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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
STANDING ADVISORY GROUP
MEETING
FRIDAY
NOVEMBER 16, 2012

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1 MS. CEYNOWA: Good morning, everyone. I'd like to
2 report that my group was very lively. We applied the street
3 rules, as Marty had suggested yesterday, and I'm happy to
4 report that there were no serious injuries after all the
5 debates that we had. There were no fist fights, so
6 everything turned out okay.

7 So, there was a considerable amount of discussion
8 about the merits of the emphasis paragraph, or expanded
9 auditor discussion in the report, and whether AS 16 should
10 really be a starting point.

11 One issue that was mentioned was that starting with
12 the auditor communications may cause a chilling effect
13 between the auditor and the audit committee, and that was
14 sort of cited as something to consider as an issue.

15 With regard to whether financial statement matters
16 or auditing matters should be emphasized, the group
17 generally favored financial statement matters, and did not
18 favor auditing matters such as specific auditing
19 procedures because describing this type of information
20 could be extensive, may result in information overload,
21 and may not appropriately reflect the amount of effort that
22 went into an audit area.

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1 And, of course, I just want to reiterate what Marty
2 said. If anyone in our group, if I said anything wrong
3 please, obviously, chime in, or if I left anything out,
4 please chime in.

5 Participants generally believe that the emphasis
6 of the audit process was not as important as the robustness
7 of the disclosures in the financial statements. With
8 regard to financial statement matters to emphasize, it was
9 recommended that the PCAOB look to what analysts look at
10 in developing their models and their cash flows.

11 We heard that there was interest in knowing the
12 following in emphasis paragraphs; that is, what has
13 changed, areas subject to sensitivity, areas that are not
14 apparent to users; for example, a disclosure that may be
15 subtle, information that goes beyond what is required by
16 GAAP to provide more valuable information to the user.

17 In terms of what should be communicated, there are
18 certain matters communicated to the audit committee that
19 are required to be included in the auditor's report. We
20 had heard that investors want the following four things,
21 which is insights on the quality and not just the
22 acceptability of the accounting policies and practices,

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1 significant unusual transactions, high financial
2 statement risk, the appropriateness of critical
3 accounting estimates.

4 There was debate regarding the amount of insights
5 with this regard -- the amount of insights that the auditor
6 would provide to the audit committee that would be
7 different information provided to users by management.

8 There were also factual matters, you know, in terms
9 of what is not specifically required in AS 16 should be
10 included in emphasis paragraphs. We heard that there are
11 factual matters that should be emphasized. These include
12 material fraud, violations of law, and instances where
13 there's impaired independence.

14 A counter to that, there are also things that
15 investors do not care about that is included in AS 16 and,
16 therefore, should not be emphasized. Some examples of
17 these are difficult or contentious matters, disagreements
18 with management as these would be presumed that these would
19 be resolved.

20 In terms of if things were left to the discretion
21 of the auditor, what are the factors or the criteria that
22 the auditor would use in determining those -- the things

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1 that they would highlight. It was suggested that auditors
2 look at what investors demanded through the PCAOB's
3 outreach, what we had heard, that the PCAOB should consider
4 whether we use data points, such as audit effort or time
5 spent discussing with the audit committee versus factors,
6 such as impact on future cash flows.

7 If the PCAOB would provide specific topics that the
8 auditor should emphasize and allow the auditor to use their
9 judgment, we had heard some people, or one person say that
10 this approach may result in firms competing via emphasis
11 paragraphs by conveying the quality of their work.

12 In terms of what is the appropriate level of detail
13 that should be provided in the emphasis paragraphs, we
14 heard that it should include the description, it should
15 include why it's important, and it should include the
16 location.

17 We had a considerable amount of discussion in this
18 area. The disclosures, we heard some believe that they
19 should just point to disclosures in the financial
20 statements serving as a roadmap for investor's attention
21 to those areas. And as a consequence to that, we also heard
22 that by emphasizing certain of these areas that these areas

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1 would most likely be the best written disclosures. Some
2 did not think a roadmap was necessary. Instead, they prefer
3 to receive specific detail from the auditor whether it was
4 original or not. We also had heard communicated to us that
5 investors will be disappointed if we only require a
6 roadmap.

7 But others indicated that there would be concern
8 about confusion between what management reports and what
9 the auditor emphasizes, so the question was posed how are
10 users supposed to reconcile the information when it's
11 different. However, others believed again that this would
12 not occur because management would probably not allow that
13 and adjust their disclosures.

14 And to that point then the question was okay, so
15 if management suggests their disclosures and we auditors
16 have the emphasis paragraph, then there would be a repeat
17 of information, the information would be shown twice.

18 We also heard are you driving GAAP through
19 auditing, believes that the auditor should only attest to
20 the information. Another challenge noted was that free
21 writing would take negotiating the language in the
22 emphasis paragraphs -- would cause negotiation of

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1 language in emphasis paragraphs, and that would add some
2 more time causing constraints with trying to meet your
3 reporting deadlines, your already tight reporting
4 deadlines.

5 When asked whether there should be specific reasons
6 to cite in the emphasis paragraphs as to why the auditor
7 chose to emphasize a certain matter, we heard that the
8 reasons should be self-evident because they would probably
9 be related to matters that are volatile, material,
10 subjective, and have an effect on the future.

11 With regard to the question on whether there should
12 be special reporting considerations for auditors of
13 smaller and less complex companies, brokers and dealers,
14 and emerging growth companies we heard the following. We
15 heard consider making it scalable, possibly consider a
16 phase-in period starting with large accelerated filers.
17 Investment companies should be excluded because they are
18 simple and their infrastructures are outsourced, exclude
19 wholly owned subsidiaries which brokers/dealers may fall
20 into that. And in deciding what types of audits to exclude
21 look to who the users of the financial statements are and
22 the complexity of the organization.

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1 And then a question was raised, what if you have
2 a company that is not complex or doesn't really have
3 anything significant to report, what should the auditor
4 say in that situation?

5 With regard to the last question, are there
6 specific elements of the project of other regulators that
7 standard setters at the PCAOB should consider for its
8 auditor's reporting model project? There were no specific
9 elements noted. However, it was recommended that the PCAOB
10 continue to monitor these activities of other regulators
11 and standard setters.

12 There were also some other points that were made,
13 and I'll go over those, as well, that were not specifically
14 on point with the questions. We heard some want the auditor
15 to indicate that the financial statements are presented
16 fairly and not just that they are presented fairly in
17 accordance with the accounting framework.

18 We heard that this project should not be viewed in
19 a vacuum. When auditor partner identification becomes
20 effective along with the required and expanded use
21 emphasis paragraphs, the market or investors will start
22 tracking disclosure of the emphasis paragraphs by partner

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1 to glean any trends associated with that partner.

2 We heard auditor liability concerns relative to
3 emphasis paragraph, and then we heard some points
4 regarding cost benefit, that the PCAOB should continue to
5 issue standards that are in the best interest of investors
6 and should not be fearful of cost benefit analysis, that
7 auditors should do a better job articulating costs of what
8 investors want in auditor's reports including impact on
9 audit quality.

10 And then, lastly, we heard a recommendation or
11 suggestion that we do a five-year Sunset provision for
12 implementation of this with retrospective -- with a
13 retrospective cost benefit analysis. Hopefully, I got that
14 right.

15 MR. BAUMANN: I especially like the part about don't
16 worry about a cost benefit analysis. Was that
17 authoritative?

18 (Laughter.)

19 MS. CEYNOWA: I think Mike Gallagher has his card
20 up.

21 MR. BAUMANN: Again, so thank you very much,
22 Lillian. That group was led by Keith and Jeanette was in

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1 there, as well, and Lillian. Mike.

2 MR. GALLAGHER: Yes, thanks, Marty. Good summary,
3 Lillian.

4 Marty, let me start by complimenting you on the
5 format of yesterday. I think it was incredibly conducive
6 to a substantive dialogue, and I would hope that we would
7 take this forward to future discussions in having the break
8 outs, because I think it really is conducive to a good back
9 and forth where we can grab a lot of substance. I know we
10 have to balance what we do in the public versus what we
11 do privately, but I think that was a really good balance.

12 In terms of the subject, I think it was a really
13 good session. I think it was a good dialogue. I think
14 Lillian summarized it well. I do think it's important that
15 the emphasis matters I think is the way to go. I think it's
16 important, however, to stick with the principles. We laid
17 out some principles both as a firm and as a CAQ particularly
18 around the original information about the company and
19 where that should come from, respecting roles, the
20 different roles of management, audit committee, and the
21 auditor, and at the same time making sure that investors
22 and users get the information they need. And the role of

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1 the auditor is critical in making sure that that
2 information is high quality. And we all know that the
3 auditors play a significant role even in the financial
4 statement footnotes that occur today in working side by
5 side with management making sure they're as transparent
6 and clear as they can be. And I think that this would move
7 it even to a higher level. As you said, Lillian, anything
8 that the auditor would emphasize, those are likely to be
9 the best written footnotes in the document. I think there's
10 definitely value there.

