I mean, I would make a couple of observations. One thing I think when you're looking at the benefits and costs of disclosure, and, you know, not just in the auditing context or even in the financial reporting context, but generally there is a huge literature in economics on disclosure and regulation.

You know, it's in the law literature, in the economics literature, and so, you know, I spoke to that literature as opposed to specifically the accounting literature. And I think one of the big problems is, it is very hard to get a -- to measure costs and benefits. It is basically impossible. And so, you know, one of the things we sort of know theoretically -- and, you know, it's pretty much got to be the case that if you put more disclosure out there and increase transparency, it can't be a bad thing. So there are clearly benefits. It is just very hard to actually quantify those benefits.

So to give you an example, there is a tremendous amount of research in the last 10áyears or so on the benefits of IFRS adoption. And if you look around the world -- and I couldn't tell you how many studies there has been on this and how much discussion there has been about it, cost of capital goes down with improved IFRS reporting. But the benefits are pretty small.

So, you know, there is going to be benefits in terms of cost of capital, how large are those benefits in the U.S. You know, that may be small. But the problem is, if you ask investors, you get the problem that I mentioned briefly which is you survey them, and, you know, what -- if you ask someone, "Do you want more information?" they are pretty much going to say, "Well, yeah, I'd like more information." So I'm not sure how much you learn about that.

And so then you've got to counterweight that against the cost. And like I said, the real effects' costs -- I don't know that we really understand those very well, and that's why I'm a little cautious about this proposal because, you know, I think we are even seeing a little bit of evidence from the UK about, you know, some of the dynamics between management and auditors changing. We don't really know much about that, so --

MR. DOTY: Jeanette Franzel?

MS. FRANZEL: Thanks to the panel for your insightful comments and views and research. I found this panel very helpful and interesting.

Alan, I want to go back to the principles that you set forth. I find them very intriguing, and I'd be interested in knowing more about how you developed these principles. And then I'd be interested in hearing the other panelists' views on these principles and where we might be out of line perhaps, or where you see a lot of additional work that we would need to do under some of these.

And then, finally, I'm thinking maybe we need an eighth principle to deal with the long-term view as we are looking at potential changes. So your comments on those principles would be appreciated from all the panel members. But, Alan, if you wouldn't mind starting off by letting us know, how did you develop these principles, or where did they come from?

MR. BELLER: Oh sorry. This is the audit as a means to an end principle or --

MS. FRANZEL: This is on page 5 of the written statement that I've gotten from you.

MR. BELLER: Ah, okay. Hang on. Let me -- I won't say they come -- I think -- I can't tell you that I've surveyed the academic literature and derived them. There are no sources for these. These are -- if you start with my kind of first principle, which is what we should be striving to do here, including with the changes to the auditor reporting model, is to enhance audit quality and to enhance investor understanding of what financial -- of what is being said in financial reporting.

These are for me the things that kind of fall out of that -- that fall out of that concept. And certainly the first five are -- or the first six are, but the second -- the seventh is really just cost -- benefits should exceed cost -- that's a truism, a difficult-to-apply truism, as Professor Skinner has pointed out, but a truism nonetheless.

I think the other six really are subsets of the -- we should be trying to improve financial reporting. We should be trying to enhance investor understanding. You know, to repeat myself, my concern about the CAM proposal is I think there is a more direct way to get to a better place. And I think -- I don't think that issuers should be the source of disclosure and auditors should be the source of attestation is a -- is something written on a stone tablet somewhere. I think if you depart from that principle, you risk confusion. And that is the reason I view that as a kind of guiding principle. I don't think it has any -- it doesn't have any value standing there by itself. It is because of the consequences of it that I am concerned about it.

MR. DOTY: One of the problems -- Jeanette, am I clear? One of the problems I have --

MS. FRANZEL: I wanted to see if any of the other panelists wanted to comment as well on the principles.

MR. DOTY: Joe, do you want to hit it first?

MR. UCUZOGLU: Sure. Many have observed that one of the overriding principles here ought to be that management is the source of original information. And often the conversation ends there, and we don't go the next layer down with respect to original information about what. If it's original information about the company's accounting policies, and original information about the company's controls, management ought to be the source of that original information.

But if it's the original information about the audit that was performed, the auditor may well appropriately be the source of that original information. And so the auditor shouldn't be introducing wholly new topics that don't fit within the various categories of what management has already disclosed.

But there is clearly an interest from investors to understand how the auditor went about approaching the task, scoping the audit, where they focused, what kept them up at night. And if that's the kind of original information we are talking about, it ought to come from the auditor.

The one other area that I would touch on -- and it has been hinted at throughout the morning -- is this subject of materiality. And it is not currently part of the proposal that was put out. But we're of the view that there would be a benefit along the lines of helping users understand how the auditor went about approaching the audit for the auditor to disclose materiality.

MR. DOTY: Brian, your flag is up.

MR. CROTEAU: Thank you very much. Joe, I think you might have just started to answer the question I was going to ask you, but I just wanted to be clear. When you described the CAMs maybe need relatively minor modification relative to the way they have been teed up in the proposal, I just wanted to be sure I understood, when you're talking about things like a going -- an ongoing concern or a material weakness or a disclosure that is otherwise not required, you would in some way scope those out or rewrite the definition of CAM to exclude those, is what I think I understand you to be saying. But I just wanted to be sure of that, because if that's the case I think some might think of that as more than a minor change, but I just want to be sure we're clear.

MR. UCUZOGLU: So if we took them one by one, with respect to the possibility of the auditor touching upon going concern, I actually think the likelihood of the auditor venturing into territory that management hasn't covered would be mitigated if the FASB -- when it moves forward with its work on going concern.

With respect to the possibility of the auditor touching upon a control weakness that was less severe than a material weakness, that would be the auditor venturing into an area of management's controls that the securities laws currently don't require management to disclose. And so one can have a debate about whether that is information that should or shouldn't be in the public domain, but that debate ought to take place in the confines of disclosure requirements imposed upon issuers. So I would scope out a requirement for the auditor to mention a controlled deficiency less severe than a material weakness.

MR. DOTY: Marty, your flag is up.

MR. BAUMANN: Thank you. I have a question for Professor Mock and Joe Ucuzoglu. Both Alan Beller and Professor Skinner have suggested a solution to improving the auditor reporting model via the auditor reporting on critical accounting estimates.

So there's a number of issues there potentially, aside from maybe suitable objective criteria upon which auditors could report on CAE.

I guess the question I have for you, Professor Mock, and for you, Joe, based upon your outreach and your research, which included that users want more information from the auditor on risk, materiality, and other information surrounding the audit, do you think that would meet investors' needs in any way, the additional reporting on critical accounting methods? And that is for Joe and Professor Mock.

MR. MOCK: I think the research would support that, but there is nothing -- there are very few specific studies that look at those particular issues. So the general conclusion was, yes, it would probably be viewed positively. Now whether it would be -- affect decisions, affect behavior, these kind of things are basically unanswered.

MR. UCUZOGLU: I think there are two broad objectives that the PCAOB proposals are trying to accomplish, one of which is, you know, captured in the form of reporting critical audit matters, giving users a better understanding of where the auditor assessed there to be risk; and, second, to have the auditor say something about what they did with respect to other information.

I would actually view the auditor making a statement about the propriety of management's disclosures in the area of critical accounting policies and estimates as being perhaps more responsive and relevant to the second of those objectives -- the auditor reporting on other information -- than the first.

And there is clearly some level of crossover. But as we work through how to come up with a subset of information outside the financial statements that is both within the competence of the auditor and has a close nexus to the audit that was performed, that critical accounting policy disclosure is a rich source that potentially lends itself to some direct targeted form of auditor reporting.

MR. DOTY: One of the problems which I have as an aging securities lawyer holding a job for which I am not qualified and get no -- is to try to get below, to get beneath the objections that we hear in these meetings to determine how serious do they go. I mean, we have heard the words pernicious and undermines and -- there have been a lot of the adjectival -- the usual adjectival advocacy that comes with strong opinions from strong minds.

So mindful of that, I am trying to be sure that I understand what people whom I consider to be my mentors mean. And I start with Alan Beller as one whom I consider to be my mentor.

And going back to your advice to the co-chairmen of ACAP, Alan, I do not understand your position to be that we can't have -- that we, at our peril, disclose anything new.

Going to Joe Ucuzoglu's comments, and picking up on your concern about risk factors and MD&A, there is nothing statutorily that keeps the auditor from saying more than they now say, transgressing this line of what is said by management and commented on by manager, and it makes me wonder, where would we be if we had not begun with risk factors and MD&A.

There has been some boilerplate that has vexed all of us, but I don't think you're saying that your proposal or your alternative formulation keeps the auditor out entirely of the area of saying something new.

MR. BELLER: I guess a couple of thoughts. One, I think if the auditor and the -- with respect to the specific proposal about critical accounting policies and estimates, I think if the auditor and the Audit Committee have the kind of conversation that I am used to having with an auditor as a member of an Audit Committee what you would ideally get is better critical accounting policy and estimate disclosure by preparers and some sort of affirmative statement by auditors as to the -- it's all there. They have identified all of them, and they have described them correctly.

Just to be clear with what Joe said, I don't think of this as just another -- as part of the other information standard. I think it is -- I think auditors do enough work around critical accounting policies and estimates that it is fair to ask auditors to -- I'm not the standard setter, but you can -- you can develop a standard that would support an affirmative statement. Maybe it's a statement of negative assurance, but some kind of affirmative statement around critical accounting policies and estimates.

So that would not lead to -- unless the issuer said, (No, I'm not going to do that, and the auditor says, (I have to do that, then it goes in the audit report.

With respect to CAMs, beyond that, I guess two thoughts for you. One, I really do think if you get the critical accounting policies and estimates right -- and I'm not sure they're right in the current disclosure regime. I don't think -- too much of it looks like Footnote 1 or Note 1 to the financial statements as opposed to what it should be.

But the answer to the question, what keeps the auditor awake at night ought to be in that list of critical accounting policies and estimates. It shouldn't be, "Oh, my goodness, I had to spend 60 more hours than I expected I would auditing the cash reconciliation of the intercompany accounts." And I'm honestly not sure that that is not a CAM under your current definition. So that's one thought.

Our comment letters have said this, my written presentation said it, the oral one did not -- if you're going to go the way of the auditor talking about the audit, one, Joe and I agree -- and I use the significant deficiency example just because it's so glaring to me, but it's not obviously the only issue. There shouldn't be auditor disclosure about issuer matters.

Secondly, there has to be -- in my view, there should be a much more powerful materiality filter than there is in the proposal to get to the stuff that really is important. And the final point I would make because, I'm sorry, but the UK idea of materiality is $500ámillion or 500 million pounds.

I understand that that is the way auditors begin their analysis, but I'll also tell you when I sat at Corpfin -- and I'm sure the SEC folks here today would agree -- the SEC is never and should never sign off on a quantitative materiality standard. You go down a very slippery slope if you start talking about, well, materiality for this company is $300ámillion, because SAB-99 tells us correctly that that's not the way to think about it.

MR. DOTY: Mr. Kroeker? Sir?

MR. KROEKER: Thank you. I had a followup, Alan, and Professor Skinner perhaps as well, on the critical accounting policies and estimates. It occurs to me that is certainly one area where there is a big -- a potential for overlap with what we do at the FASB.

And to be clear, the first piece of this -- I'm speaking only on my own behalf. I'm not representing the Board in this view. But it does intrigue me as to whether that means we ought to be thinking about perhaps folding critical accounting policies and estimates into a financial statement footnote requirement, which would then, by that very nature, require auditor direct association. They already have certainly association with those in the context of you need to know what those are in order to do your audit. But if you pulled that into direct obligations that we impose through GAAP standards, would that -- I guess what would be the pros and the cons of that? Would that address the auditor association?

And also perhaps might address, Alan, your issue of it looks today like Footnote 1, and maybe we could get rid of redundancy and focus those on what they are supposed to be focusing on.

MR. SKINNER: Yes. I mean, I would agree. I think that would be very helpful because my impression, similar to Alan's, is that that initial footnote, as it currently stands, is not very helpful. And I think the point I was generally trying to make was that having some form of consistency about what the issuer's disclosure requirements are, including the accounting standards and what the auditor was reporting on, having those things meshed together I think is pretty important. And, I mean, the UK example, we are seeing that in a different form, but we are seeing that same thing.

The thing that concerns me a little bit about the U.S. proposal right now is that the auditors, you know, in some situations I think would go beyond what the issuer is currently required to disclose, whether it's through the FASB or the SEC regulations. And that is -- we just don't know what that is going to do.

MR. DOTY: I have one more question, but I want to be sure my colleagues have a chance. Jay, do you have --

MR. HANSON: Yes, I've got one for Alan and one for Joe. So, Alan, you were heavily associated with ACAP, sat there during all of the discussions. And I thought it was interesting this morning on the panel, the opening panel, that most of the members here supported what we're doing relative to CAMs and the proposal, and, obviously, several wanted to go further than what we've done. And yet you're kind of in a different space than they are about this, and just your thoughts about not --

I know you can't speak for other ACAP members, but just your thoughts about maybe why you're in a different place than some of the others are.

And before you answer, I'll just give Joe a question to think about, which is if you can just talk a little bit more about the field testing that you've done and maybe some of the discussions you have had with management and audit committees about the proposal, because we have more than 200 comment letters from preparers saying we don't like this, and you've probably had discussions with about 25 percent of those people that sent us comment letters, and just your thoughts and discussions that you had with the preparers about your views versus their views being against it.

So I'll turn to Alan.

MR. BELLER: I heard the back end of that panel. So I think perhaps the principal reason I'm coming out at a -- and I'm not sure it's a hugely different place, because some of what Jeff Mahoney said sounds a little bit like what I was saying in terms of focusing on the critical stuff and the policies and estimates and not into the weeds of the audit.

I challenge the notion. I guess I have principally two answers for you. One, I challenge the notion that the details of the audit process are what -- and, look, I'm not going to say investors shouldn't have what they think they want, because they're the investors and -- but the details of the audit process just strike me as much less important in terms of both of my objectives of enhancing understanding and making the audit better than some of the things I have been talking about.

The second reason is I think just your experience -- my experiences formed me. I spent a lot of time with the preparer community. I spent a lot of time with audit committees. And I -- you know, I can't deny the fact that I come with a little bit of that perspective. And I think that probably somewhat shapes my views.

I honestly have not spoken to -- and I have talked to a fair number of preparers. I'd love to hear what Joe is going to say, because I haven't talked to a single preparer who is really enthusiastic about this. I am more enthusiastic about it than they are.