11 I just think the important part of sticking to the
12 principles is to avoid the idea of moving to auditor
13 discussion and analysis just by a different name, one
14 paragraph at a time. And I think that those principles kind
15 of stick to driving the value that you can get out of
16 emphasis of matter. It's something that's practical, it's
17 doable, and I think it provides significant value to
18 investors.

19 So, thanks again. I thought it was a great session
20 yesterday.

21 MR. BAUMANN: Thanks, Mike. Joe Carcello.

22 MR. CARCELLO: Let me start by saying I agree with

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1 Mike that it was a great session yesterday. I think it was
2 very productive. We may depart in terms of the second part
3 of what we said.

4 I think if all you end up with, Marty, at the end
5 of the day is the standard as currently written with some
6 wording changes and reference to two, or three, or four
7 paragraphs in the notes that the auditors emphasize and
8 that's it, I think the Board really runs the risk of having
9 this project viewed as an abject failure in the investor
10 community.

11 I have rarely seen so much commonality in terms of
12 feedback the Board has received both directly and
13 indirectly in terms of multiple studies in terms of what
14 investors want. Yesterday when we talked, and Steve Buller
15 from Blackrock was very articulate, but if you go back and
16 you look at the transcript of the roundtable on auditor
17 reporting, Marty, I would say Blackrock, although
18 supportive of changes among the investors who spoke at that
19 meeting, were probably among the more cautious investors.
20 The other investor groups and investor advocates wanted
21 even more information than they seemed willing to accept.
22 So, I think that's -- it's very important to keep in mind.

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1 And the thing that keeps coming through to me in
2 terms of three major areas, if at the end of the day
3 investors don't know more about risks, if they don't know
4 more about judgments and estimates, and if they don't know
5 more about unusual transactions, there's going to be a
6 significant percentage of the investor community that's
7 going to say you have failed. I don't know how to be polite
8 but more direct than that.

9 MR. BAUMANN: Jeff, your card was up. Are you -- did
10 Joe speak for you?

11 MR. MAHONEY: Just to add to what Joe just said.
12 In developing the concept release that was issued last
13 year, the PCAOB staff did extensive outreach to the
14 investor community. And their conclusion was, and I'm
15 quoting from the concept release, "There was consensus
16 among investors that the auditor has significant insight
17 into the company and that the auditor's report should
18 provide additional information based on that insight to
19 make it more relevant and useful."

20 So, if that view is correct, if that is the
21 consensus of investors, and there seems to be some other
22 surveys and studies that suggest that that is accurate,

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1 I think that raises the question, if you move forward and
2 you're just pointing to other footnotes and you're not
3 providing auditor insights, I think when you get to the
4 cost benefit analysis that you have to perform, I think
5 there's a question as what is the benefit if this change
6 that you're making to the auditor's report is not
7 responsive to the consensus from investor's, consensus
8 view. Thank you.

9 MR. BAUMANN: Rick Murray's got his card up. I know,
10 Rick, you weren't in that group, but did you want to --

11 MR. MURRAY: Marty, I think we need and deserve your
12 guidance at this point for making the best use of this
13 morning as to whether we're going to, in fact, run through
14 the reporting cycle as you outlined, or take the deep dive
15 into what's the right answer at this point of the
16 discussion.

17 MR. BAUMANN: I think each group member here has had
18 an opportunity in their group to make key points, as we
19 heard an issue from Mike, and we've heard the other side
20 of the equation from Joe and Jeff, and that group. So, I
21 think we got a lot of benefit of hearing a summary from
22 Lillian, but then maybe some emphasis from the others. So,

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1 I would like to keep with the path of going through the
2 groups and letting people who were in that group comment
3 on that.

4 We'll have more time after that to kind of delve
5 into your point, which I think is get to a solution, but
6 I think that would be -- if that's what you said, I think
7 that would be a challenge in this room.

8 MR. MURRAY: I was hoping we weren't going to do that
9 at this point.

10 MR. BAUMANN: I misunderstood your point, Rick.

11 MR. MURRAY: My concern was that we seem to be
12 drifting quickly into searching for final summaries of
13 position rather than going through the process you had
14 outlined.

15 MR. BAUMANN: Okay. Well, we will try to go through
16 the process I outlined, but as we said, after each team
17 reports as to what they heard in their group, we did want
18 to give people who were in that group an opportunity to
19 say I think I have a little different color than maybe what
20 you said in your summary. So, we'll try to stick with that
21 and see how it works.

22 The second -- sorry, Steve, were you in that group?

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1 MR. BULLER: Yes, thank you, Marty. So, I just wanted
2 to clarify the one point you highlighted. I think that the
3 group felt that the PCAOB should not feel constrained about
4 cost when considering solutions initially so that they
5 have the chance to come out with what they think is the
6 best solution. But we agreed, I thought, that cost still
7 is an important factor that needs to be considered at some
8 step along the process. We just thought the initial process
9 has to be free flowing, it has to be -- make sure all ideas
10 are on the table.

11 And Lillian, by the way, did a wonderful job
12 summarizing our group, and made us sound much better than
13 we were, believe me.

14 MR. BAUMANN: Lillian has a way of doing that, so
15 very good.

16 The next group is going to be summarized by Elena
17 Bozhkova, which included Jennifer and Steve Harris.

18 Thanks.

19 MS. BOZHKOVA: Good morning, everyone. The
20 discussion in our group was a little bit different from
21 that in Group A. It was a little bit more free flowing,
22 so I will not necessarily be associating each one of the

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1 take aways from our group to a specific question. But the
2 key take aways from the discussion in Group B are the
3 following.

4 The majority of participants in Group B suggested
5 staying away from the list of required communications in
6 Auditing Standard 16, and instead focusing on a more narrow
7 list of areas that could be considered for emphasis
8 paragraphs in the auditor's report.

9 Some consensus seemed to emerge around a list of
10 four items that would generally be of interest to
11 investors, such as, one, how comparable are the financial
12 statements to those of peer companies in the same industry?
13 Is there any reason for them not to be comparable? Two,
14 how different would the financial statements be if
15 management used other reasonable estimates and judgments?
16 Three, what are some of the unusual transactions and
17 events? And, four, what is the auditor's view about whether
18 there are any unusual risks related to the company?

19 It was recognized that there are a number of
20 challenges with respect to this list, such as potential
21 litigation. Upper discipline suggested a safe harbor for
22 auditors in the case of expanded reporting. Another

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1 challenge that was discussed was the historical nature of
2 the audited financial statements including the auditor's
3 report versus the more current financial information such
4 as earnings releases and quarterly reports that are often
5 used in investment decision making. Another challenge that
6 was mentioned was whether the auditor is motivated to make
7 any of these disclosures.

8 A few SAG members in Group B thought that Auditing
9 Standard 16 may be a source for determining the kinds of
10 considerations and factors that would go into a framework
11 for what should be disclosed in the auditor's report which
12 should be based on the auditor's judgment, and not
13 disclosing the actual communication with the audit
14 committee.

15 It was further discussed that a reasonable investor
16 might want to know those items that were contentious
17 between the auditor and management. Many participants also
18 thought it was very important not to chill the discussion
19 with the audit committee as a result of any additional
20 auditor reporting.

21 Some participants said that an argument can be made
22 for management to provide information of interest to

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1 investors rather than the auditor. Other participants
2 pointed out that there are reasons for auditors to be the
3 source of that information, such as their independence.

4 A key point of discussion was whether any emphasis
5 paragraphs should be focused on audit-related or
6 accounting related matters, and many of the participants
7 in our group supported a view that management should be
8 providing any accounting-related information and the
9 auditor should be focused just on audit-related matters.

10 While there was a general support that the auditor
11 could provide audit-related information there was no
12 consensus on what that information could actually be, but
13 it was mentioned that it could be related to the four items
14 described earlier.

15 The group discussed that the current reporting
16 model does not give the auditor a voice. It was
17 acknowledged that at the heart of this project is whether
18 in order to serve investors better we should provide the
19 auditor a voice and consider on which topics the auditor
20 should provide information to benefit investors.

21 Auditor association with management discussion and
22 analysis and with non-GAAP measures was deemed valuable

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1 by many participants as this type of information is
2 typically used in investment decision making.

3 It was also noted that there will be some cost
4 associated with anything of value that the auditor can
5 provide, and there is also a time aspect to the auditor
6 providing more information in the auditor's report.

7 A few participants believe that it would be
8 worthwhile to combine the going concern project with this
9 project due to the reporting of risk and uncertainty
10 elements. And last but not least a participant thought that
11 certain brokers and dealers should be exempted due to their
12 ownership structure and nature of operations.

13 So with that, any comments from Group B? And I see
14 Rick. No. Steve?

15 MR. BAUMANN: Wayne Kolins.

16 MS. BOZHKOVA: Oh, Wayne. I'm sorry.

17 MR. KOLINS: Yes, a good summary, Elena. One thing,
18 in terms of the audit process and the focus being more on
19 the audit rather than financial reporting was a view taken
20 by some. But in terms of the audit process, I believe it
21 was the results of the audit process, not the -- the
22 results of the audit, not the process itself. In other

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1 words, no detailed listing of audit procedures that
2 resulted in an auditor's view.