MR. DOTY: Lewis?

MR. UCUZOGLU: Well, you have found more preparers who are enthusiastic about this than I have. You had asked, Jay, about some of our experiences during the field testing process. I would say that the number one concern that has been articulated really relates to this possibility of the auditor disclosing original information about the company's financial accounting and controls.

And the subset of that broader set of concerns that is most often raised is this issue of the auditor disclosing a significant deficiency that management wasn't otherwise required to disclose. I suspect if the proposal were modified in such a way to alleviate that outcome that it would take a lot of noise out of the system. There have also been concerns raised about issues such as timing and the crunch to get the report out, concerns around or the effect on the dynamic in the board room with respect to auditor -- Audit Committee communications.

But, frankly, one can come up with a long list of the risks of doing something and moving forward. What I'm equally focused on is the risk of not doing something. And I was struck by sort of one particular piece of Professor Mock's research; 91 percent of users of audit reports don't read it.

So if you're sitting in my shoes, and 91 percent of your customers don't read your basic product, what is the risk to the viability and relevance of the profession of not evolving to meet the information needs of investors? And that ought to be every bit as much front in mind as the risks which I believe are manageable of crafting the proposal in such a way that it can be moved forward.

MR. DOTY: Lewis?

MR. FERGUSON: I guess the question I have grows out of some of the discussion here, and particularly the assumption that there seems to be that the proposal that Alan had and Professor Skinner had that instead of our proposal on CAMs that what the auditor do -- should do is really comment on whether the critical accounting policies are the right ones and whether the information about them is correctly stated.

It seems to me in many ways they are quite different approaches in certain cases. They wouldn't necessarily always be, and that's what I want to get to. But they are different approaches in the sense that we are asking the auditor to speak originally, but not about -- we are just asking the auditor to speak originally about what the auditor did, as Joe said. What did he do in the audit? And what were the critical matters?

And those may or may not intersect with the critical accounting policies. And it seems to me that we have at least come -- or at least I have come to believe, in listening to investors, that investors would like to hear about what the auditor did.

I mean, what I thought was interesting about the discussion about Footnote 1 is it strikes me that if the company is in fact adequately disclosing the critical accounting policies, in fact the auditor may do nothing but look at critical accounting policies. I mean, is that a fair statement? Does that reconcile things or not? Or are we in fact talking about two really quite different approaches here?

MR. BELLER: I think we are talking about two different approaches. I'm not sure they are completely different. I think they are related. And it goes back to the question that we sometimes use to frame what we are trying to get to here, which is, what keeps the auditor awake at night?

And as a lawyer who thinks about financial reporting and financial statements and financial disclosure, and talks a fair amount to auditors, I think what keeps auditors awake at night is principally, I blew the audit and the numbers are wrong.

And, you know, the individual items of that question really should be -- and if they're not, issuers and auditors are not doing their jobs currently -- should be what is listed in critical accounting policies and estimates. Those are the things that are the likely items that will lead to a blown audit.

And if I'm an investor, that is what I really want to know the most. I take the point that investors want to know how auditors conduct the audit and what they scoped out, and that is a different point. But it is not a completely unrelated point to my vision of what keeps auditors awake at night. And I think you've got to kind of think about the two of them together.

MR. DOTY: Joe? Steve? Is there another

comment? Sorry. Sorry, Doug.

MR. SKINNER: I just had one simple observation. Having read a number of the examples we now have from the UK, a lot of them actually do look quite similar to the critical accounting policies. I mean, if you look at the -- I've read the HSBC audit report that came out a few weeks ago, the Rolls Royce one. Some of the things are very similar, and the informative part is of course what the auditors did about this.

So I think there could be a fair bit of overlap between potential CAMs and what we are seeing in the UK.

MR. DOTY: Steve?

MR. HARRIS: I think I take the Sir Tweedie view that was expressed this morning about original information, I think, Alan, which is somewhat at odds with yours, and in terms of keeping the auditor awake at night, and more in lines of what, Joe, you were articulating. And nobody did more work on Sarbanes-Oxley and promoting the rules and regulations in a timely fashion or a more brilliant job than you did.

But I read Section 101 as giving the PCAOB considerable authority in this area and considerable liberal authority in terms of information provided by the auditor to the user, or in this case the investor. I mean, 101 says -- which defines the mission (to protect the interests of investors in the preparation of informative audit reports.

And so what informative audit reports? I think what I'm hearing from users or investors is it goes a little bit beyond enhancing investor understanding of financial reporting. So I think there is a disconnect, and I think that to the extent that we can either bridge that disconnect, I think that it's important that we continue to focus on it, because I think once again there is the expectation gap in terms of what is expected from the audit report.

And then I'd just ask the question, in terms of your analysis and your testimony, which once again I thought was typically excellent, you focus a lot on the Treadway Report. But I'm wondering, what is your original statutory authority with respect to supporting your view about the auditor not providing original information about the company, putting aside whether we should or we shouldn't? Is there any statutory authority along those lines, or is it just -- is it the --

MR. BELLER: I don't think -- I don't think this is -- let me be absolutely clear. I don't think this is a question of authority. I think 101 gives you the authority to make and adopt the proposal that you've made. I think the question is whether there is a better idea, but it's not -- do not misread me as saying you don't have the authority to do it. I don't think that's an issue. There may be others who disagree with me, but I don't think that's an issue.

MR. HARRIS: And then, how do you both -- we have asked this question of all the witnesses. How do you avoid the creeping boilerplate? And what do you put in the audit report? And what do you put in an appendix?

MR. UCUZOGLU: I will start, Steve. You know, this idea of an appendix has been raised at various times. And it is at least worthwhile to consider whether there is some important baseline information that doesn't change over time from year to year, and that folks ought to have access to sort of go back and refresh the basic confines of an audit, but that essentially clutters up the report and has the potential to obscure the really important stuff that does change from year to year.

And so I wouldn't necessarily be averse to at least exploring the idea of some basic information about sort of, what is an audit, in an easily retrievable form or linked to a report. It is worth exploring.

With respect to the issue of boilerplate, there are a host of reasons that we are all well aware of as to why pressures might exist to move in that direction. But I actually believe that the most powerful tool that you have within your disposal is to make clear in the standard that some form of standardized, you know, I pulled this off the shelf for this industry -- you know, while it might serve as a guidepost in terms of you ought to think about these particular matters, and here is some of the types of information that might be relevant, that at the end of the day it ought to be a tailored communication and that you mandate that through the standard, which would, again, sort of put the auditor in a position of meeting the professional standard that we are required to tailor something specific to the circumstances of the engagement.

MR. DOTY: Jeanette, you have a parting shot coming.

MS. FRANZEL: I'm struck a little bit by the hints of cynicism among the panel that the various players in the system will take this requirement and do the wrong thing with it. You know, they will quickly turn it into boilerplate. You know, auditors will stop communicating with audit committees, and management and auditor communications will be chilled.

And so I want to explore a little bit, because I think, Doug, you raised the issue about management and auditor communications and how that could deteriorate potentially with this type of a requirement. Alan, I think you raised the same concern. And, Joe, you thought that this is a manageable risk, so I'd like to hear all of your comments on that issue.

MR. SKINNER: Yes. I mean, I was just raising the general economic principle, which I think is pretty well established that whenever you change the disclosure regime, the mandated disclosure regime, whoever is subject to that disclosure are going to change their actions in some fashion. And I think, you know, it is likely this will happen.

Now, some people talked this morning about this happening in a positive way, that the auditors and the management had a more energetic discussion. So it may be a positive change rather than a negative change.

But, I mean, I don't think there is any doubt that, you know, some of -- the proposal, when you read it, says at some places things like, (Well, what the auditors are doing right now won't change. All we're doing is we are making that information available.

I think that is not the case. I think as soon as you disclose something you then are going to change economic behavior. And I think what I don't know and what is very hard to predict is how exactly that will change.

MR. DOTY: It has been a terrific panel. Ah, 50 seconds, Alan.

MR. BELLER: Sorry?

MR. DOTY: Fifty seconds.

MR. BELLER: Okay. Jeanette, the cynicism, to the extent you are detecting it, comes out of thirty-plus years of experience. And it's not unique to your proposal. The MD&A suffers from this problem. Note 1 suffers from this problem. Critical accounting policies and estimates suffer from this problem.

One thought I have is I think -- I mean, when I was at Corpfin, we -- comment letters, stop writing boilerplate. It's a long, slow struggle. One thing, aspirationally, I would suggest, not just what Joe was talking about but all three agencies take an initiative to try to encourage preparers, auditors, to do a better job of that kind of -- of that kind of disclosure.

On the cynicism about audit committees -- the red light is on, so I'm not going to say anything.

MR. DOTY: Eternal vigilance.

This has been an extraordinary panel. You all have made a great contribution to the dialogue. Thank you.

I am going to introduce the new panelists as you all vacate and as they come to the rostrum. We are on time and we are going to stay on time, but thank you all. This has been wonderful.

This panel -- we have -- we are now going to focus on -- this was a panel that showed the range of perspectives on this proposal. We are now going to talk about critical audit matters related to the audits of large companies, and we have an extraordinary panel.

Ann Cavanaugh has been a Managing Director and a global head of accounting policy at BlackRock since December 2011. She is a member of BlackRock's New Products Review Committee, which analyzes and approves new products offered to clients, and their Global Valuation Committee.

She is involved in the firm's project to assess IFRS implementation and is one of 35 women selected to participate in BlackRock's inaugural Global Women's Leadership Program. She served as the Director of Accounting Policy at BlackRock from July 2008 until December 2011. She previously served as the Director of Accounting Policy at Merrill Lynch from October '85 -- '95 until July 2008.

Wallace Cooney is Vice President of Finance and Chief Accounting Officer of Graham Holdings Company, where he is responsible for accounting, internal and external financial reporting, consolidated budgeting and forecasting and income taxes.

Previously, he was Director of Consolidation

Accounting and Financial Reporting at Gannet, where he directed internal and external financial reporting, and before joining Gannet he was an auditor at PriceWaterhouse.

He serves on the Committee on Corporate Reporting of Financial Executives International, a current member of our standing advisory group. And it is always good to see Wallace here.

Kevin Reilly, America's Vice Chair, Professional Practice and Risk Management, Ernst & Young. He is responsible for the national office accounting, auditing, and U.S. Securities and Exchange Commission reporting functions. He oversees the quality and the risk management activities of the firm's assurance practice. He has been with the firm for more than 30 years during which he served as a coordinating partner for major clients and the media and entertainment sector and for financial services, private equity industries.

He previously served on FASB's Financial Accounting Standards Advisory Council, a current member of the PCAOB's standing advisory group.

Aulana Peters, a former partner of the law firm of Gibson, Dunn & Crutcher from '84 to '88, a Commissioner of the SEC from 2001 to 2002. She was a member of the Public Oversight Board of the AICPA. She has also served as a member of the FASB's Steering Committee for its financial reporting project and is a member of the Public Oversight Board's Panel on Audit Effectiveness.

She serves also on the Comptroller General's Accountability Advisory Council and the Board of Trustees of the Mayo Clinic, a director of Northrop Grumman, 3M, and Deere & Company. And she also served on the board of Merrill Lynch during the past five years.

A panel extraordinarily well qualified to talk about this in terms of the impact on major companies.

Ann, would you please proceed? Thank you.

MS. CAVANAUGH: So thank you for the opportunity to be here today and share BlackRock's views regarding the proposed changes to the auditor's reporting model.

For most of you -- I'm going to assume they already know -- BlackRock is a global investment manager, overseeing approximately $4.3 trillion of assets under management at year-end 2013. BlackRock, together with its subsidiaries, manage approximately 3,400 investment vehicles, including registered investment companies, hedge funds, exchange traded funds, collective trusts, as well as separate accounts.

As an investment manager, we are in the unique position to provide commentary on the proposal from several different perspectives. One, that of a corporate preparer; two, that of an investment fund preparer; and, three, as a user. For purposes of my remarks today, my response primarily will reflect those of our research analysts as users of both financial statements and auditor opinions.

So overall we commend the PCAOB for undertaking a project to enhance auditor communications and provide information useful to users of financial statements. Overall, we support the concept of communicating critical audit matters and believe that much of the framework will provide useful information.

As users of financial statements, our analysts have expressed that they find value in identifying critical audit matters, particularly matters resulting from changes in principles or in areas that involve significant judgments, which therefore may require further analysis and discussion with management in order to be properly understood and reflected in their analyst models.

The additional information provided will be particularly useful to our analysts to the extent that it provides a better understanding of financial risks, including future cash flows of a company.

We are concerned, however, that some investors may misinterpret the communication of a critical audit matter as indicative of an issue with respect to the quality of financial statements. And, as a result, we would suggest additional language be added to the auditor's report to explain that critical audit matters are not necessarily indicative of a financial statement deficiency.

We wish to emphasize that certain entities, such as 1940 Act investment companies, have inherently less complex business models than traditional operating companies, and, therefore, may not warrant disclosure of critical audit matters.

Because mutual funds assets are primarily invested in securities, it is likely that the only fair valuation of investments would be deemed a critical audit matter. Given the extensive disclosures that are already required under the FASB's Accounting Standards Codification 820, we recommend clarifying that routine audit procedures, such as testing Levelá1 and Level 2 fair valuation inputs would not be deemed critical audit matters, absent significant judgments therewith.

Accordingly, we would suggest there should be a rebuttable presumption that the auditor's report on most investment companies state that there are no critical audit matters to communicate.

From a preparer's perspective, we do believe there will be additional time and expense associated with interacting with and providing information to auditors in connection with the required assessments and reporting of critical audit matters and their documentation of such matters.

We do not believe that the auditor should be required to document why all other possible critical audit matters were not included as critical audit matters in the auditor's report.

We continue to recommend that the description of critical audit matters in the auditor's report exclude audit procedures performed or an indication of the resolution. In order for the auditor to convey the context around such matters, it may be necessary to include expansive details that could overwhelm the auditor's report.

Additionally, inclusion of such information may lead a user to believe that the auditor is expressing a piecemeal opinion on individual matters, and any given -- and any audit procedures enumerated may be taken out of context or misunderstood, given their necessarily abbreviated descriptions.

Furthermore, we are concerned it may be difficult to succinctly convey the nature of an audit procedure in a manner that qualifies -- I'm sorry, in a manner that provides users with an understanding of the full scope of these procedures and the quantitative and qualitative factors that went into reaching their decision.

We recommend that the Board clarify that highlighting audit procedures should be infrequent. However, if included, only those most significant procedures should be identified and then only when it is important to understanding why the matter was identified as a critical audit matter.