3 MS. BOZHKOVA: Thank you.

4 MR. BAUMANN: Bill Platt.

5 MR. PLATT: Thanks, Marty. First, I guess I would
6 just compliment you also on the format of the meeting. I
7 think it was very productive. I found both the breakouts
8 I was in yesterday afternoon to be a very good dialogue
9 that took I think each of the participants, evolved their
10 thinking or views as a result of that dialogue. And I found
11 it to be a more productive way to try to really tackle how
12 do we best solve issues.

13 Also, Elena, I don't know how you took the chaos
14 of our group and turned it into that nice organized
15 summary, but congratulations. You made it sound like we
16 were geniuses, but I would say that the point about
17 focusing on -- and you mentioned four questions or four
18 areas. And I would say in our group we didn't necessarily
19 say that -- we didn't have a vision as to whether that was
20 accomplishable or not, or how one might best accomplish
21 best adding value in providing an auditor's voice on each
22 of those items. They are aligned with what investors were

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1 asking for. If you look at page 3 of the summary, I think
2 there's four bullets, and they're generally aligned with
3 those four bullets. But we thought that rather than
4 exploring hundreds of types of things that may be
5 facetious by that comment but hundreds of types of things
6 that might be considered, that maybe if we took a deeper
7 dive on for and really tried to explore to say what's
8 practicable, what's feasible, and what can add value at
9 the same time and maybe value is a more important driver
10 than I implied by the ordering of what I had that that would
11 be a productive exercise to go through. But I think you
12 did a great job summarizing what the group's discussion
13 was.

14 MR. BAUMANN: Bill, I'm interested in -- or anybody
15 else in your group in the context of the first group I
16 thought I heard a lot of support for emphasis of matters
17 paragraph, and then Joe made an editorial, emphasized that
18 it needed to go further than just pointing to the
19 footnotes. But the listing that Elena gave of matters that
20 maybe would be discussed, and I don't know, Elena, if you
21 could just summarize those one more time, it didn't sound
22 necessarily like matters in the financial statements to

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1 be emphasized. It sounded -- it did sound more of I'll say
2 AD&A like. Can you just say what those four or five items
3 were that you thought there was some support around?

4 MS. BOZHKOVA: Sure. The first one is how comparable
5 are the financial statements to those of peer companies
6 in the same industry, and is there any reason for them not
7 to be comparable? Second one is how different would the
8 financial statements be if management used other
9 reasonable estimates and judgments? Three, what are some
10 of the unusual transactions and events? And, four, what
11 is the auditor's view about whether there are any unusual
12 risks related to the company?

13 MR. PLATT: Marty, I think that certainly some of
14 those would be disclosures in the financial statements and
15 are consistent with emphasizing that. One would think that
16 the -- take estimates as an example, that the significant
17 estimates and the ones that if estimates were different
18 would have significant impact on financial statements
19 should have robust disclosure in footnotes, and so the
20 auditor's reporting I think would be complementary with
21 the disclosure you would see in financial statements. I
22 think significant unusual transactions would be the same

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1 aspect.

2 I think when you get to things like risk, and I think
3 our discussion focused on financial statement risk, not
4 risks to the entity, although some had some discussion
5 about risks to the entity but I think there was a number
6 of people in our group who felt that an auditor is not
7 really the right person to talk about business risks, or
8 environmental risks, but we are -- we do have a special
9 area of expertise in some financial statement risk. That
10 might be something that's not in the notes, that the
11 companies aren't necessarily disclosing that. But I think
12 part of looking at this would be to say what information
13 is useful to investors, and then how best to convey that.
14 And I think, ultimately, it probably is a combination of
15 management reporting supplemented to some degree by
16 auditor statements or auditor's views.

17 MR. BAUMANN: Thanks for that clarification. And
18 the point you made about risks I think is a good one, too.
19 That word is tossed out a lot, and you clarified that you
20 thought that you were talking about risks are material in
21 the statement of the financial statements.

22 Joe, you said before three things have to be

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1 included, otherwise we'll miss the boat. You said risks,
2 significant usual transactions, and significant judgments
3 and estimates. Is your context of risks the same thing,
4 risks of material misstatement in the financial statement?

5 MR. MURRAY: Yes.

6 MR. BAUMANN: Thanks, Thanks a lot. Wayne.

7 MR. KOLINS: I just wanted to add one thing. In the
8 context of the unusual items there was an idea thrown out
9 about the auditor -- some kind of auditor association with
10 non-GAAP information, with a non-GAAP earnings number
11 which might then flesh out unusual items that are reported
12 by management or unusual items that should be reported by
13 management and called out by them.

14 MR. BAUMANN: Kevin Riley.

15 MR. RILEY: Yes, Marty.

16 MR. BAUMANN: You were in my group, Kevin. You
17 forgot?

18 MR. RILEY: I have a question for Elena and maybe
19 other members of the group. But one of -- and as Barb gives
20 the debrief on our conversation, one of the thoughtful
21 comments that was raised is we don't want to risk turning
22 auditors into equity analysts. And when I hear the four

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1 issues that Elena raised as things that auditors might want
2 to focus on, particularly things like what might the
3 financial statements look like if management had used some
4 other assumptions or issues, is that we're drifting away
5 from auditor responsibility more into equity analyst land,
6 and I just wanted to get some additional perspective or
7 color commentary on that particular question.

8 MR. BAUMANN: I agree with your point. That's why
9 I sort of went to that, as well. That sounded outside of
10 the financial statements, including how does the
11 accounting compare to a peer group. I think that was one
12 of your points, too, so --

13 MS. BOZHKOVA: Well, I think the way this list was
14 developed was really points that would be of interest to
15 investors, and the discussion focused around that. And
16 there were various points of view as to who may be in the
17 best position to provide some of this information. And I
18 wouldn't characterize the discussion as a consensus that
19 all of this would come necessarily from the auditor, but
20 there was general consensus that these types of matters
21 would be of interest to investors, and so it's up to us
22 to consider how to take that in consideration for purposes

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1 of this project.

2 MR. BAUMANN: Mike Cook.

3 MR. COOK: Marty, maybe just to add a little bit of
4 flavor to that, as well. Our group was just wide ranging,
5 very provocative kind of a discussion. I thought it was
6 very good, and capturing it is an incredible task, and well
7 done. But I think this discussion of the four items was
8 not recommending that those four items are going to find
9 their way into the auditor's report. I think it was in the
10 context, and Greg should speak to this because he was the
11 thought leader behind that particular discussion, was
12 about the kinds of things that investors would be
13 interested in and might, if practical, considerations
14 could be or problems could be overcome, might be targets
15 to be moving toward both by management and the auditor in
16 reporting. And I thought there was very good discussion.

17 I don't think there was a consensus that we're ready
18 to move to those items being included in the auditor's
19 report other than in a transition basis. But I would like
20 to just -- and Wayne picked up one of these items, follow
21 a suggestion which again didn't necessarily garner great
22 hordes of support, but it was suggested that there are

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1 existing disclosures and information outside the basic
2 financial statements that you by auditing or by
3 associating the auditor with them, MD&A, the risk factors
4 that are disclosed and non-GAAP information could be
5 dealing with and giving auditor assurance at some
6 appropriate level to a number of the things that people
7 tell us that they would be interested in. MD&A would take
8 you to critical accounting policies, judgments and
9 estimates, risk factors would deal obviously with that
10 subject, and non-GAAP information would be particularly
11 valuable because the message here is that GAAP isn't
12 telling people what they need to know. And here's what you
13 need to know to assess the results of this company. And
14 the auditors are directly associated with what doesn't
15 tell you enough, but are not associated with what you need
16 to know. And that seemed to me, and perhaps others, to be
17 a bit of anomaly when I think about how important the
18 non-GAAP presentations are to investor communications,
19 and audit committees. And the time that is spent on them,
20 for the auditors to be detached from that seemed to be
21 missing an opportunity. So, that was kind of where we were
22 coming from, or at least my thought in those three items

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1 is instead of the almost impossible task of identifying
2 all the things that people might emphasize in the future,
3 or auditors might be reporting on in the future, that seems
4 like almost a hopeless task. And I certainly, and I think
5 our entire group almost to a person said AS 16 is not the
6 right framework, and we should not be using AS 16 as a
7 source for what auditors might report on. But I think if
8 you can use existing frameworks that are there well
9 understood, and all we need to do is wrap some part of the
10 auditor around those disclosures, you could accomplish a
11 high percentage of this without the, again, impossible
12 task of trying to define what should be in and should be
13 out.

14 So, I thought that was an important part of our
15 discussion, but I don't think we should over-emphasize the
16 four items. They were very thoughtful, but I don't think
17 anybody was ready to sign on that we're going to have
18 auditors doing those things in the near future, or maybe
19 ever.

20 MR. BAUMANN: That's a good clarification, so thanks
21 for sharing that. And I had a feeling it was an engine and
22 caboose discussion coming down the path any moment, as

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1 accounting estimates and critical accounting policies and
2 practices, as well as significant risks.

3 AS 16 also includes a lot of information about the
4 audit. There was limited or no support really for including
5 a lot of information about the audits, such as audit
6 procedures or audit strategy. And partially the reason for
7 that is because it would be very difficult to summarize
8 the audit procedures into a concise paragraph that would
9 be understandable to users of the financial statements.

10 We also talked about whether or not there should
11 be certain matters that the PCAOB prescribes should be in
12 an auditor's report, or if a lot of the matters should be
13 up to the auditor's discretion. And there was really no
14 support in our group for the PCAOB determining what should
15 be in an emphasis paragraph; however, that maybe there are
16 certain matters that we could point out in the standard
17 that the auditor should really consider and think about
18 these certain matters but maybe not make it a requirement.

19 So, we found in our group that there really was more
20 consensus for the auditors to use their discretion in
21 determining what to emphasize using an established
22 framework or some kind of framework, not one that's

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1 currently established. And so, we talked about what kind
2 of things that the auditor should think about in
3 determining what to emphasize.

4 And so, someone in our group suggested that the
5 auditor should think about the greatest risk of the
6 material misstatement to the financial statements, and
7 about significant risks that the auditor identified in
8 doing the risk assessment procedures. And then you have
9 other matters such as the estimates, the critical
10 accounting policies and practices, and the critical
11 accounting estimates.

12 We also talked about what kind of details should
13 be included in the auditor's report, and I think one of
14 the things we talked about was, obviously, the matter
15 should be identified, but really why the auditor is
16 identifying it as opposed to just a roadmap that says go
17 look at a certain financial statement disclosure, but why
18 is the auditor identifying it? And one person gave an
19 example in our group that presenting information to
20 investors that might be calculable from the financial
21 statements but maybe not readily apparent may aid
22 investors in understanding why such matters are important

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1 from an audit perspective. In that instance, it was such
2 as a percentage of Level 3 assets or the hard to value
3 assets. And that would at least give information to the
4 investors about why the auditor is highlighting it but
5 without providing new information, because that
6 information can come from the financial statements.

7 We also heard that the auditor should not be
8 communicating matters that are not in the financial
9 statements, so the auditor should be really pointing to
10 things that are in the financial statements, and also maybe
11 summarizing them in a manner that is easier for an investor
12 to understand why the auditor is highlighting it.

13 There was a broad concern in our group. We think
14 that these emphasis paragraphs could become boilerplate
15 over time, and that the PCAOB needs to consider how to avoid
16 boilerplate disclosures, the same disclosure every year,
17 or the same disclosure for the different companies that
18 have similar matters. It should be specific to the company
19 and specific to the matter.

20 We also talked about whether there should be
21 certain reporting considerations for different types of
22 entities, smaller and less complex, brokers and dealers,

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1 and emerging growth companies, and what we got out of that
2 is really we need to think about the standard as being
3 scalable. As opposed to trying to eliminate or exempt
4 certain companies, maybe we just need to consider that it
5 should be scalable.

6 And then there are some other suggestions that came
7 out of our group that the Board should perform field
8 testing on the standard and that it should include the
9 auditors, issuers, and investors in our field testing. And
10 then we should also do a post implementation review after
11 the standard has been implemented. So, we could do that
12 through inspections or otherwise.

13 And then we did have one suggestion that perhaps
14 we should make changes to the auditor's report gradually
15 over time. We could start with a roadmap and then work
16 towards maybe more disclosure in the emphasis paragraphs
17 over a period of time. And then, ultimately, we had a
18 suggestion that emphasis paragraphs or in changes to the
19 auditor's report could increase the quality of the
20 financial statement disclosures if you are pointing to it
21 and could increase the audit quality. So, that was what
22 we heard in Group C. Does anyone in Group C want to comment?

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1 MR. SHOWALTER: Yes, good job of summarizing getting
2 a diverse view. I had two points. I just want to emphasize,
3 really not disagree but emphasize with your point. One was
4 that, and it relates back to what, Lillian, you reported,
5 as well; is we thought when auditors do include an emphasis
6 paragraph it will clearly improve the disclosure in the
7 financial statements. Particularly when we talked about
8 adding the second piece to that disclosure, which, why the
9 auditor thought it was important, would really focus the
10 issue we're on making sure those disclosures are
11 appropriate in that.

12 The other point you mentioned about liability, we
13 were a little concerned that as this went forward, you
14 could get over disclosure on behalf of the audit firms
15 because they were trying to minimize their risk, as well.
16 So, when we talked about that we were concerned about okay,
17 if one firm has six risks and someone is talking about eight
18 risks, then the next thing you the next firm next year will
19 come out with eight risk because their attorneys have told
20 them what happens if you don't get the risk disclosed in
21 the emphasis matter, so we were concerned about driving
22 those disclosures to the point where they don't become

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1 helpful because it's like the current risk disclosures in
2 10(k), not very helpful. Thank you.

3 MR. BAUMANN: Gary Kabureck.

4 MR. KABURECK: By the way, Jessica, very good
5 summary of our meeting yesterday. Just one thing we did
6 discuss, I don't know that we had a consensus on it but
7 it was discussed in any event, not violently rejected, was
8 should the audited financial statements and/or the
9 auditor's report be amended to include critical accounting
10 policies, that today is resonant in the MD&A. And I think
11 a lot of the items that the investor community is asking
12 for about auditor involvement with sensitivity,
13 alternative accounting policy selections and stuff,
14 that's what the critical accounting policy section is
15 designed to do.

16 Now, there might be degrees of compliance with it
17 out in the world, but I think what would happen is if the
18 auditors were associated with it, I think the bar would
19 be raised, perhaps better critical accounting policy
20 disclosures more consistent with at least the spirit of
21 which of the CAP rules were enacted, 10 years or so would
22 help.

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1 Again, there wasn't necessarily a consensus on it
2 but by sweeping those inside the financial statements and
3 underneath the audit report I think some of the concerns
4 being addressed here about the criticality of accounting
5 policy start to get to be addressed. Again, no consensus
6 but I think something you could put in the work plan for
7 consideration.

8 MR. BAUMANN: I assume it's recognized that that
9 point, Gary, whether the opinion should be extended to
10 cover critical accounting policies would be really
11 probably outside the scope of -- I think outside the scope
12 of what the PCAOB could do. What's in financial statements
13 is based upon rules that are not ours so, therefore,
14 auditors express an opinion on what's in the financial
15 statements, so somebody else would have to make that
16 determination to put that into the financial statements.

17 MR. KABURECK: Yes. No, we understand that, I mean,
18 but as your organization, the SEC and the FASB work
19 together. It's just part of the overall process.

20 MR. BAUMANN: Jerry De St. Paer.

21 MR. DE ST. PAER: Thank you, Marty. I'd agree also
22 that the summary that you gave, Jessica, was right on the

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1 mark. And the one spin, and it was only that that I wanted
2 to add, is that the idea that as we were looking -- going
3 through this process with the auditor determine what was
4 in and what was not in, it was going to be sort of a
5 framework, that part of that framework would be something
6 akin to, I'm not saying it would be the same as, but a
7 SAD-99, what's important to the investor. So, the focus
8 here is back on the user, and not just on the accounting
9 and the numbers, because some numbers can move in material
10 ways and not have a material impact on what investors are
11 thinking. And others can move in less ways and have more
12 impact, so the idea here was to try to get a focus on what
13 would be important to the user.

14 MR. BAUMANN: Thanks, Jerry.

15 MS. PAQUETTE: Thank you. Jessica, very good
16 summary. I just wanted to underscore one of the points from
17 the group. We keep hearing comments about potential
18 roadmaps, and I'm not sure all of us have the same idea
19 of what a roadmap might look like. And I just wanted to
20 highlight from a user's perspective that if an emphasis
21 paragraph is included having some commentary on why it is
22 important. Our group talked about whether we wanted a "War

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1 and Peace," or we wanted a third-grade reader in terms of
2 the content of what was being added. And I take that point
3 to heart, but I think from a user's perspective why the
4 paragraph is being added is important. And I think the
5 intention is to provide more information and more valuable
6 information, and from my perspective if it becomes an
7 indexing of information that's already provided in the
8 financial statements, that will not be helpful.

9 MR. BAUMANN: Sam Ranzilla.

10 MR. RANZILLA: I just want to pick up on the point
11 Gary made. And we had very limited discussion as a result
12 of a very effective discussion leader on anything other
13 than the five questions. But I do think, as I have for two
14 and a half years now, that the answer here is somewhere
15 embedded in the critical -- in an attestation by the
16 auditor of critical accounting estimates, critical
17 accounting policies. One very well could argue why do we
18 need both of those terms and, Marty, I fully recognize that
19 such an approach requires the Board to work with other
20 organizations in order to effect such a change. But while
21 I am a supporter of where you're headed, or where I think
22 you're headed in terms of emphasize of matter paragraphs,

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1 I continue to believe that that is the second best option.
2 And that an attestation of some limited portion around
3 critical accounting estimates and using existing
4 interpretations that the SEC has would really drive better
5 disclosures and the auditor's association with those
6 better disclosures I think hits the mark closer to what
7 investors are asking for.