With regard to the auditor's responsibilities for other information, BlackRock supports including a statement clarifying the auditor's responsibility for other information and documents containing financial statements. We do not, however, support changing the auditor's responsibility for other information to evaluate such information versus the current requirement to consider the information.

We believe that the scope of the audit procedures involved in evaluating the material inconsistency and material misstatement of fact criteria should be related solely to financial information included in the filing, such as MD&A and exhibits, and should not extend to documents incorporated by reference, some of which may have been superseded, and should not extend to other non-financial information.

Such procedures are not routinely performed today on documents incorporated by reference, contrary to the statements that were included in the proposal which states that the Board believes, in practice, some auditors currently perform procedures related to other information similar to procedures in the proposed other information standard.

However, if procedures are applied to other non-financial information, these criteria may require significant judgments given the complexity of many corporate agreements. We do not believe that the costs associated with such procedures, including preparation of related audit documentation, would justify the benefit received.

Many analysts and users of financial statements already assume that MD&A and exhibits are read by the auditors for consistency with the financial statements. And, therefore, we believe that reporting on those procedures performed would clarify the auditor's role and responsibility.

In closing, we support the Board's efforts for increased transparency and providing additional useful information to users of financial statements. As users of financial statements and auditors' reports, our analysts have stated that succinct disclosure of critical audit matters in the report is a step forward toward accomplishing that goal.

We encourage the PCAOB to work together with the IAASB to standardize, to the extent possible, the form and content of the auditor's reports in order to increase comparability and ease of use for users who may be readers of reports subject to both sets of standards.

Thank you for your time and attention to this matter.

MR. DOTY: Thank you.

Wallace Cooney?

MR. COONEY: Good afternoon. Thank you for hosting the public meeting and inviting me to participate on the panel. This project has been underway for many years now, and I commend the Board for all the outreach that has been undertaken during this time. The Board has shown great interest in hearing from all interested parties on this topic over a long period of time.

Management has a very distinct role, so I will offer my observations on the proposed reporting of CAMs from a financial statement preparer perspective. I believe that my observations are shared by many in the preparer community.

On several occasions, the Board has pointed out that the auditor's report has changed very little since the forties. Just from a personal standpoint, I don't really see it that way, since the opinion was expanded in 2004 to include a report on the internal control over financial reporting. And from a preparer's standpoint, that was a huge change, a major overhaul, that fundamentally expanded and changed the financial reporting process and the audit process. At many companies, audit fees doubled or tripled as a result of this new requirement.

My hope is that the Board will consider the implementation problems with ASá2 as they deliberate on the best approach for this project.

Another point I'd like to make is from a preparer perspective, receiving a clean opinion is a major accomplishment each and every year. A lot of effort is undertaken by management and auditors. It is substantial and costly from the more routine and material components to highly subjective, judgmental, and complex areas.

A clean opinion comes at the end of a very comprehensive and robust audit process and only once all important matters are resolved and many, many questions are answered and lots of dialogue and supporting documentation and discussion. And at the end of the day, the auditors need to be fully satisfied in terms of resolving all of those issues. So I believe a clean opinion should mean a lot to investors.

With respect to CAMs, overall, I have concerns about the proposal as drafted. The examples, quite frankly, are more troubling than some of the concepts. And so I believe it's imperative that the Board lead a comprehensive field test to assess whether the proposal will produce the information that investors are seeking at an acceptable cost.

With respect to the proposal, it does not include an AD&A, which was of great concern to the preparer community. The CAM approach, however, does have some elements that we have similar concerns with as follows. My primary concern relates to preserving and not confusing the distinct roles of management, auditors, and Audit Committee.

Management is responsible for financial statement preparation and the footnotes and ensuring full disclosure of important qualitative and quantitative financial information, including the MD&A. Open communication between auditors, management, and the Audit Committee is vital to this process.

The proposal, in certain cases, could require auditors to be the original source of new information as well as highlighting potentially items that aren't particularly important.

The audit report, in my view, should not be used as a vehicle to communicate new information. This will serve to inhibit a healthy and well-functioning financial reporting process. And if there are shortcomings in the financial reporting model currently, the FASB or the SEC should work to address these concerns. And management will take the lead on improving whatever shortcomings are of concern.

Written auditor communications, from my standpoint, are really the beginning part of a dialogue between auditors and audit committees. And the written reports have limited value without the important discussion that takes place between auditors and audit committees as well as management. Ideally, all important matters are discussed in detail, context is provided, there is an opportunity for a robust dialogue and followup on specific questions or concerns as necessary.

With CAMs included in audit report, there really would be no effective mechanism for any dialogue with investors. In certain cases, this could result in questions coming to issuers about an auditor's report, about what they might have meant in talking about a CAM, which would put issuers in a difficult position.

As I mentioned earlier, the CAM examples in the proposal are of significant concern. Disclosure by the auditor of a significant deficiency is not currently required, so this example is in direct conflict with existing rules. Discussion of an immaterial corrected error would not, in my view, seem appropriate for discussion as a critical audit matter. Since management isn't required to disclose these matters, I don't believe it is appropriate for the audit report to provide detail on them.

I am also concerned that auditors will err on the side of including too many CAMs, and they will spend too much time documenting why certain matters should not be included as CAMs. This could worsen the so-called disclosure overload problem that is subject -- by the SEC currently.

And from my personal experience, auditors, in my view, should spend more time performing audit work, less time documenting the work that they have done. Documentation requirements are overwhelming audits and could be an obstacle to auditors spending time on important issues.

Much of the work on CAMs is expected to be completed near the end of the audit -- another concern because it could be a distraction for auditors and management as they are wrapping up critical areas. The proposal is also unclear but seems to imply that a discussion of audit procedures with respect to critical audit matters is preferred. And, in my view, quite frankly, talking about audit procedures may be more appropriate than analysis of management's financial statements.

I am concerned about audit fees potentially rising and would encourage a robust cost-benefit analysis.

Lastly, there is no substitute for actually reading the financials, and I think there is some risk that an auditor's report that included CAMs could be used by a reader as a shortcut, a cheat sheet, that investors would rely on to dummy down the extensive and important disclosures that an investor gains from actually reading the entire financial statements and the 10-K.

MR. DOTY: Should we drop the project and forget about it?

(Laughter.)

You don't have to commend us if you think we should drop the project and forget about it. Is that --

MR. COONEY: I actually don't --

MR. DOTY: No change in the binary model?

MR. COONEY: I actually don't think you should drop the project. I had a few --

MR. DOTY: I'm waiting for the reason why.

MR. COONEY: I have a few other just overall general comments. I think that at the end of the day my personal opinion is the CAM approach has a lot of risks associated with it. The concept release talked about required emphasis of matter paragraphs. I think that approach would be preferred.

The other idea that has been discussed was some type of auditor association with critical accounting policies and estimates. And I think, again, that would be a preferred approach in general.

If the CAM approach is continued, I believe that the requirements should be tightened to avoid the unintended consequences and to make the process more efficient.

That concludes my remarks.

MR. DOTY: Kevin Reilly?

MR. REILLY: I thought the last panel solved all the CAM-related issues, so I'm a little uncertain as to what you want me to cover, Mr. Chairman. But I thank you and appreciate the opportunity to be with you today and talk about issues surrounding the projects, specifically as they may relate to critical audit matters or CAMs.

My firm, and the profession more broadly, has been supportive of exploring ways to improve the informational value of the auditor's report, and we commend the Board and the staff -- Marty tells me the staff does all the work around here -- for the many efforts on this project. And I certainly hope that the Board has found the many suggestions we have raised in our letters, our comment letters, including those from the Center for Audit Quality, to be constructive and helpful as you work through this challenging effort.

I also want to acknowledge and appreciate the work of Arnold Schilder and his team from the IAASB as they pursue and tackle the similar issues.

My firm, Ernst & Young, is supportive of the concept of CAM disclosure in the audit report, be it with a C or a K, and believe the concept, if it is properly developed, could help investors focus on aspects of the company's financial statements that were important or challenging in the audit.

But I think the real lightning rod on the CAM front doesn't so much involve the identification of the CAM; it really revolves around what the auditor should say about the CAM in the audit report.

The proposing release notes that the report should identify the CAM, describe the considerations that led the auditor to conclude that the matter is a CAM, and then reference where that matter is covered, where applicable, in the company's financial statements.

We understand these broad objectives, and we think this general framework makes sense. However, we do have some significant concerns with how the approach has been applied in crafting the specific examples that appear in the proposing release.

Wally touched on some of those concerns. You have heard them front and center relative to the many comment letters that we have seen, the original information issue that was covered in the last panel, the redundant, potentially lengthy repetitive disclosures that may appear in the audit report, a discussion about audit procedures and how that could lead some to conclude the auditor is issuing a piecemeal opinion.

And, last but not least, you know, the example language focused so much on the difficulties and challenges faced by the auditor in a particular area that it left me wondering whether we are serving to undermine the company's accounting and reporting for that very matter.

So, Mr. Chairman, you raised a good question at the last panel which is, okay, well, smart guy, what is really bothering you with respect to what is proposed? So let me give you some granularity with respect to that question.

So go to the deferred tax valuation allowance example that is contained in the proposing release. It has four paragraphs, runs for a page and a half, uses the term (difficult or (difficulty a half dozen times. And I get it; deferred taxes are challenging.

The example also highlights a number of very specific matters we thought would be company disclosure areas, such as the occurrence of an unexpected cost increase in an important component part that is expected to unfavorably impact future profitability.

The example also makes reference to various audit steps or actions, such as consultations with others outside the engagement team, that we don't really see as particularly relevant to the overall disclosure. We think the overall objective -- to inform financial statement users of those matters that were truly important or challenging in the audit -- can be met with a much more pragmatic approach.

This alternative would require a crisp, fact-based outline of the issue that does not compete with the company's disclosure or reflect original information about the entity, to an outline of the principal reason and not a checklist of any and all influences that may be in the mix, but the principal reason why the auditor believes the matter is a CAM. And, finally, a reference to where the matter is covered in the company's financial disclosures.

So let me boil that down to how this approach would differ from what is reflected in the proposing release. So we think this approach could distill the CAM in two or three sentences, and let me read the suggested format for you. "Our assessment of the company's evaluation of the realizability of deferred tax assets and the related determination of the valuation allowance required for such assets was a critical audit matter in the audit of the company's financial statements.

Deferred taxes are material to the financial statements. The company's realizability assessment involves many complex and subjective judgments, including those used to prepare forecasts of future taxable income, and this was a challenging audit area.

The company's accounting policy for deferred taxes and its valuation of the realizability of deferred tax assets are covered in Notes 2 and 12 to the financial statements."

We think this approach -- it's shorter and more to the point -- still accomplishes the objective -- telling investors what were the critical audit matters faced by the team in the execution of the audit.

I expect one reaction to the suggestion is that it will potentially drive some to have CAM disclosures take on a more standardized language format. It's clear boilerplate is now viewed as the new four-letter word in this discussion.

I fully appreciate that some are calling for this project to drive audit report disclosures of special insights, views, or impressions on a company's financial reporting. We think attempts to meet such objectives could lead to some harmful consequences.

In a more freeform writing world, two different auditors could have different views and perspectives on similar fact patterns. The resulting diversity in what might be said, and how matters might be characterized in the two instances, could lead to misinterpretations by financial statement users.

Do more details point to more problems with the company's account? Do more details or color commentary on the audit -- does it really point some towards a more thorough audit? I don't think so, and I think those are some of the harmful and unintended consequences that could be achieved if we head in this direction.

We think a concise articulation that is to the point, even if the description becomes somewhat standardized, would nonetheless be valuable to users of the financial statements. We also think that highlighting the CAM in the audit report will lead to improved financial reporting in those identified areas for the benefit of investors and other financial statement users.

So, to sum up, we support CAM. We have some significant indigestion relative to the examples in the proposing release. We are hopeful that the approach I have outlined could be considered by the Board and staff in terms of moving this ship forward. And I look forward to your questions on this area.

MR. DOTY: Thank you.

Aulana Peters?

MS. PETERS: Good afternoon, all. Thank you for this opportunity to share my views on the Board's Release Number 2013-005 on changes -- proposed changes to the auditor's report.

As you know from my written statement, I firmly believe that users of financial statements could benefit from an expanded audit report, and I support the PCAOB's efforts to improve the current form of auditor report.

The question is, of course -- and all of the panels today have tried to answer this question -- what should the auditor's report communicate? In my view, the contents of the report should relate directly to and illuminate the auditor's opinion. Therefore, it should include more information about the audit process, and also my friend Alan Beller is not going to be happy to hear me say that. Are you still here?

(Laughter.)

About the audit process and the approach, the audit approach, so that users of financial statements better understand the role and responsibilities of the auditor. In other words, I would focus on information designed to reduce the expectation gap, and that rather than to rebalance a lack of symmetry between information accessible and available to management and that available to investors.

I was going to -- but I am going to make a point now that I was going to save to the last, and that is about the investors about whom we should be concerned, that we are concerned about. These investors, I would like to emphasize, are institutions with -- and powerful institutions with considerable resources. I will only say that. And that the lack of symmetry I think is more perceived than real and actual.

That is not to say that they don't -- shouldn't get some of what they are asking for, but the Board should keep in mind that these are not uninformed and -- well, just uninformed individual investors.

The Board's proposed standards for audit reports that express an unqualified opinion would require the auditor to identify and address critical audit matters, CAMs, which are defined as -- and this is -- I paraphrase it, so you can pull me up short if I'm doing so inappropriately -- defined as (matters which the auditor found to be the most challenging and difficult to audit with respect to the complexity of the issue presented, the amount of effort required, and the ability of the auditor to obtain sufficient, appropriate evidence.

This definition, while it focuses most certainly on issues that auditors must and do address, does not seem, in my reading of the release and the standard, does not seem to take into account the notion of materiality or the fact that auditors apply a risk-based approach in performing their audits today, not only in planning them but in, also, executing them.

I would suggest that the factors that should be used to define CAM should be based on what the auditor determines presents the greatest audit risk and the greatest risk of material misstatements in the financials, whether due to error or fraud. In my view, such information would be much more useful to the user of financial statements and understanding the auditor's opinion on those statements.

Again, in my reading of the release and the language in the proposed standard, the focus on requiring the auditor to report problems and challenges encountered during the audit, rather than to outline the process through which the auditor reached his or her opinion in question. That is the focus. My concern about this approach is that matters which present the auditor with significant challenges and require a lot of effort to audit may not be material and may not present a risk of material misstatements in the financials, or they may be completely unrelated to management's financial condition.

As the Board knows, if auditors encounter difficulties, they are resolved during the course of the audit, thus requiring a detailed account of challenges and difficulties, all of which have been either eliminated or resolved before the unqualified opinion is issued, in my view is more likely to cloud the reader's view of a final audit result and might undermine the value of the auditor's pass-fail opinion.

For me -- this probably will reveal that I watch far too much television -- they are just sort of like asking the auditor to perform an autopsy on a living patient. If you've given a pass-fail, the patient is still alive. We should not be performing a post mortem in that respect.

I think that an audit report structured on a -- this is the lawyer coming out. If I didn't like the definition, I am going to suggest another one. So, but I think we get to the same place. I would recommend that the definition of "CAM" focus on identifying the most significant risks of misstatements and the specific financial misstatements, whether due to error or fraud, and the risk that the audit procedures selected and applied selectively might not uncover such misstatements. That approach would be, in my view, far more useful in understanding the auditor's opinion and the financial statements themselves.

Significantly, if the auditor's report focused on how the auditor planned and executed the audit with the greatest risks in mind, I believe that the most complex, the most subjective, and the most challenging matters should be revealed in any event in that process and discussed, albeit in a different context -- the context of what were the risks as opposed to what were the problems.

One final point, and I'm just going to say it because everybody else has pointed to significant deficiencies, which I believe the standard would require disclose, or at least that's what the panel seemed to indicate. And putting my Audit Committee hat on, I really do agree with the suggestions that that would not be beneficial necessarily to users of the financial statements.

In my experience as an audit committee, of course, these significant deficiencies are reported on an ongoing basis. But I can tell you that the two or three that might be reported in a quarter, most of the time there is something new in the second quarter and the third quarter and the fourth quarter. And frequently, of the significant deficiencies that are uncovered either internally by the Finance Department or the external auditor, they are resolved before they are even disclosed to the Audit Committee.

As I sit here -- and I am in favor of full disclosure -- I really do not see that it advances the goal of understanding the opinion on the financial statements to know that there were five or six significant deficiencies that were all resolved and that did not have a material effect on the final product.

Thank you very much.

MR. DOTY: Thank you.

Steve Harris, questions?

MR. HARRIS: Yes. I was struck on the last panel -- I'm not sure I remember who the panelist was. I think it may have been Joe Ucuzoglu who mentioned it, where he said that 91ápercent of the users do not read the product. I have heard that before; the percentage may differ.

But my feeling is that if we have a report, the report ought to be read and it ought to be informative. And so the question is, how do we get a report which is read and informative?

And then, Aulana, you know, getting back to you, you stressed, you know, by and large we are dealing with the BlackRocks of the world, although you mentioned BlackRock, but you used institutional investors -- no, no, you used the term (institutional investors. But I don't want to believe that the retail investor is dead and buried in this country. Hold on for a second. So what I want to do --

(Laughter.)

So what I want to do is I want to try and figure out, how do we get an audit report which is read and used not only by the institutional investor, who is plenty sophisticated, but the individual investor? And what do we do, and what's critically important?

But that was -- I wasn't addressing the comment. I was going to -- because you can all answer that. But I did have a question, and I --

MS. PETERS: I would defer to Kevin for your first question, and then I'm happy to address the second one if you'd like.

MR. HARRIS: The clock ticks. I wanted to ask Ms. Cavanaugh a question, because you indicate here that, (we recommend clarifying that routine audit procedures, such as Testing Level 1 or 2 fair valuation inputs would not be deemed critical audit matters, absent significant judgments therewith. I think everybody would agree with that.

MS. CAVANAUGH: Right.

MR. HARRIS: The question I have got is, what do we do about Level 3? And where should that be reported? And for all practical purposes, it can't be valued or it's very difficult to value. So does that have any place in the audit report, or where does that come up? And where should that be disclosed to the investor? So I know there are a lot of questions up there. Go for it.

MS. CAVANAUGH: We were -- I was intentionally silent when I put that paragraph together because I do think when it comes to Level 3 there may be, when you're talking about hard to -- difficult-to-value securities, that may be something that would warrant a CAM disclosure. And I think that's one of the reasons why -- there was a question in the proposal that said, (Should certain entities be completely scoped out, meaning investment companies, and we don't think they should be completely scoped out. We think you have to look at the nature of what the transactions are.

So for Level 3s, they may warrant CAM disclosure.

MR. REILLY: Steve, on your first question, the 91 percent, I would submit to you that I do think financial statement users do use the report. When you say, (Read the report, I think they focus in on one thing, which is the binary nature of pass-fail. And if it's a pass, move on. If it is not a pass, or there is an emphasis of matter paragraph being stressed in the report, I do think those reports get a lot of focus.

MS. PETERS: Steve, I can count on you for seizing the wrong end of my double-edged sword, in terms of the comment that I make. I did not -- I'm not going to back off my remarks that most -- 90 percent of the investors out there are institutional investors, but I also said they deserve the information that they need to make their investments.

However, my point is that there really -- I don't think there are any more investors like you and me. I don't rely on my own acumen, investment acumen in making investments. I turn to my financial planner to do that. Warren Buffet does that. So I really think that your focus needs to be on making a useful audit report that does not muddy the waters, that really gives information that illuminates and focuses on, what does this audit opinion mean?

And from my point of view, it would be requiring the auditor not to discuss problems and like -- and making his job seem more Sisyphus-like than it perhaps really is, but would discuss the actual audit and what the risks were and how they address those risks.

MR. COONEY: I would just make one comment.

MS. PETERS: And not many from Missoula will understand that.

MR. COONEY: With respect to level of knowledge, I think at the outset at least we had commented that it would seem reasonable that the Board would expect users to be reasonably well-educated. And I guess from my standpoint the audit report could certainly highlight areas, whether it's through a matter of emphasis or whether it's through some type of association with the critical accounting policies for users.

But, really, I think any reasonably well-educated investor should be able to look at an annual report, go through the MD&A and the financials, and there is a lot of information in there. And I'm not sure it's necessarily the auditor's job to go back and pull out all the pieces of information that someone might find important. That's really an investor's job to do that.

MR. DOTY: Jay? Oh, of course.

MS. CAVANAUGH: One other comment I wanted to add. I think, you know, from speaking to our analysts, their prime concern is they are interested in cash flows, companies, financial risks. And by at least highlighting the CAMs, without giving a lot of detail, it at least alerts them to discussions that they then may want to go back and discuss with management. It allows them -- pinpoints to them what particular areas are that they really need to get more information on.

So they don't expect everything to be in the auditor's report. I think that would be -- what we heard is disclosure overload. But what are those key points that they can then take back to management and drill deeper on?

MR. FERGUSON: Okay. I have a question that is directed I guess to the whole panel but primarily to Kevin as a preparer and to Ann as an investor, a user of financial statements. And it's a question I seem to keep asking and it may reflect --

MR. REILLY: I'm not a preparer. That would be a clear independent --

(Laughter.)

MR. FERGUSON: Whatever it is you are.

MR. REILLY: Let the record show --

(Laughter.)

MR. FERGUSON: I know you're relevant. I don't know what you are, but I know you're relevant to my question.

This question may reflect either my fixation or my lack of imagination. But, you know, we're doing this project in the midst of a lot of stuff that is happening in the world. And we are actually beginning to see some real examples of new models that are out there. The UK has one, the Netherlands is now doing it, Arnold Schilder has got a proposal that is very close to ours.

And as either a firm that has audited financial statements and has had to write audit opinions in the United Kingdom, or for you who I assume have investments in companies in the United Kingdom and in the Netherlands, where you have seen these new reports, do you find that what is coming out of there is confusing to you? Or is it useful?

And certainly in the UK I know the reports have not been standardized. They have been kind of all over the lot. Has that been a problem in auditing these things? Has it been a problem in preparing your report? So just -- I'd just like to get the panel's impression of what they have seen going on around the world.

MR. REILLY: Great question, and a fair question. I think, as Professor Skinner mentioned in the last panel, I think the UK experiment, which is now live and in color, we are still in the early days. As I said in my prepared remark, we think CAM, concept of CAM, is a good thing and will be helpful to users of financial statements, irrespective of geography.

The real issue is, how do you translate that into practice? And how is it made practical? And I'm hearing a whole lot of pie-in-the-sky concepts in the various interactions this morning and earlier this afternoon. And I'm just struggling with, how do we land the plane and bring this thing, you know, to fruition?

MR. FERGUSON: But it is happening in the UK. You're doing it. Are you able to do it? Is it impossible? What is the experience there?

MR. REILLY: It is most definitely not impossible. As you said, it is happening now. I will tell you, though, you know, we have seen it in other countries, and let me share with you a reaction that I found interesting relative to what has happened in France over the last 10-plus years.

So they adopted a justification of assessments approach for commentary in the audit report. They did that in I think 2003. They did a fairly comprehensive look-back in 2012 or '13 as to how is it going. They found a lot of movement towards standardization, not unexpected.

But one of the things in the report that I found fascinating is -- one of the observations, and that is things are moving towards standardization. But in an otherwise black and white audit report, the commentary is a helpful shade of gray.

So, again, I don't think we are going to be able to make this perfect. I think we need to make it practical. And I think by making it practical it will still be useful to investors.

MR. DOTY: Jay?

MR. HANSON: I've got a question primarily directed at Ms. Cavanaugh. I really appreciate that you, on this panel especially, and the one most directly connected to people that actually make investment decisions. And so I'm going to ask you to imagine what your analyst -- how your analyst would answer this question.

So Commissioner Peters suggested that instead of focusing on the most difficult matters at the end of the day that the auditors spent the most time on, kept them up at night, that the approach be a little bit more holistic around what were the risks that the auditor considered initially.

And that is very similar to this UK model that -- I don't think you were in the room this morning as we had the discussion about it, but it was their approach is focused on, what were the most important risks that were identified in the audit plan? What was the materiality level established? And then how did the scope of the audit address all the risks? And that's a very different model than, what were the most difficult areas of the audit, all things considered?

And I know we talked for a bit about the -- Steve's question about the Levelá1/Levelá2 securities, that routine procedures aren't necessary to include. And your comment letter also referenced that the audit procedures performed on a given CAM would not be helpful except would maybe tend towards a piecemeal opinion.

But what are your views on whether an approach more like what Commissioner Peters suggested, that holistically describing the most significant risks and what the plan was to address them as something -- an alternative to what we propose for CAMs, maybe how you think your analysts would react to that.

MS. CAVANAUGH: I mean, I think just based on the conversations that we have had with them, and based on what I'm hearing here, they would probably be more in line with that holistic financial risk type approach as opposed to what is currently in the document today, because I think financial risk and cash flows is what they are interested in. And what is going to give them that information is going to be most useful.

MS. FRANZEL: My comment is along the same line as Jay's. You know, all day here we have been listening to concerns about the CAM approach, but support for the concept and support for the notion of, you know, getting the right information to investors that they need.

And so I'm really struck by Aulana's suggestion here because it seems to just tie together a whole lot of what we have been hearing, you know, and that is really the suggestion that the CAM should be based on what the auditor determines to present the greatest audit risk and the greatest risk of material misstatements in the financials.

It is similar to the UK and EU approach, and we have been hearing that we need to somehow figure out how to bring our approaches closer together. We have heard concerns about materiality and the potential for disclosure of immaterial and irrelevant information, and I think that this type of a framework would help maybe mitigate some of that risk.

We have heard concerns about non-helpful information, you know, potentially irrelevant and confusing information. So I guess I would like each of the panelists to comment about your thoughts on, would this help mitigate some of your concerns? And would this be useful to investors if, in fact, the CAMs were based on a framework that really focused on those areas of the highest risk of misstatement in the financial statements?

And let's start with Ms. Cavanaugh.

MS. CAVANAUGH: I do. I do, because right now, the way the PCAOB proposal is written, it is -- as we mentioned, you could wind up with CAMs, which may not be very material to the company. In those instances, I don't think our analysts are going to find a lot of value from there.

Overall, their big picture view was, what are the risks to the company? You know, anything I can learn about that, I don't need it detailed within the auditor's report, but something that will pinpoint that and allow me to go back to management and further explore. That's what they are looking for. So I think what you are proposing is something that would likely be more amenable to them.

MR. COONEY: Yes. As I mentioned earlier, when management prepares the critical accounting policies and estimates, we focus on the significant items. They are generally material. They are generally going to be, in my view, similar at the end of the day. If we went through a CAM process, I would think there would be a fair amount of commonality.

So cutting to items that are material by definition, things that, you know, not including some of these other items that we have covered earlier, and focusing on critical accounting policies and estimates with potential changes as was discussed in the prior panel about ways to improve that and make that perhaps more of a collaborative process with the auditors I think would be the best approach in terms of getting to where -- getting to where you all are headed hopefully.

MR. REILLY: I think, as I understood your question, I think there is a lot of overlap in terms of the various buckets here. But in terms of what thoughts we have conveyed to the Board and the staff is, you know, we cover a lot of ground with the Audit Committee.

Under ASá16, we are required to raise the significant issues and cover a whole host of different matters with the Audit Committee, and we think what is missing, at least relative to the identification of CAMs, is, okay, you look at this big inventory of stuff, what were the most important things out of that inventory? And we think what would be helpful is building in an additional filter which covers, what were those things that you spent the most time with, the most interaction with, the Audit Committee in discussing.

And we found that that lines up with the way practice is running right now. You know, I remember an Audit Committee meeting on that. I'd go through the whole enchilada on ASá16, and the Audit Committee Chair looks at me and says, (Thanks for the warning, Kevin. But tell me, what were the handful of matters that really cause you some indigestion relative to the execution of the audit? We think it would be helpful to bring that practical approach into a final standard.

MS. FRANZEL: Aulana, did you want to comment on your own suggestion?

MS. PETERS: I'm not sure that you really needed to hear more from me, other than to say I don't disagree. In fact, I agree with the comments on my comments.

I would say that I intentionally did not focus on circumscribing the auditor's report solely within the parameters of auditing standard -- what is it now? I knew it when it was -- 16. 16. I think that that is important, but I think that the approach that I suggest gets you there anyway, and also makes sure that any new issues that crop up that change from quarter to quarter, from year to year, gets pulled into a more expanded auditor's approach as things change at the issuer themself.

So I agree, but I wouldn't leave it -- circumscribe it with audit -- communications between the auditor and the Audit Committee for that reason.

MR. DOTY: Marty?

MR. BAUMANN: Thanks. I have a question for Wally Cooney. Thanks for being here, Wally, and participating. And thanks for being in our SAG.

We have a long list of investors who have sent us comment letters, and we have surveys prepared for the Investor Advisory Group, all of which -- covering trillions of dollars of assets under management, and we have letters from BlackRock and Vanguard and the Council of Institutional Investors.