8 MR. BAUMANN: Sam, do you think there are sufficient
9 rules around requirements and critical accounting
10 estimates, and critical accounting policies that an
11 auditor could attest to that today versus what I'll say
12 is maybe interpretative guidance out of the SEC with
13 respect to those areas?

14 MR. RANZILLA: I do. I mean, I think that if you look
15 at the existing interpretation that the SEC has,
16 especially -- I mean, my focus has been primarily around
17 critical accounting estimates. And, again, I struggle a
18 bit with why we need three different concepts around a
19 company's accounting policies and estimates. Significant
20 accounting policies, critical accounting policies, and
21 critical accounting estimates, I mean, we ought to be able
22 to come up with a definition of things that when you look

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1 at it you say what are the most important policies and
2 practices of the company with respect to its financial
3 reporting. And, as a result, we end up with I think
4 complications that are unnecessary. But to your point, I
5 think if others don't, I wouldn't object to additional
6 interpretations, to additional frameworks that would help
7 an auditor benchmark against that, but I think today an
8 auditor could do that.

9 MR. BAUMANN: Thanks, Sam. I'm sorry. Dan
10 Montgomery.

11 MR. MONTGOMERY: Thanks, Marty. And, first of all,
12 I just wanted to express again my appreciation for allowing
13 me to represent the IAASB at this meeting and in the
14 breakout session yesterday. And, Jessica, great job,
15 definitely a very good summary of the discussion of the
16 group.

17 I did want to come back to one point, and that is
18 it's been raised by a couple of the other folks on including
19 in the emphasis paragraph at least something to indicate
20 why the auditor believed the matter was of importance
21 to users. And this is something that the IAASB has heard
22 from global stakeholders. And I think in part it speaks

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1 to some of the misperceptions about why this information
2 is being asked for in the first place.

3 What we have heard, what the IAASB has heard
4 internationally is that this is more related to the
5 relevance and the value of the audit, and it's not about
6 the accounting. So, while some believe that the auditor
7 is being asked to provide information to fill gaps in terms
8 of understanding the accounting or the complexity of the
9 accounting, the global stakeholders that the IAASB has
10 talked with have said that is not the case. They recognize
11 that if there are issues with accounting that need to be
12 fixed, that that is the role of the accounting standard
13 setters. What's helpful, though, is to get a little more
14 transparency into the audit, and by having the auditors
15 identify those matters that were of the most importance
16 or considered the most importance in the audit because they
17 were matters of financial reporting complexity or matters
18 of significant management judgment, or matters that had
19 been discussed with those charged with governance, that
20 that information is what is important to users to get a
21 better understanding of where the auditors were focusing
22 their effort. And then in turn by having at least a little

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1 bit of information about why that matter was considered
2 important to the audit, that that provides at least a
3 little bit of insight into the auditor's risk assessment
4 process and the way the audit was approached.

5 MR. BAUMANN: Thanks, Dan. And I'm glad your sort
6 of clarified I think further at the end about the audit,
7 because on the other hand I do think we're hearing that
8 people are not necessarily interested in some sort of brief
9 summary of audit procedures. And I think you've
10 acknowledged that's not the case here. It's about the
11 audit, but why was this particular matter in the financial
12 statements being emphasized because of its importance to
13 the audit. And then why was it important to the audit as
14 opposed to procedures. Thanks. Any cards up?

15 Okay. Then the final group Barbara Vanich is going
16 to report on, and I was in that group with Jim Doty and
17 Jay Harris, as well, from the PCAOB. I always mix up Steve
18 Harris and Jay. I combine the two of you constantly.

19 MS. VANICH: Thanks, Marty, and good morning. At
20 least I know I can't screw up worse than that.

21 (Laughter.)

22 MS. VANICH: It's always great going last once all

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1 the best jokes have been used, but honestly, Group D, take
2 comfort in the fact that everyone knows we save the best
3 for last.

4 (Laughter.)

5 MS. VANICH: Group D had a really constructive
6 discussion. We didn't exactly stick to the discussion
7 questions no matter how many times I kicked Marty under
8 the table, but I believe at the end of the day we answered
9 most of them. So, I tried to summarize the topics we
10 discussed in that order, which I can just hope does justice
11 to the thoughtful commentary that we had from our
12 participants yesterday.

13 We also had some suggestions that were a little
14 beyond the scope of the discussion paper but which,
15 nonetheless, were very valuable so I'll try to add them
16 on to the end. And in the interest of summarizing, I'm
17 really going to take the first two discussion questions
18 kind of at the same time because that's how we discussed
19 them.

20 So, with respect to what matter is communicated to
21 the audit committee under AS 16 should be in an emphasis
22 paragraph and why, and what would not be appropriate and

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1 why, and whether financial statement in auditing matters
2 should be emphasized or only should financial statement
3 matters be emphasized. I think our group focused on what
4 was important, and that it's important to have important
5 matters included in an emphasis paragraph. And given the
6 existing requirements for auditors to communicate
7 important matters to the audit committee, there's likely
8 going to be overlap. However, I didn't hear that we should
9 use AS 16 as a checklist or as a kind of check the box on
10 what should be included.

11 Our group was fairly supportive of including
12 emphasis matters paragraphs, and focused I think more on
13 financial reporting type matters such as significant
14 accounting estimates and judgments, significant unusual
15 transactions, transactions with related parties that are
16 material, material uncertainties and other matters that
17 affect the risk of material misstatements to the financial
18 statements.

19 With respect to auditing matters, there wasn't as
20 strong support. There wasn't a lot of dissent on perhaps
21 some very high-level matters such as audit strategy or
22 plan, but we didn't as a group seem to have a lot of value

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1 in communicating audit procedures at that level of detail.

2 Some participants thought that when you talked
3 about what matters are important to an audit there would
4 generally be overlap with significant accounting matters,
5 so you might actually get to the same place.

6 With respect to what should not be included, I think
7 our group was generally of the view not to include original
8 material by the auditor, and that while the auditor should
9 have judgment and discretion on what should be emphasized,
10 they should not use judgment in the actual material that's
11 being reported.

12 We spent quite a bit of time kind of starting with
13 a model matter of emphasis paragraph that would include
14 the matter, why the auditor chose to emphasize the matter,
15 and where the matter is further discussed in the financial
16 statements.

17 While our group suggested that we could go ahead
18 and require the emphasis paragraph, they were definitely
19 not as supportive of being prescriptive regarding the
20 content. And we had a range I thought that was interesting
21 of kind of at most having a rebuttable presumption that
22 certain matters would be communicated while others at the

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1 other end of the range suggested it should be much more
2 discretion based on the auditor's judgment.

3 With respect to if matters to emphasize were left
4 to the auditor's discretion what factors should the
5 auditor consider in determining what matters are most
6 important to financial statement users. I think that we
7 generally focused on items that were subject to
8 measurement uncertainty, or that were otherwise
9 significant to a user's understanding of the financial
10 statements. You know, it all came down at the end of the
11 day to where auditors spend their time, and what keeps the
12 auditors up at night.

13 With respect to what the appropriate level of
14 detail that should be provided in the emphasis paragraph,
15 I think we spent quite a bit of time talking about the
16 merits and the risks associated with various types of
17 discussion that the auditor could have. And that
18 generally, again, auditors would not include new
19 information, but would rather reference where in the
20 financial statement information is included. And while I
21 think we did acknowledge that many investors might find
22 more information valuable than the risks don't outweigh

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1 the rewards. And that you could potentially, if an auditor
2 reported inaccurate or --inaccurate information or made
3 the wrong judgment, you could have the auditor -- that
4 paragraph changing the valuation of the company, and that
5 would not be a good consequence to have.

6 When we talked about whether there would be any
7 special reporting considerations for audit of smaller and
8 less complex companies, broker/dealers, or emerging
9 growth companies, I think we didn't hear that there would
10 be any kind of carve-outs. And, in fact, several people
11 mentioned that they thought it might be particularly
12 important for emerging growth companies who because of a
13 lack of a large accounting staff or focus might actually
14 have more risk of material misstatements related to
15 significant unusual accounting matters.

16 And with respect to whether there are specific
17 elements of projects of other regulators or standard
18 setters that we should consider, similar to Group A I
19 believe, we didn't have any specific matters noted.

20 Some of the other things we heard that again our
21 group, I think, was relatively supportive of matters of
22 emphasis paragraphs, and that while it might seem like a

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1 small step, we thought that there would probably be a good
2 change generated by having that small step, and whether
3 it focused auditors more on what was most important, or
4 if it improved the disclosures that are referenced to
5 include more important information, that that would be,
6 in general, a very good result, and a very good first step.