All of those letters indicate that investors are looking for much more from the audit report and from the auditor. The BlackRock letter says, What type of information? "The additional information provided will be particularly useful to our analysts to the extent it leads to a better understanding of financial risks, including future cash flows of the company."

Jeff Mahoney was here this morning and saying that our CAM is useful but only to the extent that it talked more about an assessment of the critical audit matter and, you know, management's estimates and subjective judgments, et cetera.

So many of these, I assume, are some of your owners in your company. So how do you respond to the owners of your company who say, (I want more information, and I want it from the auditors, about the critical aspects of the audit, about the difficult judgments in financial reporting, and about the information that will lead to better understanding of cash flows. And I want to hear that from the auditors. And how do you respond to your owners and say, (I don't think the auditor's report should include any of that?

MR. COONEY: Okay. Well, I mean, my experience may not be similar to everyone else's. But I've been to a lot of annual meetings and a lot of investor days at several companies I have worked for when I was an auditor. And in all those years, there has never been a single question, ever, in my career that has ever been directed to an auditor. Not once, at any annual meeting or investor day.

We are -- the company I work for is not widely traded. I'm not aware of a single question ever being posed by any investor about the audit or the auditor. Questions are directed to management.

I believe, you know, based on my experience that shareholders want -- generally want information from management, from the people who run the company and manage the business. Auditors certainly gain a lot of knowledge about the company, about the management team, et cetera, but, really, at the end of the day, the management really has far more knowledge and expertise about the company. They're in a much better position to answer questions effectively and provide information that I think is most useful to investors.

With respect to some of the surveys and the comment letters that I looked at from investors, I think someone mentioned earlier that they didn't find surveys particularly helpful because generally the question is, do you want more information and they say (yes. That's not necessarily a great barometer for what is actually valuable.

I didn't find many of the comment letters -- and I didn't read them all, so there may be some out there -- that were really that specific about specifically what they thought would be valuable. They just said, (We think discussion about CAMs would be valuable. We would like to know more information about the audit. But I didn't find anything in particular that I found compelling, this, you know, idea that there's a real desire or clamor for information.

And in my personal experience, I just haven't ever been asked a question or seen a question been asked at a meeting about the audit or the auditors.

MR. DOTY: You are drawing me out, Wally. Annual meetings have been structured often to discourage large attendance and questions from -- of the auditors. Aulana is nodding. I take that as a concurrence.

The knowledge about the audit has been limited. There is a proposal by the Basel Commission and the others that there be a vastly expanded discussion of the audit that go to the regulator, directly to the regulator.

I must say, speaking, again, as one unqualified for the job of judging auditors that it seems to me that that has been part of the problem that we have, that what you've got -- an MD&A is what you're going to get.

I think I hear Kevin as saying that in fact a more general -- if the proposal and the CAMs offered guidance at a more general level and avoided the detail, examples, stayed away from the more detailed examples, that that would be something that auditors might welcome, and that it might actually help management do a better job of communicating with its shareholders, such as BlackRock.

Doug Skinner, very important academician. I let him out of here without asking him whether we should simply wait to see if the market starts to price American equities at a disadvantage to European equities. I think this was involved in Lewis' comment. There is some Chicago research that suggests that is going to happen. So maybe 10 years from now we wake up and we find that, in fact, we are trading at a discount because we are conceived to be -- perceived to be a more retrograde disclosure regime.

I am leaning on you, but is it really in the interest of preparers to say, (We just don't want it when BlackRock wants it, when TIAA-CREF wants it, when people such as Aulana Peters say that there would have been -- the audit profession, which she advises would have been better off if there had been more interaction with shareholders at annual meetings.

When Kevin Reilly says that he thinks that in fact we can do it, are doing it in London, when Alan Beller says, you know, you might even go farther than just critical audit matters. You might even start having auditors make judgments about whether the companies -- and communicate whether they think the company's critical accounting policies are better. We seem to be coming in, as I said this morning, somewhere between what the most expansive view of what the auditors ought to say would be and what in fact others have done abroad.

How far -- this is Marty's -- this really is where Marty is going. How far are you willing to go in saying, (We just don't want anything anytime soon? And if you want something, if there is something more to do, if it's -- is it something that has to be -- that management influences, controls, and dictates? Is that the problem? You are concerned that you are losing control with the CAMs of something management has traditionally controlled? Because that's an independence issue.

MR. COONEY: I am not sure I have communicated my position well, because I am actually not opposed to this proposal. I have a lot of concerns that I think other people share.

In my comments, I talked about if you are going to go forward with a critical audit matter framework, which I don't have strong conceptual issues with, that I thought you should more tightly define the framework. And I had some ideas that I put in writing. They were also in the -- in some of the other prepared comment letters as well.

I personally think a matters of emphasis would be a better approach because I think it could a little bit more -- it could be a better framework to do that.

I actually think that Alan Beller's suggestion, and others -- one of the accounting firms talked about auditor association with critical accounting policies, which would be a significant change. So I think that all of these options should be looked at carefully.

I don't have strong opposition to critical audit matters in general. I just have some concerns about the way it would be applied, and it wouldn't be my first choice. But I believe that, based on all of the work that you've done, that this is an important project, and that you should go forward with some type of change. And what that is I think we are just here to talk about today, about what the best way would be to go forward. But I'm not personally opposed to that.

And as I said earlier -- I answered Marty's question directly -- my experiences at the companies I have worked for is just my experience. Just because I haven't heard a question ever about an audit or an auditor doesn't mean people from BlackRock and other companies who are in that profession, that maybe they hear it all the time, I just haven't personally.

He asked me, (How do I answer owners in our company? I have never had the opportunity to answer them because I have never gotten questioned.

MS. PETERS: May I address that? Because, Chairman Doty, I did nod when you described what the current situation is generally at annual shareholders' meeting, but I don't think, while I agree with that observation, that it really discounts Mr. Cooney's observation that rarely is there a question put to the auditor, who is at every annual meeting that I have attended in the past 23 years of serving on a total of seven different Fortune 500 boards -- I am not touting myself, but just sort of defining my experience.

Has there been a question put to the auditor about the balance sheet or the profit and loss statement, or anything that would go to understanding better that pass-fail opinion on the financial statements? And I have attended meetings where there have been 5,000 people, 5,000 shareholders there, down to currently people tend to try and winnow it down to 50 attendees and 15 minutes.

But that is not the universe. Sometimes these meetings last for three hours, and in those meetings the questions don't arise, and I won't bore you with the questions that do.

MR. HANSON: Aulana, I would like to just ask you a followup from your role as an Audit Committee Chair, Audit Committee member, and the large esteemed companies that you are associated with, and just a reflection that from the discussions I have had with some Audit Committee Chairs, their pushback or feedback comes very similar to what Wally has said, that they don't get questions from investors about what the auditor thinks. And their earnings calls or other direct interaction with investors, they don't see the swell from that side coming.

And just I wonder about what your experience has been relative to investors either directly talking to you, which I know is a challenge with a lot of committees, you know, the connection to investors, but on earnings calls or other situations where you have seen a manifestation of this demand that we -- we are talking about.

MS. PETERS: Well, first of all, for the record, I am currently not an Audit Chair. I have served in that capacity, but currently I am not. So, and because I am not and haven't been, say, for the past five or six years, I am usually not in the front line of communications with investors.

But I do know from my work on boards of directors and on audit committees and governance committees that most of the inquiries that come into us for more information are -- say over the past 10 years, are more related to governance issues rather than issues relating directly to the financial condition of the company or financial statements. Is that an answer? Is that -- did I get your question, Jay, or --

MR. HANSON: Yes. I think that's reasonable.

MS. PETERS: Okay.

MR. FERGUSON: I have a question.

MS. PETERS: We get a lot of them.

MR. FERGUSON: Given the fact that in this panel, and in the previous panel, when Alan Beller and Doug Skinner were on and talked about critical accounting policies and then approach on that, would it be a good idea for -- and given the fact that those two are related but not necessarily coextensive, would it be a good idea for us to require both of those? That the audit report include CAMs and include a statement that the critical audit policies are, in the auditor's opinion, in fact, the critical audit policies, and that what the company has said about them is complete information? That we do both, because they are not coextensive. What do you guys think about that?

MR. REILLY: Good question. But, you know, when we started talking about this issue in 2010, 2011, one of the suggestions the CAQ put forward was a separate attestation of the segment of MD&A that comprises the discussion of critical accounting policies.

MR. FERGUSON: I take it you were in favor of my suggestion.

MR. REILLY: We were. And we thought it -- there was a great deal of overlap. We heard from investors that these are the types of things that they have particular concerns about. Alan Beller mentioned in the last panel discussion that, you know, there is some degree of unevenness relative to the extent of the disclosure and discussions in this broader area. And we thought this would be one tool to employ that would help with providing information to investors.

MS. PETERS: I would like to be clear and at the same time respectful. Since I -- although CAMs are not coexistent with critical accounting policies, I have to reiterate the fact that since I don't like the way you have defined CAMs -- and I think you -- I would recommend and suggest that you take a different approach to your definition, you will get to where -- you will probably get to where the other panel was trying to lead you ultimately.

So I would say, no, I don't think it would be helpful to require both a discussion of critical accounting policies and CAMs, mainly because I don't think the way you defined (critical accounting -- audit matters that that will be particularly useful. With respect.

MS. FRANZEL: Let me take this one step further. And I want to address this question to Ms. Cavanaugh, since you are here representing investors. You know, today we have heard a lot about focusing on critical accounting policies, management estimates, and risk of material misstatements. And if we were to somehow mix all this up into the perfect solution, in the definition of a CAM or whatever we're going to call it, would those types of things be, you know, what your analysts look to when they're looking to make investment decisions?

Because in your statement, you know, you say that additional information would be particularly useful to the extent that analysts can use it to better understand financial risks and to -- including future cash flows, to have those conversations with the company.

So some of these things we have been talking about -- critical accounting policies, management estimates, material areas of risk. Are those the types of areas that would be helpful?

MS. CAVANAUGH: For the analysts --

MS. FRANZEL: Right.

MS. CAVANAUGH: -- you are asking? You know, I think it really varies. They didn't give us a lot of specifics, but I think, you know, for example, loss of a major customer relationship. That's something they may be interested in that may impact cash flows.

So items that might highlight, you know, issues with revenue recognition may lead them, then, to go back to management and say, (Well, why was that the case? Was it because of the loss of a customer relationship?  And allow them to dig deeper, and that's not information I think you would normally obtain today in the financial statement.

So I think it varies, but some indication of where risks and changes have taken place ultimately will get them what they want, which is cash flows.

MR. DOTY:  If there are no further questions, it may be that we have saved four and a half minutes for the next panel.  But we shouldn't adjourn without telling you what a terrific job you have done in responding to the questions, to the dialogue, to the back and forth, and how valuable your written submissions are.  This is a real contribution to the seriousness of what we have to do.

With that, I think we could move on to the next panel.  Thank you.

We'll take a break now.  We have 10 minutes -- 15.  We have 15 minutes, so we're going to start -- we can start, instead of at 4:10, we can start at 4:05.  We can start a little past 4:00.  4:05.

(Whereupon, the proceedings in the foregoing matter went off the record at 3:41 p.m. and went back on the record at 4:05 p.m.)

MR. DOTY: All right, the sixth panel, Critical Audit Matters Related to the Audits of Smaller Companies. Kurt Schacht, Managing Director of the Chartered Financial Analysts Institute, he heads the ethics and professional standards area there, leads advocacy and think tank functions. He is an attorney and the CFA charter holder. Previously, he spent 15 years in the investment management industry as a chief legal and compliance officer for a large public pension plan and later a hedge fund. He was Chief Operating Officer for a retail, mutual fund complex. He serves as a member of the SEC's Investor Advisory Committee. And he's also a member of the PCAOB's Standing Advisory Group.

Andy Bishop is the CFO and the Chief Accounting Officer of Hallador Energy Company. Previously, he was with PriceWaterhouse. He also served on the Audit Committee of SemGroup Energy, SemGroup Energy Partners, now Blueknight Energy Partners and we welcome Andy.

Dr. Cartier Esham serves as Executive Vice President for Emerging Companies at the Biotechnology

Industry Organization and in this role she manages and directs BIO's policy development, advocacy research, and educational activities, and initiatives for emerging companies which comprise approximately 90 percent of BIO's member. Prior to joining BIO, Dr. Esham was the Vice President and Director of Research at Dutko Worldwide, a private consulting firm based here in Washington. And she also has published papers in peer reviewed science journals.

Joan Waggoner, a partner in Professional Standards at Plante Moran, she specializes in accounting, auditing, ethics, professional liability and quality control issues. She has recently completed her service on the Professional Practice Executive Committee of the Center for Audit Quality. She has also served on various subcommittees and task forces of the CAQ and has participated in various roundtables of the U.S. Government Accountability Office, the SEC, and the PCAOB, so we welcome all of these panelists who have important views to share.

Kurt, you want to lead us?

MR. SCHACHT: Thank you, Chairman Doty and the rest of the PCAOB Commissioners and PCAOB staff. Thank you very much for including us in this discussion today.

I am Kurt Schacht. I'm from the CFA Institute. That's the Chartered Financial Analyst people. It's a global organization now of 120,000 professionally trained financial analysts around the world. We have another 250,000 or so people in our 3-year program. So it's growing tremendously and it's our next generation of financial analysts.

In that capacity and working for CFA as well as having the pleasure and the opportunity of being involved in the SAG for a number of years, our organization, I've been helping our organization and its members in talking about improved audit quality. For many months now, and as you know, some of these debates have been going on for decades, as a means to improve the audit process, its independence, its quality, particularly of things like outputs around the Auditor's Reporting Model.

We very much appreciate the PCAOB and its staff and the very interesting and challenging position that they find themselves in. Trying to change audit rules is a very slow process to begin with, but particularly when you're talking about anything that is a major regulatory change. And we've witnessed that time and again over the years as to how difficult it is, particularly when there's very deeply ingrained professional and commercial interest in not changing the practice. The road to reform is always very long. It's always more difficult. And it's always more acrimonious.

We certainly put the Auditor's Reporting Model change proposals in that category. We're very hopeful that we're getting closer to some changes there, but honestly I felt that in times past in a number of different settings, but I think now with the two proposals from the IAASB and from the PCAOB on the table around key and critical audit reporting matters, that maybe we're a little bit closer.