7 We did hear that it was important to strike the
8 right balance of what was important without going
9 overboard, so while there was the view that it shouldn't
10 be limited to one paragraph, we also shouldn't encourage
11 something that was so long that the important details got
12 masked in the level of detail presented.

13 And another good comment was made regarding just
14 the design and engineering of the opinion, in general, and
15 that's something we could consider as we move forward with
16 this project, that the auditor's opinion is still the most
17 important opinion to investors, and to be careful that it
18 didn't get clustered among other unnecessary information
19 which could, in effect, diminish the value of the report.

20 With that, please, if there is anyone from Group
21 D that would like to emphasize something they said that
22 I didn't capture, please raise your tent card. Bob Herz.

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1 MR. HERZ: Barb, you captured this, but it's a point
2 that kind of building off of what Dan said about the
3 international view. And I think some of that was in our
4 discussion, too, as to really whether or not the auditor
5 report, the emphasis should be based upon what the auditor
6 viewed most significant to the conduct of the audit versus
7 what the auditor thought was most significant to
8 investors. And there might --hopefully, the two would
9 overlap, but the issue of what was the point of departure
10 in judging significance, whether it was the audit, or
11 whether it was what the auditor thought investors might
12 think most important, I think there were those little bit
13 of back and forth, a little bit of -- in our group, you
14 know, some people kind of I think framed it more from one
15 point of view, and other people framed it from the other
16 point of view. But listening to Dan, it seems to me that's
17 something important to sort out.

18 MR. BAUMANN: Is that Kevin, Kevin Riley.

19 MR. RILEY: Yes, thanks, Marty, and great job, Barb.

20 The only other thing I just wanted to emphasize
21 coming out of the group, it wasn't a total consensus but
22 recognizing that this project will be a change, and we

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1 should perhaps focus on being more modest out of the gate
2 with respect to the demands placed on the auditors to do
3 things along these lines. See how things develop in
4 practice, take a deep breath down the road and consistent
5 with what I think came out of Jessica's group, then perhaps
6 change on the fly after we've had a chance to take a look
7 at how it's working. So, I thought that was an important
8 concept.

9 MS. VANICH: Arnie.

10 MR. HANISH: Barbara, I thought you did a great job,
11 also. I guess the only comment I would make is, I just want
12 to make sure that we all understand that at least from the
13 perspective I believe, and I think others believed in the
14 room, I don't know if we had a total consensus, but that
15 it would not necessarily be fully appropriate on the
16 auditor's part to I'll call it opine or focus on the
17 judgmental aspect of the accounting estimates. I think,
18 you know, to try to stay focused on the emphasis of where
19 the audit was being performed, the nature of the estimates,
20 or the nature of the areas of most significance that would
21 provide a reader with the understanding that these were
22 the areas where there was significant time being spent.

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1 This is where the areas of risk from a material financial
2 statement misstatement existed, but to fall short of
3 necessarily providing additional context around the
4 nature of the judgments and accruals. Again, recognizing
5 that the financial statements are made up of significant
6 estimates with ranges, but it wouldn't necessarily be
7 appropriate for the auditors to -- because they've already
8 given an opinion on the financial statements, that they're
9 in accordance with GAAP. And to go further to try to provide
10 contextual aspects around the nature of those estimates,
11 at least my view is that that would be one step too far.

12 MR. BAUMANN: Gaylen.

13 MR. HANSEN: Yes, just as a follow-up to -- and I
14 don't know that we -- Barbara, I don't know that we
15 necessarily discussed it in great detail yesterday in the
16 breakout, but focus on what's important. And I raised that
17 question yesterday, important to whom? And a reasonable
18 investor, that -- and I appreciate your input on that,
19 Jennifer, but we really need to think about who we're
20 talking about here, because there's a wide range of
21 investors. And I hope that wouldn't be overlooked.

22 MR. BAUMANN: It's very hard to summarize these

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1 comments, but I'm going to take a little bit of a shot.
2 From what I heard, and maybe you all heard things
3 differently, but the notes that I was taking down was there
4 is a reasonable amount of support for an approach that used
5 emphasis of matters paragraphs. There wasn't a lot of
6 support for simply just pointing to those footnotes or
7 those -- just saying what the matter was. There's a desire
8 for some commentary as to why that matter is being
9 emphasized, why it's a matter that was most important to
10 the audit, maybe why it should be considered most important
11 to investors, oftentimes maybe those two should overlap
12 I think I've heard, but some commentary around that, the
13 emphasis of matters not being tied to AS 16, specifically,
14 but when I hear about the nature of the matters significant
15 unusual transactions, related parties, matters with
16 significant judgments and estimates, complex accounting,
17 they're matters that are discussed with the audit
18 committee. So, I think there's just some tonal aspect to
19 that there about don't use the AS 16 necessarily as a
20 checklist for this, but the types of things you would
21 discuss with the audit committee are likely to be the types
22 of things that you'd emphasize.

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1 I guess in our group we did say could you imagine
2 emphasizing something in the opinion that you had not
3 discussed with the audit committee, and it was really hard
4 to imagine that. You might do that. It's probably the last
5 time you'd issue a report on that client, however.

6 Whether it's about matters in the financial
7 statements or not in the financial statements, I think I
8 heard more comments that it's emphasis of matters about
9 matters that are in the financial statements versus
10 matters that are not in the financial statements. And
11 emphasizing matters about the financial statements, or
12 about the audit, not about the audit procedures, but maybe
13 why it's important to the audit, but really emphasizing
14 the financial statements and what's in the financials, and
15 not audit procedures.

16 Some other tangential benefits that seemed to be
17 mentioned from a number of different groups were -- at
18 least I heard it in a couple, that the emphasis of matters
19 paragraphs will likely improve the audit of those
20 critically important things that are being emphasized, and
21 will likely improve the disclosures of those critically
22 important things that are being emphasized. And those are

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1 benefits that are not necessarily directly related to
2 meeting investor's needs with respect to some additional
3 information, but I've heard a number of times that that
4 probably is going to be an outcome of better auditing on
5 the margin around these important matters, and on the
6 margin maybe some better disclosures around these
7 important items.

8 With respect to the point that Sam raised, and which
9 I've heard a couple of times, that auditor -- and I think
10 it came out of another group, as well, maybe it was the
11 same group, but I know Mike was talking about it. Some type
12 of auditor reporting on other matters outside the
13 financial statements, or an attestation on critical
14 accounting estimates or critical accounting policies.
15 Don't think we've -- we haven't heard broad support for
16 that certainly in the 150 or so letters, 155. There was
17 not much support in the 155 letters for auditor reporting
18 on other information outside the financial statements. And
19 maybe, Jay Hanson, I'll give you the microphone. I do think
20 I recall you attending a conference and coming back and
21 saying you didn't hear that, as well.

22 MR. HANSON: A couple of us in the room here, Brian

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1 Croteau and I attended a roundtable hosted by the Center
2 for Audit Quality I think it was in January or so, early
3 in 2012, and the point was to kind of tease out some of
4 what investors wanted around the non-financial
5 information, and there just wasn't a lot of support for
6 it, which kind of surprised me because I came in with the
7 paradigm they would want it. That was just one group that
8 was pretty wide ranging group of investors, some
9 preparers, some auditors.

10 MR. BAUMANN: So, hard to summarize. And, Joe, you
11 made a very strong comment which I think you used the words
12 "abject failure." I make note of words like that. But an
13 emphasis of matter paragraph that described why it's being
14 emphasized and the importance of it, and dealing with
15 matters that are risks of material misstatement,
16 significant unusual transactions, areas of particular
17 judgment, is that directionally the types of things you
18 think would be important to make this project successful?

19 MR. CARCELLO: It's hard to know, Marty, without
20 seeing the detail of what the disclosures would have to
21 be. I think the important thing is there needs to be
22 meaningful new information around that either from

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1 management or from the auditor if all we get, as Jennifer
2 said, is a roadmap. And as Jeff said, as well, I don't think
3 the costs, I think the benefits are going to be less than
4 the costs in that situation.

5 Let me briefly respond to what Jay said, because
6 I think it's relevant. In this year's IAG meeting, Jay,
7 we reached out to investors, as well, asking them about
8 additional involvement for the auditors in some of these
9 other spaces that you're talking about, and some of the
10 feedback that came back, and the Board will remember this
11 from the IAG meeting, was if auditors are not willing to
12 communicate more to us now about what they know given the
13 very significant amounts that are being paid in audit fees,
14 we're not comfortable expanding their mandate. And, again,
15 if I was an auditor I'd be really concerned about that.
16 This is what customers are saying.

17 MR. BAUMANN: They were not necessarily saying,
18 though, they wanted auditor association with other
19 information. Right. Right. Can I just open the floor again
20 for -- this is such an important topic to us, happy to at
21 this point in time take additional comments from anybody
22 on any subject on this auditor's reporting model. And I

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1 have, first of all, Denny Beresford.