From an investor perspective, from the user of financial statements perspective, our very clear and consistent input from professional analysts and from investment manager members and you've heard reference today to several of our different surveys in this regard, is tell us more information. We like the pass/fail opinion, but tell us more information because the

Auditor's Reporting Model is now behind the times. It's been permitted to remain a bit of a remnant of the audit practice of decades gone by and it is no longer in keeping with the information demands of the marketplace in the 21st century. That's just sort of plain and simple how many of our investor members feel.

Having an auditor's signature is nice. Having a rotation of the firm is nice. Having more information, useful information from the Audit Committee or from the issuer, that's all fine and well, but in the view of many of our members, those are minor players in comparison to what would be a well-articulated discussion of the audit like we're proposing, like you're proposing with the critical audit matters discussion and coming from the auditor.

So that's our view. That's what we have communicated in this venue and other settings quite often. I certainly do understand the practitioner issue or concerns about this. The standard nature and the beauty of long-standing historical practice is important. I understand all of the opposition, the commercial issues associated with this issue and certainly appreciate the skill with which the practitioner and issuer community weigh in on this. But the fact of the matter is that everything else in the world of finance has changed dramatically in the last five years and over the last decade, rapidly changing around audit practice in terms of information, the speed, the quality, the transparency of it, and certainly the usefulness of information.

Let me address two real quick things that we come across in terms of this debate. We hear repeatedly that the financial analyst community is never satisfied. They never have enough information. It's never good enough. It is never of high enough quality. It's just another one of those requests from the financial analyst industry.

The other thing is that very few investors ever read the financial statements. A lot of our professionally-trained investors read financial statements, but very few investors read them, much less the footnotes, much less the audit opinion. So why on earth are we building up this very expensive rule book, regulatory rule book and the corresponding outputs that no one is apparently using?

I think you all know the answer to that. I think we've talked about it a number of different times. And the fact of the matter is that these practices and rules are so very fundamental to the integrity and quality of our markets. Investors know that they exist. They have to exist. They're required of those seeking public investment and if they violate those rules, there is some hell to pay in terms of having violated those. I think everybody gets that their existence is not a 100 percent guarantee on fraud or cheating or even 100 percent enforcement by PCAOB or SEC or that investors even understand or appreciate the complexity of the outputs.

What investors do know is that the rigorous nature of these is a condition to taking their investment money. It is a type of discipline and responsibility that is not optional in the U.S. publicly-traded markets.

That brings me very quickly to talk just a little bit about the smalls and mediums, whether the audit reporting model rules changes be waived for smaller issuers. We have never in our organization supported a variable system for publicly-traded companies based on market cap or size. If you want access to the public's money on the same terms as other public companies, we think the rules ought to be the same. We do get that being public is expensive. It's very complicated. It's complex. The regulations overlap sometimes and maybe they're even over broad. But if you understand that and you don't like that, then maybe you list on a lighter touch exchange or a lighter touch regulatory regime. That is your option. But if you want to access these markets and stand toe to toe with other seasoned issuers whose reputation and confidence level and standing in the marketplace are built on regulatory rigor, we don't expect there should be a free pass. We think that's the right approach from an investor protection standpoint. Thank you.

MR. DOTY: Andy Bishop. Thank you.

MR. BISHOP: I would like to extend my appreciation and thanks to the Board for including me in this panel discussion. Hallador is an underground and surface coal mining company serving Indiana and Florida electric utilities. Our mines are located in Indiana. We trade on the NASDAQ. It's HNRG. Get it, N-R-G. H for Hallador (R-G. We are a small reporting company as defined by the SEC rules and our public float June 30 was $75 million, although our market cap exceeds $240 million.

I started my career at PriceWaterhouse in 1975 in the Oklahoma City office after graduation from the University of Oklahoma, that's the team that trounced Alabama in the Sugar Bowl.

(Laughter.)

Thank you. In 1984, I transferred to the Denver office. Practically all my audit clients were SEC registrants. In 1990, I joined Hallador as the CFO, left in '93 and then came back again as CFO in 2009. From 1993 to March 2009 I was the Executive VP and CFO and a third owner of the SEC Institute. During those 16 years, I also assisted Hallador in preparing their SEC filings. In July of 2009, I sold my interest in the SEC Institute. I also served on the Audit Committee of SemGroup Energy Partners, now called Blueknight which is a NASDAQ company from July 2007 to July 2008.

Before I go further, I should tell you that the views I express today are my personal views and do not necessarily reflect the views of any of the officers and/or directors of Hallador.

So for the past 29 years, I've been intimately involved in this space and along with many others have noted that the auditor's report has not substantially changed. Now is the time for change. And nobody likes change but a wet baby.

I recall years ago in the self-regulation days when the Big Eight, now the Final Four, I picked the Gators, audited each other. I worked both sides of that fence. I firmly believe in less regulation than more, although I have to admit there were serious flaws in that system. We audited each other and I recall each firm received an A plus year after year. It's not unlike asking your mother if you're good looking.

The PCAOB system was a much-needed change. Other information in the auditor's report, I'm in favor of having the auditor's report on the other information disclosed in the 10-K. Also consider a mechanism where they also report on the earnings release. The earnings release moves the market more than the 10-K disclosures.

For smaller companies that don't have an audit of internal controls, I assume that other information includes management's representation that the internal and disclosure controls are effective. It is not clear to me how the auditors will report on the proxy statement that's incorporated by reference to the 10-K. The proposed standard states that this information is covered, but what will be the mechanism to make it clear to investors that the information was, in fact, read and evaluated by the auditor. Also, it's not clear to me that the XBRL data that is filed as an exhibit to the 10-K is covered by the proposed standard.

Critical audit matters. Rather than have the auditors include in their report the critical audit matters, I believe the Audit Committee Report should be expanded to include such matters. If the auditors are not in agreement with the report, they have the obligation to report such and include those critical audit matters that were excluded from the Audit Committee Report. Most likely, this would be a joint effort between the Audit Committee and the auditors. The CFO and/or the CAO have an intimate knowledge of these matters and such matters are included in management rep. letter to the auditors and also included in the auditor's communication to the Audit Committee.

This approach would also be more cost and time effective as we have strictly reporting deadlines and at times obtained the final wording from the auditor slows down the process. That being said, the rightful home for the Audit Committee Report is the 10-K, not the proxy statement.

Maybe this concept is a jurisdictional concern and we sure don't want Audit Committees regulated by the PCAOB. I'm sure the SEC and the PCAOB can come to an understanding if this approach was considered.

I would like to take advantage of this esteemed captive audience to touch on some other matters that I have observed over the years. Number one, referring to auditors as independent auditors could be misleading to the average investor. The issuer-pays model compromises objectivity and professional skepticism, always has, always will. For instance, GE, General Electric, pays KPMG over $100 million for their independent audit. Best I can tell, GE has been a client for over 100 years and probably will be for the next 100 years. For simplicity, let's just say the annual profit on the audit is $25 million. The present value of $25 million for the next 100 years approaches $500 million, depending on assumptions. Now that's an asset that would be safeguarded by any firm. What defies logic is if KPMG audit partners invest $25 to buy one share of GE stock, then KPMG is no longer independent. This might be heresy to some, but why not tweak the rules to allow some ownership by partners and staff. Certain partners and staff could be subject to Section 16 reporting, the same as D&Os and others.

Number two, another way to look at audit fees' independence is how significant the fees are to the firm as a whole or to that particular office. For instance, the KPMG Louisville, Kentucky office is the reporting office for the Yum! Brands engagement. The audit fees are about $7 million. Is $7 million significant to the firm? Doubtful, but how about that office? It could be. Now the point being that investors have no way of knowing. Maybe more transparency regarding these matters would assist investors in determining true independence.

I'm not picking on KPMG. The other firms have the same issues.

Number three. Being a smaller reporting company, we are exempt from the 404 audits of internal control, so are emerging growth companies. I thought the passage of SOX was great, especially the CEO and CFO certifications and creation of the PCAOB. That was good, common sense regulation. However, I think the cost of 404 internal controls audits far exceeds the benefits. I am not in the camp that if the regulation only saves one life is worth it. One would think other jurisdictions around the world would jump on the 404 audit bandwagon if it was such a good deal. But we might be the only country.

All CEOs and CFOs certify as to the effectiveness of the internal controls four times per year. That should be sufficient. As mentioned earlier, this management assertion would be subject to the auditor's obligation to report on other information in the 10-K.

Let the investors decide if they see value in the requirement. Make it an optional requirement subject to shareholder approval. Call it (Say on SOX. In the interim, the SEC could at least raise the public float from $75 million to $250 million or higher as recommended by the Advisory Committee on Small and Emerging Companies in their March 2013 letter.

Number four, another required cost that far outweighs the benefits is XBRL. At a minimum, small reporting companies and emerging growth companies should be exempt from this tedious and time-consuming project. For sure, the requirement to detail tag the footnotes of the financial statements is ludicrous. We are followed by three analysts. They seem to be oblivious to XBRL. I'm surprised Congress did not exempt the emerging growth companies from XBRL in the JOBS Act. Maybe they too were oblivious.

The only groups I know singing the praises of XBRL are the service providers. We have fewer public companies on the national exchanges than 17 years ago, 8,800 in 1997 compared to 5,000 or so today. XBRL might have made some sense years ago to assist the SEC in their mission to protect investors, but today it does not. EDGAR is a fabulous tool. XBRL is not.

Number five. In my opinion, either the CFO or the CAO, Chief Accounting Officer, or a member of the Audit Committee should be required to be a CPA.

Number six. I applaud the PCAOB for moving forward with the requirement to name the audit partner. For the last two years, we have named the audit partner and the concurring partner in our information statement filed with the SEC. We also include their ages and their tenure as auditors. We considered including biographical information for the partner not unlike that required for our own D&Os. I do believe that more than just the name of the partner is needed. Their age, years on engagement, industry experience, and any regulatory issues would also prove useful.

As has been said many times, a little something signed is the best disinfectant.

Number seven. We include the Auditor's Review Report in our firm 10-Q. Over 15 percent of the S&P 500 does the same. I'm surprised that the percentage is so low. Consider extending the other information standards of the quarterly review procedures and encourage or require the inclusion of the Review Report in the 10-Q.

Number eight. Final comment, kudos to the SEC for jumping off the IFRS bandwagon. Thank you for this opportunity to speak to you today.

MR. DOTY: Thank you. Cartier Esham.

MS. ESHAM: Good afternoon, Chairman Doty, members of the Board. My name is Cartier Esham and as stated I'm the Executive Vice President of Emerging Companies at BIO.

Roughly 90 percent of BIO's 1100 member companies are pre-revenue emerging businesses. Thus, product sales do not fund biotech research which can cost upwards of $1 billion. Instead, companies turn to external investors to finance their drug development programs. The capital markets play an important role in biotech capital formation and I want to thank you for the opportunity to speak with you today about ensuring that small public companies are given the opportunity to succeed on the market.

Because small biotechs do not have product revenue, burdensome regulations have an outsized effect on them. A one-size-fits all compliance requirements regime diverts funds from the lab and slows the development process. The JOBS Act has shown that a common sense regulatory approach helps biotech capital formation. In fact, nearly 80 biotechs have gone public in the last two years, a dramatic surge considering that two years prior the JOBS Act, we only saw 30 biotech IPOs. The reasoned regulatory approach prescribed by the JOBS Act has been a success. Bio is hopeful that the PCAOB will bear in mind the importance of right sized regulatory requirements as it considers changes to the Auditor's Reporting Model.

We agree with the GAO's finding that the proposed critical audit matters would for any science company not enhance the usefulness of the auditor's report or add value to the users.

As a representative of emerging growth companies, the proposal would only add significant cost burden on growing companies without providing a corresponding benefit to its investors. The PCAOB is proposing release notes that is virtually certain that an auditor would identify critical audit matter based on the proposed standard in any given audit report. Meaning, we can be similarly certain that the audit cost will go up. Quite simply, the new proposed standard would increase the scope of work necessary to complete an audit and these costs would be passed on to emerging growth companies and its investors which can ill afford such a substantial capital diversion.

Again, as stated by the GAO, these additional requirements they determined would not improve audit quality. Emerging growth companies in the biotech industry have few employees and a simple corporate structure, so it does not require an overly detailed analysis to understand the inner workings of their business. BIO fully supports strong investor protections, but the primary value of a biotech company is and will be based on its scientific disclosures and not additions such as proposed.

But I also believe that the provisions in the JOBS Act were designed to ensure that a one-size-fits all approach and increasing regulatory burdens on small companies should be actively discouraged, unless the SEC determines that any such additions are "necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation." We believe the proposed standard would increase the auditor's scope of work and the audit fees for the company would not provide -- would not meet that test to providing additional value to investors and would divert valuable time and resources away from these small companies' core missions.

In the case of small biotechs, this would mean a diversion away from funding scientists and their efforts to research and develop the next generation of medicines, a result Congress clearly sought to avoid.

Bio urges the PCAOB not to apply the standard to emerging growth companies which have thrived under a common sense regulatory regime rather than the one-size-fits all burden. And we thank you for your time and I look forward to answering any questions you may have.

MR. DOTY: Thank you. Joan Waggoner.

MS. WAGGONER: Chairman Doty, Board, Chief Auditor and staff, thanks for inviting me to participate in the meeting. I am a partner in the Professional Standards Group of Plante Moran which is a regional public accounting firm in the Midwest. My previous firm, Blackman Kallick, merged into Plante Moran almost two years ago.

I've been asked to discuss CAMs, the CAMs aspect of the proposed model from the viewpoint of the smaller auditing firms.

First of all, I would like to thank the Board for all the work it has done to reconsider the Auditor's Report Model. This project is, I think, one of the most difficult that the Board has undertaken since its inception, given all the diverging points of view and interests that are involved, and to focus the auditor's voice on only audit matters has been a very interesting concept to contemplate.

My partners and I discuss the typical CAMs that we would expect to see in our practice. We would expect to see predominantly valuation allowances or impairment issues on asset accounts as the most common theme, although there are certainly others. I have included a list in an exhibit at the end of my statement that is more specific and complete. I have also highlighted those that we think are especially relevant to emerging growth companies. We do recognize though that the determination of CAMs is very specific to a particular issuer and requires significant judgment on the part of an auditor.

From reviewing the comment letters of the smaller accounting firms, there seems to be a reluctance to total embrace the inclusion of CAMs in the auditor's report. From discussing the issues with my partners, we also have some worries about certain aspects of CAMs, although we are supportive of the Board's objective to make the auditor's report more meaningful to investors.

Now I should warn you there will certainly be some similarities in my following remarks about these concerns with what you have already heard today, but I will be looking at them from a different perspective which is from the smaller accounting firm and smaller issuer companies.

I believe the concerns emanate from a couple of things. First, some of the reluctance may come from accounting firms' lack of history in disclosing original information. I believe that many of the CAMs would correlate with other disclosures already present in the 10-K or that arguably should be in the 10-K. However, we may end up with some instances where we are faced with the potential disclosure of original information.

This disclosure of original information is not natural to auditors. And since the beginning of recorded time, we have been following the model of management asserts, we attest. This model has been reinforced over time as auditors' responsibilities have changed, most recently with the Sarbanes-Oxley internal control work where again management asserts and we attest.

The force is strong within us that original information should be authored by management. And I should clarify that what I mean by original information in this context would be control deficiencies and other things like corrected or uncorrected misstatements. And so that is what we are thinking of as being original information.

It is important though that the auditor's report be relevant to investors. And so the big questions with many of the small firms is will the inclusion of CAMs and auditor's report benefit the investors in small companies? As my partners and I were thinking through the possible CAMs we would expect to see in our practice of smaller issuers, we were not sure how information would be used or interpreted by investors who do not fully understand the complete auditing process.

I understand that the Center for Audit Quality has initiated a field test of the proposed Auditor's Reporting Model and I am very interested in reviewing the results of that testing once it is completed to help us see more clearly the value of CAMs to the investors in small companies.

In addition, in the comment letters I saw a lot of commentary indicating the concern that the CAM paragraphs might be construed to be piecemeal opinions within the financial statements or otherwise diminish the value of the pass-fail model.

At this point, we do not have clear information about how investors in small companies would use or perceive that information and so it is hard to conclude one way or the other as to whether or not the opinion would be enhanced or diminished by the inclusion of CAMs. But I believe that it is very important that investors understand that the audit is of the financial statements taken as a whole and that the CAMs be presented in a manner such that they enhance, rather than diminish the opinion.

Also, I expect that the volume and the cost of CAMs will be proportionately greater for smaller issuers and especially for emerging growth company audits. Many smaller issuers have excellent controls and processes, some including some emerging growth companies have not yet built the necessary financial infrastructure because of spending priorities. I expect that this lack of financial infrastructure would most often result in a lot of CAMs or at least some lengthy ones, disproportionate to the larger filers.

Lastly, many of us have concerns regarding the availability of firm resources during a very busy time. We expect that significant firm resources in terms of our most senior and experienced people will be necessary at the end of an engagement to determine the CAMs and also the content of the additional paragraphs in the report, especially for some of the smaller and emerging growth company issuers.

We worry that this additional responsibility at the end of the engagement may strain resources so that attention would be diverted from other value-added audit responsibilities. I believe these factors are the primary ones that worry smaller auditing firms with respect to CAMs. The big unanswered question though in my view though still to come is whether or not investors in smaller companies will find CAMs useful. Once that question on the information available from these surveys and to the Board's satisfaction, then it will perhaps easier for the Board to be confident in its direction regarding CAMs.

I do have a couple of suggestions for the Board's consideration to address some of these above concerns which are included in my written statement which can be looked at at another time.

Lastly, one of the questions in the proposed guidance was whether or not the guidance should be applicable to emerging growth companies. On one hand, as I mentioned previously, I would expect that for the typical emerging growth company that there would be CAMs, maybe many CAMs to be considered for inclusion in the auditor's report. On the other hand, I would expect that the market place's primary interest in these companies at this stage of their development is whether or not the issuers has the potential to be successful in its mission or its product. And if this is so, then the cost-benefit may not be there for CAMs.

Again, thank you for the invitation for me to participate on this panel and I look forward to our discussion.

MR. DOTY: Thank you. Jeanette.

MS. FRANZEL: Thank you for being here today and sharing your perspectives with us regarding smaller companies and smaller audit firms. I'd like to ask each one of the panel members in your experience what do you see in terms of how investors communicate with the company and with the boards in the smaller company environment that maybe we should be considering as we are considering this standard.

And Cartier, if you could also add comments about EGCs as well. So we can just work our way down the panel and anyone who would like to start.

MR. DOTY: They're all looking at you, Andy.

MR. BISHOP: We have three analysts that follow us. Each quarter when we report our numbers, they come up with an update of their reports and they have never asked any questions about the accounting. They ask questions on why maybe costs went up, why margins went down, but no questions on accounting.

Personally, I don't have a problem with this approach. I would like to see it done by the Audit Committee as opposed to the auditors though. If we are doing what is called a non-D&O road show, we go out and talk to investors. Again, no questions. They're more interested is the coal business going to be around for a while? That was their concern.

MR. DOTY: Any other points of view on the panel to address Jeanette?

Cartier?

MS. ESHAM: I am going to provide an answer and again, I hope it's the answer you're looking for in the sense of small companies and investors and I'm talking institutional investors actually have a very prolonged, often, relationship in determining whether or not a small company is going to go public. In regards to -- one of the things I wanted to comment in regards to some of the comments I've been hearing this afternoon in the sense of more information is better, I think that's true. But in the case of certainly the biotech community, we worked for years with the passage of the JOBS Act on that more information sort of mantra and that was really carried out in the provision of testing the waters such as provisions of testing the waters which has allowed and I think been perceived by both investors and the small companies as a huge success with the ability to communicate more information. But again, it's really been, the conversation has really been focused about educating about their ability, of the science, and the ability to carry that science forward.

We have not heard a lot of questions in regards to auditing report content, although we have had a history of working with this Board and providing numerous comments on a variety of the excellent work that you're doing in looking for improvements.

MS. FRANZEL: And do you see differences between the EGCs and the other small companies that you deal with in terms of that communication?

MS. ESHAM: Well, the other small companies we deal with are private companies, so that's in the venture capital world.

MR. DOTY: Jay?

MR. HANSON: I've got another question along the governance theme and I'll pick on Andy first, but I'm interested to hear all of your views on this.

Andy, your suggestion is having the Audit Committee report the critical audit matters and I appreciate many people have that same view that may be an appealing way to go and we're doing much more interaction now in the last year or so with Audit Committee chairs and Audit Committee members and getting good sense of what the larger company Audit Committees are doing.

We have fairly significant, albeit anecdotal feedback, and the smaller the company, the less robust the Audit Committee discharges their responsibilities and part of it is the ability to track Audit Committees that have the skills to do and part of it is maybe just not knowing what to do.

And I'm not going to ask you to comment on your Audit Committee because that will put you in a tough spot, I know you and I have been around a lot and talked to lots of companies and lots of preparers. And just your sense as to with regard to the operationality of your suggestion for the smaller companies having the Audit Committees do it, whether today you think there's the skill set and the capability across the universe of the smaller companies, just from your experience? And appreciate any of the rest of your comments about your observations about the effectiveness and the ability of the audit committees of smaller companies to do more than they're doing now.

MR. BISHOP: The way I see it playing out is that I would sit down with the Audit Committee chairman and together I'd put together the bullet points. I'd say here's what we're going to talk about. And he says I think that's right. And the auditors would have given their report, too. And he would say, Andy, you draft it. That's probably how it would shake out. He would agree with the points.

MR. HANSON: Any comments from the rest of you on this?

MR. SCHACHT: I'm not sure, Jay, I fully understand your question, but big company, small company, medium company, there's plenty and plenty of resources out there in terms of how you properly empanel and engage in the activities of an audit committee. So it's not for lack of resources. Whether small issuers can attract the same level of competence and capability that the larger issuers do on the Audit Committee is clearly, they're clearly at a deficit to do that. So I would say, generally speaking, there is not the same level of experience and expertise on the smaller company boards and on the Audit Committee. I think we're getting there. I think there's certainly a heck of a lot more attention being paid to it than ever before. And I think people are waking up to the fact that if there is one key important check and balance on corporate governance for investors it is the Audit Committee that, in fact, is probably the king of all the corporate governance bells and whistles and protections.

MS. WAGGONER: In addition having the Audit Committee prepare a report of some sort that timely goes out along with the auditor's report has a great appeal to it. As I was listening and hearing about the UK model where the FRC is in that enviable place where they can both set corporate governance regulations and also the auditing standards. You know, that's like a perfect way to bring it all together which is to say you get an auditor's report that's very much complemented or complements the report from the Audit Committee and everything just works much more as everyone is collaborating to get good information out to investors.

MR. FERGUSON: I have a question, initially directed to Andy, but the rest of you pop in if you want to. As I heard you, you said that you thought critical audit matters, if they were disclosed at all, should be done by the Audit Committee rather than the auditors. Those are two different kinds. They're not identical proposals, so the kind of disclosure would not be identical, let's assume you're correct about that. Given the fact that we have no jurisdiction over that and that would have to be done by the Securities and Exchange Commission and I would defer to my colleagues from the SEC here, but my understanding is that the SEC has a really, really full docket now. And I would suspect that this might be pretty low on their list of priorities. If that were the case, is having the auditor do it such a bad idea, in your view, that we should simply drop this project?

MR. BISHOP: No, I don't think you should drop the project. Maybe SEC could rearrange their priorities and move this up to the top.

MR. FERGUSON: Assume they don't rearrange and I'm not speaking for my friends from the Commission here. They do what they want to, but let's just assume for purposes of this argument, they're not going to rearrange their priorities for this.

MR. BISHOP: Then we'll go with what you have, let the auditors do it. But for the Audit Committee to do it, the Audit Committee Report needs to move to the 10-K. It doesn't make any sense to get the 10-K out and then two months later the Audit Committee Report comes out in the proxy statement needs to go out and the 10-K and again, that's probably their jurisdiction. But that's how I look at it.

MR. DOTY: Steve Harris.

MR. HARRIS: Mr. Schacht, you heard what Ms. Waggoner said about the disclosure of original information. And my question is why you think it is important that auditors provide additional information directly to investors?

MR. SCHACHT: I think there's been a -- just to maybe reiterate some of my opening remarks, we've been talking about this now for decades about the quality of the information that's coming from the professional firm that's actually being voted on by investors and being paid for by investors, and the quality of what -- the usefulness of that information. And I'm not an expert on the history of original information coming from the Audit Committee versus the company, but I think the fact of the matter is that everything else is changing in the world of finance and around the process of being a public company.

And I don't think there's any reason why the audit profession and the profession that they are providing, the service that they are providing for investors should somehow be exempt from those changes and from the very dramatic differences at how markets operate and how markets trade and how people invest.

And so it may be long-standing, commercial, historical practice. I get that, but does that mean we never change it? I don't think so.

MR. DOTY: Mr. Baumann, Chief Auditor.

MR. BAUMANN: Thanks, I have a question for Joan and Cartier. Both of your comments, you indicated an expectation of increased costs as a result of this and maybe disproportionate costs on smaller companies. CAMs, as we've talked about them in the proposal, are based upon what the auditor has done. It's fundamental to their work, critical audit matters are documented in their work papers, discussed with the engagement quality reviewer. That's probably the critical audit matters that's contemplated are probably the topics that are most discussed between the auditor and the Audit Committee. So there's nothing new about developing a CAM. It is the fundamental things that are being discussed with the top management of the firm and the audit firm, the engagement team, the engagement quality review, the Audit Committee, et cetera. So we're talking about here about putting in the audit report what's probably already written in the Audit Committee Report, except maybe more succinctly.

In addition to that, we heard today from several people, most notably from the UK experience where they're actually having these enhanced disclosures. And Nick Land from the FRC indicated he didn't see any reason for increased costs as a result of this for similar reasons. So given the fact that all of these matters are just matters that are already addressed with the Audit Committee and it's really adapting something that's already written to the Audit Committee for consumption by the investor and there's some experience overseas that it doesn't have any cost, where do you have the expectation of significant costs?

MS. WAGGONER: Certainly one of the big factors for the smaller companies is the cost associated with transition in the very first year because of what we would expect to be a heavier volume of CAMs that would exist for certain of the smaller companies and the emerging growth companies.

On a recurring basis, one of the things we were trying to think through is what would cause that cost to continue to be higher than we would expect. And I think it's because you know where those systems, the systems of the smaller companies aren't necessarily geared up in the early part of their lives to capture all the information needed for accounting purposes and so forth and so on, that things will just pop up a little bit more. We would expect a little bit more of a volatile environment.

So even though I would expect from year to year there would be recurring CAMs of which perhaps the cost to process the auditor's report would not be excessively high. There is an associated cost with the volatility at the end of an audit which will take up a lot of time from folks disproportionate to the engagement. So I think that would be the continuing factor that we would see.

MR. BAUMANN: Just an observation again, even though there could be more issues in a smaller company, again all of those issues should still have been discussed by the engagement team, evaluated by the engagement team, discussed with the Audit Committee if there are important issues so again, even if there's more, they've already been communicated to the Audit Committee and now it's a matter of communicating them in some lesser format or some -- to the investor.

MS. WAGGONER: Arguably, quite true, but the crafting of new ones for purposes of public dissemination would still be a significant cost because it's not just correcting the spelling and put it out there, you know. It does go through a few levels of review and consideration and so forth and that is going to be taking the time of the most senior people in the firm to get those handled properly.

MS. ESHAM: Just to agree with several of the points that Joan raised and I think as we read the proposal, I think a couple of the concerns that we have are again, they're almost -- there was an implication that essentially every auditor would have a critical audit matter outside of the context of the audit report process which includes the dialogue between management, the Audit Committee and the auditor. So I think there were a lot of mays and coulds of what that might entail that is concerning and so the presumption is that it inevitably will require more work and thus more fees by the emerging companies.

And the price tag of paying for extra auditing fees is not the only cost to an emerging growth company. Again, when you have a company that has 25 employees, and again, their core mission is in our case research and developing medicines, it is perhaps a hiring of extra staff. It is a longer runway of paying for auditing fees that are diverting funds away from again their core mission which is of concern as proposed.

MR. DOTY: I think Kurt wanted to comment on that.

MR. SCHACHT: I think the interesting thing that's going on is that everybody is still very gun shy about SOX 404 and sort of early experience with that and maybe the miscalculation of the cost benefits of that and I don't think anybody wants to make that mistake again. But I would tend to see this similar to as you just laid it out that it's not a lot of additional work. It's not the same dynamic as we were experiencing with a brand new Sarbanes-Oxley and that when you look at the audit completion document or the report of the Audit Committee that most of the work is done, it's just a matter of how you would price the step of actually having to make a professional disclosure about that and I really don't know how that would happen.

MS. WAGGONER: If I can make one more point.

MR. DOTY: Please.

MS. WAGGONER: Thank you. There is in a lot of the smaller company audits, it is a kind of a rush to the finish. The deadline looms and everybody is very focused on getting the audit done and management is working to get the financial statements done. There's still a lot of stuff happening at the last minute because a lot of these audits are not the most efficient audits in the world just because of the way the data is gathered and so forth and so on.