2 MR. BERESFORD: Just a brief comment. Marty, in your
3 summary you mentioned that emphasis paragraphs are likely
4 to improve the auditing and disclosure of the items
5 emphasized. And I think that's probably true, but keep in
6 mind, too, that to the extent that there is going to be
7 a lot of work that would go into the wording of emphasis
8 paragraphs, and I think that that would involve both the
9 senior level audit executives, senior lawyers on the side
10 of both the company and the audit firms in many cases, that
11 that is going to come at the cost of possibly taking away
12 from some other aspects of the work and/or adding cost
13 which, of course, is always a concern. So, there's always
14 at least the possibility that these procedures are going
15 to detract from other aspects of the engagement.

16 One of the concerns that I expressed in my comment
17 letter on the invitation to comment was the fact that we
18 already have engagement partners spending a great deal of
19 their time on the wrapping up aspects of the engagement,
20 and word-smithing and things of that nature, and to the
21 extent that they have even more of this type of activity
22 as opposed to the good old down and dirty auditing type

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1 aspects, that I think could be of great concern to a lot
2 of people.

3 MR. BAUMANN: Thanks, Denny. Mike Cook.

4 MR. COOK: Marty, I'm just puzzled a bit. And I heard
5 what Jay said, I heard what Joe said about investors don't
6 want auditors necessarily to be involved with other
7 information. But we've spent so much time talking about
8 auditors should be addressing critical accounting
9 policies, and estimates, and judgments, and that's what's
10 in MD&A. It's not new. We don't need to reinvent the wheel.
11 It's been there for, I don't know, 10 years, 15 years, John.
12 I don't know how long it's been there. It can be improved,
13 perhaps, but the same thing is true about risk factors.
14 Well, we'd like auditors to be engaged with risk, and
15 whether the disclosures of risk are appropriate. The
16 disclosure of significant risk has been around for a long
17 time, and it's part of the existing framework.

18 The one part that doesn't quite fit that, but I
19 think is more telling, and I won't repeat what I said
20 before, is non-GAAP information, because this is
21 management saying notwithstanding this 70 pages of other
22 stuff that we have given you to comply with one requirement

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1 or another, here are the things you really need to know
2 about the operations of this company. So, take the stuff
3 you got in the GAAP financial statements and add this, and
4 subtract that, and add these other two things, and then
5 you'll really know how we performed last year.

6 What would be more important to have the auditors
7 associated with than information that takes what they live
8 and die by, GAAP financial statements and translates it
9 into what management believes investors need to know to
10 assess the performance, the future cash flows and so on
11 of the company. And if that is being done in a misleading
12 way, or it's not being done fairly, the auditors are the
13 best positioned to make judgments about that. So, we have
14 these three things that are already there, and we're
15 thrashing around trying to define new things that we ought
16 to get people associated with. And AS 16 and all the stuff
17 that's in there, and somebody said well, it's important
18 enough to talk to the audit committee about, management
19 is talking to the audit committee about those things, not
20 the auditors. And the auditors are saying we agree, or if
21 they don't agree they're standing up and saying so.

22 AS 16, again, perpetuates this myth of a two-way

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1 communication which is not the way the world works. And
2 most of the communication is being done by the people who
3 are supposed to do it, which is the management of the
4 company. So, the auditors coming in at the end and saying
5 we talked or didn't talk to the audit committee about
6 something is almost irrelevant if management has done its
7 job properly. And we hope they have.

8 But I'm just puzzled by this -- I don't -- do you
9 know -- do all these people know what's in MD&A, and where
10 it came from, and what it's intended to tell? And all you
11 need to do is throw a saddle on that, put the auditor in
12 the saddle, and you'll get them associated with
13 management's having said notwithstanding 49 items in
14 significant accounting policies in Note One, here are the
15 four, or five, or six things you really need to know about
16 to assess our financial reporting. What could be a better
17 place to put the auditors?

18 MR. BAUMANN: Thanks, Mike. I think you're reacting
19 to what I initially summarized, and I asked Jay because
20 I knew Jay had attended a conference, but it was my summary.
21 And it's just a matter of fact, in 155 comment letters we
22 really didn't get any support for auditor association. We

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1 laid that out as an alternative so, therefore --

2 MR. COOK: Marty, if you don't ask the question in
3 the right way and you don't know what you're asking about,
4 you won't get the right answer. If you're asking the
5 question of would investors like auditors to be associated
6 with critical accounting policies judgments and
7 estimates, and the answer is no, or they're not commenting
8 I think you've asked the question in the wrong way, because
9 that's exactly what people are saying they do want people
10 to be associated with. And it's right there in MD&A and
11 it has been for years.

12 MR. BAUMANN: Okay. Dan Slack, you had your card up
13 for a while.

14 MR. SLACK: So, I just wanted to follow-up on what
15 Jeff had said, Mahoney had said earlier. And I just think
16 it's important that it should not be just a roadmap if
17 emphasis of matter paragraphs is the path that the PCAOB
18 goes down, that I think that it is important that there
19 be some qualitative approach, some sort of why, into the
20 process of why this matter is emphasized.

21 And I got a little distracted on my thoughts
22 listening to Mike speak. It's sort of interesting about,

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1 you know, bringing the auditors into the non-GAAP pro forma
2 estimates or whatever. And that is an interesting concept,
3 maybe it's a little bit beyond this auditor's reporting
4 model. I don't know, but I could see that that, in fact,
5 could be useful to us as investors.

6 MR. BAUMANN: Thanks. No, it wasn't beyond the scope
7 of this project. In our Concept Release we laid that out
8 as one of the possibilities, auditor association with
9 MD&A. And, in particular, we pointed out I think critical
10 accounting estimates as being an aspect of that in the
11 Concept Release. So, we did lay that out for investors.
12 Jay, you want to --

13 MR. HANSON: Marty, I just want to make a clarifying
14 comment on some of what I heard at this roundtable I
15 attended a number of months ago, and that was there was
16 acknowledgment of many of the people in the room talking
17 about this auditor association with the press releases and
18 the MD&A, that there already is involvement in most
19 companies with the auditors actually reading the press
20 release, and some of the context around the questions that
21 were asked. And that setting was gee, since the press
22 release often comes long before or at least weeks before

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1 the audit report is completed, the reporting that an
2 auditor could do if there's actually a report being written
3 wouldn't say a whole lot because it would say gee, we were
4 engaged to do an audit. These numbers agree to the
5 unaudited information. We're not done yet, and that would
6 give limited value to investor as an additional report,
7 but there is strong acknowledgment that there was already
8 substantial auditor involvement in the process and
9 additional reporting of what that involvement was wouldn't
10 add a lot of value.

11 MR. BAUMANN: Thanks for that clarification. I think
12 Mike pointed that out historically, too. And my experience
13 is that's the case, as well, that there is auditor
14 involvement in those things, but the question is
15 reporting, as you point out. Let's hear from Brian Croteau
16 from the SEC.

17 MR. CROTEAU: Thanks very much. I was actually just
18 going to make a similar point in reporting back from what
19 I recall hearing back in January, as well, at that meeting,
20 and very similarly it wasn't -- what I wasn't hearing was
21 that there was an interest in auditor involvement in that
22 area of MD&A, but I think the starting point consideration

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1 was that auditors have a role relative to reading that
2 information and considering material inconsistencies and
3 material misstatement of fact today. So, the question was
4 one more of the incremental.

5 Now, whether an audit of that information versus
6 what's being done today would get better at completeness
7 was a question that was put on the table, and I think that's
8 a question people could continue to give consideration to.
9 And I know that you all are giving consideration to whether
10 any improvement or changes to the performance requirements
11 would be appropriate relative to AU 550. But I don't think
12 it was -- what I wasn't hearing was people saying we don't
13 want any auditor involvement, or that we'd want to take
14 away what auditors do today relative to that information,
15 but there clearly at least in that particular group wasn't
16 support for broadly expanding the auditor's role outside
17 of auditing for financial statements and what they're
18 required to do today under 550.

19 MR. BAUMANN: Yes, we didn't include this in the
20 discussion materials and as part of yesterday's item but
21 we are spending a lot of time on the existing standard on
22 other information in audited documents, and maybe

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1 potentially clarifying in the auditor's report what that
2 auditor's responsibility is, and maybe the auditor saying
3 something about that if we can figure out the right tools
4 and mechanism to do that. But we're definitely working on
5 that aspect of other information accompanying the audited
6 financial statements.

7 A lot of cards up here in the center of the room
8 that I see, but let's start with John White, and then maybe
9 over to Arnie, and Steve Rafferty. Arnie and Jerry De St.
10 Paer.

11 MR. WHITE: I'm probably just repeating what Jay and
12 Brian said. I was actually moderating that session, and
13 we basically spent six hours with 30 investors in the room,
14 and the real question we were asking was should there be
15 expanded auditor association with MD&A and press releases.
16 And I'll have to say very much to my surprise there was
17 kind of a resounding no. Just to emphasize, I mean, it was
18 just -- I was really quite -- I was very surprised.