So there's also not just a cost, but the rush to the finish is a real thing that exists for many, many audits of small companies.

MR. BAUMANN: That environment sounds like it's even more important for the investors, therefore to understand, there's critical audit matters in those companies. So that's my view.

MS. WAGGONER: And indeed, you may be quite correct, Marty, on that. I think the proof is actually going to be as we see things roll out and how the information is used, I still haven't heard anything definitive on exactly how the investors in smaller companies actually would utilize the information. And I think that is arguably a very important thing to be resolved before we move forward on this, simply because it is so important to the smaller companies and the emerging companies because of the cost.

MS. ESHAM: I did just want to respond to that to make sure I didn't leave that just hanging out there, but again, I think from our point of view, the value of small companies, again, I can speak most assuredly about the biotech industry again. In our conversations with investors and what we hear from our CEOs is the value of the company rises and falls on the product -- their ability to advance their product, the science that they're working on. That's the value of a small business of an emerging growth company. So I do just want to emphasize that.

Again, going back to the discussions that were held in both the House and Senate during the JOBS Act debate, that is why you see provisions specifically laid out in the law that recognize one, the importance of allowing these emerging growth companies to transition into the public market. That's why there are exemptions to certain things. That's why there is not a one-size-fits-all framework in that. And again, it's pertinent to this argument, the one that specifically talks about the supplemental information in the form of the AD&A proposal and determine that that is not appropriate to apply to emerging growth companies.

MR. DOTY: I want to follow up on this with both of you because I want to talk about, get your reaction to what I'll call the bonding principle. The JOBS Act didn't wall off the PCAOB from the audit report and it certainly didn't suggest it was out of the question to add further information. It did go, as Cartier points out, to the question of an AD&A which we've taken some pains to distinguish from.

But is there any concern on the part of either you, Cartier Esham or Joan Waggoner, about the precedent we have with what I will call blue light districts that have been launched with the best intention of creating more rapid capital formation? And I'm thinking of the London AIM market and sort of the American Stock Exchange's ill-fated excursion into a midcap market. The Nuevo Mercado and certain other areas.

Are you concerned or should we be concerned or should we be concerned that if we have a rule that requires some kind of amplified audit discussion, if we modify the audit reporting model at all for big companies, for other companies, everybody else but EGCs, that if we don't fashion a rule that can be applied by EGCs, we have -- and it's required to be applied by EGCs, that we have created the beginnings of a kind of blue light district for some of the companies that we're most interested in growing.

I do understand that audits are cost. Kurt makes the point that none of the reforms in Europe have really delayed the completion of the audit cycle, but I hear Joan point out that it's harder for smaller companies. It's a messier situation, but the fact that the smaller companies will perhaps have less in the way of critical mass on controls, more of the critical audit matters, including perhaps more related party transactions and other issues that auditors have to look hard at and that, in fact, they are less likely to be free of any concern for the auditor. Isn't that a reason why we should be concerned that whatever we say about the actual disclosures that it should apply to everybody? That we don't want to have a situation in which we're creating a class of second class companies that can go on the exchange and are we really doing no favor to emerging growth companies if we create the lowest expectations for their auditors in terms of what we want them to tell the public?

Discuss among yourselves, please.

(Laughter.)

MS. WAGGONER: Well, you know, I am in actual total agreement with Kurt, that if you enter the public markets, you accept the level of responsibility and accountability. But when we are considering changes to the auditor's process and the auditor's report, I think we need to distinguish between two things. Is the change being designed to protect the markets, to protect the marketplace? Or is it to enhance the information available to the marketplace?

I would suggest that if the goal is to protect the marketplace, certainly I think rules should get applied across the board or with a much higher level of cost-benefit analysis or a lower threshold, if you will.

If the goal is to enhance the information available in the marketplace, that might be a lesser standard. And so the cost-benefit analysis would go -- the threshold would be higher. And it is then for us to contemplate are the proposed changes to the auditor's report to protect the marketplace or to enhance the information available to the marketplace?

MR. DOTY: A choice the logicians always struggle against that opting from one or the other.

Cartier, how about it? Isn't the biotech industry one that needs to be worried about having the emergence of a blue light?

MS. ESHAM: One, I do not think that we are a lower class small business on the market today.

I did have a question and I apologize for my own ignorance, but in the London example that has been brought up today, are there exceptions to emerging growth, small companies within that system that's being applied?

MR. BAUMANN: Right now, that applies to the largest companies, the FTSE 350. So it's not just emerging growth companies. They applied it initially to the FTSE 350.

MS. ESHAM: Just to clarify, we don't have --

there's not an example then in London of how this would or would not affect emerging growth companies as of yet. I just wanted to clarify that.

So again, I think Joan raises a great way to put it is protect and inform and on the informed side, again, I think the question and again, very specifically focused, my comments are very specifically focused on the proposed CAM and in that sense I don't think that we agree that the added regulatory burden would equate to again as prescribed by the JOBS Act necessary and appropriate to protect or benefit the public.

Secondly, I do also want to make clear that in the greater context of are there ways to improve the auditing process or the auditing report as to how that may inform. We've certainly been engaged with your work since 2010, 2011 and I think, in fact, have been supportive of certain proposals such as one made in our comments in 2011 around clarifying language within the auditor's report. So I want to distinguish between a very specific issue that my comments were directed at today, the proposed CAM. But again, we are willing and have been working with this Committee on looking for improvements, to ensure that that doesn't happen, any blue light districts sort of situations, it's not --

MR. DOTY: I was impressed with Joan's paper because I think you, in fact, have five very pragmatic suggestions for CAMs and for the reporting level change which are quite specific. You do not seem to be concerned that any expansion of the information in the audit reporting model conjures up concerns about excessive liability.

You don't believe that any attempt to reform the audit reporting model necessarily involves devaluing the binary report. I may be misreading you, but your concerned about that, but you have you have suggestions to avoid it.

I come away with the sense that you think that on the whole, while there's some work to do on this proposal that it's time to expand the reporting model and that your firm can do it.

And you can do it on a cost-efficient basis for mid cap and small cap issuers. Am I wrong?

MS. WAGGONER: Chairman Doty, I must say that nobody reads between the lines better than you. Well, yes, I would say we think that the CAMs model is a reasonable one to apply and that it's workable as a thought process. We would not be worried about our ability to write the CAM. We certainly have plenty of talent in-house to do that.

The cost I don't know, but we did not actually develop any sort of estimates about what the add-on costs would be associated with it, so I cannot speak to that. We've already spoken about it a little bit.

On the litigation front, we're not in the same world as the large firms and I knock on wood when I say that. So I can't really speak to the litigation side of things because it's not the world we live in at this point.

MR. DOTY: You may feel it's ungentlemanly of me to try to create these differences between you and Cartier, but that's the kind of ruthless, mean regulator that I am. At this point, I'm going to pass the -- pass it on to Jeanette, to my colleagues?

MS. FRANZEL: We heard earlier today concerns from a number of panelists about the lack of sort of a materiality threshold or filter in the current CAM proposal. And I'm wondering if we were to address that issue, would that alleviate to any degree some of the concerns that you have with the current CAM proposal?

Joan, and whomever else would like to address that question?

MS. WAGGONER: I think it would be helpful to add a materiality factor to it just to make it absolutely clear. I rather think it was kind of implicit in the way it was written and I wasn't concerned that it wasn't there. But as I've listened to the comments, it strikes me why not be perfectly clear.

MS. FRANZEL: Would that help with some of the messiness and the small companies that you -- when I was listening to you talk about sometimes it's just difficult to pull data together, I guess I was interpreting that as sort of maybe deficiencies in internal controls, but not ones that would rise to material weaknesses, but that was one of the examples we heard earlier that gee, if that's a CAM, all of a sudden that may not be material and that may be original information being disclosed by the auditor.

MS. WAGGONER: One of the things as I was thinking through the CAMs definition was was it workable? And at first I began to believe that if we were just auditing something very inefficiently, that that might be something that qualified as a CAM. But then I realized as I continued to look at it and think about it, that I believe it wouldn't necessarily be that it was an inefficient audit area as long as the test was based upon good quality evidential matter that was clear.

And so for instance, I was thinking of the area of customer contracts and revenue recognition. And maybe the system of the issuer doesn't capture all the information that it should in order for us to be able to figure out, should it be 2014 revenue? Should it be 2013 revenue or whatever. And so perhaps the testing that we do is extended. But if the customer contract is very clear as to what the terms of sale are, then we have good and sufficient evidence supporting the revenue cutoff procedures as we call them.

And so I don't think that would end up being a CAM because it just doesn't seem to hit on the definition. If, however, the customer contract isn't clear, if the customer contract was pulled off the internet and used by the company because it didn't want to pay some legal fees right off the bat, which I don't recommend by the way, you have a lack of clarity and then you just might be in CAM country. Did that address?

MR. HARRIS: I am just wondering Joan, how do you avoid boilerplate? We've discussed that all day, but in terms of the CAM, how you constrain it to what's most important to the user?

MS. WAGGONER: The big risk, I think, in writing CAMs is the ones that recur year after year, pretty much the same thing. And in a way, if you have a heightened level of detail, the detail might change from year to year and that might keep them kind of fresh. But I worry about the recurring items, but for any particular year, those recurring items may still be very relevant and helpful to investors. So I'm hoping that the world continues to evolve and that we understand the increased importance of a fresh look at things every year. And I think we can do it. I think we can do it.

MR. HARRIS: And how about the others of you. Do you have any ideas in terms of how we streamline this to avoid boilerplate and what's most important to the investor or to the user?

MR. BISHOP: Sitting here thinking about what's been discussed, just going through my mind, Hallador has always been a trendsetter in disclosures. I thought well, maybe I'll just file the Audit Committee Report as an exhibit to my 10-K and see what comes out of that. I have to get the okay from my auditor. They may not like that idea, but that would give you what you want.

MR. HARRIS: Do you have a problem with that?

MR. BISHOP: I'm just thinking, I wouldn't have a problem, the rest of the Board, auditors might have a problem with that, but that gets the answers what you guys are looking for.

MR. HARRIS: Would anyone else have a problem with that?

MR. FERGUSON: One of the things several of you have mentioned is the fact that for smaller auditors and smaller audit firms having to identify CAMs and write them up would be a squeeze at the time you have to issue your report. I'm not an auditor, so but it would have occurred to me that given that there are critical audit matters that they should have been identified in the first risk assessment meeting for the auditor. And that they then should, in fact, inform the audit work that you do because they are, after all, critical to the audit. And if that's the case, why can't these things be written up during and early on in the process so the most that has to happen in the end is simply a review of what's already been written. Because it strikes me if you find a critical audit matter right before you're about to issue the opinion, something has gone wildly wrong with the audit. Am I wrong?

MS. WAGGONER: One of my recommendations was in my letter is that the planning and Audit Committee standards of the PCAOB be amended to include the preliminary spade work on CAMs in the planning process, and in the early communications with the Audit Committee because I think we can really help the workload issue at the end if we know and can expect which are the -- well, we try to identify risk of material misstatement early on and so that kind of goes hand in glove with determining the critical audit matters.

And I believe that on a recurring basis they can be identified early on. I'm just saying we have a more volatile situation sometimes with certain of the small and emerging companies such that issues, new issues will pop toward the end of the audit.  Those are the ones I was referring to on a recurring basis.

MR. BAUMANN:  A follow up if I can.  Andy, a comment, discussion on cost was primarily focused on Cartier and Joan, but you indicated earlier that you didn't have a disagreement with CAMs, that primarily you'd like to see them in the Audit Committee Report. Secondarily, if that didn't happen then continue our project for the audit report.  But did you agree with my assessment of they shouldn't necessarily cost a lot given the fact --

MR. BISHOP:  I agree with that.  Where the costs will come in is the wordsmithing of how this is going to deal with the words.  I think we all know what the issues are.  How is -- do you put a comma here, do you capitalize that?  That's what's going to --

MR. BAUMANN:  So in other words, the bulk of the work has already been done on the CAMs.

MR. BISHOP:  Yes.

MR. BAUMANN:  I had one other follow up with you,

you did talk about the disclosure of the engagement partner's name in your information statement filed with the SEC. Any reaction from the engagement partner about disclosing the name and/or any costs involved with that?

MR. BISHOP: No. At first, I think they thought why are you doing that? Well, I think it's the right thing to do. And at the end of the day they agreed.

MR. HARRIS: Just out of curiosity so many people don't think it's the right thing to do. Why do you think it's the right thing to do? I mean the entire profession disagrees with that.

(Laughter.)

MR. BISHOP: I look at it, I have to disclose my name, my age, my bio, my compensation, what I've been doing the last ten years. And I'm paying these guys a lot of money, so what's wrong with disclosing their name? I don't see anything wrong with it at all. It's done in other countries, too.

MR. HARRIS: Does anyone on the panel have a problem with that?

(Laughter.)

With the auditor disclosing their name on the audit report? I take that everybody's saying they don't have a problem. Okay.

MR. DOTY: Your good humor and your -- throughout all of this, your good humor and your willingness to indulge us is, of course, appreciated and it relieves a long afternoon. But mainly we appreciate the kind of insight you brought from small companies, the care that's gone into the preparation of your written work which is really very good and which will be an important part of this record.

And your interest in this whole project.

Oh, Brian, my regulator.

MR. CROTEAU: Sorry, thanks. Before you wrap up, I just wanted to add not that I think -- hopefully people would not be confused by this, but Lew's comments about the SEC's workload and any considerations relative to the Audit Committee Report. Certainly, since there is now an open public comment period, if people do believe that we ought to be doing something with the Audit Committee Report, they should still continue to make those recommendations. We certainly do consider all the feedback and we will continue to think about those type things. Lew's hypothetical applied to the panel discussion here, just in the event people are listening and might be writing comments, I just wanted to make that clear.

MR. DOTY: Fair enough. You have given us insight into an important part of this whole picture that we cannot go forward without. And to get where we need to go, and to do something meaningful with the audit report, we need to take account of the things you've raised and the kind of intelligence and wisdom you've brought to us. Thank you. We adjourn. We will convene again in the morning. See you all then.

(Whereupon, at 5:13 p.m., the meeting was adjourned, to reconvene the following day, Thursday, April 3, 2014.)

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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Auditor's Reporting Model

Before: Public Company Accounting Oversight Board

Date: 04-02-14

Place: Washington, DC

was duly recorded and accurately transcribed under my direction; further, that said transcript is a true and accurate record of the proceedings.

Neal R Gross

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Court Reporter