19 I'll have to say just from my personal experience
20 of being involved with MD&A and press releases and so on,
21 and non-GAAP measures that when auditors are in the room
22 and they're part of the dialogue, I think the disclosures

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1 get better, but they're just -- there was not -- I mean,
2 there was certainly support for the existing association
3 with those, with press releases and MD&A, but not that
4 there should be an expanded association with them. I was
5 very surprised.

6 MR. BAUMANN: We were equally surprised because we
7 laid it out as one of the possibilities in the Concept
8 Release, and were very surprised by the lack of support
9 in the 155 comment letters. So, a resounding no is what
10 we're hearing. Arnie, and then Steve, and then Jerry.

11 MR. HANISH: So, just a couple of comments maybe to
12 build upon what Mike Cook was saying. I agree with Mike
13 that -- and I know that document AS 16 talks about two-way
14 communication, but I fully agree that it's really a
15 three-way communication effort. And that I, as management,
16 have that responsibility first and foremost to communicate
17 with the audit committee as to the issues around my
18 financial statements.

19 The auditors, they complement what I'm
20 communicating, and certainly have every opportunity and
21 every right to agree or disagree, provide additional color
22 commentary, to expand upon my discussion and disclosures

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1 with the audit committee, but I don't think we need to -- we
2 need to not lose sight of the fact that management has that
3 responsibility first and foremost. And to infer that the
4 auditor should be stepping into the shoes of management
5 I think is -- and I know you're not saying that, but I --

6 MR. BAUMANN: Nobody is making that inference, and
7 that's not what AS 16 says, Arnie.

8 MR. HANISH: I know you're not saying -- yes, I just
9 think we need to keep that at the forefront. I think that
10 the focus, again, should be on -- the focus should be on
11 objective perspectives. I think if this is a matter of
12 emphasis paragraph, which I do support the matter of
13 emphasis paragraph, that it needs to be an emphasis on
14 where the time is being spent, and areas within the audit.
15 I think it needs to stay away from the qualitative
16 assessments.

17 As I've said, I think that there are ways working
18 with the SEC, if there are issues around the critical
19 accounting policies, and people are not describing within
20 their critical accounting policies the appropriate risks
21 or the appropriate quantitative analysis for the reader
22 to understand the changes in those estimates and what can

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1 cause those estimates to change based upon the risks
2 assessment, the various assumptions that go into those,
3 determination of the accounting accruals and other aspects
4 of our financial statements, if we're not describing that
5 appropriately with the required quantitative deviations
6 that I believe are very clear and required within the scope
7 of providing critical accounting policies, then I think
8 the SEC has the responsibility to call us on the carpet,
9 and provide and push us to have more appropriate disclosure
10 within the critical accounting policies that I believe
11 will make the investors, and provide the investors with
12 reasonable and significant information around, again, the
13 range of outcomes that can occur, and the impact that could
14 occur if we've missed our estimates by 5 or 10 percent.
15 At least sufficient analysis to determine what a different
16 answer would be within our financial statements.

17 And I think a lot of it already exists, and to create
18 something new other than maybe providing the reader with
19 where is the auditor spending their time and the emphasis,
20 and why they are spending their time there, and providing
21 some context as to the framework for their scope and their
22 audit plan, I think would be going too far. Thank you.

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1 MR. BAUMANN: Thanks, Arnie. Steve.

2 MR. RAFFERTY: Yes, as I've listened to this
3 discussion, I think we have to appreciate the fact that
4 investors are telling us that they want and need additional
5 information. And as I listened to all of the panels'
6 report, there seemed to be something of a common theme on
7 the kinds of information that they want, being identifying
8 material estimates and why those estimates might change,
9 to Arnie's point, other matters that might give rise to
10 future volatility in financial statements, and what those
11 uncertainties are, critical accounting estimates,
12 material uncertainties, unusual transactions and events,
13 perhaps even information about going concern. I would boil
14 that down to investors wanting more information about the
15 subjectivity and volatility in the financial statements
16 potentially in the future.

17 So, I would -- it would be hard to disagree that
18 there shouldn't be some kind of an emphasis of a matter
19 paragraph around that kind of stuff, but if you -- I think
20 one of the big struggles that we're going to have here if
21 we stick to the principle that auditors shouldn't be
22 providing original information is, that's going to be hard

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1 to do in an auditor's report. It's almost an emphasis of
2 a matter paragraph or a footnote in the financial statement
3 for that to be original information from management. And
4 I think while you can argue that that information exists
5 today, it's fragmented. Some of that information is in the
6 financials, some of it's outside the financials, some of
7 it's perhaps not required at all. But I think investors
8 might be saying put that one place in the financial
9 statements where I can read about the uncertainty and
10 volatility of these financial statements. And I realize
11 that maybe as a perfect world and requires standard setting
12 beyond the scope of what the PCAOB can do, but I would
13 encourage you to think about pursuing that if it is perhaps
14 more of an ideal answer.

15 And then I appreciate the fact that investors might
16 also want an auditor's evaluation of that, of those
17 disclosures. And I wouldn't think there would perhaps be
18 anything wrong with modifying the auditor's report to
19 specify that the auditor has, in fact, evaluated the
20 disclosures around uncertainty and volatility of
21 financial statements and report that those disclosures
22 are, in fact, adequate based upon the extent of the audit

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1 work performed.

2 MR. BAUMANN: Thanks, Steve. We have Jerry, and then
3 Steve Homza, and Robyn Kravit, and I think after that we'll
4 be due for a break.

5 MR. DE ST. PAER: Thank you, Marty. I just had two
6 points that I think came out of our group, but one item
7 was only mentioned by our group, and another that was
8 mentioned in a couple that I think are worthy of your
9 consideration for inclusion in your sort of summary,
10 overall summary.

11 The first was the discussion that a couple of groups
12 have talked to, and that is identifying the target of who
13 we're trying to benefit with this. Who is the investor?
14 And in our group -- and I think that's worthy of some
15 consideration. Our group, I don't remember who it was. It
16 may have been Gary who recommended using the FASB bar for
17 that which is fairly high. It's a fairly sophisticated
18 investor, but I do think it's useful for us in terms of
19 trying to target where we're going to pitch this, to
20 understand the audience that we're pitching it to. That's
21 the first point.

22 The second point I thought really made a lot of

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1 sense was the idea of field testing. I have to say it was
2 not my idea, so this isn't something I'm promoting, but
3 it came up in our group, and I really think it's a good
4 idea, to pick a few companies, go back, take a few years
5 and see if you can kind of get a sense in a real way of
6 what you would be looking at to inform the process, some
7 field testing.

8 MR. BAUMANN: Great. Thanks, Jerry. Steve.

9 MR. HOMZA: Thanks, Marty. I just wanted to suggest
10 that perhaps as I sit here and listen to this discussion
11 there is a role for internal auditors to provide more
12 assurance around information about risks in MD&A and so
13 on and so forth. I hear a lot of gray through this
14 discussion, so it may be appropriate, maybe kind of a
15 compromise position between the investor world that is
16 clamoring for more information and additional assurance,
17 and auditors that may not be able to provide that, perhaps
18 some responsibility could rest with internal auditors
19 because they are inside the companies. They know the
20 companies very well, and I think in the public company
21 world, especially at that level, they're staffed with
22 CPAs, Certified Internal Auditors, that have a deep

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1 background in business that come from major accounting
2 firms, regulators, so on and so forth. So, I think that
3 point is perhaps worthy of some consideration in this
4 process.

5 MR. BAUMANN: How do you see that working, IIA coming
6 up with a proposal, or companies voluntarily asking their
7 auditors to do that, or what?

8 MR. HOMZA: That would be my suggestion for the PCAOB
9 and the Institute of Internal Auditors to work together
10 to come up with something around that. I understand that
11 the IA, I have it in front of me, the comment letter to
12 the Concept Release dated September 30th of last year, and
13 it is one suggestion in that letter.

14 MR. BAUMANN: Thank you. Robyn, I think you get the
15 last word.

16 MS. KRAVIT: Great. I know this is beyond -- I'm
17 speaking to the PCAOB here, and this may be beyond scope,
18 but in our breakout session I mentioned, and I think there
19 was some support for the fact that really the audit
20 committee's role -- I mean, I understand that investors
21 are clamoring for more information, and I'm sympathetic
22 to that, but maybe it's the audit committee's role to

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1 provide emphasis and additional information, because
2 after all it's the audit committee that hears from an
3 internal audit. It's the audit committee that has robust
4 discussions with external auditors. And to decide where
5 to point investors might be better placed in the audit
6 committee scope working with the SEC, so I just throw that
7 solution out as opposed to mandating certain information.

8 MR. BAUMANN: Thanks, Robyn. And, of course, as
9 Jennifer commented yesterday, the FRC in the UK has gone
10 down that route with expanded audit committee reporting.
11 Their process and what they've done in the oversight of
12 financial statements in the audit, and to make some
13 commentary about financial statements and the audit, and
14 then for the auditor to actually report on the fairness
15 of the audit committee report. So, there is a model for
16 that in the UK.

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